February 2021

Mosaique Views

Rothschild & Co
Wealth Management

Staying constructive

We think economic recovery will resume and gather momentum in 2021

Contagion is still disappointingly high, and many economies are again being constrained to deal with it. As yet, however, measures have been less far-reaching than in early 2020, and have had a less dramatic impact than many feared.

China's economy of course has long since retraced its lost ground. Its economy is larger – and, untroubled as yet by a second wave of contagion, may be growing more quickly – than it was before the crisis. But the US economy has also been able to continue to grow solidly through year-end, and business surveys suggest a remarkably resilient start to 2021 (with more fiscal stimulus yet to kick-in). US GDP may yet regain pre-crisis levels in the first half of the year.

As ever, Europe is the weak spot. Anti-virus measures are tougher, and seem unlikely to be loosened soon, and on the Continent in particular the rollout of vaccines has been slow. Even here, however, the renewed weakness in economies has been less pronounced than was widely expected. German industrial output likely grew in the fourth quarter.

We have always felt that a mix of adaptation and tolerance would eventually help economies to move back towards something approximating "business as usual": we have not placed all our faith in vaccines (though we are as happy to see them as everyone else). We may be seeing this playing out in the sort of trial-and-error progress being made. The lesson from last summer is that people do still want to travel, eat out, watch sports events and even work, and as it becomes safer to do so, economic recovery will resume – supported of course by strongly expansionary monetary and fiscal policy.

Meanwhile, geopolitical risks have perhaps faded a little. The new US administration will be more predictable than the last; an EU-UK trade deal was signed after all; and the pandemic recovery fund is going to happen (albeit slowly).

The question for us as investors is whether to focus on short-term risks, and today's higher valuations, or instead to continue to "look across the valley" at the rebound in profitability.

We are again sitting tight, with a continuing bias towards assets that benefit from economic growth. We have further shifted our emphasis towards cyclical (short-term), rather than structural (long-term), growth.

Asset allocation summary

We stay overweight equities, underweight on bonds, and neutral on cash and gold (the latter is now formally part of our strategic asset allocation). We have added some additional cyclical exposure by increasing US financials to overweight and cutting US communication services to neutral

– Neutral +

Equities

We felt from the onset that the lasting damage done by the shutdowns may not be as big as the stock market initially implied in March 2020. We moved overweight equities at mid-year as global contagion rates slowed and the economic rebound became more visible as lockdowns eased – positions we have since maintained. The second wave of contagion clearly poses resumed short-term risk, but we think markets will continue to focus on resumed recovery.

– Neutral +

Fixed income

Safe-haven appeal was probably overpriced to begin with, and the viral crisis has made it even more so. While we see little chance of inflation-beating returns from these levels for the asset class (most European yields were below inflation to begin with), we have seen selective opportunities and added corporate and emerging market bonds to portfolios as spreads widened substantially during the spring.

– Neutral +

Money market

The prospect of positive returns is even more remote, but cash offers the continuing opportunity to capitalise on volatility. Nominal capital values are stable, safe from the mark-to-market risk that faces expensive bonds, and low inflation helps preserve real value too. We cancelled our overweight position at mid-year as lockdowns loosened and we saw opportunities to add to risk assets.

– Neutral +

Gold

Gold has been a long-term store of value for three millennia, though its short-term volatility can be high. Currently, with real interest rates low, we think it can be held alongside cash. Its credibility does not rely on central banks, governments or an internet connection, and its low correlations with traditional investments can provide diversification.

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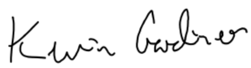

Asset allocation overview

Key	–		Neutral		+
Material overweight					●
Benchmark weight			●		
Material underweight	●				

Fixed income

EUR	–		Neutral		+
High-grade	●				
IG low-grade				●	
High-yield				●	
Duration			●		

USD	–		Neutral		+
High-grade		●			
IG low-grade				●	
High-yield			●		
Duration			●		

CHF	–		Neutral		+
High-grade	●				
IG low-grade				●	
High-yield				●	
Duration			●		

Gold

Gold	–		Neutral		+
Gold			●		

Currencies

Currencies	–		Neutral		+
USD			●		
EUR			●		
GBP			●		
ROW			●		

Equity regions

Equity regions	–		Neutral		+
North America				●	
Eurozone			●		
UK		●			
Switzerland		●			
Japan			●		
Pacific ex Japan		●			
EM EMEA			●		
EM Asia					●
EM Latin America			●		

Equity sectors

US		–		Neutral		+
Energy			●			
Materials					●	
Industrials					●	
Utilities		●				
Consumer discretionary					●	
Consumer staples			●			
Communications	←			●		
Healthcare				●		
Technology					●	
Financials	→				●	
Real estate			●			

EU	–		Neutral		+
Energy		●			
Materials				●	
Industrials				●	
Utilities		●			
Consumer discretionary				●	
Consumer staples		●			
Communications			●		
Healthcare				●	
Technology				●	
Financials		●			
Real estate		●			

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