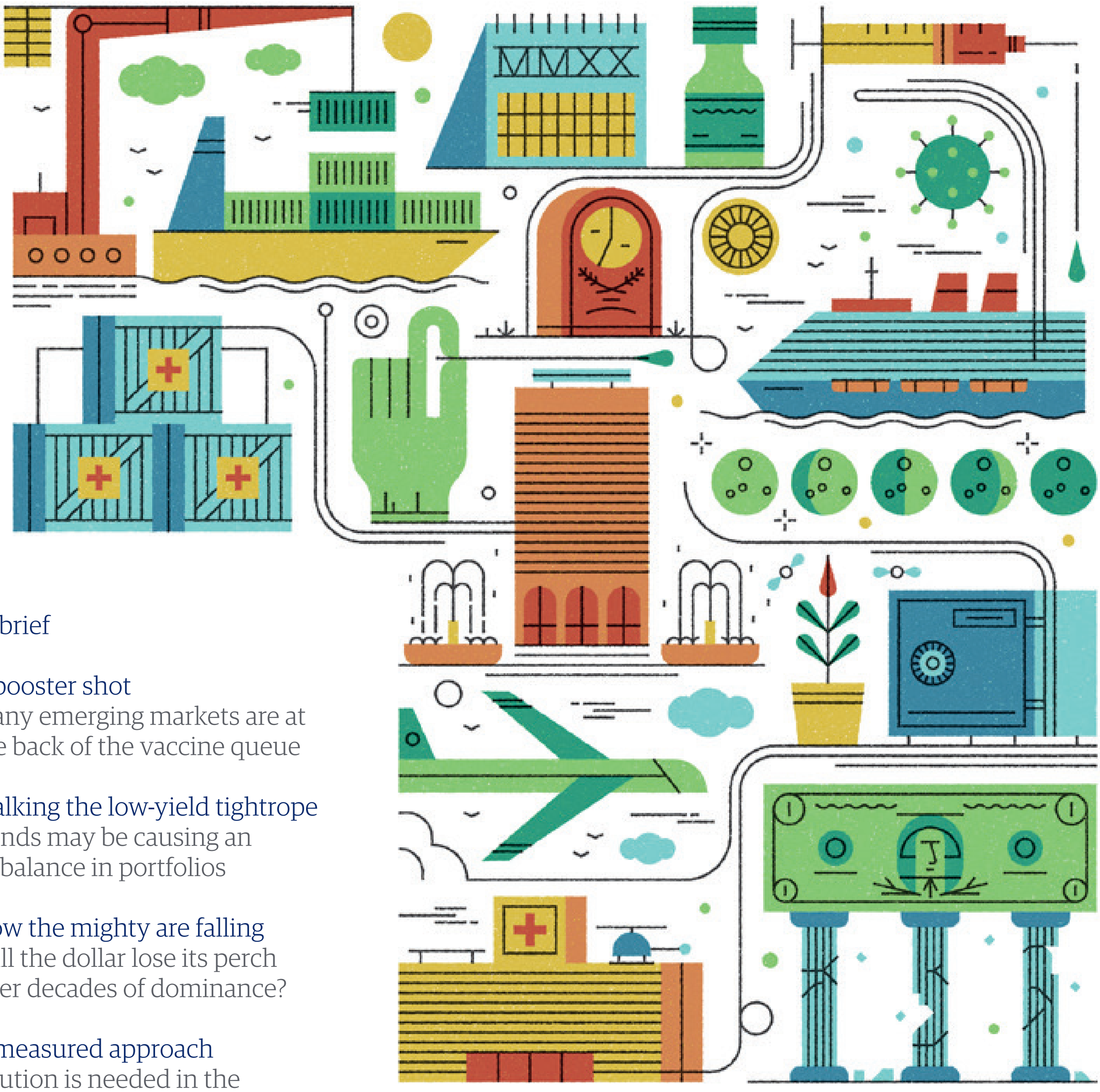
Investment*Insights*

Issue 27 — First quarter 2021

Life after the virus

There are likely to be plenty of investment opportunities but also lots of hidden risks as the global economy recovers from the pandemic



Rathbones
Look forward

Foreword

Financial markets have been on a rollercoaster over the past year. There was a sharp drop in March as countries locked down and then a swift upswing followed, led by technology shares. Even unloved companies, particularly banks and energy firms, have rebounded lately, thanks to good news about vaccines.

In our first article, we explore what's likely to happen as vaccines are gradually rolled out and the global economy recovers in 2021. Many investors had shifted their portfolios away from stocks that were seen as winners of the pandemic into cheaper 'value' stocks that have been hard hit by lockdowns. Although we see limits to how much further this rotation can continue, we do believe a less cautious stance is now justified.

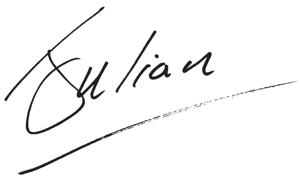
While some developed countries have ordered more than enough vaccines to inoculate their entire populations, many emerging markets have been pushed to the back of the queue. On page 5, we look at how developing nations are likely to take longer to recover from the pandemic as a result.

With bond yields extremely low, we explore what the other options are for adding the right degree of safety and diversification to portfolios on page 6. Rather than just focusing on returns, we believe portfolios should also be built with risk protection in mind. The framework we use when assessing risk allows us to better understand the potential for losses at the overall portfolio level.

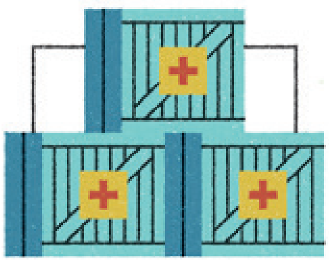
The US dollar looks like it may be flying too high against most major currencies on a longer-term basis. On page 8, we explore whether recent weakness in the currency could continue over the next few months, and what the implications might be for global investors based in the UK.

In our final article on page 9, we examine how recent events have highlighted the complexity of making decisions about active versus passive investing. Looking over the past 10 years, the FTSE 250 index of mid-sized companies has outperformed the FTSE 100 large-cap index, the broader FTSE All Share index and an index of active investors. But it's also been the most volatile and those returns don't look as good when adjusted for risk. This highlights that a careful, measured approach is needed, whether investing actively or passively.

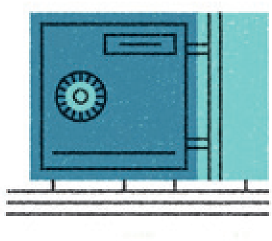
I hope you and your family remain healthy and safe. I'd also like to reassure you that we're doing everything we can at Rathbones to keep track of what remains a rapidly evolving investment environment. Please visit rathbones.com to find out more about our latest views.



Julian Chillingworth
Chief Investment Officer



Investment risks and opportunities in a world recovering from the pandemic



With three effective vaccines now in the offing, and the prospect of more to come, investors can look forward to the prospect of economic recovery in 2021 with more clarity. We believe it's time to start moving towards a more positive stance on equities and other riskier assets – especially given the extremely high valuations of safe-haven assets like government bonds.

The risk of a market correction in the nearer term remains elevated. Winter has brought a resurgence in coronavirus cases and additional lockdown measures, with falling high-frequency indicators of activity and leading economic indicators, such as Purchasing Managers' Index (PMI) surveys in Europe.

Positive vaccine announcements fuelled a global stock market rally, with cyclical sectors that were negatively affected by the pandemic gaining popularity as hope grew about the world returning to normality. We believe some weakening in macroeconomic data suggests there may be a little too much optimism about the recovery, but a setback is by no means certain. The backdrop of extraordinary fiscal and monetary support may continue to enable investors to look through to a vaccinated economy.

Are value stocks the way to go?

As vaccines dominated the headlines, many people shifted their portfolios away from stocks that were seen as winners of the pandemic into cheaper 'value' stocks that have been hard hit by the pandemic. However, we don't think this rotation will continue much further – the beginning of the last three significant rallies in value stocks happened in 2009, 2012 and 2016 when economic conditions were very different than they are today.

Those past value rallies occurred when leading economic indicators were depressed, when yields on corporate bonds versus safer government debt had spiked and when the broad market had experienced a large sell-off. None of those conditions are in place today.

It's also unusual that the recent bounce in value stocks has not been driven by rising bond yields. If central bank bond buying programmes continue to keep a lid on yields, the policies could hold back any further rally in value.

Around half of the MSCI World Value Index is made up of companies in the financials, energy and materials sectors, the earnings of which haven't grown in aggregate since the global financial crisis. While there are undoubtedly attractive names in each of these sectors, we are cautious about increasing our broad exposure to them given the uncertainty ahead.

However, we think it makes sense to reduce exposure to the most expensive growth stocks, while sticking with quality factors found in the cyclical companies in the middle of the growth-value distribution. We continue to see 'pure value' and 'deep cyclicals', whose prospects rest solely on the COVID recovery rather than any structural or fundamental drivers, as unattractive for long-term investors.

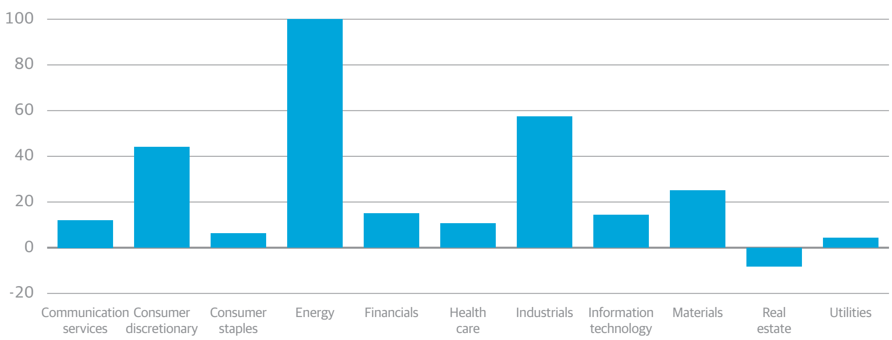
Recovery's winners and losers

Some sectors look more likely to benefit as the global economy recovers (see figure 1 for a US example). In particular, the industrials sector has performed well recently due to its cyclical qualities. Elsewhere, the travel and leisure industry has been in the eye of the storm for much of the pandemic, so it could offer many opportunities if the economy picks up. However, these opportunities depend on how long it will take for working practices and consumer behaviour to return to normal.

For other industries, the outlook is more mixed. For example, oil should benefit from improving global economic growth due to higher oil demand and

Figure 1: The shape of the recovery

This chart shows S&P 500 earnings forecasts for the next 12 months, measured by earnings per share growth (%).



Source: Refinitiv, I/B/E/S, Rathbones.

Past performance is not a reliable indicator of future performance.

prices. Energy stocks bounced following the positive vaccine news but remain at historically low levels. While they could perform well during a recovery, the upside is tempered by longer-term uncertainty regarding the transition to clean energy. There's also a possibility that Iranian oil supply could re-enter the world market under a more dovish Biden presidency, and drive down prices.

Mining is traditionally a highly cyclical sector, but it has been supported by the unique circumstances of the COVID-19 crisis. With China quickly tackling the pandemic and resuming normal industrial activity, iron ore prices stayed high and mining shares stayed strong. Still, they have suffered a setback recently over concerns that iron ore prices are now too high and could well fall from here, particularly as China reassesses the carbon footprint of its steel industry.

UK real estate is another highly cyclical sector and an economic recovery could lead to better prospects for medium-term rental growth and net asset values. Although there are opportunities, structural issues persist around retail and office demand, with the long-term impact of the pandemic still uncertain.

In terms of regions, Japan's Nikkei 225 index has been one of the world's strongest-performing stock market indices in 2020, even beating the S&P 500. Its resilience can partly be explained by a combination of sector exposure, stocks that have 'growth' and 'quality' characteristics (especially low debt levels and high cash balances) and stable dividends, while also benefiting from a weaker yen.

Asia, and particularly China, have had a strong year, but we see reasons for caution on the prospects for this to continue in 2021. For one, Asian equities tend to outperform when the gap between the region's GDP growth and developed market GDP growth is increasing. The COVID vaccine would help consumption expenditure in Western countries more than elsewhere, as some emerging market countries may struggle to access sufficient numbers of vaccines at first.

Although PMIs and other leading indicators of economic activity continue to make multi-year highs in China, economists generally believe these will start to wane in early 2021. The profits of Chinese exporters have been supercharged this year, picking up market share from countries with longer-term lockdowns, amid increased spending on electronics, furniture and other household goods, particularly those offered by online sellers.

In a vaccinated world, some parts – though not all – of this trend could unwind.

Tech is not in a bubble

Despite the rising popularity of value stocks, tech stocks are still performing well and we don't think that the sector is in a bubble – although some companies may well be. The tech industry has been one of the main beneficiaries of the pandemic, with the adoption of digital technologies increasing as people spend more time socialising and working from home.

Figure 2 shows the performance of a 'working from home basket' – 15 US-listed stocks representing companies specialising in video conferencing, electronic document signing and cloud hosting, among others – relative to the broader US equity market. The basket has returned more than double the broader US market so far this year.

Despite an incredible rebound in economic activity and positive vaccine news, these tech stocks are still outperforming. This evidence suggests that the pandemic has accelerated the digitalisation of work and leisure, and this trend is likely to continue in the post-COVID world.

Focus on growth and quality

We still think it makes sense for investors to keep a bias toward companies with a track record of persistently strong growth, and haven't changed our view on the longer-term attraction of technology shares. However, with effective vaccines coming out, a more balanced stance is now warranted, moving more towards the middle of the value-growth spectrum – looking for quality companies that have cyclical characteristics, and are available at a reasonable price.

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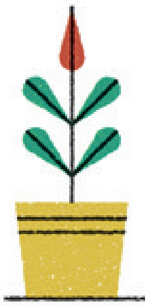
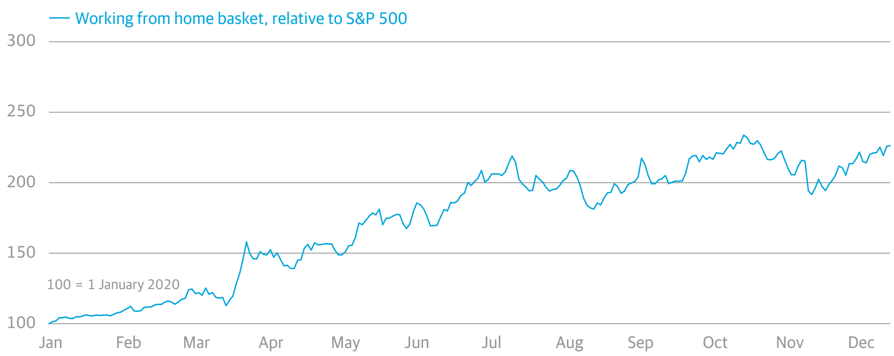


Figure 2: Investing in home working

Our basket of 15 US-listed technology companies outperformed the broader market substantially during 2020, as the shift online accelerated throughout the pandemic.



Source: Refinitiv, Rathbones.

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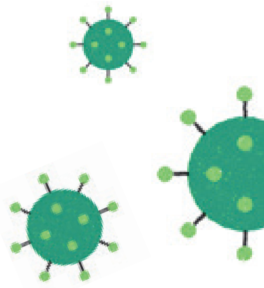


Many emerging markets are at the back of the vaccine queue

The prospect of widespread inoculation is like a shaft of light in the darkness of a very long year. But just how much of the world will that light touch?

Developed nations have been instrumental in producing viable COVID-19 vaccines. Their governments stumped up research grants, subsidised production and agreed forward orders for yet-to-be-approved vaccines. So it's perhaps no surprise that Western pharmaceutical companies and universities have been behind most of the workable vaccines that have been rolled out round the world. However, this has meant that Western nations snapped up most of the doses immediately.

Due to forward purchases, large developed nations have dibs on enough vaccine doses to cover between 610% of their population (Canada) and 115% (Japan). However, because production simply can't match the huge demand, it's expected to take months for the vulnerable and most at risk to receive one of the jabs on offer. These nations are unlikely to be able to vaccinate everyone even if they wanted to. And if they do, it will take a very long time.

Waiting in line

Yet they have pre-bought the lion's share of the global supply. So where does that leave emerging nations? Vietnam bought enough vaccine doses for about 80% of its people, more than any other large developing nation, while Bangladesh had secured zero upfront for its 160 million citizens. The Southeast Asian textiles hub has recently ordered enough of the AstraZeneca/Oxford vaccine from an Indian manufacturer to inoculate 15 million people starting in January.

It is also getting help from the public-private inoculation partnership Gavi, the Vaccine Alliance, which has offered it 68 million doses, protection for a further 34 million Bangladeshis. However, that would still leave more than 110 million citizens susceptible to the virus. The rest of the developing world is in a similar situation, to varying degrees.

This means developing nations are likely to take longer to control the virus and allow households and businesses to live and operate normally than it will take Western nations that have greater access to vaccines. Not only that, but as richer nations shake off the pandemic, the economic recovery will probably start pushing interest rates slightly higher.

The way that works is that investors selling bonds to buy riskier assets, like stocks, would push the price of bonds down and therefore send yields higher. Bond yields are just a tradable market for interest rates at the end of the day. This would increase the borrowing costs of all companies and nations – but those in developing economies still battling the virus may not have the benefit of improved commerce to offset higher interest bills.

One nuance here is that while this scenario doesn't look good for emerging markets themselves, an economic recovery in the West would mean a boost for export-focused businesses. Take Bangladesh again: if Westerners can flock back to office or nights out, they will want some new threads. So Bangladeshi clothing makers would probably get huge orders. That, of course, comes with other risks, given those busy workplaces would cause the virus to spread even faster.

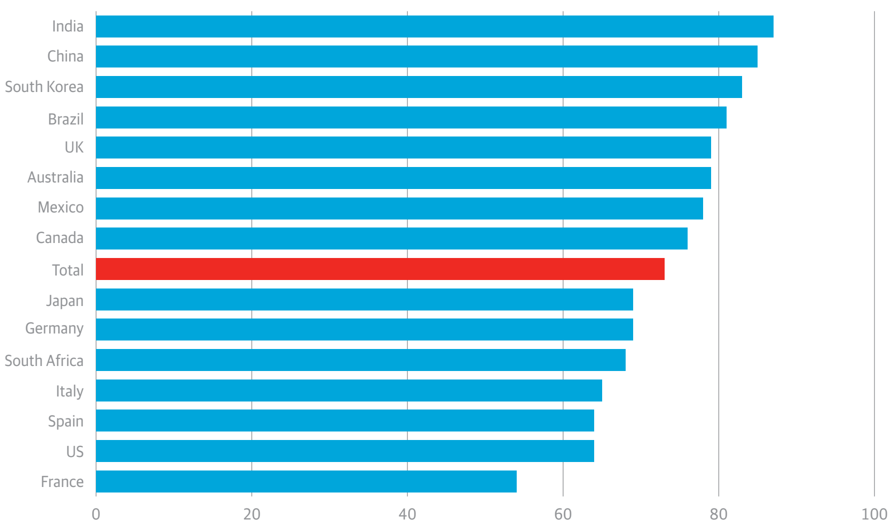
If they take it

The great irony of the vaccine rollout is that developed world populations, which have greater access to vaccines, are more likely to refuse one (figure 3). Meanwhile, more people in developing nations that are at the back of the queue have no qualms about getting inoculated.

Perhaps the difference is that poorer nations have greater experience of harsh diseases and viruses and know the power of modern medicine to keep them at bay. We in the West are lucky because we don't have to think about yellow fever, typhoid and malaria. But if our mistrust of medical science continues to spread, we may have to contend with more than just COVID-19. Diseases we thought we had conquered may return – measles, mumps, rubella and many more besides.

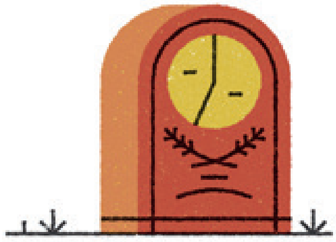
Figure 3: If a vaccine for COVID-19 were available, I would get it

Many people living in emerging markets would prefer to be at the front of the queue



Source: Ipsos Mori; online survey of 18,526 adults aged 16–74 across 15 countries.

Bonds may be causing an imbalance in portfolios



It's hard for seasoned investors not to give in to nostalgia for the days when government bonds could be counted on for both inflation-beating income and portfolio protection in times of market stress. In our current times, the good old days of the 60-40 portfolio – mostly equities with a good slug of safe, income-producing bonds that had cash-like liquidity – seem almost mythological.

Today, so many bond yields are negative that investors the world over are effectively paying governments for the privilege of lending them money (figure 4). We think it's likely that gilts would continue to appreciate in value in the event of further sharp falls in equity markets (they would be negatively correlated). However, we would expect the fall in yields (and hence increase in price) would be of a significantly smaller scale given the lower absolute level of yields at the moment. So lower yields and less protection in market sell-offs – not the most attractive of propositions.

So, what's a cautious investor to do, short of sticking their cash under the mattress?

Rather than focus just on relative or potential returns – whether income, capital gains or both – we believe portfolios should also be built with risk protection in mind. To do that, we divide assets into three building blocks, which play different roles – liquidity (mostly safe-haven government bonds and cash), equity-type (such as shares, corporate bonds and emerging market debt) and diversifiers. Using this 'LED' framework helps us better understand the potential for losses at the overall portfolio level.

What comes down must go up

As noted above, we can envisage a scenario where gilt yields go even lower. But the laws of nature in the bond universe look unfavourable in the current environment. The lower interest rates go, the greater the risk for investors that they will go up in the future, which equals falling bond prices. Given that interest rates have been moving lower for decades, most investors may not have experienced this phenomenon, and for the rest it's a distant memory. It's hard to see a catalyst for rates to go up in the foreseeable future, but we shouldn't get too complacent about yields staying low forever.

The other difficulty for bonds today is that, even if rates do keep going down, there is a lot less room for them to do so given how low they already are (and therefore how high prices are) relative to history. What could drive bond prices higher into the stratosphere? We think it would take either a greater risk of deflation (falling consumer prices) or the Bank of England (BoE) deciding to take official interest rates into negative territory, or both.

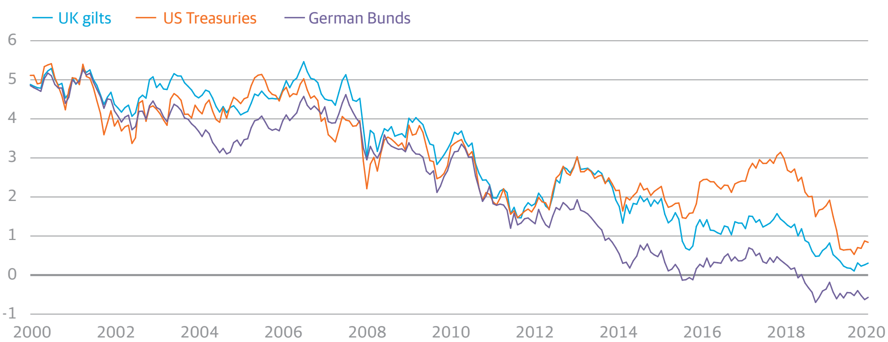
We've questioned BoE Governor Andrew Bailey and his colleagues about negative interest-rate policy (NIRP) at various roundtables and conferences, read their recent speeches on the subject and listened to the feedback from the large commercial banks that are in close contact with the central bank. It's clear to us that the BoE has not yet determined if negative rates are operationally feasible, whether they are likely to be effective in the context of the British financial system, or if they would be appropriate given the state of the UK economy (see our *Investment Update* on dealing with rising UK debt). In short, we expect negative rates would only come as a last resort, and the successful COVID vaccine trials and a Brexit deal have clearly diminished the chances of NIRP coming to these shores.

What about the chances of interest rates rising significantly from here, and returning to some semblance of the old norms? We think it's low over the next year or two at least. As the economic recovery matures and appetite from households and business to take on more debt grows, it's possible that interest rates could rise to avoid an overheating. In such a scenario, government borrowing costs may face some upward pressure. But we think inflation in the UK and other major developed economies is

What's a cautious investor to do, short of sticking their cash under the mattress? Rather than focus just on relative or potential returns, we believe portfolios should also be built around risk protection.

Figure 4: 10-year government bond yields (%)

Aggressive easing from central banks, including huge asset-purchase programmes, means that the returns available to new buyers of government bonds are slim.



Source: Bloomberg.

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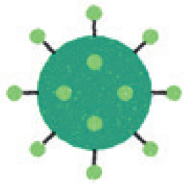


likely to remain stubbornly low for the foreseeable future, and central banks are more likely to be concerned about keeping prices supported than about keeping inflation from overheating (see our *Investment Update* on inflation).

A shakier footing

Although gilt yields were already very low when COVID-19 struck in the first quarter, that didn't stop them from going lower (and prices going up further) as riskier assets like equities plummeted. At the time of writing, 10-year gilts had delivered a capital return of 5% in the year to date and a total return of 6% when including coupon payments.

As we noted earlier, it's probable that in the event of another growth scare gilt yields could fall further yet, again providing offsetting gains. After all, some £13 trillion of global debt already trades at negative yields. However, any further price increases during such times are likely to be less with the lower absolute level of yields. Also, the historically negative correlation between equity and bond returns has become more sporadic in the current era of ultra-low rates (figure 5). This creates a need for alternative sources of portfolio diversification.

A traditional alternative to so-called conventional gilts is index-linked gilts, whose returns are linked to moves in inflation. 'Linkers' had some attraction in the short term as a hedge against a hard Brexit, which could've led to a fall in the pound and rising import prices. But longer-term, and with that risk now off the table, we think they are pricing in too much inflation risk and are therefore less attractive than the conventional variety.

They look particularly expensive when we consider the recent announcement on reform of the Retail Price Index (RPI), which we have been wary of for a while. In 2030, we can expect RPI to be aligned with the Consumer Price Index including housing costs (CPIH), which historically has been significantly lower than RPI. Therefore, returns for index-linked gilts will be lowered from that point.

In this new normal of ultra-low rates, high-quality corporate bonds are another 'unconventional' approach for keeping your money safe and accessible (or 'liquid'), while getting at least a bit more yield than what's on offer from gilts (conventional or otherwise). Though not traditionally looked to for liquidity, we believe high-quality corporate bonds can continue to provide these benefits during a contracting business cycle.

Thinking even longer-term, low interest rates are a function of desired savings and desired investment. Over the past four decades, the desire to save has increased and the desire to invest has decreased due to a range of structural factors including demographics, rising inequality, the global savings glut, lower public investment, falling productivity, and financial engineering.

These are highly unlikely to screech into reverse. But given the paltry yields on offer, gilts may come under pressure if the risks to the COVID recovery recede further over the coming months. At the same time, the additional yield on offer from high quality corporate bonds may look even more attractive.

In addition to that bit of extra yield, these low-risk corporate bonds can also cover some of the need for liquidity within a typical balanced, or cautious, portfolio. But they may not provide sufficient diversification, and hence the need for other assets in what we call the diversifiers bucket - the 'D' in our LED framework. We believe using a combination of these 'LED' assets allows us to construct a portfolio which will provide more attractive risk/return metrics than the classic 60–40 portfolio with government bond yields so depressed.

If you'd like to find out more on the different kinds of diversifying strategies and their importance you can read more in "Diversifiers provide an antidote", an article our July edition of *Investment Insights*, or speak to your investment manager.

Although gilt yields were already very low when COVID-19 struck in the first quarter, that didn't stop them from going lower (and prices going up further) as riskier assets like equities plummeted.

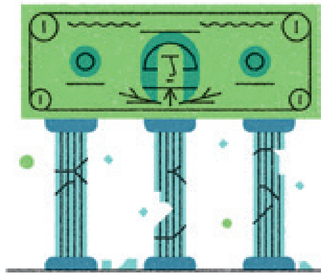
Figure 5: Correlation between UK gilts and FTSE 100

UK government bonds and shares used to be negatively correlated, meaning when one of them increased, the other decreased, and vice versa. But this relationship has changed.

Source: Bloomberg.

Past performance is not a reliable indicator of future performance.

Will the dollar lose its perch after decades of dominance?



Exchange rates are volatile beasts, whose movements are unpredictable with any accuracy over short time periods. The US dollar is the biggest of them all, and it's been tottering a bit lately. But can we tell if it's heading for a bigger, longer fall? One that could have some very large ripple effects through the global markets?

From a number of perspectives, the dollar looks like it may be flying too high against most major currencies on a longer-term basis and vulnerable to a more sustained fall (figure 6). These include purchasing power parity (an estimate of fair-value-based relative prices of a basket of consumer goods and services) and our own behavioural equilibrium framework (which looks at relative trade prices, relative productivity and relative savings).

Over the next few years large fiscal deficits (government borrowing funded by central bank bond purchases), large current account deficits (trade and investment income) and low savings rates could push the dollar down, stimulating demand for foreign investors to fund these deficits. While a relaxing of tariffs would probably contribute further to a widening in the current account deficit, Joe Biden has recently said he wouldn't reduce them until the US had gathered more leverage against China.

If, as we expect, US real rates (interest rates minus inflation) remain entrenched deep in negative territory over the longer term, and the current account deficit widens further, the dollar may continue to weaken. But we have less conviction over the next three months and we are sceptical of anyone who claims they do. Currencies just don't have a consistent enough short-term relationship with common variables.

A number of tailwinds could work against our longer-term forecast for a weaker dollar over the next few months. First, heading into year end, there are a large number of speculative short-term positions against the dollar (shorts) relative to history, particularly versus the euro. At a time when US real yields are rising more than German real yields (as Europe battles against COVID with more stringent lockdowns), this could lead to a lot of dollar buying if these shorts are unwound. Second, while the US Federal Reserve (Fed) is likely to keep monetary policy very loose for the next two to three years, the minutes from the Fed's November meeting discussed the prospect of tapering bond purchases at some point – a slightly hawkish surprise, even though tapering is likely many months away. Meanwhile, European, UK and Japanese central banks are likely to make further asset purchases, which could be positive for the dollar relative to the euro, sterling and yen.

Headwinds are gathering

However, the dollar faces some potential headwinds too. Data from Citi suggests only half of all overseas investment into dollar-denominated financial assets is hedged through offsetting dollar sales. In 2016, before the Fed embarked on a series of steadfast rate rises, the hedge ratio was around 90%.

The size of the stock of dollar-denominated assets in overseas portfolios is huge, and a change in hedging mindset could add fuel to any dollar weakening. Also, if COVID-19 vaccinations are successful, raising global GDP growth prospects relative to the US, the relative growth advantage that supported the dollar in 2020 could fade. This could be especially dollar negative if emerging market and commodity-backed currencies responded positively too.

At the other end of the spectrum, the pound appears undervalued against most major currencies. The crucial question is whether the UK's already rather poor economic performance becomes so much worse relative to the rest of the world that its exchange rate actually looks overvalued? Our analysis suggests not. Even if we assume a Brexit that's a bad deal for the UK, the pound still doesn't look overvalued. Assuming the consequences of Brexit are not extreme, on a three- to five-year view, we believe there is more scope for sterling to appreciate than there is for it to fall.

If these forecasts for a weaker dollar and stronger pound come to fruition, they could subtract from returns for global investors based in the UK when translated back to their home currency. However, these are long-term assessments. It's best not to try to predict where these volatile beasts are heading in the short term.

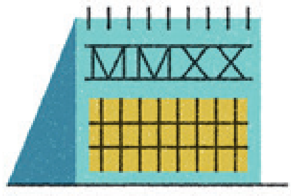
Figure 6: Still flying too high

The trade-weighted dollar index (shown here since it launched in 2006) is still near historically high levels despite its recent fall.

Source: US Federal Reserve.

Past performance is not a reliable indicator of future performance.

Caution is needed in the active versus passive debate



It's been a volatile journey for UK equity investors in recent years. Even if you take 2020 out of it, Brexit, general elections, twirling global macroeconomic policies and geopolitical risks have led to a rollercoaster of a time for markets. Investors enjoyed a brief pause for breath at the start of the year before the pandemic hit markets.

It could be argued that the recent volatile returns have given active managers an opportunity to show how their asset allocation and stock picking expertise can generate outperformance. Or put another way, active managers should be outpacing their passive counterparts. Although looking purely at performance over the past five and 10 years, using the IA UK All Companies as a proxy for active managers, investors arguably would have been best served sitting tight in a FTSE 250 tracker (figure 7). But that doesn't tell the whole story.

Active lags in selloffs...

In the face of market selloffs, active managers have generally lagged. They mostly underperformed the FTSE All Share over the past three periods of market stress (the first quarter of 2020, and first and last quarters of 2018). The 2016 Brexit referendum produced a much shorter and shallower selloff in UK equities but the outcome was similar – the FTSE All-Share preserved capital better than active funds and the FTSE 100 even more so.

So, why can passive investing creep ahead in periods of stress? Active managers aim to deliver outperformance by fishing for less researched, smaller companies as they have a greater potential for outperformance. But in periods of stress, these smaller shares tend to be harder hit. It's also important to remember that although tactical decisions are made, active equity investing is generally a long-term exercise. So accepting periodic and temporary drawdowns, or market volatility, comes with the territory.

...but rebounds sharply

With that in mind, do active managers maintain their composure and continue with their initial allocations during these periods of stress? Looking at performance during recent market rebounds (April to November 2020, and the rebounds of 2019 and 2017) suggests active managers do indeed rebound more sharply than the market.

However, reviewing performance this way has its flaws – it's backward looking and subject to survivorship bias. Sectors and risk factors should be considered, and not just market capitalisations. We should also avoid generalising the objectives of every fund in the IA sector. Some invest solely in mid-size companies, or are contrarian by style, or incorporate a yield target in their return objective. It's a mixed bag.

Risk and reward

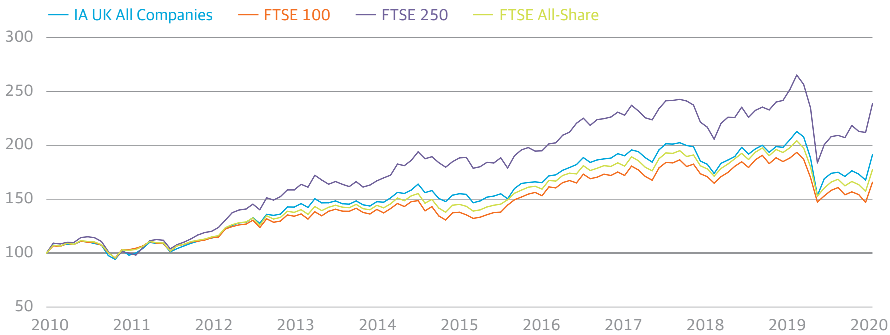
Investor appetite for risk is also something we cannot generalise. The FTSE 250 has been one of the most volatile indices with the highest levels of drawdown (falls from the previous peak) in the UK over five years. In this case, the greater risk equated to greater reward. But for some investors, active approaches have been more palatable because their collective returns have been less volatile, while also outperforming the broader FTSE All-Share index; a win-win.

These debates highlight the careful and measured approach investors need to consider when investing in UK equities, whether actively or passively.

Performance during recent market rebounds suggests active managers do rebound more sharply than the market. Yet this measure has its flaws – it's backward looking and subject to survivorship bias.

Figure 7: Tracking returns – just part of the picture

10-year returns for the Investment Association's (AI's) UK All Companies sector (a proxy for active investors in general) are behind the FTSE 250, but this doesn't account for risks.



Source: Morningstar and Rathbones.

Past performance is not a reliable indicator of future performance.

Financial markets

Positive vaccine news boosted confidence about an economic recovery and helped lift US equity indices to all-time highs. Following the announcements, there was a rotation into sectors that have been hardest hit by COVID-19, including airlines, energy, retail and hospitality. Despite the vaccine breakthrough, these industries are still trading well down on the year.

Many tech firms that have been buoyed by the pandemic faced some profit taking on positive vaccine news, but overall the sector was still outperforming strongly for the year. The enduring strength of tech stocks suggests many investors see the COVID-19 crisis as having accelerated the digitalisation of the economy.

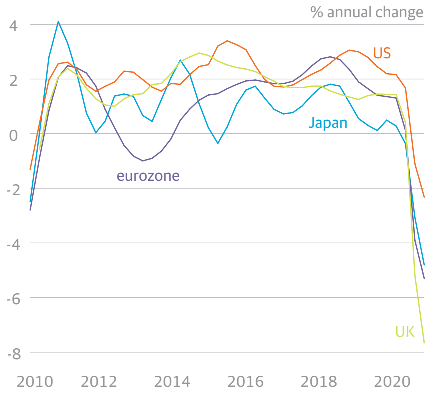
Safe havens fall back

Some investors moved out of government debt following vaccine news, pushing the yield on the US 10-year Treasury note as high as 0.97% — a level not seen since the pandemic struck in March. Yet yields remain near record lows and could stay there for some time. With yields so low, this makes the opportunity cost of holding bonds less attractive. Corporate bond yields are also depressed and don't offer much additional return. Default rates are low but there are concerns some companies may be relying on fiscal stimulus measures.

Following a strong performance in 2020, the price of gold fell slightly after news about the vaccine trials. Yet gold still has a useful role to play in portfolios due to its unique hedging properties.

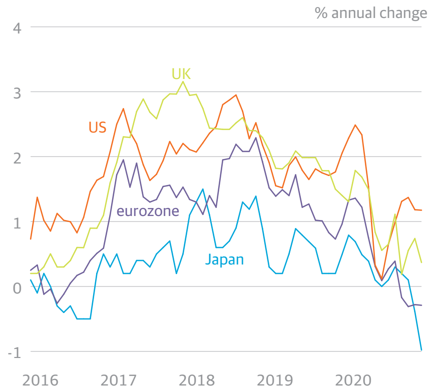
Oil prices rallied on hopes that improving global economic growth would spur demand. Brent crude rose above $50 a barrel, its highest price since early March, when markets went into meltdown over the coronavirus. However, longer-term uncertainty remains about how to navigate the clean energy transition.

GDP growth



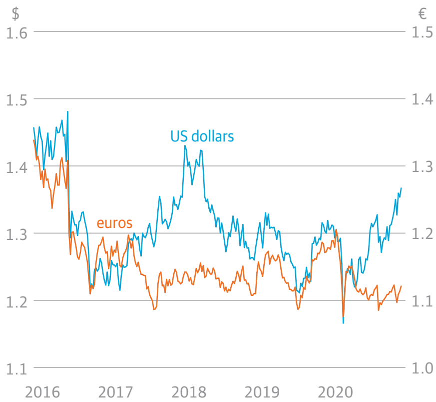
Source: Factset and Rathbones.

Inflation



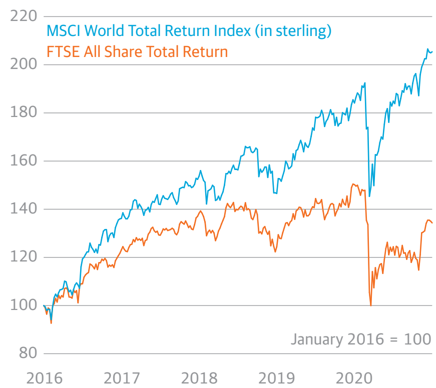
Source: Factset and Rathbones.

Sterling



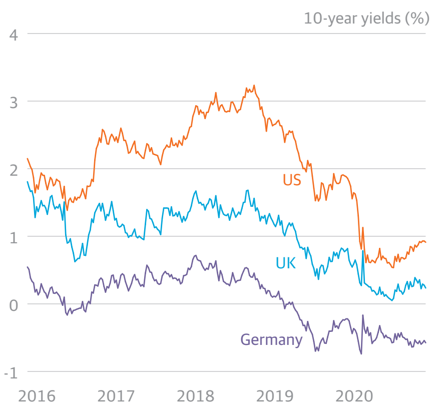
Source: Factset and Rathbones.

Equities



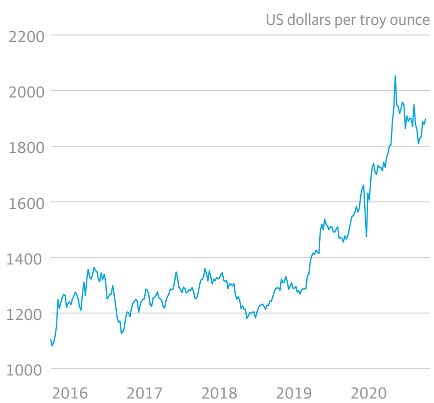
Source: Factset and Rathbones.

Government bonds



Source: Factset and Rathbones.

Gold



Source: Factset and Rathbones.

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