Investment Review – EUR

Fourth quarter 2020

Against a challenging macroeconomic backdrop, global stocks concluded the year at record highs, delivering double-digit returns. Most notably, the US stock market gained +16.3% in 2020, while the tech-heavy Nasdaq index posted its best annual performance since 2009, up +43.6%.

During the fourth quarter, global equities returned +12.8% in local currency terms, or +10.0% in EUR terms, alongside European government bonds, +1.3% (all maturities). A vaccine breakthrough in the fourth quarter, alongside supportive policy and subsiding geopolitical risks, were key drivers of market performance. For the full year, global equities returned +6.8% (EUR terms) and global government bonds +5.6%.

Positive investor sentiment continued in the fourth quarter, buoyed by the approval and initial distribution of vaccine treatments across the US, UK and, to a lesser extent, Europe. Infection rates have risen once again – more dramatically than before – with a new and more contagious variant of the virus having emerged in the UK. Governments continued to reintroduce stricter suppressive measures – most European countries re-entered lockdowns, while some US states implemented local restrictions. Despite this, stock markets continued to look 'across the valley': strong returns fostered a flurry of new issuance coming to market in the fourth quarter – six times the amount seen in the first three months of the year – rounding off a record-breaking year. Despite echoes of the dot-com bubble, not all regions and sectors appeared equally expensive; the fourth quarter saw a cyclical rotation away from frothier growth names to value-orientated stocks as confidence in the economic recovery took hold.

For the most part, economic indicators remained robust. Survey data and retail spending numbers suggest that the second-wave-induced setback in the fourth quarter might not be as dramatic as feared; retail spending in the UK and the US has softened but remains above pre-pandemic levels, while in Europe retail sales have grown. Labour market data continued to strengthen in the US, with the unemployment rate falling from 8.4% to 6.7% over the quarter. Comparable data in the UK and Europe remains muted with many job retention schemes still in place. Surveys of business sentiment – the Purchasing Managers' Indices – for major economies mostly continued to improve in the fourth quarter. Most notably, the forward-looking component of US ISM manufacturing survey – a long-term gauge of wider US economic health – touched a 17-year high in the final month of the year. Elsewhere, China's recovery continued to outpace other major economies in the fourth quarter and is estimated to be the only major economy to have grown in 2020.

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On the policy front, both government and central bank action remained supportive. After months of negotiation, Congress approved a further $900bn stimulus package as part of a wider $2.3trn spending bill, including direct payments to households and additional local government funding. While keeping rates unchanged, the Fed has indicated that asset purchases would remain at their current pace for the time being. The Bank of England and ECB have also kept rates unchanged but boosted their asset purchase programmes: the Bank of England expanded its programme by an additional £150bn in November and the ECB by €500bn in December while extending its programme through to the end of March 2022. In addition to this, the €1.8trn EU seven-year budget and recovery fund was finally approved after a compromise led to Hungary and Poland lifting their objections to the disbursement of the budget.

Geopolitical events supported risk assets in the fourth quarter. Despite Trump's ongoing attempts to delegitimise the election result, November saw the White House turn blue in a decisive win for Joe Biden; Congress is likely to move in the same direction, but this has yet to be officially confirmed. In Europe, a lengthy and last-minute Trade and Co-operation Agreement was signed, concluding Brexit discussions (for now at least) with the overall outcome – a free trade agreement for trade in goods – a far better result than the blanket 'WTO rules' alternative feared. Collective developments continued further afield, with China and 14 other countries – covering close to one third of global GDP – signing the Regional Comprehensive Economic Partnership (RCEP), creating the world's largest trading bloc.

Market review

In equities, strong fourth-quarter performance was evident across most major markets. In local currency terms, Latin America (+23.9%), emerging Asia (+16.2%) and Pacific ex. Japan (+14.3%) were the standout performers. Europe (excluding the UK) and emerging Europe were the relative underperformers returning +10.2% and +10.3% respectively.

In terms of sectors, the fourth quarter saw a cyclical shift away from growth stocks to traditional value sectors, with Energy (+23.6%) and Financials (+21.3%) outperforming, while Consumer Staples (+4.3%), Healthcare (+5.5%) and Real Estate (+7.3%) underperformed.

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In fixed income, global government bonds remained unchanged (unhedged, local). The US benchmark 10-year yield rose to a five-month high – almost breaching 1% – but ended the quarter at just over 0.91%. In Europe, yields were more stable, and peripheral spreads continued to compress. Spain issued its first negative yielding 10-year note, while Portugal's benchmark 10-year yield turned negative. Meanwhile, most breakeven inflation rates continued to nudge higher. In credit, high yield bonds outperformed investment grade (+6.8% vs +2.8%, respectively), while spreads continued to tighten in the quarter.

In currencies, sterling was the standout performer (+1.3% on a trade-weighted basis), as Brexit risks subsided following the completion of a trade deal between Europe and the UK. Meanwhile, the US dollar (-4.5%) was the weakest major currency in the quarter.

Elsewhere, oil benefited from optimism around vaccine distributions and ongoing policy support to post seven consecutive weekly climbs, ending the quarter up strongly (Brent +26.5%). Meanwhile, platinum and silver were the precious metal outperformers (+20.0% and +13.6% respectively), while bitcoin surged further and ended the quarter at record highs of $34,000.

Data sources: Bloomberg, MSCI, JPM, Rothschild & Co

Notes

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