ANNUAL HOUSE VIEWS

2021 Outlook

A New Dawn

Macro

Recent announcements of three successful anti-COVID-19 vaccines have brought real hope that the pandemic can be brought under control over the next year. There are many logistical challenges of course but significant portions of the most vulnerable parts of the population – healthcare workers and the elderly – could be vaccinated by Spring. Until then, we expect lockdown policies to remain in force – albeit less stringent than at present – for much of Europe and some US states. Asia, which has largely sidestepped the second wave of infections, remains the exception, with growth in industrial production and retail sales currently accelerating in China.

Central Banks

Recent communication from the Federal Reserve (Fed) and European Central Bank (ECB) has reinforced expectations that both will ease policy at their December meetings. Moreover, the Fed is opposing plans by the current Treasury Secretary to withdraw its emergency funds so they can be spent elsewhere, a clear sign that it wants to retain full firepower given the near-term risks to growth. We expect easing to come in the form of enhanced and extended asset purchase programmes – of government and high-quality corporate bonds – to ensure that borrowing costs remain under control. Further, the ECB is likely to offer cheap refinancing to encourage bank lending.

Markets

Financial markets tend look ahead rather than worry about near-term risks and the vaccine announcements have fostered a rise in investors' risk appetite. This means that safe havens – such as government bonds, the dollar or gold – are less in vogue than more cyclically-sensitive assets like equities. Within equities, we expect a shift from "lockdown winners" such as megacap tech and internet stocks, which tend to be extremely expensive, towards more cyclical sectors where valuations are much more attractive. Within fixed income markets, corporate bonds and emerging market debt – especially in Asia – remain our preferred segments.

Bottom line

The rally in high-grade corporate bonds has pushed the yield premium (or "spread") available on high-grade corporate bonds down close to historic lows and we have moved back to Neutral to lock in some profits. We maintain an Overweight in equities and have upgraded allocations to both Europe and Japan, two rather cyclical markets. With economic activity moving back towards normal over the next twelve months, there is less need for safe havens such as the US dollar and gold and we have scaled back positions. In addition, we expect direct exposure to equities to outperform hedged strategies like Hedge Funds and accordingly have reduced allocations to Neutral.

In accordance with the applicable regulation, we inform the reader that this material is qualified as a marketing document.
CA159/H2/20

OUR STRONGEST CONVICTIONS

Diversification is vital

The pandemic has accelerated a number of trends in markets – sovereign yields have fallen ever-lower while tech and internet stocks have dominated year-to-date equity markets with ever-higher valuations. As a result, government bonds no longer offer much in the way of diversification benefits – positive performance is hard to come by with negative yields – and long-term expected returns from large-cap equities have tumbled. In this context, investors should seek broad diversification across markets, regions and sectors.

The dollar could shift lower

During bouts of risk aversion in markets, investors tend to rush to the perceived safety of safe havens such as gold, sovereign bonds, Swiss francs or the dollar. However, recent vaccine announcements have raised investor hopes that activity might soon return to normal, diminishing the need for such havens in portfolios. Moreover, the dollar has been trading at rather expensive levels – for example, it is 16% overvalued against the euro on OECD figures – which offer little support.

Asian local currency bonds offer a rare source of yield

Under the weight of disinflationary tendencies, investor risk aversion and central bank asset purchases, sovereign yields have plummeted, with around $17.4 trillion of government bonds trading with negative yields. As a result, investors in search of yield have bid up prices of many other fixed coupon bonds, with high grade corporate bonds now offering negligible yields which afford little protection against an adverse change in circumstances. For investors ready to take the additional risk, Asian local currency debt offers an interesting opportunity.

Time to highlight cyclically sensitive equities

In the course of 2021, widespread vaccination should help bring COVID-19 under control and enable households and businesses to resume normal life as lockdowns and restrictions are lifted progressively. The resulting pick-up in activity should favour those equity markets where exposure to the economic cycle is the highest – for example, Emerging Markets, Europe and Japan. The same should hold true for cyclically sensitive segments within markets like Consumer Discretionary, Industrials and Materials or indeed small-capitalisation stocks in the US.

Locking in some profits on gold

With safe havens falling out of favour, we expect less upside from gold. Inflationary pressures remain moderate, some central banks have reduced exposure and purchases via ETFs have declined. On the other hand, real bond yields (i.e., after inflation) remain negative and massive increases in government debt may cause some investors to question the viability of fiat currencies, two factors which tend to favour gold. We have moved to a Neutral allocation, thereby locking in some profits.

Stay flexible

In coming months, when vaccines will not yet be widely available and seasonal factors in the northern hemisphere may favour further waves of coronavirus infections, activity across Europe and North America is likely to remain depressed. Brighter days do lie ahead but great uncertainties remain – many companies may not survive in their current form while consumer behaviour and preferences in areas such as travel and tourism may be lastingly altered. Investors should remain flexible, ready to make tactical adjustments to portfolios as circumstances evolve.

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OUR ASSET ALLOCATION

The table below presents the latest conclusions of our Global Investment Committee

Asset class	Segment	Asset	Strong UW	UW	N	OW	Strong OW	Change since last GIC
			Summary house views					
EQUITY		**GLOBAL EQUITY**				X		
EQUITY		**United States**			X			
EQUITY		**Eurozone**				X		+
EQUITY		**United Kingdom**				X		+
EQUITY		**Japan**				X		+
EQUITY		**Emerging**					X	
FIXED INCOME	SOVEREIGN	**GLOBAL RATES**		X				
FIXED INCOME	SOVEREIGN	**U.S. Treasuries**	X					
FIXED INCOME	SOVEREIGN	U.S. Breakeven			X			
FIXED INCOME	SOVEREIGN	**Bunds**	X					
FIXED INCOME	SOVEREIGN	EMU Breakeven			X			
FIXED INCOME	SOVEREIGN	**Gilts**	X					
FIXED INCOME	SOVEREIGN	Gilts Breakeven			X			
FIXED INCOME	SOVEREIGN	**EM Govies ($)**			X			
FIXED INCOME	CORPORATE	**U.S. IG**			X			-
FIXED INCOME	CORPORATE	**U.S. HY**			X			
FIXED INCOME	CORPORATE	**EMU IG**			X			-
FIXED INCOME	CORPORATE	**EMU HY**			X			
FIXED INCOME	CORPORATE	**UK IG**			X			-
FIXED INCOME	CORPORATE	**UK HY**			X			
FIXED INCOME		**Duration USD***		X				
FIXED INCOME		**Duration EUR***		X				
FIXED INCOME		**Duration GBP***		X				
FOREX		**EURUSD**				X		+
FOREX		**USDJPY**			X			
FOREX		**GBPUSD**				X		+
FOREX		**EURCHF**			X			
FOREX		**EM FX (vs. USD)**				X		+
CMDTY		**Brent**		X				
CMDTY		**Gold**			X			-
ALTERNATIVE		**ALT. STRATEGIES**			X			-
ALTERNATIVE		**L/S Equity**			X			+
ALTERNATIVE		**Event-Driven**				X		+
ALTERNATIVE		**FI Arbitrage**			X			-
ALTERNATIVE		**Global Macro / CTAs**			X			

	Positioning	*Duration
O/W	Overweight	Long – 7-10 years
N	Neutral	Intermediate – 5-7 years
U/W	Underweight	Short – 3-5 years

EQUITIES	
United States	The prospect of a vaccine-driven recovery should spark some rotation in market leadership, and we expect more cyclically sensitive markets to outperform the US.
Eurozone	We have decided to tilt portfolios towards more cyclically sensitive markets and accordingly have moved euro zone equities to Overweight.
UK	We expect a last-minute trade deal with the EU to boost the UK – a rather cyclical market – and we have moved Overweight.
Switzerland	Corporate fundamentals remain strong – return on equity has risen this year – which should help cushion any underperformance.
Japan	Tokyo ranks as the cheapest among major equity markets and we have moved Overweight.
Emerging (EM)	EM equities have failed to keep pace with earnings growth so far this century, leaving considerable catch-up potential. Strong Overweight.

FIXED INCOME	
Sovereigns	Government bonds remain unattractive, offering negligible or negative yields to investors.
Duration*	We still prefer shorter-dated bonds, which are less sensitive to any rises in rates.
Inflation-linked	Output gaps remain wide, keeping inflationary pressures under control.
Investment Grade	Spreads have tightened again, leaving little further potential. We move back to Neutral.
High Yield	Near-term sluggish activity could put further pressure on those issuers with the weakest balance sheets.
Emerging debt (in € and $)	We continue to prefer Asian issuers given the cyclical upswing which is well under way.

CURRENCIES	
EUR/USD	The zero-yield environment, increased fiscal spending and deteriorating twin deficits do not favour the US dollar.
GBP/USD	Brexit negotiations are likely to dominate trading in the near term but we expect a deal in due course.
EUR/GBP	The UK economy got the additional support it needed as the Bank of England increased asset purchases.
USD/JPY	Japan has coped well with COVID-19, thereby limiting the recessionary impact, and the transfer of power from Abe to Suga has been smooth.
EUR/CHF	The Swiss franc has lost ground against the euro on hopes that a vaccine could be launched soon. We expect further modest franc weakness.
Emerging	Vaccine-inspired hopes for a cyclical recovery should help emerging currencies trade higher next year against the dollar.

ALTERNATIVES	
Hedge funds	Our preferred strategies are Special Situations, Long/Short (L/S) Credit, discretionary and EM Global Macro traders, and directional L/S Equity.
Gold	Prospects of post-pandemic recovery mean less demand for safe havens like gold.
Oil	Near-term sluggish demand should keep a cap on oil prices.

Source: SGPB, 27/11/2020
* Duration: short = 3-5 years, medium = 5-7 years, long = 7-10 years
HY = High Yield bonds (higher return but greater risks), IG = Investment Grade bonds (higher quality but lower return)

ECONOMIC OUTLOOK

Changing the Game

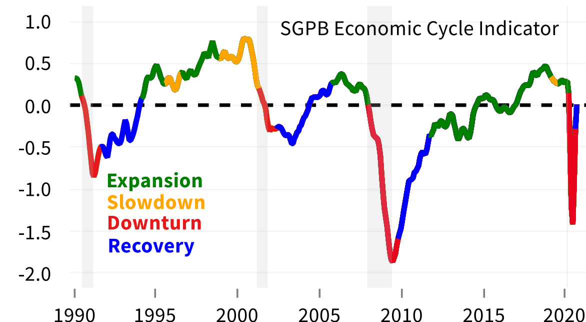
While important regulatory and logistical hurdles remain – inoculating billions of people will be no easy task – a viable vaccine candidate is a material milestone in the global battle against the ongoing pandemic, making economic conditions more favourable for risk assets.

Our leading macroeconomic indicator for the US – the developed world's cornerstone – suggests the global economy has been in a state of recovery since the since the summer months. However, given the unusual influence exercised on the underlying indicators by the COVID-19 pandemic, there has been a higher than usual chance of a reversal back into a regime of "contraction".

In our judgement, this risk has lessened meaningfully with the November 9 announcement that Pfizer and BioNTech, two pharmaceutical firms, have co-developed a vaccine which demonstrates an efficacy of over 90% in preventing COVID-19 infections. This has since been followed by two more major vaccine announcements, one by Moderna and the other from AstraZeneca and Oxford University in collaboration. While important regulatory and logistical hurdles remain – inoculating billions of people is not to be taken lightly – the availability of three viable vaccine candidates is a material milestone in the global battle against the ongoing pandemic.

While we first began increasing exposure to risk assets over the third quarter as the recovery gained momentum, we remained wary of the plausible possibility of a double-dip recession caused by COVID-19 lockdowns. Ironically, as the blistering pace of recovery over the third quarter gives way to a slowdown in the fourth on rising new infections and hospitalisations, the vaccine announcements make the future path much brighter, an encouraging prospect for financial markets which can look forward to even more favourable economic conditions.

Back into recovery



Source: SGPB, Macrobond, 27/11/2020

Nonetheless, valuations for equities – the largest source of risk and return in most portfolios – remain challenging in absolute terms. However, with global interest rates near zero, there is a case for more tolerance than usual to high valuations (i.e. future cash flows are discounted using lower rates). Moreover, the emergence of a vaccine – and the ensuing increase in economic activity – is likely to be supportive of higher corporate earnings, which will serve to trim valuations (all else being equal).

Furthermore, momentum in global equities has been positive since the summer on the ten-month moving average metric we favour. The strong momentum picture has been given an additional tailwind by the vaccine news and, to a lesser extent, the conclusion of the US election in early November, which had been a source of worry for some investors.

Given this backdrop, we have tilted our risk positions towards equity regions which should benefit from a cyclical pickup in growth, such as the Emerging Market (EM) complex, Europe and Japan. The largest country in EM is China, the only major global economy that is not expected to contract in 2020, and which is expected to continue its robust trajectory thereafter. We also expect a somewhat weaker US dollar in the coming year, with the Federal Reserve maintaining near-zero interest rates as well as keeping up the pace of its asset purchase programme. Historically, a weaker US Dollar has been a tailwind for EM equities.

We have also upgraded our view on Japan. It is also procyclical in nature and should benefit from the nascent global economic recovery, which is led by China, its single largest trading partner. Japan's government stimulus program is also the largest of any major economy as a percentage of GDP.

Bottom line. While economic conditions should remain challenging in coming months as governments attempt to avoid health systems being overwhelmed by COVID-19 cases, the medium-term outlook has been brightened by the prospect of multiple vaccines enabling more normal economic activity by mid-2021. Accordingly, we have further increased exposure to more cyclically sensitive assets.

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FIXED INCOME

Where have all the yields gone?

Government bonds remain unattractive, offering negligible or negative yields to investors. "Credit" markets – i.e., corporate or emerging market debt – offer more value but great selectivity is required. Given low yields and tight spreads, we have scaled back exposure to Investment Grade (IG) corporate bonds.

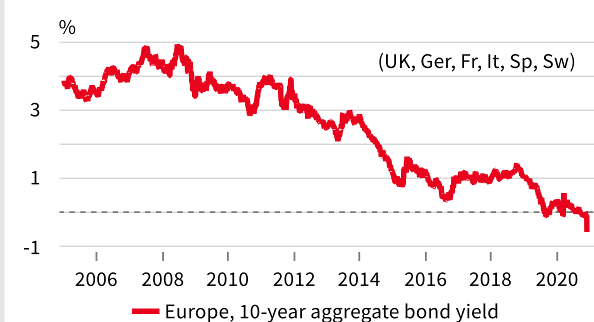
Continued central bank purchases and generally low inflation data are combining to keep sovereign bond yields close to historic lows. This has encouraged investors to seek higher returns in credit markets, tightening corporate bond spreads and pushing yields close to all-time lows. In this context, we still prefer corporate bonds to sovereigns but have locked in some profits.

Sovereigns

US. Hopes of Democratic "clean sweep" of the presidency and Congress have been dashed for now, thereby hushing speculation of massive fiscal stimulus. Nonetheless, 10-year Treasury yields are little changed in recent weeks as investors have begun to look forward to the end of the pandemic. However, employment growth has slowed, economic growth remains well below potential and inflationary pressures are likely to remain muted, which means upside for yields is limited for now.

Eurozone. With headline inflation stuck in negative territory and COVID-19 restrictions pushing the economy back into recession, the ECB has signalled its intention to increase and extend asset purchases of sovereign and high-grade corporate bonds at its next meeting. As a result, German bond yields are likely to remain negative and periphery spreads (i.e., the difference in yields between 10-year German bunds and Italian, Spanish or Portuguese bonds) extremely tight.

Government bond yields remain historically low



Source: SGPB, Macrobond, 27/11/2020

UK. The Bank of England (BoE) surprised investors by raising its total asset purchase programme by £150bn to £895bn, more than double the end-2019 level, on fears of COVID-19 and Brexit risks. Negative BoE base rates appear unlikely for now, but the buying should help keep sovereign ("gilt") yields close to zero.

Credit

US. Yields on IG corporate bonds have fallen to 2.0%, only 5 basis points (bp) above August's all-time low, taking spreads back to pre-COVID-19 levels. Investor appetite for corporate paper remains strong with IG new issues up 16% year-on-year (YoY) in October and +28% for HY. However, the recent rally in IG leaves little room for spread compression and we have moved allocations back to Neutral. High Yield (HY) default risk remains elevated according to Moody's and we recommend concentrating on the better-quality issuers in this segment.

Eurozone. Yields on euro IG bonds are back at 25bp, barely higher than 2019's 23bp all-time low. The ECB's asset purchase programmes – shortly to be boosted – and the double-dip recession are keeping investor demand high but there is little value left – we have decided to scale back positions to Neutral. Spreads on euro HY have tightened from 489bp in late October to 374bp today on rising risk appetite and offer little protection against recession-weakened balance sheets. Here again, we focus on better-rated issuers.

UK. In four short weeks, sterling IG spreads have tumbled from over 130bp to 110bp, leaving little margin for error, and we recommend taking some profits. HY spreads are now at a rather demanding 353bp, given pandemic restrictions and Brexit worries, and investors should focus on the least risky issuers.

Emerging debt

As described last month, a number of sovereign defaults – Zambia was recently added to the list – have not dampened investor enthusiasm for EM borrowers, with spreads over US Treasuries now at 318bp. However, we think credit quality will improve as EM stand to benefit from the cyclical recovery led by China and we remain Neutral. As highlighted on page 8, we also find opportunities in Asian local-currency EM debt.

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INVESTMENT IDEA

Emerging Asian debt in local currencies

The monetary and fiscal response to the economic impact of the COVID-19 pandemic, led by the United States, has been one of the most vigorous in world history. Emerging Asian central banks have been just as active in easing monetary policy as their peers in advanced economies – they were able to cut rates significantly thanks to their higher starting point; asset purchase programmes were launched in countries like Thailand and Indonesia; and measures were implemented to promote bank lending. We expect easy policy settings to stay in place over coming quarters – the sustainability of economic recovery in developed markets remains uncertain and monetary policy there is still very accommodative, removing any pressing need for Asian central banks to tighten policy for now.

The latest economic projections from the International Monetary Fund (IMF) suggest that global gross domestic product (GDP) may contract 4.4% in 2020, following by a +5.2% rebound in 2021. However, there are wide disparities – advanced economies are expected to see GDP fall 5.8% this year and recover by only 3.9% in 2021 while the IMF expects Asian emerging markets (EM) to contract by only 1.7% in 2020 and then bounce 8.0% next year. Asia's growth advantage looks set to widen.

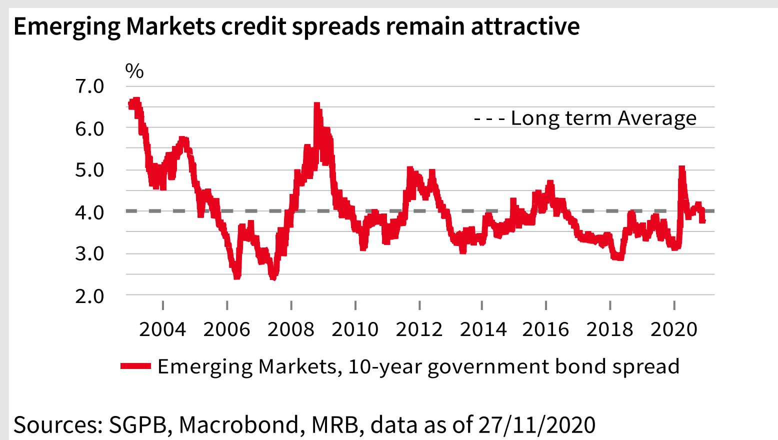
Despite the strong bounce in new COVID-19 cases across the globe, Asian countries seem to have been better prepared for the pandemic. China in particular has reported negligible numbers of new COVID-19 cases over recent months and has registered a strong recovery, suggesting a strong correlation between how well a country contains the outbreak and economic performance. South Korea and Taiwan have also demonstrated the same link. Strong growth should attract capital inflows, as should the attractive yields available – we expect emerging Asian currencies and debt markets to benefit from sustained demand.

We anticipate gradual recovery in the global economy in 2021, led by Asia which should be less reliant on vaccine availability than other regions. Moreover, although we expect the new Biden administration to maintain a hard line with China, we believe that he will favour multilateral engagement over trade tariffs, which should benefit exporting nations across Asia. Furthermore, emerging Asian currencies should be supported by their higher "carry" (the differential in interest rates) in a yield-starved world.

Local-currency EM credit spreads have shrunk steadily from 5.1% in late March 2020 to 3.8% at present (see chart below), but they remain close to the 4.0% average since 2003. This still represents an attractive pick-up in yield in such a low rate environment, much higher than anything available in developed markets outside of the riskier segments of high yield bonds. Moreover, economic recovery should help buttress government finances across the region, thereby improving the outlook for sovereign debt ratings. Investors searching for high-yielding assets may turn to emerging Asian debt.

Bottom line. The outlook for resilient growth across emerging Asia, strengthening currencies and attractive yield differentials should prove a winning combination for local currency debt markets.

Emerging Markets credit spreads remain attractive



Sources: SGPB, Macrobond, MRB, data as of 27/11/2020

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INVESTMENT IDEA

Insurance-Linked Securities – Marching to a different beat

What is the connection between hurricanes in the Gulf of Mexico, earthquakes in the Pacific Rim and forest fires in Southern Europe? And what is the connection between these natural disasters and trends in financial markets? The answer to both questions is, of course, none. And this is precisely why Insurance-Linked Securities (ILS) are such an interesting asset category.

ILS – also known as Catastrophe or Cat Bonds – have been around since the 1990s in the aftermath of Hurricane Andrew which devastated the Bahamas and Florida. The limits of reinsurance capacity had become apparent and insurance companies sought new ways to securitize these exposures in the form of tradable bonds. The advantages were two-fold – the insurance industry greatly augmented its capacity to cover such unpredictable natural phenomena, and investors gained a new type of security.

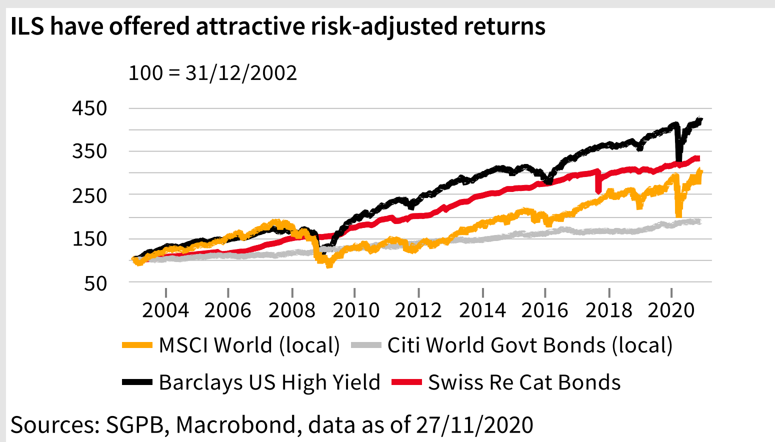
This area has grown steadily since the first issued in 1997 – total outstanding ILS capital reached $2.8bn in 2000, $13.9bn in 2010 and stands at $45.6bn at present according to the consultancy Artemis. Issuance so far this year has amounted to $14.2bn, the highest on record, illustrating strong investor appetite for these securities.

How do ILS work? Reinsurance companies transfer some of their portfolio of risk exposures to a special-purpose vehicle (SPV). In exchange for accepting the risks, the SPV receives a premium from the reinsurer which is then invested in short-dated fixed-coupon bonds. The SPV then issues a bond – the ILS – which typically has a less-than-3-year maturity and pays an above-market floating-rate coupon. If the underlying natural disaster does not occur, the SPV pays out the coupons and will redeem the bond at maturity. If it does and predefined trigger conditions are met, the SPV will transfer the principal back to the reinsurer, meaning losses for investors. As suggested by the first question above, the key for investors is diversification of risks across geographies and risk categories.

How can ILS fit into portfolios? Given their higher risk profile and lower ratings, a well-diversified portfolio of ILS should only form a small complement to overall fixed-income holdings. However, the ILS pay higher coupons than fixed-coupon bonds and have less sensitivity to variations in long-dated yields. This means that their correlations to other asset classes are extremely low. The chart illustrates the relative performance of the Swiss Re Global Cat Bond Index against traditional asset classes – correlations have been low against sovereign bonds (8%), high yield (18%) and equities (21%), and risk-adjusted performance has been stronger despite the periodic occurrence of natural disasters. Moreover, ILS are now recognised as ESG-compliant investments by institutional investors across Europe, thanks to initiatives such as the UN's 2012 Principles for Sustainable Insurance.

Why now? After a period of high claims on reinsurance policies, the premia charged to clients for insuring this risk tend to rise, as does the principal paid to the SPV – as a result, new issues of ILS offer more attractive terms. The last three years have seen a larger-than-average number of catastrophes – 2017 brought Hurricanes Harvey, Irma and Maria; in 2018, Japan suffered a typhoon and two earthquakes while California saw large wildfires; and 2019 was marked by hurricane Dorian and two major Japanese typhoons. After the drawdowns related to payouts for these incidents, risk premia have risen, improving potential returns for investors – it could be time to revisit ILS again

ILS have offered attractive risk-adjusted returns



Sources: SGPB, Macrobond, data as of 27/11/2020

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EQUITIES

Cyclical Upswing

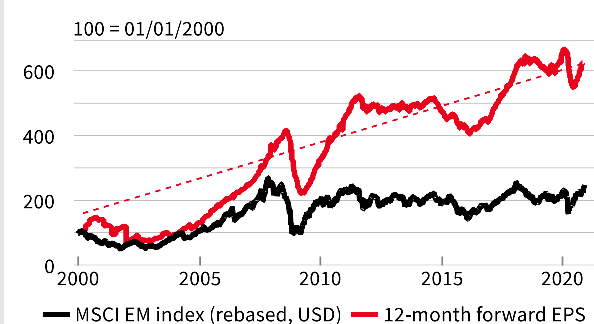
With the global economy set to shift into cyclical recovery, we have decided to highlight those markets which should be most sensitive to the upswing, foremost among which should be emerging markets (EM), Europe and Japan. We have also decided to increase overall exposure to Overweight.

US. Market participants had long feared a close-run election race and reluctance from President Trump to accept defeat. As is so often the case, when those fears were realised markets took it in their stride and indeed rallied on hopes of more expansive fiscal policy. While this is unlikely to materialise as long as the Republicans control the Senate, the same is true of president-elect Biden's tax hike plans, which has reassured investors. Moreover, recent strong purchasing manager surveys lend weight to our view that the US may avoid a double-dip recession for now.

US equities trade at 22.5 times 12-month forward earnings, 36% above the 10-year average, much higher than other major markets. The prospect of a vaccine-driven cyclical recovery should spark some rotation in market leadership, away from expensive mega-cap technology and internet stocks. Small cap stocks, for example, are more sensitive to upturns in the cycle and relative valuations versus large caps are back at lows last seen in 2000.

Eurozone. We have decided to tilt portfolios towards more cyclically sensitive markets and accordingly have moved euro zone equities to Overweight. Euro zone companies are often heavily dependent on exports and therefore stand to gain from the strengthening recovery in China. Moreover, fiscal and monetary stimulus provides ample support for financial assets, especially with the ECB likely to increase asset purchases in December.

The gap between prices and earnings favours Emerging Markets



Source: SGPB, Macrobond, 27/11/2020

Recent downgrades in analyst forecasts show a weakening outlook for sectors as diverse as Energy, Real Estate, Health Care and IT. The improving cyclical outlook argues for a shift in sector preferences towards Materials and Consumer Discretionary, which have already seen upward earnings revisions over the past three months. The environment has turned less negative for financials – banks should see an improvement in credit quality as the recovery takes hold for example – but it remains too early to Overweight the sector.

UK. The formal deadline for the UK to exit the EU is only a month away and as yet no clear progress has been made on the future trade regime, a challenging outlook for UK exporters. We continue to expect a limited-scope deal which could trigger a rerating of UK stocks. Moreover, the market houses many cyclical stocks and we have moved Overweight.

Switzerland. With the shift underway in markets towards cyclicals, Swiss equities have given up some of their year-to-date outperformance as investors have shed positions in defensive quality stocks, a key feature of the market. Nevertheless, corporate fundamentals remain strong – return on equity has risen this year – which should help cushion any underperformance.

Japan. Japanese equities have rallied 13.5% since end October, reaching their high for the year. The market has welcomed the new prime minister's statements regarding economic reforms, in addition to the boost that Japan gets from the rapid recovery in China, its major export market. Moreover, Tokyo ranks as the cheapest among major equity markets on cyclically adjusted earnings and trades with a low correlation to other markets.

Emerging Markets. With the global economy set to shift into cyclical recovery, we have decided to highlight those markets which should be most sensitive to the upswing, foremost among which should be EM. Growth in Asia has already resumed, led by China, Taiwan and South Korea (which together account for 68% of total EM capitalisation), the only three markets which will show earnings growth this year. Moreover, as shown on the chart, EM equities have failed to keep pace with their earnings growth so far this century, leaving considerable catch-up potential.

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INVESTMENT IDEA

New Energies, New Horizons

Slowly but surely, we are shifting towards a carbon-neutral world. US president-elect Joe Biden's programme aims for net zero emissions by 2050 at latest and Xi Jinping has pledged that China will achieve that goal by 2060. But to get there, the world must abandon its reliance on fossil fuels (which met 81% of total global energy demand in 2018, according to the International Energy Agency) and learn to depend on renewables. This would enable us to cut greenhouse gas emissions progressively to zero by mid-century in each of the three main areas of energy consumption – heating, power generation and transport (see chart).

Heat supply today is dominated by fossil fuels, which represent around 81% of supply. For that to fall to zero by 2050, there will have to be a massive shift towards heat pumps and direct electric heating. Currently, these are estimated to represent 5% of supply, a share which is projected to rise to 70% by 2050.

New power generation is shifting increasingly to renewables, which have already reached grid parity (i.e. they are able to generate power at an equivalent price to fossil fuels). According to Bloomberg, solar and wind totalled over 67% of all new global generating capacity last year, up from less than a quarter in 2010. However, solar and wind are, by definition, intermittent, meaning that storage has become the key challenge for power companies. Today, 97% of storage is hydro-electric but it would be extremely difficult to expand hydro's capacity in scale. Power companies will have to look to alternatives such as batteries (both lithium-ion and vanadium), heat storage in volcanic rock or "green" hydrogen. The latter is produced via electrolysis of water using electricity from renewables and is well-suited to long-term electricity storage – in large tanks, disused mines, caverns or depleted oil or gas wells – given its high energy density. However, electrolysis remains expensive and further efficiency gains – in renewable power generation and electrolyser capacity – will be necessary for wider adoption.

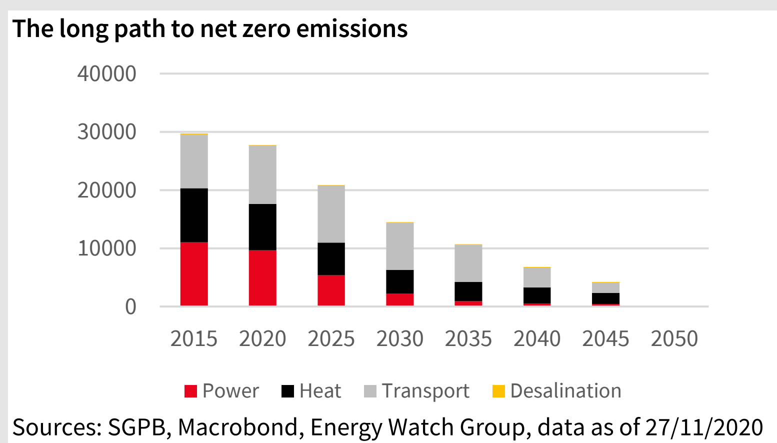
Hydrogen also offers important advantages in transport over battery power, such as better range (1 kg of hydrogen can power a fuel-cell electric vehicle over 100 km) and faster refuelling (2-3 minutes). However, there are drawbacks – the vehicles can cost twice as much as battery-powered versions; the infrastructure for a fuel cell charging station costs over five times as much as battery recharging stations; and the cost of fuel per km is much higher, all of which will slow consumer acceptance.

Nonetheless, there is a future for hydrogen in transport, thanks to its greater energy density – its specific energy is 40,000 Watt hours (Wh) per kg whereas the most efficient lithium-ion batteries only offer around 250 Wh/kg. This means that hydrogen can enable longer ranges and power heavier vehicles, making it competitive for long distance, heavy goods vehicles or in aircraft, given the weight of batteries they would require. On the other hand, hydrogen tanks take up a lot of space, making them unattractive for small cars.

Bottom line. Achieving carbon-neutrality involves reducing greenhouse gas emissions to zero, meaning a massive shift from fossil fuels to renewables. Advances in technology have enabled costs to tumble – solar electricity is 85% cheaper today than in 2010 – and solutions exist to solve issues like intermittence. However, completing the transition will require massive public and private investment in new energy technology and infrastructure. And hydrogen – the most common element in the universe – is likely to play a leading role. We expect the companies involved to see sustained growth in demand over the next four decades.

Sources: *International Energy Agency, Bloomberg New Energy Finance, Bank of America, Hydrogen Council, Energy Watch Group and LUT University.*

The long path to net zero emissions



Sources: SGPB, Macrobond, Energy Watch Group, data as of 27/11/2020

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CURRENCIES

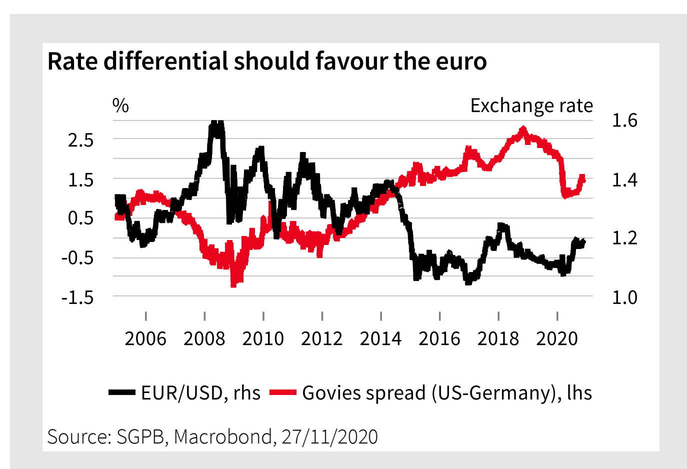
Investors question the dollar's appeal

Volatility remains surprisingly low, leaving FX markets pretty well rangebound. The dollar hasn't recruited many supporters and, with further fiscal and monetary easing on the way next year, this is unlikely to change. Emerging world currencies have recovered modestly from April's all-time lows and more upside may lie ahead.

Dollar Index. We had all been waiting for at least a minor USD rally, but it never came. US 10-year yields ticked up in November, but this provided little support and the dollar index is trading at its lows for the year. There has been a lot of talk about the dollar's days as the world's reserve currency being over. We think this is premature. However, the zero-yield environment, increased fiscal spending and deteriorating twin deficits (i.e. budget and current account) do not cast a favourable light on the greenback.

EUR/USD. European equities had a stunning surge in November as did the euro. The cross-rate has now crossed the $1.19-level again and is in touching distance of $1.20 for the first time since mid-2018. For now, markets appear to be ignoring the short-term impact of euro zone lockdowns. In part, this is due to the huge cyclical upside Europe could experience in a post-vaccine world, given its sensitivity to global trade. And part is due to the euro's undervaluation and the euro zone's healthy current account surplus.

GBP/USD. Cable has surged upwards in November – breaking out of a holding pattern and crossing above $1.33 – as markets increasingly expect some resolution on post-Brexit trade with the EU. Moreover, the Bank of England recently increased quantitative easing (QE) by £150 billion, which counter-intuitively is likely to boost the pound's prospects, as the UK economy gets the additional support it needs. However, we must not forget that no-deal Brexit remains a real risk to the downside.



Source: SGPB, Macrobond, 27/11/2020

USD/JPY. The Yen has benefitted from the fall in US real yields more than it has from risk aversion. In addition, Japan has coped well with COVID-19, thereby limiting the recessionary impact, and the transfer of power from Abe to Suga has been smooth. USD/JPY has fallen 4% this year but has managed to hold above the 104.0 level for the most part. We now expect the yen to trade sideways against the dollar.

EUR/CHF. The Swiss franc shot lower on November 9 as the first successful vaccine trials raised hopes that the pandemic could come under control, reducing the need for safe havens. As a result, the Swiss National Bank has been able to step away from currency intervention for now with the euro back above CHF 1.08. We continue to expect further modest franc weakness.

EM currencies. Since hitting its all-time low in April, JP Morgan's index of emerging currencies has staged a modest recovery. There have been pockets of weakness, such as the Argentinian peso or the Turkish lira, but they may trigger policy reactions – for example, Turkey recently pivoted to more orthodox monetary policies, hiking rates 475bp to 13.5% to buttress the currency. Vaccine-inspired hopes for a cyclical recovery should help emerging currencies trade higher next year against the dollar.

USD/CNY. Contrary to our expectations, the renminbi has continued to gain ground against the dollar, rising a further 1.7% in November so far. China has not needed to wait for a vaccine to stage a V-shaped recovery with manufacturing activity already back at trend and retail sales recovering steadily. Although we expect the new Biden administration to maintain a hard line on China, policy should be less unpredictable with less focus on punitive tariffs. These factors, combined with attractive 3.3% yields on 10-year government bonds, have drawn portfolio inflows, thereby supporting the currency.

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ALTERNATIVES

The Shine Comes Off Gold

Near-term sluggish demand should keep a cap on oil prices. Prospects of post-pandemic recovery mean less demand for safe havens like gold. In hedge funds, our preferred strategies are Special Situations, Long/Short (L/S) Credit, Global Macro – especially discretionary and emerging market traders – and directional L/S Equity.

Commodities

Oil

Crude oil prices recovered sharply in November (up 29%) as news broke of three successful anti-COVID-19 vaccine trials and traders began to look forward to demand returning to normal. However, restrictions remain in place across much of Europe and North America, and mobility and demand for petroleum are unlikely to begin to recover until the vaccines are actually available. Indeed, the International Energy Agency has revised its 2020 demand forecasts down again, by 0.4 million barrels of oil per day to 8.8 mb/d – 2021 should see partial recovery by 5.8 mb/d.

In this context, OPEC and Russia may keep output curbs in place at their early December meeting, especially as Libya – which is not bound by the agreement – has ramped up production from 0.1 mb/d in August to 1.0 mb/d. Moreover, it is likely that a Biden administration might seek to revive the Iran nuclear deal, paving the way for it to resume exports (Iran used to produce 3.7 mb/d against around 1.9 mb/d at present).

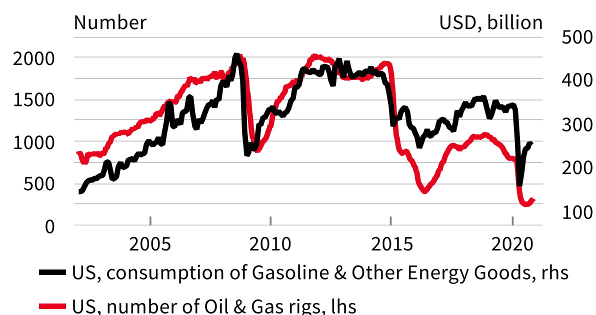
All in all, oil inventories should continue to build again, keeping a cap on upside in crude prices in the months to come.

Gold

The vaccine news has taken the shine off safe havens, including gold which has shed 5% in November so far. Gold supply has weakened this year, down 5% over the first three quarters as pandemic restrictions caused many miners to suspend operations in the first half.

Demand for physical gold has also shown signs of weakness as COVID-19 disrupted the jewellery sector in H1 with many retailers closed, especially in India and China, the two largest markets.

Rising demand and oil prices encourage drilling



Source: SGPB, Macrobond, 27/11/2020

Moreover, central banks registered modest net sales of gold in Q3, led by Turkey and Uzbekistan. In addition, inflows to ETFs slowed markedly in October to 20 tonnes (t) from a monthly average of 111t in the first three quarters.

As India emerges from its pandemic-induced recession and China continues its expansion, we expect household demand for gold and jewellery to recover, which should help prices to stabilise. Nonetheless, with safe-haven demand in abeyance, we have moved back to Neutral.

Hedge funds

Long/Short (L/S) Equity

Although dispersion in returns – which measures how differently stocks in a given market behave – has fallen sharply from recent highs, it still remains well above the average for the last decade. And with cyclical economic recovery looming, directional L/S managers should outperform their Market Neutral peers, which may struggle to cope with fast-changing market conditions.

Event Driven

Merger Arbitrage has seen a sharp fall in deal spreads – the difference in price between acquirer and its target – which should crimp returns in the near term, although M&A volumes remain high. Special Situations funds tend to have relatively high sensitivity to market movements, which could be an advantage as equity markets play the recovery.

Fixed Income Arbitrage

L/S Credit Arbitrage specialists offer attractive risk-adjusted returns in corporate credit markets. annualised returns have been close to those of High Yield bonds over the past decade while volatility – a measure of the risk taken to achieve those returns – has been much lower, thanks in large part to their strong credit analysis.

Global Macro / CTAs

November has seen another sharp reversal in trends in markets which may have caught trend-following funds (known as CTAs) unawares. We continue to prefer Discretionary Global Macro managers who have been better able to capture this month's rally in equities and falls in sovereign bonds. In addition, macro funds focusing on the additional yield (or "carry") in EM currencies and debt should continue to do well.

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TACTICAL AND STRATEGIC THEMES

Strategies still open

Launched	Conviction	Strategy description	Time horizon
27/11/2014	Blue gold (Water)	Many regions of the world face large water supply disruptions. Water remains underpriced.	Strategic
06/10/2017	Convertible Bonds – Yin and Yang	CB combine the attributes of different asset classes in one security. As long as their credit quality is not impaired, they can offer unlimited upside with downside protection.	Strategic
29/03/2018	Artificial Intelligence: from fiction to reality	Global spending on artificial intelligence is expected to rise from $12bn in 2017 to $57.6bn in 2021. As investment increases, AI should bring transformation to nearly every sector.	Strategic
07/12/2018	Cybercrime – the omnipresent risk	As internet connectivity in the global economy has become indispensable, the scale of cyber risks means sustained investment in cybersecurity.	Strategic
20/03/2019	Bridging the gender gap	Gender equality represents a strategic advantage from which businesses can draw lasting benefits. Investing in such companies should allow investors to reap those rewards.	Strategic
21/06/2019	5G Technology: a breakthrough for telcos	The 5G revolution could create attractive investment opportunities for network suppliers and businesses able to leverage the capabilities offered by the new network.	Strategic
21/06/2019	Climate change – stepping-up decarbonisation	The global transition to a low-carbon economy offers investment opportunities in a wide range of sectors.	Strategic
21/06/2019	Green (Bond) shoots	With improving liquidity, green bonds are a promising asset class offering both positive impact and long-term sustainability.	Strategic
18/09/2019	Food for Thought – Sustaining the World	The challenge of feeding the world creates investment opportunities in companies making food production healthier and more sustainable.	Strategic
29/11/2019	The Final Frontier – Space investment lifts off	Rapid technological progress in satellites and rockets and the proliferation of start-up entrants are opening up an investment frontier.	Strategic
29/11/2019	The HealthTech Revolution – Investing for a healthier future	Rising costs and growing needs will force disruption of healthcare by technology insurgents.	Strategic
30/03/2020	ESG – Sustainability for the Long Term	We believe that high sustainability and ESG standards will prove a key competitive advantage for long-term success	Strategic
26/06/2020	Waste not, want not	Reducing, reusing and recycling waste products will ensure growing demand for waste management specialists	Strategic
26/06/2020	Reinventing the factory	The wake-up call served by COVID-19 will force increasing numbers of industrialists to embrace the Industry 4.0 revolution	Strategic
29/09/2020	Redefining the future of payments	COVID-19 will accelerate the shift from cash and traditional means of payment to the dominance of digital solutions in global payments systems.	Strategic
29/09/2020	The Changing Consumer	With Millennials giving way to Generation Z consumers, profound changes are sweeping consumption patterns.	Strategic
25/11/2020	Emerging Asian debt in local currencies	Resilient growth across emerging Asia, strengthening currencies and attractive yield differentials should prove a winning combination for local currency debt markets.	Tactical
25/11/2020	Insurance-Linked Securities – Marching to a Different Beat	ILS represent a source of uncorrelated returns. After three years of larger-than-average numbers of natural catastrophes, time to relaunch the ILS theme.	Strategic
25/11/2020	New Energies, New Horizons	Completing the transition to net zero emissions will require massive public and private investment. And hydrogen is likely to play a leading role.	Strategic

Denotes a change from our previous Quarterly

Strategies closed

Launched	Conviction	Closing rationale	Type
08/12/2017	Insurance-Linked Securities – Marching to a Different Drum	After three years of larger-than-average numbers of natural catastrophes, time to relaunch the ILS theme.	Strategic
07/12/2018	Cybercrime – the omnipresent risk	Although cybercrime risks remain omnipresent, performance has been very strong offering an opportunity to lock in profits.	Strategic
21/6/2019	Africa's business revolution	The coronavirus pandemic may slow growth across Africa for now, leaving better opportunities elsewhere	Strategic

Sources: Societe Generale Private Banking, Datastream. Data as at 27/11/2020 * Strategic: 1-3 years. Tactical: 3-12 months

GLOBAL ECONOMIC FORECASTS

Growth and inflation

YoY changes in %	Real gross domestic product growth					Consumer price indices				
	2018	2019	2020f	2021f	2022f	2018	2019	2020f	2021f	2022f
World (Mkt FX weights)	3,2	2,6	-3,9	5,0	3,4	3,0	2,8	2,2	2,1	2,3
World (PPP weights)**	3,7	2,9	-3,9	5,1	3,6	3,8	3,6	3,2	2,8	2,9
Developed countries (PPP)	2,2	1,6	-5,3	4,2	2,7	1,9	1,4	0,7	1,2	1,6
Emerging countries (PPP)	4,6	3,8	-2,8	5,7	4,3	5,0	5,3	5,0	3,9	3,8
Developed countries										
US	3,0	2,2	-3,5	3,9	2,6	2,4	1,8	1,2	1,8	1,9
Eurozone	1,9	1,3	-7,4	4,1	2,1	1,8	1,2	0,2	0,8	1,2
Germany	1,3	0,6	-5,8	3,0	3,4	1,9	1,3	0,4	1,2	1,1
France	1,8	1,5	-9,4	6,7	1,3	2,1	1,3	0,4	0,6	1,1
Italy	0,7	0,3	-8,9	4,8	1,5	1,2	0,7	-0,2	0,3	1,0
Spain	2,4	2,0	-11,7	4,8	2,1	1,7	0,8	-0,4	0,3	1,0
UK	1,3	1,3	-11,4	5,1	3,8	2,5	1,8	0,9	1,3	2,1
Japan	0,3	0,7	-4,9	4,4	1,9	1,0	0,5	0,1	0,4	1,4
Switzerland	2,7	1,1	-4,0	2,7	2,6	0,9	0,4	-0,7	-0,1	0,4
Australia	2,8	1,8	-3,5	3,5	4,0	1,9	1,6	0,9	1,5	1,6
Emerging countries										
China	6,7	6,1	2,0	7,8	5,0	2,1	2,9	2,6	0,8	1,7
South Korea	2,9	2,0	-1,0	2,9	2,7	1,5	0,4	0,5	1,1	1,3
Taiwan	2,7	2,7	1,8	3,3	2,8	1,0	0,8	-0,3	0,9	1,4
India* **	6,6	4,9	-7,9	7,1	4,2	4,0	3,7	6,3	4,5	4,1
Indonesia	5,2	5,0	-2,1	5,4	4,8	3,2	2,8	2,0	2,3	2,8
Brazil	1,2	1,1	-4,7	3,7	1,8	3,7	3,7	3,1	4,1	3,2
Mexico	2,2	-0,3	-9,1	4,8	2,5	4,9	3,6	3,5	3,6	3,4
Chile	3,9	1,1	-6,2	5,0	2,7	2,7	2,3	2,9	2,5	2,5
Russia	2,5	1,3	-4,3	2,7	2,0	3,1	4,2	3,5	4,0	3,9
Slovakia	3,9	2,3	-8,3	2,9	5,9	2,5	2,8	2,2	1,7	1,9
Czech Republic	3,2	2,3	-7,6	3,0	4,6	2,1	2,8	3,2	2,3	1,9

Sources: SG Cross Asset Research / Economics, IMF, 26 Novembre 2020
* (f: forecast)
** PPP: Purchasing Power Parity
*** In India, the numbers are averaged over the Fiscal Year, ending in March.

Forecast figures are not a reliable indicator of future performance.

MARKET PERFORMANCE

Developed market equities		Performance – total return (in local currency)							
	Current level	1m	3m	YTD	12m	2Y	3Y	4Y	5Y
S&P500	3630	4,9%	5,8%	14,2%	18,0%	43,4%	47,8%	77,4%	92,1%
DJ Euro Stoxx 50	3512	9,9%	5,8%	-3,8%	-2,7%	19,3%	8,2%	31,3%	20,3%
FTSE100	6391	9,3%	6,4%	-12,7%	-10,8%	-0,8%	-2,9%	9,3%	22,9%
Topix	1768	8,8%	9,7%	5,0%	6,3%	14,0%	6,6%	32,3%	24,2%
MSCI AC World ($)	620	6,8%	7,7%	12,0%	15,9%	37,0%	32,6%	64,8%	71,7%

Developed market bonds		Performance - total return (in local currency)							
	Yield to maturity	1m	3m	YTD	12m	2Y	3Y	4Y	5Y
BAML Corp Euro IG	0,33%	1,0%	2,1%	2,5%	2,6%	9,1%	7,4%	10,8%	14,6%
BAML Corp Euro HY	3,37%	3,1%	3,9%	1,7%	3,4%	12,5%	9,0%	18,8%	24,1%
BAML Corp US IG	1,94%	1,9%	1,5%	8,7%	9,2%	25,8%	22,0%	30,3%	35,9%
BAML Corp US HY	5,32%	2,7%	3,5%	4,0%	6,5%	16,9%	16,8%	27,8%	43,4%
BAML Corp UK IG	1,62%	1,5%	2,3%	7,1%	7,5%	20,0%	17,9%	25,7%	36,7%
FTSE US Sovereign 3-7y		0,0%	-0,2%	6,8%	6,7%	15,3%	14,4%	16,2%	17,5%
FTSE Germany Sovereign 3-7y		-0,1%	0,4%	0,7%	0,2%	1,4%	1,5%	1,2%	2,3%
FTSE UK Sovereign 3-7y		-0,2%	-0,1%	2,7%	2,1%	4,9%	5,5%	6,4%	10,1%
FTSE Japan Sovereign 3-7y		0,1%	0,1%	-0,1%	-0,4%	-0,2%	-0,4%	-0,2%	0,3%

Emerging market equities		Performance – total return (in USD)							
	Current level	1m	3m	YTD	12m	2Y	3Y	4Y	5Y
MSCI EM	1218	7,3%	9,7%	11,7%	18,6%	32,8%	14,7%	58,7%	66,9%
MSCI EM Asia	674	6,5%	9,7%	21,4%	28,6%	45,2%	22,5%	75,6%	82,8%
MSCI EMEA	230	8,5%	6,5%	-10,9%	-6,4%	3,0%	-6,3%	18,0%	18,8%
MSCI Latam	2234	13,8%	14,7%	-21,4%	-14,3%	-6,5%	-12,4%	10,4%	29,7%

Emerging market bonds		Performance – total return (in USD)							
	Yield to maturity	1m	3m	YTD	12m	2Y	3Y	4Y	5Y
BAML EM Sovereign	4,08%	3,7%	2,6%	3,4%	6,3%	18,9%	11,5%	25,2%	32,7%
Asia	3,09%	2,1%	-0,7%	5,4%	6,4%	25,1%	19,3%	30,9%	41,4%
EMEA	4,19%	5,0%	5,0%	5,0%	7,1%	22,1%	15,8%	29,1%	34,8%
Latam	4,43%	2,8%	1,2%	0,1%	5,0%	11,8%	2,8%	17,5%	26,2%
BAML EM Corp	3,61%	1,8%	1,9%	5,9%	7,1%	19,6%	16,8%	23,7%	29,7%
Asia	3,26%	1,0%	0,7%	6,3%	6,9%	21,0%	18,3%	27,7%	35,6%
EMEA	3,28%	2,1%	2,5%	6,4%	7,7%	21,4%	16,4%	33,2%	44,7%
Latam	4,64%	3,5%	4,0%	4,9%	7,2%	19,5%	16,1%	25,3%	30,2%

Source: Societe Generale Private Banking, Bloomberg, Datastream (data as of 26/11/2020), YTD = year-to-date

BAML: Bank of America Merrill Lynch
Corp: Corporate
EM: Emerging Market
EMEA: Europe, Middle East, Africa
IG: Investment Grade
HY: High Yield
LatAm: Latin America
Gvt: Government

MARKET PERFORMANCE AND FORECASTS

		Forecasts		Performance					
Currencies	**Current**	**3 months**	**12 months**	**YTD**	**12m**	**2Y**	**3Y**	**4Y**	**5Y**
EUR/USD	1,19	1.21	1.24	6,3%	8,2%	5,1%	-0,1%	12,5%	12,1%
USD/JPY	104	104	103	-3,8%	-4,1%	-7,5%	-6,3%	-7,6%	-14,9%
EUR/CHF	1,08	1.09	1.12	-0,3%	-1,4%	-4,3%	-7,4%	0,8%	-0,3%
GBP/USD	1,34	1.35	1.35	0,9%	3,8%	4,4%	0,3%	7,3%	-11,5%
EUR/GBP	0,89	0.90	0.92	5,3%	4,3%	0,6%	-0,5%	4,9%	26,7%

		Forecasts							
10-year yields	**Current**	**3 months**	**12 months**	**YTD (bps)**	**12m**	**2Y**	**3Y**	**4Y**	**5Y**
USA	0.88%	0.95%	1.10%	-103	-89	-218	-146	-149	-136
GER	-0.59%	-0.45%	-0.20%	-38	-22	-91	-94	-81	-105
UK	0.28%	0.35%	0.60%	-51	-38	-106	-93	-110	-157

		Forecasts							
Commodities	**Current**	**3 months**	**12 months**	**YTD**	**12m**	**2Y**	**3Y**	**4Y**	**5Y**
Gold in USD	1813	1800	1900	19,2%	24,4%	48,2%	40,7%	53,0%	69,0%
Oil (Brent) in USD	48.7	45.0	55.0	-26,6%	-23,4%	-17,4%	-23,4%	3,0%	10,0%

		Forecasts							
Equities	**Current**	**3 months**	**12 months**	**YTD**	**12m**	**2Y**	**3Y**	**4Y**	**5Y**
S&P 500	3630	3750	3850	14,2%	18,0%	43,4%	47,8%	77,4%	92,1%
Euro Stoxx 50	3512	3700	3875	-3,8%	-2,7%	19,3%	8,2%	31,3%	20,3%
FTSE 100	6391	6700	7050	-12,7%	-10,8%	-0,8%	-2,9%	9,3%	22,9%
Topix	1768	1850	1950	5,0%	6,3%	14,0%	6,6%	32,3%	24,2%

Source: Societe Generale Private Banking, Bloomberg, Datastream (data as of 26/11/2020), bps = basis points

BAML: Bank of America Merrill Lynch
Corp: Corporate
EM: Emerging Market
EMEA: Europe, Middle East, Africa
IG: Investment Grade
HY: High Yield
LatAm: Latin America

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IMPORTANT INFORMATION – PLEASE READ

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Subject of the document

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