Irish Life

JANUARY'S RALLY RUNS OUT OF STEAM

Following a late sell-off, global equities were marginally lower in January in local-currency terms, but rose slightly in euro terms. Equities gained for most of the month, supported by hopes of additional US fiscal stimulus and strong fourth-quarter earnings. But markets sold off in the last days of January as a retail-driven squeeze on hedge funds led to some forced selling by these funds and heightened volatility.

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Eurozone sovereign bonds fell as higher US yields due to concerns over increased issuance of bonds pulled global bond yields higher. Peripheral spreads also rose following the collapse of the Italian coalition government.

A boost to US growth

US growth expectations for 2021 received a boost when the Democrats won two crucial Senate seats in the run-off elections in Georgia. With the resultant control of the Senate, President Biden announced plans for an additional $1.9 trillion fiscal stimulus programme. Due to likely compromises to satisfy demands from some more moderate Democrats, a smaller package of $1–1.5trn is expected to be agreed. When combined with the earlier programme of $900bn (announced in December), the boost to US growth in 2021 from recently proposed fiscal measures is significant, at around 2%.

Game Stop squeeze

The positive sentiment driving equities faded in the last days of January, due to uncertainty associated with a squeeze on hedge funds. A group of retail investors targeted specific stocks known to be heavily 'shorted' by the hedge fund industry. They caused a sharp rise in some of these heavily shorted shares, including Game Stop. The video game retailer rose over 400% in the last week of January, bringing its gains for the month to over 1600%. As Game Stop and other stocks were squeezed higher by a surge in retail buying, hedge funds with large shorts in these stocks were forced to close their positions, incurring significant losses. They also had to reduce some of their long exposure to the market, which contributed to the selling pressure on the overall market. The disruption and uncertainty caused by the short-selling squeeze also led to some general profit-taking following the strong performance in equities since October.

Encouraging earnings results

The fourth-quarter earnings reporting season to date has been strong and well ahead of expectations. In the US, just over one third of companies have reported results, and earnings are 21% ahead of forecasts and up 4% compared to the fourth quarter of 2019. In Europe, results are 19% ahead of expectations and up 9% compared to quarter four of 2019. In Japan, the respective figures are +14% and +13%. Consensus global earnings forecasts for 2021 have been revised slightly higher in recent weeks, with growth of 27% now expected this year.

CHART OF THE MONTH

WTI Oil (US$ billion)

Source: ILIM, Bloomberg. Data is accurate as at 1 February 2021

Global political highlights

In the US, divisions between the Democrats and Republicans became deeper as former president Donald Trump was impeached for a second time following riots at the Capitol in Washington. In Italy, Prime Minister Conte was forced to resign as one of his coalition parties withdrew its support. Negotiations are currently underway to form a new government. These are expected to result in a new coalition being formed, broadly similar to the previous one, thus avoiding the need for early elections. In Germany, Armin Laschett was elected as the CDU's new Chairman and will eventually replace Angela Merkel. He is seen as representing continuity, having a similar centrist philosophy and approach to Merkel.

Covid vaccine delays

The distribution of vaccines has been slower than initially expected due to production and logistical difficulties, although these should be overcome. Despite this, vaccination rates have continued to climb, with 34% of the population in Israel already vaccinated, 13% in the UK, 7% in the US, and 2.0–2.5% across Europe. Two other vaccines are shortly expected to receive regulatory approval following the recent publication of trial results, meaning there will be five vaccines available for distribution in developed regions by the end of the quarter.

MARKET ROUND-UP

Equities

The MSCI AC World equity index fell -0.1% (+0.3% in euro terms). Emerging markets rose 3.8% (3.8% in euro terms), benefiting from their sensitivity to the improving global growth outlook as growth forecasts were revised higher. Pacific Basin equities rose 1.1% (1.4% in euro terms), supported by relatively strong economic news flow across Asia and higher commodity prices, which benefited the Australian market. Europe fell -1.1% (-1.1% in euro terms) as economic data was weak, with growth in the region expected to contract in the first quarter as restrictions were extended across many countries. The US fell -0.9% (-0.2% in euro terms) and was affected by the sell-off related to the squeeze of short positions among hedge funds at month-end.

Bonds

Eurozone >5-year bonds fell -0.8%, with the German 10-year yield rising to -0.52%, pulled higher as fears of rising bond supply on the back of increased fiscal stimulus weighed on US and global yields. Peripheral spreads widened slightly on the back of renewed political tensions in Italy, with Italian 10-year spreads rising to 116 basis points (bps). Meanwhile, Spanish spreads were marginally higher, at 62bps.

Currencies & commodities

The euro fell slightly against the US dollar to 1.2136 as the European Central Bank (ECB) attempted to 'talk down' the euro after its recent appreciation, and suggested it is monitoring the exchange rate and could adjust policy if necessary. The dollar also benefited from the more 'risk off' environment at month-end. Commodities rose 4.9% (5.7% in euro terms) as global growth forecasts for 2021 were revised higher. West Texas Intermediate (WTI) oil rose 7.6% as Saudi Arabia announced that it would cut oil production by 1 mbl a day through February and March. Meanwhile, demand forecasts were revised higher on the better economic backdrop. Gold fell -2.5%, negatively affected by the stronger US dollar.

Central banks round-up

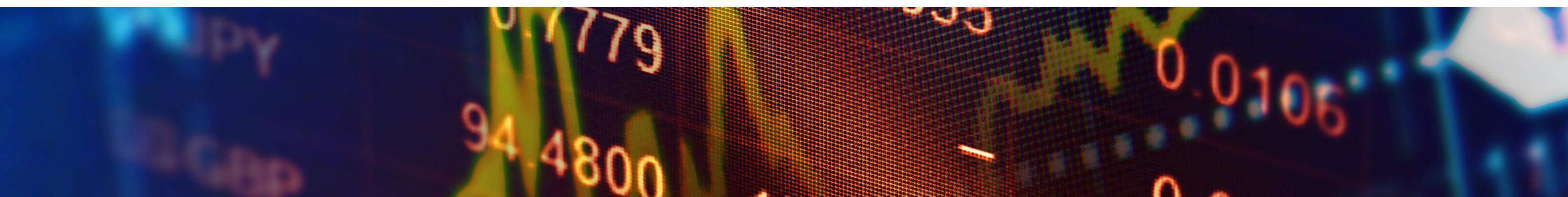
The US Federal Reserve indicated that current loose policy is set to stay for some time. Chair Powell said the Fed does not intend to raise interest rates any time soon and suggested that discussions related to scaling back policy support were premature. The ECB emphasised that it wants to maintain favourable financial conditions, and left open the possibility of recalibrating the size of asset purchases in its Pandemic Emergency Purchase Programme (PEPP) if required. The Bank of Japan announced plans to review its current policy tools in coming months with a view to making policy more effective and sustainable. Comments from the Bank of England suggested that while negative interest rates are a tool which should be at its disposal, associated costs for the banking sector could mean that these might not be introduced in the short term.

MARKET SNAPSHOT

Market returns (EUR)

Equity Markets (EUR)	MTD Return (%)	YTD Return (%)	2020 Return (%)
MSCI Ireland	-2.98	-2.98	5.97
MSCI United Kingdom	0.47	0.47	-17.83
MSCI Europe ex UK	-1.08	-1.08	2.43
MSCI North America	-0.23	-0.23	10.64
MSCI Japan	-0.30	-0.30	5.42
MSCI EM (Emerging Markets)	3.83	3.83	8.89
MSCI AC World	0.28	0.28	7.18
10-Year Yields	**Yield Last Month (%)**	**2020 Yield (%)**	**2019 Yield (%)**
US	1.07	0.91	1.92
Germany	-0.52	-0.57	-0.19
UK	0.33	0.20	0.82
Japan	0.05	0.02	-0.02
Ireland	-0.19	-0.30	0.11
Italy	0.64	0.54	1.41
Greece	0.68	0.63	1.43
Portugal	0.04	0.03	0.43
Spain	0.10	0.05	0.46
FX Rates	**Current**	**2020 Rates**	**2019 Rates**
US Dollar per Euro	1.21	1.22	1.12
British Pounds per Euro	0.89	0.90	0.85
US Dollar per British Pounds	1.37	1.37	1.33
Commodities (USD)	**MTD Return (%)**	**YTD Return (%)**	**2020 Return (%)**
Oil (WTI)	7.58	7.58	-20.54
Gold (Oz)	-2.47	-2.47	24.40
S&P Goldman Sachs Commodity Index	4.94	4.94	-23.72

Source: ILIM, Bloomberg. Data is accurate as at 1 February 2021



THE ILIM VIEW – LOOKING AHEAD

The outlook for equity markets over the next 12 months depends on several factors, including the evolution of Covid 19, the scale of recovery from the 2020 recession and the level of stimulus provided by global authorities.

While equity markets are expensive in absolute terms, they remain very attractive in relative terms, given the low yields available on assets such as bonds and cash. The current low level of bond yields justifies higher-than-average valuations in equities. We believe global equities can trade on a 12-month forward price-to-earnings (PE) multiple of 18.5–19 times at the end of 2021. With the global economy in the initial stages of a new cycle and strong economic and earnings growth forecast over the next two years, upside of at least mid-to-high single digits in global equities is expected over the next 12 months.

Potential risks to the positive outlook include a resurgence in Covid-19 cases and a failure to contain the virus; vaccines proving to be ineffective, which would threaten the improving growth backdrop; fiscal and monetary supports being reduced; or a significant rise in bond yields, which would diminish the relative valuation case for equities. The probability of these occurring is viewed as being low. But volatility could remain a feature in markets if any of these issues become a cause for concern over the course of 2021.

THE MONTH AHEAD

Economic data and political events to watch

Economic data releases

1 February	China Caixin Manufacturing PMI (January)
4 February	Australia balance of trade (December)
5 February	Canada balance of trade (December) US non-farm payrolls (January) US balance of trade (December)
9 February	Australian business confidence (January) US balance of trade (December)
10 February	China inflation rate (year on year, January) US inflation rate (year on year, January) US core inflation rate (year on year, January)
12 February	UK balance of trade (December)
16 February	Japan balance of trade (January)
17 February	US retail sales (month on month, January) UK inflation rate (year on year, January) Canada's inflation rate (year on year, January)
18 February	Japan's inflation rate (year on year, January)
19 February	UK consumer confidence (February)
22 February	China one-year loan prime rate
25 February	US durable goods orders (month on month, January)
26 February	US personal spending (month on month, January)

Political events

Political events to watch: Europe-UK vaccine fallout, Myanmar coup, and WHO team's visit to China

Source: ILIM, Trading Economics. Data is accurate as at 1 February 2021

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Figures referenced herein have been sourced from ILIM and Bloomberg. Forecast figures have been prepared by ILIM based on reasonable assumptions, internal data and data sourced from Bloomberg.

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