Market review January 2021

Source: John Pritchett, U.S. Consumers in denial of inflation threat.

We have said it over and over again, the year 2020 will go down in the annals!
A quick look at the performance of most asset classes would lead us to believe that it was a quiet and boring year. As proof, equity indices ended the year up, most of European indices underperformed US indices (as in previous years), rates continued to decrease, credit spreads continued to tighten, oil corrected by 21% (after experiencing prices in negative territory…) and gold appreciated by 25%. So, by looking at the "photo finish", some investors might think it was an easy year… but you who read this market review regularly, know that it was not the case.
We experienced the biggest supply shock in history with, in spring, a first lockdown imposed by Governments all around the world. This caused massive earnings' revisions for certain sectors. Without the intervention of central banks (as well extraordinary), financial markets would have certainly imploded, which could have sounded as the death knell of capitalism as we know it.
But it did not happen! It is true that the year 2020 caused significant and even irreversible damage for certain sectors, but as often during a shock, it also generated historic opportunities that other players have taken advantage of. On this point, we invite you to read, once again, our September 2020 market review, which explains this phenomenon of K-shaped recovery.

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Market trends at the end of December 2020

			Equities in Local Currencies					
End of December	**MSCI World**	**S&P 500**	**EuroStoxx**	**CAC**	**Spain**	**Switzerland**	**MSCI EM**	**CSI 300**
Perf 1 Month	4,14%	3,71%	1,72%	0,60%	-0,04%	2,17%	7,15%	5,06%
Perf 3 Month	13,63%	11,69%	11,24%	15,57%	20,21%	5,07%	19,34%	13,60%
Perf YTD	14,06%	16,26%	-5,14%	-7,14%	-15,45%	0,82%	15,84%	27,68%

		Commodities				Currencies vs EUR		
End of December	**WTI Oil**	**Brent Oil**	**Gold**	**Copper**	**USD**	**JPY**	**GBP**	**CHF**
Perf 1 Month	7,01%	8,85%	6,83%	2,45%	-2,37%	-1,39%	0,13%	0,26%
Perf 3 Month	20,64%	26,50%	0,66%	16,40%	-4,06%	2,05%	1,46%	0,16%
Perf YTD	-20,54%	-21,52%	25,12%	25,79%	-8,22%	-3,50%	-5,41%	0,41%

			Bloomberg Indices Bonds Total returns					
End of December	**Global Aggregate**	**US Aggregate**	**Euro Aggregate**	**US 10 Year Treasury**	**German 10 Year Bund**	**Global Credit**	**Global High Yield**	**Emerging Sovereign $**
Perf 1 Month	1,34%	0,14%	0,14%	-0,27%	0,16%	1,27%	2,47%	1,52%
Perf 3 Month	3,28%	0,67%	1,26%	-1,32%	1,17%	4,03%	7,66%	4,50%
Perf YTD	9,20%	7,51%	4,05%	10,05%	8,60%	10,03%	7,03%	6,52%

Source : Bloomberg 31/12/20.

Enough talk about the past... what to expect in 2021!?
What we do know is that there are several vaccines with very high rate of efficiency against Covid-19. Vaccination campaigns have already started a few weeks ago (at least in industrialized countries) and people at risk are the first to "benefit" from injections. This should therefore enable us to return to a "normal" life (we are not going to debate here on what a normal life is, but this implies that we will regain our freedom of movement to do something else than going to work...) and thus enable certain industries to reconnect with their activity of yesteryear.

S&P 500 – Earnings Growth vs Valuation

Sector	Relative P/E	10 Yr Average	Ratio	Next 12M EPS Gr.
Cons. Disc	1.97	1.28	1.541	53.27%
Industrials	1.56	1.04	1.496	68.77%
Technology	1.15	1.05	1.103	14.03%
Materials	1.00	1.00	1.002	26.43%
Comm. Svcs.	1.00	1.15	0.877	13.21%
Utilities	0.73	0.95	0.770	4.50%
Cons. Staples	0.84	1.11	0.760	5.79%
Health Care	0.67	0.95	0.713	10.40%
Financials	0.64	0.91	0.706	18.12%
Real Estate	0.80	1.19	0.676	4.28%
Energy	-7.35	0.96	-7.673	1604.38%

Source: Factset, Raymond James Equity Portfolio & Technical Strategy, 22.12.2020.

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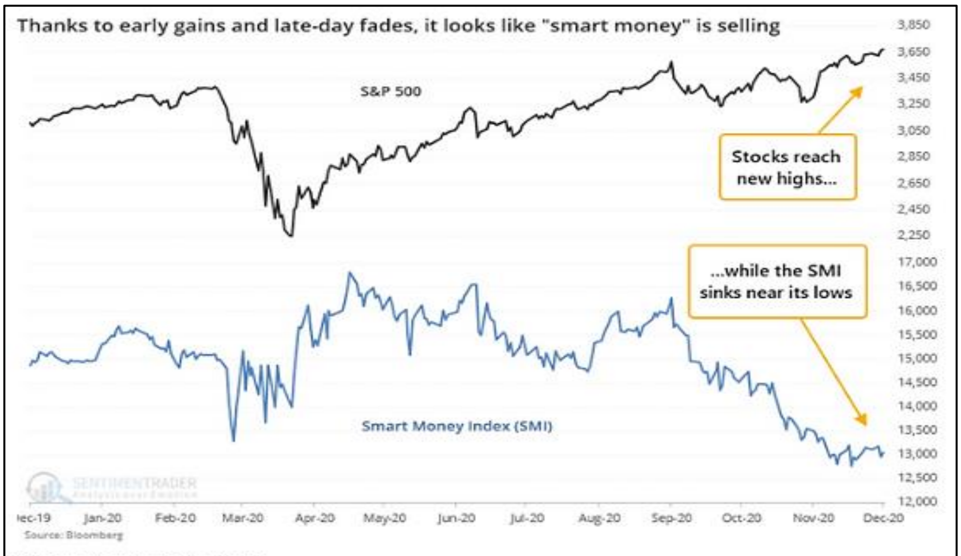
This of course delighted financial markets, which ended the year on a rather positive note. The Brexit saga has finally found an epilogue… or is it rather the beginning of new quarrels between Europeans and Britons? In any case, an agreement was signed with forceps. Still in the news, an investment agreement between China and the European Union was validated on December 30. This agreement had been under negotiation since 2013 and seemed to be at a standstill. Soon, we should have more details about this agreement which isolates the United States even more… Another good news, Republicans and Democrats finally agreed on a new $900 billion stimulus package. In addition, central banks delivered what the markets were expecting at their last meeting of the year, even if some were hoping for more from the ECB. So, all the stars seem to be aligned in the best of all worlds for risky assets.

But caution is still required. The recent rises in equities are to be put on the blame of retail flows. The "Smart Money Index" (SMI), which tracks flows from professional investors, confirms that the latter are not at the origin of the rise in equity markets over the last few months of the year. The past has shown us several times that retail investors often come at the end of the cycle… let's see if this is confirmed again.



SOURCE: VIA SENTIMENTRADER

Another interesting indicator that argues for caution is the extraordinary year in terms of IPOs (Initial Public Offering). A large part of these IPOs (almost half) were made through SPACs (Special Purpose Acquisition Companies) which are vehicles created by well-known venture capital players to facilitate the listing of a private company on the stock exchange. In the past, we have seen a certain correlation between equity market valuation and the number of IPOs.

Private companies are often interested in being listed when levels of valuation are high. This gives them more room to finance their development.

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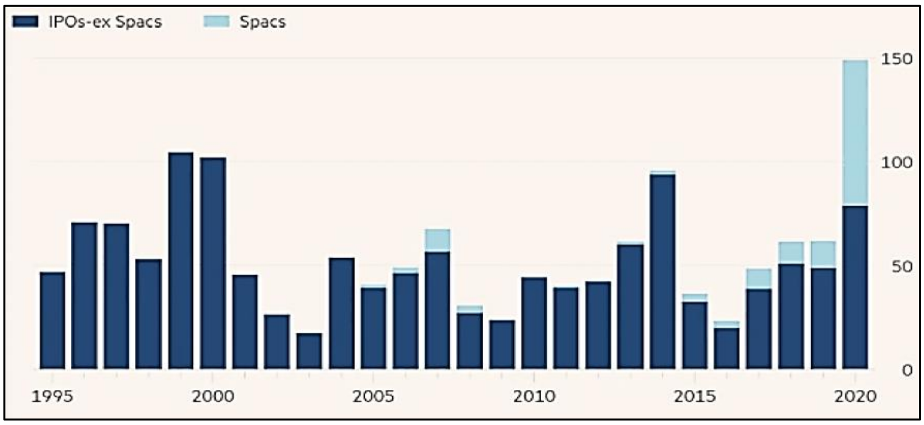
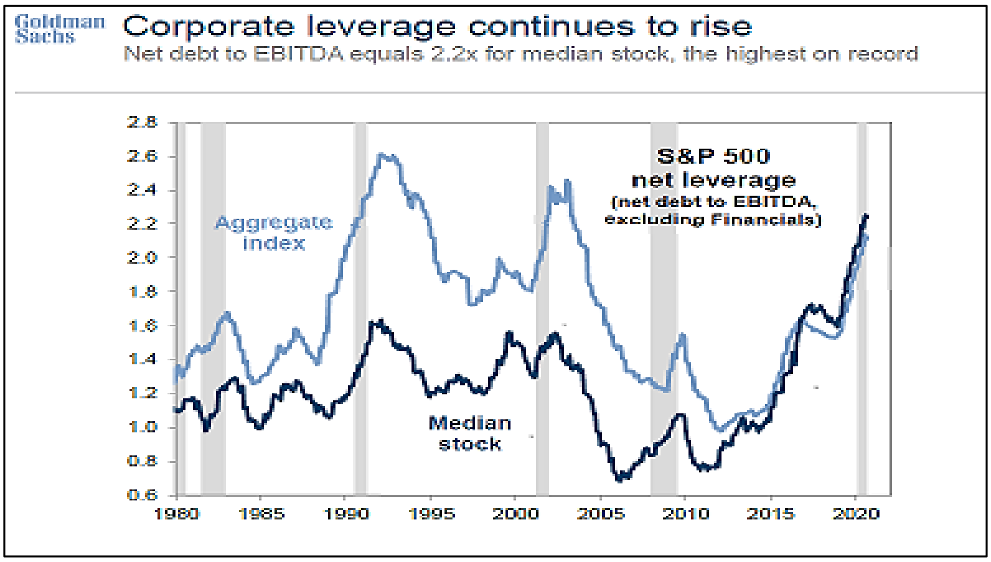


Source: Refinitiv, FT.

This indicator is to be taken with a grain of salt, but it should be kept in mind when equity indexes are at their highest level ever.

Year in, year out, the Dollar Index has lost 6.7% over the year 2020. The greenback has even depreciated by nearly 9% against EUR and 3.1% against GBP (a currency that was weak over the year due to the uncertainties related to Brexit). This is of course linked to various factors. The growing US twin deficits (trade and budget) and the proactivity of the American Central Bank to reduce the negative effects of the recent recession are the main reasons for this weakness. We do not expect the US dollar to continue to fall strongly in the coming months, but it should remain weak against most other currencies as long as there are no clear signs of a return of inflation and therefore as long as the FED does not change its position regarding its monetary policy.

Let's talk about inflation. Even if expectations remain relatively low, the current context could be conducive to a return of the latter. We do not expect a strong acceleration in 2021, but the extraordinary supply of liquidity that we have been witnessing since March 2020, should encourage a reflationary context. As we have already mentioned several times, the world cannot afford to have uncontrolled inflation that would lead to strong rate increases. Considering the level of indebtedness of states and companies, this would have catastrophic consequences.



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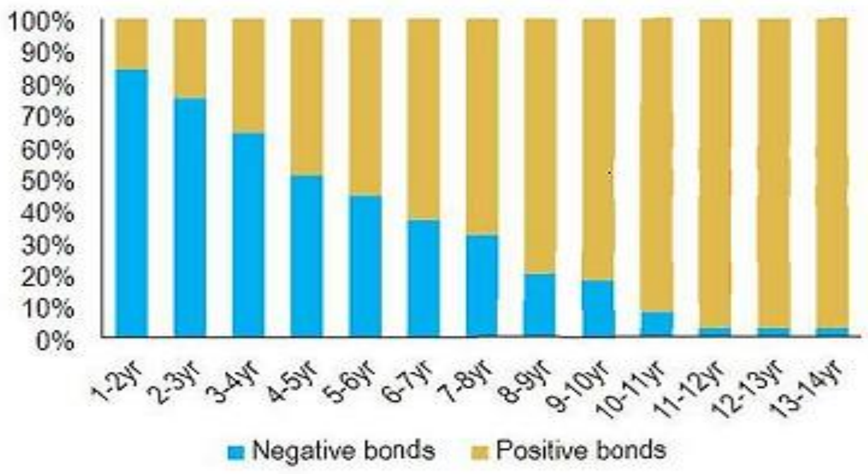
Having said that, we cannot exclude a new steepening of the US yield curve (this is not a subject in Europe for the moment), as it is difficult to justify that an investor should seek maturities beyond 10 years to minimize the risk of ending up with negative returns!

Chart 6: Investors have to reach for 10+yr bonds now to escape the dominance of negative yielding bonds in Euro IG credit (share of debt)

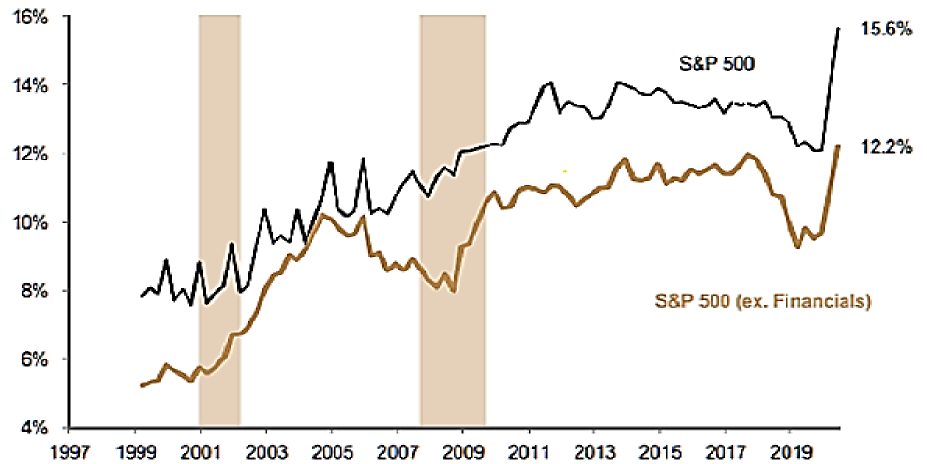


Source: BofA Global Research, ICE Data Indices LLC. Proportion of debt negative/positive yielding.

A slight steepening of the yield curve with a moderate return of inflation could have a positive impact on equities. We have already talked about the "TINA syndrome (There Is No Alternative)" which could continue into 2021. Investors have a lot of cash at their disposal, as well as companies.

Figure 46: Record Balance Sheet Cash

Cash as % of Total Assets



Source: J.P. Morgan US Equity Strategy & Global Quantitative Research, Factset

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When the latter will have their hands free again, share buyback programs and dividend payments will resume and should provide further support for equity markets.
If this scenario of return of inflation is confirmed, it should lead to an extension of the sector rotation that we have seen after the announcements of reliable vaccines with cyclical sectors that should do well. Of course, technology will always remain a segment on the rise, but its strong outperformance could crumble. We are therefore relatively confident for the year 2021, even though we will probably have to face periods of stress again. Markets are currently valuing a rather optimistic future.
The slightest accident (a monetary policy error?) or the slightest disappointment will certainly be immediately sanctioned by investors. This could offer interesting reallocation opportunities.
Wishing you a happy start to 2021.

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