

By the start of Q3 we began to see most of the major economies begin to open up after being in lockdown since mid-March. As expected however, the number of coronavirus cases increased, as regions began to ease lockdown restrictions. By quarter end, the number of cases of Covid-19 had grown to over 33m with over 1 million Covid-19 related deaths. Despite this, the majority of indices saw positive returns throughout the summer months with the NASDAQ and S&P500 hitting all-time highs and erasing their year to date losses by August. Markets were helped by a number of factors including stronger global economic data, better than expected corporate earnings and extensive fiscal stimulus packages, with the promise of further support from Central Banks and Governments.

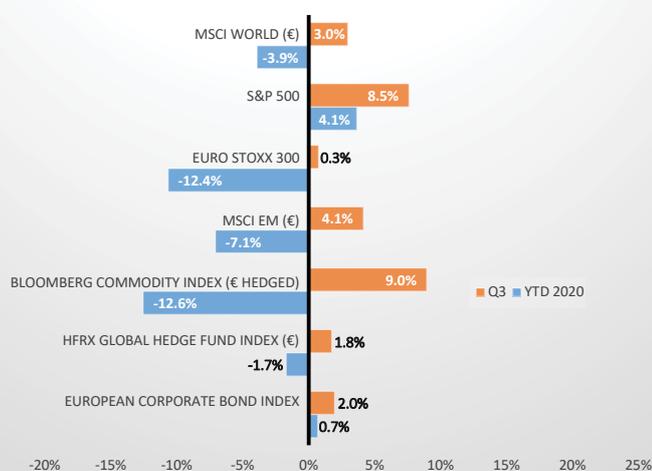
European market returns lagged those of other global indices with the Eurostoxx index up 0.3% in Q3. Markets were impacted by concerns that countries such as Spain and France were experiencing a significant resurgence in COVID-19 cases. Markets did gain some support by the announcement from the EU of additional stimulus measures which will be used to aid the bloc's recovery from the worst recession since its creation. The region was in addition negatively impacted by uncertainty over Brexit negotiations with in August an announcement by the UK prime minister that they would violate parts of the recent withdrawal agreement reached with the EU.

Commodities had a positive quarter growing 9% (on a euro hedged basis). In August we saw the gold price reaching historic highs of over \$2,000 per oz. This sharp increase in gold was primarily linked to investors seeking a safe haven asset given continuing market uncertainty and coronavirus concerns. In relation to oil prices we have seen the price recover strongly following its fall to a negative value in April. The weaker US\$ and higher demand from China helped to lift prices over Q3.

Over Q3 the euro appreciated against the dollar finishing out the quarter at \$1.17 per euro, from €1.12 at the beginning of July. Euro/Sterling was broadly unchanged finishing out the quarter at £0.91 per euro.

Eurozone sovereign bond markets also experienced a positive quarter helped by continued Central Bank support packages and the promise to keep rates lower for longer. German 10 yr. bund yields fell in the period to -0.52% and Irish bonds yields declined from -0.02% to -0.14%. On the other hand US 10 yr. yields marginally rose to c. 0.7% at the end of the quarter. The Eurozone short dated bond index rose 0.1% in the quarter and is broadly flat on a year to date basis. European corporate bonds experienced a positive quarter as the combination of lower sovereign yields, improved stock market sentiment and increased QE helped the index deliver a return of c.2%. Hedge funds continued to benefit from the favourable conditions for most asset classes with the broad index returning 1.8% in the quarter.

## Asset Class Performance - Q3 2020 and YTD



Morgan Stanley Capital Index (MSCI); Hedge Fund Research (HFRX)  
Source: Refinitiv Datastream.

Over Q3, equities delivered satisfactory returns with global indices returning 3% in euro terms, although returns varied widely on a geographical and sectoral basis. In the period to end August, the NASDAQ continued to beat its previous recording breaking highs, with the FAANG's + Microsoft leading the pack. Apple reached a market cap of US\$2tr during the quarter, making it the first US company to do so. The best performing stocks remained those that were complimentary to the working from home environment, with the broad market returns being dwarfed by that of the technology sector.

By September however, following their strong run and with renewed concerns surrounding US-China trade tensions and increasing coronavirus cases, we began to see a move from technology stocks to more cyclical/value stocks. In September the NASDAQ declined 5.2% although it still delivered a very strong return of 11% for the quarter. The broad S&P 500 index also delivered a satisfactory return of 8.5% in the quarter.

Emerging Markets (EM) also performed well in the quarter, up 4.1% in euro terms. Indices were helped by the regions success, in particular with China, in keeping new coronavirus cases at bay. In addition key indicators coming out of China were positive and signalled a continued recovery in economic growth. GDP for Q2 was 11.5% beating the 10% expected. During the quarter however, US/China tensions worsened following an executive order issued by Trump restricting the US activities of TikTok and WeChat, amid national security concerns. The order essentially set a 45 day deadline for the sale of TikTok's US operations and in September Oracle entered into talks with TikTok to purchase its US assets.

## Investment Market Outlook

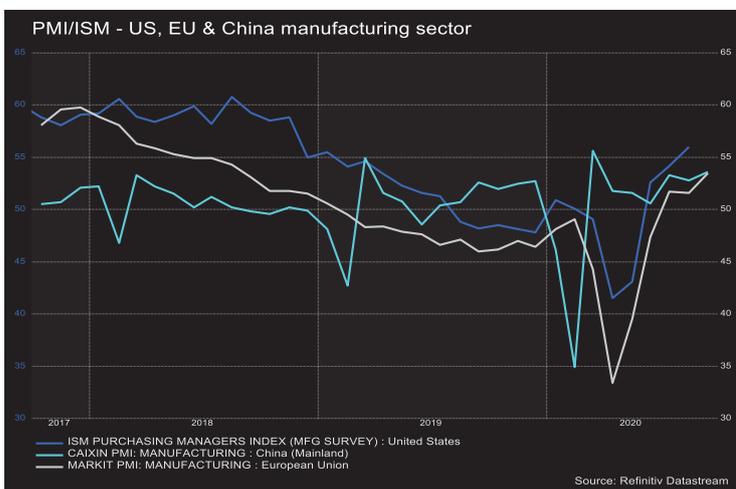
In our Quarter 2 Outlook we outlined that over the short to medium term, equity markets should be supported by favourable Central Bank and Government policy actions as well as improving macroeconomic data. This indeed proved to be the case over Q3 as most markets delivered positive returns in the period and indeed some markets, such as the US, hit all-time highs during the quarter. As we enter the final 3 months of the year, there has been some nervousness among investors that markets may have gotten ahead of themselves and we saw some evidence of this during September as volatility rose (see Graph 1 overleaf) and most equity indices declined. Looking out over the remainder of 2020 however, while there is likely to be bouts of volatility with upcoming US elections, Brexit and ongoing high new coronavirus cases, markets still have scope to benefit as a result of expected additional government stimulus measures, better economic data and continued positive developments in relation to a coronavirus vaccine.

Graph 1

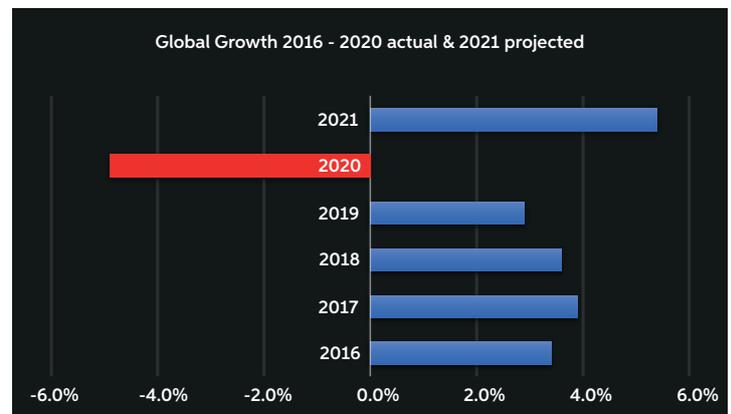


Having experienced the sharpest economic contraction in 90 years, thankfully it now appears that the global economic recovery is gaining pace. Business and consumer confidence levels, along with broad macro-economic data, are continuing to improve (see Graph 2 below). In addition we are seeing ongoing unprecedented levels of monetary and fiscal stimulus measures which should continue to sustain a solid pick-up in growth and help lead to a projected robust global expansion in 2021 (see Graph 3). While there has been some nervousness around the sustainability of the recovery given the rising coronavirus case numbers, particularly in Europe and the US, this has been offset by a reluctance from European and US authorities to return to full lockdown measures. For now the prevailing approach has been to restrict mobility on a local scale and this is likely to remain the case as long as hospitalisations remain manageable. Given the economic damage caused early in the pandemic and which is still continuing in a number of sectors (e.g. hospitality, travel, etc.), governments are likely to avoid restricting economic activity more than is absolutely necessary. The current strategy appears to be one of trying to balance between allowing a sizeable portion of the economy to operate (albeit remotely in the case of many industries!) but at the same time trying to limit a significant increase in cases so that a country's health system does not become over-run.

Graph 2



Graph 3



Source: International Monetary Fund (IMF)

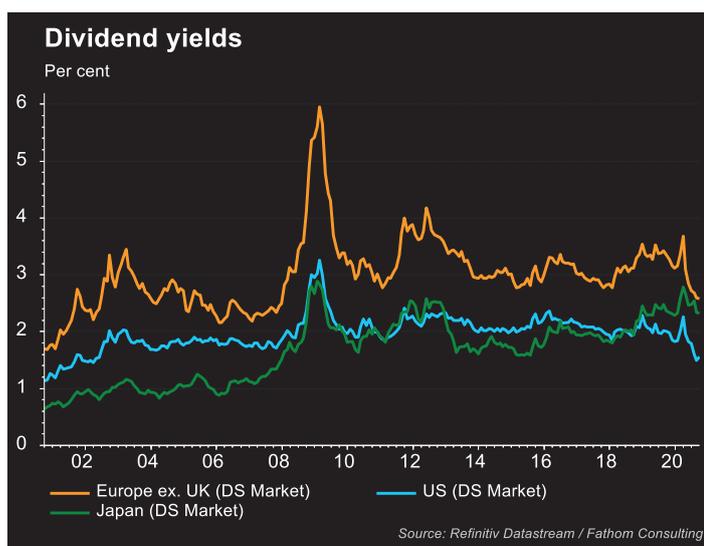
On a positive note, in developed economies the number of deaths remains much lower than during the peak in April/May despite the jump in cases. This has been helped by better treatment strategies, improved hospital capacity and a lower average age of infection. In addition, testing in many economies has ramped up significantly (c.800,000 now being tested daily in the US with over 100 million now tested in total) and the development of a vaccine continues to progress at an aggressive pace. There are currently c.9 vaccines in phase 3 trials with significant funds pledged globally to finalise and roll-out a vaccine by 2021 (including US\$10bn under the US "Operation Warp speed" initiative).

Markets should also continue to gain support from other sources including further stimulus measures, improving global economic data and a recovery in corporate earnings. The combination of a mostly zero interest rate environment and an unprecedented level of fiscal stimulus packages in many major economies (c.13% of GDP committed for 2020 by G20 countries) should be a strong support for equities. The ECB and Fed both remain firmly in dovish mode and could provide further stimulus measures by year end. Both Central Banks have recently indicated that they are likely to keep interest rates at current historically low levels even if inflation (currently -0.3% and 1.4% in the Eurozone and US respectively) overshoots their target rate of 2%. This is likely to prolong the "equity friendly" environment in the US and Eurozone of lower rates for longer. The Fed has indicated that it sees no rate hikes through to the end of 2023 although some forecasters believe that it may be 2025 before we see a rate rise in the US.

At a corporate level, attention will soon turn to US Q3 earnings which will commence in mid-October. Consensus expectations have increased in the run up, led by the IT and Healthcare sectors, although earnings are still expected to fall c.22% compared to the previous year. However given the low expectations, there is room for positive surprises as we saw for Q2 where a record c.85% of companies reported earnings that were in aggregate 23% over expectations. In addition, earnings are expected to show a considerable relative improvement compared to Q2 where earnings declined 37% compared to 2019. Markets will also closely watch commentary around the outlook and in particular if recent higher new coronavirus cases are having an impact on revenues and profitability. Overall the current consensus is that earnings in the US and Europe will decline in 2020 by c. 20% and 30% respectively but experience a sharp rebound of c.30% in both developed and emerging markets in 2021.

Regarding other factors that may influence markets, support should continue to come from the relative attractiveness of equities compared to sovereign bonds and cash rates, with dividend yields still attractive despite recent declines (see Graph 4 below). Institutional positioning is also cautious with high weightings in cash that are available for investment and other indicators (e.g. bull bear ratio, put call ratio) not at extended levels. Valuations (Price to Earnings, etc.) while high by historic levels, need to be viewed in the context of historically low interest rates and inflation as well as high liquidity.

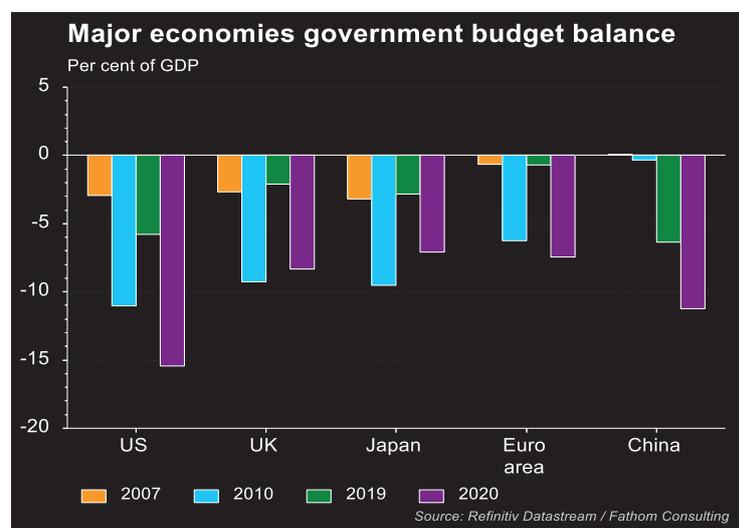
Graph 4



There are however reasons to be cautious in the near term as a number of factors could unsettle markets and lead to volatility into year end. Political events are to the fore at the moment with the upcoming US presidential election on 3rd November as well as ongoing negotiations taking place between the EU and UK that are seeking to avoid a hard Brexit. In addition a jump in new coronavirus cases is unsettling markets and we also have the current impasse between Democrats and Republicans over the level of a new fiscal stimulus package which is much needed for the US economy. This is expected to be resolved with talks ongoing although it may be after the election when it is finalised. The US election has the potential to cause market volatility particularly if either party contests the final result. While a Biden victory would likely see higher corporate and personal taxes as well as greater regulation, these changes would possibly be phased in so as not to damage the economic recovery. While Biden has indicated that he will increase the corporate tax rate to c.28% (currently 21%) this would still be less than the 35% rate prior to 2018 and would be in line with the average for most developed economies. Other potential tax changes include increasing the minimum wage and, for higher earners, equalising capital gains and income taxes.

While corporate tax changes would be a downside risk to earnings, it is likely that they would be phased in over several years and could be offset by increased infrastructure spending. It may however be the case that whoever wins the White House may have to increase taxes given the scale of budget deficit that is projected for 2020 (see Graph 5). This could also be replicated around the world as the fiscal stimulus packages are required to be paid for. On a positive note a Biden victory could see a less confrontational approach towards trade relations which might allow for more comprehensive agreements in Sino/US and EU/US trade talks. While there are some concerns from investors about a Democrat election victory, research has shown that annualised stock market gains have been lower under a Republican president at 3.5% versus 5.2% when there has been a Democrat president.

Graph 5



In relation to the outlook for other asset classes, Eurozone sovereign bonds remain at expensive levels although they will continue to receive support from ongoing and potentially increased ECB monetary easing. Investor nervousness over the increase in coronavirus cases and its effect on European economies may also help yields. Uncertainty regarding a US election result would also benefit the asset class. Corporate bond markets should also benefit from ongoing quantitative easing (QE), lower issuance and investor demand although the outlook for corporate earnings and default expectations will also be important. With this positive backdrop the general consensus outlook is that corporate spreads could narrow over Q4.

In relation to commodities, oil prices, following a volatile but positive Q3, could still push higher as OPEC supply cuts, a limited return in US shale gas production and normalising global demand helps prices. Price rises however may be capped by concerns over future demand following the recent spike in coronavirus cases. Market direction is also likely to be influenced depending on the timing of further stimulus measures and positive developments in relation to a vaccine. Gold, despite experiencing some recent weakness, has scope to appreciate as its safe haven qualities may be in demand as lingering concerns remain over the economic recovery. In addition, as the Fed has indicated that it will tolerate an inflation rate of greater than 2% before it increases interest rates, this should lead to "lower for longer" real bond yields which is traditionally positive for gold. Some industrial metals (e.g. copper, aluminium) and agri commodities (e.g. corn, wheat) have a positive outlook helped by stronger demand from China as its economy continues to recover post coronavirus and an expected weakening in the US\$.

Overall looking out to year end, we may well see increased volatility as events such as the US election and Brexit unfold, with outcomes that are still finely balanced and therefore difficult to confidently predict. However markets should continue to get support from favourable monetary conditions, positive economic growth, a strong earnings outlook for 2021 and expected positive progress on coronavirus vaccines and treatments. Further Government stimulus programmes are also expected and should be a positive for markets.

As we approach the final months of 2020 and faced with this potentially volatile environment we believe that holding a well-diversified portfolio remains particularly important. The year to date has proven to be one of the most turbulent in recent times with a significant equity market correction followed by the fastest recovery on record. Against this backdrop having a portfolio that contains an appropriate mix of investment assets can help reduce market volatility while allowing the opportunity for satisfactory risk-adjusted returns over the long term.



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