ABN·AMRO Investment Solutions

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Global Investment Outlook 2021

Business-cycle reset

December 2020

Global Investment Outlook 2021

Macro

Macro Outlook 2021

Business-cycle reset

GROWTH

Following many years of late-cycle dynamics, the coronavirus pandemic caused a deep recession that has set a low base from which to rebound. We now face early-cycle dynamics not seen for a decade: above trend-line GDP and corporate earnings growth and rock-bottom interest rates.

INFLATION

We see limited drivers of substantial inflation before 2022. A large amount of money is waiting to be spent and Covid-19 could accelerate the process of de-globalisation. But low inflation is also structural (demographics, digitization, etc.) and the pandemic may have boosted productivity.

MONETARY POLICY

Central banks remain attentive to downside risks. They have already discussed possible ways to adjust monetary policy if more accommodation is needed. Towards a new policy framework (flexible average inflation) tolerating inflation to overshoot to make up for past misses of their target.

POLITICS

The end of Donald Trump's presidency is not the end of populism in the US or more broadly. This probably means continued political and geopolitical turmoil, but more importantly, it also makes additional fiscal stimulus by governments more likely to address the causes of populist discontent.

GEOPOLITICS

Supply chains become shorter and more diversified. Geopolitical uncertainty and wage-cost convergence have been shortening global supply chains for more than a decade already. The coronavirus pandemic added further impetus to this trend. The ongoing transformation of supply de-globalization could lead to regionalisation.

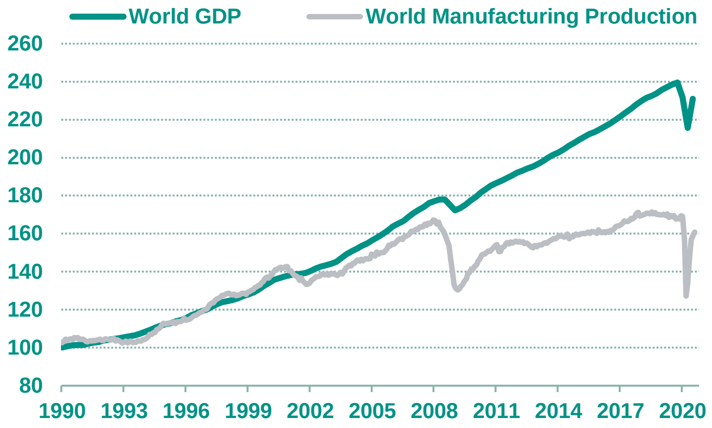
KEY TAKEAWAYS

A return to early-cycle dynamics while the Covid crisis reset the business cycle. We see no substantial reflation at few quarters horizon.
High political pressure on central banks to keep rates low in a high debt environment.
The shift to sustainability, and the joint monetary - fiscal policy implicit coordination are being accelerated.

Macro Outlook

GDP and manufacturing growth

- The swift and massive shock of the COVID-19 pandemic and shutdown measures to contain it have plunged the global economy into a severe contraction, the worst since World War II. **But a divergence remains between industry and GDP, dominated by services.** The Services sector **is lagging the global activity rebound**. The recovery gap between manufacturing and services will be reinforced by last lockdown measures.



World GDP and Manufacturing Production in USD (100 in Q1 1990)

World GDP and Manufacturing Production y/y growth

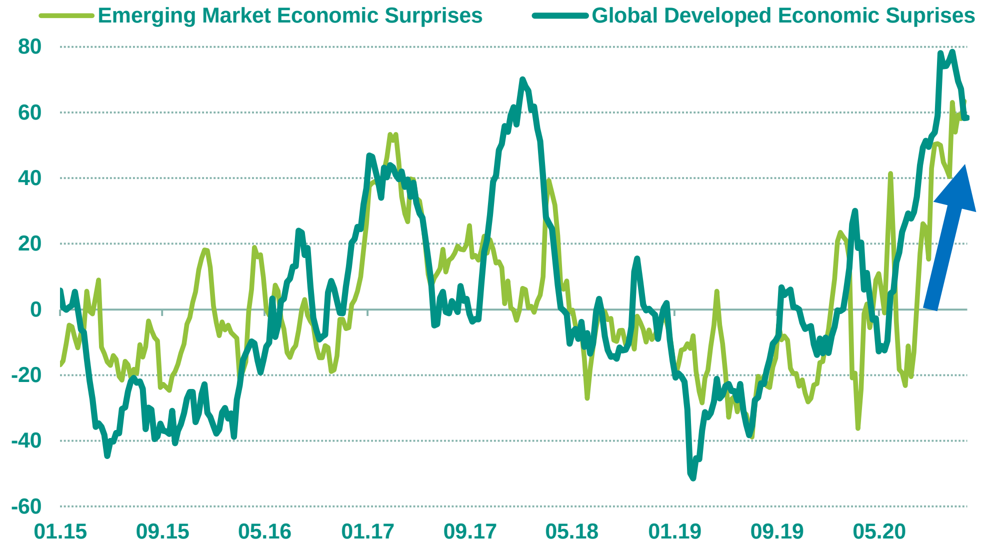
Sources: Datastream, IMF, OECD, Year-on-Year changes, Quarterly data in USD from Q1 1990 to Q3 2020, ABN AMRO Investment Solutions.

Macro Outlook

Global Economic Surprises

- **Between the 2 waves** of the COVID-19 pandemic, **the activity strongly rebounded.** The Economic Surprises surged with the reopening of developed economies in May. This post re-opening recovery was also helped by governments' **stimulus packages** and **central banks' pandemic emergency decisions.**

- The activity is expected to slowdown at the end of 2020 with the new (partial) lockdowns decided in Europe. However, **we expect that the global activity will quickly rebound in H1 2021.** Some of restrictions on mobility and the closure of shops in parts of Europe can be eased gradually after some improvement in virus trends.



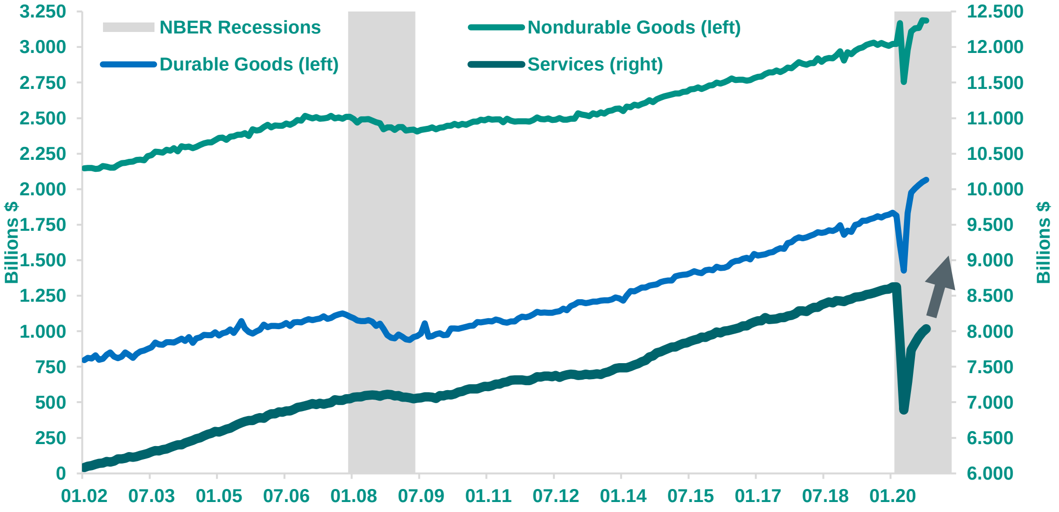
Indices of Global Developed and Emerging Market Economic Surprises

Source: Bloomberg, weekly data, 01/01/2015–27/11/2020. The Global Developed Economic Surprises index is a weighted average of Bloomberg economic surprise indices for US (ECSURPUS Index; 60%), eurozone (ECSURPEA Index; 35%) and UK (ECSURPGB Index; 5%). The Emerging Market Economic Surprises Index is the Citigroup Emerging Market Index (CESIEM Index) ABN AMRO Investment Solutions.

Macro Outlook

Consumption of goods and services during the COVID-19 recession

- The Great lockdown across the world led to a sudden stop in household consumption. Helped by policy makers' ultra-accommodative, monetary and regulatory response to the pandemic, **the consumption of Durable and Nondurable goods has surged** (V-shape) with reopening economies.
- The **services** were the most hit by the COVID-19 pandemic such as restaurants, travel, leisure and transport. **The rebound of the services activity is lagging** especially with the **restrictions to contain the second wave**.
- In past recessions, on the contrary, we observed smooth services and procyclical manufacturing activity.
- The progressive lift of restrictions (lockdowns, curfews) as well as the approbation of a vaccine (Pfizer, Moderna) against the COVID-19 **should accelerate the recovery in the services consumption.**



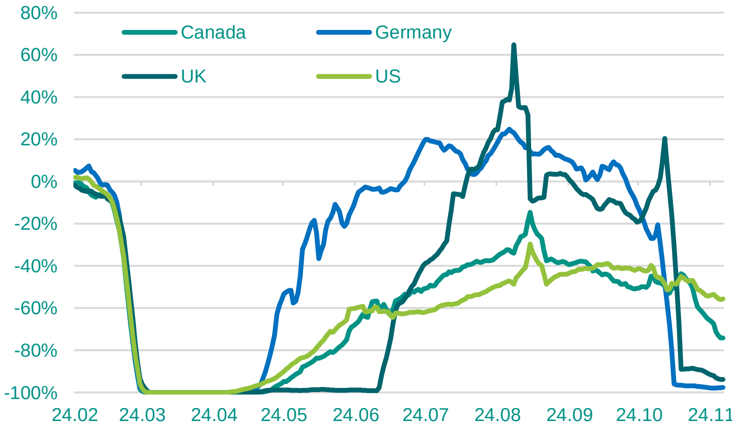
US Real Personal Consumption

Source: Datastream, US Bureau of Economic Analysis, NBER, monthly data, 01/01/2002–01/10/2020. Billions of 2012 Chained prices in USD. ABN AMRO Investment Solutions.

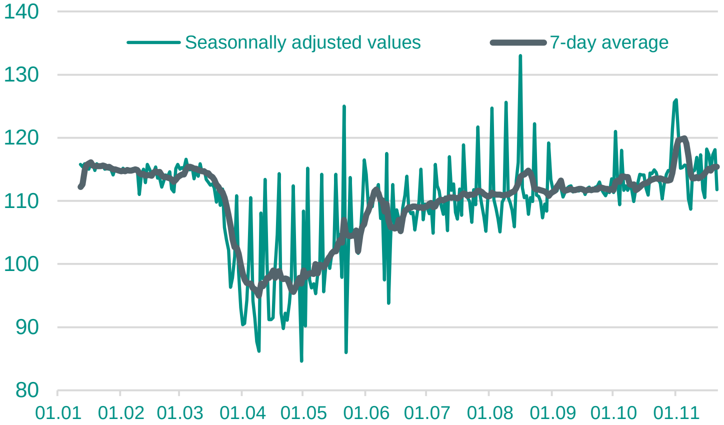
Macro Outlook

Restaurants are close (close early) but trucks keep rolling

- The Global lockdown in March and April have **plunged the economic activity by up to 30%.** The **curfews and "partial" lockdowns** decided to contain the second wave of the pandemic **were much less severe**. The worst hit sub-sectors by the new measures are especially the accommodation and food services. But **industrial and manufacturing activity continue to run** with factories allowed to open during the lockdowns.



Seated diners from reservations (y/y 7-day moving average)



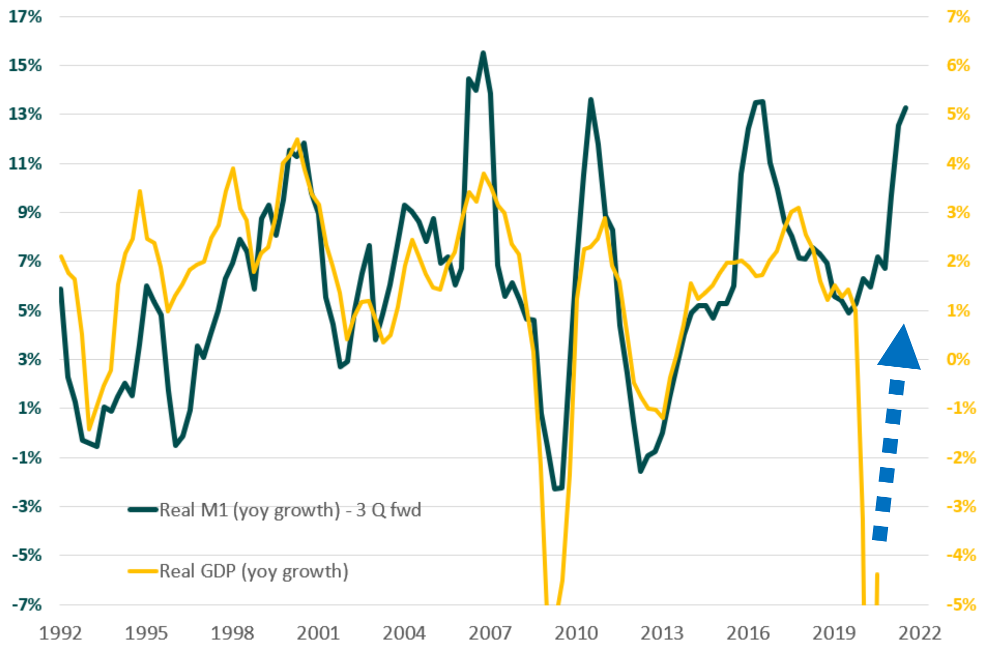
German Trucks Toll Mileage 2020 Index

Sources: OpenTable, German Federal Statistical Office (Statistisches Bundesamt, Destatis), daily data from 01/01/2020 to 30/11/2020. ABN AMRO Investment Solutions.

Macro Outlook

Eurozone Real Money Supply vs. Real GDP

- In the eurozone's bank-based financial system, M1 money supply remains a leading indicator of real GDP growth. After the Global Covid-19 Crisis, **we can expect a pick-up in 2021 eurozone growth.**
- **A lot of cash is available and waiting.** With reopening after the first lockdown, a part of this cash has been consumed, but precautionary savings remain (uncertainty, "lockdown insurance", Ricardian equivalence effect).
- Our scenario is that **this cash will be used progressively later** (in few months/quarters) leading **to higher demand and then increasing Capex and slightly more inflation** (as well as asset prices).



Eurozone Real Money Supply is leading Real GDP y/y growth

Source: Bloomberg, ECB, Eurostat, Quarterly data from 01/01/1992–24/11/2020. Year-on-year changes in %. Real M1 money supply, deflated by consumer prices, advanced by 3 quarters on the right-hand scale. Real GDP on the left-hand scale. ABN AMRO Investment Solutions.

Global Investment Outlook 2020

Markets

Market Outlook

MARKETS

EQUITIES

Equities remain our preferred asset class. Emerging markets equities offer the highest risk-return trade-off (valuations). Equities are one of the few asset classes that still offer attractive yields with High Return Debt and Emerging Debt.

STYLES

We favour Small and Quality factors for their resilience. Despite long-term support (strong fundamentals, digitization, low interest rates, ESG appetite) for growth stocks, rotation risks on cyclical/defensive are high with vaccine news. We prefer a neutral position on value-growth.

INTEREST RATES

Major central banks have signalled their intention to maintain low interest rates a long way out on the yield curve. This will prevent a too strong steepening of the yield curve usually observed in the early-stage of the business cycles.

CREDIT

Like every recession, credit spreads widened. However, rapid and substantial fiscal and monetary stimulus made this an exceptionally short-lived phenomenon, leaving investors with a mix of early- and late-cycle characteristics (some defaults to come while spreads are low).

VOLATILITY

Volatility will remain probably volatile during the first-half of the year amid news about vaccine campaign issues and economic policy news. We see a low volatility regime take hold later in the second half of the year.

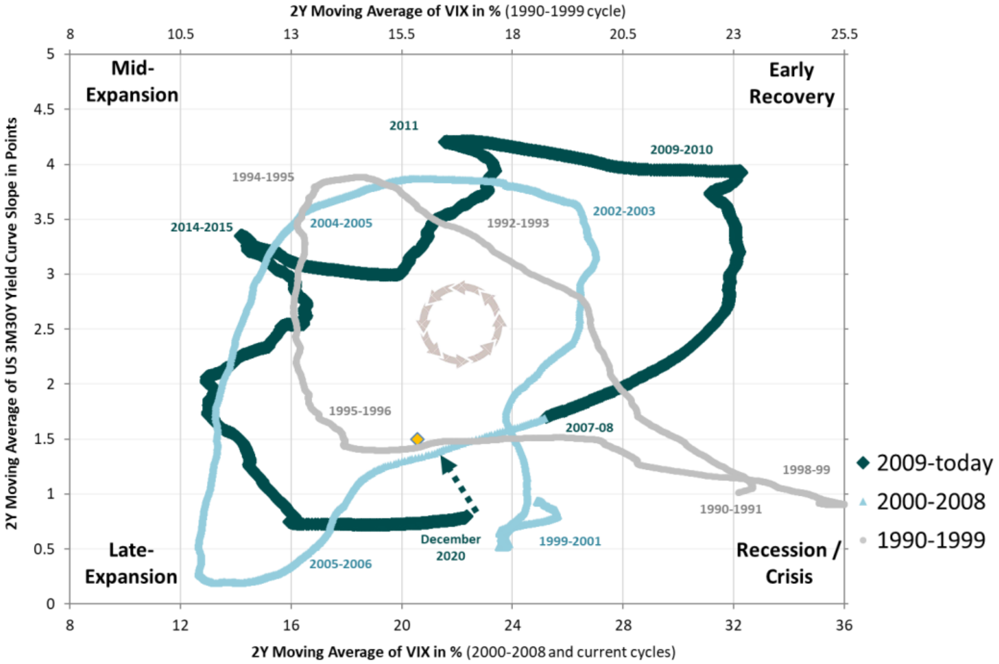
KEY TAKEAWAYS

Equities will probably benefit from the economic recovery and the early cycle dynamics.
High forced and precautionary savings will progressively be spend. This will be directly or indirectly in favour of risky assets. The combination of high debt and low yield for less-risky assets would reinforce the “There Is No Alternative” effect .

Market Outlook

The Macro Financial Clock

- **With structural shifts toward low inflation** (flat Phillips Curve, digitisation, globalisation, shrinking worker bargaining power) **and low real interest rates** (demographics, capital price, excessive savings, etc.), **end of business cycles are no longer characterised by inflation and monetary tightening.** We have to monitor business cycle developments with new tools.
- Changing US financial conditions over the last three cycles have been counter-clockwise. Indeed, **volatility tends to rise before a recession and ease with the recovery whilst the yield curve flattens before a recession and picks up during the recession.**
- The end of the longest economic cycle in history was precipitated by the shutdown of the global economic activity to stem the coronavirus outbreak. Volatilities hit record high while the yield curve stayed flat, typical movements in crisis time. **Now, easing volatilities and modestly steepening yield curve signal the dawn of a new business cycle.**



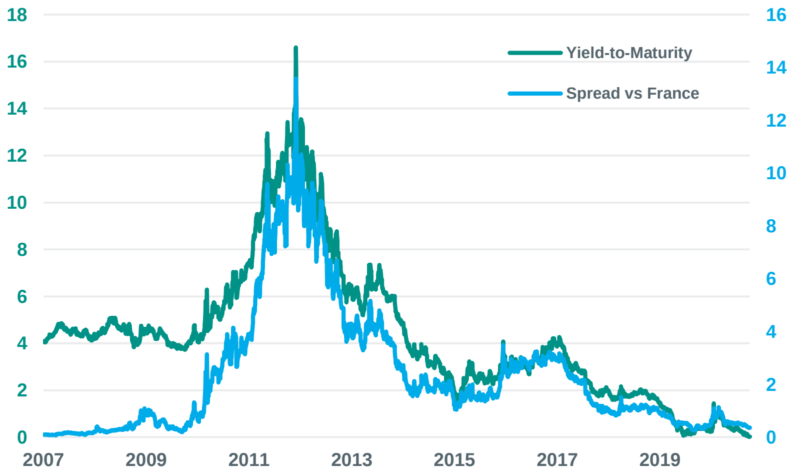
A renewed cycle with more favourable conditions

Sources: Datastream, daily data from 01/01/990 to 30/11/2020. The yellow point represents spot conditions. ABN AMRO Investment Solutions.

Market Outlook

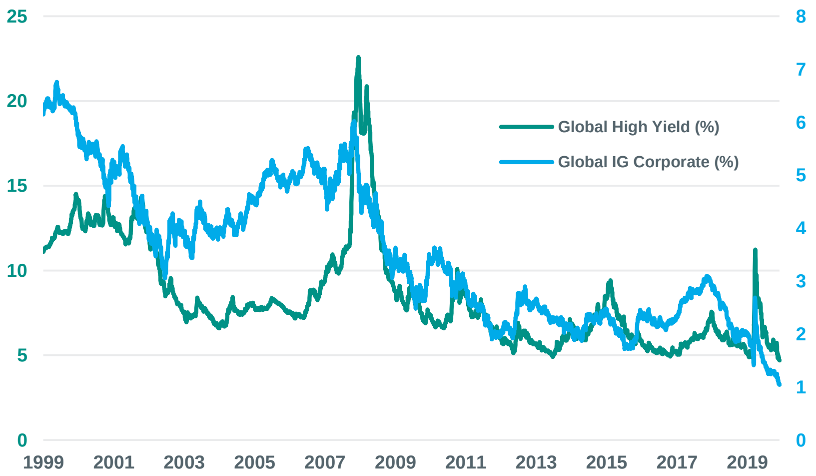
Ultra-low interest rates environment

- Central banks across the globe turned more accommodative than ever to support the economic activity in 2020. **Bond purchase programs and other stimulating tools drive interest rates to historic lows while spreads remain tight** (e.g. Portugal sovereign debt). Fixed income asset returns are set to stay low for a long time.



Portugal 10Y Sovereign Debt (%) at historic low levels

Source: Bloomberg, France and Portugal 10Y sovereign bond yield-to-maturity.



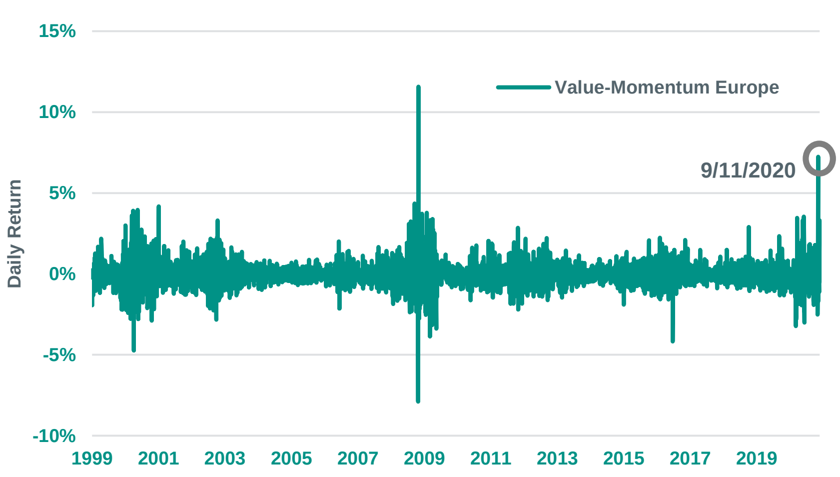
Yield on main fixed-income asset securities continue to fall

Source: ICE BofAML, Global High Yield Constrained Regular Rebalanced Index and Global Investment Grade Non-sovereign Index yield-to-worst.

Market Outlook

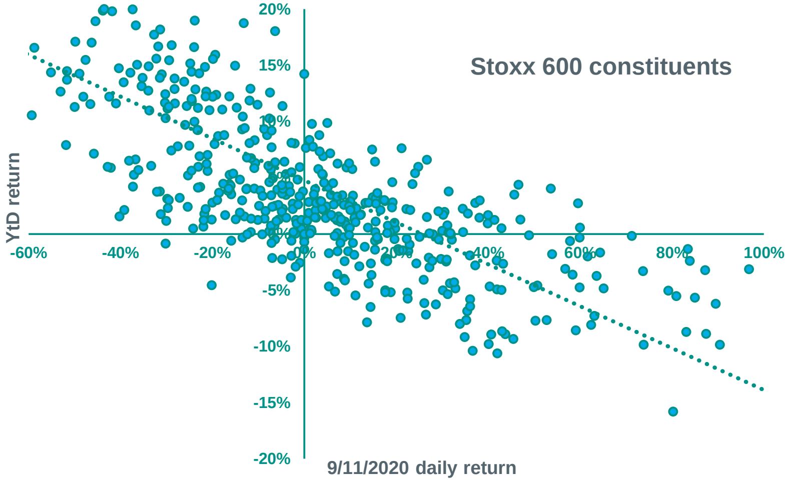
Lasting factor rotation or temporary market overreaction

- **Positive announcements on vaccines effectiveness against the COVID-19 triggered a "Black Swan" movement on stock markets**. Momentum stocks that overperformed since the beginning of the crisis were heavily dumped by investors in favour of more cyclical/value stocks that suffered the most of the pandemic consequences.



A "Black Swan" on factors

Source: Bloomberg, MSCI Europe Value Index daily returns - MSCI Europe Momentum Index daily returns.



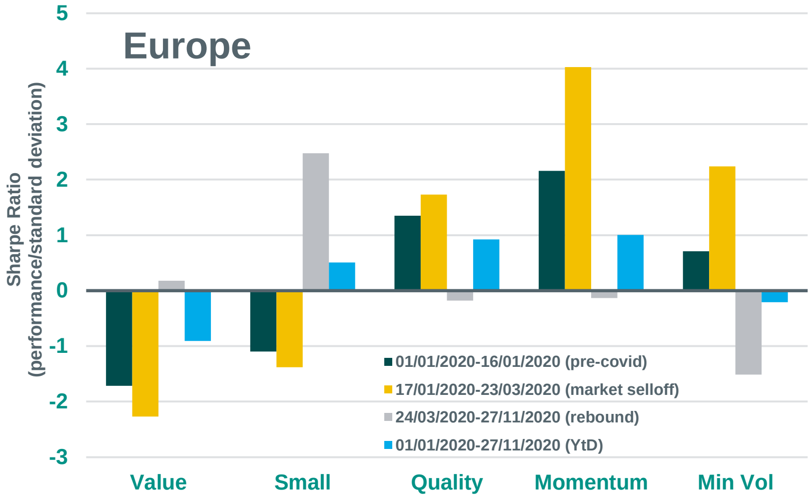
YtD return explains most of the cyclical stocks outperformance

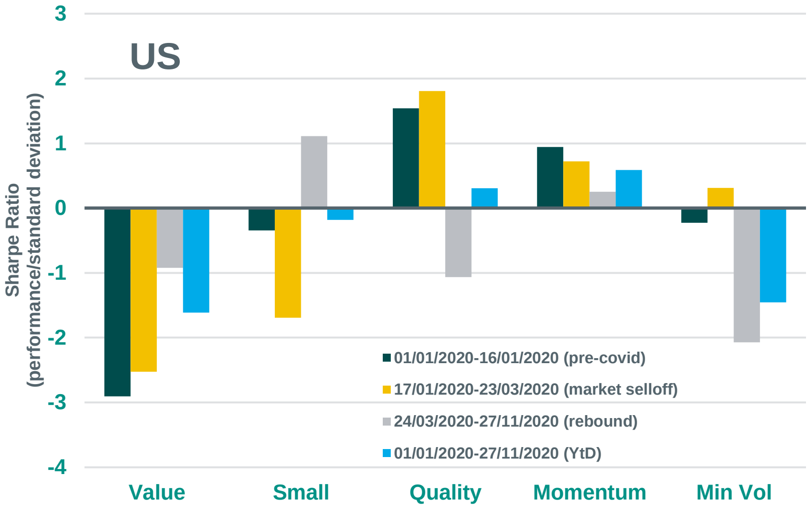
Source: Datastream, daily and YtD performances of individual constituents of the Stoxx 600

Market Outlook

How factors perform in highly volatile markets

- **Value factor** (relative to growth) significantly underperformed as Energy and Financial sectors **were penalized by respectively lower oil demand and reduced interest margins**. On the other hand, **small size companies were preferred during the rebound amid stable credit conditions and weak interest rates**. While the minimum volatility factor offered protection to investors during the market downturn, it underperformed with rebounding equities.





Source: Bloomberg, MSCI Europe (Blend), MSCI Value Europe, MSCI Growth Europe, MSCI Small Europe, , MSCI Large Europe, MSCI Quality Europe, MSCI Momentum Europe, MSCI Min Vol Europe, MSCI USA (Blend), MSCI Value USA, MSCI Growth USA, MSCI Small USA, , MSCI Large USA, MSCI Quality USA, MSCI Momentum USA, MSCI Min Vol USA. Value is relative to Growth, Small is relative to Large and Quality, Momentum and Min Vol are relative to Blend,

Global Investment Outlook 2020

Risks

Risk Outlook

What we are watching in 2020

MACROECONOMICS

Too many stop and go policies

As Europe and the US face a new wave, the virus's apparent seasonality could lead to further periods of partial lockdown by next winter putting public debt under pressure.

Vaccine logistic: people and frozen chain

Moderna's vaccine has to be shipped at –20°c and stored at that temperature for six months. Pfizer's vaccine must be kept at –70°c. Once transferred to a refrigerator, it must be administered within 30 and 5 days respectively.

Vaccine acceptation: achieving or not herd community

The success of any vaccine depends on the share of the population that gets vaccinated. According to some simulations, a vaccine will benefit public health by saving many lives but nevertheless may.

MONETARY POLICY

Inflation surprises

Inflation is unlikely to rise much over the next two-to-three years. However, post-Covid crisis, inflation would be volatile from time to time with some extreme surprises fuelling the market sentiment that 'great inflation is coming'.

The Fed-Treasury nexus

President-elect Joe Biden's nomination of Janet Yellen is a significant signal for the Biden administration's economic policy, from near-term stimulus to Fed-Treasury cooperation. Will the Fed remain fully independent?

Central bank credibility

By making the fight against global warming one of its priorities, the European Central Bank is starting an alarming development, according to some commentators. The risk is to jeopardize its credibility patiently built over many years

POLITICS

Elections and political events

In the next twelve months, from Peru to India, the Netherlands to Australia, many elections are scheduled. But the future of the Senate majority (fiscal stimulus plans and level of US long term yields) will depend on the second round of elections in Georgia on January 5, 2021.

De-globalization

The heyday of globalization is behind us. Globalization is on the back foot, with the ratio of trade-to-output moving sideways for more than a decade. The risk is that the "Trade-war' by former president Trump will evolve in "securing supply-chain" conflicts.

Brexit

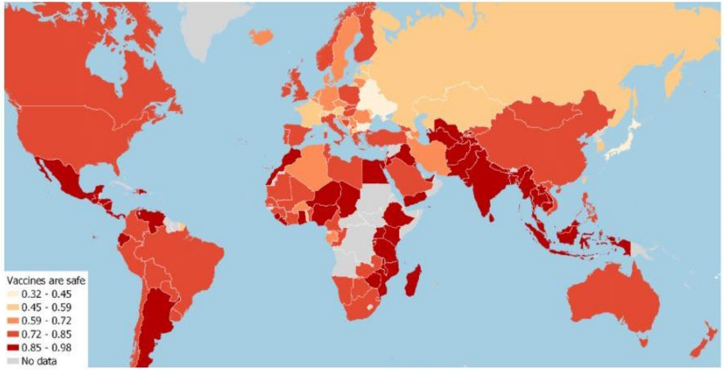
Those hoping that Brexit will disappear of the news agenda forever from 2021 may be a little disappointed. Even if a deal is agreed, it will inevitably be a basic one. A free-trade agreement will avoid tariffs but may not prove to be a particularly sustainable trading platform in the long-term.

Risk Outlook

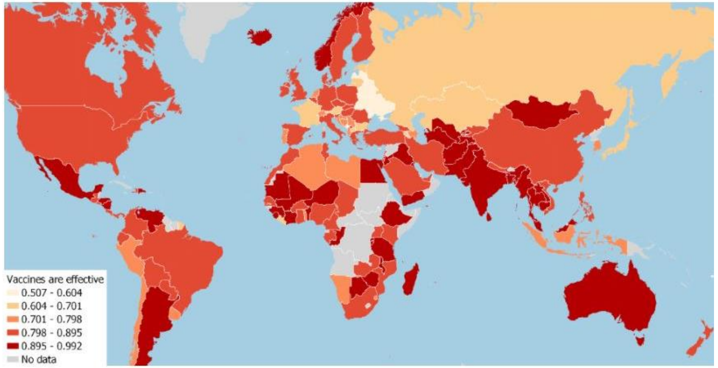
Vaccine challenges

- Huge challenges remain before a vaccine can be rolled out. The global battle to secure prospective supplies has raised alarm about equitable access, while questions remain over logistics, distribution, and, perhaps most significantly, cost, as well as efficiency over the long-term. The challenges of manufacturing and distributing the vaccine lie ahead

- But some experts argue that the most difficult challenge may actually be getting people to take it. A September survey of more than 10,000 Americans showed that only a slim majority of adult respondents would definitely or probably get a vaccine to prevent Covid-19, were it available today. A 2018 study shows that vaccine scepticism is even greater in a number of other countries.



Share of respondents who agree that vaccines are safe



Share of respondents who agree that vaccines are effective

Source: Aksoy, C, B Eichengreen and O Saka (2020), "Revenge of the Experts: Will COVID-19 Renew or Diminish Public Trust in Science," SSRN.org, May. And Wellcome Trust (2018), Wellcome Global Monitor 2018.

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