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Source: Guy Venables, 24 March 2021

Moving on – towards a post pandemic world

It has been another week of markets feeling on edge, without going anywhere. Markets seem to have caught a bit of worry about the passage of growth, oddly just as the wider populace gets more confident and the recent headwind of rising bond yields abated.

Perhaps we should attribute the bubbling up of political tensions as the cause of the recent market torpor, replacing expectations of a very fast and unprecedented recovery growth spurt with just a fast and substantial one. In any case, we ended last week with a slightly lessened sense of EU-UK conflict, with Boris Johnson putting in a creditable performance in discussions with European Union (EU) counterparts. Meanwhile, in his first press conference, US President Biden delivered a calmer presence after some unexpectedly confrontational noises towards his Chinese and Russian opposites.

In Europe, pandemic politics continues to dominate, with EU leaders still embroiled in unseemly skirmishes over the ineffective vaccine distribution and its consequences. Germany's Angela Merkel faced her own crisis, after a backlash from lockdown-fatigued German citizens, who simply said "Nein" to her new Easter restrictions. One might think this would be a bad thing for markets, but private freedoms are what makes markets function. Perhaps the prospect of regaining those freedoms are also why business and consumer confidence readings last week were especially robust in the EU, stronger than economists were anticipating and at levels we seldom see. We look at these 'flash' business confidence indicators in detail in a separate article.

Other measures, like the IFO Institute business climate index was also substantially stronger than expected, led by a considerably improved expectations component (outstripping Bloomberg's economist consensus panel by 4 points, a huge gap). These type of margins have only occurred previously in periods of growth after exiting recessions.

Looking through the political lens, politicians have every incentive to overcompensate economically for their shortcomings in the vaccination roll-out. With Germany and France both heading for election campaigns, 'effectiveness' should be very much the mantra of politicians through the rest of the year. The gap between the temptation for the electorate to swallow simplistic populist slogans from opposition parties and the more rational science-based approach favoured by incumbents will likely create tension. German politics remains very centrist despite some worries about right-wing populist parties like the AfD. However, the situation may have some read-through to France's elections next year where currently the two most likely candidates remain Emmanuel Macron and nationalist Marine Le Pen.

Meanwhile, the US Treasury has announced it has now handed out 127 million Rescue Act payments, amounting to $325 billion since the bill's passage on 11 March. That figure is over 2% of the pre-peak yearly personal consumption. Talk about effective… The US is already in the process of increasing the opportunities to spend, but is finding that a rapid expansion could prove more difficult. Durable goods turnover data showed a contraction in February, mostly because of the cold weather, but partly because goods were in short supply. In the coming months, US consumers are likely to shift expenditure more towards services (tourism and leisure particularly), and the weather is not going to remain a limiting factor. This is already affecting employment – leading to consumer sentiment improving on the back of tightening jobs markets.

So, despite the latest pandemic updates not providing the short-term relief that many were hoping for, the medium-term prospect of easing restrictions and a gradual reduction in the impact to public health is well worth holding on to. Both the public at large and the business community are once again taking the long view, and moving on towards a post pandemic perspective.

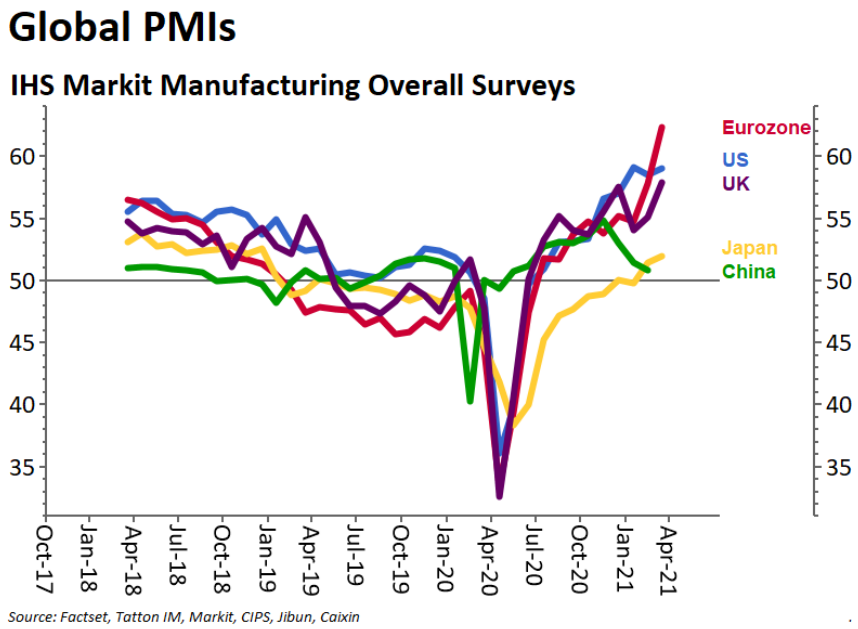
Given the lack of short-term certainty, market activity cannot be expected to run in a straight line, even as economic activity improves. But increasingly, the topics that preoccupied the pre-COVID world – such as the risks arising from geopolitical tensions (covered this week) – are becoming focal points once again. That may provide an element of comfort for a world that has grown so weary of talking about COVID, but it also underlines the fact that economic opportunities and challenges far bigger than the pandemic (such as climate change) are still waiting to be addressed.

Europe is poised for improvement

Positive stories about Europe are thin on the ground at the moment – notwithstanding that core European equity markets have broadly outperformed their global peers, including the US, so far this year. With a sluggish vaccine rollout and a renewed rapid spread of infections across the continent, restrictions look set to remain in place for the foreseeable future. This will seriously hamper certain economic activity, at a time when a sharp recovery in the US looks all but certain for the rest of this year. The comparative fortunes either side of the Atlantic are understandably making investors more nervous about European assets, especially as there is some evidence that the absent buyer has typically been foreign. Some good news, then, is long overdue.

Fortunately, the latest data shows that the slump in Europe is not quite as bad as feared. The latest purchasing managers indices (PMIs – measuring business confidence about future conditions) came in stronger than expected across the Eurozone. French manufacturing posted a 58.8 figure (above economist expectations of 56.3), while Germany's manufacturers came in at 66.6, versus expectations of 60.5. Overall, the Eurozone posted a 62.4 figure for manufacturing against a predicted 57.6. The UK, despite being substantially further along its vaccination programme, posted 57.9, versus expectations of 55. For reference, anything above 50 indicates expanding activity, whereas 50 or below indicates a decline. Readings above 60 mostly occur during periods of above-average economic growth.

Unsurprisingly, for the services sector – arguably the biggest casualty of government-mandated social distancing – the outlook is less positive. This has resulted in a continued divergence in fortunes between producers and service providers. Nevertheless, the services sector across Europe still beat expectations, with France contracting less than predicted, and Germany posting a (slightly) expansionary 50.8. It does now seem service providers are more able to deal with lockdown measures, and some even becoming hopeful about potential easing of COVID restrictions. This is most visible in the UK, where the services PMI came in at 56.8, significantly outpacing the expected 51.0. Improved sentiment likely has something to do with the steady easing of restrictions in Britain, but it also shows businesses are holding up better than previously feared.



These positive surprises here and on the continent stand in contrast to the US, where the latest economic figures have fallen a little short of expectations. Some of that disappointment seems weather related (so may pass quickly), and comes against a backdrop of much worse expectations for Europe than then US (making the beat less impressive). But it does give reason to be hopeful, dispelling at least some of the European economic doom and gloom.

A brighter outlook is something investors could certainly do with. European markets have reacted negatively to rising virus cases and the slow vaccine rollout, despite continued restrictions now a key factor in holding back EU businesses. This is understandable. Even if German manufacturers can continue well enough in current conditions, a summer lockdown could be a serious setback for the hospitality-heavy economies of Greece, Spain and Italy.

However, the current pessimism could be exactly the reason to be more positive about European assets. Despite the world being mired its deepest-ever recession, equity markets remain at highs globally. Investors are not just hopeful about a strong recovery later this year, they are expectant – with a big rebound already priced in, particularly in the US. European equities are one of the few asset groups for which this recovery is not already fully discounted. European businesses have plenty of catching up to do, but that leaves their share prices with much more room to rebound than US rivals.

What's more, Europe's export-heavy economy means it often does well in times of strong global growth. We certainly have already seen export sectors and markets performing well, but we expect the global recovery to broaden later this year. What is needed on top of external demand is also a solid domestic base, which leads us back to the current vaccine rollout.

Export disputes and 'vaccine nationalism' clearly rains on this parade somewhat. But again, there are reasons to think not all is lost. Negotiations with AstraZeneca and the British government are ongoing, and we suspect a compromise will come sooner rather than later. Moreover, despite the gloomy headlines, Pfizer-BioNTech is set to deliver an additional ten million more doses to the EU by the end of June than was initially planned, while there are hopes that Johnson&Johnson's single shot vaccine could become more readily available. Ultimately, while disputes are unhelpful, the vaccination programme is likely to markedly accelerate from here, if only because it has reached its low point. We write more on political concerns in a separate article.

We have already reached the point where post-pandemic expectations are driving market moves even more than COVID news, and that may suit European equities. Global markets are still digesting the recent rise in bond yields, and what it might mean for stocks, as well as how the world will move on once everyone has been vaccinated. The questions here are around what large-scale macroeconomic policy should look like. Indeed, this debate has been occupying investors in the US. But that debate has not yet reached Europe's shores – when it does, things may look a little different.

One of the biggest concerns for markets currently is when and how the US Federal Reserve (Fed) will have to start tightening monetary policy. But this concern is entirely absent in the Eurozone for good reason – no-one is in any doubt that Europe still needs extreme monetary easing for the foreseeable future. This ultimately stems from weakness in Europe's economy, but it could nonetheless turn into a positive. As the world moves away from easing, and markets get the recovery they are expecting, Europe could be the one market still powering forward just to catch up. Ultimately, that could help investors further down the line.

Geopolitics back on the radar as diplomacy runs aground

As we enter spring, the world thankfully looks a little brighter. The vaccine rollout is well underway in the UK and US, and is having palpable effects on the outlook for the second half of this year – despite disruptions on the continent and virus mutation scare stories. For investors, despite the caveats, there has also been a notable improvement in near-term economic expectations. Nowhere is this truer than the US, where easing conditions, an accommodative Fed and a blast of fiscal stimulus have set the stage for a full-speed recovery. But this strength should fortunately filter out to the global economy and, even without the US spillover factor, there is a sense that for the rest of the world the harsh winter is also behind us.

Although the economy is looking better, the pandemic's influence is not gone yet. 'Vaccine nationalism' has shown up around the globe – with countries either choosing to keep first supplies to themselves (like the US) or now having second thoughts about its export drive. This has been particularly visible in the EU, which has put forward plans to restrict vaccine exports to those countries not exporting many vaccines themselves and with a higher immunisation rate than the EU. As things stand, the EU has stopped short of a firm export ban, but the tug of war around AstraZeneca's supply has likely not yet come to an end. A similar mood is gripping India, where vaccine exports have been banned outright, and unfortunately they are the world's largest vaccine producers.

Perhaps more importantly for the medium-term investment horizon, broader geopolitical themes are moving back into focus. This may just happen as improved pandemic (and thus economic conditions) allow politicians to refocus on pre-pandemic issues. Therefore, it may be worth keeping track of recent developments.

In an unusual move when compared to the most recent decades, the 'Western' nations – comprising the EU, UK, US and Canada – have imposed sanctions on senior Chinese officials over the treatment of Uighur Muslims in the north western autonomous province of Xinjang. China reacted immediately with counter-sanctions on western private individuals. While sanctions are a long-used political tool, and have been in place against Russia for several years, this is a new feature in the West's relationship with China.

On the trade negotiation side, things did also not go smoothly when China and the new Biden administration engaged in an hour of sabre-rattling in front of the global media. Delegations from both nations met in Alaska to commence the new relationship, but the resulting shouting match was hardly a 'diplomatic' start. Add to this that Joe Biden labelled Vladimir Putin a "killer" on national television, and the new administration's first international interactions were somewhat underwhelming. It was certainly not the anticipated conciliatory approach – the complete opposite of the abrasive approach favoured by former President Trump – that most observers had been expecting.

We took comfort though from Biden's first press conference last Thursday, when he clarified that the US was not aiming for confrontation with China, but acknowledged a situation of "steep competition". Biden outlined three areas on how the US is approaching the situation: a) the US must increase its efforts to promote innovation; b) it must re-establish alliances with nations outside of China, be it in Asia or Europe and c) it has a responsibility to promote US values. In other words, the US will keep pointing out areas and countries that are falling short of the 'American' value system. Admittedly, this leaves a wide array of possible political outcomes.

The relationship between the world's two largest economies has been strained, with Trump's trade war building a substantial wall of tariffs on both sides. The hope was that the trade relationship would improve in the Biden era, but as we noted at the end of last year, this hope was always a little far-fetched. Anti-China sentiment is a rare point of bipartisan support in Washington, although the Democrats are more concerned with issues over freedom. It has certainly proved that way so far, with Biden corralling allies to take a united stand against human rights abuses in the People's Republic and threats to Taiwanese independence. North Korea's nuclear ambitions are another pressure point in the region, where any sign of US-Chinese co-operation would help to lower tensions.

The tools at Biden's disposal are still those used by Trump. Biden has moved forward with Trump's threat to delist Chinese equities from the US stock market – a decision many investors expected him to reverse. These moves have already had an effect on equity markets, with Chinese stocks declining after the delisting rumours spread (as well as a domestic Chinese clampdown on its own tech companies) and the Renminbi weakening against the dollar. But by and large, capital markets have so far shrugged off these tensions. While we expected Biden to keep up policy pressure on China, we had hoped for a more diplomatic tone than his predecessor. So far it has been a patchy start. We shall watch developments in this area closely.

We always try to be careful when linking geopolitics to investment. Our experience at Cambridge is that being overly focused on specific risk scenarios can lead to overestimating both their likelihood and/or their negative impacts. We maintain the belief that investments grow best under applied risk management rather than risk (and therefore return) avoidance.

Another aspect for investors to remember is that risks are all about 'unknowns'. Individual investors can never have all the information, and there are always areas where some information is less reliable than others. Companies may try to present the best interpretation of their outlook, but strict regulation prevents them from skewing this interpretation too much. Politicians and diplomats are not subjected to the same types of audit. So, in general, we look to monitor political risks while being moderate in the application to investment strategy. At the moment, geopolitical concerns are not enough to derail economic positivity. In other words, 'risks' are not the same as 'themes'. But they are certainly narratives we should continue to watch as the wider world returns to a more normal state.

CAMBRIDGE
INVESTMENTS LIMITED

29th March 2021

Global Equity Markets

Market	Fri 16:05	% 1 Week*	1 W	Technical Short	Technical Medium
FTSE 100	6728	+0.3	+19	⬀	⬀
FTSE 250	21471	+0.2	+51	→	↗
FTSE AS	3836	+0.3	+11	⬀	↗
FTSE Small	6775	+0.5	+36	↗	↗
CAC	5983	-0.3	-15	↗	↗
DAX	14742	+0.8	+121	↗	↗
Dow	32769	+0.4	+141	↗	↗
S&P 500	3934	+0.5	+21	→	↗
Nasdaq	13028	-1.4	-187	↘	↗
Nikkei	29177	-2.1	-615	→	↗
MSCI World	2775	-0.8	-21	→	↗
CSI 300	5038	+0.6	+31	↘	↗
MSCI EM	1288	-3.6	-48	↘	↗

Top 5 Gainers

Company	%
Micro Focus Int'l	+10.7
Halma	+6.1
Smiths	+4.7
Rightmove	+4.5
DCC	+4.2

Top 5 Decliners

Company	%
TUI	-11.0
Rolls-Royce	-9.4
Burberry	-7.6
Carnival	-6.4
Int'l Consol Air	-5.2

Currencies

Pair	last	%1W
USD/GBP	1.379	-0.6
GBP/EUR	0.856	+0.3
USD/EUR	1.18	-0.9
JPY/USD	109.58	-0.6
CNY/USD	6.54	-0.5
Bitcoin/$	53,441	-8.5

Commodities

Cmdty	last	%1W
Oil	64.58	+0.1
Gold	1733.3	-0.7
Silver	25.05	-4.6
Copper	407.6	-1.2
Aluminium	2246.0	+1.4
Soft Cmdties	421.9	-2.1

Global Equity Market - Valuations

Market	Div YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	3.4	20.3	14.5	14.0
FTSE 250	1.8	18.1	22.4	15.3
FTSE AS	3.1	19.9	16.4	14.1
FTSE Small x Inv_Tsts	1.4	19.2	-	14.9
CAC	1.8	23.8	18.0	14.5
DAX	2.3	22.0	16.4	13.2
Dow	1.9	22.9	21.2	16.1
S&P 500	1.5	27.9	22.8	17.1
Nasdaq	0.7	33.7	32.4	22.1
Nikkei	1.4	27.1	21.6	17.4
MSCI World	1.8	25.6	20.9	16.2
CSI 300	1.7	18.2	13.7	12.4
MSCI EM	2.0	19.9	15.2	12.4

Fixed Income

Govt bond	%Yield	1 W CH
UK 10-Yr	0.75	-0.09
UK 15-Yr	1.11	-0.09
US 10-Yr	1.64	-0.08
French 10-Yr	-0.11	-0.06
German 10-Yr	-0.35	-0.06
Japanese 10-Yr	0.08	-0.03

UK Mortgage Rates

Mortgage Rates	Mar	Feb
Base Rate Tracker	1.50	1.50
2-yr Fixed Rate	1.62	1.73
3-yr Fixed Rate	1.72	1.90
5-yr Fixed Rate	1.80	1.89
10-yr Fixed Rate	2.53	2.53
Standard Variable	3.62	3.62

* The *% 1 week* relates to the weekly index closing, rather than our Friday p.m. snapshot values
** LTM = last 12 months' (trailing) earnings;
***NTM = Next 12 months estimated (forward) earnings

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Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

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