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Santander Asset Management

State of Play

19 November 2020

Our Investment Specialist, Simon Durling, shares his thoughts in our latest update.

As negotiations on a final Brexit deal stall, and with the end of year transition period looming, both sides start to plan for what could be a last minute rush to ratify any deal before it is too late.

Brexit countdown

Over four years have passed since UK citizens narrowly voted to leave the European Union (EU) . After many twists and turns, including two general elections, two Prime Minster resignations and a whole host of bitter political division, we are fast approaching the end of the transition period when the UK is due to cut ties with their European neighbours.

With less than seven weeks to go before the UK leaves the single market and customs union, negotiations remain stuck with the discussions on fishing rights in UK waters not having progressed significantly since the summer. It is ironic that so much energy is being spent on thrashing out a post-Brexit arrangement on UK fishing waters, as the economic contribution to the UK economy is less than 1%, but it has enormous historical and symbolic baggage that seems to stir up emotions more than any other topic within the negotiations. Tracing back our history within the EU, it was fishing rights that almost prevented the UK from entering the Common Market back in the 1970s and it could be this again which has the potential to derail any final deal.

Other outstanding issues include fair competition rules for business, including rules on domestic subsidies and defining the process for future disputes within the final treaty. It is understood that common ground is being found on how both sides will regulate future domestic subsidies but there is no agreement on a mechanism for maintaining similar frameworks on labour, environmental and social standards in the years to come with the UK insisting it will not tie itself to the EU rulebook. According to The Guardian newspaper, under an emergency EU plan ,a European parliament vote to seal a Brexit trade deal could be delayed until 28 December, three days before the end of the transition period, in case it takes longer to agree a final deal. It seems likely that the negotiations will miss the current deadlines for passing the legislation on both sides of the channel, forcing a last minute rush to ratify the final deal before 31 December 2020.

Second successful COVID-19 vaccine trial findings announced

In last week's update I explained about the successful third stage trial results on a vaccine developed by Pfizer and BioNTech which provided an immediate boost to markets as the prospect of an end to the current pandemic looks possible. A bit like buses, nothing happens for what seems like ages and then two come along in quick succession. Moderna, an American biotechnology company based in Massachusetts, has been working on a similar type of vaccine to Pfizer and BioNTech, but has produced better trial results with nearly 95% success in protecting people from contracting the virus. Both vaccines use the same approach of injecting part of the virus's genetic code in order to provoke an immune response.

When you compare the trial results from previous vaccine developments in the past, the effectiveness of these two experimental vaccines has taken medical and science experts by surprise. In addition, the conditions for distribution seem less problematic than Pfizer and BioNTech's, with Moderna's vaccine easier to store as it remains stable at -20 degrees Celsius for up to six months and can be kept in a standard fridge for up to a month (when compared to -75 degrees Celsius and only lasting five days in a fridge for Pfizer and BioNTech vaccine). Other vaccine trials around the world are at different stages depending on the type of vaccine but there are others nearing the end of their stage three trials and the market is sure to continue to monitor their progress closely over the coming weeks.

The trial results have totally transformed the prospect of ending this pandemic, especially given the efficacy of any vaccine would normally be celebrated in the event it offered at least 50% chance of protecting people. Given the potency of both vaccines the outlook does appear to be much more promising. The data so far also raise hopes that the other vaccines in development will be successful too, but returning life to normal will not be as easy to bring about. The logistical task of vaccinating potentially billions of people is enormous, assuming the vaccines pass through the authorisation process to be used in the first place – a task that usually takes many months or even years to complete.

If, as expected, these vaccine approvals are 'fast-tracked', the next steps for those in power will be prioritising those most in need and the most vulnerable who will likely receive their inoculations before the general population. Realistically this approach will not be completed until the back end of 2021 at the earliest. The other risk for vaccine development longer-term is twofold. Firstly, it is too early to assess how long immunity will last for after being inoculated and little is yet know about whether, like Influenza (commonly known as 'the flu'), COVID-19 may mutate over time requiring further vaccines to be developed periodically. Despite these obvious risks, at last governments have something to be optimistic about whilst surrounded by the ever increasing data demonstrating the huge impact this pandemic has had on society.

One of the potential impacts of the vaccine announcements is that they may influence the approach of governments around the world to the lockdowns currently in place. Given that vaccine deployment may only be a month or two from potentially starting this may provide an incentive to stay in lockdown for longer, especially during the more challenging winter flu season, to stem the tide of infections long enough to commence inoculations of the elderly and vulnerable early in the new year. The festive period may receive an exemption given the impact on lockdowns on individual mental wellbeing. Comments from Prime Minister Boris Johnson and other leaders of the devolved nations within the UK are hinting that they are working closely together to discuss a special plan to allow people to see their loved ones over the Christmas period, even if only for a few days.

US Election update

Following several legal challenges that have either been dropped or overturned in the courts, President Trump came close at a press conference to admitting Joe Biden had won. The media has now finally called the remaining two states, leaving President-Elect Joe Biden with the same number of electoral votes as President Trump won with in 2016, which he described at the time as a 'landslide'. Despite this, President Trump refuses to concede or co-operate with a smooth transition of power and has blocked the release of resources that would normally be used to fund this process between now and Joe Biden's inauguration speech on 20 January. He continues to post numerous accusations on Twitter about voter fraud and challenging the recount in Georgia on the grounds that signatures have not been verified properly. His own Republican Party was in charge of the count in Georgia and they disputed the President's claims saying that signatures have been double checked twice.

The state of Georgia is playing an unusual power-broker role in defining the balance of power in the US Senate. Georgia's two Senate seats, unusually, were both up for election this year, and both races are headed for run-off elections on 5 January after no candidate in either race managed to win a majority of the votes. As election results stand as of Friday 13 November, the Democrats and the Republicans will each hold 48 seats in the 100-member Senate. Two other races, in addition to Georgia, are still outstanding, but both are widely expected to be won by Republicans. With the Georgia runoff on 5 January, that will leave the question of which party will control the Senate unanswered until after the rest of the new Congress is sworn in on 3 January.

Market sector rotation prompted by vaccine

As I explained in last week's update markets have reacted positively to the recent vaccine announcements. One of the consequences of being able to see an end to the crisis where we may return to somewhere near normal in the next 12 months, is that markets focus their attention on the winners and losers. The last two weeks have seen what is described as a rotation in markets, where shares in companies that have benefited most from lockdowns and home working have been sold causing their shares price to plummet and the profits from these trades have been shifted into buying companies that have been hurt most by this global pandemic. Some of the biggest winners like Zoom and Peleton have seen sharp falls, whilst travel, tourism and energy companies have seen big rises, with IAG (British Airways parent company) and BP having risen significantly. Markets remain fickle though and we may see further reversals of this rotation if any poor news about the spread of the virus grows, or if the existing lockdowns are extended beyond the current deadlines. Any hiccups in the approval, manufacture or distribution of the vaccines will also prompt market reaction keeping the environment volatile for the foreseeable future.

Tesla to join the S&P 500

S&P Dow Jones Indices announced after closing on Monday 16 November that Tesla, the electric car maker, will be admitted to the S&P 500 on 21 December. It had previously not been admitted, despite being one of the biggest quoted US companies, because in order to qualify a business needs to have reported net profits for four consecutive quarters. Tesla has just notched up its fifth. The move however is going to create a headache for many tracker funds. Tesla shares surged by more than 12% on the news and is now one of the biggest companies ever to be admitted to the S&P 500. Its stock market valuation (as 17 November) is $387bn meaning that if it was admitted at that valuation on 17 November, it would immediately be the tenth largest company in the index. Many passive funds that track the index will have to put a strategy in place about what other companies are sold in order to replicate Tesla's inclusion.

One possible victim of the admission of Tesla is Amazon because the S&P 500 itself is divided into 11 sectors which are also tracked by passive investors. Tesla will be admitted to the 'consumer discretionary' sector of which, at present, Amazon accounts for nearly 40%. That will fall to approximately 35% after Tesla joins the index. So it is possible some passive investors will sell Amazon shares in order to build up their weighting in Tesla. Because of the sheer size of this new entry into the S&P 500, it has not yet said which existing S&P 500 member will make way for Tesla and has reached out to market participants for feedback on how they think the company should enter the index, in particular whether they would like to see Tesla admitted in stages. Whatever the outcome this is going to be a big event in the index history and has wider knock on consequences for investors to navigate.

Find out more

Listen here to our latest **Market Views** from our Portfolio Manager, John Mullins, as he shares his thoughts on the main themes dominating markets.

Note: Data as at 17 November 2020.

Important Information