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Q 01 / 2021

Quarterly Investment Review and Outlook

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Clarity isn't a thing of the past.

At IRISOS, we advocate for investment opportunities of all sizes, with a steadfast focus on fundamental top-down and bottom-up figures and avoiding unnecessary complexity.

Unlimited success can be achieved by applying a clear investment plan and staying focused on its long-term trajectory. Clarity is not the result of merely reading historical patterns, but also of reading the future outlook and correctly interpreting consumer views.

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Quarterly Report – Q01/2021

At a glance

Review – 1st quarter of 2021

a) **Rotation out of tech, but it's not "game over" for the tech rally**
The style rotation happened suddenly and powerfully. We believe that the rebalancing period has ended, and that the wide valuation gap between 'value' and 'growth/quality' has been significantly reduced, now appearing to be highly sustainable.

b) **What the $ 1.9 trillion stimulus means**
The massive bill orchestrated by the Biden administration is expected to support companies related to consumer discretionaries, financials, healthcare, energy, industrials, and real-estate investment trusts. At this stage, we expect a tax hike (high earner and corporate profits) to be implemented later in the year, which may result in some volatility for technology companies.

c) **Negative interest rates in the UK?**
With an inflation rate of 1.5% being projected for 2021 (1.8% for 2022, and 1.9% for 2023) – which is below the historic average and below the peak level of 2.7% reached in 2017 – it is likely that the BOE will introduce negative interest rates to simulate consumption.

d) **Where is the barrel price headed?**
Crude oil prices averaged $62 per barrel in February 2021, up $8/b from January's average. The projected average price for the month to come is $65-$70/b, followed by an average of $58/b in the second half of 2021, according to a recent outlook of the U.S. Energy Information Administration's (EIA).

e) **Major concerns of investors currently:**
1. Problems with the vaccine rollout
2. Geopolitical and trade tensions do not fade
3. Fiscal and/or monetary policy tightening
4. A zombie economy
5. Interest rate/dollar shock

f) **Upside scenario**
a) We have a positive medium-term outlook for economies and corporate earnings. We are in the early post-recession recovery phase of the cycle, which implies an extended period of low-inflation, low-interest rate growth that favors equities.
b) US GDP recovery is expected to be the fastest ever since 1971, which is expected to come on the back of full employment by the end of 2021.

g) **Downside risks**
A year ago, there were concerns that economies and the GDP could not recover, which turned out to be a somewhat exaggerated view. Similarly, we believe that current talk about rising inflation is unwarranted.

Governments may come under pressure to reduce deficits only after bond yields rise meaningfully and markets question debt sustainability. We expect that fiscal austerity and tighter monetary policy are still some years away.

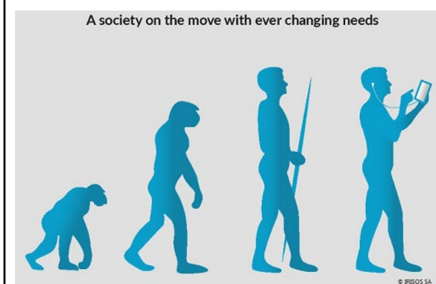
The massive increase in government debt is sustainable for a prolonged period of time as the cost of debt close to zero. The example of Japan highlights this: the country runs with debt to GDP ratio of over 250%. By 2023, the Japanese government's net interest payments are expected to be close to zero.

Top-down view: March 2021

Macroeconomy
The most recent concerns about a renewed and faster spread-out of the pandemic means that the global recovery in DM could be slowed down, if not delayed.

Even so, while global consensus views on GDP recovery remain unchanged, downside risks are rising. In this context, GDP 2021 growth estimates of 4.7% for the US, 3.7% for Europe, and 2.7% for Japan are probably not too elevated. The Chinese GDP is expected to grow by around 9%, which is a realistic objective given that consumer spending and services are progressively taking over from the manufacturing industry.

Nevertheless, since last year's readjustment was so huge, we now expect that GDP growth acceleration will be the fastest in DM since the early 70s, and this should support the projection that a significant number of countries will reach full employment by early 2022.



Asset allocation
Enthusiasm about "stay-at-home" and "disruptive companies" was driven by expansive economic policies, making brick-and-mortar companies look – by comparison – less like opportunities. While we agree that not all brick-and-mortar companies may reach their digital potential and a full digital compatibility, we note that many of them have strong balance sheets and solid, loyal customer bases. It is therefore possible that the asset rotation towards companies with a cyclical connotation has more wiggle room, especially for small- and medium-sized companies.

In recent weeks, inflation expectations have started to pick up. These concerns are based on the US, where a massive USD 1.9 trillion stimulus bill will soon hit the market. Opinions about the impact of the stimulus bill are divergent. Nobel Prize winner Krugman asserts that the risk to inflation will be almost zero, since the majority of the stimulus bill will hit the economy over a given period of time and capex projects will be implemented afterward; in this view, it is only then that the actual cash will flow. In Europe, the environment appears to be better, and we would expect Europe to lag the US inflation curve by about three to six months.

Long-term investors should stay connected to digital opportunities (med tech, contactless payments, advertising, and e-commerce); short-term investors are advised to put their capital through proxy strategies at work or alternatively, invest in market neutral strategies, playing cyclical trends against each other.

Equities
Equity valuation has reached a new valuation high, reflecting both the excellent corporate earnings guidance issued and the hope that the US stimulus package will be released in full. In recent weeks, volatility has picked up, which indicates that the level of concern among professional investors is elevated.

On the back of a strong demand for semiconductors and other electronic components, EM indices have outperformed in January. We will likely see more recovery in these markets, since EM are still trading with a discount of 35% when compared with DM.

Re-opening stories: a number of consumer discretionary stocks have anticipated a rapid return to the new normal. We are mindful that the re-opening will be progressive only, and that some forecasts may be elusive. Another concern is the impact of rising input prices; profit margins will inevitably be impacted to the negative, as not all companies will be able to transfer this to already stretched consumer budgets.

Supply chain management issues: Port congestion–for example, the average time to unload a ship has increased from 2 days in the past to 8 days now; however, this is not increasing the cost of goods, but rather impacting the profits of companies selling the products. In the case of Nike, the average delay of products from factory to store is now in excess of 4 weeks.

Currencies
Safe-haven buying has temporarily halted the USD downturn. We maintain our negative stance on the USD; for instance, versus the euro, the USD has a limited yield advantage. Furthermore, the US's large twin deficits are expected to rise further; the currency will therefore remain in a state of constant overvaluation.

Long-term investment engagement or crunching the supply chain jigsaw

The stranding of the 400 x 56 meter Ever Given illustrates how quickly the globally interconnected economy begins to creak when placed under stress.

Recently, a number of events have weakened both world trade and the well-being of humanity.

The world economy has undergone a number of strains. First, Covid-19 highlighted our relative shortage of protective gear and medical supplies, as well as our limited capacity to produce vaccines (not because we lack research results, but because we lack production capacity). Next, a severe winter storm put refineries and other industries out of work in the southern US states, affecting polymer production and products used across all industries, including pharma and the roll-out of vaccination products. And a few weeks later, a fire at the Renesas Electronics chip factory in northern Japan caused further disruption to a semiconductor industry already reeling from shortages. This occurred on the back of a change in consumer behavior – namely, during lockdowns, consumers ordered more electronics (PCs, laptops, wearable gear, and so on) which unexpectedly changed the supply/demand equation.

But even so, why do we grumble? Things are still perfectly well-orchestrated. E-commerce models that serve consumers around the world 24/7 work with perfection. Delivery models put in place by Alibaba, Noon, Zalando, and Amazon – to name just a few – rely on a complex network of shipping, haulage, logistics, and distribution companies. The system did its job perfectly; even during the peak of the pandemic, consumers received their deliveries, supermarkets were full with both consumer staples and discretionary goods, and there was petrol at the gas stations. As of today, more than 528 million doses of vaccine have been administered worldwide, every single dose of which relies on more than 250 components that come from different countries on different continents.

However, a few things have gone wrong since the onset of Covid-19. For instance, currently, many containers are in the wrong part of the world, and shipping prices have gone up as a result. More importantly, to cover the higher demand for overseas transport capacities, older containers have been put into service and ships are loaded up to full capacity. In consequence, from October 2020 and February 2021, a number of ships en route to Los Angeles have lost about 5,000 containers in total. This is only about a quarter the number of containers loaded onto the Ever Given.

How can we do better without losing its benefits?

More than ever, waterways like the Panama and Suez canals continue to hold a grip on global commerce. Perhaps alternatives, such as the new Silk Road, might be welcome developments, once their full consequences and ripple effects are analyzed. Whatever is done, global trade will not dissipate; it has been and will continue to be part of humanity. Neither bringing home production (as suggested by the former US administration), nor avoiding strategic connections with other countries for specific products and protocols (such as for 5G), nor imposing extra taxes to companies and societies to pressure them to change to a more sustainable expansion will change the fact that we rely on a broad supply chain.

Reorganizing world trade

Mrs. Okonjo-Iweala, Director-General of the World Trade Organization, outlines how we are not going from globalization to "slowbalization," but rather through a period of reorganizing globalization. I can only agree. Since 1990, global commerce has been growing at twice the rate of output, because big economies such as those in China, India, and eastern Europe were being integrated into the global economy. Now that they have been more or less absorbed, it is only natural that things would slow down; still, this does not mean we have reached the high-water mark.

That economies and concepts can evolve was clearly illustrated by the run-up to Iraq's 1990 invasion of Kuwait, which stressed the oil market at that time. In less than a few weeks, oil prices had more than doubled. Today, given that there is a broader range of producers and consumers rely on an expanded supply chain that is more global, such an occurrence would be a non-event in terms of oil prices—we would not expect barrel prices to spike.

As the supply chain has its own supply chain, we believe that the IIoT, one of our favorite secular investment themes, has a bright future. Technology is able to provide a workaround to nearly all issues, and believing that end-consumers don't understand the economic ramifications is wrong.

The digital world is able to trace production progress. I remember a time when my son ordered a parka online, and the sales company was able to provide him with real-time access to the production cycle. Giving that kind of insight to consumers provides highly valuable input and this, I believe, will ultimately allow people to better understand global connectivity, allowing them to consume in a more conscious manner. But to begin with, the consumer needs to be made aware of the production cycle.

Investment recommendations by type

1. Equities:

Short-term view: - Neutral to positive

Medium-term view: - With another turbulent and rapid market rotation 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, e-commerce, and payments.

2. Bonds:

Short-term view: - Neutral

Medium-term view: - With the market recovering, we favor BBB and single A debtors from emerging markets, yielding in the range of 3% p.a. We recommend a focus on companies with strong historic cash-flows and government related corporations that benefit from a quasi-government guarantee.

3. Credit:

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

Medium-term view: - With spreads at an all-time high and Central Banks rolling a renewed bond purchasing program, a sharp recovery in 6 to 9 months can be expected.

4. Metals:

Short-term view: - Neutral to positive

Medium-term view: - Neutral to positive: Historically, metals are a refuge play – however, this has only partially materialized.
- The demand for EV is now continually increasing, and to cover the long-term demand, new facilities need to be added. This should be price supportive.

4. Commodities:

Short-term view: - Neutral to positive

Medium-term view: - In the oil market, the supply/demand equation is starting to find its own new balance.

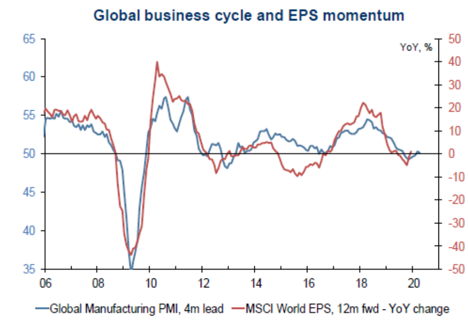
5. Structured solutions:

Short-term view: - Conditional capital guaranteed products offer an ideal risk/reward, as markets have corrected while volatility remains elevated.

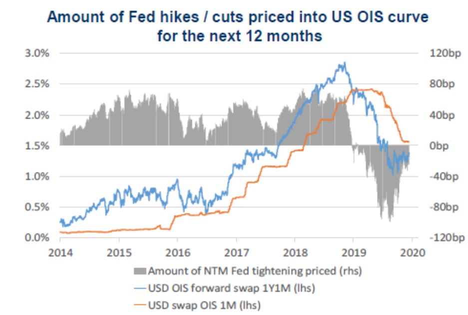
Medium-term view: - Longer-term investors should consider capital guaranteed long-short strategies that benefit from the increased dispersion between technology-related business opportunities and traditional business models.

Companies that fail to adapt new technologies are expected to lag behind, while those that evolve will become the next disruptors.

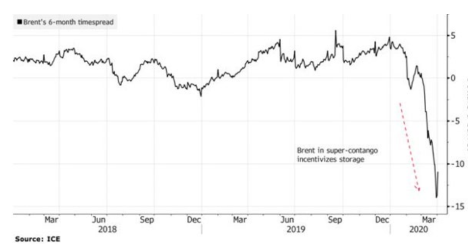
EPS Momentum again at average!



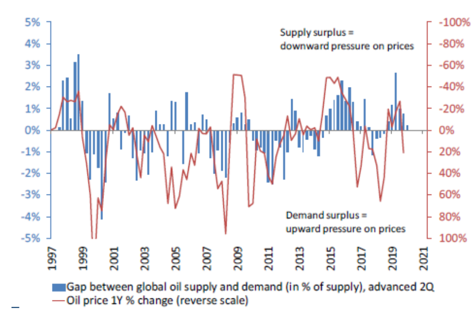
Fed hikes versus cuts: Expect the cycle to reverse



Unsold oil impacting the spot price.



Excess of supply vs. demand before the crisis!



Investment recommendations by theme

1. **Globalization 2.0:**

Short-term view: - Mixed

Medium-term view: - **With interest rates stable until at least 2023, 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 as a result.

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

Short-term view: - Neutral

Medium-term view: - Fiscal and monetary policies are expected to be very accommodating for the quarters to come.

3. **Volatility**

Short-term view: - Neutral

Medium-term view: - In the past, event-driven sell-offs [e.g., EM debt crisis, collapse of LTCM (1998), TMT over-valuation (2001), retreat of energy prices (Q4/15), US-China trade war (Q4/2018)], have resulted in average market corrections of in excess of 10%. The most recent market correction and the resulting volatility is no different.

At present, there are a few triggers left that can further disrupt the market. Volatility is relatively high and investors can take advantage of selling volatility.

4. **Global order – a quick shift**

Short-term view: - Neutral

Medium-term view: - The impact of COVID-19 will not be over quickly, as substantial damage to consumer confidence will impact the global order.

The gigantic amount of debt that has been added in the course of the last few weeks will force states to prioritize decisions differently, as compared with the last GFC.

The present crisis highlights the limits of restless globalization; for instance, it may be that world population depends on one single supply chain of basic preparations for medical purposes.

Globalization is entering a period of unparalleled deconstruction that promises to transform industries for years to come.

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Asset class view:

Our investment decision-making process – based on growth vs. value, cyclical patterns, and sentiment – is again pointing towards a moderately positive stance for a risk-on-strategy, especially when it comes to credit and equities related to secular growth trends.

Based on a moderate outlook for value companies, we consider these to be expensive, while the model considers growth opportunities as moderately cheap, pending the time-frame applied.

Over the last few weeks and following the post-vaccine announcements, the general sentiment in the market has moved on to slightly overbought. Still, we note that the current cycle is supportive for risk assets over the medium term. Short-term elevated volatility may provide stock-pickers with great entry points. In the base-case scenario, a long period of low-inflationary growth supported by monetary and fiscal stimulus is expected remain steadfastly in place.

- We prefer U.S. equities to non-U.S. equities. The post-vaccine economic recovery should favor a new growth cycle to unfold on the back of the massive stimulus package.

  Cyclical value stocks may look attractive, given an expected catch-up effect. However, we are less optimistic on this issue, as technology is dominating our day-to-day life more than ever. For a value company, closing the technology gap is becoming increasingly complex.

- We like the value in emerging markets (EM) debt. China's early exit from the lockdown and stimulus measures should benefit EM more broadly, as will the recovery in global demand and a weaker U.S. dollar.

  High yield and investment grade credit are slightly expensive on a spread basis, but have an attractive post-vaccine cycle outlook. In our view, bank loans and U.S. dollar-denominated emerging markets debt offer the best opportunities.

- Government bonds are expensive. Low inflation and dovish central banks should limit the rise in bond yields during the recovery. U.S. inflation-linked bonds offer good value with break-even inflation rates well below the Fed's targeted rate of inflation.

- Real assets: Real Estate Investment Trusts (REITs) sold off heavily in March 2020, with investors concerned about the implications of social distancing and online shopping for office buildings and shopping malls. Sentiment appears overly bearish, while value is positive. These should be a pandemic recovery trade. Listed infrastructure should also benefit from the global recovery, boosting transport and energy infrastructure demand. Datawarehouse providers are expect to expand their business opportunities exponentially.

- Given its counter-cyclical behavior, the U.S. dollar should weaken into the global economic recovery. The dollar typically gains during global downturns and declines in the recovery phase. The main beneficiaries should be the economically sensitive commodity currencies: the Australian, New Zealand and Canadian dollars. The euro and British sterling are undervalued. Both currencies should be boosted by the post-vaccine recovery.

Market-by-Market View

United States:

We remain bullish about the economic outlook. There will likely be two distinct phases to the path forward. The first, over the northern spring months, still appear challenging. COVID-19 infections are still a major concern across the region and are again leading to partial localized lockdowns. These lockdowns are a far cry from April, when 95% of Americans were under stay-at-home orders, but the measures should slow the pace of positive economic performance into year's-end. The post-vaccine period should deliver another strong V-leg for the recovery that delivers real GDP growth in excess of 5% in 2021. Vaccines should allow dislocated sectors (e.g., restaurants, travel, hotels) to bounce back strongly in the second half of 2021.

Meanwhile, the Fed continues to maintain an ultra-accommodative policy stance. Even with our expectation of a robust 2021, the Fed's focus on generating an inflation overshoot will leave plenty of leeway for the expansion to strengthen and broaden. The three biggest challenges for U.S. investors are:

1) the concentration risk in major U.S. equity benchmarks that are skewed toward stay-at-home mega cap technology stocks;
2) moderately expensive valuations in equity and credit; and
3) an increasingly optimistic industry consensus, which has gravitated closer to our macro view.

Consumer strength
As consumer spending picks up speed, business investment should soon follow. The latest edition of the Fed's Beige Book, which collects information from business contacts across the country, notes that "Most businesses remain optimistic regarding the next 6-12 months as COVID-19 vaccines become more widely distributed." Just as there is pent-up consumer demand, we believe that businesses will soon be ready to move forward with investment projects that were put on hold because of the pandemic.

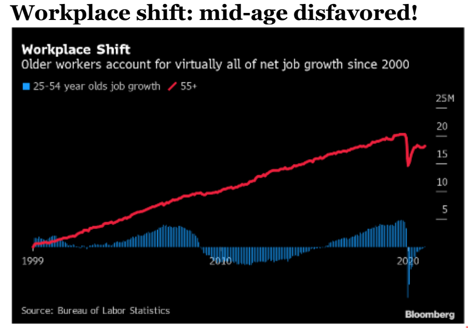
The ex-pandemic period should also create new investment opportunities. For example, many restaurants have closed permanently, and we expect a good percentage of these to be reopened under new ownership. In most cases, that will require some investment for remodeling, new equipment, and advertising. Further, the pandemic has accelerated some structural changes that should promote investment. For example, shopping malls and underutilized office buildings may be converted into residential developments and IT infrastructure may need to increase capacity, upgrade or shift to the cloud to accommodate the new demands of remote work.

The Fed's position
Central Banks and Governments want to avoid, at any price, any market turmoil that could be caused by moves to a more normal monetary policy. It intends to give markets fair warning before announcing a plan to taper its asset purchases, and time to digest the announcement before actually starting the taper. The plan itself is expected to be gradual, with the size of the purchases falling by no more than USD 15 per month. The whole process of ending QE is therefore likely to take at least 12 months, which is a long time if the economy is experiencing very rapid growth. This situation could encourage the Fed to at least start dropping hints about tapering too soon.

If rapid growth is accompanied by higher inflation, it could create a very tricky situation. The Fed wants inflation to overshoot its 2% target in order to anchor inflation expectations, which have been too low in recent years. It also wants to run the economy hot to encourage the return to work of millions of people who have left the labor market since the start of the pandemic. At the same time, falling too far behind the curve could undermine both the Fed's credibility and faith in the dollar.

Fed Chair Powell has stated that inflation triggered by pent-up demand would be transitory, allowing the Fed to be patient. However, it could be hard to maintain that stance if markets start to get nervous.

Workplace shift: mid-age disfavored!



Europe:

The second wave of virus infections has reversed the Q3 V-shaped recovery and the region is on track to record modest GDP growth in Q1. The new lockdowns (#3) are working, however, and infections across the region peaked in early February. Lockdowns are being reinforced in some countries heading into Easter, but the likelihood is that this spring will see ongoing virus outbreaks and renewed lockdowns until a vaccine becomes widely available, possibly by summer.

We note that Europe is poised for a strong post-vaccine recovery. Its economy suffered a big hit from the pandemic and can therefore rebound from a low base. Europe is more exposed to global trade than is the U.S. and will benefit from a recovery in Chinese demand.

After five years of underperformance, we expect that the MSCI EMU Index should outperform the S&P 500 in 2021. Europe's exposure to financials and cyclically sensitive sectors (such as industrials, materials and energy, with its small exposure to technology) give it the potential to outperform in the post-vaccine phase of the recovery when economic activity picks up and yield curves steepen.

Fiscal response

As expected, The European Central Bank left its monetary policy stance unchanged at its March meeting. However, the Governing Council was committed to accelerating the pace of bond-buying in the next quarter.

The inflation outlook is still key. While inflation may rise in the short term, ECB forecasters still expect it to be materially below target by 2023. This will likely keep policymakers accommodative.

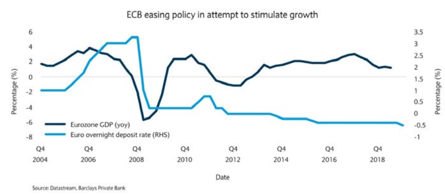
The market reaction was mainly seen in bonds – spreads on peripheral bonds tightened after the announcement. The euro was unmoved – much like the Governing Council, FX markets just watched closely.

Focus on a green recovery

The recovery funds disbursement will come through in 2021. Particular focus will be given to the €750 billion Next Generation EU scheme. This is designed to build a greener, more digital and more resilient Europe. In contrast to the US stimulus bill, which is trying to kick-start the economy with massive money flow, the European Union is subsidizing and actively promoting longer-term investment projects. The emphasis on a 'green' recovery is encouraging and should support stocks related to renewable energy, for example. The secondary idea behind this approach is to reunify the European Community around one idea – that is, a common project and long-term driver.

Obviously, this comes with a cost, especially in the short-run, since it takes time to unlock ideas into a substantial and actionable project. However, we would expect that as the effects of the pandemic fade and the economy recovers, economically-sensitive parts of the market – such as materials – will do well. This could also include stocks that will benefit from the re-opening of those parts of the economy most affected by Covid, such as engineering firms in the aviation sector.

ECB easing policy in attempt to stimulate growth



Emerging Markets:

The Chinese economy has returned to almost pre-pandemic output levels – a significant achievement, given the depth of the first quarter downturn. The IMF does not expect other large countries to return to pre-COVID economic levels until at least 2022.

Consumption has played catch-up to production and this is important for the outlook on government policy. The Chinese government has a focus on the concept of dual circulation which aims to rebalance the economy towards domestic demand and away from reliance on exports and capital investment. The government believes this transition is needed to ensure that China does not fall into the middle-income trap.

The government and People's Bank of China have been discussing when to start reducing the amount of stimulus. The most likely outcome is a continuation of the hand-over from monetary policy to fiscal stimulus. Fiscal policy should remain supportive through 2021. More stimulus packages may be announced at the National People's Congress meeting (likely in March 2021) as the government continues to support consumption.

The trade war between the U.S. and China should be less heated under the Biden Administration, but we do not foresee a return to pre-Trump era relations with China. Two key watchpoints will offer clues to the future of U.S.-China relations. The first will be the initial meeting between Biden and Chinese President Xi Jinping and subsequent discussions about the future of the current tariffs and the Phase One trade deal. The second watchpoint will be Biden's attempt (and ability) to forge a multi-country alliance to force China into improving access to its markets.

The long-term case for Emerging Markets
Asian EM were remarkably adept at re-invigorating and adjusting supply chains. Although economies exposed to services suffered as travel, tourism, and brick-and-mortar retail collapsed, hard exports (i.e., goods) have been surprisingly strong.

With inventories lean, corporate earnings have proved, at the very least, resilient; in fact, in some cases, corporate earnings have actually been remarkably robust. As the world has gone virtual – virtual work, virtual play, virtual shopping, and virtual everything else – this robustness of corporate earnings has been particularly true in the information technology complex:.

The pandemic has served to further accelerate digitalization trends that were already firmly progressing. Asian stock markets have ample representation of companies that benefit – computer gaming, e-payments, e-commerce, and electric vehicles, as well as enablers of new trends such as specialists in robotics, artificial intelligence, and semiconductor testing and production.

When it comes to the future, it helps to understand where we came from. We remain convinced of the long-term case for Asia, but acknowledge its handicaps: 1) continued tension between the US and China (a fact of life), 2) political fissures (Hong Kong, North Korea, Myanmar), and 3) differing cultural ideas regarding the concept of property from east to west.

Shorter-term, valuations are somewhat stretched overall, so the expected recovery in corporate earnings appears to be already well priced-in by the consensus. More importantly, earnings disappoint more frequently in EM than in DM. However, since Asia (ex India) has fought a "good war" over Covid-19, it is not likely to experience the same degree of potential disappointment as we expect elsewhere.

We would also expect most regional monetary and fiscal authorities to continue a relatively conservative stance, led by China, which has recently signaled some concern over exuberant markets. Given distinctly "hype-like" valuations in areas such as bio-technology and electric vehicle manufacturers, we believe this assessment is correct.

Sector Analysis

Basic Materials

The Materials sector is sensitive to fluctuations in the global economy, the U.S. dollar, and inflationary pressures. Accommodative monetary and fiscal policies are underpinning global economic growth and pricing power. In this environment, the U.S. dollar has trended lower, which historically provides a strong tailwind for the sector.

However, the sector still faces challenges. Global growth is not necessarily expected to provide an enduring tailwind to industrial metals or demand for chemicals (the largest industry in the sector). That said, any traction on the Biden administration's clean energy and infrastructure initiatives could spark a boom for industrial metals and materials.

Positives for the sector:

- Expectations are for an improving economy and weakening trend in the U.S. dollar.
- Improving global economic growth is supportive of chemical demand and pricing power.
- Strong gold demand is supportive of precious metals mining.
- Relative strength is improving.
- U.S. clean energy and infrastructure spending could create a surge in demand for industrial materials.

Negatives for the sector:

- Longer-term global growth is expected to be lukewarm, providing only modest growth in demand.
- The slow recovery in the oil rig count is a headwind for oil-fracking chemicals.

Risks for the sector:

- Global COVID-19 cases could rise.
- Potential for more-stringent environmental regulations and/or reversal of the 2017 corporate tax cuts.

Investment opportunities:
This sector is one of the most correlated to global industrial production.

The sector is highly leveraged to an improvement in manufacturing sentiment. As economic data strengthens, sentiment should improve and be a positive driver. However, higher materials pricing (e.g., steel) is likely unsustainable at current levels, and could lead to future stock underperformance.

Earnings momentum has continued to improve, supported by accelerating industrial production and rising commodity prices. Valuations have re-rated and are now relatively expensive versus history, but remain reasonable relative to other cyclical sectors. We also expect the chemicals and construction materials sub-sectors to benefit from the EU's sustainable investment plans.

At present, we favor material companies from Europe versus the U.S. Names to consider: Air Liquide, BASF, DSM, and Linde Plc.

Consumer Staples

After benefiting from "panic" buying during lockdowns, this classic defensive sector is likely to underperform in the economic recovery. Expected earnings growth in 2021 will likely lag the overall market by a substantial margin.

The ongoing recovery of the economy and a shift toward cyclical sectors has resulted in underperformance of the Consumer Staples sector since the market low in March 2020—as would be expected for a defensive sector whose constituents are less affected by changes in the business cycle.

However, with prospects of reduced social distancing and a full reopening of restaurants, food wholesalers that service restaurants have regained some footing, but at the expense of some big-box stores. In general, retailers within the sector have aggressively cut costs, leaving them in reasonable financial condition. However, limited pricing power in a low interest rate environment gives them less-than-exciting top-line growth potential.

With additional fiscal stimuli, the vaccine rollout, and accommodative monetary policies, we believe the economic recovery has a better chance of maintaining traction. At this stage of the business cycle, the Consumer Staples sector typically underperforms the overall market. We expect that growing confidence in the economy will continue to weigh on relative performance going forward, though overexuberance in the markets could potentially spark volatility that would favor the defensive sector.

Positives for the sector:

- It typically has a stable earnings profile
- Companies have engaged in aggressive cost-cutting
- During periods of strong economic growth, Consumer Staples can leverage their strong pricing power

Negatives for the sector:

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

Risks for the sector:

- Additional government stimuli and successful distribution of COVID-19 vaccines 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 February 19 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 high absolute valuation and limited upside potential, high yield dividend stocks are at risk; companies to consider include AD, ABI, BAT, NESN, EL, MO, and PM.

Key figures for Europe:

Target values:
Present fair value (DJStoxx600): 428
E12 months value (DJStoxx600): 475
Upside potential: +10%

Key economic ratios:

GDP Growth 21(E)	3.2
GDP Growth 22 (E)	4.0
CPI 21(E)	1.2
CPI 22 (E)	1.3
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
- Gemalto
- Richemont
- Swatch

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

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 are typically the primary drivers of sector performance, impacts related to COVID-19 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 (although 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 COVID-19-related supply chain issues—have been a concern. However, there are signs that investment in cloud and networking equipment is picking up, which could persist if the economic recovery continues. Also, the ongoing rollout of 5G wireless infrastructure is likely to accelerate, increasing demand for telecommunication components and semiconductors.

Longer term, a trend away from globalization and a pent-up demand for productivity-enhancing technologies are likely to improve the already solid financial position for much of the sector. Counterbalancing strong fundamentals and price momentum, investor optimism about future growth potential has pushed valuations to well above the historical average; higher interest rates can weigh on investors' perceived value of future earnings. Additionally, there are increasing legislative and antitrust risks for some of the largest companies in the sector.

Positives for the sector:

- Companies generally have 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.
- There are long-term growth tailwinds, as businesses enhance productivity with tech investment.

Negatives for the sector:

- Valuations are very stretched relative to the historical average, making higher interest rates a significant headwind.
- Capital expenditures are weak, albeit improving.
- Semiconductor prices are rising amid low supply and hoarding.
- The sector is highly concentrated in a few stocks.

Risks for the sector:

- Continued high unemployment could weigh on consumer technology revenues.
- There is the potential for antitrust suits in the U.S. and Europe.
- There is the potential for reversal of the 2017 corporate tax cuts, which have 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.

Secular trends remain strong and tech profits will likely recover to peak 2019 levels more rapidly than any other sector. However, valuations are high and the sector's defensive behavior during the pandemic gives us less conviction that it will outperform in the ensuing economic recovery.

In this vein, we highlight Microsoft, Palo Alto Networks, Salesforce.com, Splunk, and Accenture. Investors looking for small cap exposure, may look at Okta, Twilio, Pinterest, Zuora, and Etsy.

Communications Services

Pandemic-related stay-at-home behaviors have been good for some companies in the sector because they have led to increased use of social media and demand for streaming entertainment. With the shift from traditional TV and cable to online, advertisers have struggled but are quickly pivoting toward the new mediums. Wireless service revenues have grown, and equipment sales have been supported by the initial rollout of fifth-generation (5G) cellular technology. While the larger social media companies (Alphabet/Google and Facebook) enjoy significant competitive advantages due to their dominance (products, business model, and number of daily users), they also face emerging antitrust risks, as well as potential market saturation.

Longer term, we believe the continued expansion of 5G could further increase growth within the sector, as it is likely to lead to increased demand for equipment and services. Upgrading networks will require substantial capital investment, but government infrastructure initiatives could result in subsidies and investment.

Positives for the sector:

- Social media has a competitive advantage.
- 5G rollout should boost growth potential, but companies face near-term high capital expenditures; government subsidies and investment may help.
- Social distancing has accelerated a shift toward streaming entertainment content.

Negatives for the sector:

- The antitrust regulatory trend is negative for search engine and social media companies.
- There is potential for increased social media regulation (for example, the Section 230 legal shield is under scrutiny).
- Streaming services risk market saturation.

Risks for the sector:

- Sector market capitalization is heavily concentrated in the top two stocks — Facebook and Google — whose movements can significantly influence the sector overall.
- Recent developments in process flow management are pushing towards more and more DIY operations. We see companies entering uncharted territories, with potential legal precedents to follow and the potential for an increase in lawsuits and provisions for customer losses.

Investment opportunities:

The sector should continue to benefit from the shift of ad dollars to digital platforms. However, due to the defensive nature of telecom companies (around 20% of the sector), combined with uncertainty related to antitrust issues, the sector is more likely to perform in line with the market in an economic recovery.

We believe that many Communication Services companies currently 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).

Energy

Despite still-low demand, the price of oil has risen above what it was entering the COVID-19 crisis and is now higher than the price that is generally profitable for many oil companies. The oil rig count has been slow to rise amid slashed capital expenditures by oil companies, inventories have declined, and OPEC has been in general agreement to hold production down, supporting oil prices. The Energy sector continues to face heightened uncertainty due to the supply/demand imbalance perpetuated by COVID-19-related economic shutdowns, and OPEC agreements could fail now that the price of oil has risen sharply. This paints a challenging fundamental backdrop for the sector, given questions as to when the oil market will rebalance.

However, with relatively stronger balance sheets and access to cash, large energy companies are in a much better place than the entire oil patch, which is facing high insolvency risk. In addition, cash flow should improve if the higher price of oil persists. However, an increasingly onerous regulatory environment and clean-energy initiatives may be a significant headwind to the sector—though this may be more of a long-term issue, as there is likely little bipartisan appetite to erode U.S. energy independence. Additionally, larger oil and gas companies—which have the resources to navigate a more complex regulatory environment—will likely gain market share from smaller companies.

Positives for the sector:

- Oil is priced above the level at which the average company can cover expenses
- Supply has declined with lower production and OPEC compliance
- Large diversified energy companies have strong balance sheets and access to capital
- The ongoing recovery of the global economy bodes well for returning oil demand

Negatives for the sector:

- Oil demand is still down significantly
- Valuations are opaque
- There is weak long-term stock price momentum

Risks to the sector:

- New or expanded regulations could inhibit company growth potential—this would be harder on small companies, as larger oil and gas companies can better navigate regulations
- OPEC's current supply agreement could fail if prices rise much higher
- Clean-energy initiatives may eventually dampen demand for oil

Investment opportunities:

The collapse in oil prices due to the inability of Saudi Arabia and Russia to agree on a production cut darkens the sector's outlook. The current barrel price recovery occurs on the back of lower production capacities, as a good number of E&P have gone bankrupt or closed low-capacity rigs.

Relative to oil prices, the sector looks cheap. Free cash flow yields are very attractive, capital discipline has improved, and the sector should benefit as demand recovers. In our view, it will take many years before the shift away from fossil fuels begins to crimp industry cash flows.

In terms of sector approach, we favor global upstream and downstream operators as most likely the only players to endure a lasting price war with Saudi Arabia.

We favor names such as BP, RDSA, BKR, CVX, COP, XOM, SLB, and PBR

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Financial Services

The recent passage of the $1.9 trillion U.S. stimulus package raises the potential for stronger economic growth. Combined with a Federal Reserve that is likely to maintain hyper stimulus for years to come, along with the rollout of effective vaccines, longer-term interest rates could continue to rise, augmenting solid fundamentals in the Financial sector.

Banks' balance sheets came into the pandemic crisis relatively strong, thanks in part to stringent regulations put in place since the financial crisis of 2008. The two stress tests conducted by the Federal Reserve last year confirmed this. Under the most rigorous scenario—a W-shaped double-dip recession—banks' aggregate capital reduction would leave them with still-adequate capital ratios. Fiscal and monetary stimulus measures, which have contributed to the recovery, have softened the expected wave of bankruptcies and defaults. This is allowing banks to release loan loss reserves that were increased dramatically early in the crisis, effectively reversing previous expenses, which increases profits.

The Fed's commitment to keeping short-term interest rates low likely opens the possibility for the yield curve (the difference between short-term and long-term interest rates) to continue to steepen, which would help net interest margin revenues. The sector tends to outperform in the early expansion phase of the business cycle, and we think that quite attractive valuations and strong financial positions are enough to lead to continued outperformance. One risk is that a surge in inflation could cause interest rates to rise too quickly and/or the Fed to tighten monetary policy, stalling the economic recovery. Another risk is the possibility of a significant increase in regulations on the sector under the new administration. Still, stacking up the positives, negatives and risks, we believe the sector is more likely to outperform the overall market in the coming months.

Positives for the sector:

- Companies generally are in a strong financial position due to stringent post-2008 regulations.
- Economic recovery and fiscal stimulus are tailwinds for loan demand, and will likely limit defaults.
- Cautious Central Banks, along with improving growth prospects, have started to steepen the yield curve.
- The sector has attractive valuations relative to its historical average and other sectors.
- High loan-loss reserves are being released (which supports earnings growth).

Negatives for the sector:

- Despite long-term interest rates trending higher, in general, rates are expected to remain low by historical standards.
- Longer-term price momentum has been weak, though it has improved recently.

Risks for the sector:

- A surge in inflation could cause rates to rise sharply or the Fed to tighten monetary policy, stalling economic growth.
- Banking regulations have increased.

Investment opportunities:

A recent stress-test shows that banks are well-capitalized and should see a sharp rebound when market volatility subsides.

Bank earnings are recovering swiftly as provisions for expected loan losses wind down. Banks are also key beneficiaries of higher interest rates, which drive an improvement in profitability and signal a potential pickup in loan growth. The Fed has given a green light to share repurchases, which should help boost earnings per share and return on equity. The sector remains attractively valued.

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.

Key figures for USA:

Target values:

Present fair value S&P 500:	3,973
E12 months value S&P 500:	4'400
Upside potential:	+10.7%

Key economic ratios:

GDP Growth 21(E)	8.0
GDP Growth 22 (E)	4.0
CPI 21(E)	2.1
CPI 22 (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	down
Nasdaq	down

Key names to look at:

Strong intellectual property
- VISA
- Mastercard

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

Financials:
- VISA

Healthcare

Heading into the 2020 election, the Democratic Party's healthcare proposals seemed to be major source of the angst. Now-President Joe Biden's proposed "public option"—a more affordable or free alternative to private health insurance, along with enhancements to the Affordable Care Act (ACA), have raised questions about the sustainability of profit growth in the healthcare sector.

However, since Democrats have only a razor-thin majority in the new Congress, division between progressive and moderate Democrats could well result in many of the more contentious health-care initiatives being tamed down or blocked altogether.

These more benign scenarios open the potential for renewed outperformance based on the long-term opportunities and fundamentals, including an aging global population and a growing middle class in emerging markets, both of which will demand more extensive drug treatments and medical care over time. Valuations are relatively attractive and balance sheets in the sector are solid, increasing the possibility of higher dividend payments, share-enhancing stock buybacks, and M&A.

However, there are still risks. Any legislation to control drug prices or raise corporate taxes could weigh on pharmaceutical companies' profits. Additionally, the Supreme Court is expected to rule on the constitutionality of the individual mandate provision of the ACA in 2021, and that could lead to the entire ACA being repealed. However, in the opening arguments heard in November 2020, a majority of the justices indicated that a total repeal was unlikely, and there is little political appetite to allow disorder throughout the health-care system.

Positives for the sector:

- Balance sheets are strong, with ample cash for dividends and M&A.
- Positive long-term demographic trends may support the sector, including an aging global population and a growing middle class in emerging markets.
- Demand is returning for elective procedures, drug sales, medical equipment and diagnostics.
- Valuations are attractive relative to the sector's historical average.

Negatives for the sector:

- High unemployment reduces healthcare insurance enrollment.
- Extended-care facilities have seen a decline in enrollments and are likely to see higher costs related to virus-mitigation requirements.

Risks for the sector:

- The Supreme Court is considering the constitutionality of the Affordable Care Act (ACA).
- There is bipartisan support for prescription drug price controls.
- There is a possibility of a reversal of the 2017 corporate tax cut.
- A potential resurgence in COVID-19 could reduce demand for elective medical care.
- The impact from any enhanced ACA legislation is unclear.

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.

Industrials

With the economic recovery, markets have been trading as would be typically seen in an early stage of the business cycle—which could be positive for this historically pro-cyclical sector. Additionally, prospects for an increase in infrastructure and clean-energy investment have supported the machinery and building materials industries. As economies reopen, transportation and air freight have benefited from a return in demand, as well as relatively low fuel prices and interest rates. The aerospace and defense industry continues to face significant headwinds amid expected low airliner demand and uncertainty surrounding the political appetite for defense spending. While the path of the economy remains uncertain, the recovery provides a nice macroeconomic tailwind for the sector.

Positives for the sector:

- Capital expenditures are likely to increase if global growth continues to improve.
- The sector tends to outperform early in the business cycle.
- Many companies in the sector have cash-heavy balance sheets.

Negatives for the sector:

- Capital expenditures have been tepid.
- Aircraft demand is likely to be weak until business and leisure travel resumes.

Risks for the sector:

- While we are currently neutral on the sector, if there is a stronger-than-expected surge in global growth or massive infrastructure stimulus, then the sector could perform better than expected.

Investment opportunities:

The sharp slowdown in the global economy hit this sector particularly hard. As lockdowns have eased, economic data has improved. Still, the sector has lagged the improvement in manufacturing sentiment indexes and looks poised to catch up. The accelerating vaccine rollout should be a major boost for aerospace, which has lagged and is a significant end-market for US industrials.

Medium-term investors may look at the following: CSX, Siemens, Easy-Jet, Lockheed Martin, and Stanley Black & Decker.

Real Estate

The COVID-19 pandemic continues to be a significant headwind to the overall Real Estate sector. Commercial property demand remains well below pre-crisis levels, as segments of the economy have yet to fully recover—which increases the risk of lease defaults, particularly for retail and hotel REITs. The outlook for office REITs is highly uncertain and will likely stay so until we know if there will be an enduring shift toward remote work. While net debt for the sector is low by historical standards, the risk to cash flow puts many REITs in a difficult position.

There are some exceptions, however. Warehouse/distribution center demand appears to be outstripping supply—resulting in sharply rising rents. And with the rapid rise in home prices amid low rates and de-urbanization, REITs specializing in single-family home rentals and manufactured homes stand to benefit.

Provided the economy recovers more quickly, people get back to work, and interest rates stay low as the Federal Reserve maintains accommodative monetary policy, the Real Estate sector could do very well. In a low-interest-rate environment, combined with renewed demand for office and retail space, investors' search for yield and attractive valuations could be a strong tailwind for the sector.

Positives for the sector:

- Optimism for improving economic growth and vaccine distribution.
- Fiscal stimulus is a lifeline for those behind on apartment and retail space rent.
- Low interest rates are positive for funding and make REIT dividends more attractive to investors.
- Warehouses, data center providers, and telecom towers are benefiting from technology trends.
- Single-family residential REIT segments are seeing strong demand and rising rents.
- Valuations are still relatively attractive.
- Long-term demographics support the recovery of extended-care and assisted-living facilities.

Negatives for the sector:

- High unemployment can lead to multi-family lease defaults.
- A sharp upward turn in rates of home ownership and de-urbanization is a negative for multi-family housing.
- An accelerated shift from brick-and-mortar stores to internet puts retail REIT revenues at risk.
- Short-term uncertainty about workers returning to the office exists.

Risks for the sector:

- A quicker-than-expected rise in interest rates could be a sharp headwind.
- A permanent rise in the work-from-home model could reduce demand for office real estate.

Investment opportunities:

The sharp slowdown in the global economy hit the sector particularly hard, with the exception of valuations, which have merely moved. While valuations are attractive, it may take time to assess the long-term impact of the pandemic.

Even so, there sub-segments that are less exposed to the sharp downturn. In fact, we have two distinctive eco-spheres: the digital world and the tangible physical world. The blur is important and results in 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 higher growth rates than others. Names to look at: Sergo, Goodman Group, GLP, Nippon Prologis, A-Reit, Mapletree Logistics, Equinix.

Key figures for Asia:

Target values:

Present fair value MXAPJ:	863
E12 months value MXAPJ:	1035
Upside potential:	+10%

Key economic ratios:

GDP Growth 21(E)	7.5
GDP Growth 22 (E)	4.8
CPI 21(E)	3.9
CPI 22 (E)	3.3
P/E 2021 (E):	14.4
P/E 2022 (E):	12.8
Div. Yield 2021:	2.4
Div. Yield 2022:	2.5

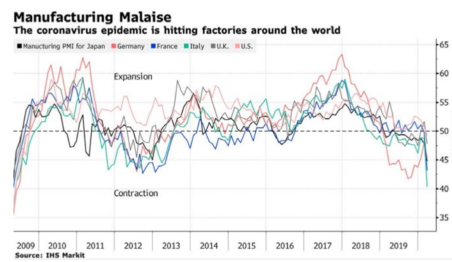
Most likely next short-term move:

MXAPJ down

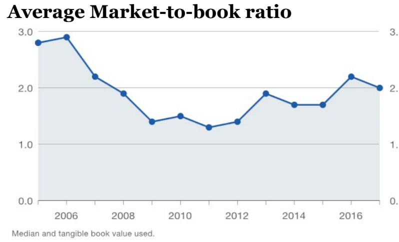
Key names to look at:

- Tencent
- Alibaba

Average ROI of Banks recovered but remains stable!



Average Market-to-book ratio



Financial sectors outperformed the larger market, but will this continue in the future?

Consumer Discretionaries

With the onset of the COVID-19 pandemic, the Consumer Discretionary sector—which is typically sensitive to swings in the economy—had its winners and losers. The massive stimulus efforts and stay-at-home orders spurred a surge in spending on home improvement and e-commerce sales early in the crisis, and related stocks led the equity market rally.

Now, with vaccine distribution expected to be substantially completed by the end of 2021, even the most beaten-up stocks in the sector—like those in the apparel and hotel industries—have recovered and in many cases, have extended well beyond pre-crisis price levels. The cruise industry is the exception. But these industries are often overshadowed by bigger companies in the sector—such as Amazon and Tesla—which constitute nearly 45% of the sector's market cap.

The longer-term trend toward e-commerce and electric vehicles is likely to continue to support the fundamentals of these growth industries, but investor enthusiasm may have pushed valuations too high. Although higher interest rates are in part reflecting stronger economic expectations, higher interest rates can weigh on investors' perceived value of future earnings. We expect share price development of very high growth companies to remain sustainable, while companies with unsustainable growth expectation models are expected to consolidate more than average.

In 2020, a lot of attention was paid to consumer staples stocks that were reliable performers during the pandemic. Particularly with folks spending more time at home, grocery store purchases seemed a pretty safe bet. But now that vaccines are starting to roll out and there is optimism that 2021 will look very different from last year, investors have begun to engage with consumer discretionary stocks that may provide upside if and when things get back to normal.

Positives for the sector:

- Vaccine distribution and ongoing economic recovery are positive for many of the more traditional discretionary industries.
- The shift away from brick-and-mortar is likely to continue to support fundamentals for online retailers.

Negatives for the sector:

- The sector is overly concentrated in internet retail and automobiles.
- Valuations and investor enthusiasm appear stretched; higher interest rates may weigh on both.

Risks for the sector:

- Antitrust action is possible for the largest online retailer.

Investment opportunities:

Consumer discretionaries are key beneficiaries of reopening the economy. Nearly USD 2 trillion of excess consumer savings looks poised to be unleashed as the pandemic winds down. The sector is also benefiting from strong secular growth in ecommerce. Low mortgage rates bolster the outlook for housing-leveraged segments.

We favor companies that benefit from "stay-at-home," such as Amazon, Nike, Deckers Outdoors, Adidas, LVMH, and Inditex

Utilities

The Utilities sector has tended to perform relatively better when concerns about slowing economic growth resurface, and to underperform when those worries fade. That's partly because of the sector's traditional defensive nature and steady revenues—people need water, gas and electric services during all phases of the business cycle. Meanwhile, the low interest rates that typically come with a weak economy provide cheap funding for the large capital expenditures required within this industry.

However, valuations have been driven up in recent years as investors have reached for yield in this new era of low interest rates; this may decrease the sector's traditional defensive characteristics. And while interest rates are expected to remain generally low, they could edge higher as the economy continues to expand. On the flip side, there is the potential for a renewed decline in the economy to push rates even lower, or there could be significant government funding to Utilities as part of clean-energy initiatives that would benefit the sector's profit outlook.

Positives for the sector:

- Revenues are generally stable.
- Investors often turn to utilities for dividend income when prevailing interest rates are low.
- Low yields provide low funding costs for this capital-intensive sector.

Negatives for the sector:

- The sector has not acted as defensively during recent periods of market weakness as in the past.
- Valuations are high relative to the sector's historical average.
- Economic recovery makes the sector less attractive relative to other sectors.

Risks for the sector:

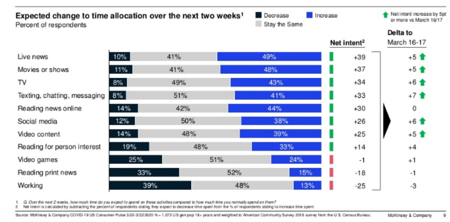
- There remains uncertainty regarding potential clean-energy legislative funding.
- Interest rates could rise due to an unexpected rise in inflation.

Investment opportunities:

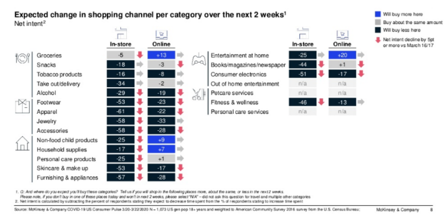
The recent spike in volatility may have encouraged investors to seek the perceived safety of the utilities sector, but we continue to believe that this is not the right move. A growing economy and rising interest rates don't make for utilities performance, and we therefore believe underperformance will 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.

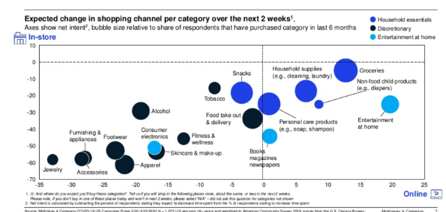
Stay-at-home to be become a winner



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



... with basics and entertainment to shine.



Foreign exchange

Currencies

Stay structurally bearish on the USD

Although the USD has recovered in the past few weeks, we maintain our long-term bearish view on the US currency on the back of low nominal yields, negative real yields – a major change from the strong USD years before the COVID crisis - a potentially more dovish stance by Fed than central bank peers, and huge and growing twin deficits.

We keep a positive bias on GBP vs USD, as the UK should benefit from the strong vaccination momentum and real-yield spread tightening versus the US.

Concerns over the US's twin deficit (the financial deficit and the current account deficit) have also contributed to the fall in the value of the dollar (see chart below). We expect this to continue for the next few years.

Moreover, the US dollar's pre-eminent "reserve" currency status could start to fade as the euro looks set to gain in strength and prominence, with Europe's leaders taking a more proactive approach to stimulating economic activity.

Heavy long positioning on the euro and the ECB's increased PEPP purchases in 1Q are likely to prevent a resumption of the EUR/USD uptrend in the short run, so we have tactically reduced our EUR exposure. Nevertheless, we maintain a year-end target of 1.27.

In addition, a weaker dollar is most definitely positive for commodities. Although most commodities are produced in emerging markets, they are usually priced in dollars. When the dollar is weak, the price of these commodities in dollar terms rises.

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 1H20, 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:	1.1500 - 1.2000
GBP/USD:	1.2500 - 1.3500
USD/CHF:	0.9750 - 1.00

Target values in 12 months:

EUR/USD:	1.20 - 1.27
GBP/USD:	1.30 - 1.40
USD/CHF:	0.90 - 1.00

Purchase power parities:

EUR/USD:	1.28
GBP/USD:	1.56
USD/CHF:	0.93
EUR/CHF:	1.19

Most likely next move:

EUR/USD	down
GBP/USD	down
USD/CHF	down

Target values in 3 months:

Oil:	\$75 - \$80
Gold:	\$1,500

Target values in 12 months:

Oil:	\$75 - \$80
Gold:	\$1,600

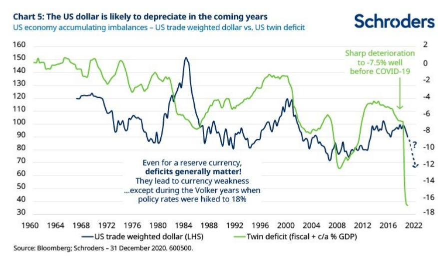
Upside potentials:

S&P GSCI	up
Oil	up
Gold	up

Next most likely move:

S&P GSCI	up
Oil	up
Gold	up

USD depreciation to play out:



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Commodities

Underinvestment could lead to the next commodity cycle

Underinvestment always precedes the next commodity cycle: Capital investments in major integrated oil and gas companies declined by 52% between 2013 and 2020, while capital expenditure in the copper industry declined by 44% between 2012 and 2020.

The only thing that can stimulate investment in these sectors is an increase in the price. If even half of the expected demand comes through, then supply will prove to be insufficient, which will push prices higher and stimulate investment.

Commodities have long been out of favor with investors, but have recently enjoyed a good run, more than matching returns from broad equity indices for the first time in many years. Increased cross-commodity demand from China, significant supply side discipline in the oil sector, as well governmental commitments to maintain fiscal economic support have all been important factors.

Whether or not we are in the early stages of another super-cycle in commodity prices and returns has become a key debate. Like an increasing number of investors, we see several structural similarities between the early 2020s and the early 2000s, the last time commodities began a long and powerful ascent to record prices.

Now, as then, we have seen significant underinvestment in commodity supply, with capex in oil and gas and global mining sectors falling by around 40% since 2011. In the early 2000s, China represented a major source of accelerating commodity demand. Today, we may be about to embark upon an unprecedented period of coordinated global capital investment to facilitate the energy transition. The switch to clean energy sources and electric vehicles may prompt an acceleration in demand for key raw materials.

Commodities are cheap

When compared to history, commodities valuations are cheap. It is also worth noting that when commodities outperform, it is often by a large number. Previous periods of strong performance have been supported by certain conditions coming into place. For example, the early 2000s saw China's boom following a period of underinvestment due to the bear market of the 1990s. We believe these fertile conditions are moving into place once again. As we move into a post-Covid world, governments around the world are enacting a combination of fiscal and monetary policies that will be much more positive for commodities.

Is inflation on the way?

In response to the global financial crisis of 2008, major global central banks sought to rescue economies with the unorthodox policy of quantitative easing (QE). Although this policy saw financial assets outperform real assets over the past decade, it was very negative and deflationary for commodities. However, the era of pure QE is now over.

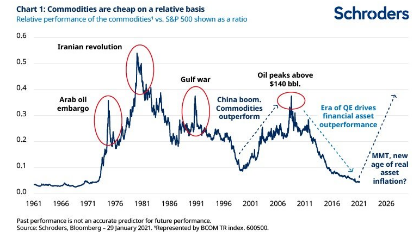
The past 12 months have seen major central banks around the world respond to the Covid-19 pandemic with a combination of unconventional monetary and fiscal policies. The speed and size of these packages have been unprecedented. In contrast to 2008, a multi-trillion-dollar fiscal expansion – including direct helicopter money to households and companies – has been delivered.

Some countries are running fiscal deficits in excess of around 15% of GDP – something which has not been seen since wartime. In the context of their existing debt burdens, this makes inflationary policy more attractive. We believe that the coordinated combination of aggressive fiscal and monetary policy means that inflation is, ultimately, waiting right outside the door. And this is beneficial for commodity prices.

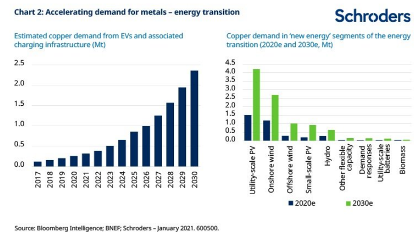
Demand for commodities is set to accelerate

The energy transition is set to see demand for metals accelerate sharply in the coming years as the world starts the switch to EVs and more renewable energy sources. There is an expected increase in demand for copper for use in EV batteries and associated charging infrastructure that will be required as part of the switch.

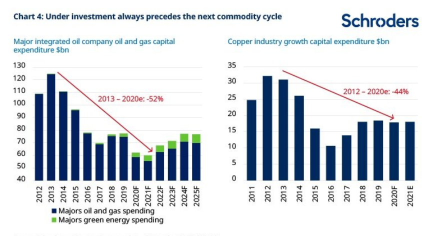
Commodities win big!



Commodities demand is accelerating



Low level of historic capex will be a price driver!



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

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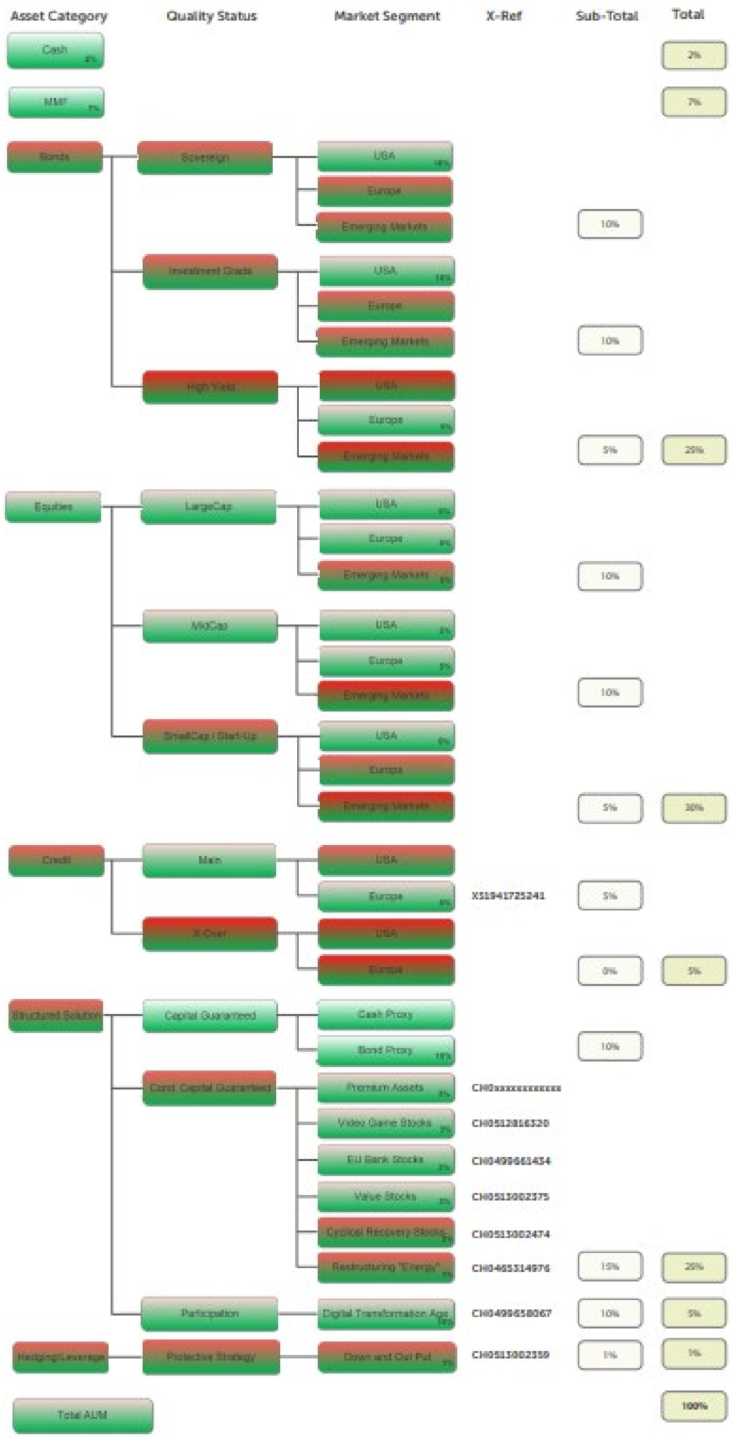
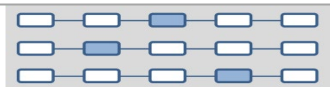
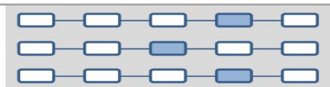
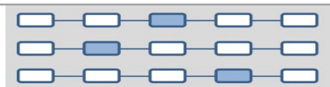
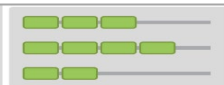
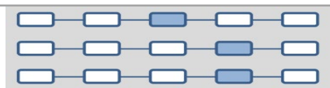
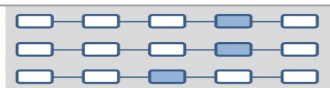
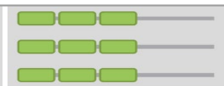
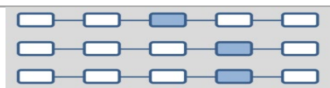
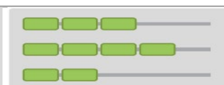
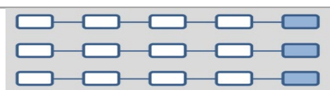
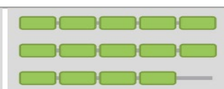
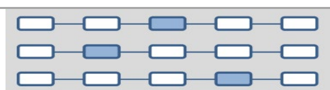
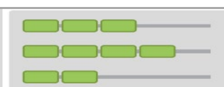
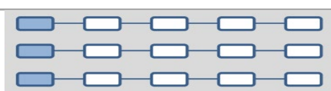
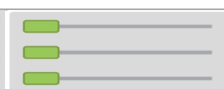
Base-case Allocation USD Balanced



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

Asset Allocation Preferences – March, 2021

Sector	Region	Fundamental	Risk/Reward	Investment case
Basic Materials	Americas Europe EM			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. After a sharp contraction in 2020, earnings are expected to recover and grow moderately, boosting profit margins; yet wage costs are expected to rise as skilled-labor shortages occur in certain segments of the market.
Consumer Staples	Americas Europe EM			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 relative valuations to above-average levels. A supply-chain disruption related to the coronavirus could affect already slim margins in much of the space.
Consumer Disc.	Americas Europe EM			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 make up 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 fundamentals to be positive for the Consumer Discretionary sector, as some of its core underpinnings remain upbeat.
Energy	Americas Europe EM			The renewed rise in the value of the US dollar also has 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, poor fundamentals and the relatively small size of the sector are negatively impacting the investment decision-making process.
Healthcare	Americas Europe EM			While there was strong relative performance recently, the current discount to the overall market in numerous valuation metrics remains attractive; the sector has generally traded at a premium to the market over the past 15 years. 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 attractive relative valuations mean an outperform rating for the sector is appropriate.
Financial Services	Americas Europe EM			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 if we see a significant pullback in the market. Payment services remain attractive investment opportunities.
Industrials	Americas Europe EM			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 once COVID-19 has passed. The rebuilding of inventories could signal the start of new cycle.
IT	Americas Europe EM			Capital expenditures have been below trend for several years, and a return to more normal spending levels would boost the sector. Rising wages, including an increased minimum wage, could accelerate this trend, as companies may turn to technology to replace increasingly expensive human workers. Consumer confidence has generally remained strong, but we are waiting for new data that might reflect another outbreak of coronavirus, which might disrupt the replacement market for mobile applications.
Com. Services	Americas Europe EM			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 forces Communication Services companies to face unique risks.
Utilities	Americas Europe EM			Utilities stocks are among the most positively affected by falling interest rates as investors seek higher yields, because the sector has high fixed costs while 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.

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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.

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

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