State of Play

11 March 2021

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

US Senate approves 'American Rescue Plan'

President Joe Biden gains Senate approval on a much anticipated financial stimulus package, albeit with uncomfortable compromises for some in the Democratic Party. Will this package be enough to restart the engine of the largest economy in the world?

The first four year term of a new US President tends to follow a well-trodden path. The moment a President takes office, much of the programme is normally built on two key objectives: their legislative priorities and getting re-elected. The first 100 days has long been a measure of how effective a new President is perceived to be by voters and often sets the tone and political momentum that can have profound implications for the remainder of their term in office. When President Joe Biden was sworn in his declared policy aims were, unsurprisingly, primarily focused on getting to grips with the pandemic - in particular speeding up the vaccination programme and agreeing further financial support for individuals, companies and the wider economy.

At the time of writing (11 March) the package had been voted into law as the House of Representatives voted by 220 to 211 to pass the 'American Rescue Plan', although not a single Republican voted for it, showing the challenge facing President Biden and how divided US politics remains. When President Trump brought in the first financial rescue package last year 96 Senators voted for the stimulus and none voted against. This time the Senate forced compromises and yet, despite these, 50 voted in favour and 49 against. There have been some negative voices from the left wing of the Democratic Party disappointed that elements of the original plan have been watered down in order for the bill to pass the legislative process. The package was designed to introduce a \$15 minimum wage, \$400 per week benefits for the jobless and individual cheques for \$1400 for much of the population. Now after strained debate the President's team have had to bow to pressure across the political divide by scrapping the minimum wage increase, reducing the benefits proposed to $300 per week and excluding approximately eight million Americans from receiving the $1400.

Origins of the 'first 100 days'

Ever since Franklin D Roosevelt coined the term in 1933, 'the first 100 days' have been seen as a vital benchmark in measuring the effectiveness of a president. A few examples are:

- President Roosevelt was able to pass 13 major laws in his first 100 days including cornerstones of his long-term recovery plan from economic depression (better known as the 'New Deal').
- Although President Barack Obama played down the significance of the first 100 days, he did start the long process towards agreeing the Affordable Care Act ('Obamacare') during that initial period.

Market update and reaction to US stimulus

Market attention will now turn to the re-opening phase of the pandemic as vaccinations in the US start to accelerate – allowing the economy to emerge from the shackles of social and economic restrictions. The implications for investment markets are profound as the leading world economy has such a huge impact on investor sentiment regardless of geography and asset class. The prospect of the US stimulus bill finally being signed into law provided a much needed boost for the NASDAQ 100 as it rose 3.7% on 9 March following a five day losing streak that has compounded the falls that began in early February.

The rise in Bond yields over the last few weeks, and recent sell-off in technology Shares, has been triggered by fears that additional financial stimulus being pumped into the US economy at the same time as the economy re-opens will increase inflation. This will potentially force central banks to reverse the current loose monetary policy, eventually increasing interest rates, which reduces the value of how the market measures growth companies' future earnings. At the same time, the prospect of lockdown measures easing as the vaccine rollout reaches a wider demographic have led to a market rotation into more cyclical, value parts of the market that should benefit, such as entertainment, leisure, energy and financial sectors.

These inflation concerns will no doubt drive market sentiment for the foreseeable future until clear evidence emerges of how effective the financial stimulus has been and what impact this has had on demand and consumption. Ironically the strength of that recovery in some ways has the potential to be harmful to certain sectors of the market. The bounce back, when it happens, could push up prices forcing investors to re-evaluate Share prices and push up Bond yields as the market prices in future tighter monetary policy.

Income investor update

As many income investors will be aware, since the pandemic began investing for income has become an increasingly difficult challenge. Central banks cut interest rates to near zero forcing Bond yields to their lowest in history regardless of whether these were sovereign or corporate borrowers. Simultaneously, many companies listed on stock markets around the world either reduced or cancelled their dividend payments to prepare for the economic lockdowns and massive drop in demand that followed.

The UK stock market was arguably the hardest hit. Despite a better than expected last quarter of 2020 (according to 'The Link Quarter 4, 2020 Dividend Monitor Report'), the FTSE 100 UK dividend pay-outs dropped by 44% or nearly £40bn last year which is their lowest levels since 2011. Just 18 members of the FTSE 100 have restarted their dividends or indicated they plan to restart which so far totals an increase of £2.8bn on last year - providing income investors a glimmer of hope that the backdrop may improve. It is however, still below the levels seen pre-pandemic with remaining uncertainty on the path of an economic recovery once the restrictions are gradually eased. The Link has forecast that the 'best' case scenario for 2021 is that UK dividends will increase by 8.1% based on 2020 levels.

Due to the inflation concerns mentioned earlier Bond yields have started to rise, albeit from record low levels. This in some ways is problematic for income funds as new Bond investments they buy may offer a better income but their current holdings may fall in value which could put pressure on an investor's capital. Central banks have commented in the last couple of weeks that regardless of the potential short-term spike in inflation they intend to hold firm on interest rates until they observe both capacity and demand recover in the economy. Andrew Bailey, Governor of the Bank of England, said earlier this week: 'The Bank of England does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably'.

So where does this leave income investors? Firstly, the vaccination programme should provide light at the end of the tunnel. The prospect of life eventually returning to somewhere near normal gives hope that when companies bounce back they should resume paying dividends, although how much they start to pay is uncertain. The story for each company will be very different depending on the sector in which they operate, the damage to their balance sheet and the changes to their long-term prospects brought about by changes to consumer behaviour following the various lockdowns. Many individuals will no doubt return to their life as it was before the pandemic struck, but others may change the way they live and work, and what goods or services they buy because of their individual experiences over the last 12 months.

Find out more

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Note: Data as at 11 March 2021.

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