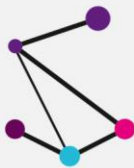


GLOBAL MACRO OUTLOOK FOR 2021

Written by Stéphanie Bigou, Global Macro Portfolio Manager at Seeyond, on December 21st 2020

BULL, BULL … but volatility should remain high

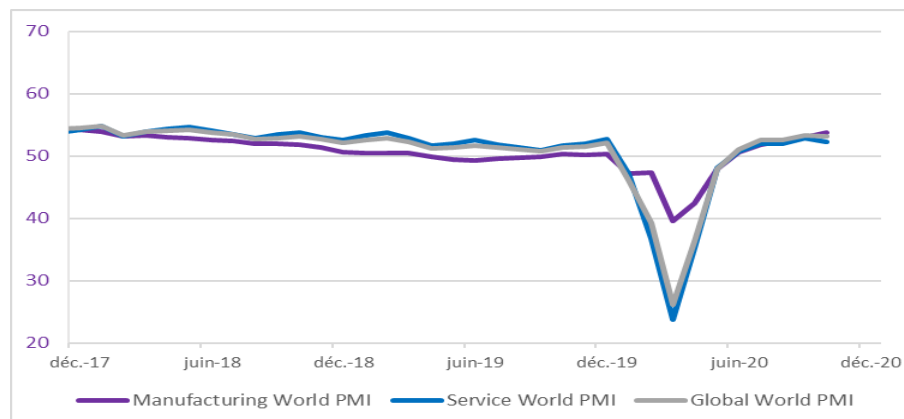
- *Further improvement in global macroeconomic and microeconomic fundamentals*
- *We see value in Equities, credit but also cyclical themes.*
- *Volatility should remain high, while allowing Equity to post further gains*
- *Inflation: not an immediate risk*
- *Our core scenario is positive on equities, minding sudden drawdown risks and cautious on govies.*

AFTER THE RECESSION, TIME FOR RECOVERY…

The global health crisis caused a historic global growth shock during the first half of 2020. With a better control of the pandemic, economies have started picking up, although at different speeds depending on local health policies.

Confidence in the Industry and Services (chart 1) has recovered globally. We expect this trend to continue as global vaccination will dissipate health uncertainties.

Chart 1 – World economic outlook – PMI confidence indicators – December 2017- December 2020 – Source: Bloomberg, Seeyond



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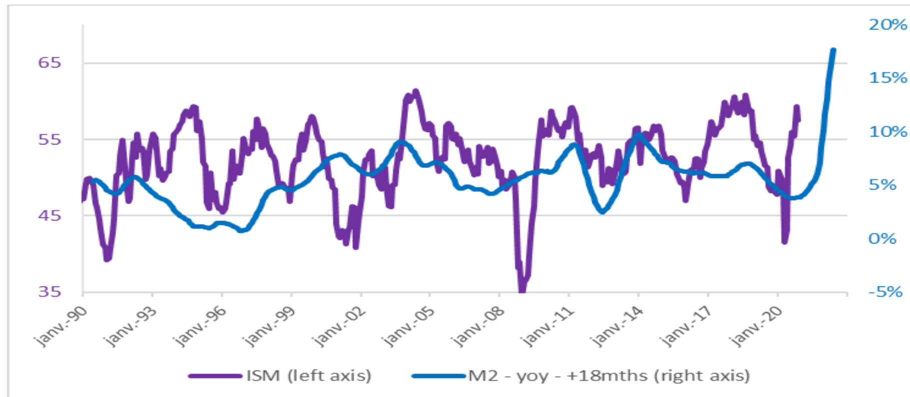
Other supporting factors of the recovery are:

- Effects of expansionary monetary and fiscal policies (chart 2)
- Persistently low short interest rates
- Increase of public investment in new technologies
- A peak of tightened credit conditions

Chart 2 – Future economic growth (ISM) and delayed effects of monetary stimuli (18-month advanced money supply M2) – January1990-December 2020 – Sources: Bloomberg, Seeyond



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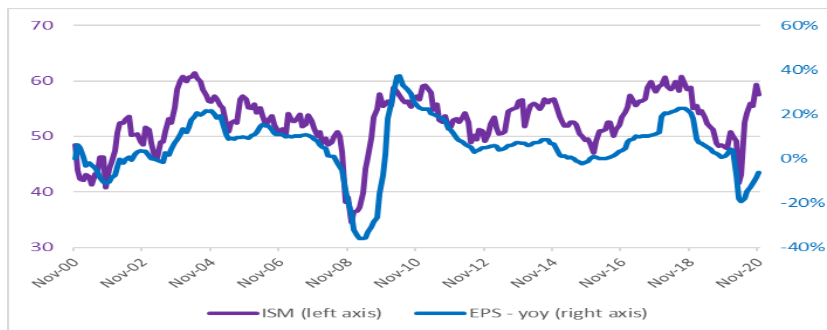
Driven by the economic recovery but also by IPOs, M&As and share buyback programs gradually coming back, corporate profits and earnings growth should accelerate (chart 3). Double-digit growths are expected, around 20 to 30% on average, depending on the geographical area.

Chart 3 – Corporate profits (EPS) and economic growth (ISM)– November 2000-December 2020 – Sources: Bloomberg, Seeyond



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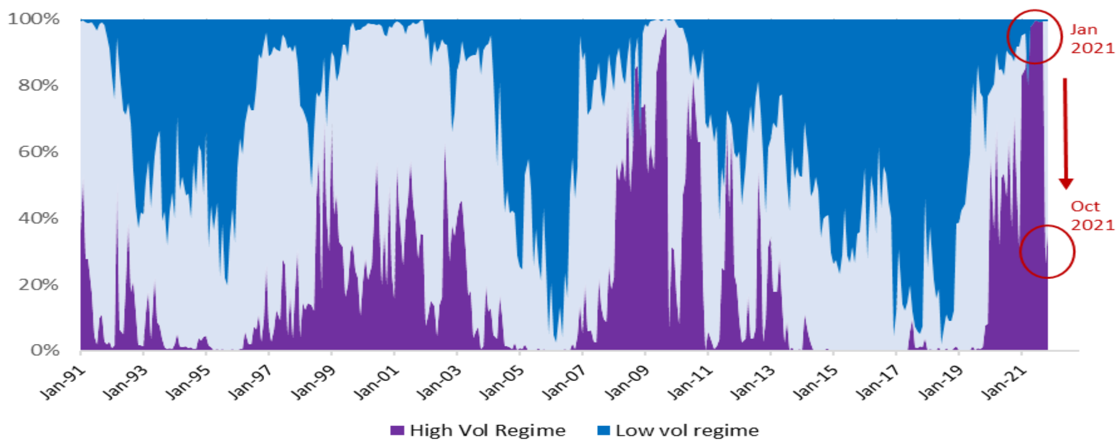
The speed of recovery will differ according to the geographical area.

- The United States should benefit from a weaker dollar and a lighter fiscal pressure if Republicans keep the Senate.
- In Europe and Asia, companies should be impacted by the recovery in global trade and by the Global Regional Economic Partnership, a historic free trade agreement for the Pacific region.

…BUT UNCERTAINTY REMAINS

Based on our volatility regime model, we do not believe there will be a significant decrease in market uncertainty in 2021 despite the expected economic pickup over the next twelve months. It is not surprising as volatility usually remains high after a recession until uncertainties regarding a sustainable recovery dissolve. The existence of these uncertainties offers investment opportunities due to persistent discounts.

Chart 4 – Volatility regimes – Probability over the next 12 months – January 1991-December 2020 – Forecasts for 2021 – Sources: Bloomberg, Seeyond



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We believe that volatility should remain high for a large part of 2021 before declining only in the second half of the year (chart 4).

First, fundamental risks linked to the health crisis remain:

- Vaccinating millions of people takes time, the first round of vaccination only will take several months

- The vaccine will not prevent from further COVID waves, as we see in Europe and America and possibly in Asia

- Important levels of anti-vaccine sentiment. In the case of vaccination incidents, this could even increase. We deem this as not unlikely with a new vaccine being rolled out on a global scale.

Secondly, there are market risks.

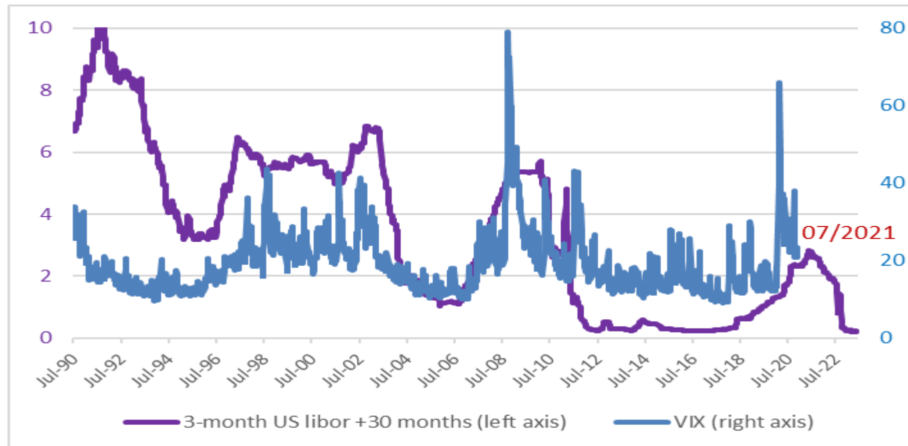
Volatility: To begin with, many investors expect a sharp decline of equity implied volatilities in line with the sharp fall in short-term rates (chart 5). We remain cautious for two reasons:

1- Historically, there tends to be a two- to three-year lag between a fall in rates and a decline of implied volatilities. A sustainable decline in volatility is therefore not expected until mid-2021 (inflection point on Libor).

2- A persistent post-crisis state of euphoria could delay this historical relationship between implied equity volatility and Libor, causing a simultaneous increase in equity and volatility.

Keep in mind that a technology shift such as the digitalization and changing patterns of consumption (e.g. e-commerce in the post-crisis health care sector) can disrupt the historical relationship. Also, correlations tend to increase sharply in times of crisis. Combined with the current extremely high liquidity, the impacts of the resulting sectoral and thematic rotation are all the more violent.

Chart 5 – Implied volatility on US equities (Vix) and 30 months advanced 3-month Libor - July 1990-May 2023 (forecast 2021-2023) – Sources: Bloomberg, Seeyond



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Inflation: With regards the risk of inflation however, we do not think it will materialize early 2021. We see mixed signals around inflation.

- Markets have just lived through a highly deflationary period, which we do not believe to be finished.
- Central banks have pumped considerable amounts of liquidity into the system to avoid deflation.
- The service industry, which naturally generates inflation, has been hit hard by the sanitary crisis.
- Global recovery plans focus on infrastructure investment, which can lead to inflation.
- A changing paradigm moving away from globalized economies might push inflation up in the longer term.

Inflation is a question of volume and speed. Obviously, liquidity has been pumped into the systems in historic amounts, but we need to see a reduction in the output gap (difference between real and potential growth). Therefore, we will be monitoring global mobility indicators as well as unemployment rates in the US, Europe and Asia.

Only a successful vaccination programs will positively impact both mobility and unemployment. The difference with previous cycles is the sheer size of the implemented policies. Without a major disruption, inflation might regain pre-crisis levels in the second half of 2021, and accelerate in 2022 and 2023. Even if the market could temporarily play a fear game in 2021, it should become a real concern for investors only later in the cycle.

CORE SCENARIO ON MARKETS: POSITIVE ON EQUITY MARKETS, CAUTIOUS ON GOVERNMENT BONDS

Given the available market and fundamental data, the volatility regime is expected to remain high for a few more months. Nevertheless, the rapid and massive intervention by the authorities (synthesized in the very rapid decline in Libor and improving macroeconomic data) limits directional risks.

We believe global economy will recover with increasing speed and intensity in the second half of the year. Global equity markets should therefore be supported mainly by improving earnings, while long-term interest rates should gradually tighten but within reason. Central Banks will be patient and wait for the recovery to intensify before changing their bias. Finally, risk premia will probably remain at their current levels and are only expected to ease later in the cycle.

Thus, equity markets should outperform bonds in terms of both valuation and dividends. Rates should lose value and should not be high enough to attract investors looking for "carry" (chart 6).

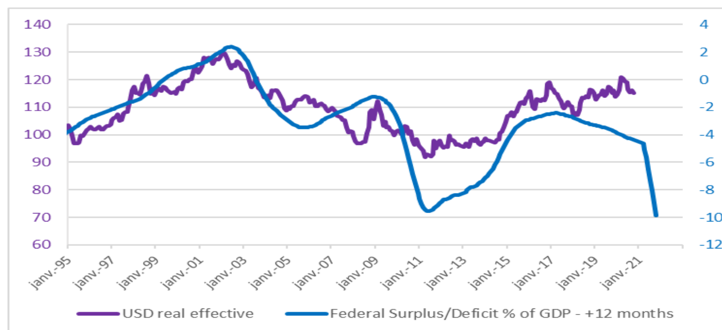
Chart 6 – 2021 Market views – YTD relative to 15th December 2020 – Source: Seeyond

Trend 2021 YtD	Central Scenario
US 10 Y	+
German 10 Y	+
UK 10 Y	+
Japanese 10 Y	=
Eur/Usd	++
Jpy/Usd	=
Gbp/Usd	-
EM/Usd	+
Oil	++
Gold	+

Forecast 2021 YtD	Central Scenario
S&P500	10%/15%
€Stoxx50	15%/20%
FTSE100	25%/30%
Nikkei	35%/40%
MSCI EM	20%/25%

The US Dollar, a counter-cyclical currency, should depreciate (chart 7) in favor of commodities-linked and cyclical currencies (EUR, GBP).

Chart 7 – US dollar Appreciation / Depreciation and 12 months advanced US fiscal deficit - January 1995-December 2021 (forecast 2021) – Sources: Seeyond, Bloomberg



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Oil should remain positive due to the increase in demand. Finally, gold should be supported by the decline of the US dollar and increasing inflationary pressures in the medium term.

We give an 80% probability to the gradual recovery scenario. We consider that there is a 15% risk that the recovery will be aborted and give way to a recession, should the vaccination campaign fail to eliminate the health risk and free global mobility from constraints. Finally, we assess the inflationary risk of macroeconomic overheating at only 5%: despite the massive inflow of liquidity, the labor market should take more than twelve months to improve and Central Banks will be patient.

KEY THEMES FOR 2021

Going further into details, we transposed our core scenario onto a Principal Component Analysis (PCA). The survey resulted in the following conclusions regarding the key themes for 2021:

- Equity markets: Cyclical areas and sectors on one side, and small caps on the other side, should be the main themes for equities. While US and European financials should perform well, the whole “Value” compartment could be more at risk, and both stock and sector picking should be key.

- Bond Markets: Corporate bonds (HY and Investment Grade), emerging markets rates and peripheral European sovereign bonds should be the main themes for bonds. Inflation-linked bonds should behave well. Nominal 10-year and 30-year rates are at risk.

- Currencies: Cyclical and emerging currencies (Korean won, Brazilian real, Australian dollar, Norwegian krone, Canadian dollar) against the U.S. dollar should be the main themes for currencies. The Yen looks neutral.

- Raw materials: Copper and gold should be the main themes for commodities. Oil should perform well, but to a lesser extent.

To access our detailed PCA and transposition of views, please click HERE.

Q&A ON THREE CONCERNS COMMONLY RAISED BY INVESTORS

➔ ***Why would inflation pick up, even at a moderate pace, now when it has been at the bottom for the last ten years?***

Because, unlike the past cycle, monetary and fiscal measures to support the post-crisis economy were massive and above all synchronized on a global scale. In 2008, the lack of synchronization and fiscal austerity imposed on peripheral European countries in the midst of the debt crisis inhibited a sustainable recovery. It caused a succession of deflationary systemic shocks, weakened potential growth and drastically reduced the effectiveness of support measures. This mistake was not repeated in 2020.

➔ ***Equity markets are too expensive. Why invest in equities today?***

The expensiveness depends on the geographical area and metrics analyzed. While US stocks valuation appears high in absolute terms and historically speaking, European and Japanese stocks are less expensive, especially when looking at Shiller's P/E (cyclically adjusted). In addition, equities remain attractive in comparison with government and corporate bonds.

➔ ***Everyone is already above historical exposures on stock markets. Who remain as buyers?***

Investors' allocation on equities is a little high without being at extreme levels yet. It should materialize in many jolts and consequently in high volatility. However, in such an exceptional context, it is not surprising to witness exceptional market dynamics and exceptional positioning. We are currently experiencing two transitions in terms of economic cycles: 1- we are at the beginning of a new economic cycle known as the major traditional Juglar cycle (5/11 years on average), and above all 2- we are beginning a new Schumpeterian super-cycle of innovation (20/30 years on average). At the end of the nineties, the fifth wave of Schumpeterian innovation based on telecommunications and the generalization of the Internet induced an historic increase in valuations and positioning. It was later called a bubble but the basis was real. Today, the beginning of the sixth Schumpeterian innovation wave based on nanotechnologies, digitalization of economies and ESG investing, is likely to cause the same craze from investors, especially since the health crisis amplified the trends among investors.

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About Seeyond

Seeyond, an affiliate of Natixis Investment Managers, specializes in active quantitative portfolio management. By adding active oversight to disciplined quantitative investment processes, Seeyond offers strategies that seek to optimally reward risk in three core areas of expertise: equity strategies, multi-asset strategies, volatility & overlay strategies. These strategies leverage Seeyond's proprietary quantitative research.

Seeyond, a team of 26 recognized professionals with 18 years of industry experience on average, manages around EUR 9 billion of assets[1]. Seeyond's solutions are marketed by the global Natixis Investment Managers' distribution platform, one of the largest asset managers in the world[2], and via the retail networks of Groupe BPCE, the second largest banking group in France[3].

> For further details: www.seeyond-am.com and

1 Source: Seeyond, as of 30/09/2020
2 Cerulli Quantitative Update: Global Markets 2020 ranked Natixis Investment Managers as the 17th largest asset manager in the world based on assets under management as of December 31, 2019.
3 Source : BPCE S.A. – 31/12/2019

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