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CIO Viewpoint

Ten Investment Convictions for 2021

Investment Solutions

23 November 2020

2020 challenged all of us. The most severe economic contraction in decades triggered vast monetary accommodation and fiscal support packages that altered the investment landscape.

Now, as we approach 2021, the promise of Covid-19 vaccines is game changing. It encourages us to anticipate a return to pre-pandemic activities. Mass vaccinations, public health measures, extraordinary government spending and monetary policy support, should accelerate the economic recovery. Although the pandemic's effects will be felt throughout 2021, we expect a pattern of uneven economic catch-up to continue as the year progresses. After all, an external shock caused by the coronavirus, rather than a fundamental weakness in the global economy caused this crisis.

Until a global vaccine distribution campaign reaches billions of people, companies and consumers will continue to need support to compensate for their losses of revenue and income. The greatest risk is therefore that policymakers prematurely phase out this support. With interest rates at new lows globally, the inflation-normalisation process is unlikely to limit central bank interventions.

The stage of economic recovery varies between markets, ranging from some almost-fully-recovered economies in Asia, to the second-wave infections of the US and Europe. Between economic sectors we also expect uneven recoveries. We expect sectors such as housing, manufacturing and trade, to outperform areas such as services, financials and energy. Finally, we anticipate a revival in global trade thanks to a change in the US/China dialogue, and an improved business climate for sectors that depend on complex production and logistic chains. This should encourage a strong recovery in emerging economies.

Investors should carefully watch as geopolitical dynamics post-Covid unfold. The most significant catalyst will be the incoming Biden administration's more multilateral ambitions. The relationship between the world's two superpowers will start a new chapter as the balance of global leadership evolves. We may see Iran return to world oil markets, as multilateral relations are re-configured. In addition, widening inequalities, apparent since the global financial crisis and exacerbated by the pandemic, may continue to contribute to social tensions.

Our portfolios already reflect the pandemic's acceleration of many structural trends. We have identified three themes that will continue to drive resilient investment portfolios, namely: considering China as a standalone investment, targeted thematic trends and using private markets to access value.

Twelve months ago, few could have imagined such a tumultuous year ahead. While 2020 will cast a long shadow, we expect next year to deliver a rapid and robust global recovery. We sincerely wish you health, happiness and prosperity in 2021.

Stéphane Monier
Chief Investment Officer, Lombard Odier Private Bank

2021 key dates

- **1 January** – EU's new relationship with UK takes effect
- **5 January** – US state of Georgia holds Senate seat run-off
- **6 January** – US Congress approves Joe Biden as 46th president
- **20 January** – Biden administration takes office
- **17-30 May** – China hosts UN Biodiversity Conference (COP 15)
- **23 July - 8 August** – Olympic Games, Tokyo
- **22 October** – Latest date for Japan's general election
- **24 October** – Last deadline for federal elections in Germany; Chancellor Angela Merkel to step down
- **1-12 November** – UK hosts United Nations Climate Change conference (COP 26)

1. Stay invested in risk assets

Positive vaccine developments and continued monetary and fiscal support are set to accelerate economic healing. Corporate earnings offered a positive third-quarter surprise, and with interest rates expected to stay low, equities should continue to rally with fixed income carry strategies still providing returns. We believe that the sound medium-term outlook will reward portfolios that stay invested and broadly diversified, while gradually adding exposure to some of 2020's cyclical equity laggards.

2. Maintaining portfolio ballast

The vaccine-fuelled recovery will not be a linear process. The low-yield environment makes traditional portfolio stabilisers, such as domestic government bonds, less efficient. We therefore favour holding a diversified set of hedges. These can range from US treasuries, or Chinese government bonds, to gold, the yen or put options. Such assets can evolve independently from the equity risk that we want to cushion, and therefore need tactical management.

3. Hold onto gold, for now

Short-term uncertainties should keep gold prices trading in the USD 1,850 to 2,000 per ounce range. This offers an efficient hedge against equity volatility. A depreciating US dollar may help the physical demand for gold, but we expect financial demand to remain the strongest price driver. Later in 2021, once a recovery is in place, real rates are back to normal levels and investors have again increased their exposure to risky assets, gold prices will likely trend closer to our 12-month target of USD 1,600/oz.

4. Use carry strategies to generate yield

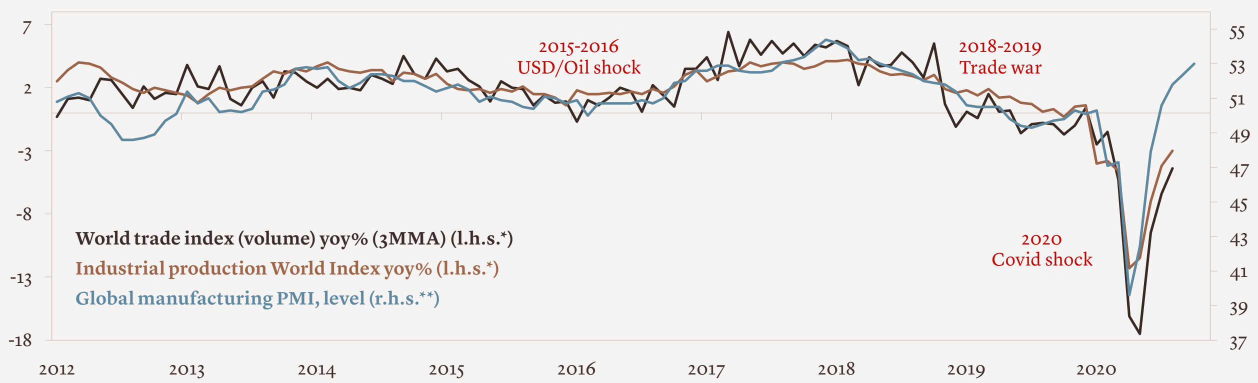
While the traditional portfolio hedging properties of government fixed income assets may be reduced given the current low yield levels, corporate credit should continue to benefit as investors seek returns. We think that this dynamic, in an environment of low inflation and anchored monetary policy, will continue. In this context, emerging market hard currency bonds look particularly attractive.

5. Capture the recovery with balanced cyclical and growth stocks

The vaccine news eliminated the worst-case scenario for the recovery and made cyclical stocks, including small capitalisations, more compelling. That sets the stage for a partial catch-up in valuations and earnings in industrials, construction, materials, financials and energy stocks, as well as in Europe's markets where these sectors are predominant. All of these sectors suffered under the pandemic slowdown and tend to perform early in an economic upswing. We expect demand for quality names in healthcare and technology to continue in 2021, especially after the initial catch-up phase, as their fundamentals remain strong.

Global trade expanding after two-year contraction...

...and a new US administration



Source: Lombard Odier calculations / * left hand scale, **right hand scale

6. Don’t miss Asian equities

China’s economic recovery and more domestic-driven economy makes the country’s equity markets increasingly uncorrelated to the rest of the world’s equity indices. The country will also be one of the earliest beneficiaries from any thawing of trade relations with the US under a Biden administration. In other emerging markets, prospects should improve on the back of the global trade revival, after two years of contraction.

7. Invest in the real economy

Private investors can make their portfolios more resilient by putting capital to work in non-listed companies. Investment activity in this market slowed during the pandemic. Lower company valuations for many investment targets and record levels of industry cash are now opening significant opportunities. This capital should help companies get back on track and generate sustainable growth. In addition, infrastructure assets are poised to benefit from massive levels of government pandemic spending. In real estate markets, changing commuting and working patterns are shifting demand for commercial property in the short run.

8. Factor-in a weaker dollar

Despite the US dollar’s 12% drop since March 2020[1], the currency remains overvalued and still includes some of the risk factored into US electoral chaos. Joe Biden’s presidential victory represents a return to normality, which, together with progress on vaccines, should allow global growth and trade to recover. As that happens, we expect more USD weakness through 2021. Major G10 currencies such as the euro, sterling and yen should remain supported. However, markets will selectively turn to emerging market currencies.

9. Expose portfolios to improving trade with emerging currencies

Specifically, rebounding emerging market growth, vaccine hopes and lower extreme risks for the weakest emerging currencies should drive the JP Morgan Emerging Market Currency Index higher in the first quarter of 2021. We favour currencies that enjoy a valuation cushion, good external balances and exposure to a world trade recovery such as the Chinese yuan, South Korean won, Czech koruna and Chilean peso as well as those, such as the Taiwanese dollar and the Israeli shekel that will fare well in a ‘low-for-longer’ interest rates scenario.

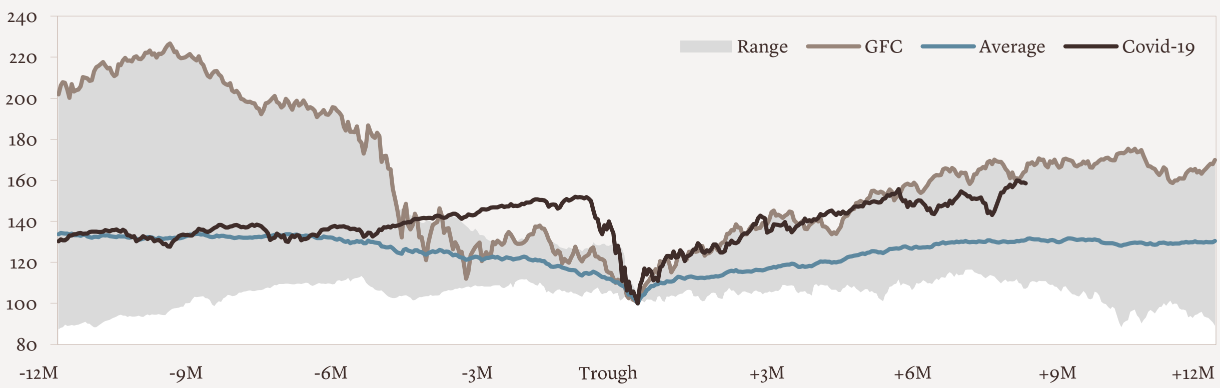
10. Sustainability is a key driver of portfolio performance

All economic activity depends on natural resources and yet the world’s current economic model is unsustainably wasteful. Companies with ambitious and sustainable solutions in every sector and industry are driving the transition to cleaner, leaner, inclusive and circular alternatives and what we call the CLIC™ economy. We favour companies developing new technologies and products to curb their high CO_2 emissions, so making a significant contribution to tackling climate change. We also believe that there are untapped investment opportunities in companies using regenerative approaches to our planet’s natural capital. These nature-positive business models offer great promise for future economic growth. Investing in these sustainable solutions is a key driver of future portfolio performance.

[1]Bloomberg dollar index (BBDXY)

Equity markets back on track

MSCI World recoveries out of main bear markets since 1970



Source: Bloomberg

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