Investment review for quarter ending 31 December 2020

"Fall seven times, get up eight"
Japanese Proverb

In a year littered with unprecedented announcements, it was perhaps the early November statement from Pfizer that was the most important. Their development of a vaccine that is 'more than 90% effective in preventing Covid-19' was the point at which hopes of a return to normality morphed into something much more concrete. Markets and society at large celebrated this news in the final quarter of 2020, but they also did so with a touch of hesitancy, knowing that the damage inflicted, and the cost of recovery will continue to shape our new normal for years to come.

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For all that knowledge though, it was still a relief to read the Pfizer announcement, which sparked some sharp upward movements in riskier assets, with hitherto 'Covid losers' rallying strongly, and previous 'Covid winners' retreating a little, but not too much, as most are in tune with structural trends which remain firmly in place.

As is usually the case, the good news on vaccines had largely been anticipated – there are literally hundreds under development in addition to the Pfizer drug, a fact which investors knew made the defeat of Covid very likely, including the vanquishing of late arriving mutant strains. In addition, the quite staggering levels of intervention and financial support from Central Banks and governments had made it virtually impossible for markets not to recover after the collapses of mid-March. When the Federal Reserve, and its international peers, form a support bubble for the global financial system, backed up with over $20 trillion dollars' worth of intervention, it is going to be hard to resist. Ultimately it was the combination of these two impulses that made 2020 a good year for portfolios.

Multiple surveys indicate fast recovering investor sentiment and consensus views for 2021 are increasingly bullish for riskier assets and riskier geographies. Although sentiment is strong on the surface, it is also the case that investors might be talking a good game but not actually doing much yet, as cash levels remain high. All other things being equal, that should imply support for asset prices as money filters back into active positions across 2021, probably in tandem with the speed and success of the vaccination roll out.

Another expected and much needed catalyst arrived in late December with the passing of another US stimulus package ($900bn this time) and although it would be next to impossible to match the stimulus of 2020 again, the coming year certainly will not be one during which governments will be tightening their belts. Monetary and fiscal policy will continue to be supportive of global economies for a long time to come. Whilst it is true that valuations of most risk assets do not look particularly cheap, that tends to matter less in a year when profits are rebounding sharply, and suspended dividends are being reinstated.

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We should also remember that several key drivers of political instability have now largely passed, with the ending of the Trump administration and the signing of a Brexit trade deal. Given the influence that both have had over markets at various points in the past four years, that is no small thing. Reduction in political risk, supportive macro-economic policies, recovering earnings and cash looking to be put to work are undoubtedly clear, powerful momentum drivers for portfolios as we enter the new year,

There is, however, one big elephant in the room. The fact that the global bond markets are so richly valued right now is great for governments who are spending freely and borrowing cheaply, but not so good for more traditional portfolio managers looking to balance out risk taking with some exposure to safer assets, as those safer assets offer near zero returns and are priced for a benign outlook.

If some unpalatable news came along to upset the bond market – perhaps a bout of unanticipated inflation or a loss of confidence in a key issuer – then the ripple effect would quickly spread to other asset classes and we would have another of those familiar volatility spikes that have been such a feature of investment life for the last decade and more. However, this time the ripple would be spreading through a financial system which is supporting a 365% mortgage ($277trn of global debt supported by a $76trn global economy*), rapidly amplifying even the smallest of changes in outlook.

*According to the Institute of International Finance Global Debt Monitor

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This is, by and large, the same big picture issue that has been hovering around in the investment background ever since the financial crisis of 2008 and whilst it is undeniably a risk, it should be less of one in a year where economies are seen to be recovering. On top of that, central banks will simultaneously be acting to keep the cost of that debt artificially low. Nonetheless we will be keeping a very close eye on developments, given the potential for far reaching consequences.

We will also be working hard within this environment to use the flexibility we have to build in as much diversification as possible into portfolios, as this is the simplest and best way of navigating the unknown with some degree of confidence. Although the general trend for 2021 is likely upwards for many risk assets, diversification opportunities are still plentiful as not every market has the same starting point, nor the same speed of movement. Equity and foreign exchange markets have significant regional dispersions in valuations for example. Bond market risk can be dampened by investing alongside managers who actively insure against adverse events as part of their investment process. Commodities, real estate, private market assets, infrastructure and the green economy all offer long run opportunities, and we think that there is a fair chance of blending all the above into a sensible, resilient portfolio with solid prospects.

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On a final note, early 2021 will see core environmental, social and governance factors structurally embedded into our investment process and into all your portfolios. Our goal is to be able to look our investors in the eye and say that not only is your money being invested to seek the best returns for your risk profile, but that it is also being invested responsibly. After a tumultuous pandemic year, during which we have all been tested personally and professionally, this is perhaps the most positive and pleasing note upon which to say goodbye to 2020 and look forward to better times.

With thanks for your continued support,

The Saltus Investment Team, January 2021

	UK equities	US equities	Europe (ex UK)	Japan	Asia	Other equities	Property	Alternatives	Bonds	Cash
MAP 2	5.1%	7.3%	2.1%	4.0%	2.6%	14.0%	2.7%	23.8%	28.6%	9.7%
MAP 3	7.5%	12.6%	3.7%	6.8%	3.8%	20.0%	1.6%	14.5%	20.7%	8.7%
MAP 4	10.6%	16.4%	4.7%	9.0%	5.7%	26.4%	0.7%	12.1%	6.0%	8.2%

	Quarter	Benchmark quarter	Year to date	Benchmark year to date	Benchmark
MAP 2	5.31%	0.59%	7.13%	2.68%	CPI plus 2%
MAP 3	7.93%	0.84%	10.01%	3.70%	CPI plus 3%
MAP 4	9.75%	1.10%	11.28%	4.74%	CPI plus 4%