Investor Insight

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V IS FOR VACCINE, BUT NOT V-SHAPED RECOVERY
Vaccine developments have revived longer-term inflation and interest rate expectations.

THE BLUE RIPPLE
What does a Democratic win mean for the US economy?

CHINA CONTINUES GROWING
Ending 2020 with a faster pace of growth than it began with.

A BREXIT DEAL AT LAST
How the UK is beginning life outside the European Union.

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Looking ahead

The final quarter of 2020 was an eventful one, with the outlook for the global economy changing for the better. As anticipated, health policy and progress in researching a coronavirus vaccine had a profound impact on economic expectations. In the US, November's presidential election determined the political agenda for the next four years. In China, growth continues to be strong but shows signs of slowing, while a Brexit deal was reached in the UK. We take a look at how these factors have impacted the investment landscape and look ahead to the rest of 2021.

V IS FOR VACCINE, BUT NOT V-SHAPED RECOVERY

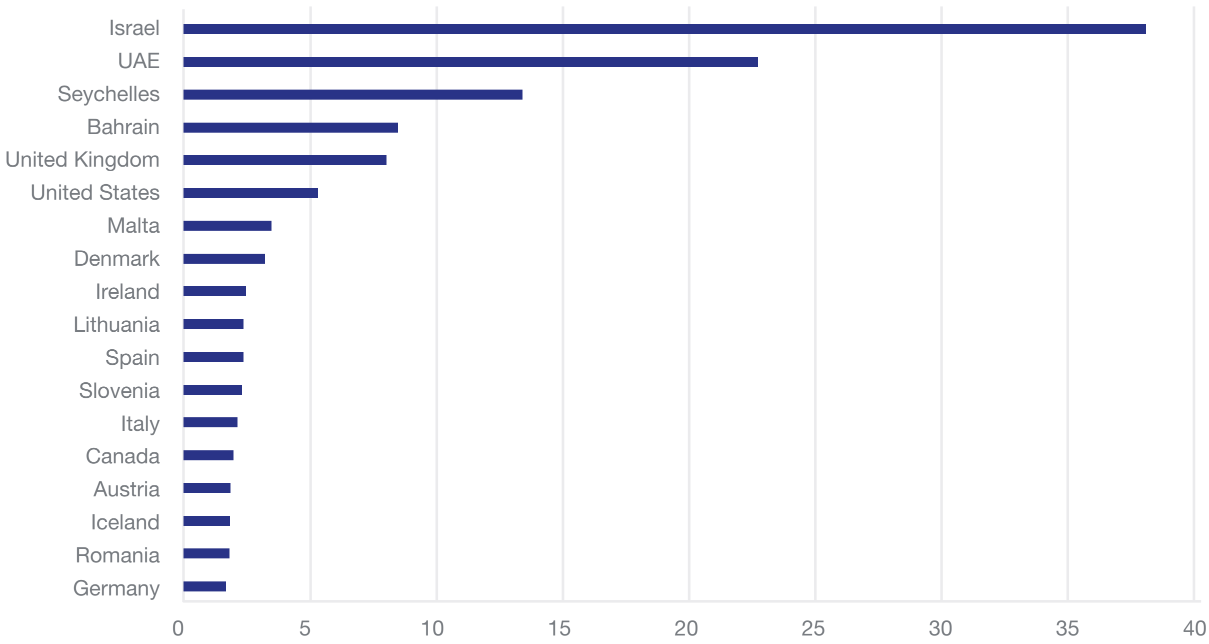
In November, drug company Pfizer announced that the vaccine it had developed alongside German firm BioNtech, was effective. In subsequent weeks, a number of other vaccines also delivered positive efficacy data, and vaccination programmes are now in place across developed markets (see figure 1).

The fact that an effective vaccine is possible is clearly good news for the economy, offering a route out of the costly social restrictions currently in place. Meaningful progress will be made on vaccination programmes in developed countries in 2021, making a return to "normal" possible.

While vaccine programmes are under way already, they will not take effect quickly enough to stop the current wave of coronavirus infections, which has necessitated tighter social restrictions in most developed market economies. These measures have slowed the spread of the virus in the UK and Europe but, until vaccination is widespread, cases are likely to rise again when social restrictions are relaxed. With this in mind, a double-dip recession is likely in many economies, with a sustained rebound likely by the autumn.

As expected, vaccine developments have revived longer-term inflation and interest rate expectations, as economic normalisation comes into view.

Figure 1: Vaccinations per 100 people by country

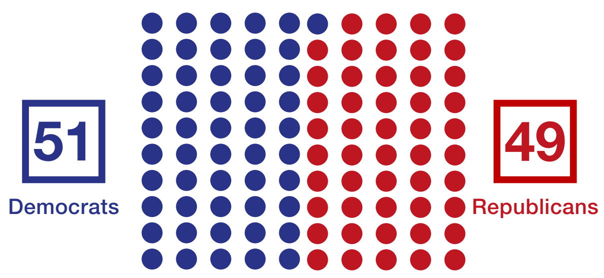


Source: Our World in Data - data from December 14 2020 to 21 January 2021

THE BLUE RIPPLE

November's US Presidential election saw Democrat Joe Biden win the presidency and a wafer-thin majority in the House of Representatives. December's run-off elections in Georgia awarded the Democrats a majority of one in the Senate as well, with Vice President Kamala Harris holding the casting vote (see figure 2).

Figure 2: US Senatorial seat map



This "blue wave" win allows the Democrats to control the legislative agenda and determine which bills are voted on. It also increases the likelihood that President Joe Biden could pursue more of his campaign policies, including a significant increase in fiscal spending, funded by higher income taxes for well-off Americans. Regulatory reform is also on the table. However, Biden does not have carte blanche – the majority is narrow and four of the Democrat senators have a track record of voting against party lines. Given that the filibuster requires a 60:40 split to pass a bill in the Senate, policies will require bipartisan support to have a good chance of success.

In December, Republicans and Democrats demonstrated that they can reach compromise on important issues, with a second fiscal stimulus package announced to support the economy through the on-going pandemic. This package includes direct stimulus cheques for households and renewed a boost to unemployment payments, both measures which will support US consumption spending. Biden has already announced his intention to deliver a third stimulus package worth $1.9trn.

Longer term, Biden may pursue an infrastructure spending programme – the Committee for a Responsible Budget estimates that Biden could support c. $4.5trn in infrastructure spending over the administration, which compares to the c. $2.7trn Republican proposal under Trump (see figure 3). Infrastructure spending could boost economic activity as well as, potentially, productivity growth.

All in all, higher US spending on income support measures and infrastructure is supportive for the global economy. US goods consumption boosts US imports from manufacturing economies and infrastructure spending boosts industrial demand. Meanwhile, higher US spending also keeps the dollar weaker, easing global liquidity conditions.

Figure 3: Summary of US candidates' proposals under CFRB Central estimate (2021-2030)

$ Trn	Trump	Biden
Childcare and education	-1.2	-2.7
Healthcare and long-term care	0.2	-2.1
Social security, SSI, retirement	n/a	-1.2
Infrastructure and other domestic spending	-2.7	-4.5
National security and immigration	-0.3	0.8
Tax policy	-1.7	4.3
Interest	-0.3	-0.3
Debt deficit effect	-5.0	5.6
Low to high estimates	-0.7 to -6.9	0.2 to -8.3
Permanent policies only	-2.5	-2.4

Source: Committee for a Responsible Budget.

CHINA CONTINUES GROWING

China has been the standout economy in 2020, managing to end the year with a faster pace of growth than it began with. This stellar performance is due to a number of factors:

1. Chinese authorities responded rapidly and robustly to the initial coronavirus outbreak, limiting the spread of the virus within China and curtailing the need for social restrictions.

2. Weakness in domestic consumption has been cushioned by robust demand for Chinese exports. The stimulative effect of one-off cash cheques for Americans and fewer opportunities to spend on services resulted in higher goods spending, and thus Chinese exports.

3. China's policy makers adopted a supportive policy mix in the first half of 2020, using a varied set of tools including loan forbearance, liquidity injections and rate cuts. With Chinese growth at 6.5% in Q4 of 2020, policymakers are now looking to gradually tighten policy and recommence financial deleveraging in order to manage the risks within China's financial system. While we already see signs of tighter liquidity in the Chinese economy, policymakers have indicated that the pace of tightening will be gradual.

While the worst of the pandemic may be in China's rear mirror, some pre-pandemic challenges linger. While the new US administration is more likely to enter a dialogue with China, its attitude will probably remain hawkish and any relaxation of trade relations is likely to come with conditions. Businesses have also been made more aware of the vulnerabilities of global supply chains and, combined, these factors are resulting in supply chains being moved. However, longer term, China remains committed to rebalancing the economy towards consumption, as was confirmed at central government policy meetings at the end of 2020. China's domestic consumption is expected to grow to $17trn by 2030.

A BREXIT DEAL AT LAST

After four years of political wrangling and negotiations, the UK is beginning life outside the European Union (EU). UK and EU negotiators succeeded in agreeing the terms of the future relationship: the Trade and Cooperation Agreement. This has avoided the disruption that could have been brought about by a no-deal Brexit, and confers benefits beyond those contained within the legal text, including a degree of sovereignty that the UK has not had for several decades. Cooperation on a foundation agreement makes further progress easier and offers some immediate clarity to business. This has boosted market sentiment around UK assets.

The agreement includes a free trade agreement, as well as commitments on areas such as security, transport and energy, but provisions for the services sector are light - especially regarding financial services. The UK will no longer have "passporting" rights across the EU, which allow firms authorised in any EU or European Economic Area (EEA) state to trade easily in any other without having to follow country-by-country application processes. The EU could allow the UK easier market access for some financial services if it were to award regulatory equivalence status, meaning that the UK regulatory framework is deemed to be of an equivalent standard to that of the EU, but the EU is yet to grant the UK such status. Equivalence is within the gift of the EU and both sides recognise that there is a "clear political dimension" in granting it. The free-flow of data is another important regulatory area to watch.

While the UK will continue to benefit from tariff and quota-free access into the EU market, the fact that UK goods are outside of the customs union and the EU regulatory regime will means that both customs and safety documentation and checks are required. In addition, imported inputs into UK exports do not qualify for tariff-free status, an issue that affects the auto industry especially.

The Government has acknowledged a lack of preparedness for this change within Whitehall and business, and will delay the implementation of checks on goods entering the UK in order to mitigate this. For goods entering the EU, checks are required. This has caused limited disruption so far, with the fishing industry worst hit, but the cost of freight has increased more broadly.

Even with the Brexit deadline passed and the terms of the future relationship agreed, Brexit discussions are far from over. Firstly, some areas of the relationship, such as the above-noted decision on regulatory equivalence, have not been finalised, while the Trade and Cooperation Agreement explicitly makes provision for review of certain areas in the future. Secondly, because of the horizontal framework, changes in policy in one area covered by the agreement could impact many other areas. Lastly, the UK will, in time, make decisions about whether to operate closer to the EU or diverge further away.

Checklist of brexit changes

End free movement of people	✓
No Tariffs or Quotas	✓
No customs, regulatory or safety checks	✗
Control of UK fishing waters	◑
Financial services passporting	✗

Source: European Commission, CBAM

What's in store in 2021?

The outlook for 2021 has undoubtedly brightened in recent months, with better news on health policy and government interventions to support growth in the near-term. With this in mind, we anticipate positive trends in 2021 in terms of social restrictions and therefore the economy. However, some of the effects of the pandemic will be long-lasting, and the economy will have to adjust.

Because shares are long-term investments and current prices must theoretically reflect the present value of all future earnings, structural changes accelerated by the pandemic will likely have a meaningful impact on asset prices. With this in mind, we advocate a balanced approach to investing, combining unloved assets that have the potential to benefit from an economic rebound with exposure to structurally supported themes. Diversification across regions, sectors and asset classes is also important.

CONCLUSION

With the initial turmoil of this unprecedented health and economic emergency behind us, we are focussing on the longer-term implications of the pandemic. We continue to closely monitor the evolution of the health data in order to better gauge the progress of recovery, and to analyse in detail individual investments, in order to find those we believe have the greatest near-term resilience and long-term prospects.

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