# QUARTER 4 2020 INVESTMENT MARKET REVIEW AND OUTLOOK

AIB PRIVATE BANKING

Markets at the beginning of Q4 adopted a more of wait and see approach, with rising COVID cases across Europe and the reintroduction of lockdown measures becoming a concern for markets. This, coupled with the upcoming US Election caused volatility and led to a pullback in October in global equities in euro terms of -2.4%. By the end of October however Biden was 8 points ahead in the polls and was projected to flip some key swing states. This prospect of a blue wave helped bolster investor sentiment and led to a positive start to November.

US Election Day came and went however, without a definitive winner, although by the end of the week it was clear that Biden was well ahead and was acknowledged as the winner (albeit still not by President Trump!). Following the win and significant positive COVID-19 vaccine developments, global equity markets surged strongly over November and December, rising 11.1% in euro terms. Markets responded favourably to the prospect of a new administration that was likely to adopt a more diplomatic approach to foreign policy and trade matters.

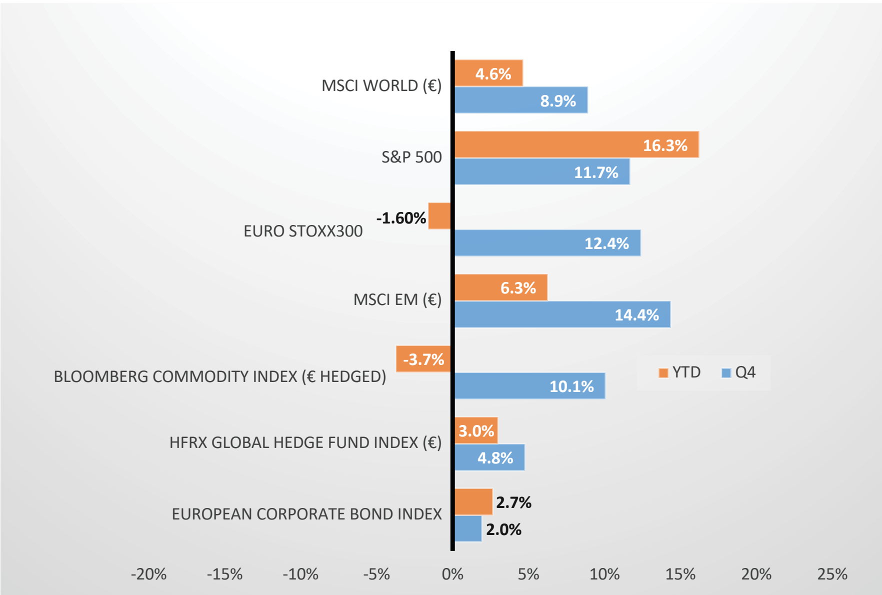
The fourth quarter saw the approval of three COVID-19 vaccines; Pfizer – BioNTech, Moderna and Oxford – AstraZeneca. The Pfizer vaccine was the first to be approved with the UK granting approval in early December and the first recipient was vaccinated on December 8th.

Purchasing Managers Indices data (PMI's) across many global economies (i.e. US, Europe and China) indicated expansion in the manufacturing and services sector throughout the quarter although services sector activity lagged somewhat in Europe. In December, European Manufacturing PMI data showed the strongest growth in factory activity since May 2018. The US and China also recorded strong PMI levels with the former having its highest level since September 2014.

The end of the year saw a conclusion to the Brexit saga with a deal agreed, a full four years after the vote. The final few weeks of the quarter saw a lot of rhetoric surrounding fishing rights and the border on the island of Ireland however as the deadline approached both sides agreed a deal and the UK left the European Union on December 31st 2020. Sterling rallied on the back of this positive outcome and finished the year trading at c. $1.37; its highest value against the dollar in 3 years.

Overall the increased certainty surrounding the US Election result, Brexit, economic growth and the approval of 3 COVID-19 vaccines helped all major indices perform well in the quarter. The S&P500 and NASDAQ reached new highs, and unlike the previous quarters where the bulk of the returns came from US Tech stocks, we saw in Q4 a rotation to more cyclical and small cap stocks. Europe and Emerging Markets outperformed the S&P500 growing by 12.4% and 14.4% against 11.7%. The NASDAQ maintained its strong performance growing by 15.4% in the quarter.

## ASSET CLASS PERFORMANCE - Q4 AND YTD 2020



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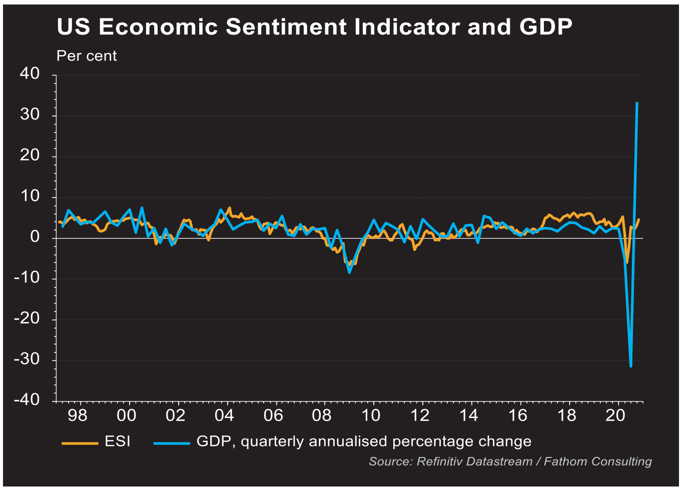
## INVESTMENT MARKET OUTLOOK

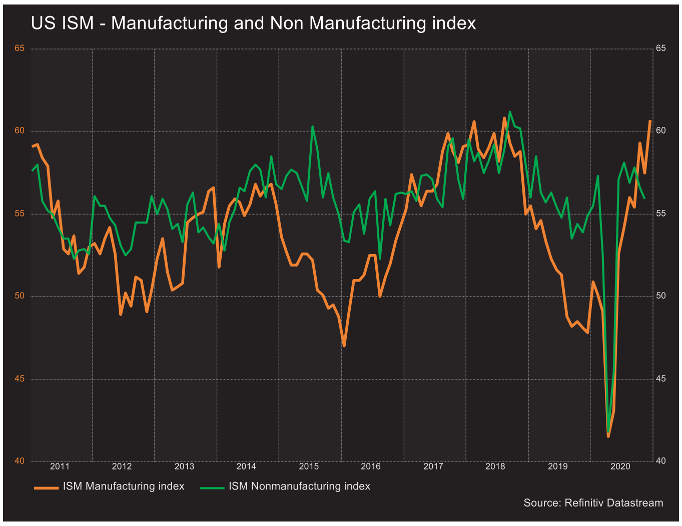
In our previous quarterly outlook we highlighted that, notwithstanding potential volatility into year end, markets could benefit from a number of factors including additional government stimulus measures, improved economic data and continued progress in relation to coronavirus vaccines. These factors did indeed prove to be important for markets in Q4 and positive developments in each factor helped markets deliver solid returns over the concluding quarter of the year. For 2021, these factors are likely to continue to remain key influencers of market direction, with the pace of vaccine roll-outs being particularly closely watched. Investors however, will also continue to look in the short term at least, to both governments and global Central Banks to maintain fiscal and monetary stimulus measures in order to help support the economic recovery. This remains an important re-assurance to investors especially given the current spike in new COVID-19 cases in most developed western economies. Overall while increased concerns around coronavirus and its economic impact may lead to nervousness among investors in the short term, the prospect of an acceleration in the distribution of vaccines over the coming months should support a stronger foundation for the economic recovery and provide a favourable backdrop for asset prices in 2021.

### GRAPH 1



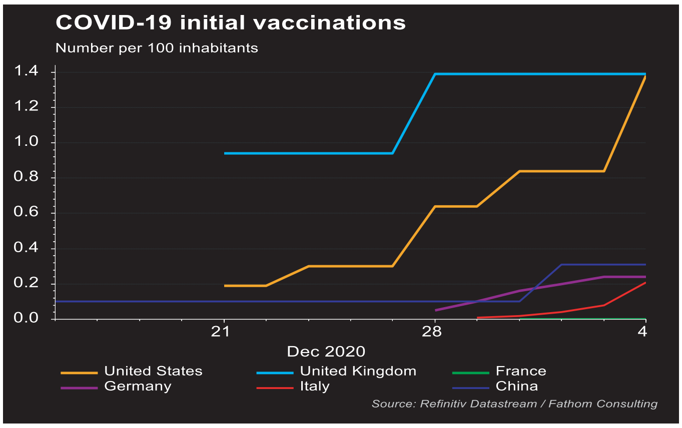

While it is hard to believe that only 9 months ago (mid-April to be exact!) the global economy experienced a negative hit to global Gross Domestic Product (GDP) of c.20%, we have seen an impressively strong recovery in the second half of 2020. This recovery, while showing some signs of potentially softening in the short term, is still indicating solid momentum with sentiment indicators in the Eurozone and US at satisfactory levels (Graph 1 above). In addition, activity levels in both the Manufacturing and Services sectors, following a strong rebound in mid-2020, are continuing to show an expansion in major developed market economies (Graph 2). The services sector (a key part, c.70%, of the US economy) is importantly showing a recovery although it continues to lag manufacturing, impacted by unemployment rates that still remain above pre-coronavirus levels. In addition and encouragingly, other parts of the US economy such as the housing market, household savings and debt levels are also supportive of growth. While we have seen nervousness around short term weakness in economic growth, there is room for optimism that economic activity will normalise as vaccine roll-out increases.

### GRAPH 2




An aggressive roll-out plan has already commenced in countries such as the US and UK with other countries such as China and Germany also recently ramping up their programmes (Graph 3 below). To date c.4.5m people in the US have been vaccinated, c.1.5% of the population. While this is below the intended target, US president-elect Biden, has indicated a more aggressive effort once he takes office in January with a plan to have 50m people vaccinated (c.15% of the population) in his first 100 days of office and has pledged that "we're going to get it done".

### GRAPH 3




Markets should also retain support from the favourable global interest rate environment and also continued quantitative easing (QE) measures from many Central Banks. No Central Bank is expected to increase interest rates in 2021 and significant sovereign and corporate bond buying by the US Federal Reserve

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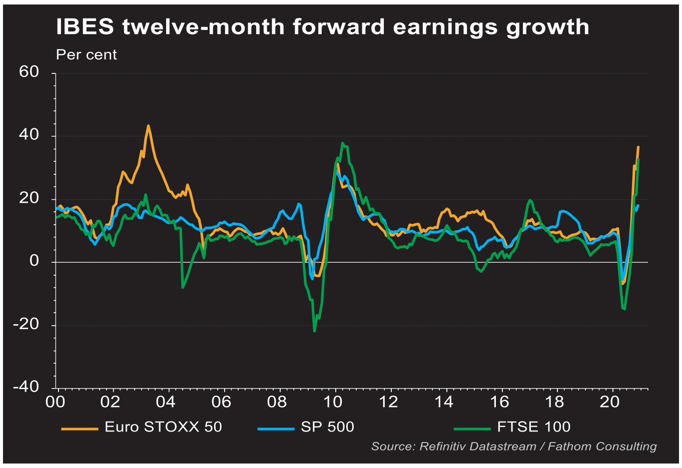
(c.$120bn per month) and the European Central Bank (c.€40bn per month) will continue in 2021. Both Central Banks have also committed to keep purchasing assets until economic conditions improve and inflation increases to at least the target of 2%. Government support, in the form of fiscal stimulus measures, is also expected to continue in 2021. Encouragingly in the US, the recently passed $920bn stimulus package (4.3% of US GDP) will provide necessary supports for US workers and businesses impacted by the coronavirus and also provide funds for critical initiatives such as the vaccine roll-out, etc. The recent win by the Democrats of the 2 senate seats in Georgia which will give the party a majority in both Houses of Congress should also allow for potentially additional stimulus measures, in particular given that they had been looking in December at providing c.$3bn of additional fiscal stimulus for the economy. Extensive fiscal support measures are also continuing in 2021 in other developed economies such as Europe and Japan.

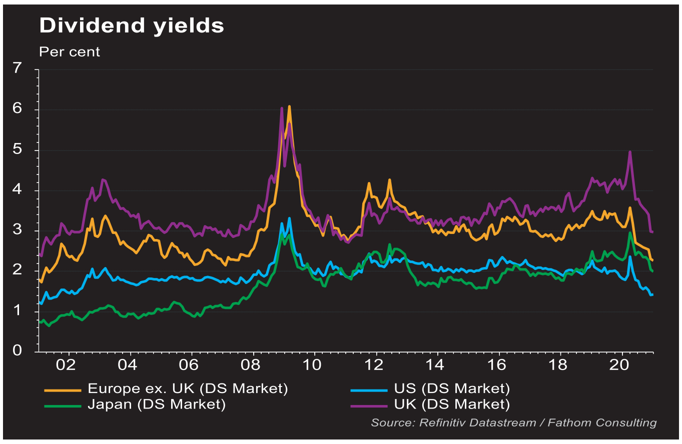
## GRAPH 4




Helped by the expected normalisation in economic activity in 2021, global economic growth is forecast to rebound strongly this year to c.6% from c.-4% in 2020. This would represent the strongest global growth rate in over 45 years. Emerging Markets are expected to be the main engines of growth (China and India - c.8% and 12% respectively) with developed economies overall recording a more modest expansion of c.4%. Developed market growth is likely to be led unsurprisingly by a rebound in those economies which were most impacted in 2020 such as the UK, France and Italy. Overall Eurozone growth is forecast at c.6% with growth in the US and Japan at c.5% and 3% respectively.

At a corporate level, US Q4 earnings will shortly begin to be released and will be closely watched. While earnings are expected to be c.10% lower than the same quarter last year, most attention will focus on the outlook for 2021 given the strong rebound in earnings that is expected this year (Graph 4 above). Overall the consensus view is that US corporate earnings will grow 22% this year following an expected c.14% fall in 2020. A higher growth rate of c.35% is expected in Europe. At a sectoral level, energy, industrial and consumer discretionary companies should see the highest recovery in earnings following a difficult 2020 helped by a higher oil price and an expected recovery in demand in sectors such as travel, leisure, autos, etc.

## GRAPH 5




With regard to other factors that will influence markets, support should continue to come from the relative attractiveness of equities compared to sovereign bonds and cash rates, with dividend yields in US and European markets of 1.6% and 2.5% respectively still attractive despite recent declines (Graph 5 above). Valuations (Price to Earnings, etc.) while high by historic levels, need to be considered in the context of historically low interest rates and inflation, which are also expected to remain that way for a considerable period of time, particularly in the Eurozone (Graph 6 below).

## GRAPH 6


While there are a number of factors supporting markets, there are reasons to be cautious particularly in the short term. The main concern at the moment is the significant spike in coronavirus cases in many countries but particularly in the US and Europe. The emergence of new strains of the virus has further complicated matters and has led to extensive new lockdown measures in a number of countries which will dampen economic growth in Q1. Measuring the extent of this is still difficult to quantify but it could result in the US and Europe recording muted GDP growth in the first quarter of 2021 before delivering significant above-trend growth during the rest of the year. Challenges also remain in relation to ensuring a significant global expansion of the vaccination programme although the likely approval of other suitable vaccines in the short term should be supportive in this regard. On a positive note, China, the world's second largest economy is continuing to experience strong economic growth as virus containment measures appear to be working. In addition the recent large fiscal stimulus package in the US should provide support to the economy over Q1 as the additional support payments start to be paid out to workers during January.

A more recently discussed risk to markets in 2021 is the re-emergence of inflation particularly in the US, driven by the large global monetary and fiscal supports that are being provided. It is possible that as economic normality resumes during the second half of the year and there is a surge in demand from consumers, that we will see a rise in inflation. However it is likely that any inflation increases will be moderate given that there is spare capacity in the labour force in the US and Eurozone with unemployment rates currently at 6.7% and 8.4% respectively. While this rate is expected to fall in 2021 in the US, it will still remain at relatively elevated levels of c.5 to 6%. In addition recent studies of US inflation have shown that prices in the major components that make up the inflation rate (i.e. rent, car prices, etc.) are expected to remain muted as a result of ongoing relatively high unemployment levels. It is also important to note that inflation is well below the targeted 2% levels in the US and Eurozone, at 1.2% and 0.2% respectively, so an uptick would be welcomed and would not be greeted adversely by markets if it is driven by higher growth expectations.

Finally the Biden US presidential victory, coupled with Democrat control of both Houses of Congress, increases the likelihood of higher corporate and personal taxes in the medium term as well as greater regulation. While Biden has indicated that he will increase the corporate tax rate to c.28% (currently 21%) this would still be less than the 35% rate prior to 2018 and would be in line with the average for most developed economies. While corporate tax changes would be a downside risk to earnings, it is likely that they would be phased in over several years and would be offset by increased infrastructure spending particularly centred around clean energy and the green economy.

In relation to the outlook for other asset classes, Eurozone sovereign bonds remain at expensive levels although they will continue to receive support from recently increased and extended ECB purchases. Investor nervousness over the increase in coronavirus cases and its effect on European economies may also help yields. European corporate bond markets should also benefit from QE (currently c.€6bil. purchases per month) and investor demand, although the outlook for corporate earnings and default expectations will also be watched particularly in light of renewed lockdown measures. With this overall positive backdrop, the general consensus outlook is that corporate spreads could show a modest narrowing over 2021.

In relation to commodities, oil prices, following a strong Q4, can still continue to push higher in 2021 helped by increased OPEC supply cuts and demand normalisation. Gold, despite more muted returns recently, should benefit from a number of factors including, in the short term, concerns over an economic slowdown and. in the medium term, a weaker US$ and the potential for increased stimulus measures in the US. Industrial metals such as copper also have scope to deliver satisfactory returns in 2021 helped by the strong rebound in the Chinese economy which remains the largest user of most industrial metals. Agri commodities may also benefit in this regard with environmental factors (La Nina) also supportive.

Overall, markets in 2021 are likely to be influenced in the short term by concern over a surge in new coronavirus cases. However this is likely to give way to increased positivity as we go through 2021, as vaccine delivery is aggressively ramped up, economies begin to more fully normalise and corporate earnings recover strongly. Favourable global Central Bank and government actions should also continue to be a key pillar of market support and they are both now seen as key overseers and guardians of the recovery. Against this potentially volatile backdrop in the short term and given the recent history of markets, the importance remains of holding an appropriately diversified portfolio that is constructed to deliver a satisfactory risk-adjusted return over the long term.