INVESTMENT UPDATE: AN EXTRAORDINARY YEAR
4th September 2020

2020 has been an extraordinary year with economic and social activity restricted to a previously unthinkable extent all across the globe as policymakers have struggled to limit the threat of the Covid-19 virus. In just a few short months, lives have been badly lost and many more have been altered beyond recognition. Meanwhile, central banks and governments have unleashed experimental policies on an unprecedented scale to try to limit the economic fall-out of the pandemic. Against this backdrop, it is perhaps no surprise that developments in financial markets have also been extraordinary.

Equity investors often define markets which fall from their peak by 20% or more as “bear markets”. By this measure, the descent into bear market territory in February and March was among the fastest on record. US stockmarket indices took just 21 days to fall 20% from their mid-February peaks – only the stock market collapse at the start of the Great Depression in 1929 comes close, but even that took 42 days. By way of contrast, it took US stocks 274 days to fall 20% in the Financial Crisis of 2007-2008. However, the recovery since has been almost as remarkable. Staying in the US, equity indices reached new highs just 148 days after their late March lows. This recovery has been ten times faster than the recovery from the Financial Crisis mentioned previously. Placed in this historical context, it becomes clear quite how extraordinary 2020 has been.

The recovery, however, has been far from equal. US technology stocks have risen sharply – in particular five companies that may be very familiar to you: Facebook, Apple, Amazon, Microsoft and Google’s parent company Alphabet. These five companies account for nearly 85% of the gains made by the US stock market this year - and if you add Tesla and Nvidia, then up to 98% of the US stockmarket’s 12% gain in the year-to-date is due to the performance of just seven companies!

Their impact, however, has extended beyond US stockmarket returns to the global market. To understand the impact on the global stockmarket we use the MSCI All Countries World Index – a truly global index which brings into play 26 emerging markets countries as well as the 23 existing developed markets – which shows an increase of 4% year-to-date, having fully recovered from the falls earlier in the year. However, if we exclude US stocks, the Index is still down 4%. In other words, just seven companies have made the difference between gains and losses for the global stock market as a whole.

We must remain mindful of the ongoing issues and future potential developments as we navigate through the remainder of this year and into next; the risk of a second wave of infections, the extent of ongoing monetary support for local economies, the US presidential elections and the stalling of Brexit negotiations – to name but a few. These factors present a challenge when formulating a market outlook.

However, the extent to which US technology stocks have risen so far this year has left them looking extremely expensive by any number of measures. While many of these companies are global market leaders that are benefiting from structural social and economic change, even the best companies can be poor investments if the price is too high. So while stock prices in the US technology sector may now be too high, valuations within other sectors remain reasonable and we believe offer greater investment opportunity against an improving economic backdrop, supported by central government stimulus.

We recognise the importance that a small number of stocks have had to the extraordinary story that has unfolded so far in 2020. We further recognise that, should others come to share our scepticism over the valuations at which these stocks are now trading, global equity markets could face a significant challenge if recent gains for these stocks retract. We are therefore underweight equities across the OMPS portfolios. However, we believe that value is the key to successful investment and that, by ensuring portfolios contain exposure to other, more reasonably valued parts of the global equity market, investors will be well-placed to benefit from the global economy’s ongoing recuperation from a truly extraordinary year. For this reason, we are underweight in the US. We remain overweight UK and emerging market equities – two markets where we believe valuations are most attractive, and where consequently we believe the prospects for longer-term investors are strongest.

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