MONTHLY HOUSE VIEWS

January 2021

Looking Ahead

Macro

Renewed and prolonged restrictions on activity are likely to weigh on Q1 output as governments seek to prevent health system overload. Thereafter, we expect a cyclical recovery in GDP growth led by those countries which best placed to ramp up vaccination programmes, enabling lockdowns to be eased. Furthermore, we expect fiscal policy to remain very expansive – the EU's recovery fund will begin its disbursements while the Biden presidency should see more focus on stimulus programmes. Thus far, Asia has been able to avoid a second wave of COVID-19 infections and should see solid growth throughout this year, especially if the Biden administration proves less confrontational on trade tariffs.

Central Banks

Headline inflation is likely to spike higher this spring as last year's collapse in energy prices will distort year-on-year comparisons. However, central banks have given every indication that they view this as a transitory phenomenon and plan to keep policy settings very loose. This means that interest rates will remain on hold and that asset purchases will continue at the current pace for the foreseeable future. At its December meeting, the European Central Bank (ECB) boosted asset purchases and enhanced its support for bank lending. And in the US, unemployment (6.7% in December) is still far from the Federal Reserve's (Fed) new "maximum employment" target.

Markets

Financial markets tend to look ahead rather than worry about near-term risks, and the rapid start to vaccine deployment has bolstered 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 global equity markets, we maintain our preference for emerging markets – especially Asia – and laggards like Europe and Japan. The weight of central bank buying of high-quality corporate bonds has pushed the additional yield over sovereign bonds (or "spread") down to historically low levels and few pockets of value remain in fixed income markets.

Bottom line

Given the supportive macro and liquidity backdrop, equities should continue to outperform other asset classes and we have upgraded allocations to Strong Overweight. In terms of sectors, we maintain a balance between high-quality megacap tech leaders and stocks which should benefit from the cyclical upswing in activity. Investment grade (IG) yield spreads are back at pre-crisis lows and we have moved Underweight. We have also downgraded lower-quality, high yield (HY) bonds – we prefer direct exposure to equities among risky assets. Finally, we have upgraded Brent oil to Neutral as the outlook for demand is likely to continue to improve.

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

OUR ASSET ALLOCATION

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

Asset class	Sub-class		Strong U/W	U/W	N	O/W	Strong O/W	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
O/W	Overweight
N	Neutral
U/W	Underweight

*Duration
Long – 7-10 years
Intermediate – 5-7 years
Short – 3-5 years

EQUITIES	
United States	The Democratic "clean sweep" is supportive for sentiment but US valuations are elevated. We continue to prefer more cyclically sensitive markets.
Eurozone	The liquidity environment is supportive and the EU recovery fund will shortly begin disbursements. We remain Overweight.
UK	UK stocks rallied sharply on the lifting of Brexit uncertainty. We have decided to lock in some profits and return to Neutral.
Switzerland	Strong corporate fundamentals and solid expected earnings should help cushion any underperformance.
Japan	We remain Overweight in Japanese equities in order to benefit from their sensitivity to the cyclical upturn.
Emerging (EM)	We continue to hold a strong Overweight position in emerging markets, in particular in Asia where analysts expect a sharp improvement in earnings.

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	We expect a pick-up in headline inflation over the spring given the rise in energy prices since last April's crash.
Investment Grade	Spreads have tightened further towards historic lows and we have moved Underweight.
High Yield	With yields close to all-time lows, HY offers insufficient compensation for default risk and we have moved Underweight.
Emerging debt (in € and $)	We continue to prefer Asian issuers given the cyclical upswing which is well underway.

CURRENCIES	
EUR/USD	Ebbing safe-haven demand, negative real rates and twin deficits have come together to put downward pressure on the USD.
GBP/USD	Finally, we can move on from the Brexit debate and focus on fundamentals which, for now, weigh against the USD.
EUR/GBP	The implementation of the new cross-Channel trade regime may weigh on sterling against the euro in coming months.
USD/JPY	All told we expect USD/JPY to trend slowly lower from current levels in 2021.
EUR/CHF	Against the euro, the franc has been weakening gradually since last summer and we expect this trend continue in 2021.
Emerging	Although China's V-shaped recovery has attracted inflows, we expect the renminbi to consolidate around current levels.

ALTERNATIVES	
Hedge funds	Our preferred hedge fund strategies remain Merger Arbitrage, Long/Short Credit and Global Macro, especially discretionary and emerging market traders.
Gold	Cyclical recovery means less demand for safe havens like gold, but fundamentals remain solid.
Oil	Demand for oil is sluggish but Saudi Arabia will reduce output, helping keep Brent prices above $50.

Source: SGPB, 06/01/2021
* 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

It was the best of times, it was the worst of times

Charles Dickens began 1793's A Tale of Two Cities with immortal line, "It was the best of times, it was the worst of times". As we step into 2021, investors again find themselves facing stunning juxtapositions.

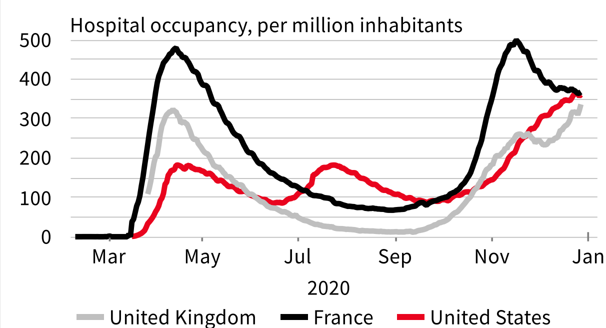
On one hand, the coronavirus pandemic has us in its tightest grip so far, with thousands of deaths each day and major economies in various states of lockdown. On the other, human ingenuity and modern technology have never shone brighter, with the fastest ever development of vaccines being followed by the largest mass inoculations ever conducted.

On one hand, last year's economic slump due to the COVID-19 pandemic is being followed by subdued recovery. Activity in manufacturing has improved markedly from mid-2020's lows, but the services sector – by far more important to advanced economies – remains tepid. On the other, global markets – with equities at all-time highs and rates close to record lows – have chosen to look through the darkness and focus on the light at the end of the tunnel when vaccine-led normality returns.

On one hand, early-January witnessed a mob storm the US Capitol, for many an emblem of the liberal democratic order that has presided over global peace and prosperity since World War II. Clearly, populist distrust of the elites remains palpable. On the other, major geopolitical tensions appear on the wane – the Biden presidency should bring more predictable policies on trade, and long-standing issues like Brexit are now in the rear-view mirror.

In an environment where economic and market signals stand in stark contradiction to each other, it remains more critical than ever to rely on those inputs we trust to guide us in matters of asset allocation.

US and UK hospital occupancy increasing rapidly



Source: SGPB, Macrobond, 31/12/2021

The first of these is the macro cycle. In the short term, much of course depends on the vagaries of virus-induced lockdowns, but December's business confidence surveys were generally better than forecast. Moreover, as the year progresses, the recovery should be less reliant on wide-ranging fiscal support and more driven by the post-vaccine "return-to-normal" for businesses (e.g. hiring, capital expenditure) and households (e.g. consumption, travel).

Second is valuation. Here the picture is nuanced. Valuations for equities are expensive across most major regions, particularly the US. Even regions which had been cheaper – for example, the euro zone and the UK – have seen a rerating since the vaccine announcements. However, with key rates at historical lows, theory would suggest more tolerance to higher valuations for equities as future cashflows are discounted at these lower rates. Moreover, central banks across the world have been very clear about their intention to keep interest rates low for the foreseeable future and even tolerate an "overshoot" in inflation.

Third is momentum. Here, there is no nuance, and risk assets remain in a powerful uptrend, which is a positive.

Fourth is sentiment. Here, indicators such as the trade-weighted dollar – which fell precipitously over the fourth quarter – would imply investors are getting less risk-averse. Indeed, there is some evidence of overexuberance, with the huge recent increase in the value of bitcoin, a cryptocurrency, a case in point. However, bond yields remain close to historic lows and safe havens like gold remain well bid, if volatile.

Bottom line. On balance, we believe risk assets – particularly equities – remain very compelling, supported by strong momentum and a recovering economy. Valuations are challenging, but tolerable given low rates and extreme overvaluation in fixed income markets. Risks, as always, remain – sentiment is bubbly in certain assets and we cannot rule out vaccine-resistant virus mutations, leading to further lockdowns. Nonetheless, we believe the case for increased risk taking is well supported.

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FIXED INCOME

Whatever happened to yield?

Most fixed-income markets ended 2020 with yields and spreads at all-time lows. With global activity set to strengthen in 2021, we suspect that this year will prove more challenging for bonds. We have decided to scale back exposure to "credit" – especially investment grade (IG) and high yield (HY) corporate bonds to Underweight.

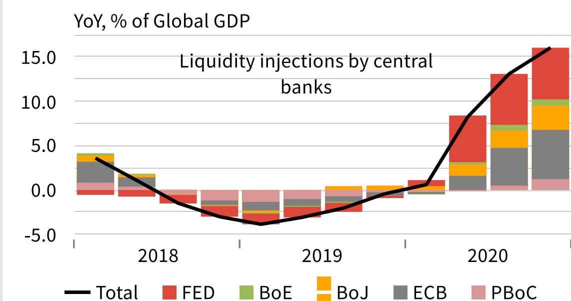
Sovereigns

US. Early January's runoff Senate elections in Georgia finally handed the Democrats a "clean sweep" of the presidency and Congress, reviving market hopes of reflationary fiscal stimulus. However, their majorities in both chambers are razor-thin which might limit the scope of Biden's stimulus policies. Nonetheless, 10-year Treasury yields have already doubled from the August low of 0.51%, core inflationary pressures remain muted and the Fed an active buyer – all in all, we expect Treasuries to consolidate for now.

Eurozone. At its December meeting, the ECB went ahead with the expected increase in asset buying and extended the horizon for its purchases of sovereign and high-grade corporate bonds by 9 months to March 2022. This ensures that euro zone bond yields will remain at depressed levels for many quarters to come. However, with little room for core bond yields to fall further and with periphery yields already at all-time lows, we find little value in this segment.

UK. With Brexit now complete and the country back in full lockdown, the Bank of England (BoE) is unlikely to change tack and its enhanced asset purchases buying should help keep sovereign ("gilt") yields close to zero. Real gilt yields – after core inflation of 1.1% - are sharply negative and we remain strongly Underweight.

Central bank asset purchases hit 15% of global GDP



Source: SGPB, Macrobond, 31/122020

Credit

US. Yields on IG corporate bonds hit 1.91% on December 31, the lowest level on record, taking spreads back to late-2019 levels. At such levels, markets have largely priced in 2021's positive outlook leaving little room for further spread compression and we have further reduced allocations to Underweight. Speculative-grade (HY) bonds also saw yields reach all-time lows at year-end, leaving little compensation for default risk and we have also cut exposure back to Underweight.

Eurozone. Yields on euro IG bonds sit at all-time lows of only 0.23%, with demand bolstered by ECB buying and pandemic-driven recession conditions. Our scenario of cyclical recovery in the second half of 2021 could put some downside pressure on bond prices and such negligible yields offer little support – accordingly, we have moved Underweight. Having topped 10.5% in late-March, yields on HY bonds are back at 3.36%, uncomfortably close to 2017's all-time lows of 3.0%. Renewed and strengthened lockdown restrictions are likely to place stress on weaker corporate balance sheets and we have scaled back holdings to Underweight.

UK. Spreads on sterling IG bonds have also tumbled to all-time lows – at 0.96% – and UK HY yields are also at the lowest levels on record. The same arguments hold as for USD and EUR credit and we have also reduced positions to Underweight.

Emerging Market (EM) debt

Among sovereign issuers in USD, EM bonds stand out. They offer spreads over US Treasuries of 277 basis points and the cyclical upturn in global activity should help improve credit quality. However, yields are close to historic lows and we would not exceed a Neutral allocation to this segment. As in previous months, our preferred issuers are in Asia.

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EQUITIES

Vaccines to drive cyclical recovery

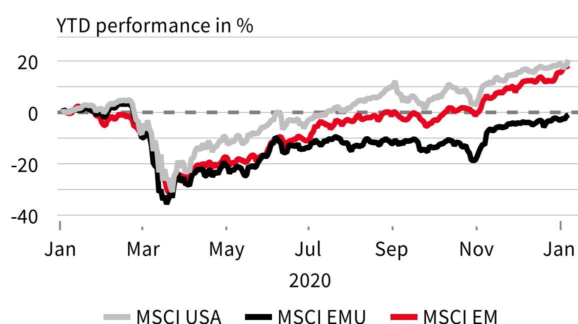
With the global economy set to shift into cyclical recovery, we have decided to highlight those markets which should be most sensitive to the upswing, foremost among which should be emerging markets (EM), the euro zone and Japan. We have also decided to increase our overall exposure to strong Overweight.

US. The US election saga is set to be resolved with a "clean sweep" of the presidency and Congress by the Democrats, bolstering market hopes of reflationary fiscal stimulus. However, the majorities are slim in the House and the Senate which means that the Biden administration may have to stick to centrist policies, scaling back both spending plans and tax hikes. Business confidence surveys point to continued expansion of activity in both manufacturing and services, aided by widespread reluctance to tighten lockdown restrictions despite rapid spread of COVID-19.

This has provided a supportive backdrop to US equity markets which ended last year at record highs. However, with the MSCI US index up 12% in 2020 and profits down 11%, valuations stand at a demanding 41% premium to the average of the last decade, led by Technology at an 80% premium. In this context, we keep a Neutral rating on US equities and highlight the attraction of more cyclically sensitive small caps.

Eurozone. The prolonged restrictions to stem the spread of COVID-19 across the euro zone will weigh on the outlook for corporate profits and recent revisions to the earnings outlook have been downwards. Nonetheless, we remain Overweight. The liquidity backdrop is supportive thanks to the ECB and the long-awaited EU recovery fund will begin disbursements this year. Moreover, valuations are well below those in the US while euro zone equities are much more cyclically sensitive than their US peers. This helps explain why investors are looking beyond the near-term recession.

Strong performance from emerging markets



Source: SGPB, Macrobond, 07/01/2021

As described in our 2021 Outlook, we have shifted preferences in favour of sectors like Materials and Consumer Discretionary – both of which have seen earnings upgrades over the past three months – which stand to benefit from the cyclical upturn which should follow broad vaccination of the population.

UK. The Christmas Eve conclusion of the trade deal with the EU removes the lingering uncertainties about cross channel trade and, as expected, triggered a rerating of UK stocks. However, the reintroduction of border checks and regulatory barriers will slow cross-Channel trade over coming years. We have decided to lock in some profits and return to Neutral.

Switzerland. Swiss equities registered strong outperformance versus other European markets until November's vaccine announcement sparked a rally in the laggards. Moreover, the index breakdown is much more defensive in nature than in the euro zone or the UK. Nonetheless, strong corporate fundamentals and solid expected earnings should help cushion any underperformance.

Japan. Japanese equities lagged the global average only slightly last year. Economic reforms continue under the new prime minister and the country has managed to keep a cap on any outbreaks of coronavirus infections. Moreover, Japan is well placed to benefit from the continuing acceleration of growth in China. We continue to hold Overweight positions in Tokyo to benefit from its sensitivity to the cyclical upturn.

Emerging Markets. We continue to hold a strong Overweight allocation in emerging market equities. Last year's earnings were resilient – particularly in Asia, where China, Taiwan and South Korea all saw an increase in profits – and analysts expect an increase of 34% in 2021. One area of potential concern is the impact of sanctions on Chinese technology and telecoms stocks. Nevertheless, this year should see synchronised global recovery in H2 which should help accelerate global trade flows – emerging markets stand to reap the benefits.

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CURRENCIES

It's all about the dollar

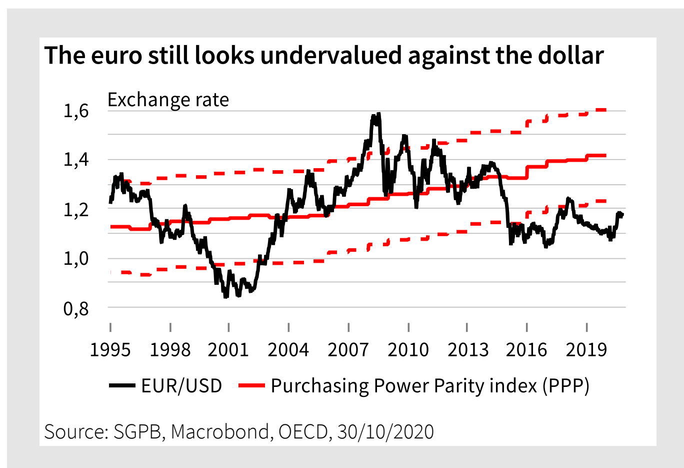
Ebbing safe-haven demand, negative real rates, enormous budget spending and a structural current account deficit have come together to put downward pressure on the US dollar against most major currencies. With the Democratic "clean sweep" of Congress and the White House, we expect these trends to remain in place.

Dollar Index. The Dollar Index (DXY) was down about 7% over 2020. With the benefit of hindsight, the impact of the US election – the event most expected to set off some currency movement – was relatively minor. Instead it has been more a story of steady decline on fundamental factors: safe-haven demand ebbed; the Fed was perceived to be loosening policy faster than its peers; huge deficit spending increased inflation expectations; and the gaping trade imbalance remain unchecked. These factors remain well entrenched, though in the short term the US dollar may be oversold.

EUR/USD. Since the lows seen March last year, EUR/USD is up 15% closely mirroring the strength in eurozone equities. The EUR was bolstered immeasurably by the agreement between needy member states and former stimulus hawks such as Germany to issue collective debt in the wake of the first wave of coronavirus infections. Investors interpreted this as a clarion call for continental unity and solidarity. As we enter 2021, the eurozone no longer appears moribund, and the euro is again gaining credibility as international payment currency.

GBP/USD. Finally, we can move on from Brexit. Cable hit a high of 1.3700 after the deal became official, before losing some lustre as the latest UK lockdown was announced. The USD side of the cross will matter more in the near term, particularly now the Democrats have regained control of the Senate. This will make it easier to pass fiscal stimulus, which will raise inflation expectations, which will in turn put further pressure on the dollar in months ahead.

The euro still looks undervalued against the dollar



Source: SGPB, Macrobond, OECD, 30/10/2020

USD/JPY. This currency cross has trundled along close to the 104.00 level over the past month. Among safe-haven currencies/commodities, we have seen much more price action in gold than in JPY. Japan has coped much better with COVID-19 than many other countries and the fall in US real yields is likely to support JPY going forward. All told we expect USD/JPY to trend slowly lower from current levels in 2021.

EUR/CHF. The US has tarred Switzerland as a currency manipulator, given the Swiss National Bank's (SNB) periodic interventions to prevent safe-haven flows pushing the Swiss franc into wildly overvalued territory. As investors look forward to lockdowns being wound, these flows have been diverted towards more cyclically-sensitive assets, enabling SNB to take a back seat. Against the euro, the franc has been weakening gradually since last summer and we expect this trend continue in 2021.

EM currencies. JP Morgan's index of emerging currencies has been trending higher against the USD since last April's all-time low. In part this reflects generalised dollar weakness, in part it is driven by burgeoning risk appetite and in part it underlines the attraction of undervalued currencies offering higher interest rates. We expect this trend to continue in 2021 as investors pivot towards regions which should benefit from the upturn in the cycle.

USD/CNY. The renminbi stands out among major currencies with 10-year government bonds yielding 3.15% while the currency has rallied 10.7% against the USD since its late-May lows. China's V-shaped recovery from recession has attracted inflows with manufacturing output growing at pre-coronavirus rates while retail sales are recovering steadily, up 5.0% year-on-year in November. 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. All told, we expect the renminbi to consolidate around current levels.

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ALTERNATIVES

Neutral on alternatives

Demand for oil is sluggish but Saudi Arabia will reduce output, keeping Brent prices above $50. Gold fundamentals are solid and we remain Neutral. 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 continued their rally in early January as OPEC and its allies including Russia held their first monthly meeting of the year. Saudi Arabia stunned traders with a voluntary cut in output of 1 million barrels per day (mb/d) in February and March – this enables Russia and Kazakhstan to increase production by 75,000 mb/d each but still leaves total supply from the allies below market expectations. Riyad's fear is likely to be that demand will continue to be crimped by travel restrictions and lockdowns across much of the northern hemisphere.

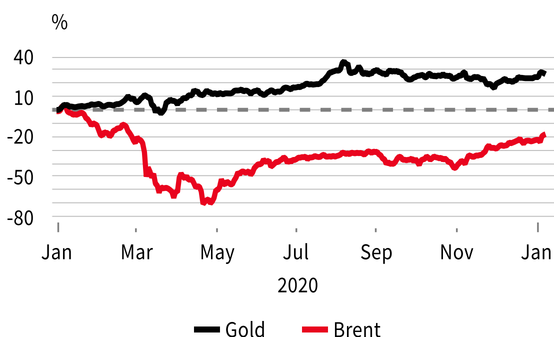
However, higher prices may encourage US producers to ramp up output – they already reached 11.0 mb/d in December, up from 9.7 mb/d at their 2020 lows, as average Brent prices rose from $43 in November to $50. This could prompt Riyad to change tack, given its reluctance to yield too much ground to US producers, whose successful exploitation of shale oil reserves saw them replace Saudi Arabia and Russia as the world's leading supplier in 2018-2019.

All in all, we expect Brent prices to trade sideways in coming months.

Gold

Gold ETF flows tend to be somewhat momentum-driven – as prices declined -5.4% over the course of November, ETFs saw the first outflows in twelve months, which drove gold sales of 107t. Moreover, in Q3, central banks registered the first quarter of net sales of gold since Q4 2010. The selling was dominated by two countries – Turkey and Uzbekistan – both of which resumed buying in October which saw net purchases of 23 tonnes (t).

Crude oil recovery from April crisis



Source: SGPB, Macrobond, 07/01/2021

As a non-yielding asset, gold prices tend to be sensitive to changes in the yields available in other safe-haven assets like US Treasuries. Despite the recent rise in 10-year yields, those on inflation-linked securities – which reflect expected inflation – recently reached record lows at -1.11%. At such levels, the opportunity cost of holding gold becomes negligible, which tends to support gold prices as we saw with December's 6.8% rally.

Safe havens like gold may be less popular during the coming cyclical recovery but its fundamentals are solid and we remain Neutral.

Hedge funds

Long/Short (L/S) Equity

Despite their short sales (bets that certain stocks will decline in price), L/S Equity funds have delivered solid performance recently, thanks to strong stock-picking. We continue to Underweight Market Neutral strategies – which balance long and short positions so as to have no net sensitivity to market direction – given our expectations of cyclical recovery in 2021.

Event Driven

Deal spreads – the difference in price between predator and prey – have picked up recently as has M&A activity, two factors which should underpin Merger Arbitrage funds. Corporate restructuring activity remains dynamic which improves opportunities for Special Situations managers, which attempt to identify events that will transform a company's value.

Fixed Income Arbitrage

Many Fixed Income Arbitrage managers will struggle in today's environment of low yields. We prefer L/S Credit Arbitrage funds which offer attractive risk-adjusted returns. Annualised returns have matched those from High Yield bonds 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

The downturn in the US dollar has benefited many trend-followers (known as CTAs) and Global Macro managers who had shorted the greenback. We continue to prefer Discretionary Global Macro funds which are well positioned to profit from further upside in equities and falls in sovereign bonds. As before, those managers with a focus on emerging market assets should do particularly well.

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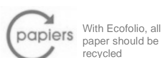

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