Irish Life

MARKETS END TURBULENT YEAR ON A HIGH

After a fall in October, equities rallied in the fourth quarter, with markets reaching new all-time highs by year-end. Equities initially fell due to a rise in Covid-19 case numbers and the subsequent reintroduction of restrictions. Concerns that the result of the US presidential election would be contested also contributed to the fall, as did fading fiscal support in the US. But global equities enjoyed a strong end to the year, as the removal of uncertainty surrounding the US presidential election and the successful conclusion of several Covid-19 vaccine trials spurred a sharp market rally. December saw the beginning of Covid-19 vaccination programmes, a $900bn US stimulus package, and a Brexit trade agreement. These helped equity markets end the year on a high.

Lenny McLoughlin
Chief Investment Strategist, Irish Life Investment Managers Limited (ILIM)

Investors eye a Biden presidency

Ahead of the US presidential election, the failure of President Trump to commit to a peaceful transfer of power if he lost gave rise to fears of unrest. After losing, Trump refused to concede the election and pursued efforts to overturn the result, but investors accepted that Joe Biden won and will be inaugurated as US President on 20 January. The removal of uncertainty regarding the election outcome and avoidance of the feared disruptions were greeted with relief by investors.

The apparent failure of the Democrats to gain control of Congress by winning the Senate also reduced the probability of corporate and income taxes being raised, which was positive for equities. The lower likelihood of a renewed escalation in trade tensions under a Biden presidency was also well received by markets. While the absence of a Democrat 'clean sweep' meant that the previously anticipated large fiscal package of up to $3trn was now less likely, investors expected a programme of around $1trn to be agreed by Congress. A $900bn compromise package was eventually reached before year-end, involving one-off payments of $600 to individuals and supplementary unemployment benefit payments of $300 until the end of March.

Covid cases rise, but vaccine brings hope

A second wave of Covid-19 emerged early in the quarter. Case numbers rose to new all-time highs, prompting many countries, particularly in Europe, to reintroduce national lockdowns. While severe, the restrictions in Europe were not as draconian as those introduced in March and April, with manufacturing and schools still open in many countries. Meanwhile, businesses had been able to adapt and conduct more operations online. As a result, the impact on growth was considerably less than earlier in the year.

CHART OF THE QUARTER

Global Equities

Source: ILIM, Bloomberg. Data is accurate as at 31 December 2020.

The news flow around Covid-19 deteriorated through the quarter, as a new, more contagious variant emerged, leading to a surge in case numbers and hospitalisations. However, the announcement of successful trial results for several vaccines was well received by markets. As the vaccines obtained emergency approval and began to be rolled out before year-end, expectations for global growth in 2021 were raised. A full roll-out of vaccines is planned in the coming months, and it has been predicted that up to 50% of the population in developed countries could be vaccinated before the middle of the year, rising to 70% before the end of 2021. This would allow more 'face to face' social and economic interactions and enable economic activity to return close to normal over the coming year.

MARKET ROUND-UP

Equities
Over the quarter, the MSCI AC World equity benchmark rose 12.9% (10.0% in euro terms). Emerging markets rose 16.1% (14.8% in euro terms), benefiting from a weaker US dollar and expectations of a recovery in global growth in 2021 linked to the roll-out of vaccines. Pacific Basin equities rose 14.3% (15.1% in euro terms), supported by a robust economic backdrop in China and Asia. Europe lagged, rising 10.2% (10.5% in euro terms) as the stronger euro acted as a drag on exporters. Meanwhile, growth was relatively weak due to the severe restrictions put in place to combat the renewed rise in Covid-19 cases. The UK also underperformed, rising 10.6% (12.1% in euro terms), due to Brexit-related uncertainty and ongoing difficulties in tackling Covid-19.

Bonds
The ICE BofA Merrill Lynch Eurozone > 5-year sovereign bond benchmark rose 1.7%. German 10-year yields fell to -0.57%, as the Eurozone economy contracted in the fourth quarter due to the restrictions announced to combat the rise in Covid-19 cases. Yields were also pushed lower by the €500bn increase in asset purchases announced by the European Central Bank (ECB) and the extension of these until March 2022. Peripheral spreads also continued to narrow, supported by the formal approval of the EU's €750bn Recovery Fund, which includes €390bn of grants. The extension of ECB asset purchases also helped to lower spreads. By quarter-end, Italian 10-year spreads against Germany falling were down to 111 basis points (bps), Spanish spreads had narrowed to 62ps, while Portuguese spreads had fallen to 60bps.

European investment-grade corporate bonds rose 2.0%, as yields and spreads fell to 0.33% and 91bps, respectively. Despite the contraction in Eurozone growth in the fourth quarter, concerns over potential defaults continued to ease thanks to the better growth outlook for 2021 and ongoing ECB purchases of investment-grade corporate bonds.

Currencies
The euro rose against the US dollar to 1.2225. The US dollar, which is generally viewed as a 'safe haven' asset, suffered in the more 'risk on' environment. While the ECB did increase the level of asset purchases, the failure to cut interest rates, combined with the continued dovish stance at the US Federal Reserve (the Fed), also contributed to the euro's gains against the US dollar. The approval of the EU Recovery Fund, which was seen as improving the long-term outlook for the Eurozone, was also positive for the euro.

Commodities
Commodities rose 14.5% (9.7% in euro terms), supported by the expectation of higher demand in 2021 on the back of a rebound in the global economy. West Texas Intermediate (WTI) oil rose 20.6%, as OPEC slowed its easing of production cuts by announcing an increase of only 500 barrels a day through January. The oil price was also boosted by falling inventory levels. Gold was down slightly by -0.2%, as reduced demand for defensive assets offset the support provided by the weaker US dollar.

MARKET SNAPSHOT

Market returns

Equity indices (€)	QTD Return (%)	YTD Return (%)	2019 Return (%)
MSCI Ireland	8.31	5.97	40.60
MSCI United Kingdom	12.09	-17.83	23.40
MSCI Europe ex UK	10.51	2.43	28.20
MSCI North America	8.48	10.64	33.90
MSCI Japan	10.50	5.42	22.30
MSCI EM (Emerging Markets)	14.79	8.89	21.10
MSCI AC World	10.02	7.18	29.60
10-year sovereign bond yields (€)	**Yield last month**	**2019 Yield (%)**	**2018 Yield(%)**
US	0.91	1.92	2.68
Germany	-0.57	-0.19	0.24
UK	0.20	0.82	1.28
Japan	0.02	-0.02	0.00
Ireland	-0.30	0.11	0.90
Italy	0.54	1.41	2.74
Greece	0.63	1.43	4.35
Portugal	0.03	0.43	1.71
Spain	0.05	0.46	1.41
Commodities ($)	**QTD Return (%)**	**YTD Return (%)**	**2019 Return (%)**
Oil (WTI)	20.64	-20.54	34.50
Gold (Oz)	-0.19	24.40	18.90
S&P Goldman Sachs Commodity Index	14.49	-23.72	17.60
FX rates	**Current**	**2019**	**2018**
U.S. dollar per euro	1.22	1.12	1.15
British pounds per euro	0.90	0.85	0.90
U.S. dollar per British pounds	1.37	1.33	1.28

Source: ILIM, Bloomberg. Data is accurate as at 31 December 2020.

Brexit deal finally agreed
Despite ongoing uncertainty during the quarter, the EU and UK finally agreed a 'last minute' trade deal which avoided the worst-case outcome of a 'no deal' Brexit and a move to WTO tariffs. The deal avoids tariffs and quotas on goods traded between the EU and UK, although services are not included in the deal. The UK is not bound by EU rules, although it has committed not to give UK companies an unfair advantage by lowering standards in relation to labour and environmental issues or by providing subsidies. The deal reduces risks to UK, European and Irish growth in the coming years.

EU recovery fund approved
The proposed EU Recovery Fund of €750bn, including €390bn of grants, had appeared to be at risk as Poland and Hungary exercised their vetoes over the condition that funding would depend on the application of the rule of law. Eventually a compromise was reached and the fund was approved, with monies expected to be distributed to countries over the course of 2021.

CENTRAL BANKS' ROUND-UP

US Federal Reserve

The Fed left policy unchanged during the quarter, but remained relatively dovish. It frequently highlighted the downside risks to growth and emphasised the need for continued accommodative monetary policy, which it saw as essential to foster an economic recovery. It provided guidance around asset purchases, indicating they will continue at current levels until substantial progress has been made towards its maximum employment and price stability goals. Following the guidance, investors believe the Fed will continue buying $120bn of assets per month through 2021.

European Central Bank

The ECB increased its Pandemic Emergency Purchase Programme (PEPP) by €500bn to €1.85trn and extended purchases until March 2022. It also announced three additional Long-Term Refinancing Operations (LTROs) through which it provides cheap funding to banks. The ECB's comments that its aim is to preserve favourable financing conditions and that it will flexibly adjust purchases according to market conditions were interpreted by investors as an implicit move to yield-curve control. The ECB's forecast that core inflation will only be 1.2% by 2023 also reaffirmed the expectation that policy will remain loose in coming years.

Bank of England

The Bank of England suggested at the beginning of the quarter that it was ready to increase asset purchases to support growth. It subsequently announced a larger-than-expected expansion of purchases of £150bn which will take place through 2021. It also extended corporate funding supports by six months and indicated that it is ready to take whatever additional policy actions are needed to support the economy. The Bank continues to review the possible use of negative interest rates. Some members have publicly backed such a policy move, although the official conclusion of the review process is still some months away.

ECONOMIC OUTLOOK

With restrictions being extended through the early weeks of the new year, global growth will remain softer at around 2.7% in the first quarter of 2021. However, it is expected to pick up in the middle of the year to a rate of approximately 6–7%, aided by fiscal and monetary stimulus measures and the widespread distribution of vaccines. Despite the drag on growth evident in Europe through the fourth quarter of 2020, business sentiment surveys rose in the latter part of 2020. Companies anticipate a strong recovery as consumer behaviour is expected to become less cautious. In the US, although growth exceeded expectations in October, there has been a noticeable slowdown since November – consumer confidence has fallen, retail sales declined, and the labour market has softened. However, the recently announced fiscal package of $900bn is expected to boost growth by 0.5% in 2021, and the impact should be felt immediately as stimulus cheques began to be sent out before year-end. This is expected to lead to growth of over 4% in the US economy in 2021.

Overall, following a contraction of 4% in 2020 in the global economy, growth of 5% is expected in 2021, boosted by the continuation of fiscal and monetary stimulus and greater confidence associated with widespread inoculation against Covid-19.

Source: ILIM, Bloomberg. Data is accurate as at 31 December 2020.

THE MONTH AHEAD

Economic data and events to watch

4 January	China Caixin Manufacturing PMI (December)
6 January	Japan consumer confidence (December)
7 January	Canada balance of trade (November) US balance of trade (November)
8 January	US non-farm payrolls (December)
11 January	China inflation rate (year on year, December)
13 January	US inflation rate (year on year, December) US core inflation rate (year on year, December)
14 January	Germany government budget
15 January	UK balance of trade (November) US retail sales (month on month, December)
20 January	China one-year loan prime rate UK inflation rate (year on year, December) Canada's inflation rate (year on year, December)
21 January	Japan's inflation rate (year on year, December)
22 January	UK consumer confidence January
27 January	Australia business confidence (December) Germany consumer confidence (February)
29 January	Japan consumer confidence (January) US personal spending (month on month, Decembe

Political events

Georgia senate runoffs, inauguration of President-elect Joe Biden, and the end of the 12-month Brexit transition period

Source: ILIM, Bloomberg. Data is accurate as at 31 December 2020.

Irish Life

CONTACT US

PHONE: (01) 704 1200
FAX: (01) 704 1918
WEBSITE: www.ilim.com
WRITE TO: Irish Life Investment Managers, Beresford Court, Beresford Place, Dublin 1