Rathbones
Look forward

Review of the week

25 January 2021

Everything is up

Markets have had a stellar run, despite mixed news on inoculations. It's in everyone's interests for asset prices to remain high, but that's no guarantee they will stay that way. As always, diversification is key.

Across the Channel, the European vaccination programme has run into the drifts. Vaccine suppliers are struggling to produce enough to fill orders. AstraZeneca has said it will provide roughly half what it promised the trading bloc (albeit, the EU medical regulator is yet to approve it). Pfizer said it will have to reduce early shipments to help boost longer-term supply. Some American states have reported similar hold-ups.

Here in the UK we're faring better. As of 17 January, just over 3.5 million people have been given the vaccine in England alone. Well, they've had a first jab at least; all COVID-19 vaccinations require a booster. The number of people who had received both - i.e. the number of people properly vaccinated - appears to be about 425,000. The speed of the vaccination programme is growing well - daily figures show almost 480,000 people were given a vaccine on Sunday - but you can see how it's going to take a very long time to get two shots to everyone. And then you have to factor in the production constraints that have already started to plague others. We must be patient for a long while yet.

Stock markets are wrestling with this too. From day to day, week to week, you can see the uncertainty rippling through them. On upbeat days, investors buy up the 'cyclical' stocks that should do well if the pandemic is contained and economies can recover in earnest. But then some poor data pops up or investors get a little nervous about prices and these companies' shares drift lower again, their ascendancy replaced by the 'growth' businesses that are less affected by COVID and likely to increase profits at a steadier, but perhaps lower, rate than their cyclical counterparts.

Through it all, stock markets, broadly, remain elevated. Emerging markets have joined the party as well: they have set a new record after leaping higher in recent weeks. The last peak was back in November 2007, so it's been a long time coming. Interestingly, the gold price is pretty high too. Typically seen as a store of value for the bad times, the yellow metal recently hit a new record and after falling back slightly it's now trading around levels seen in the European debt crisis of 2011. And then there's bitcoin. This cryptocurrency has been turning heads once again after it roared back to life following a few years' hiatus. In the few short weeks it took us to prepare a quick report on this new(ish) craze and how it would affect the diversification of portfolios, it has more than lived up to our general feeling on it: "it's a bit risky." The price leaps and falls at breakneck speed, making it a difficult asset to buy, and an even harder one to value.

There's a lot swirling around in markets and economies right now. And it's exacerbated by the lack of anything else going on in our lives. Locked up inside you can start to obsess over things, to notice things you hadn't before, to worry more. Well, for some of us at least. Many others will be up to their armpits in home-schooling. From what I've heard, there's little time for introspection about life, the markets or anything else. Just a daily reminder of how much you can forget from your childhood studies!

An unwritten understanding

UK inflation was slightly higher than expected in December, coming in at 0.6%. That is still well below the 2% target for the Bank of England. Our central bank has had a lot of practice writing explanatory letters to the Chancellor about why inflation is undershooting target by more than 1%. It has had to do it twice in the last 12 months, while the rate has been below 1% for eight months. The stigma has vanished.

UK unemployment continues to rise, albeit at a creep. The official rate for the three months to 31 October was 4.9%, 10 basis points higher than the last release. The real figure is likely to be higher, given the extra restrictions that were added in November and December, culminating in a full nationwide lockdown. In the US, unemployment plateaued at 6.7% for both November and December. Its January print is due out next week. American inflation has been running a little higher than in the UK, at 1.4%. The US Federal Reserve (Fed) meets to discuss monetary policy on Tuesday and Wednesday. No change to its stance is expected.

Underpinning most investors' outlooks for stocks and bonds is the assumption that the Fed and other central banks stand ready to buy if any market wobbles morph into a panic. They still have quite a bit of ammunition ready for if this were to occur. There are some grumbles that this policy is effectively a backstop for the wealthy. Which it is, to be fair. It keeps the value of financial assets high, which disproportionately helps those who own them – who disproportionately are the richest people in society. However, it helps workers too. It just takes a more indirect route. The central banks want to ensure that the cost of borrowing for companies remains low so they can easily roll over their debts and make the interest payments. That way they stay afloat and stay employers. The cost of that financing is intrinsically linked to the price of bonds, especially government ones. If the price of these bonds falls, the cost of borrowing rises. Thus the need to keep them high. And the price of stocks is linked to the price of government bonds: today's value for future profits, which we call share prices, goes up when bond yields are low and falls when they rise.

At the moment, it's in everyone's interest to keep interest rates low. Therefore, it's in everyone's interest to keep financial asset prices high. This is not a given, though, it's just an understanding. But one to keep in mind.

Julian Chillingworth
Chief Investment Officer, Rathbones

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