Client Note – Market & Economic Update
Reasons for Optimism

2020 was a year of extreme turmoil for large swathes of the global economy, some parts of which, unfortunately, may never recover. At times like these, when trying to makes sense of what has past, it emphasises the futility of trying to predict outlooks for the year ahead. It does however provide an opportunity to take stock of where we are now and prepare for such events.

- We had a global pandemic which resulted in extreme turmoil for large swathes of the global economy.
- The market reacted to the onset of the greatest health crisis in over a century dropping by roughly a third in just five weeks.
- By year end, most markets recovered nearly all of those losses. Some in positive territory, with Global Equity Markets up over 10% in November and December.

Market Resilience Despite the Pandemic

With all the volatility, it also looks to have been another year where Capital Markets proved their resilience. This, in the face of the most severe existential threat we have faced in some time. The global pandemic! Within equity markets, international diversification has once again proven critical. The US has led the way in the recovery. Its outperformance being powered by a small number of technology stocks which enabled the continuing functioning of supply chains and logistics.

Market Returns 2020	Euro	Local Currency
MSCI World Share Index	4.64%	4.64%
MSCI All World Index (ex US)	8.6%	-0.2%
S&P 500 (US)	16.2%	6.8%
FTSE 100 Index (UK)	-14.3%	-18.9%
Euro Stoxx 50 Index	-5.1%	-5.1%
ISEQ Index (Irish Stock Exchange)	2.7%	2.7%
FTSE Asia Pacific	17.2%	7.7%
FTSA Emerging Markets	12.6%	3.5%
Oil (US$)	-21.5%	-27.9%
Gold (US$)	24.4%	14.3%

Under Performers

The standout under-performer was UK Equities with a double-digit loss. This was due to a structural underweight in technology and an overweight to more traditional industries such as energy, financial services and leisure. Sterling volatility and Brexit uncertainty has not helped. As we have stated in the past, Brexit is a localised issue, not a global one. It is only due to our close proximity and shared border that it feels like it had such an impact. Globally, Brexit does not register with investors.

Improved Emerging Markets

Elsewhere, emerging market equities have enjoyed a new lease of life following Joe Biden's victory in November's US Presidential Election. Safe havens have also done well this year thanks to lower interest rates and huge injections of liquidity through [Quantitative Easing]() by central banks.

Global Concerns with Dramatic Consequences

2021's mass vaccinations and economic surge will herald fading bank forbearance and Government supports. We could face a prolonged period of high unemployment in many developed countries due to the effects of the pandemic. The scale of debt incurred by both business and governments to support their economies, necessitates interest rates to remain low for a considerable period.

For Closures and Job Losses

Unfortunately, 2021 may be remembered by a number of small employers where the pandemic undermined their business models due to unsustainable debt levels. As we saw after the last crash, banks learned ways to foreclose on businesses, resulting in furloughed workers being out of work.

Consumer Debt and Interest Rates at Lower Levels

However, unlike the Global Financial Crash (GFC) in 2008/09 any reserve of cash built up by consumers over the last year will not be needed to pay down over-leveraged consumer debt. Private debt has significantly reduced over the past ten years. This means much of the cash will be released into spending as interest rates move to zero or negative in some cases.

Depositors Prompted to Spend

Central Bank policy, especially in the Eurozone, will encourage consumers to spend more. This will be enacted by punishing depositors by depressing interest rates into negative territory. With stronger growth there is a significant likelihood that we will see some form of inflationary pressure which we may see towards the latter part of the year or early 2022 once lockdowns are eased.

Quantitative Easing (QE) to remain supportive

The speed and pace of the current recovery since March is no doubt down to the supports central banks and governments have put in place to help markets. Various emergency support schemes, such as QE and furlough schemes being to the forefront. It has been indicated that central banks will continue to remain highly supportive for markets even with a scale back of their QE programs. While tax increases and spending cuts will be inevitable, in order to fund this extraordinary crisis, these decisions may be delayed in order to allow for a further global recovery and financial stability.

Irish Concerns

A major uncertainty from an Irish perspective in 2021 is how the UK, our nearest and biggest trading partner, adapts to its new trading relationship with the EU. Any fallout from this new relationship will more than likely impact directly on our economic performance.

Irish Commercial Property has also seen a significant drop in values ranging between 13% to 18% over 2020. Further corrections can be expected following on from the lockdowns and continued working from home for employees with Retail Property most at risk.

Reasons for Optimism

As stated in our April note to clients (see link [A note of Optimism]) no one knows what lies ahead. However, we were optimistic at this point. We still believe there are plenty of reasons to be positive about 2021. The vaccine rollout should ensure an improving situation around the pandemic. This, coupled with low interest rates will encourage spending. **This is with the proviso that governments can, and does, roll out the vaccines quickly and efficiently.**

Political Stability Likely to Return in the US

Political trends may also be more favourable in 2021. This is a fair assumption as a more traditional style of government returns to the White House. It should also set the tone for a move away globally from the more extreme right-wing governments and greater US cooperation with its trading partners. With Democrats now taking control of both US houses, President-elect Biden should have enough backing to pass further stimulus spending for the US economy.

Equity Returns

The market is always vulnerable to **negative surprises** and this will be always the case. However, overtime, equities have outperformed all other asset classes. *We will be sending out a detailed note next month on cash/deposits and the alternative investment options available.* In the meantime I have outline the strategic alternatives for investors:

- **Sit in cash at a guaranteed zero to negative return and wait for a more stable environment**. My experience is that, individuals who take this approach will always have a reason not to invest as they always perceive the glass to be half empty. Not a good approach. Going to cash is extreme and certainly not advisable now. You would have a zero return while you wait for the correction and a "good time to invest". It is the time invested, rather than timing the investment, which makes the difference.

  Cash can be futile and costly

  For individuals with ARF funds invested in cash it is an even more futile approach. A double blow of negative returns and an annual management charge. A guaranteed circa minus 2% return a year, for a start, before you withdraw any income. And this doesn't even allow for the risk of inflation coming back due to the low interest rates and expected consumer spending splurge.

- **Reduce risk, in deference to the high level of uncertainty, and accept even-lower returns.** That makes sense but then your returns will be lower still.

- **Increase risk in pursuit of higher returns.** This one is "supposed" to work. But it is no sure thing. There is a tipping point, which if exceeded, can have a huge impact on the capital and long term returns. If time is on your side, and you have no requirement for income, then this can be considered as you can sit out any dips. If such is the case, this option is worthy of consideration.

- **Put more into special niches and alternative funds/investment managers.** Look at alternatives, private equity and alternative markets (Green Energy/Bitcoin) where there might be more potential**. *But doing so introduces illiquidity and manager risk.*** There are no free lunches.

Where to From Here - There are Choices to be Made

Equities are at frothy valuation levels. The question is, what are the alternatives? The answer is, there are very few. Low to zero interest rates mean no potential for returns from deposits or bonds. Equities, with their potential for long term growth of capital – and especially their long term growth of dividends – seem the more rational approach. But this is dependent on each individual's circumstances.

For the Bulls ⇧	For the Bears ⇩
• Vaccine rollout and virus suppression exceeds expectations • Global growth, rebounds to, and surpasses pre-COVID-19 levels • The new US administration leads to closer cooperation between the US and key trading partners • Pent up consumer savings/demand & cheap credit drive economic growth	• COVID-19 resurgence or mutation • US fiscal or monetary policy misstep • China tightens monetary policy • Eurozone growth and inflation remain depressed and become stagnant • Expensive equity markets make investors periodically nervous

Achieving a Balance - Between Short and Long Term considerations

You should have a balance in your portfolio between growth assets (equities) and defensive assets (deposits & bonds). It is about a balance, assessing your short term needs in line with the risk of longer-term investments.

Realistic and Optimistic - the Signs are Positive

We remain both realistic and optimistic about the future. Fiscal stimulus coupled with low interest rates and vaccine rollout will support continued equity performance in 2021. As stated there are always negative surprises. However, overtime, the great companies of the globe continue to generate profits and growth. These are the opportunities in which you should invest.

Finally just to wish you all the best in 2021. As always, please contact me with any queries.

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Warnings:

Past performance is not a reliable guide to future performance.

The value of your investment may go down as well as up.

If you invest in any of the funds you may lose some or all of your money.

The information contained in this document does not constitute financial advice.