

AA View

2020 look back

The record breaking year that was

Summary

- **This was the year of Covid-19.** Amidst high drama, the pandemic year saw several market and economic records break and new precedents set in the global policymaking environment that would have been deemed unthinkable in any earlier time.
- **2020 saw the swiftest bear market in all time**, markets falling by 30-40% in a matter of days as economies locked down around the world from late February on. GDP fell in a way never seen before - in the first half of the year by over a fifth in the UK, a tenth in the US.
- Early in the pandemic onset, **the swiftest and biggest policy intervention ever seen was launched by governments and central banks to fight the pandemic.** This combined fiscal-monetary and direct market intervention lifeboat was unprecedented in its scale and matched the scale of the economic challenges posed.
- **Fiscal and monetary expansion during the year was gigantic.** 2020 has very likely seen fiscal deficits reach about a fifth of GDP in both the US and UK (unmatched in peacetime) and about 13% of GDP globally; US money supply (M1) grew by over 50% between March and November and global money supply expanded over 20%. The combined fiscal and monetary firepower, termed 'Fiscal Q-E' was instrumental to market recovery as central banks directly financed government spending expansion in a way never seen, even after the global financial crisis in 2008.
- **This lifeboat had differential success in its effects on economies and markets.** On economic activity, the fiscal lifeboat undoubtedly achieved some cushioning success in limiting job and income losses. A mild recovery in H2 2020 followed the earlier collapse in activity, but this showed signs of petering out in the closing months of the year as the pandemic's second wave gathered pace.
- **The lifeboat's biggest success was in lifting risk asset markets, led by the US.** Of course, not all boats were lifted, the UK failed to lift for instance, but most assets benefited. While economies at best stabilised, the unprecedented policy intervention led to the fastest and strongest ever rebound from a bear equity market from late March. So successful was this that risk premiums in



asset markets all but collapsed. By year end, US equities were about level pegging with the most expensive valuation levels ever been, with credit spreads reaching levels in similar outlier territory seen against default and downgrade losses. Zero interest rates being promised for a long period, ongoing fiscal Q-E and unprecedented central bank backstopping and the promise of a rapid Covid-19 vaccine rollout, made all this appear, somehow, sustainable.

- **Bond risk premiums were no different, and disappeared too**, notwithstanding dramatic monetary expansion and startling levels of public debt issuance. At the height of the pandemic panic in early March, the entire US yield curve had moved below 1%. Yields then stabilised at very low levels. The closing weeks of the year saw yields rebound somewhat on vaccine optimism and expectations of more fiscal stimulus but remained well below start of the year levels.
- **2020 resembled 2019 in markets, which was odd, given the pandemic in play last year.** Not only was it the second year of strong performance in stocks, bonds did well in both years too. 2020 once again showed conventional wisdom on bond-equity relationships as hopelessly wrong, highlighting the magic of lower interest rates and abundant liquidity in goosing all asset prices. By the end of last year, the S&P 500 index showed a cumulative gain of nearly 50% for 2019-20. Bonds could not match the S&P in absolute terms of course, but in their own risk-adjusted terms did just as well if not better. Ironical too, that the S&P's stellar gains over 2019-20 were almost matched by that arch-defensive asset, gold.
- **It was undoubtedly a banner year for US stocks, and particularly for US tech stocks.** That is, for most of the year. By September, the runaway outperformance of US stocks over other markets and tech over other sectors had reached awesome proportions. Q4 saw other markets like the UK and other sectors close some of the gaps as the sheer size of valuation disparities and a pick-up in bond yields set some counter trends in motion. By year end, emerging markets had even crawled ahead of the US. US dollar weakness also helped close some of the regional gaps. But the sector gap had become so large already that much of it remained even by year end. US tech's full year 44% return compared with financials at -1.7% and energy at -33.7% hinted at the sort of year it had been. Another divergence mirror was the astonishing gap between value and growth stocks, the Russell 1000 value and growth indices delivering 2.8% and 38.5%, respectively, for calendar 2020. Of course, notwithstanding so much regional and sector divergence last year, neither the US's outperformance or the sector patterns seen in 2020 were new as such. They were like a bit of rocket fuel attached to a trend already in motion for a decade.
- **The most remarkable feature of 2020? The way the promise of prolonged easy money and ultra-low discount rates swept aside the pandemic's far-reaching economic and business effects.** This was a 'Wall Street vs Main Street' divide on a very large scale. The bet was, and still is, that that the power of easy money will outlive the pandemic's temporarily negative cash flow effects.

Let us see if 2021 bears this out.

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Aon's Global Asset Allocation Team

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How are technical factors, such as regulation, impacting prices?**

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