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Market Update

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Another Brexit talks deadline came and went last week as Boris Johnson and Ursula von der Leyen gave negotiators more time to make a deal on Sunday 13th December. After a gloomy week of headlines, both leaders agreed in a telephone conversation to go the 'extra mile'.

As we have previously written, negotiations have already ploughed through several deadlines as each side waited for the other to blink, but with the UK's transition period running out on 31st December with or without an agreement, both sides will need *some* time to ratify an agreement prior to that date.

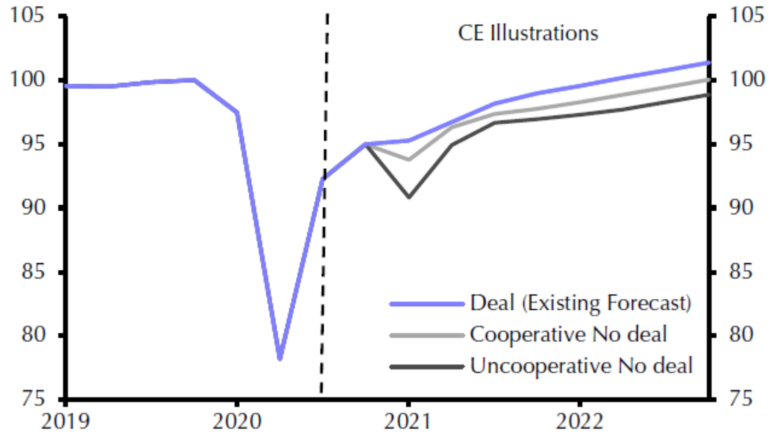
The points of contention remain the same: fishing (though progress has reportedly been made here), and the level playing field, particularly with regards the so-called 'ratchet clause' of the treaty. This clause aims to stop one side from undercutting the other by refusing to adhere to higher environmental, labour and social standards set by the other – however, the EU seeks the right to unilaterally impose tariffs in circumstances where it has tightened regulations and the UK has not followed suit.

Further, there would be no obligation to show that the UK's divergence on standards was indeed distorting trade. The current text reportedly blocks the UK from responding to measures that it might think were unfair or disproportionate with its own tariffs, or by arguing a case through arbitration. The EU argues these measures are a necessary condition of access to its single market to prevent UK companies gaining an advantage over their European competitors.

It is impossible to know whether a deal is now more likely following the weekend's events, but as previously mentioned, a 'no deal' scenario on 31st December 2020 would be very different to the 'no deal' of four years ago. The Withdrawal Agreement is in place to govern points around the financial settlement, citizens' rights and Northern Ireland, with substantial progress also made on financial services equivalence and on the rolling over of the bulk of the UK's third-party EU-trade deals.

The imposition of tariffs and customs checks at the borders will cause some disruption regardless of the outcome, and while a fall in the Pound as a result of 'no deal' would have a potential impact on inflation, the Bank of England and the Treasury would respond with looser monetary and fiscal policy respectively to cushion any blow. We still of course hope for a deal, but if one is not forthcoming, assuming sensible cooperation between the two sides the economic hit should not be too large:

Chart 12: GDP (Q4 2019 = 100)



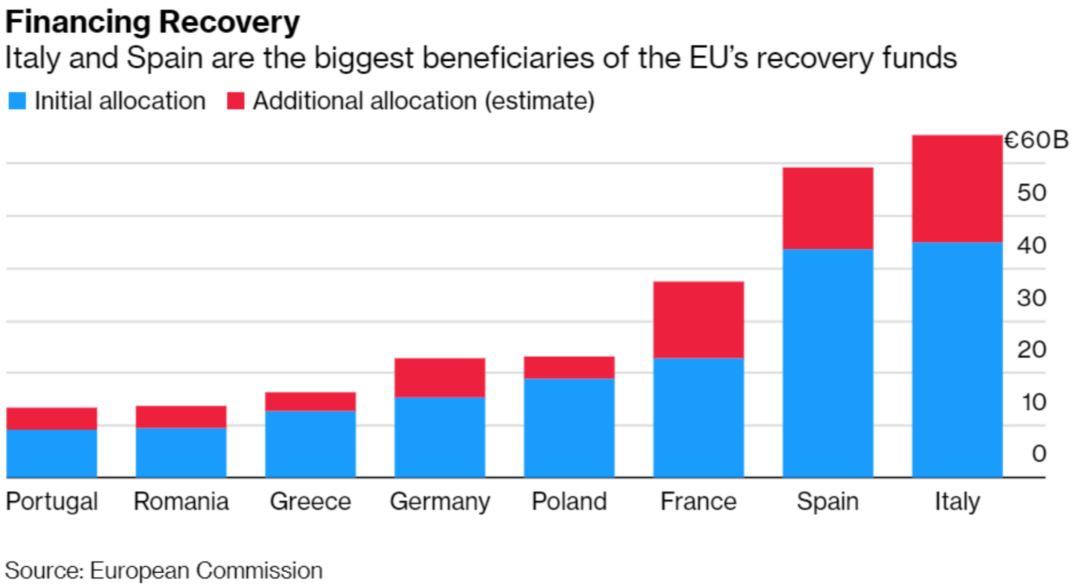
Sources: Refinitiv, Capital Economics

The Pfizer-BioNtech vaccine programme was launched last week to much fanfare, with tens of thousands of vulnerable people and healthcare workers having already received their first doses. On Monday 14th December, GP surgeries in 100 locations will receive doses and begin inoculations, prioritising over 80s and healthcare staff, while care homes around the country will start receiving their doses later in the week.

There is also still hope that the AstraZeneca/Oxford vaccine could be made available in 2020, subject to approval, with 5m doses ready for immediate use. AstraZeneca also announced that it will experiment with combining its vaccine with Russia's Gamaleya Institute's Sputnik V jab in the hope that it would boost overall efficacy. The Sputnik vaccine is 92% effective at protecting people from Covid, according to interim trial results.

Globally, Japan's Prime Minister Yoshihide Suga announced a fresh round of stimulus for the Japanese economy worth £530bn. Japan's GDP fell by 8.2% in Q2 2020 before rebounding by 5.3% in Q3 – this compares to the UK's 19.8% Q2 drop and 15.5% recovery. A large portion of this package will be used to extend subsidy programmes aimed at spurring increased consumer spending and domestic travel, while subsidies for green investment will also be prioritised. This brings the value of Japan's Covid-related stimulus to around £2.25tn – one of the highest in the world.

In Europe, the EU's landmark €1.8tn budget and stimulus package was finally passed after compromises were reached with Hungary and Poland. Conceived months ago, the funds will help Europe's economic recovery as the chart below shows, but more importantly potentially signal the start of much deeper fiscal integration within the bloc – something that is seen as crucial for its ongoing development. As a part of this program, Europe is set to become the world's biggest issuer of green debt, with a third of bonds being issued to come under the environmentally-friendly tag. The bloc will publish an accompanying green taxonomy and green bond standard next year; widely expected to become a blueprint for the rapidly growing market:



In financial markets, we saw the UK equity market underperform all others due to deteriorating sentiment around Brexit. Much of the relative differential was driven by movements in the Pound, which fell markedly against all major currencies, including drops of 1.6%, 1.9% and 2.1% against the Euro, Dollar and Yen, boosting overseas holdings' returns. The FTSE 100 fell by 0.03% and the FTSE 250 by 2.8%, with its smaller, more domestically focused constituents suffering more due to the weaker Pound.

European equities rose by 0.9% in Pound terms to be the next-worst performing region, with Emerging Market and Japanese equity markets each gaining 2.5% to finish the week strongest amongst the regions. Far East equity regions in particular have outperformed Western counterparts when Covid news has worsened due to their generally better handling of the virus; something that was again a factor this week as case numbers increased in the US and parts of Europe.

Government bonds rose sharply, particularly in the UK, in a reversal of recent weeks' price movements. Gilts gained 2.8% and inflation-linked Gilts 3.6% as investors sought safer havens. In this vein, precious metal performed well in Pound terms, with silver rising by 1.3% and gold by 2.2%, providing protection against negative UK equity market returns.

We are faced with another week in which headlines will cause volatility amongst asset prices, even if they do not contain much substance. It is through such periods that a focus on the longer-term is vitally important to avoid knee-jerk reactions to shorter-term events; something that is essential to generating consistent, positive returns over time.

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