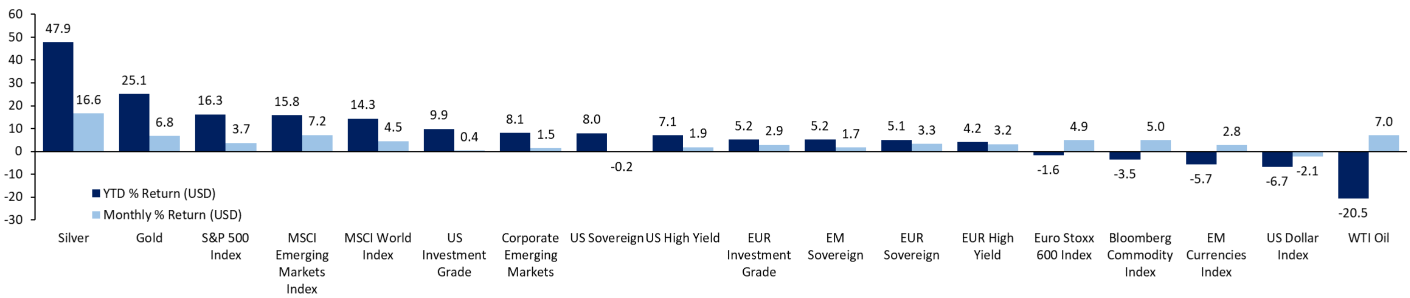
January 4, 2021

Monthly Market Wrap, December 2020

Although last year was potentially a year many would like to forget, for investors it was an exceptionally good one even though it caught many off-guard and was full of surprises. The pandemic and lockdowns accelerated digital adoption trends, propelling tech to new, all-time highs. SPACs represented approximately half of the total US IPO market and outraised all previous years combined. In the late innings, higher inflation expectations supported the reflation trade.

Chart 1. Asset Class Return YTD (USD Base)



Equities

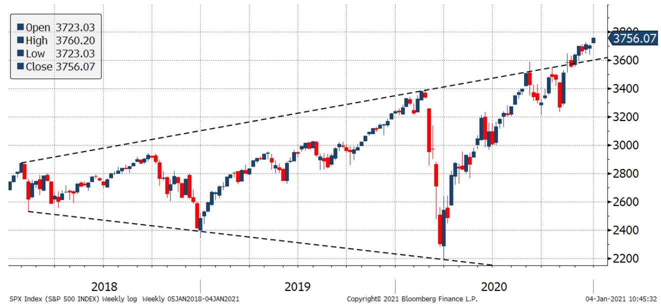
In Q4, equities continued their rally and outperformed fixed income. The US elections result and positive vaccine news helped more cyclical segments of the market to recover with value, posting its best quarter since 2009 (+16%). Global equities ended the month up 4.2%.

The last days of the year brought a long-awaited relief to US pandemic-struck companies and households. US lawmakers in Congress finally agreed on a pandemic relief plan that will extend many of the CARES Act support measures. The extension meant US stocks climbed to record highs on the final days of trading, albeit amid thinner volumes. The S&P 500 was up 3.8% **(Chart 2)**. Yet, small cap was again where the action was with the Russell 2000 up a strong 8.7%, outperforming large caps by 4.8%. On a sector basis, value and cyclicals continued to be the among top performers, but tech held up (+5.7%) **(Chart 3)**.

The pandemic took a turn for the worse with infections failing to inflect in Europe, prompting governments to impose new restrictive measures leading EU equities to lag their US counterparts. The EuroStoxx 600 was up 2.6% **(Chart 4)** partly driven by weaker regional returns in Spain (+0.4%), France (+0.7%), and Italy (+0.8%).

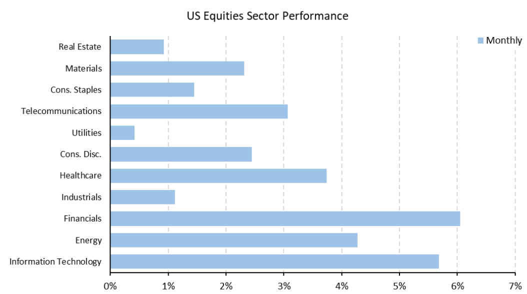
As risk assets rose further, volatility continued to dampen with the VIX trading at 22.75, a 73% decline since the March peak. However, single stock volatility still offers opportunity for yield enhancing strategies.

Chart 2. S&P 500 Index (Weekly)



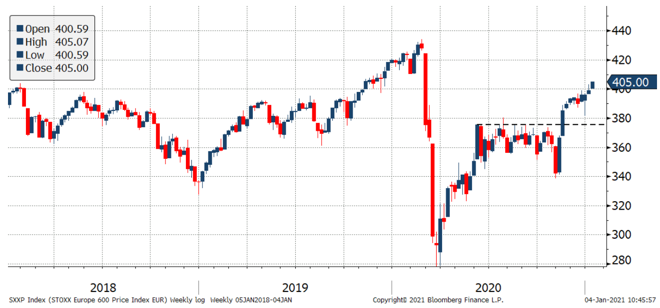
Source. Bloomberg, MAM Research

Chart 3. US Sectors Performance (MTD)



Source. Bloomberg, MAM Research

Chart 4. EuroStoxx 600 Index (Weekly)



Source. Bloomberg, MAM Research

Fixed Income

Yields continue to adjust to higher inflation expectations. In the US, the yield curve edged slightly higher last month with spreads on the 2-10 and 5-30 rising respectively by 10.2bps and 7.6bps. Almost the entirety of the move was driven by longer tenors. The US 10-Yr yields rose 7.4bps **(Chart 5)**. Shorter tenors were flat in comparison. Hence, most of the "spread expansion" was a function of higher yields on the farther end of the curve.

High inflation in 2021 is now highly consensual and the move higher on longer term yields is reflective of that. This view is further supported by US 5Yr5Yr forward breakeven rates that continue to climb **(Chart 6)**. That inflationary pressure can be found in many goods and asset prices, but has yet to find its way to long-term interest rates in a more meaningful way, It is only a matter of time until it does, and that could happen quickly.

In Europe, despite renewed restrictive measures, the picture was a bit different. German yields were relatively unchanged. UK yields dipped lower by nearly 10bps across the curve as country prepared to leave the custom union.

Currencies

In the FX market, December further contributed to the decline of the US Dollar (-2.1%) **(Chart 7)**. The currency broke out of its consolidation range and is now edging towards its next resistance level, near 2018 lows at 88.0.

In comparison, the Euro **(Chart 8)** broke out of its decade-long consolidation range with 1.25 USD/EUR looking as the next resistance level for the union's currency. The move was further supported by stable real rates, thus increasing the currency's relative carry attractiveness against the dollar due to lower inflation expectations.

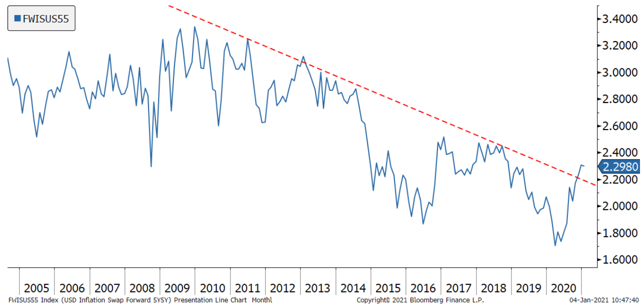
Then, as the uncertainty surrounding Brexit decreased with the different parties managing to find some middle ground in the final hours of 2020, the pound edged higher to close the month up 2.6% **(Chart 9)**, the second best performing currency against the dollar after the AUD.

Elsewhere, the Japanese Yen was supported by an overall weaker dollar (+1.0%). The reflation trade should continue to be a source of headwind to the greenback. Commodity-driven currencies (i.e. RUB, MXN, CAD) performed in line with a weaker dollar, despite lower natural gas prices.

Chart 5. US 10-Yr Treasury Bonds (Weekly)

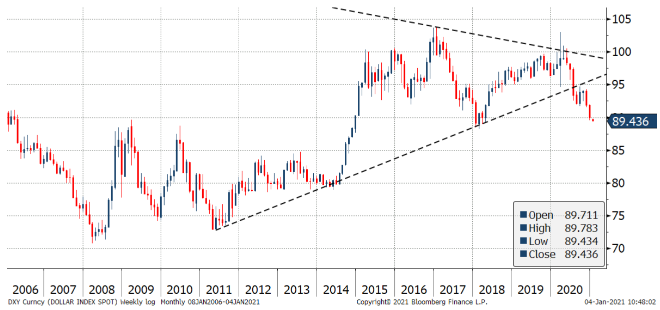
Source. Bloomberg, MAM Research

Chart 6. US 5Yr5Yr Forward Breakeven Rate (Monthly)



Source. Bloomberg, MAM Research

Chart 7. US Dollar Index (Monthly)



Source. Bloomberg, MAM Research

Chart 8. USD/Euro Spot Exchange Rate (Monthly)

Source. Bloomberg, MAM Research

Chart 9. USD/GBP Spot Exchange Rate (Weekly)

Source. Bloomberg, MAM Research

Commodities

The reflation trade, paired with a weaker dollar, prompted the strong performance of broad commodities (+5.0%). Gold **(Chart 10)** and silver **(Chart 11)** were respectively up 6.8% and 16.6% after finding technical support near their previous resistance levels.

The best performing sector was agriculture commodities, up 9.3%. Gains were mostly attributed to corn (+15.3%) and soybean (+12.6%), the second and third best performing commodities. Prices rose after crop-threatening weather in South America tightened global corn and soybean supplies amid robust demand. Indeed, Argentina suspended sales of corn for exports until Feb. 28 to ensure ample domestic food supply, while China boosted demand to rebuild the world's biggest pig herd.

Industrial metals (+0.3%) lagged with low single-digit returns on copper (+2.9%) and a negative performance in aluminium (-3.1%) and zinc (-1.6%). Energy (-0.7%) was the worst sector dragged by natural gas prices (-11.9%), worst performer on a slow start to the traditional heating season. Oil (+7%) was strong, supported by vaccine news.

Emerging Markets

The MSCI Emerging Market Index was up 7.4% last month **(Chart 13)**, thus outperforming global equities by c.3.1% and closing the year up 15.8% (c.-0.5% vs. MSCI World).

A large portion of the outsized returns can be attributed to a strong performance among South Korea (+16.6%), Brazilian (+13.6%), and Indian (+10.2%) equities. Mexican equities (+6.5%) faired relatively well and continue to be the cheapest EM country on both an absolute (-2.4SD) and relative (-3.3SD vs. EM) Price-to-Book basis. China continued to underperform both global and EM equities last month by c.-1.5% and c.-4.6%, respectively.

The EM currency index was up 2.8%, building onto the consolidation breakout highlighted last month **(Chart 14)**. The South African Rand and Brazilian Real were among the top performing currencies in the region, respectively up 5.0% and 3.0% against the dollar in December. The moves continue to highlight the strength of the equity rally and the legroom left open for an appreciation in the value of the USD-denominated investment vehicles currently providing portfolio exposure to the EM regions.

Chart 10. Gold Spot Prices (Monthly)

Source. Bloomberg, MAM Research

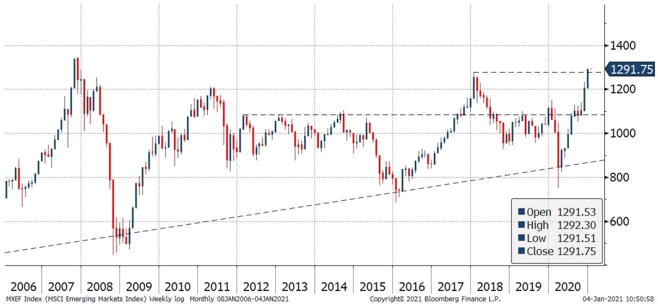
Chart 11. Silver Spot Prices (Monthly)

Source. Bloomberg, MAM Research

Chart 12. Copper Front Month Rolling Futures (Monthly)

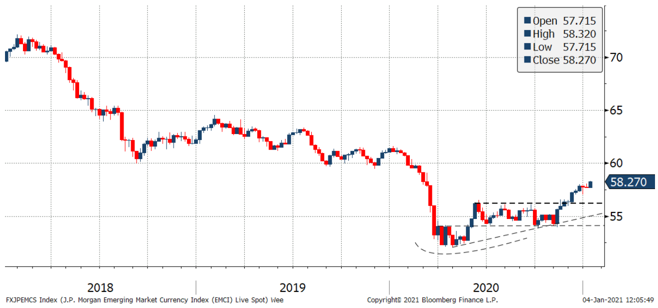
Source. Bloomberg, MAM Research

Chart 13. MSCI EM Index (Monthly)



Source. Bloomberg, MAM Research

Chart 14. MSCI EM FX Index (Weekly)



Source. Bloomberg, MAM Research