IMPERIUM CAPITAL

momentum

Global Matters Weekly

23 November 2020

Road to Recovery

– **Andrew Hardy, CFA**

Following a third consecutive Monday of hugely encouraging news in the fight against COVID-19, global equities are well on track to delivering their best one month return in over a decade, up 11% and counting. Vaccine developments have propelled economically sensitive sectors such as energy, financials and industrials higher in November – with tech stocks in the slow lane for a change – resulting in one of the most rapid shifts in market leadership ever seen in markets. The recovery potential in 'value' stocks remains massive in our opinion, particularly in the areas hardest hit by the pandemic, but investors don't necessarily have to take on high levels of risk or sacrifice quality in their portfolios, in order to access this opportunity. The infrastructure sector is a prime example of an area that we believe has plenty of open road ahead.

> The path to recovery is rarely a smooth one; while uncertainty remains high, the usually defensive and more predictable nature of infrastructure is appealing whilst it remains out of favour.

Infrastructure stocks – which span the owners of toll roads, airports, pipelines, utilities and beyond – are typically regarded as being defensive, due to reasonably steady and predictable demand for their services, even during periods of economic contraction. That hasn't been the case this year due to the unique nature of the crisis and the crippling effect of national lockdowns and travel restrictions; the sector has lagged broader global equity markets by over 10% while certain parts, notably the first three subsectors listed above, remain much more depressed despite a recent bounce. There are a few reasons to question the market's assessment at this point.

Firstly, despite the sector often being maligned for its pedestrian growth rates – the flip side of more dependable levels of returns – the prospects for longer term growth look good in many areas. For instance, communications towers are benefiting from the rollout of 5G networks, while utilities are expected to enjoy higher growth rates as a result of substantial investment in renewable energy sources. Toll roads could even come out of this crisis stronger, as commuters potentially steer more towards private modes of transport in future, as opposed to public ones. The strong possibility of a large infrastructure investment bill in the United States at some point would add another substantial growth dimension, with many other governments also eyeing infrastructure as a leading candidate for stimulus spending.

Secondly, the sector should benefit more than most others from low interest rates. That is because infrastructure businesses typically carry higher levels of debt, but also because their steady cash flow and dividend streams become more attractive on a relative basis. Readily achievable yields of 3-4% with the potential for growth over time start to look very attractive when compared against most government bonds around the world yielding 1% or less. Add to that the benefit of being able to pass through the effects of inflation – which nominal bonds can't offer and which we feel may become more of an issue for investors in the future – and we could well see a long period of outperformance from the sector driven by a global search for yield, as was the case following the global financial crisis.

Then there is the rebound potential for earnings across the sector, particularly amongst areas that have been hardest hit by the pandemic. That's most relevant for toll roads, airports and pipelines, where there is arguably only limited rebound potential priced in at present. Admittedly air travel in particular is unlikely to recover to pre-pandemic levels for several years, but infrastructure businesses are valued based on their long-term cash flow generation potential, and a return to normality is likely well within such a horizon. Nonetheless a selective approach is warranted in order to avoid some of the inevitable potholes that lie in wait, not least amongst those businesses without sufficient resources to weather what will likely be a tough winter in the northern hemisphere.

The path to recovery is rarely a smooth one; while uncertainty remains high, the usually defensive and more predictable nature of infrastructure is appealing whilst it remains out of favour. As the world gradually casts COVID-19 off over time, these characteristics will increasingly come back into focus and be prized. Now is the time for building solid foundations in portfolios in order to deliver on future outcome targets

The Marketplace

- Global equity markets returned +0.4% last week
- The Oxford/AstraZeneca vaccine is shown to prevent 70% of Covid cases in clinical trials. This follows last week's announcement from Moderna of 94.5% efficacy in phase 3 trials
- Brent crude rose +5.1% to $44.96 a barrel
- Gold fell by -1.0% to $1870.99 per ounce

Market Focus

US

- US equities fell by -0.7% last week
- Weekly initial jobless claims rose to 742k (vs. 700k expected) in the week ending November 14, up from the post-pandemic low of 711k the previous week.
- Retail sales in the US edged up 0.3% month-on-month in October, following a downwardly revised 1.6% gain in September and below forecasts of a 0.5% increase. This represents their slowest pace in 6 months.
- Treasury Secretary Mnuchin requested that the Federal Reserve return all unused stimulus funds to the Treasury Department last week, adding that in the "unlikely event that it becomes necessary in the future to re-establish any of these facilities", the Fed can seek approval again.
- US deaths from COVID-19 have surpassed 250,000 as the nation continues to struggle to bring new cases under control. Various new restrictions and curfews were rolled out nationwide.

UK

- UK equities rose by +0.6% last week
- The UK and Canada have agreed a deal in principle to continue trading under the same terms as the current EU agreement after the Brexit transition period ends. Official negotiations will begin in the new year.
- The government has announced its largest investment for the armed forces in 30 years. It represents a 10% increase totalling £4bn a year over the next four years.
- The UK and European Union are on course to strike a trade deal in the coming days even though several big differences between them still need to be bridged.
- PM Boris Johnson's officials are said to be considering plans that would end targeted local lockdowns, with tougher restrictions instead placed on broader regions of England next month.

Europe

- European equities rose by +1.1% on the back of positive vaccine news
- EU indicating that BioNTech/ Pfizer and Moderna could receive conditional European Union marketing authorisation for their Covid-19 vaccines in the second half of December.
- The ECB's Philip Lane announced that the ECB will continue its pandemic emergency purchase program for the duration of the pandemic as long as it continues to disrupt regular economic activity.
- German Chancellor Angela Merkel's government is asking lawmakers to approve a spending plan for next year that raises planned new debt by about 70%, or some EUR 70Bn in 2021, to pay for the fallout from the coronavirus pandemic.

Asia/Rest of The World

- Japanese equities returned +1.4% last week.
- Chinese equities returned +0.8% last week.
- Japan's economy grew at an annualized 21.4% in the quarter ended September 30, its fastest growth rate in over 50 years. This firmly beat the consensus estimate of 18.9% growth.
- Australia's flash PMI for November showed improvement over last month with manufacturing at 56.1 (vs. 54.2) and services at 54.9 (vs. 53.7) bringing the composite reading to 54.7 (vs. 53.5 expected).

Past performance is not indicative of future returns.

Source: Bloomberg. Returns in local currency unless otherwise stated.

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Asset Class/Region	Currency	Currency returns			
		Week ending 20 Nov. 2020	Month to date	YTD 2020	12 months
Developed Market Equities					
United States	USD	-0.7%	8.9%	11.4%	16.0%
United Kingdom	GBP	0.6%	14.6%	-14.6%	-11.2%
Continental Europe	EUR	1.1%	13.5%	-0.9%	1.3%
Japan	JPY	1.4%	9.4%	2.6%	4.6%
Asia Pacific (ex Japan)	USD	2.0%	9.7%	15.4%	21.4%
Australia	AUD	2.1%	10.6%	0.5%	0.2%
Global	USD	0.4%	10.9%	9.3%	13.5%
Emerging markets equities					
Emerging Europe	USD	3.1%	21.9%	-21.4%	-17.2%
Emerging Asia	USD	1.6%	8.1%	20.6%	28.1%
Emerging Latin America	USD	3.9%	19.9%	-24.2%	-16.5%
BRICs	USD	1.2%	6.9%	12.8%	21.8%
China	USD	0.8%	4.6%	28.2%	39.1%
MENA countries	USD	0.9%	6.3%	-4.7%	-0.6%
South Africa	USD	0.0%	12.9%	-10.7%	-7.3%
India	USD	1.7%	11.2%	2.6%	4.9%
Global emerging markets	USD	1.8%	9.6%	10.6%	17.5%
Bonds					
US Treasuries	USD	0.6%	0.5%	8.8%	8.0%
US Treasuries (inflation protected)	USD	0.4%	0.6%	9.7%	9.8%
US Corporate (investment grade)	USD	1.2%	2.4%	9.0%	9.6%
US High Yield	USD	0.6%	3.2%	4.3%	6.9%
UK Gilts	GBP	0.4%	-0.8%	6.9%	6.2%
UK Corporate (investment grade)	GBP	0.9%	1.3%	6.4%	7.1%
Euro Government Bonds	EUR	0.4%	0.2%	5.0%	4.0%
Euro Corporate (investment grade)	EUR	0.3%	0.9%	2.5%	2.6%
Euro High Yield	EUR	0.8%	3.4%	0.7%	2.6%
Japanese Government	JPY	0.2%	0.3%	-0.8%	-1.2%
Australian Government	AUD	0.1%	-0.2%	5.0%	3.0%
Global Government Bonds	USD	0.8%	1.2%	8.2%	8.1%
Global Bonds	USD	0.7%	1.5%	7.8%	8.1%
Global Convertible Bonds	USD	1.1%	5.7%	18.4%	21.9%
Emerging Market Bonds	USD	0.1%	4.4%	5.3%	8.3%

Source: Bloomberg. Past performance is not indicative of future returns

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Asset Class/Region	Currency	Currency returns			
		Week ending 20 Nov. 2020	Month to date	YTD 2020	12 months
Property					
US Property Securities	USD	-0.6%	12.2%	-10.3%	-10.9%
Australian Property Securities	AUD	0.7%	13.1%	-7.3%	-10.9%
Asia Property Securities	USD	2.1%	13.6%	-10.1%	-6.2%
Global Property Securities	USD	0.7%	12.6%	-9.8%	-8.2%
Currencies					
Euro	USD	0.2%	1.8%	5.6%	7.1%
UK Pound Sterling	USD	0.7%	2.6%	0.1%	2.8%
Japanese Yen	USD	0.7%	0.8%	4.6%	4.5%
Australian Dollar	USD	0.6%	4.1%	4.1%	7.6%
South African Rand	USD	1.2%	6.2%	-8.8%	-3.2%
Swiss Franc	USD	0.2%	0.6%	6.0%	8.7%
Chinese Yuan	USD	0.7%	2.0%	6.1%	7.2%
Commodities & Alternatives					
Commodities	USD	2.4%	7.9%	-14.6%	-11.2%
Agricultural Commodities	USD	1.8%	5.6%	9.0%	14.2%
Oil	USD	5.1%	20.0%	-31.9%	-27.9%
Gold	USD	-1.0%	-0.4%	22.9%	27.2%
Hedge funds	USD	0.4%	2.2%	3.6%	5.5%

Source: Bloomberg. Past performance is not indicative of future returns

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