RAYMOND JAMES

The curtain falls on a tumultuous year

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The curtain is slowly coming down on 2020. Not before time! After what has been a tumultuous period for most, and a tragedy for many, the time to turn the page and move on is slowly arriving. Centre stage, the principal actors are going through their closing lines. Following the US elections, the leading actor refuses to go quietly into the night. Legal actions lie strewn about like discarded party poppers... this is going to be quite a mess to clear up. Feelings have been hurt and emotions have run hot. We may look back on 2020 as a year defined by a great tearing apart. If that is the case, then we might all pray that 2021 turns out to be the start of the great patching up.

Yet throughout all the sound and fury, financial markets have quietly, almost unobtrusively, picked their way across this blasted heath. Under the ever-watchful, ever-diligent stewardship of the world's systemically significant central banks, financial assets have made good headway. So much so, in fact that the MSCI World Equity Index has just posted another extremely strong monthly return. Whatever happened to the much-feared autumn tempests? Although threatening from time to time, the storm never arrived. And now hope. Ah, hope! Like a watery sun emerging from behind scudding clouds, we can look forward and no longer backwards. Financial markets are always and ever have been discounting mechanisms. The maelstrom has been circumnavigated. It's time to move on.

None of this is to say that there is not much work to be done. Before we can truly arrive at the sunny uplands, a great healing must take place. This will not be easy. Arguably chief amongst the great rifts is that between the United States and China, comfortably the two largest global economies, and between whom little love is lost. Mr Biden is likely to be inaugurated on 20th January and his appointment to the position of chief trade representative will be watched closely. This is an appointment that requires Senatorial approval. So we await the result of the high profile Senate run-off election in the state of Georgia on 5th January. A Democratic victory in both those seats up for grabs, coupled with a Biden-led administration in the White House, would deliver a "Blue Wave". This is, however, by no means assured. So the worry goes on.

Elsewhere, and to much fanfare, the pharmaceutical industry promises a vaccine to rid us of the dreaded plague. Full global roll-out will take some time and questions remain as to how an effective distribution, particularly to many of the poorest countries, might be achieved. Although we are assured as to the vaccine's efficacy, many remain unconvinced by products hurriedly pushed through clinical trials to meet ambitious deadlines. Time will be of the essence. Immunity, either through innoculation or herd is the goal, but this will not happen overnight and the economic scarring will likely be visible for much time to come. Fear can turn into optimism and those dark hours after sunset are eventually replaced by a new dawn.

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And how might governments deal with the economic costs associated with combating Covid-19? Around the world, public sector debt and deficits are sky high. Might a new era of financial repression lie ahead? Across developed economies, government bond yields are already at epochal lows. In part this is because many countries are already making use of measures that look very much like the deliberate suppression of borrowing costs. In the developed world we should expect even more central bank purchases of government bonds. In the emerging world, banks are likely to be incentivised, or perhaps coerced even, into buying government debt. In both instances, the process does not need inflation for it to work, but it does work better if inflation rises simultaneously.

Financial markets sense a straw bending in the wind. Small cap equities have experienced a fleeting burst of outperformance, while the tech-heavy Nasdaq is showing signs of wilting after a very long winning streak. More generally, November has seen momentum strategies come under pressure and give up some ground while, relatively speaking, value strategies have made headway. Turning to commodities, precious metals have lost ground (unusual given the US dollar's concomitant weakness), but industrial commodity prices, both metal and crude oil, have exploded higher. Is this a key turning point? Speculators certainly seem to think so, but wise heads counsel caution.

The government bond yield curve is both low and flat, a clear sign that the markets anticipate extremely low interest rates for a very long time to come. Rising longer term interest rates would send a clear signal to investors that the rotation has legs. This is a matter for considerable conjecture and the focus of heated debate. The bottom line, though, when all is said and done, is that the inevitable consequence of a prolonged period of financial repression is that investment returns from government bonds would likely remain subdued for years, while riskier assets, such as stocks, would be more likely to outperform.

While Raymond James' European Strategist Chris Bailey is away, we have the pleasure of working with Jeremy Batstone-Carr whose knowledge, expertise and pithy writing style will adorn our market commentary.

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Jeremy has worked in the City of London for more than thirty years, both on the "sell" and the "buy" sides. For more than twenty years Jeremy was Head of Research at a number of well-established City businesses including Coutts and more latterly Charles Stanley, where he was also Chief Global Economist. More recently, Jeremy has brought his experience to bear in academia, operating from a "top down" perspective, building macro economics and investment strategy into asset allocation. Jeremy has a strong reputation for thought-provoking analysis, is an experienced presenter and has a high profile in both print and broadcast media. He now lives mainly in Southern France and spends much of his spare time renovating a medieval property.