Markets Review - to end March 2021.

THORNTONS INVESTMENTS

Market Returns

(Total returns in £)	1 month	3 months	6 months	1 year
UK Equities	4.2%	5.0%	16.4%	21.9%
Global Equities	4.8%	4.0%	12.9%	40.8%
UK Gilts	0.0%	-7.1%	-6.6%	-6.0%
UK Property	0.5%	1.6%	3.0%	0.7%
Gold	0.0%	-11.0%	-15.9%	-5.0%
Commodities	-1.6%	9.2%	16.7%	36.6%
Sterling	0.6%	3.6%	5.7%	5.3%

Returns to 31st March 2021. Source: Thomson Reuters

Market Overview

The success of the UK vaccination programme is helping bring us closer to restarting the face-to-face economy. This stands in contrast to Europe, where rising case numbers are forcing the reimposition of lockdowns. However, their manufacturing sector continues to recover well. With Asia, and China in particular, already recovering well and US vaccination also progressing rapidly, stock markets have rotated towards those stocks that should benefit from reopening and recovery. Approved and proposed stimulus plans in the US, totalling more than $4tr, have also supported the recovery theme. The positive response of stock markets is contrasted by the negative response of bond markets, which have sold off as concern rises about inflation being encouraged by monetary and fiscal stimulus.

Although there are some concerns about new variants of Covid-19, the pace of vaccination in the UK and initial data on its effect are hugely encouraging. The indicative roadmap for removing restrictions gives some confidence to prepare and plan for reopening, and with expanded government support, will hopefully allow many of the 4m plus furloughed to return to work. Optimism on this front has seen sterling become one of the strongest currencies this year. Commodities have also rallied strongly on optimism of global economic recovery this year. The price of oil has eased slightly in the last few weeks as estimates of demand in Europe have been trimmed and OPEC has agreed to unwind supply cuts over the next few months.

The impact of Covid, and to some extent Brexit, has been quite disruptive to supply chains globally and there are pockets of shortages, not helped by the recent blockage of the Suez Canal, and price increases popping up around the world. Should this become sticky central banks will find they have some very tricky decisions to make. For now, though, markets are embracing economic recovery. The headwinds that UK equities have faced for many years are abating and this should help to reverse the significant underperformance of UK equities against global stocks.

Commodities have had a very strong start to 2021. Oil is back at $60 per barrel, largely due to OPEC+ restricting supply. Almost every commodity, oil, metals, grains have risen strongly since the first successful vaccine result was announced, rising by more than 20% in dollar terms and fuelling inflation concern. Commitments to de-carbonise and promises to 'grow back better' are energising anticipation of a new era of infrastructure spending. Gold and silver have fallen back this year as bond yields have risen, but if inflation does rise, inflation adjusted interest rates are likely to remain negative, which would act as a support for gold. Silver is also an industrial metal with uses in things like solar panels and so should see increasing demand.

With the Bank of England and other central banks employing their full range of quantitative easing (QE) tools, and an essential promise to do whatever it takes, bond yields remain compressed, despite the recent move higher. Market expectations of inflation have begun to edge up, as it is anticipated that government spending will continue once Covid-19 restrictions are removed, to ensure an economic recovery. UK gilt yields have risen, with none now negative and bigger rises for longer dated gilts, raising the implied future rate of inflation. With government deficits still rising, central banks are required buyers of government debt, in order to keep debt costs low and prevent a collapse in bond markets. In this environment financial stresses are more acute and likely to keep market volatility elevated as there is no room for policy error.

Property funds have reopened for dealing, although one or two are still suspended from daily dealings, as the industry endures a phase of 'price discovery' in an environment of changing demand and significant levels of non-payment of rents. REITs are at significant discounts to stated property values. Although it is too early to know how demand for office and industrial property will be affected, there was little surplus property prior to coronavirus and paid rental yields are substantially above bond yields.

Companies are slowly re-establishing dividends and forecast guidance, but many, still forced to close, have not. Despite the positive news around vaccines and the inoculation programme, there is still uncertainty as to the timing and shape of recovery. For some well-known High Street names, it is already too late. Some of the demise is down to structural decline as well as the impact of Covid-19, so there are likely to be other collapses, even once restrictions have been removed. This will create space for survivors and substitutes, which has always happened in economies and markets, but perhaps not at the same accelerated pace we are witnessing currently.

Political stress is undoubtedly being amplified by restrictions and economic stress currently. Democracy is being tested all around the world. In the US, President Joe Biden and his team will bring a calmer air to Washington, but the national divisions run deep, and the Democratic control of Congress is very fine. This 'blue wave' is pushing for greater fiscal stimulus, but also higher US corporate taxes and greater Congressional oversight of large companies, particularly tech companies that have benefitted greatly from the pandemic. For now, as almost everywhere, rapid immunisation, removal of restrictions and a quick return to economic growth are essential requirements for some harmony.

The 'buy now, pay later' UK budget highlights the dilemma financial markets find themselves in currently. Tax incentives for capital investment and forecast growth of 7.3% next year are encouraging prospects, but these are relatively short-lived expectations and there is a cost. The significant increase in corporate tax rates from 2023, is part of the cost and shaves the future value of companies. The debt that has been built up during the pandemic will cast a long shadow over potential economic growth rates and returns, however, this does not mean they will be negative, just that investment selection needs to be taken carefully and will be a more important factor than in an era of constantly declining bond yields.

Markets Review - to end March 2021.

THORNTONS
INVESTMENTS

Market Outlook

Equities	Stock markets have had a solid start to 2021, buoyed by the start of vaccination programmes and an expected large stimulus package in the USA and supportive budget in the UK. However, optimism has been checked by a rapid rise in bond yields undermining the high valuations of growth stocks. Recovery stocks, however, are benefiting from the positive initial results of vaccination, giving line-of-sight to the end of lockdown, particularly in the UK, and strong economic recovery later this year.
Fixed Interest	Central banks continue to absorb record levels of debt issuance from governments and corporates, keeping the cost of debt very low. This has kept the UK government yield curve close to zero over the next couple of years and with investment grade bonds offering little extra, means realistic investment returns are minimal. Bonds are susceptible to sell-offs on any concerns about rising inflation. High yield bonds are also sensitive to any deterioration in credit quality once government support is removed.
Commercial Property	Property fund difficulties persist, due to uncertainty over market values, a year of reduced rental income payments and some property funds still suspended. Whilst the outlook for retail remains problematic and uncertain for office property, industrial property continues to offer an attractive headline yield and diversification benefits (where not listed).
Alternative Assets	Infrastructure investment funds offer benefits for exposure to physical assets, often with attractive inflation linked contracts, and growth connected to improved connectivity and de-carbonising economies. However, as with private equity, there has been significant capital applied to these investments, reducing investment yields and increasing vulnerability to any rise in the cost of debt. Absolute Return strategies have shown some defensiveness but offer low returns and we continue to choose sparingly.
Cash	The 'safety' of cash is counterbalanced by zero interest rates and a lack of protection against inflation.

Thorntons Investments 6th April 2021