INVESTMENT OUTLOOK 2021

Edelman Smithfield

The views contained within this book are from clients of the following DJE Holdings companies:

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FOREWORD

Andrew Wilde, Head of Financial Services, Edelman Smithfield

Every year, Edelman Smithfield compiles a collection of views from the investment management clients of firms within the DJE Holdings family of businesses, looking at the major trends which will shape the year ahead. As we move from the year of Covid into the "Year of the Vaccine", the economic rebuild following the pandemic will be the dominant narrative of the coming twelve months. It is fascinating to see the different ways in which the contributors to this collection – representing asset management houses responsible for more than $16 trillion in aggregate - believe this theme will manifest itself across the various asset classes in which they invest.

Seema Shah of Principal Global Investors describes the distribution of the vaccine as "a game-changer" for markets – but cautions that issues with supply chains, manufacturing challenges and suppressed vaccine acceptancy rates might mean the mass roll-out occurs in the latter part of 2021. Until that point, she warns, "a full rotation away from U.S. mega cap and tech stocks seems unlikely to stick". Hal Reynolds of LA Capital agrees, suggesting that factors they analyse as a quant investor continue to favour growth over value investing in the near term.

Understandably, after a turbulent year and with light flooding in at the end of the tunnel, there is a strong sense of optimism among investors and confidence in the opportunities across markets. The upbeat sentiment of the contributors to this book is rooted not only in vaccine progress but also the impact of a more harmonious political climate in Europe, the UK and the US.

Giles Rothbarth at BlackRock sees "2021 as having all the ingredients required for a strong year of earnings upside surprise" for many European companies, noting that the vaccine - coupled with the strides taken by EU member states towards greater integration via the EU Recovery Fund – provides the basis for earnings to accelerate "across the breadth of the market." Similarly, in the UK, Jon Hudson at Premier Miton, envisages "a scenario playing out that results in UK equities outperforming most other asset classes next year", which is predicated both on successful vaccine distribution and an eventual, positive resolution to years of Brexit uncertainty. At Aberdeen Standard Investments, Kirsty Desson's assertion that "2021 is shaping up to be a good year for small-cap investors" is founded on a post-vaccine normalisation and, following the US elections, an assumption "that we will have a clearer direction on policy, allowing companies to plan ahead."

In credit markets, accommodative central banks will mean fewer bonds being downgraded from investment grade to sub-investment grade in 2021 than in 2020, according to Tom Ross at Janus Henderson.

Beyond the opportunities to generate returns, there is also consensus among investors that 2021 offers a chance to rebuild the economy in a more sustainable way. Sheila Patel at Goldman Sachs Asset Management highlights that Covid "fundamentally changed the way [companies] interact with their employees, customers and communities". She expects that, in 2021, investors will have a crucial role to ensure that "shifts in corporate behaviour this year - such as on their environmental impact, their treatment of employees, their approach to tackling inequality and racial injustice - become permanent rather than temporary".

Egbert Nijmeijer at Kempen anticipates "a step-change in green investment", whilst Xavier Barton at HSBC GAM predicts that primary issuance of green bonds will pick up next year – in particular in Asia where he forecasts USD17-20bn in gross issuance.

Although investors enter 2021 with optimism, there is also a widespread acceptance that the economic scarring following the pandemic will be long-lasting and businesses face enormous challenges, with some contributors - such as Richard Hope at Hamilton Lane and Patrick Marshall at Federated Hermes - anticipating a spike in corporate insolvencies and defaults. As Charles Schwab's Liz Ann Sonders neatly puts it: "we are optimistic about getting to the other side of the COVID-19 chasm, but there are likely to remain some broken planks on the bridge to get there."

As we enter a pivotal year for global economies, where the effective and sustainable deployment of capital has never been more important, we very much hope you find the views from the investors in this book to be insightful and thought-provoking.

"THE UPBEAT SENTIMENT... IS ROOTED NOT ONLY IN VACCINE PROGRESS BUT ALSO THE IMPACT OF A MORE HARMONIOUS POLITICAL CLIMATE IN EUROPE, THE UK AND THE US"

ECONOMIC AND CORPORATE

MACROECONOMIC

Seema Shah, Chief Strategist, Principal Global Investors

The vaccine breakthrough has undoubtedly lifted spirits and economic forecasts. Yet, although the pandemic will likely loosen its grip on global growth in the second half of 2021, the prospect of a successful vaccine cannot alter the reality of a challenging winter, involving stringent social restrictions, business closures and job losses. Not only will the virus resurgence weigh on earnings recovery in early 2021, but the long-lasting aspects to this economic damage will delay full mean-reversion.

With supply chain bottlenecks, mass manufacturing challenges, and suppressed vaccine acceptancy rates likely to push widespread vaccine distribution into the latter part of 2021, social distancing could persist. High contact sectors such as restaurants, hospitality and travel will therefore continue facing capacity constraints, weighing on their earnings outlook in the first two quarters.

While the distribution of the vaccine will be a game-changer, in the meantime, a full rotation away from U.S. mega cap and tech stocks seems unlikely to stick. U.S. markets should retain their strong performance in the first half of the year.

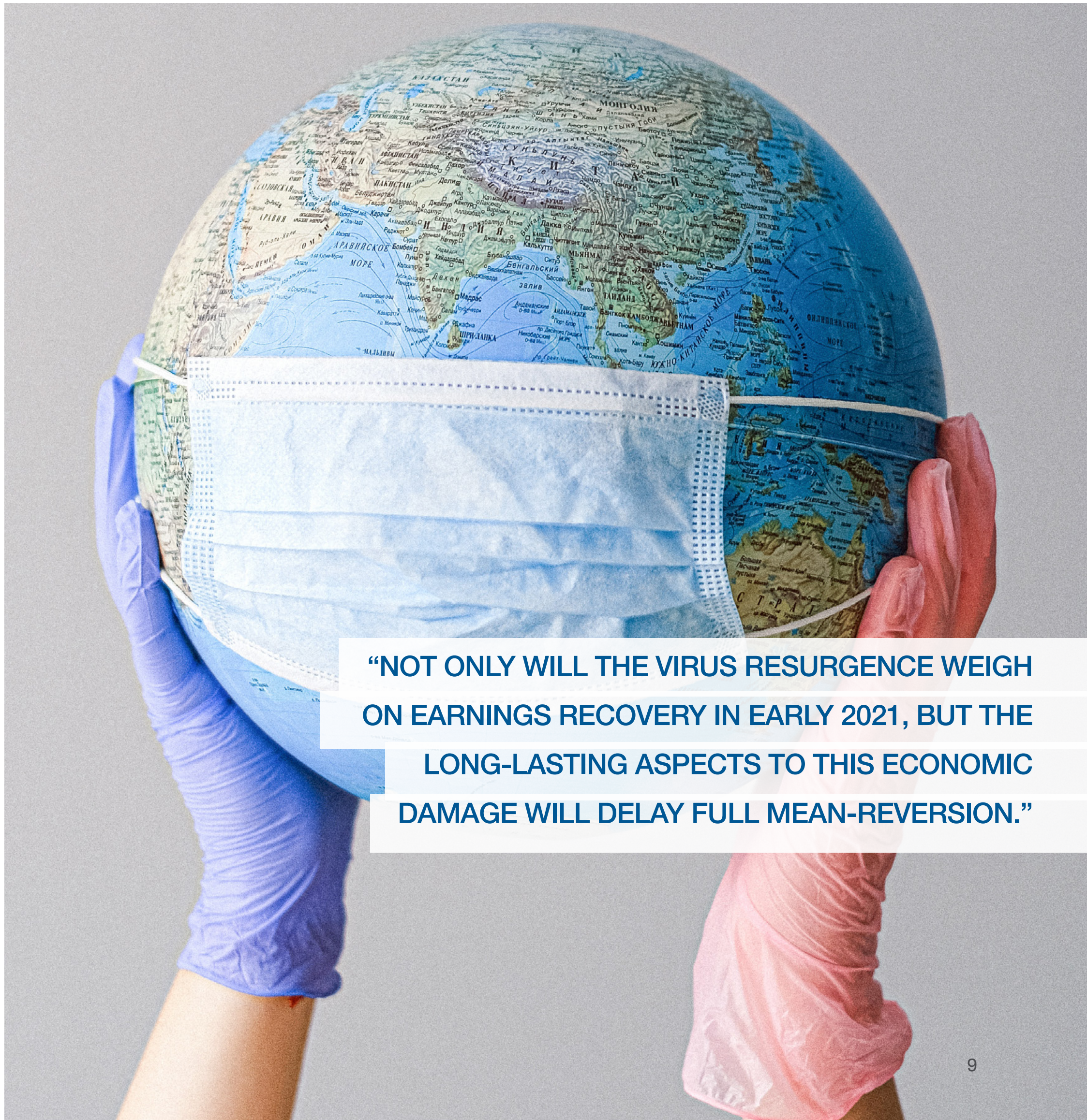
By contrast, Europe has underperformed global markets in 2020, held back by its overwhelming virus struggles and repeated national lockdowns. The eventual return to normal offers Europe the prospect of strong gains – especially given its greater weighting of value companies.

While U.S. and European fortunes are linked to the vaccine, Asian markets such as China, Korea, and Singapore appear to have successfully broken the link been mobility and virus. As they have learned how to live alongside COVID-19 without inflating its spread, these markets stand to gain the least from the vaccine.

Emerging economies on the other hand, have been persistently struggling under the weight of the virus and stand to gain significantly from an effective vaccine. Yet, the somewhat limited geographic scope of distribution means they also face the greatest barriers to getting inoculated. Beyond producer countries such as Russia (and China), many emerging countries have been unable to secure sizeable deals that will rapidly give them access to a successful vaccine, extending the normalization of activity late into 2021.

Greater visibility to a stronger growth path and COVID normalization will be supportive of a gradual rotation to value stocks, cyclical sectors, and small caps. With most central banks set to continue pinning rates close to zero, upward pressure will emerge at the longer end of the yield curve – a much-longed-for result for value stocks. Regional markets that have struggled most with COVID-19 may take longer to recover, but they also stand to gain meaningfully from the eventual vaccine rollout.

Yet, investors should proceed with caution. While valuations indicate there is still scope for ample gains in beaten down sectors, styles, and markets, the economic scars inflicted by the pandemic suggest that distinguishing between good and bad companies will be even more imperative in 2021. We believe that investors who are selective and focus on quality should continue to be rewarded for their efforts.



"NOT ONLY WILL THE VIRUS RESURGENCE WEIGH ON EARNINGS RECOVERY IN EARLY 2021, BUT THE LONG-LASTING ASPECTS TO THIS ECONOMIC DAMAGE WILL DELAY FULL MEAN-REVERSION."

THE CORPORATE LANDSCAPE POST COVID

Sheila Patel, Chairman of Goldman Sachs Asset Management

The shape of the global economic rebuild post-COVID-19 will be the dominant narrative for the year ahead. During 2020, companies were faced with unprecedented challenges that fundamentally changed the way they interact with their employees, customers and communities.

In 2021, a crucial role for investors will be to ensure that positive shifts made in corporate behavior this year – such as on their environmental impact, their treatment of employees, their approach to tackling inequality and racial injustice – become permanent rather than temporary.

Will companies do more to ensure they are giving advancement and leadership opportunities to diverse candidates? Will initiatives that companies embarked on around mental health and fair treatment of employees continue to get the attention they deserve? Will the dramatic pauses on many carbon-intensive economic activities be taken as an opportunity to shift to cleaner technologies and practices? 2021 will be the year for companies to demonstrate clear action in response to all these questions.

One of the primary lenses through which companies will be judged is diversity. At GSAM, we are taking our voting policies even further in 2021 - voting against nominating committees at companies in the US that do not have at least one female and one diverse member at board level and against the entire board at companies without any women. We will continue to vote against nominating committees or senior executives at companies that lack gender diversity at the board level globally. This is an important lever that shareholders can influence directly, but we see it as equally important to engage with companies and understand their approach to building diverse, inclusive cultures, which we believe produce better business outcomes. The pandemic has highlighted how those companies that demonstrate a commitment to their people's physical and mental wellbeing gain in terms of business resiliency, customer sentiment and ultimately performance.

Through the pandemic, climate change may not have always been front-page news but that does not mean it was not front of mind for asset owners, pension funds and sovereign wealth funds. Our clients continued to be extremely focused on the climate impact of their investments. COP26 will sharpen the climate discussion next year, as will an incoming US President with a clear green agenda and – tragically – the growing severity of extreme weather events and natural disasters.

In addition to the influence that public equity owners can have, we see 2021 as a year when investor pressure on corporate behavior will be increasingly joined up. In credit and private markets too, ESG is becoming a ubiquitous consideration for the ultimate owners of capital. Combined with the fact that the majority of companies recognize the need for a serious environmental and social strategy, we are also encouraged by the focus of governments and central banks on ensuring the next chapters of growth are as green as possible. We are optimistic that 2021 can be the year when progress on these fronts is crystalized and the relationship between the corporate world and the society within which it operates continues to improve.

"IN 2021, A CRUCIAL ROLE FOR INVESTORS WILL BE TO ENSURE THAT POSITIVE SHIFTS MADE IN CORPORATE BEHAVIOR THIS YEAR... BECOME PERMANENT RATHER THAN TEMPORARY."

EQUITIES

UK EQUITIES

Jon Hudson, Co-Fund Manager, Premier Miton UK Growth Fund and Premier Miton Ethical Fund

As I write this there are lots of uncertainties. The UK economy is being held back by regional restrictions to contain the spread of COVID-19 and trade negotiations with the EU have entered the 11th-hour but still no agreement has been reached. This makes predicting the short-term outlook for UK equities rather difficult but I can foresee a scenario playing out that results in UK equities outperforming most other asset classes next year.

The first piece that needs to fall into place is a free trade agreement with the EU, which would avert a potentially chaotic disruption come 1st January. Should this be achieved we can finally start to look at Brexit through the rear view mirror. Consumers can spend with more confidence, businesses can invest with more certainty and foreign direct investment has one less reason to avoid the UK. International investors who have shunned the UK since 2016, understandably deciding that predicting UK politics is not a career risk worth taking, may finally be ready to reallocate.

The multiple positive vaccine news during November saw the markets rise as we now have greater clarity over when life may return to 'normal'. As the vaccines are distributed throughout 2021 the need for further lockdowns and restrictions is less and investors can have greater confidence in both global GDP growth and company earnings. GDP may be starting from a lower base but markets tend to rise when there is synchronised global GDP growth and this should be further supported by a weaker US dollar. The UK has been quick to approve the Pfizer-BioNTech vaccine which should give it a head start in returning to normality compared to other nations.

Should these events play out, sterling is likely to continue its recovery against the US dollar so investors may want to favour the more domestically-focused small and mid-cap sectors over multinational large caps. A stronger currency isn't necessarily a bad thing for the UK economy as being dominated by consumption it benefits from cheaper imports. In fact 2021 could be a strong year for consumption as consumers are finally able to spend the money they were unable to during 2020. According to the OECD, the saving rate for 2020 will be close to 20% compared to 6% in 2019.

The final factor that could act in favour of UK equities outperforming is the potential for rising global inflation expectations. Inflation has had many false dawns over the past decade and deflation trends such as ageing demographics and technological innovation haven't gone away. But with synchronised global growth, both monetary and fiscal policy currently running hot and commodity prices generally rising, expectations for higher inflation could rise. Of course the fiscal books need to be balanced but it appears the main target for the UK government is raising capital gains tax, a tax that doesn't have a big impact on the average citizen.

Rising inflation expectations would favour the UK equity market because it would benefit many of those sectors that dominate the UK market such as financials, energy and mining. These are sectors currently deemed 'value' and could give legs to the value rally that we have seen during Q4 this year. The UK market trades at a discount to other developed markets and even quality UK companies such as B&M and Gym Group trade at big discounts to their international equivalents. There is a good chance the discounts close during 2021.

"THE UK MARKET TRADES AT A DISCOUNT TO OTHER DEVELOPED MARKETS... THERE IS A GOOD CHANCE THE DISCOUNTS CLOSE DURING 2021."

EUROPEAN EQUITIES

Giles Rothbarth, Co-Manager of the BlackRock European Dynamic Fund

At the very core of investing, individuals buy securities for one of two reasons – either they believe that the market is wrong on the future earnings expectations of a company, or wrong on the valuation ascribed to those earnings. We believe for many European sectors the market may be wrong on both and see 2021 as having all the ingredients required for a strong year of earnings upside surprise.

Take travel as a good example: the industry body IATA estimates that passenger traffic in 2021 will still be less than half of 2019, and won't recover to previous levels until 2024. Better virus testing capabilities, a successful vaccine rollout, and a resilient global consumer are just three reasons we think this assumption set is eminently beatable.

We have exposure to travel primarily through the aerospace engine manufacturers. These are companies with strong market positions, through large installed bases of engines, that can generate significant cashflow. However, airlines need to buy new engines too. These engines can provide a cost advantage with better fuel efficiency, but, more than that, these are cleaner technologies that are required for airlines to meet their carbon reduction goals. This will likely lead to demand growth, irrespective of the precise passenger growth rates.

The climate agenda, more broadly, provides for multi-year growth tailwinds for many European companies. We tend to find the best opportunities in businesses we think of as 'giants in niches' - from renewable fuel manufacturers and wind farm operators, to specialty chemicals distributors, to semi-conductor businesses. Whilst the latter are lower profile than some of the US tech companies, these businesses are at the leading edge of technology and should continue to benefit from long term trends, requiring greater and more efficient computing power. We see this all around us with shifts towards electric vehicles, 5G, and increased use of AI and automation.

Across the breadth of the market, we can see examples where European companies' earnings will accelerate in 2021, after a torrid 2020. Going into the New Year, we have therefore favoured cyclical exposure and companies with recovery potential. However, we think the case for Europe is not only grounded in a recovery from a Covid-hit 2020 but, more importantly, in the long run benefits from 2020's political action. We've seen EU member states in 2020 take enormous steps towards greater integration with the creation of the EU Recovery Fund – this is the first time we've seen debt mutualisation within the EU, and it is a big step for EU solidarity. Its long-term significance cannot be overstated. This Recovery Fund has created precedent for any future crises and provides a mechanism by which to distribute funds to build Europe's competitive edge through sustainable and digital transitions. We believe the next 10 years for Europe could look very different to the last 10.

"THE CLIMATE AGENDA, MORE BROADLY, PROVIDES FOR MULTI-YEAR GROWTH TAILWINDS FOR MANY EUROPEAN COMPANIES."

EM EQUITIES

Dominic Bokor-Ingram,
Senior Portfolio Manager,
Fiera Capital Europe Limited

Starting with the virus – most of the EM world has either suppressed it or is not at risk of further lockdowns. They have chosen to accept that the medical and mortality impacts are not as great as the economic impact of shutting down their economies.

Whilst economically this doesn't mean that EMs are immune to Europe and the US's second wave, as exports and commodity prices should be negatively impacted, the domestic demand stories look very robust. As evidenced by recent Chinese policies designed to stimulate domestic rather than export growth.

Moving on to US politics. The defeat of Donald Trump is likely to reduce (but not remove) trade tension with China and removes the risk of the trade wars widening. Unsurprisingly, when MSCI Global Emerging Market Index is about 40% China, the trade wars have not been helpful to the EM investment case. With President Joe Biden, we expect the US to build stronger links with America's allies, rather than to escalate attacks on them. This should have an important impact on Foreign Direct Investment flows.

It seems that fear of US tariffs under the Trump administration encouraged foreign companies to invest more in the US than they otherwise would have done. Flows to the US under Trump in 2017-2019 averaged about USD 250 billion annually. Combined with pressure on US corporates to repatriate previous year's accumulated offshore profits, the results of these policies in 2018 and 2019 meant that average daily inflows to the US were over USD 1 billion each working day. This contributed to US dollar strength which is usually unhelpful for emerging markets. We suspect the temptation of cheap productive labour in EM together with the threat of tariff increases much reduced, should once again see net FDI flow out of the US, thus weakening the dollar.

Portfolio flows are likely to be another major, and quicker, factor contributing to dollar weakness. One underlying driver caused by the pandemic could be low yields available from developed market debt. With high developed market debt to GDP ratios, any rise in US treasury yields may risk sending economies back into recession. It is therefore likely that US Treasury yields will trade within a 0-2% range for the next decade and that Eurozone yields will remain around 0% or below.

These flows may continue to drive down interest rates in EMs. The obvious uplift in equity valuations from lower risk-free rates can be compounded by suppressed inflation and interest rates and may encourage more bank lending and investment. Faster economic growth will result, attracting more money to EM. Dollar GDP could rise faster than real GDP, improving debt ratios, and probably credit ratings.

Emerging markets have been under-owned relative to their weight in global indices and in generating global growth for many years. What has been missing is a catalyst to prompt a reversal in investor appetite. These events in 2020 may be enough to turn the corner.

"EMERGING MARKETS HAVE BEEN UNDER-OWNED RELATIVE TO THEIR WEIGHT IN GLOBAL INDICES AND IN GENERATING GLOBAL GROWTH FOR MANY YEARS."

FRONTIER EQUITIES

Dien Vu Huu, Portfolio Manager, Vietnam Enterprise Investments Limited (VEIL), Dragon Capital

Despite the coronacrisis Vietnam will end 2020 as one of the best performing economies globally; but the impact will linger even though the IMF predicts 2021 growth of 6.4% and ourselves 7%.

The VNI is now up YTD and trading volumes are running 80% above 2019 levels in November thanks to low interest rates and this is in spite of over $500m of foreign outflows.

Looking forward to 2021: In January the communist party congress decides the country leadership for the next 5 years but we envisage little change in the course of economic development and international relations. Accommodative monetary and fiscal policies, plans to spend $150bn in the next 5 years on new infrastructure, and support for those disadvantaged by the pandemic seem set to continue.

The EU-Vietnam Free Trade Agreement (EVFTA) and the Regional Comprehensive Economic Partnership (RCEP) trade agreements signed in Q4 2020 should begin to bear fruit over the course of the 2021, adding to an already upbeat trade picture with a growing market share in global exports.

MSCI frontier index reform in 2020 will leave VN at close to 36 % of that index: while the PR is good, this is unlikely to attract much more than a current days trading volume in new interest. The anticipated upgrade to emerging market status awaits NVDR (non-voting depositary receipt) issuance and we think this is still more than 18 months away.

A new US administration in January and their view on section 31 semi- annual report to congress will impact the Vietnamese Dong: Vietnam does trigger all three criteria looking at 2019 year end data: a bilateral trade surplus, current account surplus and one sided FX intervention. FX reserves at the end of November stood at over $80bn – an all-time high – and the fact the RMB has been on a 6-month rally offer further challenges.

Our investment approach focused on domestic consumption, growth in the middle class, urbanization and financial market development is unlikely to change a great deal.

MobiWorld Group: One of our largest positions and what we see as a category killer in certain areas of Vietnam retailing. Like most non-essential retailers MWG has been impacted in the coronacrisis and consumers propensity to spend and confidence have yet to recover fully. But by Q4 2020 retail sales had resumed positive YOY growth. Using in-house numbers the forward PE is 13X, PBV 4.1 with ROE of 29.5%.

Real estate and banks may be a little riskier but they seem cheap to us.

Khang Dien Homes: a mid-cap real estate firm focused on developments in Ho Chi Minh City might not be the cheapest real estate firm, but with a 2021 PE of 8.8X, PBV 1.2X, ROE 15.9% and discount to NAV of 10% we feel the strong brand presence in this city and a substantial land bank offers good long term potential returns.

“OUR INVESTMENT APPROACH FOCUSED ON DOMESTIC CONSUMPTION, GROWTH IN THE MIDDLE CLASS, URBANIZATION AND FINANCIAL MARKET DEVELOPMENT IS UNLIKELY TO CHANGE A GREAT DEAL.”

US EQUITIES

Liz Ann Sonders, Senior Vice President, Chief Investment Strategist, Charles Schwab

Looking ahead to 2021, we believe we will see another dip in economic activity courtesy of the resurgent virus and implications of mandated, as well as self-imposed, lockdowns. But courtesy of the coming vaccines, the outlook beyond the near-term is brighter.

Aside from the vaccine, other tailwinds include the prospects of a divided Congress – and therefore relatively benign implications for major changes to tax policy and general support for a new fiscal package – and stronger-than-expected corporate earnings, the majority of which has been retained as cash during the year relative to history.

However, despite the massive liquidity and relief offered by monetary and fiscal authorities, the near-term backdrop remains disinflationary. Money velocity has been falling while money supply has been rising; but inflation has not, due to many structural, global and demographic reasons. We should keep an eye on velocity heading into 2021, even if the recent uptick is the beginning of a trend, but inflation won't necessarily rise.

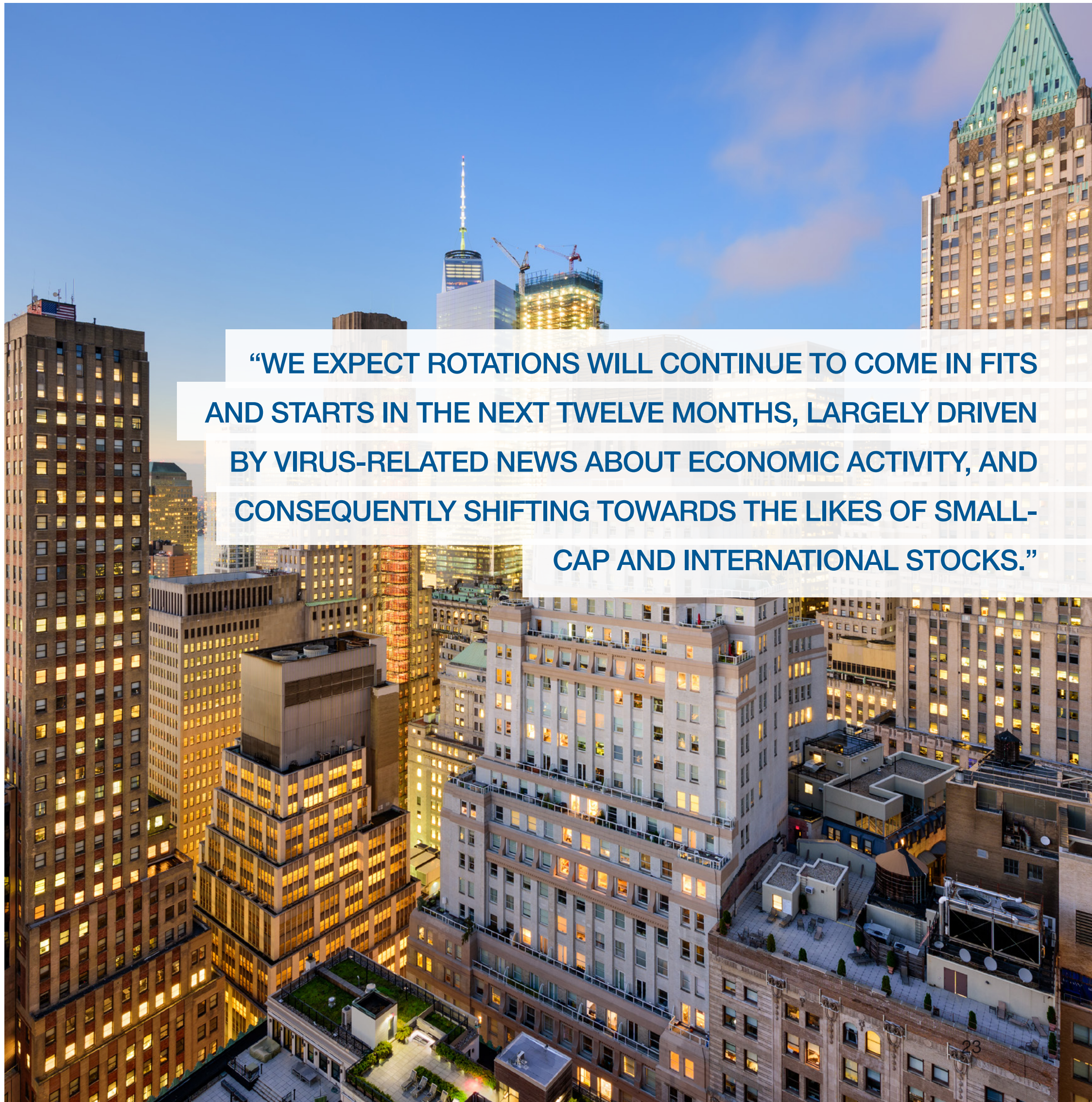
Where we do see some inflation risk is if the economy surges more quickly, and with greater force, than is presently expected—while global productive capacity remains constrained.

While monetary stimulus has not resulted in real economy inflation, it's certainly resulted in asset inflation—including the stock market, as evidenced in the significant disconnect between the stock market and the economy. Looking at U.S. equities, a rotation away from the "big five" U.S. stocks that dominated performance during the early part of the pandemic already has begun. These stocks were very much thrivers during the year – their performance peaked in September, representing nearly 25% of the S&P 500 – this has since been balanced by investor attention being drawn elsewhere. We've seen shifts from growth stocks to value stocks, from large-cap to small-cap, from defensives to cyclicals, from stay-at-home stocks to get-out-and-about stocks, and from leaders to laggards.

We expect rotations will continue to come in fits and starts in the next twelve months, largely driven by virus-related news about economic activity, and consequently shifting towards the likes of small-cap and international stocks. Assuming the U.S. economy moves into a higher gear in 2021, small caps should be relative beneficiaries given their higher-level of cyclical exposure.

Diversification is important as we enter into the new year. Stock valuations represent a risk in 2021, especially if earnings do not live up to expectations, and although multiples will continue to receive implicit support from extremely low interest rates, valuation is as much an indicator of sentiment as it is a fundamental indicator—and therefore frothy sentiment is also a risk heading into 2021.

Whenever the market is trading at or near all-time highs, it's important to assess the risks. We are optimistic about getting to the other side of the COVID-19 chasm, but there are likely to remain some broken planks on the bridge to get there.



"WE EXPECT ROTATIONS WILL CONTINUE TO COME IN FITS AND STARTS IN THE NEXT TWELVE MONTHS, LARGELY DRIVEN BY VIRUS-RELATED NEWS ABOUT ECONOMIC ACTIVITY, AND CONSEQUENTLY SHIFTING TOWARDS THE LIKES OF SMALL-CAP AND INTERNATIONAL STOCKS."

GLOBAL SMALL CAPS

Kirsty Desson, Investment Director – Smaller Companies Equities, Aberdeen Standard Investments

2021 is shaping up to be good year for small-cap investors, not least because we are entering a phase of market recovery in which typically small-cap stocks outperform large-caps. Certainly that was true as we came out of the downturn in 2003 and, again, in 2009. Small-cap outperformance during these periods was significant and lasted several years.

Another reason is that relative valuations appear to favour small-cap versus large. The asset class is currently trading at a discount compared to historic valuations too.

By their nature, small-caps tend to be more nimble and economically sensitive so as we look into 2021, there are a number of reasons to be optimistic. The first, of course, is a return to normalisation as the vaccine is rolled out. A comprehensive immunisation programme starting early next year should help to restore confidence and allow businesses to reopen.

However, even before the news of a vaccine was announced there were signs of early cyclical indicators picking up. The coordinated wave of government stimulus and accommodative central bank policies have already started to work through the system and a broad based recovery is underway.

What is important to remember is that economic growth in many areas had stagnated even before the pandemic took hold. Uncertainty caused by the US-China trade war, which was the focus of 2019, resulted in companies holding off on capex and consequently inventories dropping down to minimum levels. The bounce back we are seeing is therefore even more meaningful.

Indeed, another area of uncertainty this year was the US Election. While we cannot say for sure what the incoming US administration will do, it is reasonable to assume that we will have a clearer direction on policy, allowing companies to plan ahead.

Before getting carried away, it is worth sounding a note of caution. There may be speed bumps in the road to recovery as some businesses will not recover from the lockdown measures and job losses are still to come when the furlough schemes stop.

As investors look towards 2021 and beyond, small-cap exposure will offer some of those cyclical elements that make sense in the near to medium term. Especially where the cyclical uplift provides an additional kicker to the secular growth, for example in EV vehicles or automation equipment. At the same time, investors will want to retain holdings in structural growth stories where there is a high degree of confidence in the outlook. The shift to online activity in its many forms and a greater awareness of our impact on the environment are two such themes that are here to stay and will play out over the long-term.

"BY THEIR NATURE, SMALL-CAPS TEND TO BE MORE NIMBLE AND ECONOMICALLY SENSITIVE SO AS WE LOOK INTO 2021, THERE A NUMBER OF REASONS TO BE OPTIMISTIC."

TECH

Amanda Lyons, Investment Manager, Disruptive growth and technology GAM Investments

In a year that has seen the world's economies shut down for prolonged periods, the Nasdaq is on track for one of its best years of performance this century. This is quite remarkable when we consider that the index contracted by more than 20% at the start of the pandemic. There have only been three years this century when the Nasdaq fell by more than that - 2001, 2002 and 2008.

The Covid-19 pandemic has led to a polarisation of the market between so-called 'Covid winners' and 'Covid losers'. Many tech names fall within the 'winner' category. This year has seen a significant shift towards ecommerce and digital at the expense of offline, with many companies commenting that they experienced the equivalent of several years of growth in just a matter of months. But perhaps the most prominent theme of the year has been the pivot towards 'working from home'. Technology became the primary focus in the boardroom, as enterprises ensured that their systems were robust enough for entire workforces to operate remotely. Zoom quickly evolved from being a little-known player in the conferencing software niche, to a verb used in common parlance.

While many of the winners from 2020 are now on higher growth paths than pre-crisis, in many cases they do not necessarily represent the best opportunities in 2021. Instead, some of the less loved companies of 2020 are becoming more attractive as Covid-related restrictions are lifted. For almost all of 2020, travel literally ground to a halt and understandably both business and leisure travel companies suffered. Recent survey data suggests that the number one activity people want to do post-crisis is travel, particularly for leisure, implying there is huge pent up demand. At the same time, consensus estimates do not expect a full recovery to the travel industry for several years. This gap between recovery estimates and pent up demand offers opportunity for investors.

Beyond the potential rotation in cyclicals, we are at an inflection point for a more permanent structural shift. We are moving from a world with billions of devices (digital 3.0) to a world with trillions of devices (the Internet of Things era, digital 4.0). Advancements in AI, the ability to process, use and store data, and the roll out of 5G means that this is now possible. This theme is playing out in multiple verticals, most notably healthcare, transportation, robotics, and the automation of knowledge work. At the heart of digital 4.0 is the cloud. With penetration of the cloud still below 10%, the opportunity ahead is enormous.

2020 will be seen as the turning point, where digital transformation was pushed to the top of priority lists. Companies who successfully embed technology at their core in 2021 and beyond will set themselves apart from those who don't. We are already seeing a polarisation between technology enabled companies and this is only set to increase.

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PRIVATE MARKETS

Richard Hope, Head of EMEA, Hamilton Lane

In March, the pandemic jeopardised fundraising, deal-making, domestic and international trading. Private markets investors adapted in a way no one had anticipated. General partners embraced ESG more than ever before. Portfolios were stabilised as GPs worked intensively to ensure they were supported and capitalised.

Valuations snapped back in Europe and the U.S. in late Q2 and Q3. New transaction volumes picked up as confidence returned in underlying portfolio company trading and GPs were able to resume some travel again. Specifically, GPs with on the ground, in-country teams could take advantage of the situation and strike deals with good insight and limited competition.

Fundraising continued at a fast pace, as LPs didn't panic and kept making commitments. LPs without global scale and existing relationships were hampered, however the shortfall was often made up by those increasing commitments with existing managers. Most GPs struggled to forge meaningful new LP relationships during 2020 and will work hard to cover the ground and spend time with new potential LPs in 2021, with view to future-proofing their fundraising capacity.

Although a Covid-19 vaccine is on the horizon, we expect a spike in corporate insolvencies ahead of global economies fully re-opening during the first half of 2021. This could drive near-term distressed and turnaround investments as companies deal with liquidity constraints ahead of a full economic recovery. In an industry with an ever-increasing focus on ESG, it will be important that GPs focus on reputational matters here.

Growth, technology and healthcare will also drive deals in H1 2021 with GPs continuing to pay a premium for strong growth metrics and/or resilient, cash flow generative businesses. As a vaccine-driven recovery develops pace we expect a return to thematic areas such as consumer and leisure where short-term working capital constraints drive investment activity as companies seek interim funding to return to more normal levels of activity.

Whilst we believe the exit activity from H2 2020 will surprise to the upside, the natural question in 2021 is on exits and potential distributions to underlying fund investors. Due to Covid-19 related business interruption, many GPs are invested in companies they won't be able to realistically exit before 2022 with today's buyers not willing to pay the high multiples to which we've become accustomed.

Many GPs have invested in market-leading, price-setting businesses, paying more for that higher strategic value. They won't sell if they don't need to, because the assets continue to be strategic leaders and because there may be further opportunity to increase value through actionable M&A. GPs may seek alternative liquidity for these underlying investments whilst continuing to own and manage them. 2020 spurred numerous GP-led deals or continuation funds, and with a well-capitalised secondary market, this will persist into 2021 and 2022.

The outlook for next year is one of cautious optimism. Private markets investors have proved themselves both nimble and shrewd in the face of previous crises – I expect they shall continue to do so.

"2020 SPURRED NUMEROUS GP-LED DEALS OR CONTINUATION FUNDS, AND WITH A WELL-CAPITALISED SECONDARY MARKET, THIS WILL PERSIST INTO 2021 AND 2022."

FACTOR INVESTING

Hal W. Reynolds, CIO,
Los Angeles Capital Management

Value's dominant performance over growth on welcome vaccine news from major drug manufacturers has provided some relief for long suffering value strategies, but how is the factor outlook shaping up in 2021?

In spite of positive short-term momentum globally given the recent vaccine news, the value factor (book-to-price), relative to future cash flows, does not appear to be attractive on a longer-term basis in Europe and the US. Given that the preponderance of the world's earnings over the past five years have been derived from human capital in the technology and services sector, the question must be asked what will be the catalyst to improve the earnings outlook for these capital intensive assets?

Similar to value, the fundamentals have been particularly weak for smaller capitalization securities and their valuations do not appear to be inexpensive in the US and Europe as well. While momentum has experienced a short-term crash, on a cash flow basis, it is generally not expensive. Given the strong fundamentals of growth stocks, this is a very different picture than the one we saw at the end of the Dot. com bubble when momentum was quite expensive. We believe investors may be wise to not write off the current momentum cycle quite yet.

Low volatility, a significant under-performer in 2020 and thus currently with negative sentiment, may look attractive for 2021, particularly in the continued absence of inflation. Low volatility stocks generally respond well to falling, but not rising rates.

The greatest factor surprises for 2020 were the outsized positive return to risky factors. These include high volatility, low profit margins, low dividend yield, low earnings quality, and highly shorted stocks. In a typical bear market, one might expect the opposite to occur but given the magnitude and speed of the stimulus programs, investors took on more risk and were encouraged to look past the pandemic. While additional fiscal stimulus is likely, expect a majority of these factors to reverse in 2021. During slow to moderate growth periods, investors typically turn back to earnings quality and dividends. Today, negative yielding debt is reaching historic levels suggesting the demand for capital remains weak.

Analyst Insight and cyclical factors continue to favor growth over value, but the gap has closed since the end of July. Fundamental Momentum, continues to favor growth, just as it did pre-crisis and though out 2020.

The rollout of the vaccine suggests we are entering the third phase of the economic crisis when economic output will have the opportunity to rise with fewer interruptions from spikes in the virus. This is an important step in building the foundation for creating the conditions necessary for a sustainable value rally. Investor preferences will likely shift back to smaller capitalization and value-oriented securities as employment, economic gains, and earnings growth become sustainable in the months ahead.

FIXED INCOME & REAL ASSETS

CREDIT

Tom Ross, Corporate Credit Portfolio Manager, Janus Henderson

Markets typically look ahead of current economic conditions and cyclically-sensitive credits are already responding, with credit spreads tightening in anticipation of improving cash flows and declining default risk. While many companies were able to raise capital in 2020, not all will survive, so a keen eye on credit fundamentals will remain critical. We believe that selective opportunities exist in some of the more COVID-sensitive areas that have lagged the market, including leisure and real estate. There is also likely to be more opportunity lower down the credit spectrum and smaller issuers as we embark on the repair phase of the credit cycle in which companies seek to improve their balance sheets. Investor appetite for risk and low interest rates should propel the grab for yield. This does not mean throwing caution to the wind. We expect credit spreads to tighten, but in a more limited fashion given they have tightened significantly since March 2020.

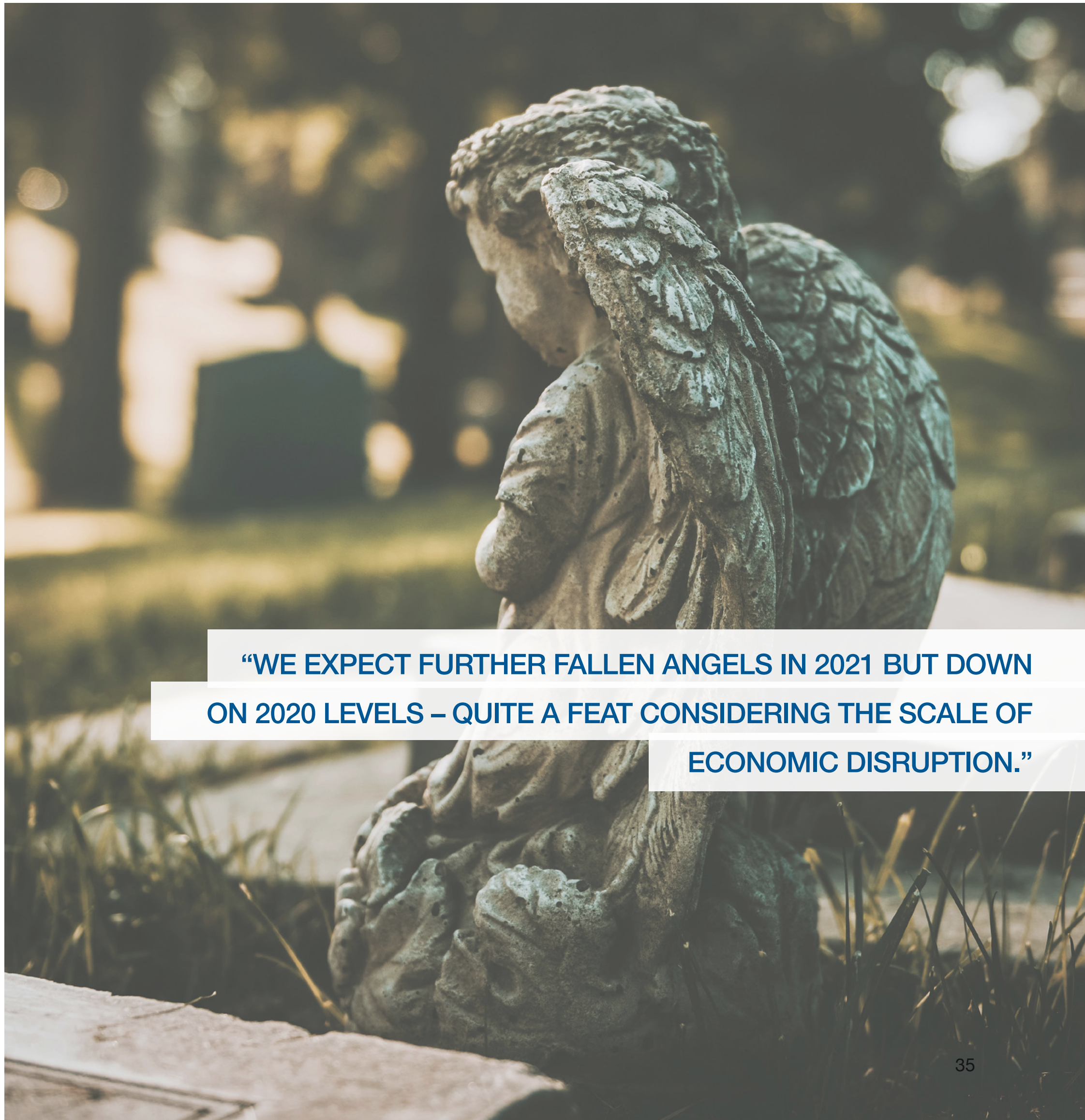
The structural changes that have been taking place, such as digitalisation, will likely persist. Similarly, the factors that typically make for a good credit, including reliable cash flows, strong management and an improving ESG trajectory, will remain important. Bonds from companies that demonstrate these qualities should help act as ballast against market volatility.

A notable feature of 2020 was the debunking of the notion that a wave of downgrades would destabilise the high yield market. While there was a big rise in fallen angels (bonds downgraded from investment grade to sub-investment grade) the high yield market proved adept at absorbing the increase in supply. In fact, high yield credit spreads are only mildly wider than at the start of 2020.

We welcome the increase in supply after a paucity of net new issuance within high yield markets in the years leading up to 2020, since it helps increase choice for high yield investors. What is more, for technical reasons the market is often poor at correctly pricing bonds when they transition between investment grade and high yield and vice versa, creating opportunities to profit from these pricing inefficiencies.

We expect further fallen angels in 2021 but down on 2020 levels — quite a feat considering the scale of the economic disruption. We think accommodative policies will be maintained throughout 2021 by holding interest rates low and ongoing asset purchase schemes. With central banks still buying bonds (albeit primarily investment grade) and issuance likely lower, this should create a favourable demand/supply dynamic.

A combination of the recovery building momentum and rising headline inflation may spook investors worried that interest rates may rise. The higher yields on high yield bonds traditionally act as a cushion against interest rate risk but we need to be mindful that government bond market volatility may spill over into other segments of fixed income. Our base case is that central banks will seek to dampen volatility in government bond markets but it is ironic that the biggest risk to high yield may come from what happens at the other end of the credit spectrum.



"WE EXPECT FURTHER FALLEN ANGELS IN 2021 BUT DOWN ON 2020 LEVELS – QUITE A FEAT CONSIDERING THE SCALE OF ECONOMIC DISRUPTION."

GREEN BONDS

Xavier Baraton, Global CIO
Fixed Income and Alternatives,
HSBC Global Asset Management

The Asian green bond market is rapidly catching up with the rest of the world and now accounts for almost a quarter of the global USD green bond universe. China is the largest issuer in the region and second-largest globally, with issuance dominated by banks and property developers. The booming market has attracted bond issuers to fund green projects and investors in ESG products. This is strongly supported by governments' climate initiatives and their commitment to the Paris Agreement for 2030.

While green bond issuance has slowed this year given COVID-19 and a shift to pandemic bonds, we expect primary issuance to pick up next year with improving global economic activity. In the coming years, the supply number could be materially higher, driven by strong investor demand and favourable government policies. If Europe continues to lead the charge with the introduction of the EU green funding program, we expect Asian USD green bond issuance to pick up in 2021 which should attract a lot of interest. We forecast USD17-20bn in gross issuance in the region next year, backed by growing green projects and cUSD8-10bn refinancing needs in 2021 and 2022.

Banks, renewables and property issuers remain the key issuers, however, in line with the global green bond market, we expect to see more green building related projects and financing. Asian USD green bond financing has been focused on projects in renewable energy, energy efficiency and clean transportation as part of efforts to reduce carbon emissions. We expect this trend to continue in the medium term and we also anticipate more resources allocated to pollution prevention and natural resources management. This would invite a greater diversity of issuers to join the green financing market.

Although still in its infancy in Asia we also anticipate the issuance of sustainability-linked or KPI-linked green bonds to increase in the coming years. This will likely be in response to investor pressure to ensure promised environmental benefits are delivered, with clear consequences if they are not.

Investors have welcomed green bonds and Asian USD green bonds are receiving particularly strong traction given their attractiveness in value versus their global peers. The order-books for new issues this year are, on average, 5.7x larger than the actual bond sizes with most of the demand from Asian investors and fund managers. On a relative value comparison, we find that Asia USD green bonds offer better risk-adjusted premiums than their global peers, especially in 'BB' and 'BBB' credit curves.

We attribute the USD green bond market's strong growth to a rising awareness of environmental threats and climate change, as well as increasing demand for ESG and sustainable investment products. As issuers look to display their environmental commitments we believe more global investors will tap in to the Asian space in the search for yield, and that will continue to support the space's long-term growth and future development.

"WHILE GREEN BOND ISSUANCE HAS SLOWED THIS YEAR GIVEN COVID-19 AND A SHIFT TO PANDEMIC BONDS, WE EXPECT PRIMARY ISSUANCE TO PICK UP NEXT YEAR WITH IMPROVING GLOBAL ECONOMIC ACTIVITY."

GLOBAL CONVERTIBLES

Arnaud Brillois, Managing Director and Lead Portfolio Manager on the Global Convertibles team at Lazard Asset Management

Convertible Bonds have not disappointed investors throughout 2020, offering double digits returns and outperforming global equity indices as well as global corporate bond indices. The high level of convexity and the good sectorial mix going into 2021, after several years of elevated levels of new issuance, has allowed the asset class to present downside protection and upside capture during a volatile 2020.

The high level of new issues this year means that 2020 is on track to be a record year in terms of new issuance volumes, and comes mainly from two types of issuer. First, we've seen issuers use convertible bonds to fix lower refinancing rates due to their current relative strength (technology issuers, for example). At the other end of the spectrum, we've seen elevated volumes from companies negatively impacted from lockdowns, that have needed to shore up their cash positions. Overall, this active environment in terms of new issues is bringing new potential investments, increased convexity, and attractive terms at issue with regard to both coupon and premium. All of this combined greatly benefits the asset class as a whole.

The current market conditions makes us optimistic for the year ahead, when looking at the drivers of performance at play for convertible bonds. In terms of equity sensitivity, the convertible bond markets now offer attractive investment options on companies that benefit from the remote working environments, typically in cloud computing or e-commerce, that we believe will continue to outperform expectations.

Tourism or event companies most impacted by Covid-19 have recently been active in issuing convertible bonds, offering the possibility to participate in their potential recovery while being protected by the defensive aspects of convertible bonds.

From a credit perspective, we observe virtuous cycles in these recovery names, where a strength of the underlying equity will bring significant credit tightening, adding to the potential returns of these convertible bonds. If the situation was to deteriorate, convertible bonds typically exhibit 45% less defaults rates than traditional High Yield corporate bonds.

From an interest rate perspective, we believe that interest rates will remain in a trend in the near term as central banks across regions wish to remain accommodative to maximize economic recovery. In any case, convertible bonds are not particularly sensitive to interest rates, with a modified duration around 2.5 years on average.

These factors combined let us anticipate a strong first six months of 2021, driven by continued solid performance of the technology sector, a recovery of the consumer and tourism sectors, both from an equity and credit perspective, and an overall high level of convexity following a record year of new issues. We anticipate that new issues volumes will remain elevated in 2021, particularly during the second half, where companies will need to refinance high levels of maturities and secure additional cash. Upward pressures on the valuation of the market, currently at a relatively cheap level, will be balanced by the benefits of increased diversification of issuers and higher convexity.

"TOURISM OR EVENT COMPANIES MOST IMPACTED BY COVID-19 HAVE RECENTLY BEEN ACTIVE IN ISSUING CONVERTIBLE BONDS, OFFERING THE POSSIBILITY TO PARTICIPATE IN THEIR POTENTIAL RECOVERY WHILE BEING PROTECTED BY THE DEFENSIVE ASPECTS OF CONVERTIBLE BONDS."

PRIVATE DEBT

Patrick Marshall, Head of Private Debt, at the International Business of Federated Hermes

2021 will be a year of continued uncertainty for both lenders and prospective borrowers. This will be a year when discipline in lending criteria and strong origination platforms will be key to success.

For the past ten years, the private debt market has gained ground over the large banks who were more restricted by post financial crisis capital regulations. But, in an increasingly crowded market where there has been little marginal gain to be found on pricing due to lending margins having reach levels below the target returns of most direct lenders, competition came in the form of loan terms and leverage. This was compounded by the way in which many unitranche funds structured deals by inflating EBITDA through add-backs, ultimately meaning that many unitranche lenders found themselves in aggressive loan structures with fewer options when it came to maximising their recoveries in an impaired credit.

The private debt market wholly is reliant on deal flow, especially from the M&A market. The M&A market will remain subdued in the first quarter and only pick up when potential acquirers are able to get clarity on the financial performance of proposed acquisitions post Covid. Until there is a significant pickup in the M&A pipeline, transactions will remain centred on small financings for add-on acquisitions and refinancings.

After a period of lending discipline during the Covid crisis, the limited transaction flow will lead to unitranche lenders, already under pressure from LPs to deploy capital, to go back to competing on loan terms for borrowers of better credit quality. This competition will only increase as banks gain market share on the back of their positive lending behaviour during the Covid crisis, during which they provided liquidity support to many struggling companies.

Companies, in more cyclical business sectors such as the retail sector, will continue to struggle raise financing. Non-cyclical companies will continue to borrow although loan yields are unlikely to move much for senior secured lenders, and may contract a little for unitranche lenders, but lender protection rights will weaken, removing some of the early warning signs for lenders and potentially negatively impacting default recoveries in the longer term.

Defaults will continue to rise, with many companies continuing to survive on government support schemes, delaying not preventing their demise. Defaults will remain centred on business sectors reliant on consumer spending which have already been affected strongly by the Covid pandemic. Many lenders will try to find short-term solutions to potential defaults by increasing covenant headroom or providing borrowers with other forms of short-term relief. In the longer term, this strategy of not being willing to restructure failing businesses early on will negatively impact recoveries.

We continue to believe that a low-risk strategy centred on senior secured lending, in non-cyclical industries provides investors with the best value. Ongoing economic challenges from Covid and Brexit will mean that the year ahead is one of uncertainty.

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REAL ASSETS

Egbert Nijmeijer,
Co-Head of Real Assets
at Kempen Capital Management

The impact of the pandemic on the real estate sector in 2020 has been profound. We have seen significant acceleration of pre-COVID trends across sectors such as logistics, self-storage, and data centres, in addition to continued declines observed for sectors such as physical retail.

Looking to 2021, new trends have emerged that have begun to ask new questions of this sector. Much has been made of the purported "death of the office" as employees have undergone a shift to working from home. While Canary-Wharf-type offices will not die, they will be in lower demand, and will need a lot of capex to make them attractive places to work in the post-coronavirus world. This means they will require a higher rate of return, which by definition means prices will have to fall.

We believe the hub-and-spoke model, with a smaller central headquarters and several low-to mid-rise offices in fringe locations on city outskirts, will dominate in the future. Coronavirus has shown people can efficiently and effectively work from home, and, with people now used to social distancing, they are unlikely to want to have to make long underground journeys every day to an office where they have to get in an elevator to go up 40 floors.

Elsewhere, we will see a further rise in the success of gateway cities and that definition will be expanded to include places that may have traditionally been classified as Tier 2 like Austin, Rotterdam and Manchester. While major cities that remain culturally and economically vibrant will clearly not disappear, there will be a reshaping in the status quo as people move to less expensive centres that, in some respects, offer a greater quality of life.

Additionally, we may also see a reshuffling of micro-locations within cities. In London, areas like Kennington and Peckham may become more popular, as people seek to move to more affordable and less crowded areas, which also fits into the hub-and-spoke theme.

Turning to infrastructure – we believe the future to be a green one. The infrastructure benchmark already has significant exposure to power generation & transmission, gas distribution and transport infrastructure.

All will see a step-change in green investment in the next year and beyond; renewables will continue to become increasingly competitive driven by technology gains and supportive regulation; the multi decade shift from coal to gas will deliver broader sustainability benefits such as reduced CO2 emissions and lower water consumption; as electric vehicles gain market share, investors will reward companies that promote EV infrastructure which has a direct impact on rail, road, airport and port sectors within infrastructure.

Beyond traditional assets, there are new sectors that will emerge which will place an emphasis on infrastructural sustainability. For instance, tomorrow's technological breakthroughs in battery storage or carbon capture will create new opportunities for global infrastructure. As the cost curve reduces, battery storage will be used more frequently by utilities to back up wind- and solar-parks.

Over the past decade there has been an undeniable focus on sustainability issues impacting society, and over the coming decade, I believe we will see a step change in the contribution Real Assets make to UN SDGs, namely Climate Action & Sustainable Cities.

"TOMORROW'S TECHNOLOGICAL BREAKTHROUGHS IN BATTERY STORAGE OR CARBON CAPTURE WILL CREATE NEW OPPORTUNITIES FOR GLOBAL INFRASTRUCTURE."

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