IRISOS
Knowledge is power.

Q 04 / 2020

Quarterly Investment Review and Outlook

Predicting the Future in Unpredictable Times

According to the International Astronomical Union, we are moving faster and inching closer and closer to Milky Way's black hole, with the solar system orbiting 7km/s faster around the Galactic Center. The good news? Planet Earth is still 25,800 light-years away from impact!

We may not be able to control the overall situation, but our understanding of the big picture allows us to manage our day-to-day lives with a degree of certainty and security.

Similarly, even volatile markets follow knowable physical and mathematical rules. Although we are currently experiencing unpredictability on a global scale, our ability to leverage history's lessons and analyze massive amounts of data empower us to successfully navigate the markets.

Quarterly Report – Q04/2020

At a glance

Review – 4th quarter of 2020

a) Global rebound, interrupted?
The initial growth rebound has been powerful and surprisingly symmetrical. Some sectors, such as retail sales and to a lesser extent, capital investment, have maintained strong momentum into 4Q.

b) Brexit
Another outright economic contraction is to be expected for the end of Q4/2020 and extending briefly into Q1/2021. Even so, the rebound should again be strong, particularly as Brexit enters its final negotiations and a minimally restrictive EU / UK trade deal is expected to have worldwide impact.

c) GDP recovery
The scope for a broad and lasting rebound at the start of 2021 is limited by high unemployment rates around the globe; pre-crisis GDP levels will not be reached until the end of 2023.

d) US Central Bank policy
Because of election issues, the policy response in the US has to date been lighter. Given that the economic and societal risks are squarely skewed to the downside, we expect another tranche of QE in Q1/2021, which should translate into some solid gain in GDP.

e) Central Bank policy going forward
The six major Central Banks have increased their balance sheets by over USD 8.4 trillion in the last 12 months. Going forward into 2022, one can expect that the additional QE will be reduced to USD 3.1 trillion; while this amount is largely below the pick-level seen in 2019, it is still above the long-term trend of USD 1.5 trillion.

f) Lowflation for years
Inflation is expected to remain low for the years to come. In DM, it is expected to remain below even 2019 rates. This means that global inflation will – in our view – remain around 1.5% over the coming four years, a historically low level.

In the 2000s, world CPI inflation averaged 4.2%, followed by 3.5% in the 2010s. Looking ahead, inflation is expected to tick up a bit from extremely depressed levels (0.7%) in advanced economies.

g) Limited deflationary risks
Deflationary impulse is created when, for instance, a basic commodity devalues. It can be expected that the deflationary impulse from the oil price correction (-34%) was an exceptional event and will not be repeated. However, lockdowns, teleworking, and social distancing have driven people into different consumer patterns. Clear evidence of this change of habits is seen in the limited availability of some household appliances (ovens, mixers, dishwashers, microwaves, etc.)

h) This time really is different
The trade contraction and the magnitude of the decline experienced in 2020 matched that of the GFC and the Great Recession. In contrast to the pronounced U-shaped cycle in 2008-10, with a very lengthy bottom, this trade cycle is clearly V-shaped, with a short and sharp trough. And there is another change: the prospect that a US-instigated trade war – which was at least partly to blame for anemic growth in 2019 and imputed global growth by about 1% – will no longer hang over global trade.

Our 2021 Outlook

a) **GDP:**
Strong GDP recovery is expected to continue in EM, while downside risks remain in DM because of basic societal issues and the general populace's inability to engage with the uncharted future.

b) **Inflation/Deflation**:
Deflationary concerns exist, yet they should evaporate in the course of 2022. The return of inflation in DM is still some years away.

c) **Normalization**
Based on a bounce of Capex, China is leading the economic recovery. In China, the manufacturing and construction industry accounts for 80% of its GDP; the opposite is true for US, where 80% of the GDP is related to the service industry.

d) **General guidelines**
Policy fatigue and the subsequent decline in consumer satisfaction is a key risk for 2021.

e) **Market returns**
Global equities are expected to return to between 10-15% (base case scenario: PE to decline by around 15%, EPS to increase by 25%, and dividend yield to remain around 2%).

f) **Blue sky scenario**
Emerging Market investors focus on China and Asia in general.

g) **Market rotation**
In DM, capex-related cyclicals (materials, industrials) have the best upside potential.

h) **Do-from-home (DFH**)
On the back of mean reversion, general IT will lose some of its gloss, but the long-term trend of DFH will have some lasting beneficial impacts for the IT sector.

i) **Back to basics**
The favorite investment themes: IIoT, AV/AR, Semiconductor, 5G, Clean energy, ESG, Biotech, and Timber.

j) **European Recovery Fund**
Supported by the European Recovery Fund, EURO Credit offers the most attractive opportunity in the fixed income/credit segment.

k) **USD weakness**
Based on broad based risk-on strategies, the USD is expected to weaken further in 2021.

l) **Key-Valuations end 2021:**
S&P500: 4,000; US 1Y TB: 1%; Bund: -0.4%; EUR/USD 1.25-1.30

Reshaping the world

2020 is most likely a turning point. Because of a stronger awareness of global economic interconnections, the role of governments, central banks and companies may take a radically different direction in the future.

One year ago, we, like the majority of asset managers, were optimistic about the year's economic prospects. Many of 2019s dark clouds, including the US-Sino trade war, political and social instability in Europe, and Brexit, appeared to be evaporating. One of the few wild cards was the US election.

Consumers looked to be in great shape, helped by historically low unemployment and above inflation pay growth. Central banks were accommodative and policymakers promised fiscal support when required to extend the cycle. While geopolitical uncertainty remained, growth looked marginally higher as compared to 2019.

However, as is often the case, the 20/80 rule fully applied. Specifically, a factor that was considered to be relatively low down in any risk matrix was to have the most profound effect on society since the Great Depression.

The locking down of economies resulted in a record drop in activity, with surging unemployment, permanent losses in output, and temporarily slower potential growth. The Organization for Economic Cooperation and Development (OECD) estimates that the resulting damage to the world's major economies is four times greater than the 2009 financial crisis.

The controlled lifting of restrictions has helped to alleviate some of the economic pressures, with a number of economies registering a robust rebound in activity through the summer. However, activity is likely to be vulnerable to surges in infections which trigger further restrictions and renewed lockdowns. The assumption that a vaccine would available by December was correct, but the roll-out and actual vaccination of individuals will take some time. As a result, the global economy may not recover in 2021 from what has been the deepest contraction since the Great Depression.

Governments have embarked on an extraordinary fiscal response, such as allowing companies to furlough staff, as well as pledging vast sums in loans, grants and credit guarantees. These and other measure will have lasting effects, and aftershocks will be felt again and again for years to come.

A new shape?

Looking forward, we believe investors are likely to see permanent changes as to the role of the state (stronger), working patterns (less relaxed) and corporate responsibility (a drive for compliance).

These changes are added to the fact that ever since the early-to-mid-eighties, governments around the world have intervened and fundamentally changed society like never before. The result is that the economy and financial markets have radically taken a different shape, one that is not able to transform shift from one day to the next. It is like a big container ship; it can't make a U-turn, but it can change direction of over time. Elevated levels of state involvement and regulation are likely to be a long-term consequence. We would also expect weaker levels of globalization in many areas. It may well happen that the Trump Administration will be praised in the future for actions that aimed at re-establishing independence in key strategic areas.

Focus on the long-term

In hindsight, the global economy and financial markets are incredibly resilient. Ultimately, the population is resilient as well. Throughout history, progress has been the norm rather than the exception. Therefore, output will expand as demand from rising populations increases and innovation is expected to boost productivity. The resulting long-term economic expansion should drive corporate earnings growth and asset appreciation over time.

Should we therefore consider 2020 generating the effect of a sword cutting through water or the start of more profound changes that will change both societal and corporate behavior?

Investment recommendations by type

1. Equities:

Short-term view: - Neutral to positive

Medium-term view: - With the shortest recession behind us, we believe that equity markets are truly at their fair value at present! We remain strongly positive on strong secular trends; in particular, 5G, IT security, and IT-Services. We take a careful stance towards a fully-fledged sector rotation (in favor value), which we believe could result in beating a dead horse.

2. Bonds:

Short-term view: - Neutral

Medium-term view: - For the first time ever, no major bond market offer a yield to maturity (YTM) in excess of 5.5% p.a.! As short-term interest rates are expected to remain low (close to 0%) for the coming quarters, the average YTM may shrink even further.

3. Credit:

Short-term view: - **Highly Attractive**

Medium-term view: - In particular and by means of the European Recovery Fund, the European high-yield market has very supportive conditions. We expect annualized returns to be in the region of 7.5% p.a. for investments with a 4 year time horizon, with a below average risk level.

4. Metals:

Short-term view: - Neutral

Medium-term view: - Neutral to negative: Historically, metals are a refuge play; however, this only partially materialized.

4. Commodities:

Short-term view: - Neutral to negative

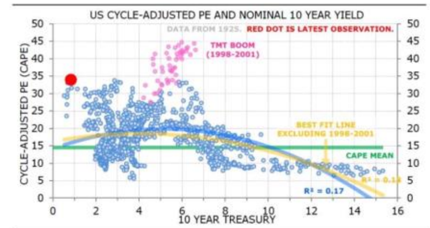
Medium-term view:
- In the oil market, the supply/demand equation starts to find its own new balance, though at much lower levels.
- Basic materials should continue to be supported by strong Chinese growth.

5. Structured solutions:

Short-term view: - Asset class rotation trades will generate short-term volatility – beneficial for structured solutions.

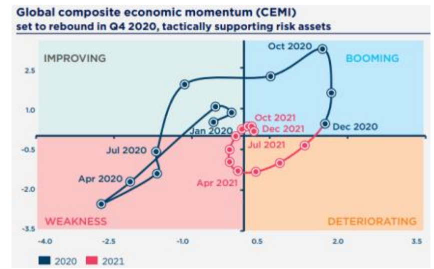
Medium-term view: - Risk-on investors should focus on pro-cyclical opportunities in the fields of energy, hospitality, and UK equities.

Market valuations: rarely were they so high!



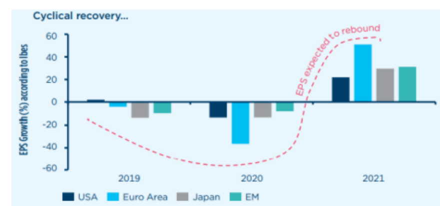
Source: DataStream, Shiller, GFD, Standard & Poor's, BLS; Minack Advisors

The rebound to continue in 2021?

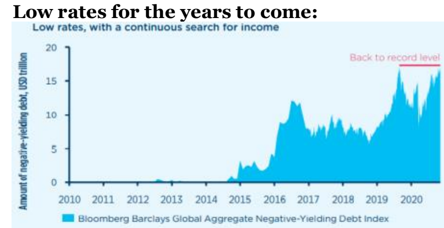


The cyclical recovery is on its way, with:

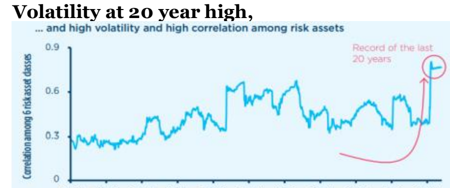
The cyclical recovery on its way



Low rates for the years to come:



Volatility at 20 year high,



IRISOS
Knowledge is power.

Investment recommendations by theme

1. **Globalization 2.0:**

Short-term view: - Positive

Medium-term view: - **With interest rates stable until at least 2024, a risk-on strategy is warranted.**

More than ever, we believe we have entered into a reversal of Globalization 1.0, and that there will be excellent opportunities. Companies engaged in Next Generation opportunities are, in our opinion, not expensive. Based on discounted valuations ratios, Next Generation-focused companies even look cheap when compared with traditional value companies.

2. **From monetary policy to fiscal policy**

Short-term view: - Neutral

Medium-term view: - Policy stimulus fatigue is the biggest risk for 2021. QE has led to a strong GDP recovery, but activity is set to remain below trend for years to come. This is particularly true for DM, where about to 80% of GDP growth is related to the service industry.

3. **Volatility**

Short-term view: - Neutral

Medium-term view: - In the past, event-driven sell-offs have resulted in average market corrections of in excess of 10%. The recent 2020 market correction and the resulting volatility is no different. However, we would expect 2021 to be less volatile than 2020.

4. **Global order – a long shift**

Short-term view: - Neutral

Medium-term view: - Personal consumption is the primary driver of the US economy, comprising around 70% of the GDP. In March, access to services was significantly reduced due to business closures, social distancing and stay-at-home orders. In addition, the huge increase in unemployment in 2020 slashed disposable income for many households, which is the most important determinant of consumer spending.

The consensus outlook for 2021 suggest a year of the global order being reestablished and during which recent imbalances in trade are to be corrected. This is to come on the back of companies rehiring workers, consumers spending, and the overwhelming size monetary and fiscal policy to be managed away.

While conditions are set for these activities to happen, we are less confident than the consensus. Rather, we rather expect a move towards a new normal, which will take some time to settle into.

Asset class view:

Cash / FX

Many investors are long USD, be it by definition or for historical reasons. Historically, the USD has devaluated on average by around 4% annually, while at the same time interest rates have adjusted to lower levels during the past 30 years. This was a positive for US consumers.

The long-term outlook for the dollar remains negative, given the persistently expansive Fed policy and the Fed's commitment to keeping average inflation at 2%, i.e., looking for an overshoot of inflation after persistently below-target inflation in recent years. Yet, this time around, it may result in a slightly less favorable situation for US consumers, and consequently, we see more opportunities elsewhere.

Near term, we see a 1.20-1.25 trading range for the EUR/USD; on the back of a European trade recovery, which is a long-term plan, the pair could appreciate by around 20% versus the USD by 2024/2025.

MMF

We consider short-term money market instruments to be passive investment vehicles. Although they have their benefits (low cost, very high capital resilience, and projectable returns), they have lost some of their past appeal, i.e., as short-term interest rates are below zero for the main reference currencies, returns have become negative. It is for this reason that we do not actively cover this asset class; instead, we offer cash-enhancement strategies that have capital protection features.

Bonds

During its last meeting before US elections, the Federal Reserve voted to keep short-term interest rates anchored near zero. The Fed also provided specific language about its intent to hold rates low until inflation increases. According to input from individual members, rates could stay anchored near zero through 2024.

This statement is the blueprint for all other central banks from developed market countries. Interest rates cannot go up in the near future, given the ongoing QE.

Given the above, along with the already low interest rate scenario, income-seeking investors need to focus on alternative risk-on strategies such as income proxy strategies (see our current selection in “Products”).

Bond Funds

We consider Bond Funds and trackers/ETF Bond Selections to be the opportune investment vehicle for passive investors. Their advantages are important: optimal benchmarking, cost effectiveness, and high degree of diversification.

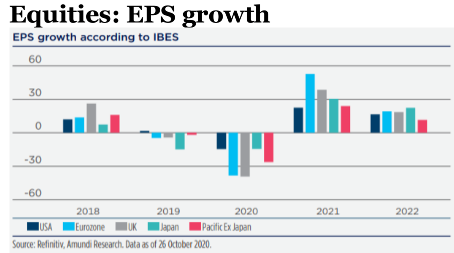
IRISOS SA takes a proactive stance vis-à-vis the market; we therefore use Investment Funds and ETF Structures only when we do not have the opportunity to cover a specific segment of the investor’s asset allocation. For this reason, we do not follow or issue a particular view on a fund, strategy, or concept to follow.

Equities

In the shadow of coronavirus, bloated government debt levels, low rates and expensive equity valuations, prospective investment returns are likely to be low. What might investors do to position portfolios for a post-pandemic world?

It is impossible to take a view on 2021 without first reviewing this year and its unprecedented events. The economic shock caused by the effects of the pandemic was far from a typical slowdown. It was much more brutal and sudden than that. Normally, growing imbalances in some parts of the economy would trigger a readjustment.

Equities: EPS growth



Depending on the size of the imbalances, it could take between six months and two years to reach equilibrium. This time the contraction did not begin with an imbalance, but stemmed from stringent restrictions imposed to tame the COVID-19 pandemic. This meant that relatively stable economies came to a halt almost overnight. The shock was broad based but disproportionally affected the services sectors compared to a traditional recession, which tends to hit manufacturing and industrial production more. Considering the large size of the services sector in developed economies and the sector's reliance on labor rather than capital, this shock resulted in a sizeable increase in unemployment.

Finally, technological change and sustainability are two topics which have benefited from the crisis. Social distancing has led more activities, whether work- or leisure-related, to move online. The pandemic has accelerated the process of digitalization and virtual experience. This has implications for real estate, transport, retail and leisure, among other sectors. Events have put more emphasis on the fragility of our economic system, with its sustainability increasingly coming into question. Almost all fiscal spending announced this year has a sustainable bias attached to it, and the momentum behind sustainable investments is likely to grow ever stronger.

Equity Funds

We consider Equity Funds and ETF Selections as the opportune investment vehicle for passive investors. The advantages are important: optimal benchmarking, cost effective, and a high degree of diversification.

IRISOS SA takes a proactive stance vis-à-vis the market and hence we use Investment Funds and ETF Structures only when we do not have our own opportunity to cover a specific segment of the investor's asset allocation. It is for this reason that we do not follow or issue a particular view on a fund, strategy, or concept to follow.

Credit

Among Credit, we recommend Europe as the key market. The higher quality segment (BBs in particular) appears to be a more opportune segment. EUR Credit continues to be more resilient to default risk than its equivalent in US, thanks to its higher credit quality and a quasi-non-exposure to shale-oil. However, the need for selection and cash buffers remains high across all market segments.

Products:

To benefit from tactical and strategic investment opportunities, we engineer a number of vehicles that can be

- Income proxies,
- Participative instruments, or
- Leveraged product strategies.

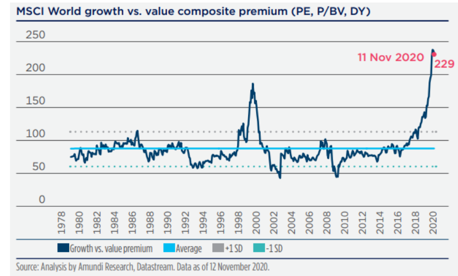
Given present market conditions (low interest environment, fast progressing stock market segments, and a pro-market stance of central banks), it is opportune to invest via such vehicles. Our present strategic opportunities see values in:

- Income opportunities: WOF on Oil Majors, stay-at-home companies, and Swiss Prime Companies
- Leverage Opportunity: Capital protected note linked with a Market Neutral Strategy

For product references and term sheets, please follow the links below

- Oil Majors: [link]
- E-Marketing Opportunity [link]
- Swiss Prime Companies [link]

Growth vs. Value



Strategic Allocation:

The flagship strategy was launched in 2017; it is based on a fundamental top-down and bottom-up thematic equity offering. It is a pure-play approach to actual growth themes such as artificial intelligence (AI), Cloud computing, connectivity, robotics and automation, biotechnology, and the "new normal" for consumers. The concept favors companies that manage, develop, and implement knowledge-intensive processes. The allocation is risk optimized with market standard tools, combined with our heat-map identification process.

Within the portfolio allocation, we identify two performance drivers which are impacted by short-term consumer behaviors and the longer-term capex spending. Typically, in the short-term, we find social media and consumer-spending-related stocks, while in the second segment we have companies that benefit from capex related to secular trends of 5G, the shift from CPU to GPU, AR/AV technologies, and IIOT, amongst others.

While market valuation is high, we don't consider our key performance drivers as overvalued! Based on the PEG-Ratio, we consider that our secular growth themes are still below fair value when considering their long-term growth opportunity

Product fact sheet [click here]

Market-by-Market View

United States:

US performance is steadily improving, but downside risks are rising, too!

In complete contrast, we have further lifted our US growth forecasts, driven by a speedier normalization in economic activity than we had anticipated. At -3.5% for 2020 and +3.9% for 2021, we are above consensus.

Nevertheless, downside risks to this outlook are clearly rising, owing to the surge in COVID-19 infections. It remains to be seen whether President-elect Biden will try to adopt a national policy to contain the virus, but the chance of this, in our view, is not high. We think national policy guidelines to be implemented at the local level – depending on conditions – are more likely such as states and counties taking the lead on mandating what their respective population will tolerate in terms of government control.

In any case, President Trump remains in office until at least 20 January, and on past record, no policy of federal restrictions looks at all likely. One reason for optimism about US growth is the continued easing of the policy stance as the Fed rapidly expands its balance sheet and indicates that it will hold short-term interest rates at effectively zero until at least the end of 2023.

Monetary policy has proven to be notably more effective in the US than in Europe; we believe this is because the US residential real estate market has taken off . The impact of lower interest rates has been amplified by changes in preference caused by the pandemic, with many families abandoning metropolitan centers for the suburbs. The effectiveness of cheap credit is also reflected in another traditionally highly interest, rate-sensitive sector – automobiles. A slump in March/April was quickly and almost entirely reversed. Overcoming months and quarters, demand for cars is likely to remain underpinned by the move to the suburbs.

Labor market

The strength of the labor market directly filters through to consumption levels. Before the pandemic, the US unemployment rate was at a multi-decade low of 3.5%. The locking down of the economy triggered a surge in job losses, with the unemployment rate hitting 14.7% in April 6, the highest since the Great Depression. The labor market has since experienced a rapid recovery, although it seems to be losing some momentum now. We expect the US unemployment rate to finish this year at 6.5% and at 5% by the end of 2021.

The increase in unemployment and consumer debt from the pandemic will keep consumer spending suppressed among some groups for a significant amount of time. However, we do expect private consumption growth of 4.8% in 2021, which would recover most of the contraction from this year.

US-China Trade tension

The outcome of the US elections is unlikely to change the US stance against China. 5G, foreign holdings, the situation in HK, potential US sanctions on Chinese banks and a Phase 2 of the trade deal are all topics that will make a strong comeback in 2021.

This “cold war” might also extend to Europe. The EU received the green light from the WTO to hit the US with US$4bn in tariffs on the back of Airbus Boeing, and France has initiated a tax on Big Techs.

Key figures for USA:

Target values:

Present fair value S&P 500:	3,650
E12 months value S&P 500:	4’000
Upside potential:	+9,5%
(figures as of 15.12.2020)	

Key economic ratios:

GDP Growth 21(E)	4.9
GDP Growth 22 (E)	3.5
CPI 21(E)	1.5
CPI 21 (E)	2.0
P/E 2021 (E):	20.1
P/E 2022 (E):	18.2
Div. Yield 2021:	1.9
Div. Yield 2022:	2.0

Most likely next short-term move:

S&P 500	Up
Nasdaq	Up

Key names to look at:

Industrials:
- CSX

Technology:
- Microsoft
- Micron Technology
- Nvidia
- Apple
- IBM

Financials:
- VISA
- Mastercard

Mapping the market:

The relative absolute size of shocks of key US economic variables in the worst quarters of 2020 and 2008

Source: Bloomberg, Barclays Private Bank, November 2020

Europe:

Europe united in the misery!

When it comes to the pandemic, there is no need to differentiate between the EU and the UK, between Western and Eastern, Northern and Southern European countries. The situation is bad in all of them, with sharp increases in confirmed cases (far beyond the first wave) and ongoing deaths (albeit at much lower percentages than in the first wave).

And the number of countries which are re-introducing restrictions on daily life is growing rapidly. This includes countries which experienced mild first waves, such as Poland, the Czech Republic, Germany, Portugal and others.

For the euro area and the UK, even though the downside scenario has materialized and is now our base case, including a double-dip recession with a renewed drop in GDP in 4Q20, there is still room for an even worse downside scenario. This would entail the current partial lockdowns being extended beyond the governments' current month-long plans or even the six-week duration we assume. And the severity of the business closures could be increased to include, for example, parts of the manufacturing and/or construction sectors. In fact, there is no limit to how gloomy it might get. After the second lockdowns and a reopening for Christmas – seen as a political imperative by many – a third wave may hit during the winter, which would scupper the chances of a second rebound in 1Q21.

Europe facing uniquely European shock: Brexit

As if COVID-19 was not enough, Europe has a problem of its own making – or more precisely, of the UK's making. Brexit will inevitably hit the UK and the EU economies with a negative shock, though its extent will depend on whether a last-minute deal between the UK and the EU can be struck, and what sort of deal it is.

We have just changed our view on Brexit from that of a 'no-deal' scenario to now expecting a deal, although it is bound to be quite minimal. But it would mean that trade in goods between the UK and the EU would remain tariff-free and free of quotas. However, even if a deal is struck ahead of 1 January 2021, disruption in EU-UK trade is almost certain to occur, for example, because goods have to have the required amount of local content to qualify for tariff-free border-crossing.

In fact, although they are very different in terms of their origin, COVID-19's economic impact and that of Brexit are similar in that they are in the first instance supply-side shocks. But these supply shocks also weaken the demand side. This change in view has boosted our 2021 UK GDP growth forecast to the order of 2pp, and that of the euro area by about 0.5pp – revisions which were swamped by the spike in COVID-19 infections and business restrictions.

2021 recovery less V-shaped, more L-shaped

The rebound from the latest lockdowns across Europe, which we expect to run through into February 2021, will be stunted by the inevitable disruption that Brexit will cause at the start of 2021. This alone is likely to exacerbate scarring.

Hence, while the rebound in 3Q20 just about fully reversed the 2Q contraction at the euro area level (but not the decline that occurred in 1Q20!), we expect that the 1Q21 reversal of the likely 4Q20 GDP contraction will only undo about two-thirds of the loss.

The much weaker than expected 4Q20 growth, before the second wave of infections hit, is the key reason for the sharp downward revision to our 2021 GDP growth forecast, but the detrimental effect Brexit will have on the ability to rebound was also an important factor.

Key figures for Europe:

Target values:

Present fair value (DJStoxx600): 390
E12 months value (DJStoxx600): 450
Upside potential: +15%
(figures as of 15.12.2020)

Key economic ratios:

GDP Growth 21(E)	4.2
GDP Growth 22 (E)	3.8
CPI 21(E)	0.5
CPI 22 (E)	1.2
P/E 2021 (E):	15.7
P/E 2022 (E):	14.3
Div. Yield 2021:	3.1
Div. Yield 2022:	3.3

Most likely next short-term move:

DJStoxx600	flat/down
DJStoxx50	flat/down
SMI	flat/down
DAX	flat/down

Key names to look at:

Strong intellectual property:
- Roche
- Novartis
- Amadeus

High competitiveness:
- Siemens
- Daimler
- Richemont
- LVMH
- Kerring

Sustainable dividends:
- ABN-Amro
- Imperial Tobacco
- Altria
- Philip Morris

IRISOS
Knowledge is power.

Emerging Markets:

EM are an interesting combination of secular technology-related sector plays (IT, consumer discretionary and communication services), mostly in North Asia, and more traditional cyclicals (financials and materials), especially in LatAm and EMEA. Asia has been strong in 2020. A USD breakdown would be a catalyst for a broader EM outperformance.

Equity valuations are giving different signals across the regions. Asian stock markets appear expensive: they have already rallied significantly since March, while Latin America and EMEA are lagging behind at well below pre-crisis levels.

In terms of earnings, the divergence is also strong: at aggregate level, MSCI EM trailing earnings (in USD) are currently at -19% YoY, while EM Asia is at -9%, and the picture is only slightly negative for China. In China, the recovery after the lockdown has been quicker and the containment of the virus much more effective manner than everywhere else. Moreover, China (and emerging Asia in general), benefited from their index compositions being more concentrated in those sectors that have been able to achieve profits in these difficult times: healthcare, information technology, communication services and retailing (part of the consumer discretionary sector and including some ecommerce stocks such as Alibaba).

Looking to 2021, our internal forecasts are for a double-digit (+13% in USD) MSCI EM earnings recovery at the aggregate level, mainly driven by a strong rebound in world trade, emerging exports and a mild but positive increase in commodities. The profits growth in the first half of 2021 will be more concentrated in emerging Asia, which is far more advanced in its recovery and also more linked to the booming ecommerce sector. The laggards, such as LatAm and EMEA, should only return to positive YoY numbers in the second half of 2021.

In the short term, as the robustness of the revival is still uncertain and there is a risk of further lockdowns, mainly in the Americas and Europe, emerging Asia looks set to continue to outperform (except for the laggards in the region, such as Indonesia). As we move further into 2021, we will see a gradual shift from growth to value, and the cheap countries outside Asia should also benefit from the revitalization in earnings and increase in flows. Here, the preference should go to inexpensive EMEA countries with good dividend yield prospects and low positioning – for example, Poland and South Africa. LatAm could follow, but valuations are less appealing; much will depend on the pattern in commodity prices.

Unbridled globalization ends, sustainable globalization may begin – which might become a disadvantage for EM.

Today, trade is a fundamental part of economic activity everywhere; it is difficult to envision it ending abruptly. In today's global economic system, countries exchange not only final products, but also intermediate inputs, creating an intricate network of economic interactions at a global level as production processes have become intertwined. The bottom line is that the production chains for good and services have become increasingly complex and global.

There is no willingness to backtrack from the achievements of globalization (trade generates efficiency gains, and via competition/economies of scale/learning and innovation processes, creates a virtuous circle of growth, with trade liberalization leading to productivity gains as well). However, new catalysts of change are building, as the crisis has exposed underestimated vulnerabilities that have led economic actors to become more resilient. Governments may embrace the concepts of economic and strategic sovereignty, as well as health sovereignty; meanwhile, companies have become more aware that they need to carefully evaluate their vulnerability to a range of shocks (geographical risks, cybersecurity risks, trade disputes, and long and somewhat uncontrollable value chains).

Consumers, especially the younger generation, are shifting their preferences towards more transparent, fair and green local products. Looking at the medium term, the redesign of

Key figures for Asia:

Target values:

Present fair value MXAPJ:	815
E12 months value MXAPJ:	950
Upside potential:	+16.5%

(figures as of 15.12.2020)

Key economic ratios:

GDP Growth 21(E)	7.2
GDP Growth 22 (E)	6.0
CPI 21(E)	2.6
CPI 22 (E)	2.5
P/E 2021 (E):	14.4
P/E 2022 (E):	12.8
Div. Yield 2021:	2.4
Div. Yield 2022:	2.5

Most likely next short-term move:

MXAPJ Flat/up

Key names to look at:

- Tencent
- Alibaba

production chains could see trade flows shifting from their current patterns. To give an idea of the scale involved, a McKinsey study found that 16-26% of world trade could, over time, shift to different countries, worth the equivalent of $2.9-4.6tr in exports each year.

Economic and investment implications
There was a “common factor,” – cheap, fast communication between east and west – that boosted world growth (the unbridled growth of trade), but that is likely to fade away. In the future, it can be expected that a relatively larger share of the economic cycle should come from domestic offering.

In addition, both the fundamentals of private consumption and the fundamentals of business investment vary greatly from country to country. Looking ahead, this means that business cycles will tend to be more decorrelated across countries and areas than in the past.

In terms of portfolio construction, more decorrelated cycles mean more opportunities for portfolio diversification through selection.

Sector Analysis

Basic Materials

Building Material Trends

The material disruption which occurred in the course of the 2nd quarter of 2020 has increased awareness of supply chain effects. In fact, 30% of building materials are produced in China. More importantly, for specific types of materials, such as plexiglass and window clings, the dependency ratio is even greater.

The material demand for housing is expected to remain flat. We expect that the trend of people moving out of metro areas has already peaked. More importantly, millennials have shifted away from buying; rather, they tend to rent a home in order to maintain maximum flexibility to move from place to place.

The push to curb emissions in the cement industry is strongest in the EU, where nearly all companies have set emission reduction targets for 2030. The cement industry aims to cut emissions by increasing the use of alternative raw materials such as fuels in the cement production process.

One way the industry sector is trying to address carbon neutral targets is through the inclusion of polyethylene terephthalate (PET), which is among the most recycled polymers. The material is found in bottles, recording tapes, and electrical components, and makes up 18% of the total polymers produced worldwide. PET produces far lower rates of carbon dioxide emissions than other polymer foams. It is also made of 100% recycled material.

There are multiple end utilizations of PET-integrated products. For example, PET can be used in concrete to improve its strength and durability. It can also help improve the stability of road pavement. Furthermore, PET foam panels perform well in the areas of thermoformability, temperature resistance, and fatigue resistance.

Another product that is gaining popularity is timber. Mass timber has several forms, including glue-laminated beams, dowel-laminated timber, and nail-laminated timber. The most common form is cross-laminated timber (CLT), which can be used to make walls, ceilings, floors, and even buildings. The world's largest mass timber structure is 18 stories and 280 feet tall, and has an even taller 80 story wooden tower.

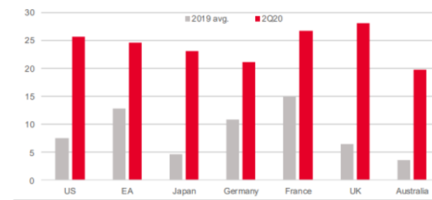
Mass timber is fire-resistant, reduces carbon emissions, and results in faster construction times with lower labor costs. If mass timber construction is coupled with sustainable forestry, it could significantly decrease the carbon footprint.

Finally, we observe a skyrocketing demand for building materials related to the construction of outdoor spaces. Consumers are seeking to build outdoor recreation facilities such as kitchens, fire pits, and patios. In the period between spring and autumn, a number of shortages were observed – namely, the building materials needed to build such projects, as well as related appliances and tools.

Investment opportunities:
This sector is one of the most correlated to global industrial production. While production is getting back online in China, it looks set to take a steep fall in the US and Europe.

We like: Lafargeholcim, Sika, Toll Brothers, Albemarle, Huntsman,

Household savings = pent-up demand



Source: National sources, Refinitiv, SG Cross Asset Research/Economics

Consumer Staples

A challenging environment ahead!

Consumer staples stocks held up well in 2020, and for good reason. When the worst of the epidemic hit, consumers stocked up on toilet paper, bottled water, and other basics. Social media platforms were full of pictures showing empty grocery store shelves, which in turn prompted people to rush back to stores to "stock up" further.

As we look to 2021, however, investors should be more discerning about what companies should be considered as opportune. While the pandemic still is raging in many areas of the globe and a renewed run on basic household supplies is occurring, a major game changer has arrived – a vaccine that is ready to be rolled out. However, the appearance of a vaccine is not necessarily welcome news for every company that sells household necessities.

Investors may want look beyond 2021 and the events surrounding the "stay-at-home trades" that did well in 2020. Going forward, here are a few areas of concern to consider: Limited pricing power in a low-interest rate environment gives Consumer Staples less-than-exciting top-line growth potential.

With the economic recovery having a good chance of maintaining its trajectory, some of this concern will evaporate. However, consumers will likely remain shy of buying brand names, while lower priced "off-brand" products will be opportune as they do the same job for less.

Furthermore, at this stage of the business cycle, the Consumer Staples sector typically underperforms the overall market. While longer-term price momentum has held up, we think that with growing confidence in the economy, investors will allocate funds differently and therefore, Consumer staples may underperform going forward.

Positives for the Consumer Staples sector:

- It typically has a stable earnings profile
- Its defensive characteristics tend to be a positive during periods of market volatility
- Companies have engaged in aggressive cost-cutting
- It has solid relative valuations

Negatives for the Consumer Staples sector:

- Historically, an improving economy and strong stock market have made the sector relatively less attractive to investors
- Companies tend to have limited pricing power in a low-inflation environment

Risks for the sector:

- Additional government fiscal stimulus and the future availability of a vaccine could further support the economy and reduce stay-at-home food and staples demand.

Investment opportunities:

The sector has been one of the best performers since equities began to plummet after the 19 February peak. Demand should remain relatively resilient for products that satisfy everyday needs, despite disruption to the economy. However, other sectors of the market appear better positioned if markets begin to bottom.

Given the overall competitive outlook for the sector, investors should seek companies with strong balance sheets, low financing costs, and a strong focus on products and services. Because of the high absolute valuation and the limited upside potential, high yield dividend stocks are at risk; companies to consider include AD, ABI, BAT, NESN, EL, MO, and PM.

Technology

Information technology is a highly concentrated sector, with just a handful of companies representing more than 50% of the sector's weight—including the two behemoths Apple and Microsoft. While those "big two" are typically the primary drivers of sector performance, short-term impacts have been broad-based and positive for much of the sector, increasing consumer demand for PCs, gaming hardware, software, personal devices and online payment services (at the expense of traditional credit card services by Visa and MasterCard).

Despite a surge in spending to accommodate remote working, weak capital expenditures—as well as trade tension and pandemic-related supply chain issues—have been of concern. However, there are signs that investment in cloud and networking equipment is picking up, which could persist if the economic recovery continues. And the ongoing rollout of 5G wireless infrastructure is likely to accelerate, increasing demand for telecommunication components and semiconductors.

Long-term, both a trend away from globalization and pent-up demand for productivity-enhancing technologies are likely to improve the already solid financial position for much of the sector. Counterbalancing the strong fundamentals and price momentum, investor optimism about future growth potential has pushed valuations to well above the historical average. Still, we do not think that all IT sub-sectors are overpriced. Finally, there are rising legislative and antitrust risks for some of the largest companies in the sector. While concerns of a split-up exist, we don't think that it will actually materialize.

Technology disruptors

The scope of the "Information Technology" sector includes both technology disruptors and enablers, as we believe growth-based investors should continue to maintain an exposure to technology disruption as a theme on a medium-long-term basis.

Technology disruptors are the companies of tomorrow. Because we believe that we are only in the early stage of, we expect disruptors and enablers to continue to grab market share and thereby open themselves up to being challenged and ultimately disrupted.

As of today, technology disruptors tend to focus on platform-based developments; in particular, companies that enable network efficacity and transfer accelerations. Among technology enablers, we like companies exposed to trends like cloud, Big Data, and artificial intelligence (AI). Meanwhile, we stay away from companies with weak product portfolios, legacy products, and declining market share.

Positives for the sector:

- Generally strong balance sheets and earnings growth potential with low funding costs
- Home office, financial services technology, and surging online retail are supporting cloud computing infrastructure and software
- Long-term growth tailwinds, as businesses enhance productivity with tech investment

Negatives for the sector:

- Valuations are stretched relative to the historical average
- Capital expenditures are weak, albeit improving
- The sector is highly concentrated in a few stocks

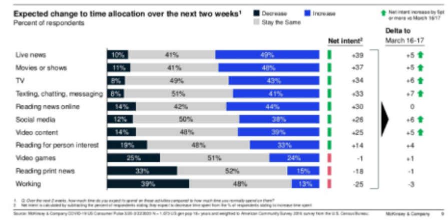
Risks for the sector:

- Continued high unemployment could weigh on consumer technology revenues
- Potential antitrust suits in the U.S. and Europe
- Reversal of the 2017 corporate tax cuts that had greatly benefited the sector

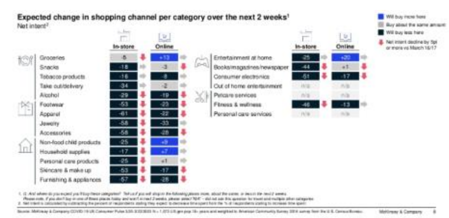
Investment opportunities:

Although the near-term is highly uncertain due to COVID-19, we believe investors should focus on technology companies that have attractive longer-term growth opportunities due to established franchises in large and secularly growing addressable markets such as software, cloud, and security. In this vein, we highlight Microsoft, Palo Alto Networks, Salesforce.com, Splunk, and Accenture.

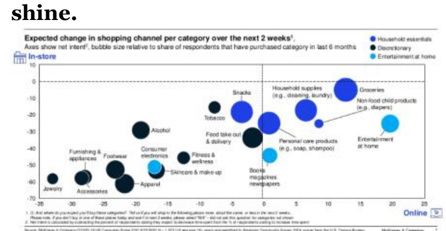
Stay-at-home to be become a winner



... details of the expected shopping channel changes, ...



... with basics and entertainment to shine.



Communications Services

Pandemic-related stay-at-home behaviors have been good for some companies in the sector, as it has led to increased use of social media and increased demand for streaming entertainment.

However, the shift from traditional TV and cable has dropped, hurting advertising revenues. Additionally, wireless service revenue growth is at risk if high unemployment persists. While the larger companies (Alphabet/Google and Facebook) enjoy significant competitive advantages due to their dominance in their respective business lines — search engine, social media and telecom — they also face emerging antitrust risks, as well as potential market saturation.

Longer term, we believe the rollout of fifth-generation (5G) cellular wireless technology could further increase demand within the sector, as 5G is expected to increase both speeds and growth potential. However, upgrading networks will require substantial capital investment, and the pandemic has slowed progress.

Streaming and Video Games: A New Normal
Video games continue to be a secular winner, with more people introduced to gaming as a major form of entertainment, and engagement levels that remain elevated (Fig. 2). However, the stocks have more recently underperformed as the market begins to anticipate a more normalized economy, coupled with a slightly disappointing management commentary.

We remain constructive on underlying trends. Next generation tools were launched, which should help support further engagement, enhance the experience, and reduced latency. In the game industry, we are seeing signals that the price tag of AAA games is rising for select titles, which has not happened since the 1990s. Also, we do not believe the number of gamers or engagement levels will return to pre-COVID levels. Instead, a "new normal" will emerge because of a more mainstream video game culture.

Pipeline disruption due to the virus is a risk we are monitoring closely. Games such as Halo and Cyberpunk 2077 have recently announced delays due to development issues stemming from the virus. Other games may face similar issues, which would prove to be a revenue headwind for the industry.

Positives for the sector:

- The competitive advantage for social media
- 5G rollout should boost growth potential, but companies face near-term high capital expenditures
- Social distancing has accelerated a shift toward streaming entertainment content

Negatives for the sector:

- Antitrust regulatory trend is negative for search engine and social media companies
- Potential for increased social media regulation (for example, Section 230 legal shield under scrutiny)
- Streaming service market saturation
- Valuations are difficult to assess

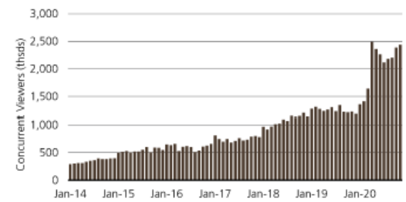
Risks for the sector:

- Sector market capitalization is heavily concentrated in the top five stocks, whose movement can significantly influence the sector.

Investment opportunities:

We currently believe many Communication Services companies face risks that outweigh their potential rewards, which is why we have a “hold” rating on most of the sector’s companies (GOOG, DI, NFLX, FB, AMZN).

Fig 2: Number of hours watched on Twitch remains at elevated levels



Energy

IAE says: Global oil demand will not recover!

Short- and medium-term considerations
At present, we estimate the broader sector stamp as follows: Global oil demand is going to fall more sharply than was previously expected and a vaccine is unlikely to significantly boost consumption until well into next year. The recent announcement of vaccine availability somewhat improved the economic visibility and we observed a share price adjustment.

The Paris-based IEA cut its demand growth forecast by 400,000 barrels per day to a reduced level of 8.8 million barrels per day this year as compared with its forecast in last month's market report. The massive reduction in demand mainly originates in wealthier countries in the OECD. According to the IEA, demand from emerging markets will be the driver of the overall pick-up in global consumption, mainly thanks to improvements in China and India.

The IEA now also predicts a recovery in oil demand of 5.8 million barrels per day for next year, but this is only 300,000 barrels per day higher than its forecast a month ago.

Long-term considerations
When assessing a long-term outlook, it is important to remember that commodity prices do not anticipate growth ex nihilo, but rather reflect the combination of supply, inventories, and demand. On the supply side, there are two factors at play: a) supply management such as production cuts, and b) strategic supply management with the aim of weakening the competition. On the supply side, historic oil-producing countries have an advantage over newcomers, which operate at higher costs.

At present, global stockpiles are about 20% above the long-term average and 10% above the maximum fixed inventory capacities. Much of this surplus is presently stored offshore in tankers with no destination to go and unload. One can expect that it will take several quarters to work off these over-capacities.

We expect that the 3rd lockdown period will be shorter and less rigorous, especially as vaccines can now be deployed in specific regions as a countermeasure. This could suggest that demand will come back relatively quickly, but softly. More importantly, oil imports by China have started to pick up, which in turn suggests that demand for petrochemical products is returning.

Barrel prices are expected to remain range-bound but volatile. Also, we would expect that a level USD 60/barrel is toppish. In this context, oil majors managing the entire value chain (up-stream, refining, marketing, down-stream) are better off than pure plays. The best opportunities can be found in the following (in alphabetic order): BP, Eni, Exxon, Petrobras, Royal Dutch-Shell, and Total. Pure plays: Pioneer Natural Resources and Occidental Petroleum Corporation.

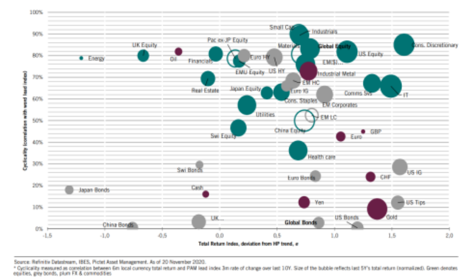
Investment opportunities:

The collapse in oil prices due to the inability of Saudi Arabia and Russia to agree on a production cut darkens the outlook for the sector, and oil demand has slowed substantially as the Coronavirus spreads globally. While conditions are challenging, oil prices are far below sustainable levels and are primed for recovery once markets stabilize.

In terms of names, we favor global up- and downstream operators, as they are most likely the only players who will endure a lasting price war with Saudi Arabia.

We favor names such as the following: BP, RDSA, BKR, CVX, COP, XOM, SLB, PBR.

Present valuation vs. Historical performance: Energy is cheap



Financial Services

For the financial sector, 2021 will be similar to 2009!

S&P Global Ratings warned that banks could face their toughest year since the aftermath of the global financial crisis, with four key risks hanging over the sector. A full recovery may take as long as two years.

Four key risks

In a recently published series of reports, S&P's base case is for a sharp rebound in global growth in 2021.

Risk # 1: Asset quality

The agency suggested that the combination of

a) strong bank balance sheets,
b) support from authorities in retail and corporate markets, and
c) regulators' flexibility

should limit further rating downgrades next year. The agency highlighted that strong fiscal support from governments is benefiting lenders, funding markets remain accommodative, and banks have been extensively provisioning to deal with weakening asset quality. The expected progressive withdrawal of support in 2021 will reveal a truer picture of underlying bank asset quality, even as economies may start to recover.

Risk # 2: Weaker or delayed rebound

As it relates to the credit outlook, the S&P report emphasized the importance of widespread immunizations being available by mid-2021. However, S&P cautioned that any deviation from this assumption, such as a weaker or delayed rebound and further economic disruption, could lead to further negative credit rating actions, especially in those areas currently enduring second waves of infections and implementing fresh lockdown measures.

Risk # 3: Corporate insolvencies - Loan loss provisions

A further concern analysts highlighted was the potential for short-term support to banks and borrowers to leave "longer-term overhangs" if policymakers withdraw fiscal measures too soon. Support measures have largely counterbalanced the effect on bank credit as significant economic volatility flowed through to bank borrowers. In the event monetary and fiscal stimulus programs diminish too early, a drawn-out recovery is likely. This could result in more damage to households and corporate balance sheets — and consequently, to banks. Meanwhile, the report cautioned that an anticipated rise in leverage may give way to a spike in corporate insolvencies, in turn weighing on lenders' loan loss provisions.

Risk # 4: Property lending

The final risk S&P raised in the report was the potential for a weakening of the property market. Should the sector suffer greater harm than expected in the aftermath of the crisis, it would further heighten the risk of defaults and weaken bank credit quality.

Investment opportunities:

The fall in interest rates to global financial crisis-era lows and the sharp slowdown in the economy will drive a steep drop in profits for banks. But banks are well capitalized and should see a sharp rebound when market volatility subsides.

We continue to have a particular interest in secular growth companies that should emerge from the crisis with strong long-term growth prospects. Our preference goes to American Express, Intercontinental Exchange, MasterCard and Visa.

Moreover, investors seeking deeply discounted valuations with strong expense leverage and robust capital should consider an engagement in Ameriprise, Capital One, and State Street.

Healthcare

From an infrastructure point of view, the past nine months have revealed several necessary improvements in order to move forward better and more efficiently:

- Adapt digital front door (remote consultation, monitoring, and health care records)
- Clean and dirty sites (in the same manner after the FT, the banking sector cleared the damage through good and bad banks)
- Supply chain resilience – In the earliest phase, the sector was exposed to the vulnerabilities of offshore and “just in time” supply chains that rely on lean manufacturing principles.
- Agile workforce – While the workforce is showing a heroic face, health systems and providers have discovered that their workforce planning and deployment models have too many limitations.

However, political priorities lay elsewhere! The Biden presidency will most likely attempt to expand insurance coverage by strengthening the Affordable Care Act, lowering drug costs through regulatory oversight and increasing legislative pressure to pave the way for a "public option" that would compete with managed care companies.

From an investment perspective, the picture is even starker. Investors are most likely eager to put an even greater premium on innovation and novel drug platforms. Should this play out as we expect, it will create more dispersion in the sector, creating winners and losers, with beneficiaries being first or best-in-class treatments that address large unmet medical needs and demonstrate meaningful improvements above the standard of care.

Positives for the sector:

- Strong balance sheets with ample cash for dividends and M&A
- Positive long-term demographics trends, including an aging global population and a growing middle class in emerging markets
- Return in demand for elective procedures, drug sales, medical equipment and diagnostics
- Attractive valuations relative to the sector's historical average
- Positive long-term price momentum

Negatives for the sector:

- Hospitals have been squeezed by high COVID-19 preparation expenses
- Pharmaceutical and biotechnology companies face the high cost of testing and delays in new trials
- Higher unemployment reduces healthcare insurance enrollment
- Extended-care facilities are likely to see higher costs

Risks for the sector:

- Bipartisan support for prescription drug price controls
- Reversal of the 2017 corporate tax cut
- Surge in COVID-19 could reduce demand for elective medical care (loss of revenues)
- Unclear impact from any enhanced ACA legislation

Investment opportunities:

The healthcare market is fragmented, as its players are striving to increase their market share through such strategies as improvements to existing solutions and software platforms, development of new platforms, and strategic alliances with other market players. Therefore, several players account for significant individual shares in the market.

While political risks for the sector have improved as prospects fade for Medicare for All, there is still uncertainty about the outlook for drug price regulation, which will likely persist with the Biden administration.

Industrials

Manufacturers are at continued risk for disruption. With product life-cycles to become ever shorter, cost management and a lean manufacturing concept are key to remaining resilient in the years to come.

More diversified, but highly specialized
In 2019, many industrial companies made inroads into streamlining operations and doubling down on the core of their portfolios. For those with historically diversified business models, activities became increasingly focused.

Businesses were realigned around key markets or customer segments to further drive results and crystallize companies' value propositions to customers and financial markets. Some are turning to mergers, acquisitions, or divestitures to get their "houses in order." In terms of divestitures, the industry observed more than 20 $500+ million deals in 2019. The number of deals for 2020 will be lower, but given business conditions in 2020, the trend observed is upwards.

This activity is the result of multiple pressures faced by these industrial companies, including pressure from shareholders, customers, and the broader public financial markets, which may increasingly favor focus over diversification. With this focus, a desire to intensify capabilities within the core business could further drive deal activity or focused investments, especially as they relate to protecting value chains from ongoing trade uncertainties.

The most diversified industrial companies could consider several different variations on this theme, identifying options for rounding out core businesses even as they divest themselves of other entities.

The Digital Build
The velocity with which the fourth industrial revolution is progressing is now challenging manufacturers to work even harder to maintain momentum as they pass milestones along their digital journey. Early successes have increased many companies' appetite for further digital exploration and investment. However, current labor and trade uncertainties within the global manufacturing industry could stall digital progress. Therefore, in recent months, many companies have shifted their efforts toward digital projects that build agility and scalability to help them manage risk.

Digital "muscle building" can be one of the leverage points to increase flexibility in global supply chains. Applying artificial intelligence, cloud computing, advanced analytics, robotics, and additive manufacturing to the value chain can increase visibility and transparency, allowing manufacturers to make faster changes to operations, in order to respond to market-based threats or opportunities. As manufacturers continue to seek out bright spots in the global landscape—including emerging markets—their ability to flex production, delivery, and customer support will continue to be important.

Shifts in sourcing (and thus production) are already playing out on the global stage. To showcase the broader picture, US imports from China were down 12.7 percent in the first eight months of 2019 versus the same period in 2018, and 2020 figures are expected to be even lower.

In a matter of months, manufacturers have shifted both sourcing and production to different geographies, seeking tariff-friendly combinations. For manufacturers, this must be executed precisely given lead times (and even customer approvals) for both original equipment and their highly profitable aftermarket components.

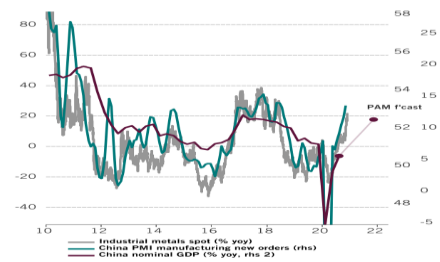
The coming year promises to be an ever-shifting environment for manufacturers as they try to regain their footing amidst continued adjustments in terms of offer and demand, prices/costs, and policy decisions.

Investment opportunities:

The sharp slowdown in the global economy hits the sector particularly hard, but valuations are attractive. Medium-term investors may look at the following: CSX, Siemens, Easy-Jet, Lockheed Martin, and Stanley Black & Decker.

Industrials are lagging capex cycle

Expect more to come:



Source: Refinitiv Datastream, Pictet Asset Management. As of November 2020.

Real Estate

A recent report issued by CBRE suggested that investors preferences have changed. Interest has shifted to industrial and logistics, where construction completion is expected to rise by 29% from 2020 to 2021.

Commercial real estate services and investment firms expect to see adaptive reuse of retail space for logistics uses accelerated, as demand for infill sites increases due to rising e-commerce demand. E-commerce growth surged to 44.5% in the second quarter, from 14.8% in the first quarter.

Data Centers
The data center sector is also projected to see significant growth, according to CBRE, which forecasts inventory to increase by 13.8% in 2021. CBRE notes investor interest in the data center market has increased because of the success of the five core data center REITs, which have seen revenue growth of more than 28% year-to-date.

Other sector projections for 2021 include:

- Office—Fundamentals are expected to recover in late 2021, with suburban markets recovering more quickly. Urban downtown markets, which rely on mass transit commuting, will likely pick up later in the year.
- Retail—E-commerce sales will slow in 2021 and may even fall further. It can be expected that an overall capacity reduction of 20% is required to balance out the market.
- Hotels—CBRE expects the overall hotel recovery will take several years, with group and business travel continuing to be weak in 2021. Hotel occupancy is slowly projected to return, though post-crisis levels are only expected by the 2023 summer season.
    - Drive-to-leisure destinations have already seen improved occupancy and will continue to do well in 2022.
    - Higher-chain scales: Many are dependent on group and business travel and that is not expected to recover any time soon.

Investment opportunities:

The sharp slowdown in the global economy hit the sector particularly hard, except valuations. While valuations are attractive, it may take time for all segments to recover.

Even so, some sub-segments are less exposed to the sharp downturn. In fact, we have two distinctive eco-spheres: the digital world and our physical one. The blur is important, with the following result: one global economy built on the back of bytes, and another composed of bricks and mortar.

As the economy is changing, data centers (cloud capacities) are required. This shift has significant ramifications for the global economy across all industry segments. Some real estate companies will experience a higher growth rates than others. Names to look at: Sergo, Goodman Group, GLP, Nippon Prologis, A-Reit, Mapletree Logistics, Equinix.

Consumer Discretionaries

The Consumer Discretionary sector, as the name implies, includes companies that produce or sell non-essential products that consumers often do without when they are under financial stress or worried about job security. These industries within the sector tend to do best when the economy is growing and consumers feel confident about spending money.

Low interest rates also tend to be a positive, as this encourages people to borrow and spend. The sector has a number of sub-sectors and economic activities that were hard hit by business shutdowns and shelter-in-place orders—particularly hotels, leisure & theme parks, e.g. Disneyland, and apparel industries. Many of them have not yet fully reopened, and thus, continue to be under sharp pressure.

However, those industries are overshadowed by industries that have been boosted by COVID-19-related restrictions, such as home improvement stocks and the internet retail industry—Amazon in particular, which constitutes about 40% of the sector's market cap. The ongoing trend away from brick-and-mortar retail business is likely to continue, but investor enthusiasm may have pushed valuations too high, despite the strong fundamentals in the sector heavyweights.

Consumption of discretionary goods dropped significantly after the outbreak of the coronavirus. We expect this to have only a temporary impact, as sales growth has sequentially improved, driven by the reopening of stores and restaurants. However, uncertainty has increased, although fiscal stimulus programs should help sales to recover.

In the run-up of the pandemic, valuations have rerated ahead of actual business pick-up! As we move in many areas into the 3rd wave of contaminations, the combination of short-term work schemes that are less generous than previous ones and lower levels of consumer confidence, raises uncertainty around the near-term consumption outlook. We therefore have a neutral recommendation on the sector and would look for encouraging news about vaccine roll-outs as a cue to turn more positive.

Positives for the sector:

- Online and home-improvement retailers benefit from social distancing
- The shift away from brick-and-mortar is likely to continue to support online retailers
- Economic recovery is positive for many of the more traditional discretionary industries

Negatives for the sector:

- COVID-19 uncertainty likely to continue to weigh on travel and leisure activities
- The sector is overly concentrated in internet retail
- Valuations appear stretched

Risks for the sector:

- Antitrust action is possible for the largest online retailer
- Renewed weakness in the economy and/or stay-in-place orders would likely hurt traditional retailers

Investment opportunities:

The virus-driven hit to the economy will likely lead to slower consumer spending as unemployment rises. Still, secular growth in e-commerce is a net positive driver for the sector.

We favor companies that benefit from "stay-at-home" such as: LVHM, Kering, Moncler, Ferrari, Richemont, Tiffany, Swatch.

Utilities

Electricity

As with most businesses, the utility industry is also feeling the disruption. Power usage will drop by an estimated 12% for 2020. Longer-term, power usage will increase by an estimated 3% annually. Improvements in battery technology and an ever-higher availability of charging opportunities will increase the switch to electricity driven power generators, whatever the end use may be.

On the production side, new and growing technologies also will drive future changes. To meet carbon neutral standards, the industry sector will need to reduce dependency on coal and fossil fuel (gas and oil) power generators.

Water

Water is one of the most common commodities. The world water demand has more than doubled since 1960, and will continue at this pace or faster. Yet ever since water-related infrastructure was built, its maintenance has grown more expensive over time. It is assumed that non-revenue generating production (i.e., water that is produced but never actually reaches the consumer) is as high as 15%, due to leaks and other losses.

Some longer-term trends for the sector include the following:

- Decentralized generation of the utility to reach the consumer faster and in a safer manner
- Carbon neutral emission targets are industry supportive and initiatives have the support of the consumers, especially in DM.
- Solar will overtake wind to include half of the renewables demand by 2050.
- Consumer knowledge about electric power usage will be critical. For renewables, one key area to overcome is the "offer/demand" imbalance. Developing specific battery technology for storing power is key.
- Infrastructure maintenance is key to increase good deliverability.

Investment opportunities:

The recent spike in volatility may have encouraged investors to seek the perceived safety of the utilities sector, but we continue to believe that this is not the right move. A growing economy and rising interest rates don't make for utilities performance, and we therefore believe underperformance will likely continue. For those who still wish to seek exposure to the sector, it may be opportune to consider the following names: in Europe, Centrica, Fortum, E.On, and RWE; in the US, American Water Works, DTE Energy, Excelon, and Nextera Energy.

Foreign exchange

Currencies

A shift from a contraction phase to a recovery will likely put the USD under pressure. A broad USD move lower is expected, but considering the higher policy flexibility and the direct link to China, we believe commodities-related currencies will be the relative winners in G10. On EM FX, volatility will remain throughout 2021, but some appreciation is in the cards.

The scenario is unfavorable for the USD, which remains about 15% overvalued with respect to our fundamental framework. We see the relative overperformance of US assets and overly high hedging costs as the main reasons behind the persistent USD deviation from fundamentals we have seen in the recent past.

In fact, the USD has lost two of its main cyclical drivers from the recent past. Its growth premium vs. the rest of the G10 countries collapsed in 2020, and the Fed has almost entirely removed the USD rates advantage that made the greenback a profitable investment opportunity, as well as a defensive play. Against such a backdrop, we believe a convergence to fundamentals will occur in 2021.

Precious metals

Since our last outlook, we have seen two dramatic events unfold. The first is what appears to be resolution of the US election. Post-election, growing confidence in a Biden win, coupled with a split US congress, has lifted risk sentiment, with the S&P 500 up 9% since the start of November. As the dollar has weakened, gold has found support and rallied with equities. However, over the longer term, we believe that the outcome of the election will have only a very limited impact on US fiscal policy. The current ultra-low interest rate and low inflation environment will remain the norm and a principal driver for gold prices in the near term.

A return to the new normal is a bearish factor for gold. As such, we forecast that gold will eventually fall to $1700/oz by 2022. In the shorter term, however, we continue to expect gold prices to be supported and forecast 2021 average prices at $2,050 with the majority of the bullishness in the first part of the year.

Commodities

In 2021, commodities will be supported by the recovery in the economic cycle and by the still favorable financial conditions. WTI oil should stay in the $40-50 range in H1 2021, while base metals should also recover. Gold will also benefit from easing central banks, and is favored in the case of continuing uncertainty.

Investment considerations:

We see a clear bias for EUR/USD to drop below 1.15 in the near term. But the tide should turn for the euro in 1H21, either due to easing trade tension and improving global growth or due to more pronounced Fed easing.

In the coming months, we recommend positioning for a 1.30 upside barrier and for a downside of around 1.15.

One risk is an unexpected rebound in US inflation and growth that brings the possibility of Fed rate hikes coming back into the picture earlier than expected. This would lift the greenback. Another risk would be a US recession after escalating trade disputes, which could weaken the USD earlier and faster, since the Fed would likely cut rates aggressively.

Target values in 3 months:

EUR/USD:	1.1850 - 1.2500
GBP/USD:	1.2500 - 1.3500
USD/CHF:	0.9750 - 1.00

Target values in 12 months:

EUR/USD:	1.25- 1.30
GBP/USD:	1.30 - 1.40
USD/CHF:	0.90 - 1.00

Purchase power parities:

EUR/USD:	1.35
GBP/USD:	1.58
USD/CHF:	0.93
EUR/CHF:	1.15

Most likely next move:

EUR/USD	up
GBP/USD	up
USD/CHF	flat

Target values in 3 moths:

Oil:	$40 - $45
Gold:	$1,900

Target values in 12 months:

Oil:	$45 - $55
Gold:	$1,800

Upside potentials:

S&P GSCI	up
Oil	up
Gold	up

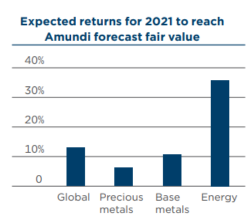
Next most likely move:

S&P GSCI	up
Oil	up
Gold	up

Commodity related stocks:

- BP
- Exxon
- EOG Resources

Expected returns of 2021:



	Sensitivity		
	Macro	FX	CBs
Precious metals	-	-	++
Base metals	++	+	+
Energy	++	++	--

IRISOS
Knowledge is power.

Capital market assumptions

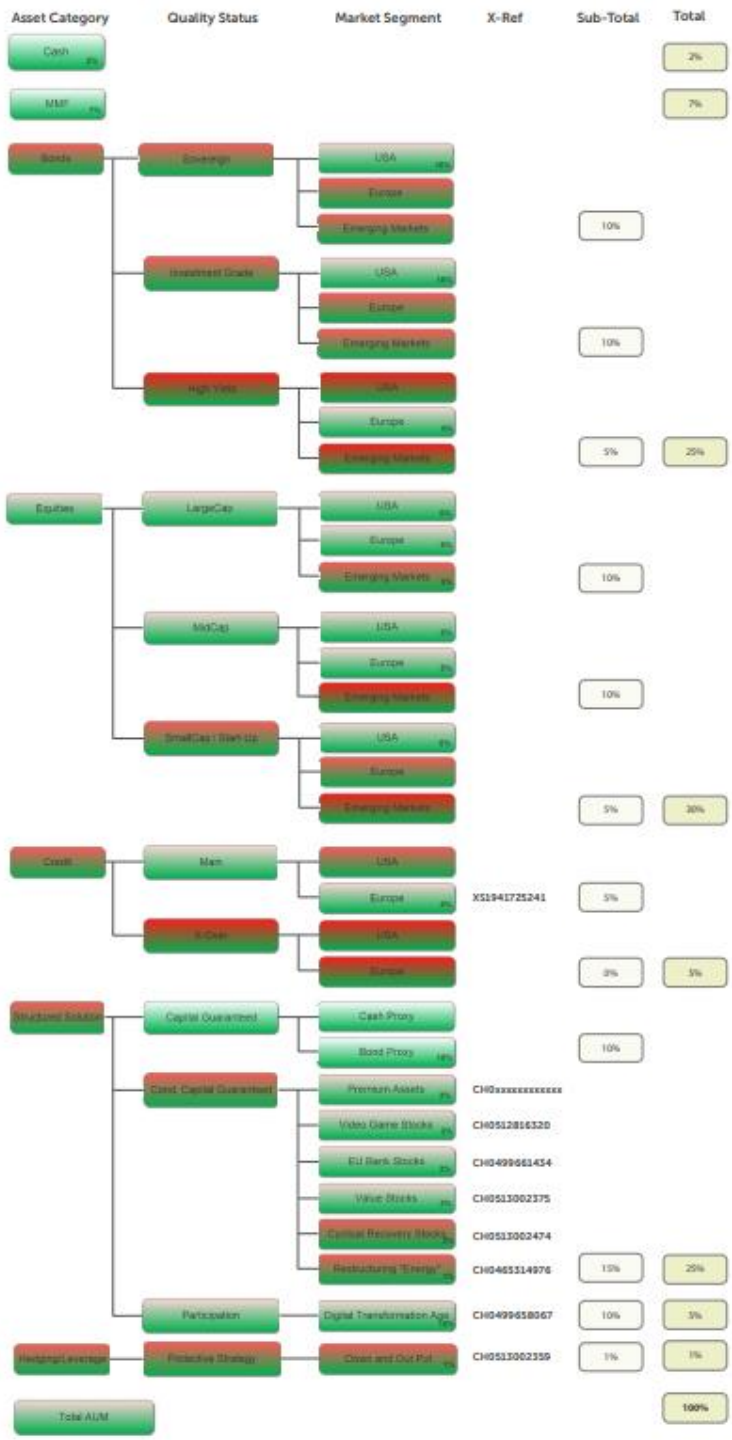
Return forecasts

Forecasts are in local currency (except EM equities); all figures are annualized

	Forecasts for the next 7Y			Average returns over the past 10Y	
	Return	Vol		Return	Vol
Cash USD	2.50%	0.00%		0.80%	0.40%
Cash EUR	0.30%	0.00%		0.10%	0.50%
Fixed income					
USD High grade bonds 5-10Y	2.60%	5.00%		5.00%	4.10%
EUR High grade bonds 5-10Y	-0.20%	4.20%		4.40%	3.90%
USD Inflation linked bonds	2.40%	4.70%		3.00%	3.30%
USD Corp bonds (IG)	3.30%	4.40%		4.80%	2.90%
USD High yield bonds	4.70%	9.70%		8.40%	6.10%
EUR High yield bonds	2.30%	8.70%		8.70%	7.30%
USD Senior loans	5.70%	6.90%		5.50%	3.50%
EUR Senior loans	3.50%	6.30%		6.00%	3.10%
EM Sovereign bonds (USD)	4.90%	8.60%		7.40%	6.30%
Equities					
US	5.70%	15.20%		13.50%	12.70%
EM (USD)	9.20%	20.70%		3.70%	17.00%
Eurozone	5.10%	17.30%		7.30%	14.40%
UK	6.00%	16.30%		7.30%	11.50%
Japan	4.60%	19.30%		7.80%	17.20%
Switzerland	4.50%	14.00%		8.40%	11.00%
Alternative Solutions					
HF (FOF, USD)	3.50%	5.20%		2.90%	3.90%
Alternative, other risks (USD)	7.20%	10.00%		7.80%	7.20%
Alternative, Private Estate (USD)	7.90%	9.20%		9.40%	5.10%
Alternative, Private Equity (USD)	10.20%	14.50%		13.90%	8.10%
Alternative, Private debt (USD)	8.20%	4.50%		10.20%	4.70%

Bloomberg, JPMorgan, MSCI, HFRL, BAML, UBS, IRISOS

Base-case Allocation USD Balanced



Disclaimer: Allocation may change as a result of the risk optimization - Past performance is no guarantee of future returns.

Market scenarios for 2021

Consensus view is "Risk-on" for 2021. Yet, this assessment warrants some further considerations of what if…!

	Base case scenario	Tainted scenario	Blue-Sky view	Inflation Surprise
	2009-2010 replay	W-Recovery	Goldilocks	1987 replay
Pandemic	In retreat but not defeated	4th Wave	Under control, no economic impact anymore	In retreat
Growth	V-Shaped recovery	Recession keeps going	Post-Recession overshoot	Strong V-Shape recovery
Inflation	Below trend	Deflation	Below trend	Surging
Fiscal Policy	Neutral	Passive tightening	Additional QE	Unchanged
Monetary Policy	Reduced easing	Too little and too late	Unchanged	Unchanged
Trade	Easing	Unchanged	Recovering	Unchanged
Earnings	+15 to +25 %	-10 to -25 %	+30 to +40 %	+35 to +45 %
PE	-10 to -20 %	-20 to -25 %	0 to +10 %	-25 to -35 %
Equities	+10 to +15 %	-25 to -35 %	+25 to +40 %	-30 to -40 %
Bond Yields	Slightly up	Negative	Slightly up	Sharply UP
Credit spreads	Stable	Higher	Tighter	Tighter
FX	USD Negative	USD Positive	USD Negative	Unchanged
Probability	50 %	25 %	15 %	10 %

IRISOS
Knowledge is power.

2021 consensus views

	GDP Growth		Inflation		Corporate Profits		Bond Yields	
	2020	2021	2020	2021	2020	2021	Present	2021
US	-3.6	4.9	1.3	2.0	-15.4	21.9	0.8	1.2
Euro-Area	-7.3	4.2	0.2	0.5	-37.6	49.7	-0.6	-0.3
UK	-11.0	3.5	0.8	1.0	-38.2	37.8	0.3	0.4
Switzerland	-5.4	4.8	-0.7	0.4	-8.6	16.4	-0.5	-0.4
Japan	-5.8	2.7	0.1	0.3	-8.6	42.5	0.9	0.1
China	2.7	9.0	3.0	1.8	1.3	18.7	3.3	3.1
Em. Markets	-1.7	7.2	3.2	2.6	-8.2	33.5	4.3	
ME	-4.7	4.5	3.6	4.1	n/a	n/a	n/a	n/a
Global	-3.8	5.6	1.8	1.9	-16.5	27.7	0.6	

Sources: Refinitiv, IBES, Bloomberg, IFM, Pictet Asset Management's Economics Team

Asset Allocation Preferences – January, 2021

Sector	Region	Fundamental	Risk/Reward	Investment case
Basic Materials	Americas			The Materials sector has been sensitive to fluctuations in the global economy, as well as to concerns about US-China trade and COVID-19. Accommodative monetary and fiscal policies may eventually support global economic growth. Recent trade agreements have eased some trade uncertainty, but the sector still faces significant challenges. Earnings are expected to recover and grow moderately after a sharp contraction in Q1, boosting profit margin, yet wage costs are expected to rise as skilled-labor shortages will occur in certain segments of the market.
	Europe			
	EM			
Consumer Staples	Americas			Historically, the sector has outperformed during periods of economic slowdown and uncertainty, as investors are attracted by the perceived relative stability of the group. After all, consumers tend to buy food, soap and laundry detergent regardless of economic conditions. However, the sector's relative safety has prompted investors to push valuations to above-average levels. A supply-chain disruption related to the coronavirus could affect already slim margins in much of the space. We keep a hold on the sector allocation.
	Europe			
	EM			
Consumer Disc.	Americas			The sector has a number of industries with a fair amount of exposure to China, such as hotels and leisure, autos and auto components, and apparel. However, those industries carry a relatively small weight in the sector, which also includes internet retail. Despite the overconcentration of internet companies in the sector and a weakening sales outlook, we judge the fundamentals to be positive for the Consumer Discretionary sector, as some of its core underpinnings remain upbeat. We keep a buy on the sector allocation.
	Europe			
	EM			
Energy	Americas			The renewed rise in the USD's value has also pressured the energy sector amid the pullback in oil prices, resulting in weak relative performance, compounding multi-year underperformance. The secular issues that the sector faces – concerns about slow global growth – are yet another headwind to the sector. While this has led to attractive valuations from a historical perspective, very poor fundamentals lead us to believe that it's a value trap. Also, the sector has entered into secular downtrend and extracting positive return over the longer term is highly challenging.
	Europe			
	EM			
Healthcare	Americas			While there was strong relative performance recently, the previous discount to the overall market in numerous valuation metrics has evaporated. The durability of Healthcare sector earnings during economic downturns tends to lead to outperformance during periods of economic weakness. We think that solid macroeconomic factors and an attractive long-term outlook mean that an outperform rating for the sector is appropriate.
	Europe			
	EM			
Financial Services	Americas			Topline revenue growth may prove to be elusive as regulatory burdens remain high, and areas such as asset management and brokerage services suffer from severe price competition and low short-term interest rates. Additionally, the sector's sensitivity to interest rates and the stock market could translate into sharp underperformance, should we see a significant pullback in the market. Payment services remain attractive investment opportunities.
	Europe			
	EM			
Industrials	Americas			The sector has suffered from concerns about slowing global economic growth, with industrial output faltering as a manufacturing downturn has broadened globally. This has prompted business leaders around the world to put capital spending on hold, while stalling revenue growth. Although fundamentals were extremely good pre-crisis, corporations are expected to continue to work on more efficient equipment to help offset weaker productivity. The rebuilding of inventories could signal the start of new cycle – we rate the sector with a buy.
	Europe			
	EM			
IT	Americas			Capex has been below trend for several years, and a return to more normal spending levels would boost the sector. Consumer confidence has generally remained strong, but we are waiting for new data that will reflect a better situation now, while facing wave #3. We remain highly positive re: disruptors and enablers in sub-sectors such as "Games," "Streaming," "IT-Security," 5G, AV/AR, and semi-conductors related to IIoT. Given the volume expansion and the raising profit margins, we consider new technology stocks as cheap.
	Europe			
	EM			
Com. Services	Americas			While these companies enjoy significant competitive advantages due to their dominance in their respective business lines, there are also emerging antitrust risks. The rollout of fifth-generation (5G) cellular wireless technology could increase demand, as 5G is expected to increase speeds and allow for more exposure to the "Internet of Things" and automated car technologies, increasing growth potential. However, upgrading networks will require substantial capital investment. This makes the Communication Services companies face unique risks.
	Europe			
	EM			
Utilities	Americas			Utilities stocks are among the most positively affected by falling interest rates as investors seek higher yields, because the sector has high fixed costs and its underlying activities are capital intensive. The sector has experienced good momentum relative to the other sectors – both on a short- and long-term basis – which could continue if interest rates continue to fall. While defensiveness can be attractive in uncertain times, valuations are not. In fact, they have risen to well above historical levels both on an absolute basis and relative to the other sectors.
	Europe			
	EM			

Expected costs of running investment strategies with our company

Estimates based on yearly activities (in % of total AUM)	Conservative	Balanced	Dynamic	Custom
Year with low activity *	1.20	1.49	1.78	2.03
Year with average activity *	1.39	1.68	2.15	2.55
Year with high activity *	1.78	2.86	3.53	3.63

*Subject to change according to market conditions, product strategies, currency diversification, and product turnover. Figures are indicative only and not binding by any means.

Disclaimer

This report is for distribution only under such circumstances as may be permitted by applicable law. Nothing in this report constitutes a representation that any investment strategy or recommendation contained herein is suitable or appropriate to a recipient's individual circumstances or otherwise constitutes a personal recommendation. It is published solely for information purposes; it does not constitute an advertisement and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments in any jurisdiction. No representation or warranty, either express or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein, nor is it intended to be a complete statement or summary of the securities, markets or developments referred to in the report. **IRISOS SA** does not undertake that investors will obtain profits, nor will it share with investors any investment profits nor accept any liability for any investment losses. Investments involve risks, and investors should exercise prudence in making their investment decisions. The report should not be regarded by recipients as a substitute for the exercise of their own judgment.

IRISOS SA will closely monitor investments; it may, however, decide to cease doing so at its own discretion and without any previous notice. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results.

The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. Options, derivative products, and futures are not suitable for all investors, and trading in these instruments is considered risky. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report.

Neither **IRISOS SA** nor any of its directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Any prices stated in this report are for information purposes only and do not represent valuations for individual securities or other instruments. There is no representation that any transaction can or could have been done at those prices, and any prices do not necessarily reflect a theoretical model-based valuation and may be based on certain assumptions. Different assumptions, by any other source, may yield substantially different results.

Sources:
Analysis and comments: Bloomberg, Reuters, Natixis, UBS, BNP-Parisbas, Pictet, Amundi.
Data and graphics: Bloomberg, Reuters

IRISOS
Knowledge is power.