Global economy on the mend

EMIRATES INVESTMENT BANK

Asset Class	View	Current Allocation*	Benchmark Allocation*
Equities	Neutral	37.5%	35.0%
Fixed Income	Cautious	45.0%	52.5%
Real Estate	Neutral	5.0%	5.0%
Commodities	Neutral	2.5%	2.5%
Cash	Favour	10.0%	5.0%

Overweight, Favour, Neutral,
Cautious, Underweight

* Allocations are based on a Balanced Risk Profile

2021 OUTLOOK

- While the recovery in financial assets has been swift and sharp from the depths of the corona-crisis in March last year, major central banks are expected to continue maintaining ultra-easy monetary policies until the global economy shows clear signs that it is out of the woods.
- Most businesses are making attempts to adjust to the new normal and get back on track. Broadly, unwavering support by central banks and generous fiscal support diffused in to the system has contained the damage to the balance sheets of large and medium companies.
- With the onset of multiple vaccines and as the global economy recovers from the short but severe recession, we expect cyclical stocks (banking, consumer discretionary, autos, energy, real estate and industrial goods) to outperform growth stocks which are attached with lofty valuation.
- We believe the turn in the business cycle should in general favor equities over bonds, despite the stretched valuations. Aggressive fiscal and monetary stimulus should put upward pressure on long-term bond yields, though the pressure on yields is likely to be limited as central banks stand steadfast in maintaining low borrowing costs, given its negative repercussions through rising costs on inflated debt levels.
- With interest rates close to zero and the market's changing composition, skewed to technology and disruptors, in part due to Covid-19, we believe there are multiple factors which argue for sustainability of the optically high valuations.
- Although we have a favourable medium to long term view on risk assets, the reflation trade has already been set in motion in the latter part of 2020 and valuations have already priced in a significant amount of the expected earnings growth for 2021. Our favourable view should be looked in the context of 2022 and 2023 and where we believe the start of a multi-year bull run has begun. Notwithstanding the bumps and market pullbacks along the way, with such liquidity support in the system, the trend on the whole should remain positive, in our view.

About Emirates Investment Bank

EIBank is an independent private bank based in Dubai. It offers a wide-range of investment and banking services to an exclusive, but diverse, client base of high-net-worth individuals from across the region and around the world.

Emirates Investment Bank seeks to build long-term partnerships based on a foundation of trust, stability and integrity, which allows it to appreciate the unique circumstances and objectives of each of its clients. This personalised approach guides the Bank when providing its clients with bespoke banking solutions in connection with their wealth, business, and every day affairs.

THE 2021 OUTLOOK

EXECUTIVE SUMMARY :

Needless to say, 2020 was anything but expected. As challenging a year as it was for individuals, corporates, and governments alike, reflecting on its ups and downs allows us to look forward and see the world in a different light. Many lessons were learned and these lessons will continue to have investment implications for years to come. The lessons range from government action, corporate adaptability, and individual resiliency.

At the peak of the pandemic in March and April of last year, policymakers had to weigh the economic fallout of shutting down their economies against an uncontrolled spread of the virus. While strict restrictions on mobility adversely affected aggregate demand and hurt business activity, it was decided that containing the virus was the priority, especially due to a shortage of health resources. One of the primary health scares during the midst of the pandemic wasn't that we didn't know how to deal with those infected with the virus but that the healthcare system would simply have been overwhelmed by the sheer numbers of those infected. This is an important point as it has caused us to think very differently today.

Pre-pandemic, the cost of having extra hospital supplies outweighed their benefit should they ever be needed. Today, we realize the true costs of falling short of such supplies. Pre-pandemic, outsourcing certain supply chains to the lowest cost producer made perfect sense. Today, having multiple supply chains even at the expense of higher costs makes greater sense. Pre-pandemic, cloud computing was a luxury that many corporates wished to have one day. Today, the accelerated move to an online world is not only more efficient, it's a 'must have' for companies that wish to have more robust business continuity processes.

In the same way that corporate business models need to be more flexible and resilient, investment portfolios need to follow the same path. Although yields are anchored at record lows, and while much of the fixed-income space continues to trade at extremely rich valuations, fixed-income continues to serve as a stabilizer to our investment portfolios and will continue to partly cushion against equity volatility / drawdown risk. That said, and although asset prices across the board are trading at elevated valuations, we believe that we have entered into a multi-year, expansionary period as economies gradually re-open throughout 2021 and beyond.

Pent-up demand, in addition to central banks that are willing to withstand periods of inflation overshooting their target rates before taking action to normalize monetary policy, has created an expansionary economic environment. Couple these two phenomena, with savings rates at record levels for both individuals and corporates, the global economic environment is conducive for the beginning of another growth cycle.

In such an environment, exposure to risk assets is warranted and we favor equities over fixed-income. Within the equity space, cyclical stocks, such as financials, travel & entertainment, manufacturing and consumer discretionary have room to re-rate. Borrowing costs have been anchored at record-low levels and many corporates have refinanced their shorter-term debt obligations into longer term debt commitments, alleviating any refinancing concerns.

Meanwhile, we continue to hold strategic longer-term positions in thematic plays that should perform well over the next decade, in our view. Cloud computing, cybersecurity, big data, artificial intelligence & robotics, fintech, biotechnology, in addition to healthcare innovation should continue to transform our daily lives. Many of these companies are generating significant free-cash-flows and are sitting on net cash positions that give them the ammunition to continue investing in R&D. They generally have multiple levers of growth through their various business lines and are growing both organically and inorganically.

Left tail risks, such as the ongoing pandemic, may not be expected year-in-year-out but we should be prepared for them. History has proven that economies self-correct and rebound from natural disasters, pandemics, or global financial shocks. Systemic risks, although uncertain in terms of magnitude and severity, are temporary. It's important to not lose sight of the larger picture amidst all the chaos and to be able to withstand these temporary shocks. This is one of the lessons that 2020 has reminded us of.

Policymakers have also proven to be a strong backstop and are willing to go to any length to help smooth the transition back to normalcy. While this may encourage excessive risk-taking, we believe that we need to be very conscious of such policy-action and the precedent that has been set since the global financial crisis. Fortunately or unfortunately, it's almost become a common expectation for central bankers to be the be-all and end-all, providing counter cyclical measures in times of crisis in order to ease the economic fallout from any abnormal event. While this may provide upside potential in the short-to-medium term, it can have vast investment implications over the longer term and needs to be monitored closely.

Thematic investing and disciplined portfolio management can help navigate the investment landscape over the horizon, allowing for attractive risk-adjusted returns. We have attempted to address several themes in more detail below as we continue along our investment journey in 2021 and beyond.

THE 2021 OUTLOOK

2021 THEMES:

- **Continuation of accommodative Fed stance and the sheer size of required stimulus could further weaken the USD, somewhat offset by a steepening UST curve.**
- **Earnings growth rebounding but elevated asset prices already baking in a rosy scenario.**

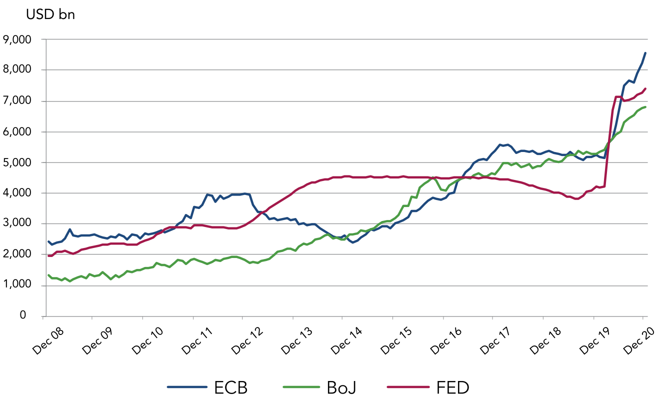
Despite one of the worst pandemics in a century, risk assets continue to be in favour due to extremely supportive economic policies, which are unprecedented. Factors such as plans for mass vaccine administration, an ensuing economic recovery, and the after-effects of a massive fiscal and monetary response have kept investor optimism high as we enter into 2021.

While the recovery in financial assets has been swift and sharp from the depths of the corona-crisis in March last year, major central banks are expected to continue maintaining ultra-easy monetary policies until the global economy shows clear signs that it is out of the woods.

Post the Great Financial Crisis of 2008, central banks were guilty of premature interest rate normalization for fear of spiralling inflation, which didn't materialize despite ultra-loose monetary policies. This time around, it is clear that central banks will accept inflation to overshoot the target, which is an average of 2%, and want to have significant evidence of sustainable recovery before moving on to applying brakes on monetary easing. Meanwhile, the global economy still faces structural deflationary forces, such as the effect of digitalisation and, to a lesser extent, ageing of the population. Given the continued benign inflation backdrop, some uncertainty over the path of the new variants of the virus and elevated unemployment, we believe the asymmetric response function of central banks is justified and warranted. We expect gradual rise in inflation over the next 2 years.

Most businesses are making attempts to adjust to the new normal and get back on track. Broadly, unwavering support by central banks and generous fiscal support diffused in to the system has contained the damage to the balance sheets of large and medium companies. Several sectors have held up relatively well and manufacturing in particular has recovered stronger than expected. Looking forward, pent-up demand is very high and elevated cash levels for both corporates and individuals will likely result in a meaningful economic improvement in the coming quarters. A conducive economic environment is expected to translate into strong earnings growth and we are positive on the earnings outlook throughout 2021. Steadily improving earnings in the first half of the year are expected to gather further momentum in the second half as more people get vaccinated and life returns to normal.

Expanding Central Bank Balance Sheets



Source: Bloomberg, EIBank

Meanwhile, the USD faces downward pressures against most major currencies due to the Fed's unprecedented stimulus injected in to the system to keep liquidity flowing. The US has clearly led the way in terms of the magnitude of the response and we expect this to continue to keep the US Dollar under pressure. This should bode well for emerging market (EM) assets as a weaker USD is expected to lower borrowing costs on hard currency debt and should allow for greater monetary and fiscal room for some EM economies. Having said that, faster than expected rise in longer term UST yields and any slowdown in the expected recovery, could reverse this consensus opinion and the ongoing weakness in the USD.

Although we have a favourable medium to long term view on risk assets, the reflation trade has already been set in motion in the latter part of 2020 and valuations have already priced in a significant amount of the expected earnings growth for 2021. Our favourable view should be looked in the context of 2022 and 2023 and where we believe the start of a multi-year bull run has begun. Notwithstanding the bumps and market pullbacks along the way, with such liquidity support in the system, the trend on the whole should remain positive, in our view.

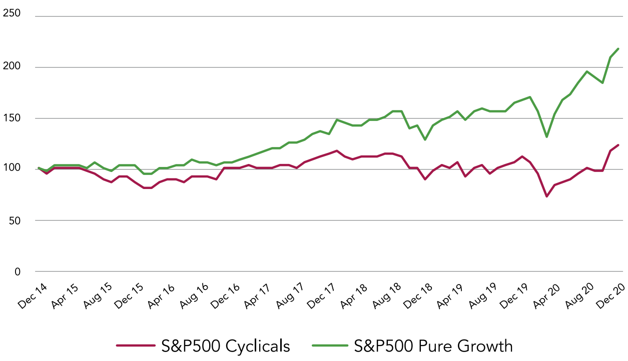
THE 2021 OUTLOOK

- **Favouring selective cyclicals (banking, consumer discretionary, autos, energy, real estate and industrial goods)**
- **EM assets favoured in a pro-cyclical growth environment and warrant allocation in a diversified portfolio**
- **Balanced approach to investing - small caps/EM to play catch up while technology leaders to provide quality; FI to continue playing a stabilizing role especially in quality EM and HY credits**

Despite the large economic impact of the Covid-19 pandemic-induced recession, risk assets have recovered sharply from their March 2020 lows, although the rebound has been quite polarized. At the peak of the pandemic and amid strict restrictions on mobility, technology and stocks that benefited from stay-at-home measures enjoyed a boost to their earnings. The accelerated shift to an online world boosted their business prospects at a time when traditional companies were struggling for business. Now, with the onset of multiple vaccines and as the global economy recovers from short but severe recession, we expect cyclical stocks (banking, consumer discretionary, autos, energy, real estate and industrial goods) to outperform growth stocks which are attached with lofty valuation.

With extraordinary fiscal stimulus already infused globally, led by the US, the incoming Biden administration is likely to prop up household spending further with more financial aid, after Senate elections this month gave Democrats a majority in both chambers of Congress.

Conditions favor cyclicals



Source: Bloomberg, EIBank

Consumers have accumulated savings while waiting out the pandemic. Stimulus checks and higher unemployment benefits pushed aggregate household income higher even as economic output shrank. As soon as society is no longer in the throes of the pandemic, broad money now sitting in households' bank accounts will be chasing goods and services and one could expect more consumption and spending towards non-essential goods and travel.

Overall, we believe the turn in the business cycle should in general favor equities over bonds, despite the stretched valuations. Aggressive fiscal and monetary stimulus should put upward pressure on long-term bond yields, though the pressure on yields is likely to be limited as central banks stand steadfast in maintaining low borrowing costs, given its negative repercussions through rising costs on inflated debt levels. With the USD likely to weaken further and given its countercyclical nature, non-US, smaller cap, and EM equities should outperform given the rebound in economic activity that we are expecting. While cyclical/value areas of the market have already run up significantly in anticipation of a cyclical recovery, a return to almost full normalcy by the second half of 2021 should help extend the rotation that began in early November away from technology/ growth leadership toward cyclical/value stocks.

That said, while expectations of high equity returns for 2021 are entrenched, high valuations across sectors and asset classes continue to be a major risk. Sectoral and asset class diversification boosted risk-adjusted returns throughout 2020 and should continue to do the same in 2021, in our view. With asset prices being elevated across the board, high conviction calls are becoming more difficult to come by and ensuring your portfolio is protected against potential market drawdowns should help enhance risk-adjusted returns going forward. As such, a combination of strategic technology exposure, defensive exposure, cyclical exposure, and EM exposure continues to be warranted, with dynamic asset allocation aimed at lowering drawdown risks. Additionally, selected alternatives (precious metals) and defensive / hedged fixed income portfolio strategies should continue to act as stabilizers and help in partly cushioning against any sharp equity drawdowns.

- **Technological innovation and transformation to continue (COVID-19 led digital momentum to persist in e-commerce, robotics, fintech, healthcare)**

Powerful structural trends in the technology space (ecommerce, digital payments, tele-healthcare) that were already taking hold before the pandemic should

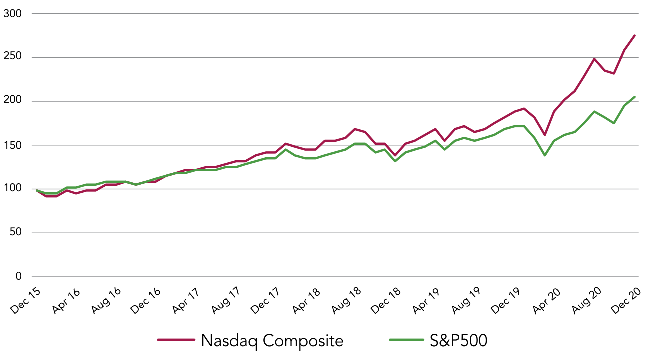
THE 2021 OUTLOOK

by and large be the same structural trends in a post-Covid 19 world. However, the pandemic has clearly accelerated these structural changes. We expect these trends to gain further traction over the next several years, leading to profound changes in how policymakers, businesses and society operate and evolve.

The world has realized that Big Data and Artificial Intelligence (AI) are inevitable enablers of digital transformation, healthcare innovation and sustainability in a limited resource world.

For instance, digital transformation may have started off as a technical innovation but has now become a movement driven by consumer demand and enabled by innovative digital companies. The cashless payments market has been digitally disrupted with the meteoric rise of fintech giants like PayPal, Alibaba, and Tencent. Social media is among the major creations of digital transformation and has gone from a novelty to an omnipresent feature of the present world.

Big Tech enjoys structural tailwinds



Source: Bloomberg, EIBank

Meanwhile, online banking is morphing into mobile banking and phones and watches everywhere are being used to transact on a daily basis. Restaurant payments, shopping and wire transfers are being made through a quick scan or by simply knowing someone's phone number. In healthcare, while robots have been used to assist in surgery for over three decades now, Robotics is rapidly growing as part of the modern healthcare landscape. Advances in sensor and motion control technologies mean robots are not just more precise and autonomous, they are increasingly capable of carrying out complex surgeries themselves. Post-operative care to reduce hospital stays, time-reduction and accuracy in surgery are some of the benefits of robotics in the medical field.

Furthermore, desperate measures needed to protect the environment are forcing governments to reduce their reliance on fossil fuels and facilitate a smooth transition toward clean energy. Although trading at lofty valuations, companies like Tesla are pioneers in this space.

Additionally, with an already burgeoning Chinese middle class and a vast population and slowly rising productivity levels in India, consumer purchasing power is slowly but surely shifting toward Emerging Asia and this trend should play out with greater force over the next decade. As such, companies need to cater to the tastes and needs of the Asian consumer in a large way. Most global companies such as Nike and Adidas are very conscious of this huge market and are spending considerable resources to understand and market to this consumer base.

Millennials also constitute another important market segment whose influence continues to grow. By 2025, millennials are estimated to comprise a significant part of the workforce and they have showed a clear preference for mobility and optionality, whether it's a gym membership or a shared office space. While stagnating income levels/unaffordability have dissuaded youngsters from owning the coveted house/car to an extent, there is a preference for the convenience of renting shared services. The stellar growth of shared mobility / shared economy businesses like Uber / WeWork confirms that this shift is here to stay and should only get stronger. On the opposite end of the spectrum to a millennial consumer base, an ageing consumer should also not be ignored. Broadly, as the world continues to age and healthcare makes rapid strides, people will be living longer in retirement, creating further demand for elderly care facilities, innovative insurance and savings schemes, and cutting-edge therapeutic pharmaceutical products.

Broadly speaking, there is a trade-off between unbridled growth and sustainability which makes us vigorously search for investible themes that could benefit disproportionately as policymakers and consumers focus on the many and far-reaching implications of climate change. This expansive trend is bound to present many opportunities in areas like clean energy/electric vehicles, water conservation, smart cities, innovation in farming and health & wellness (including meat alternatives).

- **US-China strategic rivalry likely to continue**
- **Competition and Co-operation to be the norm**

While China's meteoric rise in the last two decades or so has been largely peaceful, US-China relations saw a marked deterioration under the Trump administration, right from a feverish election campaign by Trump in 2016 to a gradually escalating trade war thereafter. Also, military tensions between the two sides have

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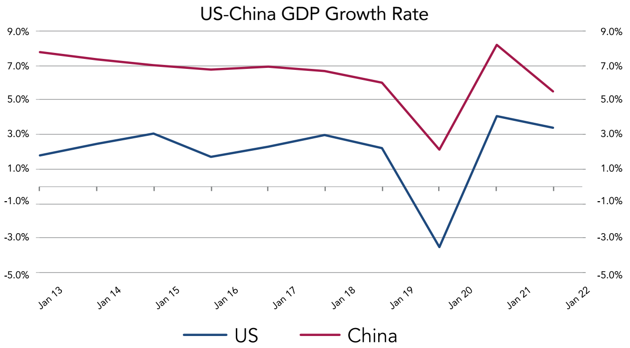
been ratcheting owing to Taiwan, the South China Sea and Hong Kong. Amid alleged discriminatory policies by the Chinese government against foreign firms and accusations of forced technology transfer

misuse of advanced technology for military use, the US has been moving aggressively to block Chinese technology firms, such as TikTok and Huawei, from access to the US market.

The coronavirus, which may well have originated from China, has further strained ties between the US and China, with the previous US administration clearly holding China responsible for the pandemic. Given this backdrop, both countries have been in a confrontational tit-for-tat stance.

China closing the gap with the US



Source: Bloomberg, EIBank

After collaborating closely for over three decades now, the US is now clearly leaning toward cutting technology ties with China and pressurising its allies to do so. While there is no doubt the Trump administration used an aggressive approach toward China, we believe incoming US President Biden's China strategy would place greater emphasis on a structured approach and would strike a balance between collaboration and deterrence.

Regardless, we believe the rift between the US and China is not principally about trade. It is really about China's emergence as a challenger to US in technology and economic and military might.

For example, 5G networks will boost internet speeds by a factor of 10 to 40. This has huge implications in future technologies like Internet of Things (IoT), self-driving cars and robotics. Trump's recent order to ban Chinese telecom giant Huawei from access to US computing chips is a clear sign of the US trying to delay if not deny China's inevitable rise.

While there is no doubt that the relationship is under considerable strain, the two economies remain closely connected via trade and need to collaborate to address global challenges like climate change, nuclear proliferation and rising income inequality. Overall, China's economic reach continues to strengthen and a future relationship with the US based on cooperation, mutual respect and basic human rights will be in everyone's interest.

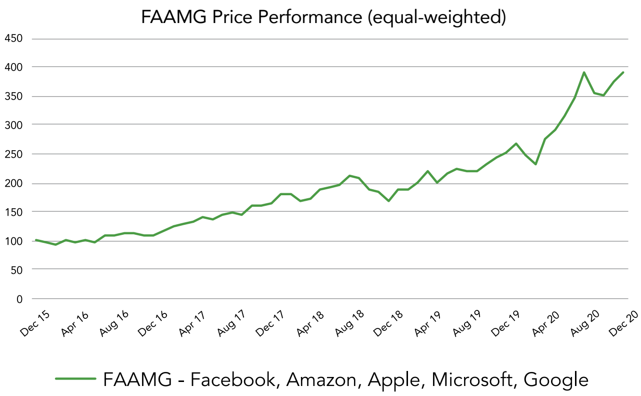
Regulation is a risk that is increasingly garnering more attention

A handful of the largest tech companies, including but not limited to Facebook, Apple, Amazon, Google and Microsoft have come to dominate the value of the S&P500 as the pandemic-induced sudden and forced shift to online disproportionately benefitted the tech sector as a whole, leading to their soaring valuations. This has come at a time when Big Tech is coming under increasing threat from regulators globally.

For most companies this was a year of tumult. For Big Tech, however, it was an extraordinary year of accelerated market share gains as business and consumer activity shifted online to circumvent restrictions on mobility. Their improved business fundamentals were handsomely rewarded by investors and the US information tech sector was among the year's big winners, up by 43.6% in 2020, as measured by the Nasdaq Composite Index.

Yet, in hindsight, 2020 may have well been the year in which the mega tech companies attracted heightened regulatory backlash for their excesses. The tech titans are accused of using their market power to gain monopolistic benefits and allowing their platforms to be used for misinformation.

Regulatory pressures on big tech to rise



Source: Bloomberg, EIBank

In our view, regulators may have finally woken up to the dominance of the tech sector as competitors, regulators and politicians look to curb their excessive power. In response, all major regulatory authorities including from the US, the EU, China, India and UK have put pressure on Big Tech in different ways.

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While the US Department of Justice (DoJ) tightened the noose around Google and Facebook on antitrust grounds, Europe plans to tax the digital economy and introduce stringent rules for the sector. Even China recently announced measures to crack down on Alibaba over alleged anti-monopolistic practices.

Meanwhile, incoming US president Biden is likely to be more activist, and with control of both chambers of the US Congress, would look to focus on the need to reform Big Tech's privileges and obligations. Democrats could introduce significant regulatory and tax changes to make US growth more equitable and climate-friendly, chipping away at the unbridled success of major technology giants.

That said, there remains a trade-off between too much regulation and growth at least in the short to medium term. Excessive regulation can increase costs for firms and stifle innovation that paves the way for creative destruction and a dynamic economy. Also, US lawmakers and regulators face a catch-22 situation. Any significant crackdown that breaks up the technology leaders or gets in the way of innovation may hand the leadership role to China at a time when both countries are vying for supremacy in future technologies like 5G, AI, Robotics and Quantum computing.

While equity markets have continued to bid up technology stocks based on their solid fundamentals and robust growth prospects, the way ahead for some of the mega technology companies is expected to be bumpy as regulatory oversight gains further momentum.

Investor focus on ESG investing & sustainable practices to gain further traction

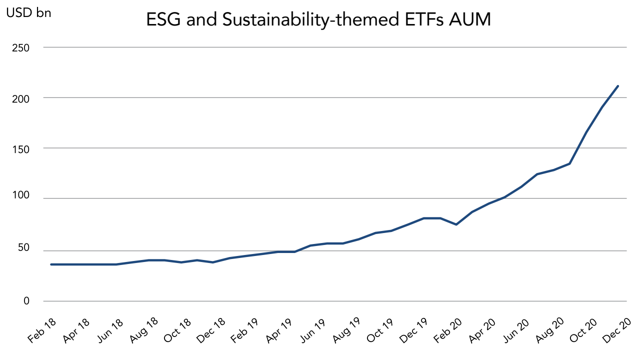
Environmental, Social, and Governance (ESG) refer to the three key non-financial metrics measuring the sustainability and societal impact of an investment in a company or business. ESG investing involves looking at nonfinancial information to identify potential risks and rewards associated with how a company deals with environmental, social and governance issues.

Despite the large-scale disruptions of 2020, ESG theme witnessed significant growth in assets under management and influence. We expect many of the drivers of strong returns for companies with strong ESG credentials to continue in 2021 as the focus on sustainability will be a key investment trend going forward.

For instance, climate change will be a big 2021 focus in ESG. Increased focus on climate policies is creating opportunities for certain sectors, while presenting challenges to others. Green commitments made by governments in 2020 will be followed through in 2021 and implementation will gain further traction with policies like Biden's push for greater EV penetration and China's goal to become carbon-neutral by 2060.

Against this backdrop, we believe renewable energy will enjoy long-term secular tailwinds as the world transitions to a less carbon-intensive economy and as solar and wind power become more cost-competitive. A large part of Tesla's dizzying valuations can be attributed to its status as "the go-to alternative energy car company".

ESG-linked valuation premium to sustain



Source: Bloomberg Intelligence, EIBank

Meanwhile, the social and governance factors under the ESG gambit often go unnoticed and are garnering attention in the current pandemic. How a company treats its employees and consumers is becoming a key factor in investment decision-making. The Covid-19 pandemic has created the need for companies to put health and safety of their employees above all else. Businesses that rely on face-to-face interactions have had to adapt to new virtual methods to ensure safety of their employees. Socially conscious actions have always made a difference, but are increasingly being implemented and rewarded by investors.

From a governance perspective, how good a company is with water management, how effective its health and safety policies are, how the supply chains are managed, and whether they have an unbiased corporate culture are increasingly being used as inputs into investment decisions. For instance, Indian cement producers have committed fresh investments to build waste heat recovery systems. Power generated through this system will reduce dependence on fossil fuels and translate into cost savings in the long run.

All of this makes investing with an eye towards ESG credentials an interesting proposition. Having said that, it is imperative to be mindful of premium valuations amid a rush to invest more and more money in a very narrow set of assets as investor demands and new regulatory pressures rise.

THE 2021 OUTLOOK

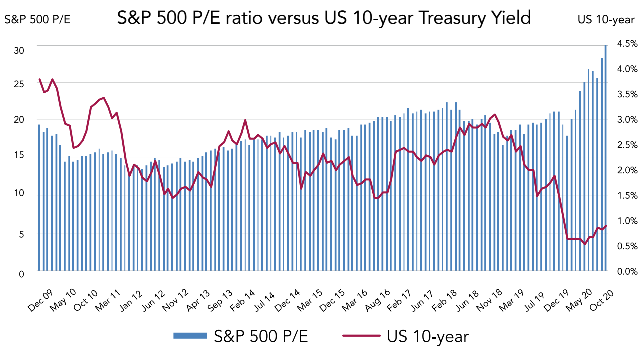
- **Optically lofty equity valuations to be viewed against the backdrop of unprecedented monetary backstop and technological innovation**

- **Lower interest rates explain, if not justify, higher equity valuations**

Most conventional valuation metrics including Price-to-Earnings, Price-to-Book, Price-to-Free Cash Flow, EV/EBITDA depict that global equity valuations look extremely stretched relative to history. However, with interest rates close to zero and the market's changing composition skewed to technology and disruptors, in part due to Covid-19, we believe there are multiple factors which argue for sustainability of the optically high valuations. Also, given early stages of the global business cycle and unprecedented monetary and fiscal support, several factors can sustain the elevated valuations:

- Early stage of economic recovery with continued negative to zero rates are forcing mass liquidity to chase risk assets, with significant opportunistic allocation waiting to time the market. Rock-bottom rates help raise share multiples, all else equal.
- With continued unprecedented backstop and support by major central banks, the credit environment remains benign with a low perceived risk of default, further supporting growth and higher equity valuations. For instance, interest rates are expected to be held at or near their current low levels for at least 2-3 years. Even with modestly rising earnings/cash flows discounted at low rates, earnings yield (inverse of P/E) and cash flow yields appear attractive relative to bond yields, increasing the relative attraction of equities in relation to bonds in general.
- Robust growth and high visbility in earnings for technology companies, has over the years, increased the sector's concentration in major global equity indices. Their superior performance increases their weight further and disproportionately affects the performances of the indices they are a part of.
- In a fast-paced technological innovation-led environment and high institutional interest to have an early stage stake, investors are compelled to look at non-traditional metrics such as growth in sales, market penetration, new product mix suiting the future.
- All said and done, justifying lofty equity valuations with interest rates is dangerous. If interest rates move higher from their artificially depressed levels, it would cause a permanent impairment to cash flows via the higher discount rate. Moreover, as we discussed in the "Threat of regulation" theme, if serious momentum gathers against Big Tech, their domination and earnings power would come under question, leading to a sharp de-rating of their high P/E multiples.

Ultra-low interest rates partly explain higher multiples



Source: Bloomberg, EIBank

With the above themes in mind, we expect the following areas/sectors to perform well in 2021 and beyond:

1) Areas of niche technology (e-commerce, healthcare) will continue to provide market leadership for years to come.
2) With a large swath of the global population to be vaccinated by mid-2021, we could well witness a global synchronous recovery benefitting domestic-oriented smaller caps.
3) International equities (notably EM) will benefit from the ongoing carry trade as dollar-denominated investors chase higher growth assets.
4) Superior ESG credentials will continue to command a significant premium across asset classes and over time as sustainable investing becomes mainstream.
5) In a yield-starved world, stable cash-flow generators with a proven dividend track record will gain favor as an alternative to lower-yielding fixed income instruments. We like quality REITs in the residential housing, and physical & digital warehousing space.
6) While a strong global economic recovery is imminent, the path is expected to be volatile warranting some exposure to traditional haven-assets (Gold, Silver).
7) Given the ultra-low interest rate environment and expectations of a recovery, inflation expectations could rise putting upward pressure on yields. To counter this, we prefer hedged fixed income exposures via Treasury futures.

MONTHLY INVESTMENT OVERVIEW

MARKET COMMENTARY

While 2020 was a very difficult year for most people, it ended up being an unusually upbeat year for risk assets as global central banks, led by the Fed, went "all in" and prevented the grave health crisis from morphing into a full-blown liquidity and economic crisis. With unprecedented infusion of liquidity in to the global economy and the Fed's decision to backstop even corporate credit, yields collapsed and forced investors to chase higher-yielding credit while big tech & online companies benefited from stay-at-home restrictions mandated by the authorities. In the last quarter of 2020, the rally broadened beyond growth equities to more economically sensitive areas of the economy on the back of the first Covid-19 breakthroughs and the prospect of an economic rebound. The S&P500 finished 2020 with a gain of 16.3% while the Nasdaq Composite, dominated by tech, gained a whopping 43.6%, as work and consumer spending moved online.

Fixed Income

A range of extraordinary steps to fight the pandemic-induced recession were taken, keeping credit flowing and anchoring US yields at all-time lows. Expectations are for the Fed to keep its benchmark short-term interest rate near zero through at least 2023. While officials expect the US economy to rebound at a healthy pace in 2021, the Fed is prepared to allow growth and inflation to overshoot to sustain the much-anticipated economic recovery. The 10-year US treasury yield has held firmly between 0.5% and 1.0% since late March and ended 2020 at 0.91%. While victory for Democrats in the Georgia Senate race for 2 seats would result in a united Congress and could push yields higher given the propensity for higher spending by Democrats, the Fed's unwavering monetary support should prevent yields from rising meaningfully in 2021.

Europe

Another round of mobility restrictions to contain the second wave of Covid-19 infections means the Euro-area economic recovery could be adversely impacted even as governments continue to offer the fiscal support needed, accommodated by a supportive ECB. Broadly, Eurozone inflation has decelerated in recent months, unemployment remains elevated, industrial production has faltered and the composite PMI suggests contact-intensive services continue to bear the brunt of the damage caused by fresh restrictions on mobility. In response, the ECB expanded its Pandemic Emergency Purchase Programme by EUR500 bn in December to EUR1.85 trillion. It also further eased lending conditions. The EuroStoxx50 was down 5.1% while the EUR rode a wave of confidence on Europe's joint pandemic response, gaining 8.9% against the USD in 2020.

UK

After blowing through multiple deadlines, UK lawmakers finally agreed on a withdrawal trade pact with the EU. While this shields the UK from a worst-case scenario of a no deal exit, the country's economic outlook remains bleak as the EU trade pact does not extend to services or the financial industry. There is also growing concern that Scotland, which voted to remain in the EU in 2016, could seek to leave the UK. Meanwhile, rising coronavirus infections and lockdown controls are expected to weigh on the economy at the start of 2021. The export-oriented FTSE100 underperformed and lost 14.3% in 2020 while the GBP had a volatile ride tracking Brexit-related news flow and ended 2020 with a gain of 3.1% against the USD.

Japan

Japan's industrial growth stalled in November after rising for five months, underscoring the fragile nature of its recovery as lockdown measures in some major economies hurt demand for its exports. Meanwhile, CPI fell further and retail sales also slowed in November, highlighting a cautious consumer amid concerns that the virus is showing no signs of abating even after the country stepped up containment measures. On the back of massive monetary easing and the government's extraordinary stimulus packages combined with optimism surrounding vaccines and a clearer US political outlook, the Nikkei225 gained 16.0% in 2020. Meanwhile, the safe-haven JPY benefitted from the pandemic-related uncertainty and broad-based Dollar weakness to gain 4.9% against the USD for the year.

China

While production and investment may have led China's rebound from the Covid slump, both domestic and external demand are fuelling the continued pickup in the economy with private capex and consumption also showing signs of revival.
While US-China confrontations in trade, technology and geopolitics remain headwinds in 2021, a Biden administration is expected to balance engagement with deterrence.
Following a sharp decline in Q1 2020, a rapid response to contain the virus leaves China in a solid position for 2021. The Shanghai Composite gained 13.9% while the CNY rallied 6.3% against the USD in 2020 on superior economic performance.

Other EM

Emerging Market (EM) equities, as represented by the MSCI EM Index, climbed to their highest level since 2007 as easy financial conditions, optimism over the global rollout of vaccines, and a slide in the Dollar index have boosted the prospect of a global recovery in 2021 and aided risk assets in general. After the coronavirus pandemic ravaged EM assets earlier this year, they have gained from a favourable US election outcome, historically low interest rates, large fiscal aid and vaccine rollouts. The MSCI EM Index, rose to a 13-year high, ending the year with a 15.8% gain.

MENA and Oil

After a historic crash at the peak of the pandemic in March-April, oil prices have staged a comeback on sustained supply cuts by OPEC+ and a strong recovery in Asia, led by China. After falling to sub-20 levels per barrel (WTI traded went into negative territory), Brent has stabilized above the USD50/bbl mark despite OPEC's pledge of extra supply, bolstered by vaccine developments and the re-opening of economies. Despite the strong rebound, Brent still closed down 21.5% for the year and oil prices remain far below the levels most oil-reliant economies need to cover government spending. Major economies of the region lagged their developed and EM peers with the S&P Pan Arab Composite ending lower by 2.4% for the year, due to double whammy from the pandemic-induced recession and low oil prices.

Asset Class	Opportunity set	UW	C	N	F	OW	Comments
Main	Equities						On a near-to-medium term basis, we are Neutral equities given rich valuations and limited upside potential. Selectively, we prefer cyclical/commodity plays and EM equities on a weakening USD, low rates and superior growth prospects.
	Credit						While longer duration IG credit spreads are offering very little compensation for any pickup in yields, selectively HY still offers some appreciation potential in low rate environment. With major central banks firmly behind corporate credit, the economic restart should continue to benefit the cyclical issues.
Equities	US						With a cyclical upswing underway and further stimulus expected under a unified Democratic US government, we continue to prefer smaller-cap, inward facing companies likely to benefit from a strong economic rebound.
	Europe						European indices have a high exposure to financials and the bloc remains a cyclically geared market. With near-term Brexit challenges addressed and a vaccine-led recovery to play out starting mid-2021, the medium-term outlook looks decent although valuations remain heady.
	Japan						Sluggish economic performance in 2020, but a deep value/cyclical index composition makes it a bottom-up stockpickers market for 2021.
	EM						We Favor EM equities as a stable political environment under a Biden administration, a weakening USD, expected sharp economic rebound with relatively bettter valuations and a search for yield in a lower-for-longer interest rate world should benefit EM assets.
Fixed Income	US IG						2020 witnessed sharp compression in IG-Treasury spreads since the Fed's invervention in March last year. This has led to an acceleration of returns in 2020, leaving longer-duration IG corporate debt vulnerable in 2021 with potential Treasury-curve steepening the biggest risk to performance.
	US HY						On the back of further stimulus euphoria, HY spreads are approaching cyclical lows amid a still uncertain macroeconomic environement. A lot hinges on the continued free flow of monetary stimulus. The fact that CCC-rated bonds are trading near their tightest levels in five years vs. the rest of HY calls for caution on the space. We remain constructive on the US HY space selectively.
	Europe IG						With expanded ECB buying through 2021 and nearly two-thirds of eligible net supply to be consumed by the ECB, Euro IG should remain supported but upside remains capped given the tight spreads.
	Europe HY						Euro HY has room to appreciate amid an economic recovery and decent premia over IG. Fundamentals are improving gradually and filtering into ratings. Widening Treasury yields are neative for IG, but Euro HY offers cushion in terms of valuation and its cyclical nature should benefit it in a reflating environment.
	Global Aggregate						While spreads have narrowed significantly, we believe the asset class remains an attractive source of income in a yield-hungry environment. We see pockets of value within Asia as the region has done better in containing the virus and leads the global economic recovery.

UW - Underweight, C - Cautious, N -Neutral, F - Favour, OW - Overweight

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