# MONTHLY HOUSE VIEWS

## February 2021

# Stepping Out

**Macro**

As noted last month, the leaders in vaccination programmes – notably the UK and the US – will be best placed to ease lockdown restrictions in due course. For now however, the rapid spread of new mutations and vaccine supply disruptions are pushing governments to tighten and extend restrictions, which will surely weigh on Q1 growth potential. In this context, fiscal policy will remain very expansive. President Biden has already called for a new USD 1.9 trillion support package, while the EU's recovery fund is due to commence disbursements. China's 2020 GDP data confirmed the economy registered solid 2.3% growth in 2020 and this year should see a marked acceleration to over 8%.

**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 January's meetings confirmed they plan to keep policy settings very loose. In the US for example, a short-lived move above 2% would not meet the Federal Reserve's (Fed) new target of averaging 2% over an extended period. Hence, we see no changes in key rates in 2021 (and probably none next year) while asset purchase programmes are likely to keep financial markets flooded with liquidity.

**Markets**

Despite vaccine worries, risk appetite remains high and equity markets have gained ground so far in January. Emerging market equities have outperformed, led by Asia on strong recovery data from China. As we expected, investors are looking beyond near-term problems with vaccines towards the cyclical recovery, which we expect to gather pace in the second half. In addition, we have seen some recovery in "COVID-winners", in technology, streaming and internet retail for example. Among safe havens, government bonds and gold have given up some gains, as expected, but the dollar has rallied after reaching oversold levels in early January.

**Bottom line**

We continue to hold a strong Overweight allocation to global equity markets, which we expect to continue to outperform other asset classes. In terms of regions, our preferences remain those markets with greatest sensitivity to a cyclical recovery, most notably emerging markets, Japan and Europe. Our sector allocations aim for broad diversification between growth stocks in technology for example and undervalued laggards which should benefit from the upturn in the cycle. Within fixed income markets, we remain Underweight across the board, with the exception of emerging market bonds. Finally, our view on the US dollar is unchanged – we expect the greenback to shed further ground over 2021.

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

**Summary house views**

| Asset class | Segment | Item | Strong U/W | U/W | N | O/W | Strong O/W |
|---|---|---|---|---|---|---|---|
| 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** | We remain Neutral on US equities, which reached new all-time highs in late January as investors welcomed fiscal support proposals from newly inaugurated President Biden. |
| **Eurozone** | We continue to Overweight the region in our allocations given its sensitivity to a cyclical upturn in activity. |
| **UK** | We remain Neutral given stringent lockdown restrictions and Brexit disruptions, which will have a strong impact on the UK economy. |
| **Switzerland** | Earnings forecasts are solid and corporate fundamentals remain robust, which should help cushion any downside. |
| **Japan** | We remain Overweight since the impact of the pandemic has been less severe in Japan and valuations are reasonable. |
| **Emerging (EM)** | We continue to hold a strong Overweight position given that the global cyclical recovery should translate into further growth in global trade flows, a boon for emerging markets. |

| 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 remain Underweight. |
| **High Yield** | With yields hitting new all-time lows in late January, HY offers insufficient compensation for default risk and we remain 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** | The latest UK lockdown and the impact of Brexit should put sterling's rally on pause. |
| **EUR/GBP** | The implementation of the new cross-Channel trade regime may weigh on sterling against the euro in coming months. |
| **USD/JPY** | We expect further modest yen strength from current levels in 2021. |
| **EUR/CHF** | Once the path towards cyclical recovery becomes clearer, we expect the euro to resume its gradual strengthening trend against the franc. |
| **Emerging** | We expect the renminbi to consolidate in coming months before heading higher again. |

| ALTERNATIVES | |
|---|---|
| **Hedge funds** | Our preferred hedge fund strategies remain Merger Arbitrage and Global Macro, especially discretionary and emerging market traders. |
| **Gold** | Gold's fundamental drivers should shore up prices in 2021. |
| **Oil** | We continue to expect a sideways trading pattern in oil prices until tangible signs emerge of higher demand. |

Source: SGPB, 27/01/2021
* 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

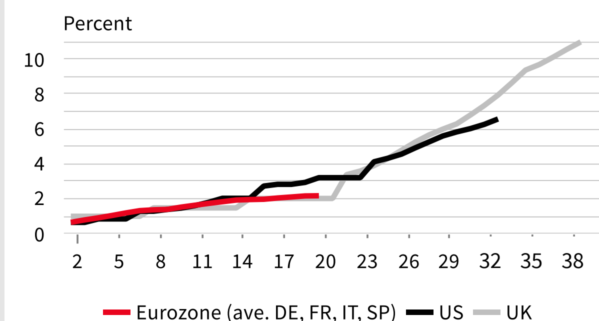
## Dancing to the vaccine tune

The successive waves of COVID-19 infections and the emergence of new, more virulent strains has put renewed pressure on the world's healthcare systems, forcing governments to tighten and extend lockdown restrictions. In turn, this has pushed economic activity back into recession across Europe and marked slowdown in the United States.

As has been the case since the start of the pandemic, service businesses have been much harder hit than manufacturers. The preliminary Purchasing Managers' Index (PMI) surveys for January confirm this trend. The euro zone manufacturing PMI reached 54.7 points – 50.0 marks the dividing line between expansion and contraction in activity – while the services survey tumbled to 45.0 points, well below expectations. In the UK, the slump in services confidence was even more pronounced – the new virus strain has led to a nationwide lockdown while the first post-Brexit disruptions has begun to bite.

The United States has taken a much less stringent approach, leaving individual state governors to decide on restrictions. As a result, mobility data for retail and recreation activities show a relatively modest 25% decline from pre-pandemic levels whereas the falls in Europe range from 45 to 65%. Unsurprisingly therefore, business confidence has remained buoyant in both manufacturing and services, according to January's PMIs. One area where weakness is apparent is the labour market – initial weekly claims for unemployment benefits have risen steadily since early November, which pushed retail sales lower in the last two months of 2020.

**Similar trajectory in vaccination programmes**




Source: SGPB, Macrobond, Our World in Data, 27/01/2021

Looking ahead, much will depend on the speed with which countries can ramp up their inoculation programmes and reach levels of collective immunity which would allow restrictions to be eased. The first movers in vaccination – notably the UK and the US – have made great strides, with 11.0% and 7.1% of their respective populations already inoculated. Vaccine approval came much later in the EU, which meant their programmes only really got underway in late December, three weeks after the UK. Provided that supply delays can be reversed quickly, we expect that countries will be able to begin to lift restrictions by the spring, with the UK and the US leading the EU by a month or so.

Recovery in Asia is much less dependent on vaccines. China – the region's powerhouse – actually saw its economy grow 2.3% last year and we expect growth to accelerate to over 8% in 2021, a level that hasn't been seen since 2011. Moreover, China has not had to resort to the type of monetary easing employed by the Fed and the European Central Bank (ECB) – although 3-month key rates were cut last year by 160 basis points to their lows in March, they then rose steadily to reach their 2020 high in late November.

Nor has massive fiscal stimulus been necessary for China's recovery. According to the Institute for International Finance, Beijing's government debt to GDP ratio rose by 10.1 percentage points (pp) to 63.0% between Q3 2019 and Q3 2020 whereas the US piled on 25.5pp over the same period, taking its ratio to 127.2%, the highest level ever in peacetime. And more is to come in Washington. President Trump signed a USD 900bn support bill in late December and his successor has proposed a supplementary USD 1,900bn package, together representing some 13.4% of GDP

**Bottom line.** The prospect of substantial numbers of vaccinations, combined with massive fiscal and monetary stimulus, is likely to ensure a synchronised cyclical recovery in advanced economies in H2 2021. While the euro zone may lag the US in the first half, we expect stronger growth there in H2, continuing into 2022.

Past performance should not be seen as an indication of future performance. Investments may be subject to market fluctuations, and the price and value of investments and the income derived from them can go down as well as up. Your capital may be at risk and you may not get back the amount you invest.

# FIXED INCOME

## Little value left

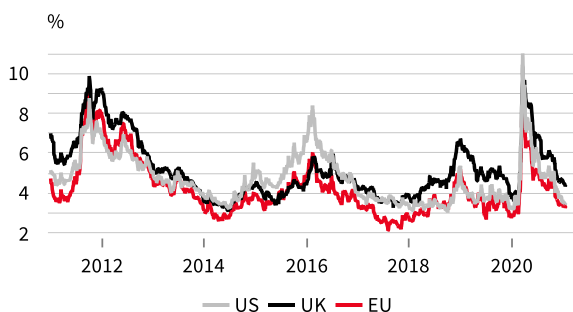
Many fixed-income markets saw record high prices and record low yields in January, on sustained central bank purchases. With little value left, our allocations to sovereign bonds are Strong Underweight and "credit" – i.e., investment grade (IG) and high yield (HY) corporate bonds – exposure has been cut to Underweight.

### Sovereigns

US. In the aftermath of the Democrats' "blue wave" victory in Georgia leading to control of both chambers in Congress, investors cut back their Treasury positions on hopes of massive fiscal stimulus, pushing 10-year yields up to a 10-month high at 1.15%. Since then however, yields have eased back to 1.0% on realisation that wafer-thin majorities in Congress mean that President Biden's plans are likely to be reined in. Moreover, regular massive buying of Treasuries by the Fed has taken its holdings to new record highs, helping keep a cap on upside in yields.

Eurozone. Upside in core sovereign bond yields in the euro zone has been extremely modest, with 10-year German Bund yields at -0.55%, only slightly above the three-month average. The tightening of lockdown restrictions across Europe and the resulting double-dip recession have bolstered investor demand for safe havens while the pace of ECB buying has accelerated since the central bank added €500bn to its bond purchase programmes in December. With cyclical recovery looming in H2, there is little scope for core bond yields to fall much lower.

UK. 10-year sovereign ("gilt") yields have traded mostly between 0.2% and 0.3% over the last six months. Stringent lockdown restrictions have pushed the composite PMI survey into recession territory while exporters are struggling to cope with the new customs checks and non-tariff barriers with the EU. Although the rapid pace of vaccination should enable the government to ease lockdown ahead of EU neighbours, the Bank of England is unlikely to tighten policy for the foreseeable future.




### Credit

US. As highlighted last month, yields on IG bonds hit all-time lows at the end of last year and "spreads" (i.e., yield differentials) over Treasuries have only risen modestly since. At these levels, IG credit has largely priced in the expected cyclical recovery and offers little value. Speculative-grade HY bond yields hit new lows in late-January, offering little compensation for default risk. We remain Underweight corporate bonds.

Eurozone. Yields on euro IG bonds are barely positive at only 0.24% and still very close to December's all-time lows. Spreads over Bunds are at 93 basis points (bp), not much more than Spanish government bonds at 62bp and again close to record lows. Yields on HY bonds are little changed in recent weeks and still only just above the 2017 all-time lows. The economic environment is likely to worsen under the weight of lockdown restrictions, which is likely to place weak balance sheets under great pressure. In all, we remain Underweight euro-denominated credit.

UK. There is little more value in sterling-denominated credit. Spreads over gilts have only widened 2bp after hitting record lows earlier in January and GBP HY yields hit new all-time lows in late January. The economy has started 2021 with a sharp slump in PMI business confidence which does not augur well for credit quality. We remain Underweight.

### Emerging Market (EM) debt

Looking around the global sovereign bond markets, EM issuers stand out with spreads over US Treasuries of 303bp. The global economy will begin to reaccelerate as vaccinations progress, helping improve credit quality. However, prices have rallied hard from the Spring 2020 lows taking yields to all-time lows. For this reason, we have capped our allocation at Neutral, with a preference for Asian issuers.

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# EQUITIES

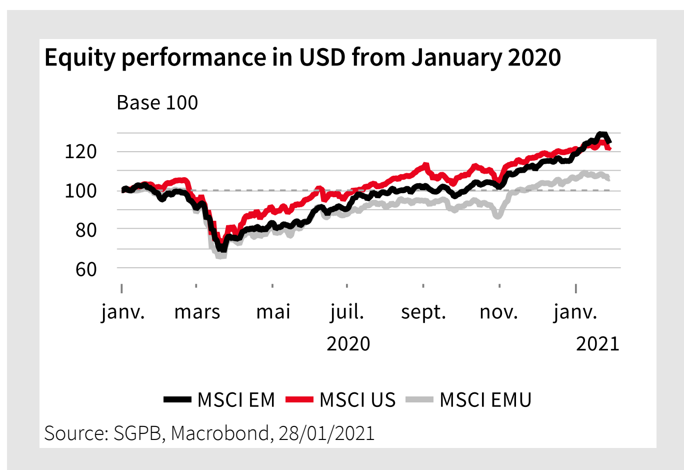
## Looking through the volatility

We maintain a strong Overweight allocation to global equities, with a regional focus on emerging markets (EM), Japan and the euro zone. In terms of sectors, investors should aim for a balance between quality growth and undervalued cyclical sectors.

**US.** US equities reached new all-time highs in late January as investors welcomed fiscal support proposals from newly inaugurated President Biden. In addition, rapid progress in vaccinations has raised hopes that the pandemic could rapidly be brought under control. In our view, the Democrats' slim majorities in both chambers of Congress mean that Biden's spending plans may fall short of the proposed amounts. Moreover, the rapid spread of new virus mutations could slow the attainment of collective immunity and keep households on the defensive. Despite the strength in PMI surveys, the job market has weakened since October with a steady rise in new claims for unemployment benefits.

The continued strength in US equities has taken valuations to 23 times forward earnings, just shy of the 25x record reached in early 2000 during the dotcom mania. This time round, the market has again been led higher by Technology where valuations stand at a 77% premium to the 10-year average. We remain Neutral on US equities.

**Eurozone.** After strong outperformance over US equities in November and December as investors reacted to excellent results of vaccine trials, euro zone equities have given up some of their advance in January. Vaccination programmes were slower to start in the EU while new virus strains have prompted governments to tighten lockdown restrictions, pushing the economy back into contraction territory. Nonetheless, we remain confident that fiscal and monetary support will throw a safety net for businesses and households and that inoculations will continue to accelerate, paving the way for strong cyclical recovery from H2 onwards, enabling investors to look beyond near-term problems.



Source: SGPB, Macrobond, 28/01/2021

Euro zone equities are trading at a 24% discount to US indices, and earnings growth should be stronger this year (up 48%, according to consensus estimates, versus +21% in the US). We continue to Overweight the region in our allocations.

**UK.** January's PMI surveys told a tale of sharp slowdown in the UK economy, given stringent lockdown restrictions – set to be extended until early March at least – and the post-Brexit slowdown in cross-Channel trade. However, UK equities are cheap, trading at a modest 10% premium to the 10-year average and should benefit from a cyclical pickup in activity. All in all, we remain Neutral.

**Switzerland.** Swiss equities outperformed other European markets for most of last year thanks to the prevalence of high-quality, defensive stocks in the index. However, November's vaccine announcements marked a shift in favour of more cyclical laggards like the UK and the euro zone. Nonetheless, earnings forecasts are solid and corporate fundamentals remain robust, which should help cushion any downside.

**Japan.** Japan steadily underperformed the global average throughout the 2010s but has managed to keep pace since the start of last year. The impact of the pandemic has been less severe than in the west and Japan is well placed to benefit from China's strong recovery. Moreover, valuations are relatively reasonable at 18.3 times forward earnings with a 2% dividend yield. The consensus expects a 37% increase in this year's earnings and we remain Overweight.

**Emerging Markets.** Overall, emerging market earnings are expected to have declined by a modest 4% in 2020. This masks sharp regional divergences however – earnings tumbled 43% in eastern Europe and -55% in Latin America while they actually rose 9% in emerging Asia, thanks to solid growth in China, Taiwan and South Korea. We remain bullish for 2021. Earnings should recover by 35% while valuations at 16x forecasts are rather attractive. Moreover, global cyclical recovery should translate into further growth in global trade flows, a boon for EM exporters

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# CURRENCIES

## More dollar weakness by year end

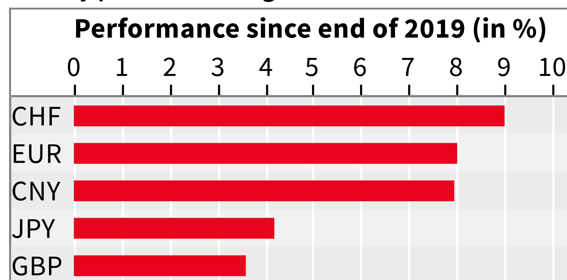
After a counter-trend rally in January, we expect the US dollar to resume its downward trend against both advanced economy and emerging market currencies. Sterling has traded higher on relief that "no-deal" Brexit has been averted but the rally should now run out of steam.

**Dollar Index.** The Dollar Index (DXY) reached oversold levels in early January, hitting its lowest point since April 2018 before regaining some lost ground. In part, this reflected some safe haven buying after mobs entered the US Capitol and, in part, the impact of a modest rise in US Treasury yields on hopes of reflation. Looking ahead, we expect the dollar to resume its decline. With key rates on hold for many quarters to come and asset purchases continuing apace, there is likely to be little dollar support from higher rates or yields.

**EUR/USD.** After gaining 8.9% against the dollar in 2020, it is hardly surprising that the euro has paused for breath in January. However, we believe that the fundamental drivers remain in place to allow the euro to resume its uptrend by year-end. The EU's decision to issue jointly-guaranteed debt has calmed fears of euro zone breakup. The economy will see cyclical recovery later this year. And the euro zone's debt to GDP levels look less alarming than in the US while the zone continues to generate substantial current account surpluses against sizeable US deficits.

**GBP/USD.** Sterling has been in a steady uptrend against the dollar since late September as market consensus emerged that an EU trade deal would be signed before the deadline. Interestingly, the strength has continued in January despite the latest UK lockdown and the disruptions to exporters from the new customs checks and non-tariff barriers with the EU. However, sterling has now risen almost 20% since last March's lows and a pause in the rally looks likely.

Currency performance against the US dollar




Source: SGPB, Macrobond, 27/01/2021

**USD/JPY.** The yen has been in a steady uptrend against the dollar since the bout of whiplash volatility last March. It has been bolstered by the fall in US real yields (i.e., after taking inflation into account) and by widespread dollar weakness. Japan has coped much better with the pandemic than other advanced economies and continuing structural reforms may encourage inward investment flows. All told, we expect further modest yen strength in 2021.

**EUR/CHF.** Like the dollar, the Swiss franc has benefited from safe-haven flows since its early January high against the euro. So far, the Swiss National Bank appears to have remained on the sidelines, judging by total sight deposits (which reflect currency interventions and which are largely unchanged since last September). Once the path towards cyclical recovery becomes clearer, we expect the euro to resume its gradual strengthening trend against the franc.

**EM currencies.** JP Morgan's index of emerging currencies had gained over 11% against the dollar since last April's record lows before shedding some ground in January. Despite last year's strength, the long-term downward trend in EM currencies remains intact. However, we think they may break out higher this year. Zero short-term rates in the US could encourage "carry trades" where investors buy EM currencies for their higher rates. Moreover, cyclical recovery should favour the whole EM complex.

**USD/CNY.** China's draconian lockdown during winter 2020 enabled the country to reopen much earlier than advanced economies, avoiding the need for the massive fiscal support doled out by western governments. As a result, China's debt ratios have suffered less during the pandemic than in the US or EU. Moreover, 10-year CNY government bonds yield 3.19%, making it one of the most attractive bond markets. We expect the new Biden administration to maintain a hard line on China but to shift its focus away from punitive tariffs. a switch which may be facilitated by recent currency strength. All in all, we expect the renminbi to consolidate in coming months before heading higher again.

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# ALTERNATIVES

## Jewellery demand should support gold prices

We expect oil prices to trade sideways in coming months until final demand makes a meaningful recovery. Fundamental drivers for gold should cushion any volatility in 2021. In hedge funds, our preferred strategies are Special Situations and Global Macro – especially discretionary and emerging market.

### Commodities

Oil

Oil prices shot up 10% in early January as Saudi Arabia announced a voluntary cut in output of 1 million barrels per day (mb/d) in February and March and news came through that the Democrats had won a narrow Senate majority. Riyad's decision enabled total supply from OPEC and its allies to be scaled back during a period of likely weak demand while also allowing Russia and Kazakhstan to increase their production. In Washington, the "clean sweep" of Congress and the White House revived hopes of stricter controls on fossil fuel development.

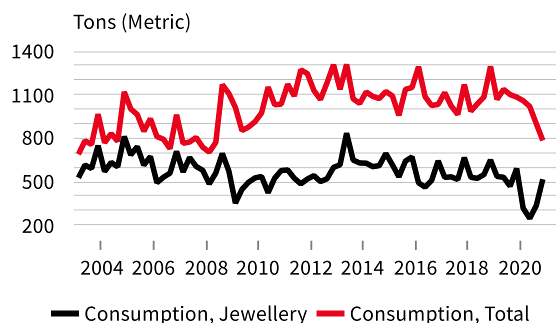
However, President Biden's executive orders on energy have suspended new leases for hydrocarbon projects on federal land but have stopped well short of an outright ban on drilling and fracking, which reduces the likelihood of sharp falls in US output for now. And with Brent prices stable around the top of our target $50-55 trading range, US production may even edge higher from January's 11.0 mb/d average.

All told, we continue to expect a sideways trading pattern in oil prices until tangible signs emerge of higher demand.

Gold

2020 saw the weakest gold demand in 11 years with an annual total of 3,760 tonnes (t). The reduction in demand was driven by the pandemic-induced recession which sparked a 34% decline in jewellery demand, in particular in India and China, the two largest jewellery markets. Central bank buying also fell precipitously, down 59% compared to 2019 to 273t, the lowest annual total since 2010. The rest of the market held up better – bar and coin demand rose 3% to 896t; and gold-backed ETFs saw record annual inflows, equivalent to 877t in purchases.

**Gold demand shrinks in 2020**




Source: SGPB, Macrobond, World Gold Council, 2020 Q4

We expect gold demand to pick up in 2021. As the pandemic recedes, jewellery demand should begin to recover. And frenetic money-printing by advanced economy central banks may encourage further reserve diversification into gold by their counterparts in emerging markets. Finally, real yields on US inflation-linked bonds are currently at -1.05%, close to record lows. At such levels, the opportunity cost of holding non-yielding assets like gold becomes irrelevant.

In sum, gold's fundamental drivers should shore up prices in 2021.

### Hedge funds

Long/Short (L/S) Equity

Within a Neutral allocation to L/S Equity, we maintain a preference for Variable Bias managers over Market Neutral strategies. The latter may struggle during the cyclical recovery we expect this year, especially in light of some high profile "short squeezes" (i.e., coordinated buying of stocks which have been sold short, forcing managers to buy them back at a loss).

Event Driven

Performance by Merger Arbitrage specialists has been strong in recent months, thanks to healthy deal spreads – the difference in price between predator and prey. Moreover, some managers have built positions in SPACs (Special Purpose Acquisition Companies, which enable easy access to listings for private companies) which have helped boost returns.

Fixed Income Arbitrage

Low rates and yields across advanced economies create a challenging backdrop for L/S Credit managers, especially as the reach for yield has squeezed credit spreads towards record lows. Strong risk management techniques and credit analysis should help protect downside, but it would be imprudent to expect to boost returns via even lower spreads than we have today.

Global Macro / CTAs

Over the past six to nine months, commodity prices have made strong gains, helping trend-followers (known as Commodity Trading Advisors, or CTAs) register solid returns. Discretionary Global Macro funds have suffered in January on their short dollar positions, but we are confident their focus on emerging market assets will ultimately prove rewarding.

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