



Monthly market blueprint

Investment management service

February 2021

mazars

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Foreword

The ‘bubble’ narrative

Is this a bubble? Is it safe to invest at such high valuations? These constitute 90% of questions clients want to know currently, and for good reason. It might seem outlandish that stock markets are sky high while the global economy recently suffered its worst quarter since the Second World War. The answer, the ‘house view’ we have put together, might not appear apparently obvious, but it is simple:

Engaging with markets, having a portfolio, is the price to pay to keep one’s assets growing. Especially when one cannot, or chooses not, to work anymore. It is noteworthy that the state is currently very actively subsidising investors who are willing to take market risks.

The idea that valuations are very high and therefore this is a bad time to invest is a reasonable one. Historically, valuations have been driven higher by investor exuberance, and this certainly holds true today.

On the one hand, equity and bond market valuations are sky high.

On the other, a not just ‘challenging’ but ‘ugly’ macroeconomic backdrop, one of new Covid-19 challenges despite the vaccines, political turmoil, lockdowns in Europe and damaged supply chains that suffer increasingly more as the unbalanced nature of the recovery is taking its toll on the global economy. Experts surveyed keep postponing their recovery projections into the back end of 2021 or maybe 2022, One potential medicine for the economy’s ill health, arguably as important as those provided by biomedical science, that of international cooperation, is presently unavailable. The postwar march towards greater global geopolitical integration continues to unravel under the weight of the pandemic in the absence of clear global leadership.

It is this dichotomy, soaring markets and a dismal economy, that has investors thinking: are valuations too high? The traditional answer, “yes, but central banks are still supportive” is met with increased skepticism: **“Are we becoming insensitive to risk, so much so that one day something bigger than central banks will wipe out the market?”**

The answer is twofold:

Firstly, this way of cautious thinking has been prevalent since 2009. An investor who had answered “no” to the question “do you trust central banks to fix this?” would have missed out on one of history’s great equity rallies.

Since the previous trough in 2009, our balanced portfolio made 138% after fees, or 8.22% per annum. For comparative purposes, before fees financial canon expects stocks to deliver 8% per annum and an average balanced portfolio, after fees, around 5% (this calculation of course includes only the rebound after the 2008-2009 downturn to compare against a sluggish economic performance of 2-2.5% during the same period).

Second, and we can’t highlight this enough, central banks **are rooting for investors, not setting them up to fail**. In the past decade they have pulled out all the stops in hope that economic policy decisions, or technological advancements will once again foster high(er) growth in western markets.

The question isn’t whether we trust them to be honest. They are. The question is whether we trust them to succeed. Can they forever reinvent capitalism in order to save it?

The answer must be a firm yes, if for no other reason than because the alternative would be so detrimental to the liberal western way of life and systemic risk would be so high that there would be no alternative channels to store wealth.



George Lagarias
Chief Economist, UK

Market performance - in a nutshell

The month in review

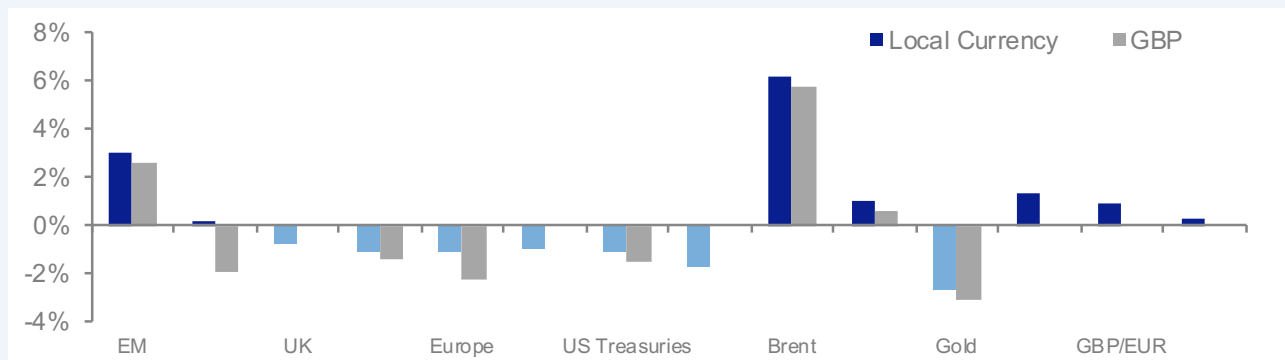
A bright start to the year for global equities, helped by an increasingly rapid vaccine roll-out in the US which rose gave way to falls in the second half of the month as rising Covid-19 cases and volatility dampened investor appetite for risk.

Equity markets endured a challenging start 2021 after December's strong rally, despite daily Covid-19 cases trending downwards during January. Almost all major equity market indices were down in Sterling terms amid rising coronavirus mortalities and issues with vaccine distribution channels. UK equities were down -0.8% in January with Sterling appreciating against the US Dollar and Euro by +0.3% and +0.9% respectively. The UK markets were influenced by both a strong Energy sector, due to rising oil prices, and the underperformance of Financials, two of the key overweight sectors in UK equity markets. US equities were down -1.4% in January. Economic data in January disappointed, nonfarm payrolls showed a weaker than expected labour market, losing 140 thousand jobs against an expectation of a 71 thousand rise. US stocks exhibited much higher volatility than usual driven in part by the elevated role of the retail trader. The US economic outlook remains tied to the ability and desire of the Biden administration to push through further fiscal stimulus. Meanwhile,

European equity markets fared worst among major equity indices, closing January down -2.2%. The European region continued to face delays in the distribution of coronavirus vaccines contributing to a weakening of the euro.

Emerging Markets equities have started the year well, being the only major market with positive returns on month-end, rising up by +2.7%, or +3.1% in local currency terms. China's GDP expanded 6.5% in Q4 2020 beating forecast and placing the country among the few whose GDP increased during the year. In bond markets, the UK 10-year was up +13.0 basis points to 0.33% whilst the US-10 year rose by +15.2 basis points to 1.07%. The German 10-year rose relatively less by +5.1 basis points to -0.52%. Gold was down -3.1% during January after a strong rally during 2020. Oil rose +7.2% to \$55.0 a barrel as investors begin to price in a recovery of demand, particularly in the second half of the year, with the Energy sector outperforming other sectors on a global level.

Basic asset classes



Asset allocation

Changes in our strategic asset allocation

Outlook and portfolios

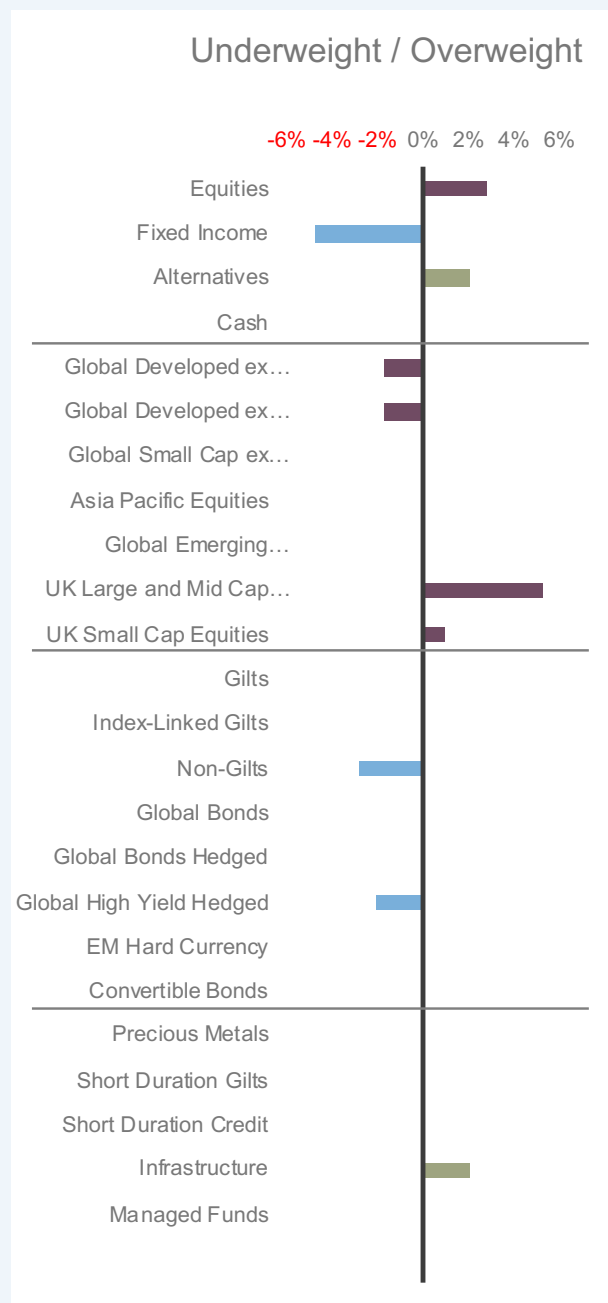
The 11-year global economic expansion cycle has come to an end, the result of a rare 'Black Swan' event, a global pandemic. Economic data remains exceptionally volatile. Imbalances in the global economy are exacerbated by the chaotic and unpredictable nature of lockdowns and travel restrictions have heavily strained supply chains, causing a global container shortage crisis.

Central bank support has greatly contributed to the continuation of the financial cycle, even while the economic cycle broke down. Meanwhile, extensive borrowing has supported employment and consumption. The rate of stimulus retraction will be of great importance for businesses when they plan for the recovery, especially in the more month-to-month cash-flow-sensitive services sector.

Following a re-evaluation of our long-term asset return and volatility assumptions, the Mazars investment committee has decided to proceed with several strategic changes in our portfolios. We reduced home bias in our equity exposure significantly and reduced the levels of government debt to reflect our conviction that low yields will persist over the longer term. Conversely, we increased international exposure through global equity ETFs, which both reduce the cost of maintenance and have asset classes available to cater for our need to hedge to Sterling. We also increased weight in less traditional areas of fixed income such as emerging market debt and convertible bonds.

We remain slightly overweight equities and risk, in the belief that even a central bank-guided market can still deliver returns. In terms of geographical allocation, we haven't made large deviations from the new benchmark, and rely more on our fund selection to create alpha. Our underweight in fixed income continues as a result of structurally low yields. In terms of Sterling, we keep close to the benchmark. We maintain a healthy exposure to gold, as the asset class remains uncorrelated with equity markets and would tend to gain in times of aggressive monetary accommodation. We zeroed out property in our portfolios, mostly due to liquidity concerns. In terms of alternatives, we maintain exposure to infrastructure, which we believe might be a beneficiary of increased fiscal spending in the next few years.

Mazars balanced portfolio as of 31 January 2020



Risks ahead

Avoiding policy mistakes will be key

Global economic growth faltered at the swiftest pace since WWII, but overall asset prices have kept climbing as policy makers actively sought to avoid market panics. Over the short-term, Covid-19 has had a significant impact on both economic fundamentals and market sentiment, while adding to de-globalisation pressures. The development of vaccines is good news, but logistical and production issues, as well as mutations which can become more menacing as the pandemic persists are still cause for concern.

Nevertheless, despite Covid-19 being the primary driver of economic performance, markets' focus has been primarily fixed on quantitative easing, with investors convinced, for now, that central bank risk suppression will be potent enough to weather the economic storm. The rate at which monetary and fiscal stimulus will be withdrawn is the main risk for the upcoming economic recovery.

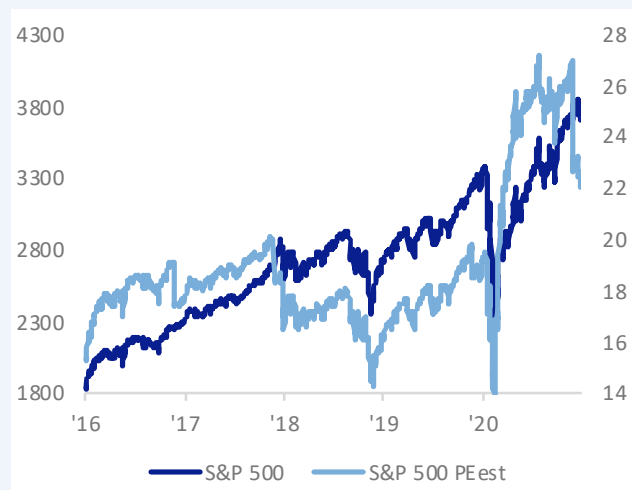
Stock prices are near all time highs, but with earnings falling behind, short term valuations are very expensive. Global bond yields might be extremely low and are likely to remain so for some time especially as the Fed has now effectively removed its 2% inflation target. However, many companies find themselves with weaker balance sheets. Possible inability to raise new debt or refinance old debts, especially in the face of a sudden stoppage of operational cash flows, could have devastating consequences, especially for smaller/mid-caps and companies teetering at the edge of the investment grade spectrum.

In the US, risks have somewhat been reduced, after the return of a more multilateral-oriented government, following the last election. In the UK, a weak economy is further threatened by adjustment issues surrounding a "Hard Brexit" deal. In China, growth conditions have been restored, and stimulus is slowly being withdrawn. In Europe some of the risks were mitigated, as countries have coalesced to mutualise some debt raised to fight the virus. However, problems in vaccine rollout and the dissolution of the Italian government are still red flags for investors.

We feel that short-term systemic risks are being reduced but that longer term risks are building up, especially in the form of high indebtedness. Debt, the price countries will have to pay for supporting their economies, will certainly be crucial in this next economic cycle.

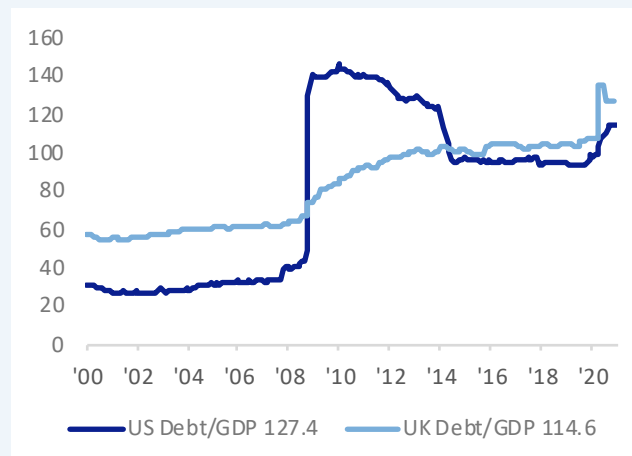
Valuations are still elevated

(S&P 500 and forward P/E ratio)



Debt has risen to levels above 100% of GDP

(Debt/GDP %)



Charts Source: Mazars Calculations

Macroeconomic backdrop

Global

For the period, global stocks fell by 1% (-1.4% in Sterling terms). The highest performing sectors were Energy and Healthcare while the worst performers were Cons. Staples and Industrials. Equities were trading at 21.22x times forward earnings, 32.1% above long-term average. Gold fell 2.7% and oil prices rose 7.6%.

As a result of lack of global coordination, economic performance remains de-synchronized across the board to the point where a uniform economic commentary is becoming very hard to articulate.

Asia has recovered the most, with the Chinese economy credibly claiming that it's now above pre-2019 aggregate output levels. The US, which never locked down on a national basis is following a decisively different strategy, through heavy borrowing and spending to support businesses and focus on vaccine development. The UK, which borrowed less, has arguably seen the biggest strain on its economy, a product of an extremely heavy Covid-19 toll and hard Brexit. Meanwhile, the EU, which took most fiscal the least and negotiated the longest over vaccine contracts, is now experiencing the economic repercussions of this strategy, as wave after wave and mutation after mutation ravage its economy. The global services sector underperformed again in January, due to further localized lockdowns. Global manufacturing, which has held up during this part of the crisis, has lost its stable footing. So far, governments and central banks respond to these extraordinary challenges with further stimulus. The cornerstone of the global economic recovery forecasted for 2021 is the rate of policy withdrawal.

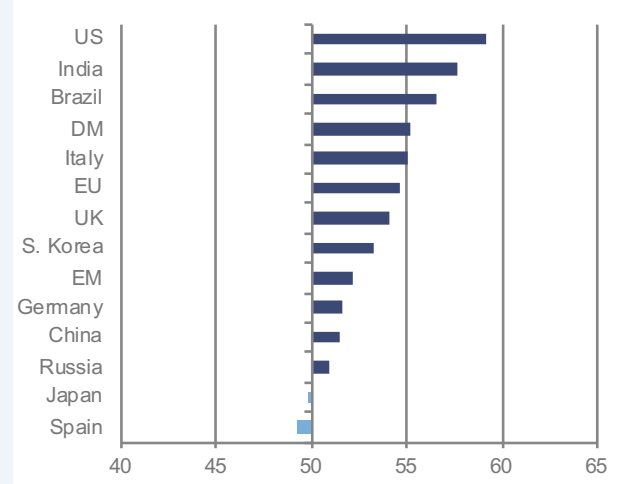
Outlook: Lockdown-associated uncertainties may persist well into Q2 2021, a period after which there's a consensus estimate that economic conditions should start to improve materially. However, operational risks in vaccination rollouts and possible impactful mutations still create a litany of downside risks for the global economy, much more so than the possibility of a major policy mistake. The effect of supply chain disruptions, global imbalances and lingering problems in the services sectors post-summer are still issues economists and investors will have to content with. Portfolio managers can, by and large, rely on central banks and governments to support risk assets, but should still be on the lookout

for risks which might demand more aggressive policy approaches, or even transcend the ability of policy makers to deal with them.

Global stocks are at all-time highs (MSCI World)



Manufacturing expanding (Manufacturing PMIs, >50 means expansion)



Charts Source: Mazars Calculations

Macroeconomic backdrop

UK

Despite a strong start to the year which saw the UK equities up +6.4% at the end of the first full week of the new calendar year, a deterioration of the economic and public health environment saw all UK major equity indices except small-cap end the month negative, the UK equities closed January down -0.8%.

The two best performing UK sectors were Energy and Basic Materials. These sectors are influenced by investor expectations for future oil demand and trade respectively. This sectoral performance suggests markets are pricing in a more positive outlook. However, Consumer Goods was the worst performing sector highlighting just how sharp the drop in consumer confidence has been in recent weeks. UK stocks are trading at 15.08x forward earnings at a discount of 27% to the MSCI World, representing the greatest discount to the MSCI World on a valuation basis of the major equity markets. The 10-year Gilt yield rose 13 basis points during the month to 0.33%.

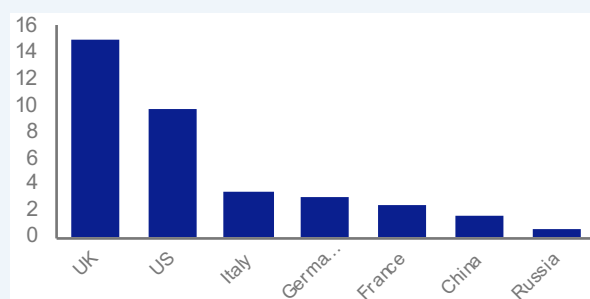
Economic data releases were mixed in January, GDP data for November showed a lower than anticipated fall in GDP following renewed restrictions. Generally the picture was one of a deterioration between slightly stronger than expected data from November and December, to weaker more current data. For example, the flash UK Composite PMI points to the steepest fall in private sector output since last May, with services particularly struggling.

The UK formally left the EU at the start of January. It is challenging to separate the effects of Brexit from Covid-19 in assessing trade with the EU, however there has been a fall in trade since the new year. Financial Services have been particularly affected, with significant volumes of euro-denominated share trading business leaving London back to mainland Europe. Until any equivalence deal can be reached with EU regulators, the outlook for cross border financial transactions remains weakened.

Outlook: For the first time in seemingly months the outlook for the UK might appear rosier than our European neighbours. Whilst the UK has certainly suffered more greatly the economic fallout of Covid-19, even after accounting for differences in GDP calculations, the vaccination programme is far swifter than the continent, providing clear upside potential for the economy and British equities.

UK Leads Major Nation Vaccinations

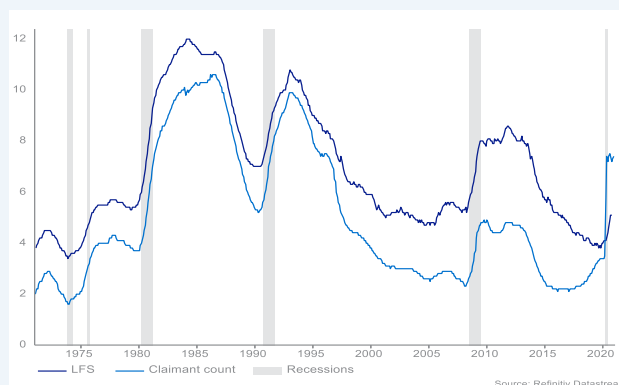
Vaccinations per hundred population, selected nations



The UK is just about on course to meet its mid-February vaccination target of 15 million vaccinations, in doing so it leads the US, Europe, China and Russia in major nation vaccination programmes.

UK Unemployment on the Rise

Labour Force Survey and Claimant Count



UK unemployment began to rise towards the end of the year as new restrictions took effect, despite generous worker subsidies from the government to encourage furloughing workers. The unemployment rise has been muted relative to the scale of the economic contraction and could provide some support for a rebound in the second half of the year.

Macroeconomic backdrop

US

For the period, US stocks fell by 1% (1.4% in Sterling terms). The highest performing sectors were Homebuilding and Energy while the worst performers were Industrials and Materials. Equities were trading at 22.62x times forward earnings, 33.3% above long term average and 6.6% above the MSCI World. 10y bonds above the 1% mark, at 1.066%.

Economic activity in the US remained moderately positive, as the country weighed carefully the cost of avoiding national lockdowns against public health. Concerns. The country's leadership in on-line shopping has also helped balance the effect of localised retail lockdowns. Manufacturing activity continued to constitute a pillar of recovery despite disruptions and challenges in the supply chain. Residential real estate activity remained strong with house supply tightening significantly. Employment conditions continued to recover, however the data is volatile as local restrictions affecting key sectors of the economy persist.

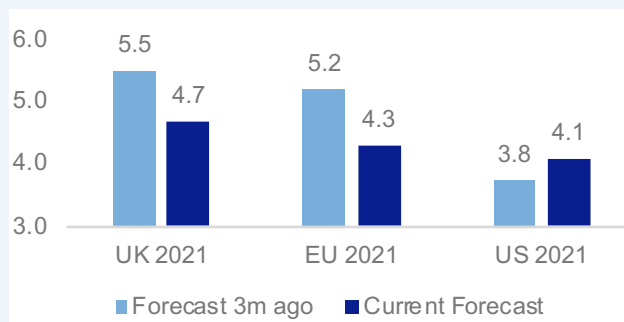
Throughout the crisis, the central bank has provided ample liquidity and several fiscal packages have been signed to contain the economic fallout and help restart the economy quicker.

Outlook: The main factor for economic performance in the next few quarters will be the rate of lockdowns, with vaccination rates determining the possibility of further disruption in economic activity. The United States have the second highest vaccination rate within the G7 (9.8/100), second only to the UK (14.9/100).

The other key factor will be the rate of stimulus withdrawal. However, currently stimulus is being expanded, with an extra \$1b to \$1.9b being negotiated in Congress.

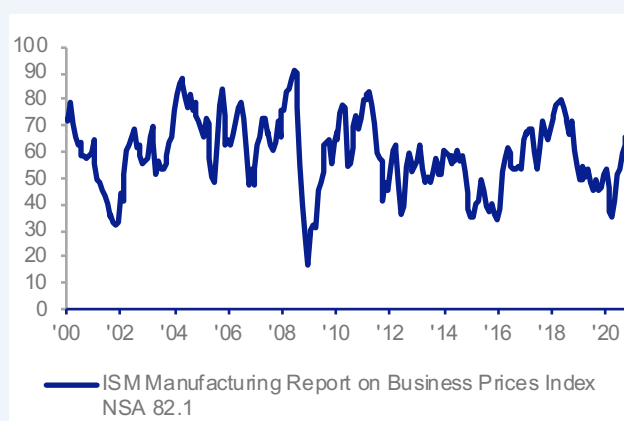
A very important aspect of economic performance, prices, has seen modest increases. Forward-looking data from Markit PMI suggest that, due to the continued resurgence of input costs, we could see a material yet temporary pick up in inflation going forward.

US economic forecasts for 2021 improved (Bloomberg Economic Forecasts)



Forward inflation indicators pick up

(ISM Manufacturing PMI, prices paid, >50 = expansion)



Charts Source: Mazars Calculations

Macroeconomic backdrop

Europe

In January European stocks fell by -1.1% (-2.2% in Sterling terms). The best performing sectors were Telecoms and IT while the worst performers were Retail and Financials. Equities were trading at 18.1x times forward earnings, 22% above their long-term average.

Europe is facing several issues which could hamper its recovery from the pandemic. The EU took about a month longer to approve vaccines than the UK, however the bigger issue is that vaccines production looks set to fall below initial guidance. AstraZeneca has said initial deliveries to the EU will fall short because of a production glitch at a hub in Belgium. The issue even resulted in the EU invoking article 16 of the post-Brexit mechanism to stop the unimpeded flow of vaccines from the European bloc into Northern Ireland, although they quickly reversed this decision.

Like the UK, the EU is coming to grips with the new Brexit reality. There are various reports of goods being slowed at customs and new complications, such as VAT issues and unexpected tariffs on goods, which is likely to add frictions to trade.

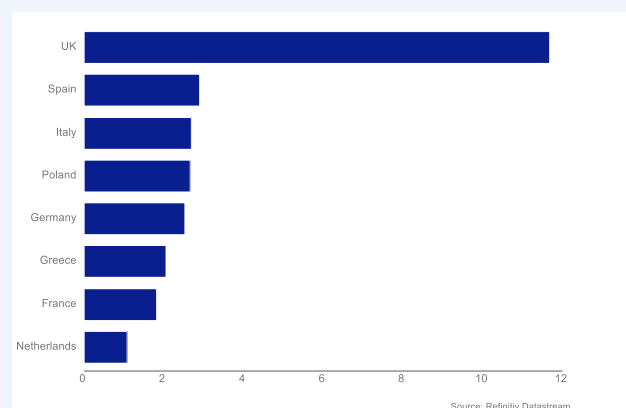
Giuseppe Conte has resigned as Italian Prime Minister following disputes within the governing alliance. Depending on whether or not he can command a reshuffled majority, Italy could well be headed for an election.

German GDP fell -5.0% in 2020 overall, with a rise of 0.1% Quarter-on-Quarter in Q4, just beating expectations for the measure to be flat. Meanwhile German business expectations fell in January, with Euro area consumer confidence also failing to show many signs of recovery.

Outlook: Europe seems to be facing a perfect storm of geo-political issues but with limited ability of monetary or fiscal policies to help growth pick up following Covid. On a forward P/E basis it is also more expensive than all major regions aside from the US.

The UK has vaccinated over a million more people than the EU

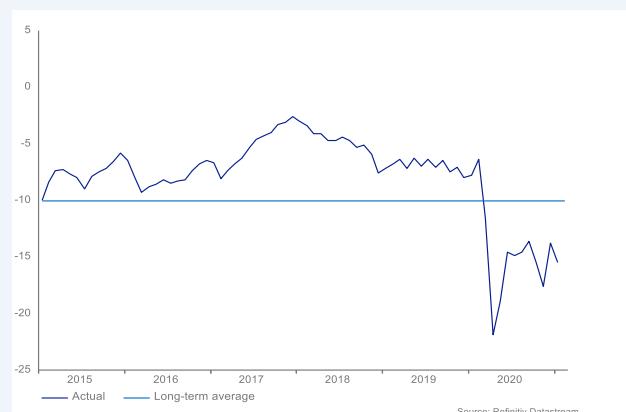
Vaccines per 100 inhabitants



With production slower than expected, the EU Commission has called for production from UK plants to be diverted to the EU.

Euro area consumer confidence remains low

Euro zone consumer confidence indicator



Euro area consumer confidence fell again in January, with households surveyed reported to be more pessimistic about current economic conditions and to be delaying major purchases, compared to the previous month.

Macroeconomic backdrop

Japan and emerging markets

For the period, emerging markets stocks rose by +3.1% and +2.7% in local and GBP terms respectively. Japanese stocks rose +0.2% in local terms but fell -1.9% in GBP terms. The highest performing sectors were Energy and IT in Emerging Markets while the worst performers were Cons. Discretionary and Healthcare.

China's economy continued to show strong signs of recovery in Q4 2020 with GDP growth advancing 6.5% year-on-year (YoY), after a 4.9% growth in Q3 and above market consensus of 6.1%. It pointed to pre-pandemic growth rates, with industrial output rising the most in 3-1/2 years in December. Manufacturing activity in the region dropped to a ten-month low of 52.4 in January from 55.7 in the previous month, as China struggled to contain a fresh wave of Covid-19 cases in some parts of the country ahead of the Lunar New Year festival. Service PMIs also dropped to a ten-month low of 52.4 in January, from 55.7 in the previous month.

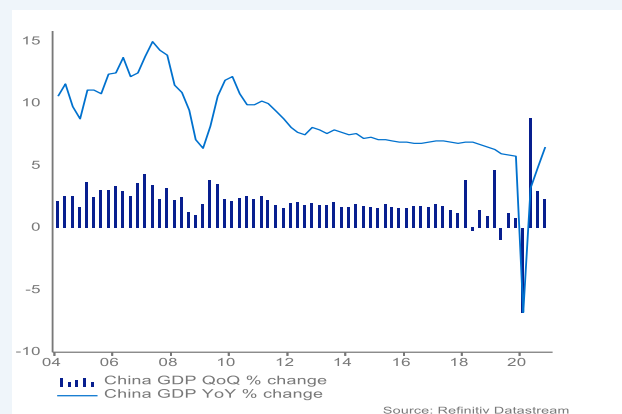
Since December, the U.S. has added a number of state-owned enterprises to its investment blacklist of stocks deemed to have links with the Chinese military. Major index providers like S&P and MSCI said they would drop 21 of the blacklisted Chinese firms from their global stock and bond benchmark indices, leading to volatility in the Chinese stock market.

Japan Manufacturing PMI was 49.8 in January, up from a preliminary estimate of 49.7 and a final 50 in December 2020. The latest reading signalled to a stabilization in operating conditions, as some business anticipated a recovery with demand in 2021. The service sector PMI declined to 45.7 in January, this marked the twelfth straight month of contraction in the sector as the government declared a state of emergency in Tokyo due to rising local infections. Exports from Japan rose by 2% YoY in December 2020, ending 24 straight months of declines.

Outlook: As a significant drop in global demand for goods and tourism hits Asia due to Covid-19, the risks for emerging market economies have risen. Although these economies have experienced significant capital outflows, overall liquidity provisions have balanced the outflows.

China GDP growth

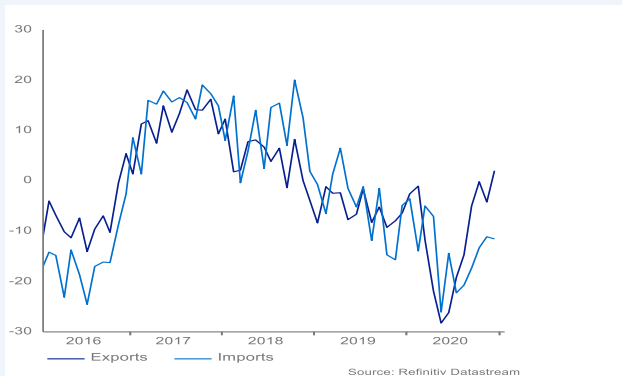
China's economy regains pre-Covid momentum



China's economy officially grew by 2.3% in 2020, making China the only major economy to regain its pre-virus trend.

Japan exports and imports

Japan's exports rise for first time in two years



Japan's economy expanded +21.4% in the third quarter of 2020 as the country's rebound from Covid-19 produced its first quarterly growth in a year.

Our themes



Macro theme 1

End of the beginning for Covid-19

The human cost of coronavirus has continued to mount, with more than 103m cases confirmed globally and more than 2.2m people known to have died.

After February 21, when it became apparent that Covid-19 was developing quickly outside of China, markets followed the “virus narrative”. Traders and longer-term investors who have, for a decade, been conditioned to respond directly and primarily to central bank stimulus, began to focus on the \$15tn of new money added to the markets this year by the central banks all over the world. Unsurprisingly, the financial and media narrative began to follow the stock market rebound, and investors started focusing on a more hopeful future. Both US and global stocks have crossed pre-Covid levels and hit record highs this year. More importantly, they are all trading at very high valuations versus projected 12m earnings, which suggests that traders are now looking past the Covid-19 related earnings drop and focusing on life after.

Global stocks had their best month since 1988, propelled by a series of Covid-19 vaccine breakthroughs in December 2020. The rally reflected investors’ growing eagerness to buy into risky assets, encouraged by progress in the development of Covid-19 vaccines at pharmaceutical groups Pfizer-BioNTech, Moderna and AstraZeneca. Investors moved out of tech stocks into sectors that they expect to benefit most from a quicker end to the health and economic crisis. The gains came despite a surge in coronavirus infections and fresh lockdowns across the globe that pose a threat to the economic recovery achieved in recent months.

Although most countries have started their respective vaccination programmes, the threat of new and potentially stronger variants of Covid-19 is troubling policy makers. With multiple variants of the virus now publicly known, health experts are worried current vaccines might not have what it takes to protect vaccine takers. As a result, Moderna is launching a trial of a new Covid-19 vaccine to tackle the South African strain after warning that its existing jab was less effective at tackling the new

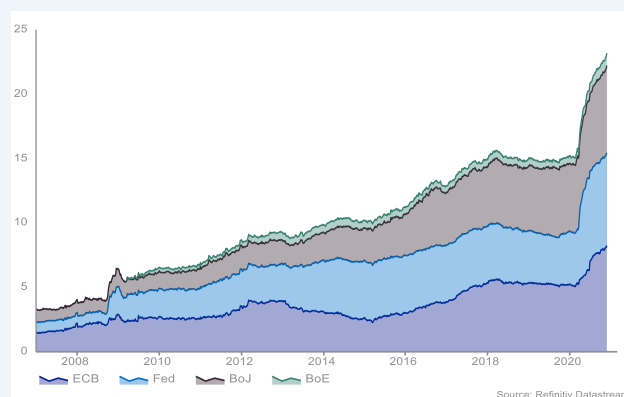
variant. In the UK, a handful of cases were discovered with no links to travel to Africa, indicating that it might be more widespread in the community than previously thought. Health officials have launched the extraordinary effort to stop the spread of the more infectious strain by conducting door-to-door Covid-19 testing for 80,000 people in England.

The human cost of coronavirus has continued to mount, with more than 103m cases confirmed globally and more than 2.2m people known to have died.

Releasing its latest forecasts for the world economy, the OECD predicts a strong rebound from this year’s historic global recession in 2021, but said that the world economy would not fully regain the lost output until the end of next year. According to the report, China’s economy is expected to be almost 10% larger than at the end of 2019 whereas the US is expected to regain its lost output by the end of next year, despite its current high infection rate.

Major central banks balance sheets

Central banks balance sheets are growing at record levels due to stimulus efforts



Globally, central banks and governments have committed an estimated \$15 trillion of stimulus already to shield their economies from the coronavirus pandemic.

Macro theme 2

Breaking up tech is a very complex task

Banning the President of the United States from Twitter might have come as a relief for some, but not for Jack Dorsey, the founder and CEO of Twitter itself. In a series of posts, he acknowledged that the move has opened a particular can of worms he was previously keen on keeping shut. The discussion around the power of Big Tech.

Breaking them up looks deceptively easy. After all, if the US government could defeat a Rockefeller, millennial Mark Zuckerberg looks like less of a problem. And, given the proven impact on electoral behaviour, one can see why the government would be keen to be rid of such influence which has already significantly disrupted the status quo.

But the implications for everyone, markets included, make matters very complicated.

Let's start with the obvious. The top 5 US tech companies (Amazon, Facebook, Microsoft, Google and Apple) account for almost 23% of the S&P 500, almost double the concentration of ten years ago.

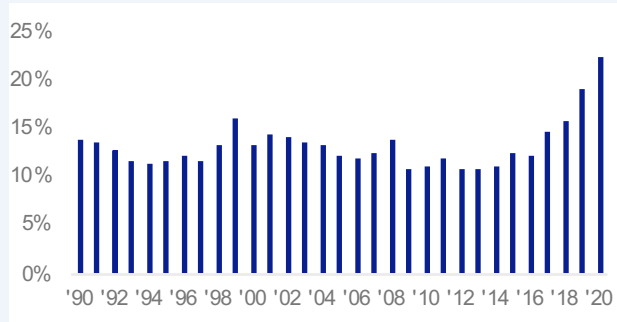
Breaking them up could have significant consequences for the world's leading equity index, as much as the retreat of banks had twelve years ago. Performance leadership also belongs to those companies.

Businesses which have spent billions building viable marketing models on social media are in danger of seeing their long-time efforts and investment lost in an instant. The power of tech is not in its tangible assets, like the monopolies of the 19th century, but rather on the large number of people and other businesses who depend on them. Will consumers embrace their successors the same? Will they want to deal with 10 platforms where they only had one? Won't concentration just happen again in the next successful platform?

For better or for worse, we live in an internet world with Big Tech at the very centre. Breaking it up would have unpredictable far-reaching consequences. Not breaking it up could keep electorates on the path of extreme polarisation and hyper-partisanship we witnessed in the last few years, with disruptive long-term effects for democracy.

Big tech dominates stock markets

(Tech concentration in the S&P 500)



Charts Source: Mazars Calculations

The solution

While regulation seems inevitable, we believe that “breaking” companies may not necessarily be the endgame and that a lot of thinking will be required in solving this particular conundrum. Facebook (which also owns Instagram) is not Standard Oil Co 120 years ago. It is much more global, accessible and interconnected. The number of stakeholder companies which rely on it amount to millions. A lot of them are smaller enterprises which have found a way to advertise and compete without having to pay expensive advertising agency fees. 77% of U.S. small businesses use social media for key business functions. Reducing social media efficacy could significantly increase industry concentration, especially in the wake of Covid-19 which already sees a lot of smaller companies scrapping for cash. Even more importantly, ownership of Facebook, Twitter, Google, Apple and Amazon is significantly more public for shareholders whose pension accounts would stand to lose. 21st century problems require 21st century solutions.

One solution proposed is a universal clampdown on social media, by accepting a more centralised and regulated internet architecture, like the one China's Huawei **proposed** over a year ago. Another, practically more difficult but demonstrably more liberal approach would be to try and regulate the proprietary -and secret- algorithms which filter and direct content.

What is important for investors is that neither scenario is catastrophic for their holdings. Both simply bring valuations closer to average and might not be as hugely disruptive for the world economy as are breakups.

Macro theme 3

A hard Brexit

In dramatic fashion and featuring a high-stakes political gambit, a Brexit deal was concluded over Christmas, averting some of the worst consequences of a no-deal scenario. According to the Bank of England's early projections, the difference between a rudimentary Canada-style deal, which was ultimately achieved, and a no-deal disruptive Brexit was about 4% in 2016 GDP, or £83b. To put the number in context, at the beginning of 2020 the UK government was expected to borrow £55b and ended up borrowing £394bn to combat the economic effects of Covid-19. Bank of England Governor Andrew Bailey warned that the loss in GDP would top £80billion, or 4% of GDP. Adding another £83b to that bill, a further 4% GDP drop, could be enough to break the economy for years to come.

The key points of the deal are:

- There will be no taxes on goods (tariffs) or limits on the amount that can be traded (quotas) between the UK and the EU from 1 January. Some new checks will be introduced at borders and N. Ireland, such as safety checks and customs declarations.
- Businesses offering services, such as banking, architecture and accounting, will lose their automatic right of access to EU markets and will face some restrictions. A light "Equivalence" regime will replace 'passporting' rights, but it's still under negotiation.
- UK nationals will need a visa for stays of longer than 90 days in the EU in a 180-day period.
- Professional qualifications will no longer be automatically recognized.
- Over the next five-and-a-half years, the UK will gradually gain a greater share of the fish from its own waters.
- Disputes that cannot be resolved between the UK and the EU will be referred to an independent tribunal instead. (The ECJ could still have a role in Northern Ireland because it continues to follow some EU trade rules.)
- The UK is no longer obliged to comply with EU standards of data protection, but data will continue to be exchanged in the same way for at least four months as long as the UK doesn't change its data protection rules.

The Pound has been edging upwards after the deal (Trade Weighted Pound)

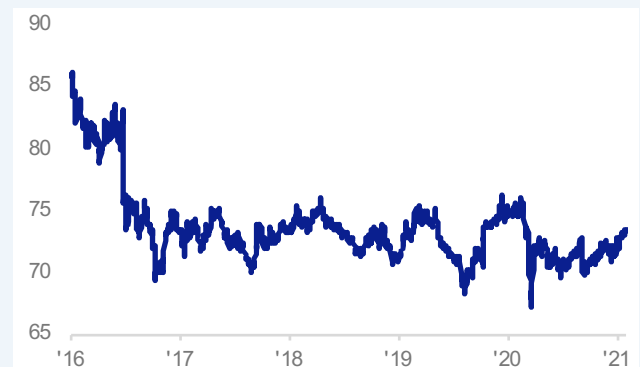


Chart source: Mazars Calculations

A complex way forward

From a purely economic standpoint we would revert to Winston Churchill's famous Dunkirk quote: "we must be very careful not to assign this deliverance the attributes of a victory". This is still a "Hard Brexit", with many unknown variables as to how the complex divorce will work out. Already we are seeing logjams in the border and tension simmering in other areas, such as vaccine exports.

For one, the blueprint of the EU – Canada deal is not necessarily pertinent. The EU accounts for 10% of Canada's exports, comprising mostly of raw materials, and Canada accounts for 2% of the EU's exports. Conversely, the numbers between the EU and the UK are 50% and 10% respectively, a lot of which involve services, signaling a much more complex and interdependent relationship.

Equity spotlight

Markets rally on vaccine news

Pfizer announced on 9 November that its vaccine was 90% effective. This was followed by announcement of similar success by Moderna and AstraZeneca and vaccinations have started apace, with 7.5mn having had the first dose in the UK at the time of writing. The news was a particular boon to those sectors which have been most affected by the crisis.

Although not always the case, in recent years stocks which are more sensitive to the economy, i.e. cyclical stocks, have also been cheapest on most metrics such as price to earnings, i.e. value stocks. With the crisis causing havoc in the economy, these sectors faced the brunt of the sell-off in March, as earnings expectations plummeted. On the other end of the spectrum have been growth stocks, in particular Tech stocks, which held up well in the initial sell-off as revenues have been less affected (or even jumped in cases such as Zoom).

The news of a vaccine wasn't a shock, as there had been suggestions for some time that trials were proceeding smoothly. However the announcement reduce the uncertainty over the timeframe for a vaccine. Further the 90% efficacy is extremely promising since regulators had previously said they would approve a vaccine that had just a 50% efficacy rate. Suddenly, sectors which faced significant bankruptcy risks the longer the crisis continued, can expect a normalisation of earnings by 2022, resulting in a rally of close to 6% in global value stocks compared to 2.5% in global growth stocks.

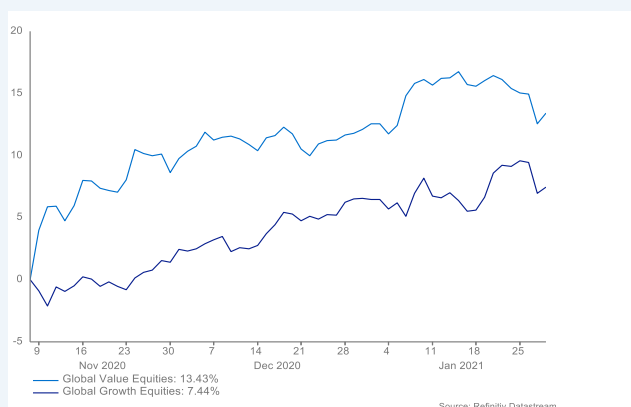
Was this the start of a long term rotation into value stocks and a reversal of the trend which has seen growth stocks significantly outperform for the better part of a decade? So far, post the initial spike in value stocks, the two styles have largely moved in lock-step, although if anything growth stocks have closed the gap.

While it is too early to be certain the trend won't continue, there have been two main reasons why undervalued stocks haven't continued to outperform:

- Markets have been rocky since the new year, with US political turmoil a factor as well as news that vaccine production is unlikely to meet expectations. These factors are likely to have a greater effect on economically sensitive sectors.
- The reality is that Tech stocks, which almost all fall under the growth banner, are no longer blue sky ideas that promise profits, but instead are significant revenue generators. Apple and Microsoft in particular significantly beat recent earnings expectations.

Value stock momentum has slowed

Gain since Pfizer announcement



Growth stocks have outperformed during the pandemic

2020 performance



Alternatives spotlight

Commercial property

Open-ended commercial property funds have seen somewhat of a crisis since the Brexit vote in 2016. There is a mis-match between the low liquidity of their underlying assets, buildings, and the open-ended funds themselves which price daily. This has led to the possibility that the FCA could force these fund to adopt a six-month redemption timeframe. Closed-ended funds (REITs) get around this issue by trading issued share on an exchange, however this adds equity-like volatility to owning these assets.

Following the Brexit vote nearly all open-ended funds were forced to suspend trading and apply significant NAV reductions as they were unable to price their holdings due to a lack of transaction data. These losses were never completely regained by several funds. Once re-opened these funds have remained largely in outflow and several have re-closed due to lack of available cash. For now we have moved out of these funds and instead use funds primarily invested in REITs, although we are now significantly underweight the asset class given the heightened volatility of these funds relative to their reward profile.

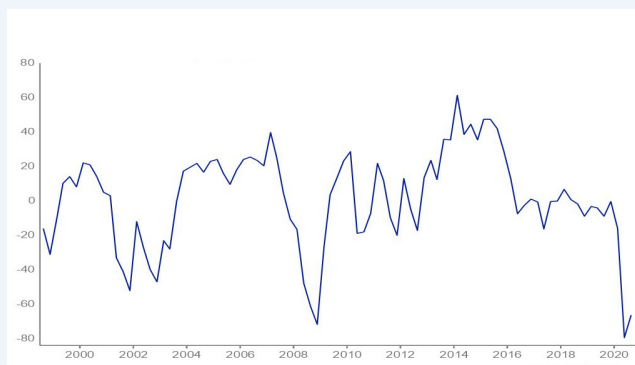
What is interesting is that although Brexit has been detrimental to sectors such as retail and offices (although the Covid-19 crisis has arguably added fuel to this fire), properties that make up what is called the industrial sector have in fact benefitted.

The term industrials tends to refer to warehouses and distribution centres. With consumers switching away from physical shopping, instead purchasing online through companies such as Amazon, well placed distribution centres were becoming more and more important before Brexit and the Covid-19 crisis. The increased difficulty of importing goods from Europe post Brexit has made prime positioned distribution centres even more important in making sure goods reach destinations without delays. Meanwhile the Covid-19 crisis has only sped up the trend to online shopping.

Offices and retail are on the wrong side of both these events: Offices with companies relocating to Europe (Brexit) and much of the population now used to working at home (Covid-19); Retail with slower expected growth (Brexit) and increased on-line shopping (Covid-19).

UK office demand has plunged during the pandemic

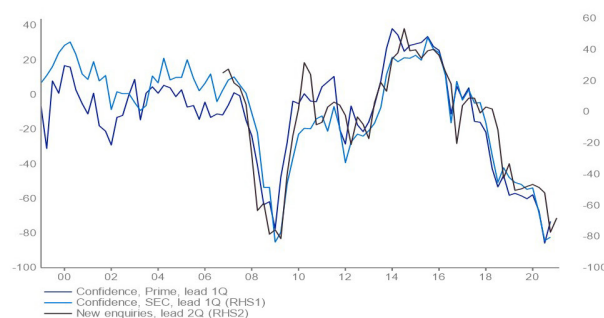
One-quarter percentage change



Charts Source: Refinitiv Datastream

UK retail property sentiment peaked in 2015

Primary and secondary confidence, and new enquiries



Equity spotlight

ESG investing

While the trend of Environmental, Social and Governance (ESG) investing, has been gaining momentum for years, this year the pace of green change has been rapidly accelerated as a by-product of the pandemic.

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ESG or ethical investing has now become a trend the investments industry can't afford to ignore. The pandemic has fuelled investor demand. Figures from Morningstar show flows into European ESG funds have reached an all-time high, attracting €52.6bn during the third quarter of 2020, helping grow overall assets across ESG funds to a record €882bn.

Opportunities for sustainable investment used to be scarce, but today it is hard to find a business that does not have an ESG policy. For example, 90% of companies in the S&P 500 index produced sustainability reports in 2019 and 81% of the FTSE 100 companies have some form of emissions reduction target.

While the focus of ESG investments has largely been on environmental impact and climate change, this year we saw the 'S' in ESG come to the forefront. The social aspect of ESG was not well defined from an investment perspective but Covid-19 has definitely changed that. From early on in the pandemic, major shareholders urged company bosses to make timely payments to employees and suppliers during global lockdowns, even at the risk of losing dividend payments. Even social movements such as Black Lives Matter pushed companies to do more on racial injustice and called for greater disclosure of their staff's racial mix. Most companies will now be expected to not only disclose data on gender diversity but also racial and ethnic diversity.

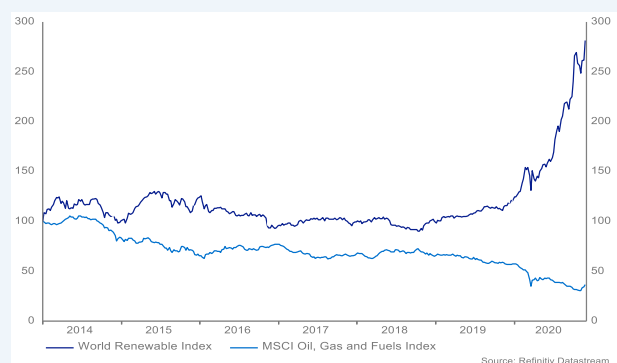
As the focus on ESG investments increases, we can also see a shift in policy makers worldwide. In Europe, the EU taxonomy, which came into force

this year, established an EU-wide classification system or 'framework' intended to provide investors with a common language to identify to what degree investment activities can be considered environmentally sustainable.

In the UK, chancellor Rishi Sunak announced the launch of Britain's first ever "green gilt" and also pledged that Britain will be the first G20 country to make large companies report their climate change exposures by 2025. China, the world's biggest producer of greenhouse gases, has said it will cut its carbon dioxide emissions to nearly zero by 2060. The US is also expected to re-join the Paris climate accord under Joe Biden, who has also called for a transition in America from fossil fuels to renewable energy.

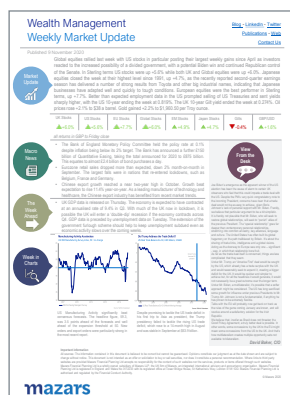
Renewable stocks have significantly outperformed traditional energy stocks

Global renewables vs Oil & Gas since 2014



Over the last few years, there is a dramatic shift in investments into renewable energy vs. traditional oil and gas companies.

More reading...



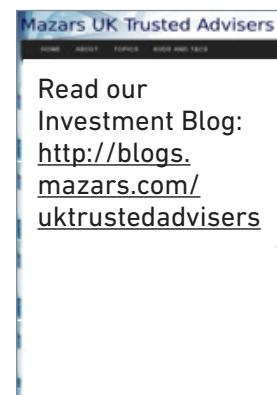
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