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Light at the end of the tunnel

by Christopher Butcher

News last week of a potentially highly effective vaccine against Covid-19 has raised hopes that there is an end in sight to what has been an extremely challenging time for countries around the world. The virus has claimed the lives of 1.25 million people and paralysed the world economy. The Pfizer and BioNTech finding was the result of the first independent analysis of any Covid-19 vaccine in phase 3 trials – the final stage before commercial licensing – and it was found to be 90% effective, a level well above expectations. To put this into context, the widely-used measles vaccine is 97% effective and the season flu vaccination is between 40% and 60% effective. This is an important milestone on our path towards potentially ending this pandemic and the developers of the vaccine described it is a "great day for science and humanity"[1].

Just as impressive as the vaccine announcement, was the instantaneous response from global stock markets. US equities were up nearly 4% in early hours of trading on Monday, hitting a record high, before pulling back later in the day. Cyclical stocks, which are likely to be greater beneficiaries of a faster reopening of economies than was previously thought possible, experienced even stronger rallies; the UK and European large-cap equity benchmarks ended the day up 4.7% and 6.4%, respectively. This sharp reaction to the vaccine news was seen across multiple asset classes: oil prices surged, gold fell, and bond yields pressed higher, with the 10-year Treasury yield rising to 0.95%, its highest level since March.

The news catalysed a wave of optimism across risk-assets, with investors rotating away from secular growth and towards cyclical value, with the MSCI Value index outperforming the MSCI Growth index by around 6% last week. Investor appetite was revived for some of the most challenged sectors including energy and financials, and these sectors performed better than the primary stay-at-home beneficiaries. To highlight this divergence over the course of the week, Rolls-Royce, which makes and services jet engines, rose +35% while Zoom, a beneficiary of the growth in remote working, fell -19%.

So, is this the point at which we see a sustained rotation from growth into value?

The preference for high growth/momentum stocks over highly unfashionable value stocks has been a dominant trend that has played out in markets for much of the past decade and has widened even further as global markets have reacted to the impact of Covid-19. In fact, the relative valuation between value and growth is currently at its widest dispersion in history.

The response to the positive vaccine news seems rational: it helps alleviate a major source of uncertainty that has plagued investors through most of 2020 and improves the outlook for cyclical stocks and sectors. However, it is very early days to say whether this rotation will be sustained. We have made the point repeatedly that in the long run we will cast this virus off, and the recent news flow supports this view, but downside risks do remain. The economy today is still in a precarious position, with much of the world now seeing high and rising numbers of Covid-19 cases. In the US, there has been a resurgence in cases with the number of hospitalisations reaching a new high, while in Europe, many countries have moved back into some form of national lockdown. It is no time for complacency, particularly for policymakers as the recovery will require ongoing support and resistance to the urge to tighten prematurely. In addition, questions remain on the safety and longevity of the vaccine as well as constraints on production. The logistics behind mass vaccination are not to be under-estimated; the UK manages to vaccinate around 15 million people for the flu each year and this takes around four months. To vaccinate around the 50 million people aged over 18 will be a huge logistical challenge. Nonetheless, the recent vaccine news provides some light at the end of what has been an unexpectedly long and dark tunnel.

Further progress made by other vaccine front-runners including Moderna and AstraZeneca would continue to fuel confidence about a broader economic recovery in 2021 and improve investor sentiment towards value and cyclical sectors. However, we do not recommend building portfolios that are beholden to a single macroeconomic outcome, but instead acknowledge the uncertainty inherent in all forecasts. Therefore, we maintain our philosophy of building diversified portfolios, with a balanced factor exposure, as we believe this is the most effective way to achieve our client's long-term investment outcomes.

1 https://www.pfizer.com/news/press-release/press-release-detail/pfizer-and-biontech-announce-vaccine-candidate-against

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For more information, please contact your adviser or alternatively contact:

Belvest Investment Services Limited
研富投資服務有限公司
9th Floor, Centre Mark II
305-313 Queen's Road Central
Sheung Wan, Hong Kong

Tel +852 2827 1199
Fax +852 2827 0270
belvest@bis.hk
www.bis.hk

Important notes