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No Winter Lasts Forever

A few weeks ago, I got talking to a stranger in the flower section of the supermarket. She told me she was searching for hyacinths – a type of flower central to Persian New Year (Nowruz), celebrated on 20th March. Nowruz, she added, is an ancient festival that marks the beginning of spring and reminds us that no winter is eternal. It got me thinking that the tragic pandemic that we have had to live with for over a year, will also not last forever.

This is already the predominant mindset in markets, with investors beginning to position themselves for a bright, post-pandemic future: A period of rebounding growth, with supportive central banks, ample liquidity and widespread benefits as expansive fiscal stimulus packages percolate into the real economy.

Already, things are looking better than expected on the economic front – the OECD recently upgraded its 2021 global growth forecast to 5.6% (up 1.4%). Similarly, earnings revisions are positive in all regions, suggesting that corporate profitability should trend upwards.

Better growth prospects have also led to higher inflation expectations and higher yields. While higher yields are causing (and could continue to cause) volatility for equities, we do not think it will derail them; the reason being that they are a reflection of better growth prospects and higher (but not too high) inflation. We believe that longer-term rates are moving up for good reasons and even if they are higher they are not “high”. As such, we carry an overweight on equities, and an underweight on safer assets, like government bonds.

DIFFERENT SPEEDS OF RECOVERY

Certain regions, like the US and China, appear closer to the light at the end of the tunnel than others, and in our equity allocation, we are more active in those places, where the reopening and recovery narrative is strongest.

The OECD expects the US to grow 6.5% this year while monetary policy looks set to remain accommodative. Despite rising inflation expectations, the Federal Reserve has said it will not hike rates until at least 2024, while it has no plans to taper its monthly bond purchases worth $120bn. This, alongside an efficient vaccine drive, plus a new burst of fiscal stimulus worth $1.9 trillion, should allow wider economic re-engagement in the Spring, with US households now better-off financially than they were prior to the crisis. This sets a benign tone for equities, however, sector and style will be crucial. We believe that pandemic high-flyers will take a backseat for now, with more cyclical sectors moving to the forefront; Materials, Industrials and Consumer Discretionary. We have also implemented a value tilt in our US allocation, a style supported by stronger growth and rising yields.

China is an economic outlier, that has benefitted from the quick containment of the virus. The Chinese government is targeting 6% growth this year, while the OECD estimates 7.8%. For now, inflation risk is controlled, largely due to falling pork prices, rendering current monetary policy appropriate.

Despite having increased our exposure modestly as of late, we are neutral on Europe for the time being, a region where the vaccination campaign is markedly slower. Various European countries still have movement restrictions in place and consumer sentiment is depressed. However, as the title says, no Winter lasts forever and Europe’s day will come. Europe is home to a concentration of value stocks and we believe that as inflation expectations and bond yields rise gradually, value will play catch-up with growth – a trend that is already prominent in the US. For now, the problem is that the earnings outlook is very much dependent upon vaccines and the reopening timeline.

The hyacinths (or sonbol in Persian) represent Spring and should be laid on the Nowruz table with six other items, all beginning with the letter “s”. One of those other items is serkeh, meaning vinegar, which represents patience. It seems that in Europe, we are going to need a little bit more of that than in other regions, but as investors, we can look further afield in order to begin benefitting from the reopening theme today.

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