

Keeping you informed matters

Economic review

October 2020



Outlook

The last quarter has seen further solid returns from financial markets. Politics are driving direction in the short term, with the pandemic seemingly overlooked by investors. But this is also because there are other long-term investment trends, such as sustainable and ethical investing, providing a new path to navigate the current social and economic crisis.

Following the relentless rise of the mega tech companies throughout the year, perhaps it was only a question of when, not if, some corrective movement would occur. But while there has been an increase in price volatility lately, it hasn't stopped the major US indices posting record highs during the last quarter, nor slowed the Asian and emerging economies recovery.

Fears of a second wave of Covid infections if lockdowns were lifted too soon appear to have been well founded. The Americas, Europe and Russia are experiencing a spike in new cases, but so far, there has been no corresponding increase in the rate of deaths. Reasons for this have included better preparedness and improved treatment regimens, but also that the spike is most prevalent in a younger demographic where death rates are statistically much lower. Providing these dynamics stay the same, it seems that investors are happy to ignore the pandemic.

But the spectre of a looming US election, Brexit wrangling, trade wars and potential for further economic fallout from harsher virus-led restrictions should make investors more cautious. The S&P 500 has delivered negative returns in the two months prior to an election in three out of the last six election years, with low positive returns in the other three. The UK market is utterly unloved and regardless of the V-shaped recovery for many other major markets, we have come into Q4 with most valuations still battered and bruised by Covid-19 uncertainty.

At the peak of the first wave and during the worst of the lockdown, economic activity fell c40% globally. The recovery still leaves us down between 10-20% depending on which country you look at, but the UK is firmly at the back of the pack, while China sets the pace with a near full recovery. But even without a full return to pre-pandemic levels, the chances of a corrective move lower remain high, with too many risks still able to derail the recovery.

But what is the prospect for navigating a path through the pitfalls? Many trends that were expected to shape markets over the coming years have been accelerated

during this social and economic crisis. The "homebody economy" is one you will hear more about and is a trend that you are already part of, perhaps without realising. It is increased demand for the shopping, studying, working and entertainment goods and services we've been consuming at home during the lockdowns.

As consumers we are also much more focused on our health and living a longer life. As our buying behaviour alters, its technology that facilitates the change, with usage of robots and automation being absorbed much faster, becoming a major growth area for investment.

A much sharper focus on the environment through the pandemic has also heightened interest in ethical and sustainable investing. With a spotlight on personal wellbeing during lockdown, people were spending more time outdoors and appreciating the benefits of nature for their physical and mental health. With cleaner air from less domestic commuting and international travel, the level of global daily carbon emissions fell on average 17% by early April and as much as 26% at the peak of the lockdown in some countries.

Our reliance on fossil fuels and the need to transition to clean energy has never been starker. Only 14% of plastic is collected for recycling. The amount dumped into our oceans each month is equivalent to the weight of two Empire State Buildings. We, and the companies in which we invest, must change the way we operate and integrate at all levels.

Coincidentally, but certainly not accidentally, many of the companies that have performed the best over the course of the year have been those with well-established environmental, social and corporate governance cultures already in place. The opportunity we see now is to enhance our strategies with these thematic ideas and to move our own culture in the same direction.

Key facts about the world

United Kingdom

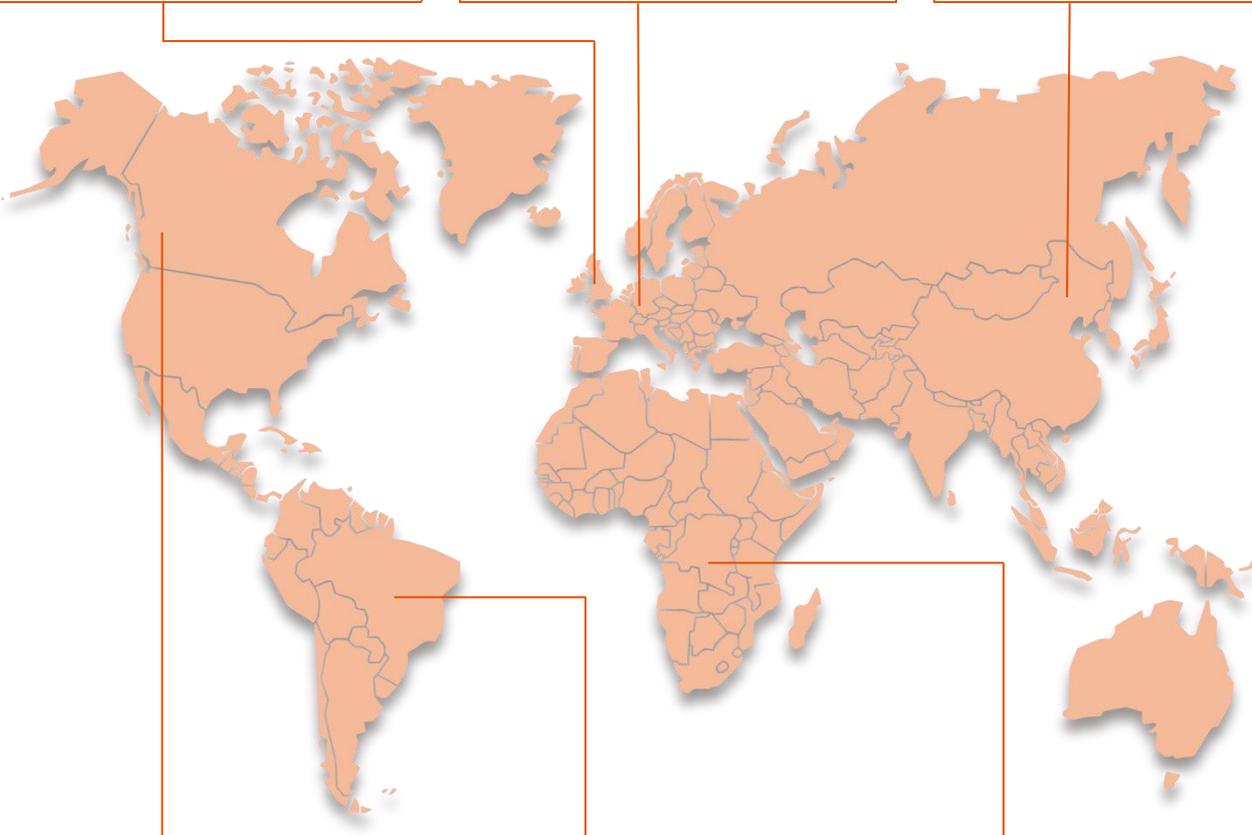
- Brexit trade negotiations reach impasse following amendment to Withdrawal Agreement, but UK and EU still hope for deal
- Covid second wave leading to tighter restrictions and prospect of a second lockdown

Europe

- EU Commission downgrades economic forecast to contraction of 8.3% in 2020 from 7.7%
- Challenge to reopen economy and stave off further economic damage from lockdowns continues

Asia

- Ongoing friction between US and China risk to market sentiment
- Policy outlook in Asia remains supportive and China has increased credit flows to support the economy



North America

- Market enters period of uncertainty as presidential election approaches
- A disputed result could lead to increased uncertainty and volatility
- Return expectations should be reduced into year end

South America

- Disrupted value chains and low demand for commodities to further squeeze exports
- Weak fiscal positions, lower inflation, job losses to ensure supportive central bank monetary policy for longer

Africa

- Collapse in economic activity due to Covid leading to increased poverty
- Public debt and debt risk are rising
- Growth weakening substantially in the three largest economies – Nigeria, South Africa and Angola

Q3 Performance Review

Key facts

- Major US equity markets set new records in September
- Technology stocks continue to drive core of market returns
- Coronavirus disrupting business reopening and delaying economic recovery
- Prefer to be underweight UK in favour of global equities
- Bonds providing stable returns and security in low interest rate and low inflation environment

Once again market performance over the third quarter has proved more resilient than could have been hoped for in the middle of a pandemic, with major US indices setting record highs at the start of September and Asian markets broadly strong throughout. Technology stocks were the leaders and subsequently, the recent weakness and increased volatility has been driven by the same, with a combination of valuation (bubble) concerns and profit taking in the lead up to the US election.

However, we view these current growth themes such as technology as tomorrow's utility companies. Just as energy companies were seen as stable, low growth income providers since the 1940's, telecoms were handed the baton in portfolios over the past three decades, and we now see this trend evolving to encompass today's high growth, mega tech companies for the future. Reliance on technology is here to stay.

As such, across our strategies we have maintained exposure to overseas large cap funds with a focus on these themes including Loomis Sayles US Equity Leaders (+7.7%), Fidelity Asia (+9.3%) and in our high-risk strategies, Scottish Mortgage (+24.6%). The Man GLG Japan and Invesco Japan funds had to be replaced across the risk spectrum. Having shown signs of improvement in Q2, a return of underperformance in Q3 meant our targets had been breached and we have replaced the positions with the Lindsell Train Japanese Equity fund. This offers a much more focused growth strategy in the region, investing in high quality, sustainable business models with established brands.

Similarly, in the UK equity allocation of the strategies, we have replaced the JO Hambro UK Equity Income fund after a period of underperformance. After consultation with the managers, we felt the fund's approach wasn't suitable for this environment currently. With our cautious outlook on the UK, we have moved to an underweight position in equities pending more positive coronavirus developments and Brexit negotiations.

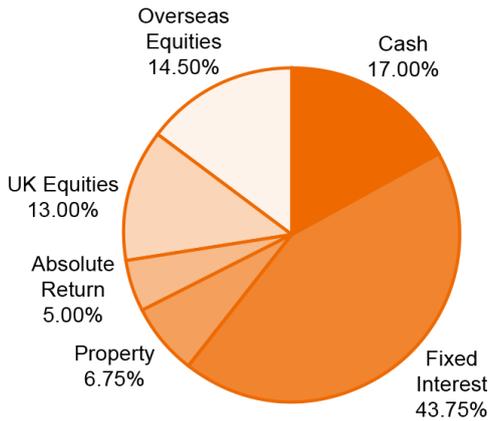
The fixed interest, cautious allocations across the strategies remains a key focus for providing yield and stability in portfolios and we continue to monitor the property allocations closely for a recovery in sentiment to boost prices.

SECTOR	Q3 2020	1 year to 30/09/20	1 year to 30/09/19	1 year to 30/09/18	1 year to 30/09/17	1 year to 30/09/16	5 years (annualised)
IA OE UK Index Linked Gilts	-1.7%	1.3%	19.1%	1.3%	-6.8%	28.6%	7.9%
IA OE £ Corporate Bond	1.6%	4.2%	9.0%	0.1%	0.8%	13.0%	5.3%
IA OE Property	-0.2%	-4.4%	-0.3%	5.8%	7.5%	-2.5%	1.1%
IA OE UK Equity Income	-3.2%	-17.4%	-0.1%	3.5%	10.8%	11.5%	1.1%
IA OE UK Smaller Companies	5.3%	0.0%	-7.1%	10.5%	25.2%	8.2%	6.8%
IA OE North America	4.3%	9.3%	7.4%	19.7%	14.5%	31.0%	16.1%
IA OE Europe Excluding UK	2.7%	3.2%	2.2%	1.9%	22.0%	19.2%	9.3%
IA OE Japan	4.0%	5.7%	-1.1%	12.6%	13.3%	33.4%	12.2%
IA OE Asia Pacific Excluding Japan	5.2%	8.1%	5.8%	3.7%	15.6%	37.3%	13.5%
IA OE Global Emerging Markets	4.2%	1.6%	6.4%	-1.4%	17.6%	37.5%	11.5%

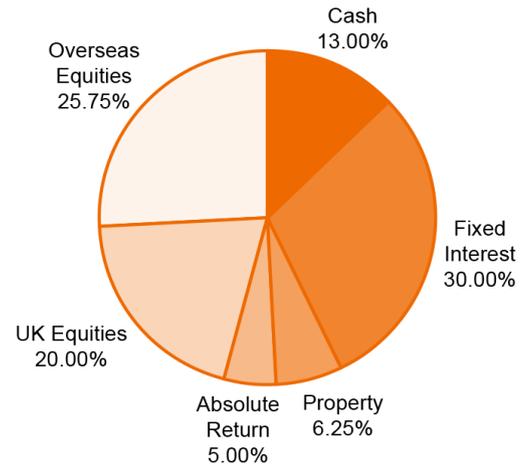
Source: Morningstar, bid-bid pricing. Net income reinvested. Past performance is not a reliable indicator of future results.

The positioning of our strategies

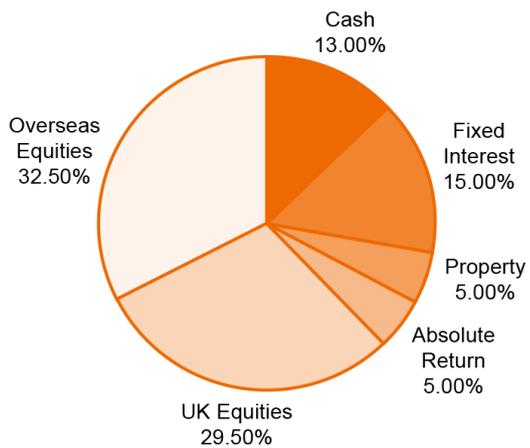
Cautious



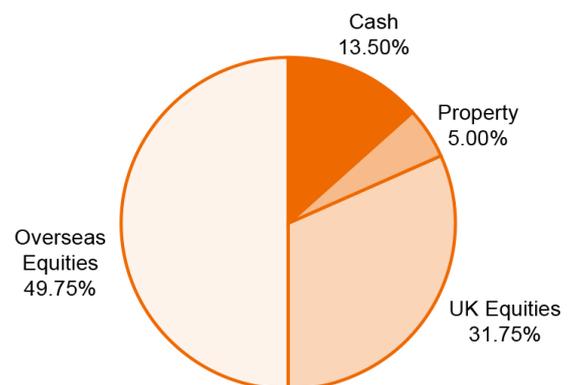
Balanced



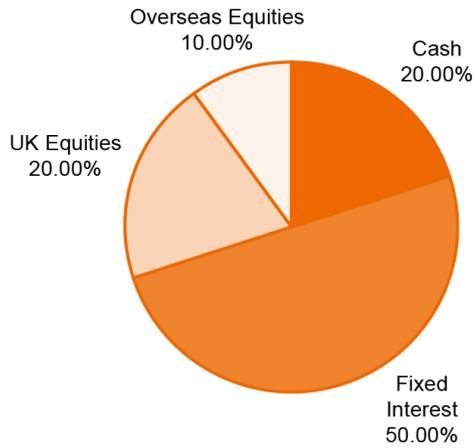
Growth



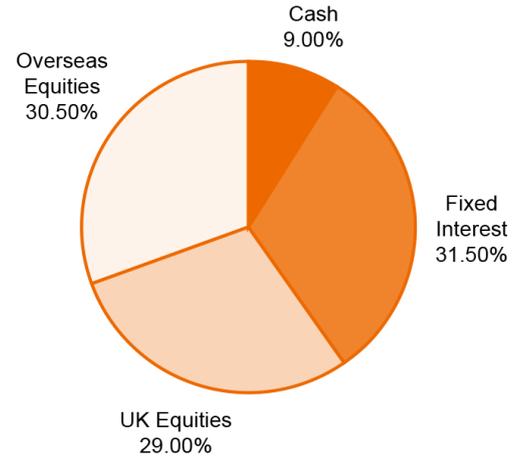
Adventurous



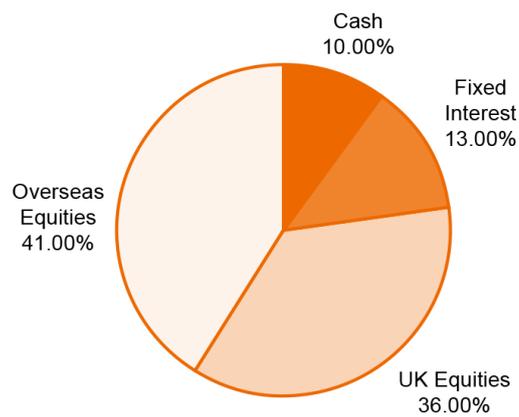
Ethical Conservative



Ethical Balanced



Ethical High Growth





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