An elusive return to normal

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Investors will most likely remember two main things about the state of financial markets in 2020. The first is that they yoyoed violently. Investors initially panicked, but were soon reassured by the massive monetary and fiscal policy support provided. The second thing is the stark contrast in performance between winning and losing sectors. For portfolio managers to make it through this period, actively managing market risk and picking securities with the utmost discipline were imperative.

The US political horizon has cleared up in the meantime, and effective vaccines will soon be widely distributed. But though that combination has given investors a sugar high, the return to normal under way may prove to be trickier than is commonly thought. This isn't to suggest that successful investment performance will be impossible. It simply means that, even in today's giddy mood, you need to keep a level head.

Public policy at the crossroads

The support provided by governments and central banks in 2020 has been both extraordinary and highly coordinated. Necessity being the mother of invention, economic orthodoxy has been temporarily put on the back burner. However, a return to broadly normal conditions inevitably raises the question of where public policy will be heading.

It is unclear at this stage how much cooperation will be forthcoming from either EU member states or the US Senate. As today's exceptional circumstances recede, the conventional advocates of fiscal restraint will come back to the charge.

And while we can reasonably expect large-scale vaccination to give a hefty boost to confidence and consumer spending, watered-down stimulus programmes will almost certainly have the opposite effect. In our view, markets might be overlooking two obstacles to growth that are still very much with us: increasing global debt and underemployment.

> It will take a long time for even a robust upturn to repair the colossal damage done to the economy in 2020

It will take a long time for an upturn to repair the colossal damage done in 2020 to a world economy already hampered by weak secular growth. This means the expected cyclical recovery should not be mistaken for a trend reversal at this stage. Destruction will not be creative in the short run – assuming it ever is.

For all those reasons, we will be sticking with our bias in favour of quality growth stocks, though we are also happy to see the commodities exposed to the re-opening of the economy can at long last contribute to our returns.

The emerging world waiting in the wings

The fallout from the 2020 economic shock will include considerable deficit financing needs. Governments will still require unstinting central-bank support to be able to avoid a surge in bond yields. Sooner or later, however, such unlimited support might end up undermining the value of currencies when money gets printed just to finance deficit spending. The US dollar seems particularly in danger of falling victim to such a fate.

A weaker greenback would be beneficial for countries that borrow and trade extensively in dollars – first and foremost emerging economies. In China and its sphere of influence, that boon would come in addition to the region's two key advantages: skilful handling of the public health crisis, which has paved the way to a swifter economic recovery; and an enviable presence in major new technology segments and alternative energy.

> The emerging world enjoys two key advantages: a swifter economic recovery and an enviable position in high-growth sectors

It also seems to us that a possible slide in the dollar, and perhaps other currencies confronted with similar challenges, could put gold back on its upward trajectory in 2021.

To conclude: beyond the "anomaly" experienced in 2020, it is important to keep in mind that with regard to equity-market performance, long-term earnings growth will remain the ultimate judge and jury. Moreover, at a time of rock-bottom interest rates, a still sluggish world economy and worsening macroeconomic imbalances, earnings growth will remain scarce – and fragile even when it does occur.

We will therefore continue to construct our investment strategy around four key "antifragile" types of assets: shares of companies with predictable profit growth, China and its regional sphere of influence, winners in the energy transition, and gold miners.

Source: Carmignac, Bloomberg, 30/11/2020

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