COMMENTARY

1st October to 31st December, 2020

One of the more remarkable years in financial market history ended on a high note, with bullish sentiment lifting equity benchmarks to new highs, credit spreads at or approaching record lows, commodity prices on a tear and perennial safe haven, the US Dollar, in retreat. A conclusive (and broadly positive) outcome to November's US elections, the announcement and approval of multiple, highly efficacious Coronavirus vaccines, along with last-minute Brexit withdrawal and US stimulus deals, all contributed to investors' increased risk appetite. This prevailing buoyant mood contrasted sharply with news of escalating COVID-19 case numbers, driven in part by more infectious virus mutations, and the consequent re-imposition of lockdowns in Europe and further afield.

Equities

Having reversed direction after a positive start, as concerns over the economic and social impacts of a resurgent virus held sway, October's downward market movements gave little indication of what was to come during the remainder of the period under review.

Equity Market Indices

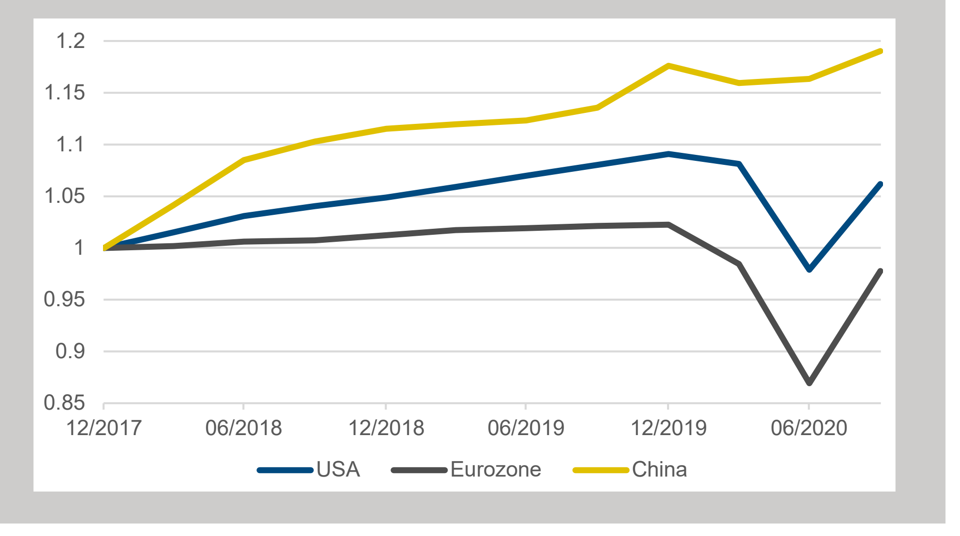
Index	Q4-2020	2020
MSCI World ($)	+13.63%	+14.06%
MSCI World (€)	+8.96%	+4.77%
MSCI World (£)	+7.47%	+10.82%
MSCI World (local ccy)	+12.04%	+11.67%
S&P 500 ($)	+11.69%	+16.26%
FTSE UK All Share (£)	+11.92%	-12.46%
MSCI Europe ex-UK (€)	+10.27%	-0.06%
Japan Topix (¥)	+11.02%	+4.84%
MSCI Asia ex-Japan ($)	+18.30%	+22.47%
MSCI Emerging Markets ($)	+19.34%	+15.84%
MSCI Emerging Markets (€)	+14.43%	+6.41%
MSCI Emerging Markets (£)	+12.87%	+12.55%

Source: Bloomberg

Following another change in direction at the beginning of November, markets began climbing rapidly even before the initial US election tally settled nerves and the first of three COVID vaccine announcements added further positive momentum. The collective sigh of relief and enthusiasm generated by the vaccine news saw a surge in demand for risk assets of all kinds and resulted in equity benchmarks recording some of their biggest monthly gains ever. Reflecting a sense of optimism over the prospective timing of a post-pandemic recovery, that first vaccine announcement also triggered a pronounced shift in emphasis away from the mega-cap growth stocks that had dominated the market thus far into cyclical / value ("recovery") stocks, as well as down the capitalisation scale. Although the pace of the rally and the extent of the style and capitalisation rotation moderated as the quarter wore on, it was pretty much one-way traffic throughout as far as markets' direction was concerned.

On the subject of that recovery, data from the major western economies provided evidence of both the healthy rebound in activity that followed the first lockdowns and the extent of the damage that has been wreaked by the pandemic. After expanding by 33.4% in real terms during the third quarter, US GDP remained 2.65% below its Q4 2019 peak in nominal terms, while the Eurozone's 12.5% growth in Q3 left the region's economy 4.39% smaller by the same comparative measure. With that pace of growth slowing markedly in Q4 and the new social restrictions imposed more recently, however, the timeline for a full recovery is likely to have been extended further and its shape more likely to resemble a W-shaped profile. By contrast, the world's second largest economy - China's - is fully back on track, after Q3's 2.7% increase lifted nominal activity to a new high; moreover, with the virus far less prevalent there, its V-shaped trajectory is more likely to remain intact.

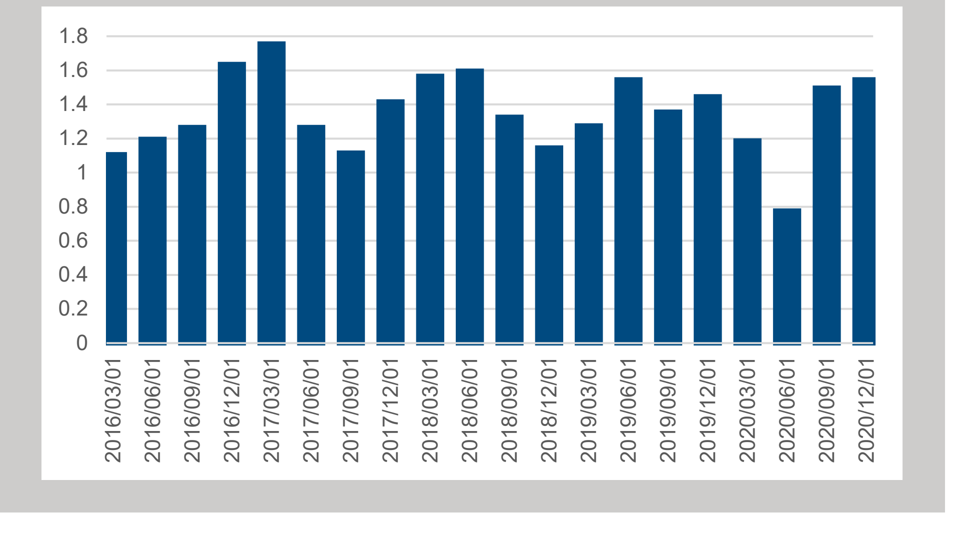
Nominal GDP (local CCY)



Source: Bloomberg

Echoing the upturn in economic performance was a strong improvement in corporate earnings, which saw reported aggregate profits for constituents of the MSCI World index up 89% in the third quarter versus the prior period's depressed levels. With those earnings some 13% below 2019's corresponding figure, however, the market's 12-month trailing price/earnings (p/e) ratio extended further towards the top of historic ranges with a year-end reading of 34x. While such a high valuation would ordinarily be cause for concern, the forward p/e (based on estimates for the next 12-months, per Bloomberg) of 24.3x is far less excessive, particularly when viewed within the context of the past year's market movements, the prevailing level of "risk free" (government bond) yields and the potential reflationary impact of global monetary and fiscal policy. Add to this the prospect for increased volumes of M&A activity, which followed the pattern in corporate earnings in Q3 and extended into Q4, and there are plenty of reasons to be positive about the outlook for equity markets.

Global M&A deal volume USD trn QoQ



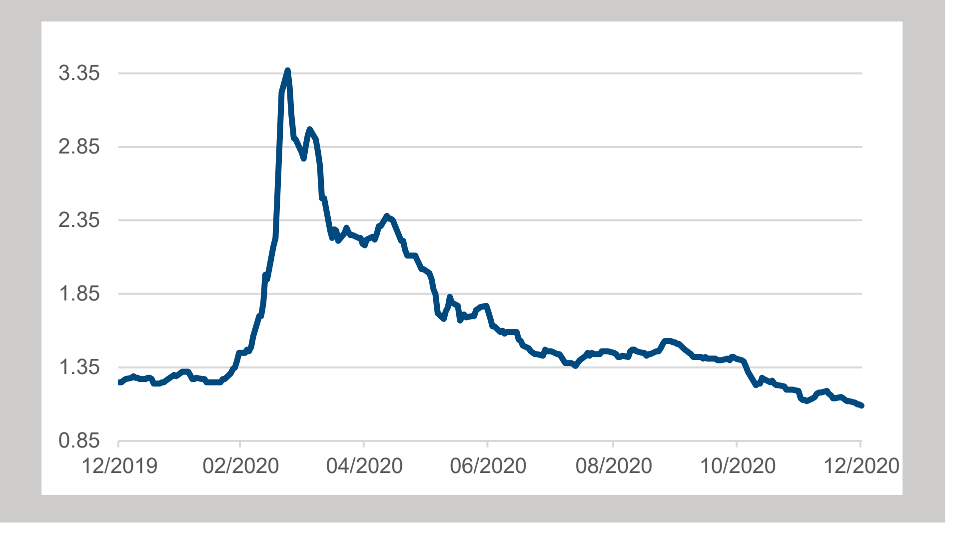
Source: Bloomberg

By the same token, the re-imposition of lockdowns and any risk of delays to the rollout of vaccination programmes do provide scope for potential disappointment, which could serve to limit markets' further progress in the shorter term. **As such, a "neutral" allocation to equities, with a balanced approach achieved via active managers with a blend of styles and specialisations seems eminently sensible to our way of thinking.**

Bonds

The quarter under review saw a meaningful divergence in the movements of, and returns from, core sovereign debt markets. Whereas the yields on German Bunds and UK Gilts followed a similar path and ended modestly lower (-5 and -3 basis points respectively, as measured by the ten-year benchmark bonds), resulting in small gains of 0.31% and 0.61% in their Bloomberg (>1yr) indices, the equivalent US Treasury indicator lost 0.83%. This reflected a steepening of the maturity curve that sent the 10-year yield 23bps higher (a trend that has continued into the New year).

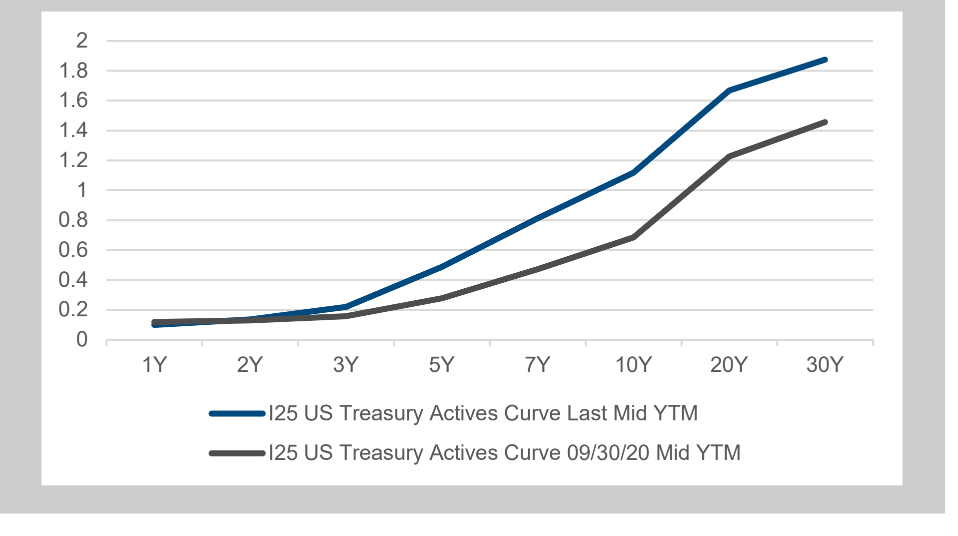
US BBB Yield vs UST



Source: Bloomberg

Meanwhile, in keeping with the prevailing "risk-on" market environment, a continuation of the narrowing in yield spreads produced healthy gains across the credit spectrum (e.g. JP Morgan EMBI +5.50%), iBoxx US Investment Grade (IG) Index +3.50% and the Bloomberg / Barclays Pan-European High Yield Index +5.34%). As the result of these latest movements, spreads on IG corporate bonds moved into record low territory, with the average yield on US BBB issues, for example (n.b. the lowest IG rating), a measly 1.09% above that of the corresponding Treasury at the year-end.

Current UST curve vs 30 September 2020



Source: Bloomberg

With a bull market stretching back to 1982, history tells that betting against bond markets for anything other than short periods can be a costly pursuit in either relative or absolute performance terms (and sometimes both). Moreover, as we have frequently stated, even within a market that, optically, seems to offer little in the way of value, the breadth and variety of instruments among the numerous sub-sets of the fixed income universe means that there are invariably opportunities to generate positive returns in pretty much all circumstances. **Thus, although current valuation levels might suggest otherwise, we remain confident in the abilities of the specialised managers with whom we have deployed our models' fixed income allocations to continue delivering attractive returns.**

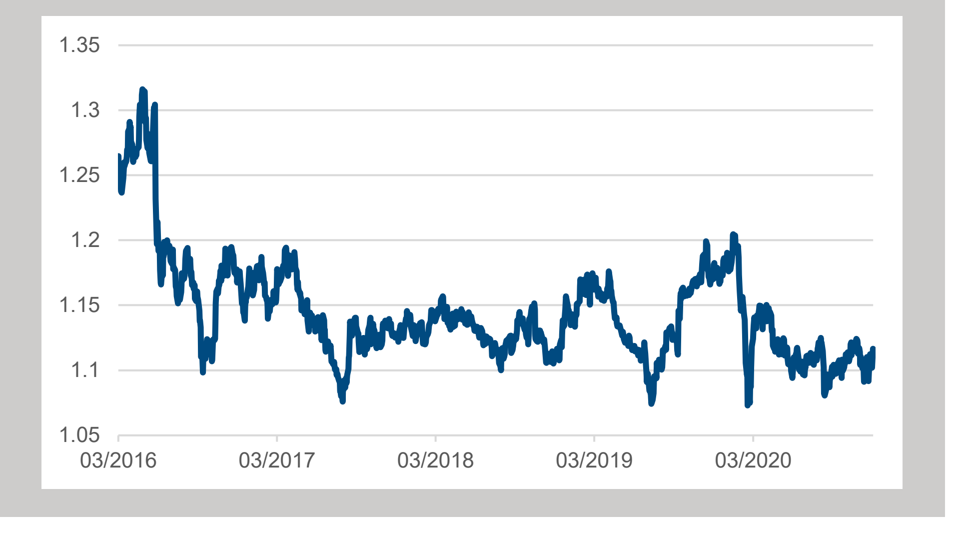
Currencies

The Dollar's continued decline, which saw the (trade-weighted) DXY Spot Index slip 4.21% on its way to a 30-month low, was very much in keeping with the bullish market tone and marked the US currency's weakest quarterly performance for three and a half years.

Every one of the 16 other major currencies listed by Bloomberg appreciated in USD terms: there were double digit gains for the South African Rand (+13.73%) and Mexican peso (+10.47%), with the Swedish Krona (+8.93%), Norwegian Krone (+8.92%) and New Zealand Dollar (+8.55%) rounding out the top five winners. At the other end of the league table was the other currency that is generally accepted as falling into the same "safe haven" category as the Dollar – the Japanese Yen - which managed a 2.16% gain relative to the USD.

Perhaps the most surprising aspect of the quarter's forex movements (for us at least) was the absence of any fireworks in relation to the post-Brexit trade deal that was announced on December 24th, the terms of which were far more favourable than consensus expectations from a UK perspective. The Pound ended the quarter with a gain of just 1.12% versus the Euro and remains in the lower half of the range that the currency pair has occupied since the UK's referendum in June 2016. Although it would be unrealistic to expect an immediate stampede towards the UK by external investors, the removal of the uncertainty that has been cited as the principle reason for Sterling and UK assets' underperformance and the terms on which the deal was struck should, we suggest, be positive for Sterling.

GBP vs EUR spot



Source: Bloomberg

Commodities

Broad commodity benchmarks recorded impressive gains even after allowing for the beneficial effects of a weaker Dollar, with the Refinitiv CRB Index up 12.99% in USD terms. There were sizeable increases across the range of commodity contracts, from the agriculture complex (Soybeans +28.51%, Corn / Maize +27.70%, Cotton +21.14% and Sugar +18.52%), in energy (per below), through to base metals (Copper +16.04%, Nickel +14.44%, Aluminium +12.15%). Indeed, such was the breadth in demand for and / or speculative interest in raw materials of all kinds that the Rogers ex-energy Index recorded its strongest quarterly gain - +14.15% - since the corresponding period in 2010.

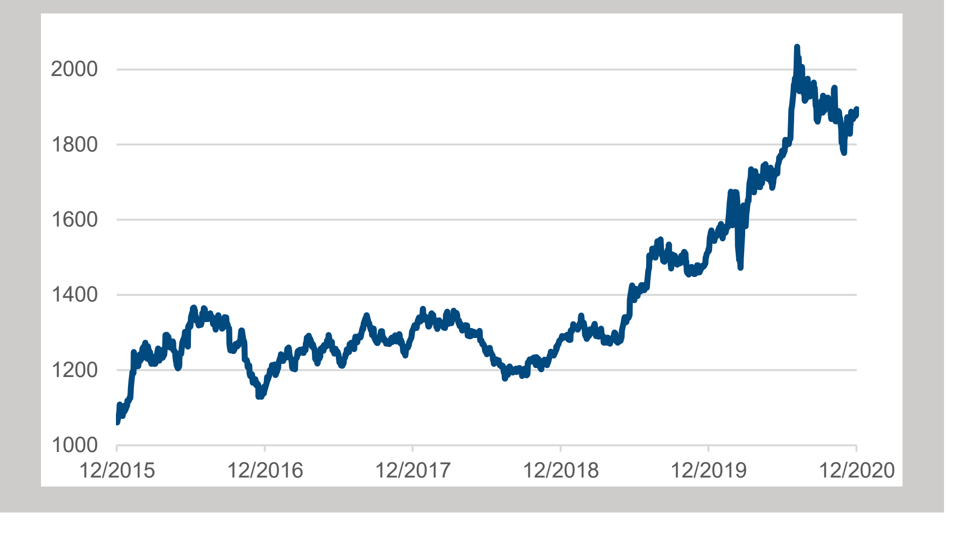
Rogers Commodity ex-energy Index

Source: Bloomberg

As was the case with other asset classes, oil markets appeared to look past the short-term implications of any disruptions resulting from new lockdown measures and a barrel of Brent Crude ended the period at $52.26, up 19.19%, based on the front-month futures contract (the equivalent figures for West Texas Intermediate were $48.52 and +20.64%). The period under review provided a further demonstration of the collective resolve of the major petro-nations, whose agreement of only modest production increases and compliance with quotas in the face of steady demand and declining inventories contributed to the firming in market prices.

The 0.19% dip in spot Gold Bullion to a year-end level of $1,894.36 per troy ounce was the first quarterly decline in the metal's (US Dollar) price for more than two years and translated to losses of 4.29% and 5.60% when measured in Euros and Sterling respectively. Though it is by no means the sole driver of the market price, this coincided with the first fall in the volume of bullion owned by investors via Exchange Traded Funds (ETFs) in a similar period, with aggregate holdings falling 3.52% over the quarter to 106.76 million ounces. Though the recent price action is not in itself a cause for concern, gold's relative price weakness during a period of Dollar weakness - ordinarily the two are negatively correlated - does raise questions over the sustainability of its long-term up-trend, particularly if US Treasury yields continue to rise (again, there is a historic negative correlation with US real interest rates). As such, the level of our models' bullion exposure is currently under review from both a fundamental and technical perspective and may be subject to change as a result.

Gold Spot ($ per oz)



Source: Bloomberg

Shaun McDade
Joint Managing Director (Guernsey)
and Head of Portfolio Management (International)

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