update

Knightsbridge Wealth

The post-Covid-19 world will be much the same as the pre-Covid-19 one in lots of ways. We will drift back to our offices. We will flood back to bars and restaurants. We will cram on to planes and cruise ships to catch up on the sunshine and fine living we have mostly missed out on over the last nine months. But one thing might seem a little different: the recovery.

At the very start of the crisis, we witnessed something we hadn't seen before - simultaneous demand and supply shocks. Demand collapsed as we were confined to our homes. Supply collapsed as factories shut and transport routes withered. This was no ordinary recession.

It still isn't. Unemployment has stayed relatively low in the UK so far and has fallen to 6.7% in the US – which may continue given that many US firms will only be able to turn their state-backed loans into grants by showing they have rehired laid-off workers by the end of the year. Consumer confidence has recovered bizarrely fast (reaching a ten-month high earlier this month). And, most unusually of all, bank deposits have soared.

Private-sector household deposits in the US are up $2.2trn since the US government started handing out cash directly to the population. Add in business deposits and the number is close to $3trn. In the UK, Bank of England chief economist Andy Haldane reckons we have built up £100bn of "excess savings". The result? Demand is back big time and once the rest of the Covid-19 restrictions are gone (once you've vaccinated the over-80s, 90% of the mortality risk is out of the equation) it should boom some more. That suggests a much faster recovery than those of us who associate recession and recovery with the aftermath of the great financial crisis (when newly printed money got stuck in the banking system) might have expected. But here's the thing. That sharp rise in demand is not being met by supply, which remains subdued.

Reduced supply means higher prices and the return of inflation. We've been used to very low inflation – so much so that even 2%-3% might make a huge difference to how we invest (and feel), particularly if interest rates on savings don't rise to compensate us (they won't). Governments will need to increase tax too. You may be worried about actual wealth taxes (with good reason). But if inflation takes off and rates stay low, the dynamics of the next decade, for those who take no action, could be just one long wealth tax. Gold is one place to hide. Equities are another.

2020 has been a landmark year for Chinese markets. Foreign investors have bought more than £113.5bn of local assets. Onshore bonds have been attracting particular attention. This should come as no surprise since they are offering a yield of 3.3%, compared to 0.9% available in the US. There were £1.2bn in net foreign inflows into bonds last year.

The world's sudden need for masks and gel, coupled with demand from locked down workers for IT equipment, has played to the country's manufacturing strengths. Medical equipment exports rose 42.5% whilst electronics exports rose 25% last year. These new global consumption patterns should unwind this year as a vaccine is rolled out. Yet lower exports will be offset by strengthening domestic activity. The Chinese economy has continued to grow across all fronts - retail rose 5% last year while industrial production gained 7%, boosting stock market values.

China is expected to be the only G20 nation to have grown in 2020. By the end of 2021, the economy could be the same size as it would have been if the pandemic had never happened. Policymakers have resorted to a familiar infrastructure-first stimulus, leaving efforts to bring down debt levels to one side. 2021 will see the country confronting the same problem it had before COVID-19 - How do you deleverage the economy without killing growth?

In these challenging times, the quality of advice, service and active management from a well regulated firm has never been more important. The team at Knightsbridge Wealth are committed to help in every way possible and we look forward to working with you.

> Our strategic partnership with UBS (Union Bank of Switzerland) gives the best of both worlds – personal service and the ability to react in a way that only a small firm can, partnered by one of the world's most prestigious brands.

Market Report

Bonds

Emerging markets look attractive

Policy is the most important driver of long-term rates. While economic normalisation will put some upward pressure on long-term rates, only modest increases are likely. Rates will remain low even as the economy continues to recover, and any spikes will be short-lived in light of the Federal Reserve's active management of interest rates and its balance sheet. Emerging market debt and Asian high yield bonds look attractive.

Bond values should be supported by the continued search for yield and accommodative global central bank policies. Default risks should reduce next year as social activity normalises as a vaccine becomes broadly available and growth and earnings recover.

Commodities

Gold to lose shine

Gold should find support in the first half of the year as stronger growth expectations, and higher oil prices, push inflation expectations higher and, subsequently, real interest rates lower. But in the second half, safe haven demand for gold will drop as central banks adopt a more neutral stance, and growth prospects continue to broaden. However, US dollar weakness should be supportive.

Base metal prices have had a strong vaccine induced rally since early November. This strength is largely justified given ample policy support and the latest hopes of a return to normal economic conditions, but prices will struggle from here. Demand from the western world should remain muted in the early part of 2021.

Oil

Positive sentiment

Crude oil prices are trading at their highest level since early March, supported by positive market sentiment. However, the near-term outlook looks difficult, as mobility restrictions in Europe, as well as higher Libyan oil production, should reduce the market deficit we saw at the end of 2020. For next year, with OPEC and its allies only gradually increasing production amid recovering oil demand, the oil market is likely to stay under supplied. Hence the outlook looks bullish for next year.

Hedge Funds

Useful source of stability

Multi-strategy hedge funds are attractive for diversification. Strategies that can navigate heightened macroeconomic and geopolitical risk - especially those exposed to tech, healthcare and Asia - look attractive.

In private markets, opportunities should exist through special situation secondary and distressed managers that can take advantage of emerging themes such as digital tech, green tech and healthcare.

Foreign Exchange

Bearish on the dollar

Among G10 currencies, it would be wise to remain bearish on the US dollar. US interest rates have collapsed, and the Fed has supplied markets with an unprecedented amount of US dollar cash to alleviate funding issues, easing its policy stance more proactively than other central banks globally. Procyclical currencies should benefit. Among them are the Euro, currencies from commodity producing countries, and the British pound.

Equities

UK looks good value

Equities have performed strongly in the 4th quarter, with global stocks, the S&P 500 and the Nasdaq all notching fresh record highs. Positive vaccine developments have supported global equities, particularly cyclical and value stocks. High-efficacy vaccines should bring the COVID-19 pandemic under control, enabling a gradual return to normality for economies and markets. Absolute valuations are stretched but in a world of zero interest rates, further upside exists.

European markets look expensive, whilst the UK is one of the cheapest developed markets at present. A strong rebound in earnings is likely in 2021, driven by a global economic recovery as well as an anticipated recovery of the oil.

Strong buying by international investors of Japanese equities, and favourable news flows, have driven Japanese stocks higher. Strong forecast earnings growth and further economic stimulus should support the market, but volatility is likely to be elevated in the months ahead, after the recent rally. The Bank of Japan's asset purchase scheme should serve as downside protection, while a successful Tokyo Olympics in 2021 would be positive for consumer sentiment, if it goes ahead.

Emerging markets bouncing back

Investors in emerging markets are finishing the year on a profitable note, but few would have predicted that back in March. The MSCI Emerging Markets index plunged by 33% between 1 January and 23 March as economies locked down in response to Covid-19. That was then followed by a 68% rally, leaving the index up by 13% for the year as of mid-December, virtually the same as the average gain for all world markets. Emerging market shares are now trading at the same level as they were in January 2018 in US dollar terms. The rest of that year was a washout, but gains over the last two years have finally erased the losses of 2018.

There were significant differences in performance between emerging markets, a category that includes everything from commodity exporters to Asian manufacturing tigers. Latin America disappointed, with both Brazil's Ibovespa and Mexico's IPC indices essentially flat over the year. Chile's IPSA index is down 15% in a year that saw voters approve plans to re-write the constitution. Argentina's Merval index shrugged off a government bond default to rocket 27%, but the benefit to most investors will be limited: the country makes up a negligible percentage of the main MSCI indices and was almost removed from the emerging markets index again this year owing to its capital controls. Russian stocks soared 39% in 2019, but had a more muted 2020, rising 6%. The market slumped on this year's weak oil prices, but has roared back since November as Brent crude returned to $50 a barrel.

This has been a difficult year in most emerging markets. Many have struggled to contain the virus and contended with lower tourism receipts and weak oil prices. But you wouldn't think that looking at the index, which is heavily weighted towards east Asia: China, Taiwan and South Korea collectively account for almost two-thirds of the MSCI Emerging Markets index. Their strong performance has dwarfed disappointments elsewhere.

Korea's Kospi index registered a 27% gain thanks to a robust response to Covid-19 and a global manufacturing upswing in the summer and autumn. Many wonder if South Korea should be classified as an emerging market at all. While the MSCI Emerging index includes it, the alternative FTSE Russell has considered it a developed market since 2009. The home of Samsung is clearly a developed economy (its GDP per capita is comparable to that of Spain), but restrictions on currency conversion and some financial products mean its stockmarket is judged to fall just short of the "developed market" standard for now.

Other Asian manufacturing economies have had a similarly buoyant year. China's CSI 300 index is up 20% for the year-to-date, with Taiwan's TAIEX up 17.5%. Vietnam's VN-index has advanced 11% this year. India has not coped as well with the virus as its east Asian peers, but its BSE Sensex is still finishing the year up by a profitable 13.5%.

Not all Asian markets were so happy. A year of civil unrest in Thailand saw the local SET index fall by 7%. Hong Kong's Hang Seng is down 7% after a turbulent year for the city, despite a string of high-profile flotations.

Hopes of a global upswing have seen foreign investors rush into emerging markets this quarter, which look set to see the biggest quarterly inflows in seven years. Some fear things are getting overheated, but emerging markets should benefit from several tailwinds: stronger commodity prices, recovering tourism, a weaker dollar and loose monetary policy that forces investors to go hunting for returns. Next year could be a breakout year for emerging markets.

Is Britain's house-price boom set to continue?

Despite the Covid-19 pandemic, UK house prices have been rising fast this year. Will that continue in 2021?

If someone had said in January that Britain was about to suffer the biggest plunge in its economic activity in modern history, most would have predicted that prices would fall – perhaps quite hard.

2020 has proved to be the best year for the UK housing market in a long time, in terms of activity at least. House prices hit new record highs and saw their strongest growth for years, This isn't just about the well-off fleeing the cities for rural properties with bigger gardens or sea views (though that has been a major feature). The boom is widespread, with transactions. Her Majesty's Revenue and Customs reporting their highest level in five years in October.

Pent-up demand has helped. House moves were delayed by the outbreak, so transactions piled up towards the middle of the year. And the stamp-duty holiday introduced by the chancellor, Rishi Sunak, has likely brought forward sales from the future as people rush to beat the March 31 deadline. But what this year should really demonstrate, to anyone who was ever in any doubt, is that the main driver of house prices is the availability of credit. Despite the economic slump and risks to employment, interest rates have remained low and securing a mortgage has largely remained feasible for most people who are in a position to buy in the first place.

Lenders might be wary but it is still possible to get a mortgage with a deposit of just 10%. And if you have a larger deposit, or a lot of equity in the property, then you can still enjoy rock-bottom rates. So what happens in 2021?

Sales will slow once the stamp-duty holiday ends. And the exodus from the cities that might have added a bit of fuel to the fire this year is unlikely to be as marked as vaccines are rolled out. Working from home is likely to be a long-term feature of many employees' lives, but others may find that commuting is still a necessity – or at least more important than it might have seemed during lockdown.

There are other factors that could slow things down a little. The UK's 'Help to Buy' scheme becomes less widely available from 31 March, while an extra layer of stamp duty also starts for overseas buyers. But house prices are most unlikely to crash. The most likely cause for that would be a surge in interest rates, which is simply not on the horizon.

Assuming that government assistance continues to cushion the worst of the unemployment risk, and that the economy recovers, then we won't see the scale of job losses that might cause widespread forced selling either. Arguably the biggest 'risk' is that inflation starts to rise much more rapidly than expected and begins to eat away at house prices in "real" terms, rendering them more affordable over the longer run. And that would be a good thing.

For now, it seems likely that house prices in 2021 will be flat or subdued.

Investors miss out on Japan

As 2020 drew to a close, Japanese prime minister Yoshihide Suga announced a new £532bn stimulus package, the country's third so far this year. About £289bn will go towards furlough programmes, hospitals and incentives for green investment. The stimulus takes the total spent on the country's virus to 14% of GDP.

Japan has so far dodged the worst of the pandemic, but the latest wave is its most serious. Japan has a serious pre-existing condition – about 30% of the population are aged over 65 and that proportion is rising. The debt-to-GDP ratio is more than 230% and is climbing towards 250%. Massive national debt, a plunging population, and now, a resurgent pandemic… talk about a grim convergence.

However, the outlook for Japan is actually not looking too bad. More women participating in the workforce and longer careers have mitigated the worst fears about an ageing population. The government has been forced to step in with extra fiscal support because the Bank of Japan has run out of firepower; the central bank now owns more than 50% of all government debt. Its $433bn share portfolio also makes it the country's biggest stock-market investor.

ING expects GDP to contract 5.4% for 2020 as a whole and for the economy to regain its pre-crisis level in late 2022.

Japan's Nikkei 225 index gained 15% in November, its best monthly showing since 1994. But it remains about one-third short of its 1989 all-time peak. The Topix, which is a more accurate (if less famous) gauge of the stockmarket, ended 2020 up around 3.5%.

British investors pulled £145m from Japanese funds in September. The wobble may have been induced by Shinzo Abe's resignation as prime minister. They are missing out. A pro-shareholder culture is slowly taking hold thanks to Abe's reforms, while Suga is now pushing digitalisation in a country still attached to fax machines.

The Nikkei 225 index outperformed the US market in dollar terms last year, but few international investors have noticed. Overseas buyers cooled on Abe in mid-2015 and withdrew funds again last year. Yet, 2021 is expected to be a good year for cyclical stocks, such as industrials and consumer discretionary, which comprise almost 40% of the MSCI Japan index. Japanese firms also have less leverage than their overseas counterparts, which gives them a strong cash buffer for dividends – Japan yields 2.3%. When global investors cotton on, the market could soar.

Britain's new deal with the European Union

After years of wrangling and political arguments, Britain is now outside the EU and has secured a trade agreement with it.

The UK-EU Trade and Co-operation Agreement, a 1,246-page treaty setting out the post-Brexit terms of trade, was passed by the House of Commons after just five hours' debate on 30 December. After all the wrangling, the EU has agreed its first ever tariff-free and quota-free trade deal with its ex-member, governing £650bn annually in bilateral trade. It's a broader agreement than Canada's, but one which – like Switzerland's – is also more open-ended. In a small but symbolically rich moment, Britain's first action under its new freedoms was to scrap VAT on women's sanitary products, aimed at helping low-income women. Under EU rules, the minimum VAT level was 5%.

The deal has enough room for more wrangling to keep trade lawyers rich for decades. There are no tariffs or quotas on goods, but there's a delicate 'rebalancing mechanism' - subject to arbitration. This is aimed at preserving the EU's 'level playing field' with the UK. In short, the treaty leaves the UK free to set its own standards in areas such as environmental standards and labour law, but at the cost of having access to the European market restricted if it diverges too far. But that arbitration mechanism doesn't rely on the European Court of Justice – a crucial win for the UK. A similar balancing act has been agreed on state aid and on fishing rights, which are subject to a transition period ending in June 2026. The deal grants transit rights to road hauliers, but with far more restrictions than previously. And there are tough new checks on agri-food products, and some on pharmaceutical products.

Boris Johnson mistakenly told MPs that the deal removes "non-tariff barriers" to trade. In fact, his government is attempting to recruit 50,000 new customs agents to enforce a wave of new bureaucracy and checks at ports – arrangements that HM Revenue & Customs estimates will cost British businesses £7bn a year. The government also published more than 300 pages of instructions to businesses on how to comply with the new regulations governing cross-Channel trade just hours before they came into force. It covers the likes of customs forms, rules of origin requirements, export health certificates for animal and plant products, and a host of other regulatory documentation. But Johnson is claiming victory. Last week he wrote of how naysayers had said that "you couldn't have unfettered free trade with the EU, without conforming to EU laws. You couldn't have your cake and eat it. Maybe it would be unduly provocative to say that this is a cake-ist treaty; but it is certainly from the patisserie department."

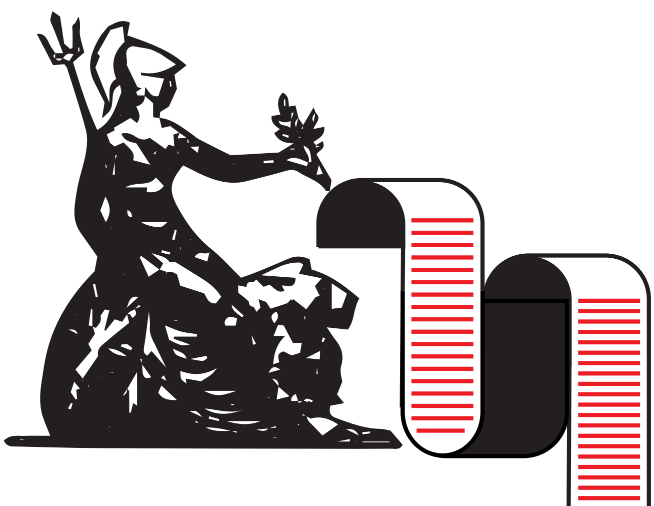
Whether this is strictly true depends on what is meant by 'unfettered.' Under the deal, the UK gets tariff-free and quota-free trade in goods only as long as it stays aligned with the EU's 'level playing field' regulations and state-aid subsidies. The Sunday Times considered "the deal owes less to the cake department than to the hire-purchase department." It is strictly conditional. It is only ours for as long as we keep paying the bill of alignment.

The treaty also appears fundamentally skewed to the strengths of the EU, in that it prioritises the trade of goods (and fishing rights) and offers next to nothing to Britain's powerful services and financial sector, which constitutes a large chunk of the economy. On financial services, data and much else the Brexit negotiations are by no means over.

Currently, the Office for Budget Responsibility estimates that, under the new trade deal, the UK's economy will be 4% smaller than it would have been within the single market and customs union, because of non-tariff trade barriers. A long touted benefit of Brexit was also the ability to make extra-EU trade deals of our own. So far, the only deal signed that is not a rollover from the deals that the UK had as EU members is the one signed in October with Japan. On UK government projections, that deal will add a modest 0.07% to GDP over 15 years. Over the longer term, the emerging freedoms of life outside the EU could well ultimately make the UK richer and happier. But it needs a strategy to achieve it, and a detailed plan to deliver that strategy.

What that strategy is will dominate politics post-Covid-19. A good place to start would be a massive deregulation drive, starting with the so-called acquis, the 80,000 pages of European law that remains on our statute book. Expunging all unhelpful regulations needs to be the primary focus of a single identifiable ministry producing a stream of EU Regulatory Repeal Bills. A sunset clause scrapping everything by 2025 unless Parliament specifically votes to retain it would help speed things up. More broadly, policymakers and bureaucrats should replace the 'precautionary principle' with the 'innovation principle' when it comes to new regulations. Without abandoning safety concerns, the presumption in the UK must be of allowing innovation to flourish.

Brexit will remain a dominant political issue, placing strains on the unity of the UK and leading to future scraps on issues such as immigration, regulatory alignment, the status of service industries, fishing, access to databases, and defence cooperation. But Brexit, after all, is a process, not an event. It will continue.



Metal prices recovering

Commodities have been in the doghouse for much of the last decade. The largest and best-performing specialist natural resources fund in this sector, BlackRock World Mining, has lost 11% of its net asset value (NAV) over the last ten years. Commodity specialist Goehring & Rozencwajg notes that raw materials haven't been this cheap compared to US equities since 1920.

Yet there are now signs of an incipient recovery as investors look forward to a global rebound in 2021, when demand for materials and energy products should improve.

Fluctuations in the value of the US Dollar have an impact on commodities too. Most are priced in dollars, so they tend to rise when the dollar weakens (this makes them more affordable for holders of other currencies) and vice versa.

A rising dollar is often a reflection of a global flight from risk, which implies concern over an economic downturn. Heavy fiscal stimulus and expansionary monetary policy could see the dollar's position erode in 2021, similar to what happened in the 1970s and 2000s when commodities reached historical highs. Lurking in the background is a possible long-term tailwind: the rise of inflation as the recovery picks up speed. Inflation bodes well for raw materials. As overall demand climbs, prices rise, putting upward pressure on the cost of raw materials needed to produce goods. It also takes a relatively long time to increase the supply of most commodities, so demand often eclipses supply in good times.

The pandemic diverted consumption towards digital goods, which have no marginal cost, but the vaccine will redirect pent-up demand towards 'real' things, which face physical constraints. It's also important to sound a note of caution in the short term, as commodity prices tend to move erratically.

The state of the energy markets shows how commodities can take their time to rebound. The path to higher oil demand might be uneven and vary by region, with much of the developing world still struggling with Covid-19 through this year. As far as industrial metals are concerned, however, the outlook is arguably much brighter. The ten-year supply shortfall is now at a record level for copper.

Uranium prices, meanwhile, have bounced aggressively while many metals associated with batteries are doing the same. The share prices of lithium producers in Australia have performed strongly as the market started to get excited about the outlook for lithium. Lithium-ion batteries are the key component in electric vehicles.

COVID-19 CORONAVIRUS

Download our guide to looking after you, your family and business during the coronavirus pandemic.

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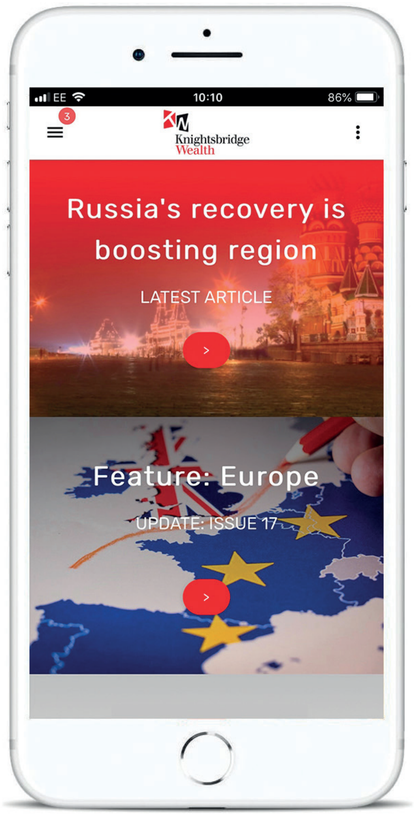

Knightsbridge Wealth's senior team and support staff have over 200 years experience in the world's largest Banks

Alexander Wade

Alexander is one of the most experienced London advisers in the international market, specialising in this field over the last 20 years at HSBC, consistently recognised as one of its most accomplished advisers. He has over 24 years' experience in financial services. He is particularly interested in the Middle East market and understands the specific issues which are relevant there.

Stuart Poonawala

Stuart has worked in financial services since 1998. In 2003, he helped to found HSBC's specialist London arm advising international clients which quickly became one of the bank's most successful UK divisions. In 2009, he launched Kubera Wealth, our sister company, focussing on providing quality advice to the UK market.

Graeme Cowie

Graeme is responsible for building our professional connections with international lawyers and accountants, as well as co-ordinating our relationship with key fund managers at a number of international Private Banks and Discretionary Fund Managers. He has spent over 20 years in financial services and investment management, most recently spending more than six years at UBS where he led the Strategic Partnership team.

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