The darkest hour is just before the dawn

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Guy Foster, Brewin Dolphin's Head of Research, reflects on a year characterised by unprecedented highs and lows fuelled by a virulent pandemic.

Most of us will have little fondness for the year just passed. The emergence of the first coronavirus cases in the final weeks of 2019 earned that year the dubious distinction of being immortalised in the virus's shortened name, but those cases only became widely known about in 2020. That will be the year marked out by history as the start of humanity's all-consuming battle against this virulent pandemic.

The deepest depths

Fear and anxiety caused by the spread of the virus would no doubt have had terrible economic consequences if left untreated, but the efforts to try to forestall and mitigate that spread caused economic disruption themselves that can barely be contemplated. Back in March 2009 US employment declined by 800,000, thus marking the nadir for the economy and many stock markets during the last coincident global recession – a disruption severe enough to be named the *Great Financial Crisis*.

The thought of a repeat of such economic carnage within a generation has been almost unthinkable, but in April 2020 the same gauge declined by 20 times that amount. This marked the onset of a global recession and a bear market for stocks which by many metrics was more severe than any experienced before. The extent of the job losses, the depth of the decline in economic activity and the speed with which share prices plummeted were without precedent.

However, despite the early crash, 2020 ended up being a mixed one for stocks reflecting the precise nature of this economic disruption.

The widest divides

Services which require human interaction such as traditional retail, hospitality, travel and leisure have suffered the greatest pressure from lockdown measures. E-commerce helped keep the route to market open for manufacturers, while remote working meant many businesses could return to work rapidly. The technological advances of recent years that negate the need for physical proximity restricted the most severe economic suffering to a narrower set of sectors than would have been the case just a few years ago and the facilitators of that technology thrived.

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America's technology-heavy benchmark NASDAQ index rose a stunning 44% during 2020, while the UK's FTSE 100, which is comparatively light in technology-enabling businesses, fell by 14%. Most other markets fell between these two extremes.

The sharpest recoveries

Considering the scale of the economic damage that has been unleashed by the virus it is perhaps unintuitive to see such a rapid recovery of all or part of the losses suffered. It means that if we have truly seen the worst of this bear market then it will be one of the sharpest, but mercifully one of the shortest, in history. Why? There are several reasons. The cause of the economic pain was clear for policymakers to see, so the policy responses came fast and forcefully. Investors also took comfort from the fact that if the virus could be tamed then companies would return to something close to their previous levels of profitability.

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Throughout the year, therefore, eyes were trained on the host of potential vaccines that could emerge to unleash the potential in locked-down or virus-afflicted parts of the economy. It took until November when at last those expectations began to be met. First Pfizer and BioNTech, then Moderna and finally Oxford University alongside AstraZeneca released results that demonstrated effective vaccines against the viral threat. That news was enough to help stock markets reach new post-Covid highs, but also to reverse the trend of US outperformance, with European shares outperforming American as the year came to a close. November was the strongest calendar month for either the FTSE All Share or the MSCI World in the current millennium.

Remaining challenges...

Infection rates and lockdown measures had a big impact on relative equity market performance, but this had more to do with where companies were listed rather than where Covid-19 cases were surging. Various waves came, went and returned again across the western world, with the multinational companies that dominate markets generally exposed wherever the cases happened to be greatest.

A noticeable distinction however was that developed economies had healthcare systems that were better able to deal with Covid-19 cases than many emerging markets. However, many Asian markets had the benefit of experience in tackling previous less contagious viruses such as avian flu. Some countries benefitted from having less concern about protecting their populations' privacy, with their governments empowered to impose restrictions to prevent the spread. Nowhere was this more so than in China, which had the most effective regime for case suppression.

Another crucial variable determining the severity of the outbreak was the specific variant of the virus. Nowhere was this clearer than in the UK where a more transmittable variant emerged during November. Variant B1.1.7 spread despite the suppression measures that were in place at the time, prompting yet further tightening of measures and a race to distribute newly-approved vaccinations.

A brightening future...

The news could scarcely have been grimmer at the end of the year, yet stock markets continued to look forward to an eventual end to these challenges. Taking heart from the old saying that the night is darkest just before dawn, investors retained their optimism as the year ended. The prospect of vaccines putting an end to the Covid misery sets up a potential multi-year expansion, as often follows a global recession.

Rather than just hoping for a brighter future, investors also took action to ensure it. A concerted effort amongst shareholders has been heaping pressure on companies to commit to reducing carbon emissions. Partially aided by experiences gleaned during their responses to the challenges of Covid and lockdown, companies have been rising to the challenge of climate change.

Governments in Hungary, South Korea and Japan joined others such as the UK's that had already made commitments to achieve net zero emissions by 2050. In September, China, the world's largest greenhouse gas emitter, committed to a net zero target by 2060. That announcement came just a month before the world's second largest carbon emitter, the United States, formally withdrew from the Paris climate agreement. President Trump had given notice to withdraw from the agreement timed to take effect on the day after the 2020 US presidential election.

The solidity of intransigence

When the US election came it was much closer than had been expected by most commentators. Some had predicted huge gains for the Democrats. Instead, Democratic candidate Joe Biden took the White House by some very thin margins in state-wide polls; the Democrats lost ground in the House of Representatives (but retained control); and the Senate remained in Republican hands initially.

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Investors had cheered this result, as it left the presidency, or executive brand of government, in the hands of Joe Biden, who they expect to be stable and competent. At the same time, the more interventionist policies espoused by the left wing of the

Democratic Party, which investors would have taken fright at, did not have a route to the statute books.

However, following a run-off election in Georgia at the start of January, the Democrats have against the odds taken control of the Senate as well.

This changes the markets' view of the potential impact of the election result, as more significant shifts in economic policy could now be possible. However, given how thin the margin of control is the most radical policies of the Democrats will still need to be kept on ice.

The end, of the beginning...

Finally, during 2020 the UK left the European Union in practice as well as in law. With a weary sense of predictability, negotiations were concluded far closer to the end of the transition period than had been intended. Tariffs will be avoided but there will be more paperwork to complete and customs checks to be carried out. There will even be further negotiations to take place as the agreement on fishing only lasts for five years and there are further agreements to be reached on financial services and data sharing. Perhaps more importantly the commitment to tariff-free trade is based upon regulatory alignment. Future divergences would see that under threat all over again.

Though for now, the end of Brexit negotiations means policymakers can focus on the immense challenges that Covid-19 still brings. The new variant raises the logistical challenges of rolling out vaccines, maintaining the education system and keeping the economy functioning over what seems destined to feel like a very long few months. From an investment perspective though, the anticipation is that a year after Covid-19 raced around the world, its management will quickly become a reality. A year is a long time to live through, but of relatively little consequence for the demand for companies' products and services. What matters more is the long-term changes to working, shopping and leisure that will stem from our period of enforced lockdown.

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Now, more than ever, the interlinking of distinct short and long-term changes is clear. Whether it is Covid-19, Brexit or climate change, things will continue to change with lasting impact for investors, companies and government.

“The future ain't what it used to be”

Yogi Berra, Baseball player, 1925-2015

Guy Foster, Head of Research

Guy leads Brewin Dolphin's Research team, providing recommendations on tactical investment strategy to Brewin Dolphin's investment managers and strategic recommendations to the group's Asset Allocation Committee. He is a CFA charterholder, holds the CISI Diploma, and is a member of the Society of Business Economists. Guy frequently discusses financial issues with the written and televised media as well as presenting to the staff and clients of Brewin Dolphin.