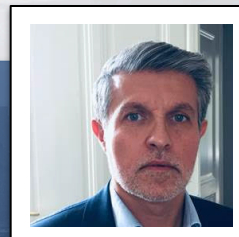


# Outlook 2021

12.28.2020



*Outlook 2021. Not to be forwarded. For professionals only. For personal use only!*

## Outlook 2021: Collision Course

Like every year, I will be going through Geopolitics, Global Macro, and asset classes to determine the investment strategy for the coming year.

Like every year, I want to point out that this document is a photograph of the past and a projection at the time of its writing, which means that it will evolve over time to adapt.

This document has always been written according to the same pattern: to answer the main questions that any investor will have to ask themselves to navigate the turbulent waters of 2021.

With your scribe writing through Global Macro Insight every day, he will get right to the point.

What are the main questions for investors?

- Global economic growth: Rapid catch up (effective vaccines?) Or “Groundhog Day” infection?
- Biden: Post-Trump Era complete shift or simple transition? The USA is back in the game? (Dollar? US equities? Govies? Overweight?).
- China: The new leader or the eternal second? Taiwan? Xi Jinping target (double the GDP, decarbonization)?
- Liquidity Binge: MMT or Reset? Good for all assets including Private Equity?
- Inflation: the awakening of the tiger?
- Bonds / Equities: Crossroad or Collision course? Still, need to be Barbell?

Your scribe believes that we can also have 6 sub-themes that will shape a large part of our future themes and the positioning of our GTO, you will find them in the background throughout this document:

1. Uneven recovery
2. Policy Challenges
3. Rising debt burdens
4. Digital Transformation
5. Environmental impact
6. Social Trend

## 1 – Global economic growth: Rapid catch up (effective vaccines?) or “Groundhog Day” infection?

For the consensus, the recovery will be effective in 2021, and the form of this return to normal being in the shape of a V, according to the same consensus. Goldman even talks about a "bull run 2021" ...

Your scribe does not agree with this for several reasons (at least at the start of the year):

- Economic and health policies based solely on an "all-in" always end badly: all-in on central banks and all-in on vaccines, two examples among many.
- As the OECD has anticipated, the pace of the recovery will be slower than expected. Your scribe subscribes to a square root repeat.
- Already, some central banks are starting to talk about normalization (such as the PBOC for example, or some central banks in northern Europe).
- Many forecasts will depend on the management of the Covid pandemic.
- Markets no longer take macroeconomic fundamentals into account:
  - M2 in the USA on a record high, but its velocity has collapsed
  - Nominal GDP and consumption are not yet at 2019 levels.
  - Indicators like the Citigroup US Economic Surprise Index still fail to recover as the S & P500 hits all-time highs.
  - Global Debt / GDP and Global Market Capitalization / Global GDP ratios are at record levels and well above those of 2000 and 2008.

On December 3, your scribe wrote a Global Macro Insight titled "What if ...". They were 6 in number:

- "What if" planned or announced economic plans did not arrive on time for political reasons?
- "What if" central banks passed their turn in December?
- "What if" the "good" economic figures, published recently, hid certain cracks?
- "What if" vaccines did not find their audience?
- "What if" China replied?
- "What if" the geopolitical conditions around Iran or Taiwan were getting out of hand?

And these conditionalities will make the start of the year problematic:

- Central banks have timidly responded to the call of the markets by increasing the duration of their asset buyback programs, but without accelerating the pace, quid the January meetings.
- Brexit has been signed, but not yet ratified, but its study will take two months from January 1. It is to be hoped that the parliaments of the member states will not be consulted ...

- The € 750 billion European plan has still not been launched.
- The American plan is finally unblocked ... But, Larry Summers (a Democrat) once said it was a mistake when talking about Trump's demand to increase aid to Americans to \$ 2,000.
- China threatens to respond to perpetual pressure from the Trump administration. After the Tariffs, it is the turn of Chinese companies, either listed in the US or having a suspected link with the Chinese military (PLA).
- If Biden is prepared to renegotiate a nuclear deal with Iran, Israel's unstable political situation may be a problem. Most importantly, your scribe's fears center on Taiwan.
- Finally, vaccines and the low adoption rate in some countries.

We will stop at the last point. Indeed, if the 1970s were marked by perpetual Stop & Go of central banks, constantly lowering or raising rates every quarter, it is the turn of health policy to carry out these Stop & Go.

The new vaccine technology and its rapid introduction to the market have raised doubts even within the ranks of the health service workforce.

The side effects that were ignored at the start and the complexity of the supply chain did not help. From the US to China, the population remains divided on vaccination and governments fear making it compulsory.

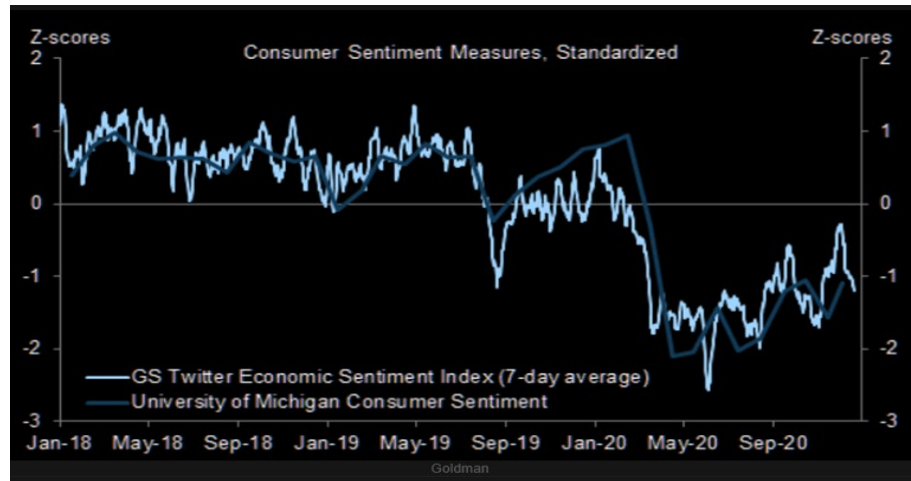
The new strains of this virus raise doubts about the effectiveness of these vaccines in the long term when it would take a minimum of 70% to 80% of the vaccinated population to hope to achieve collective immunity.

At the end of December, many countries are confining, Japan prohibits any foreigner from entering its soil, and even China is talking about the return of clusters. Globally, many economic sectors will remain completely closed until January 20.

Despite the cash amassed, it seems consumers have already realized that central bank actions and the will of government plans have only pushed back some deadlines without solving the fund issues.

The symbol of this ubiquitous situation is the dichotomy between the most accommodating monetary conditions in history, while the conditions for obtaining loans have only tightened.



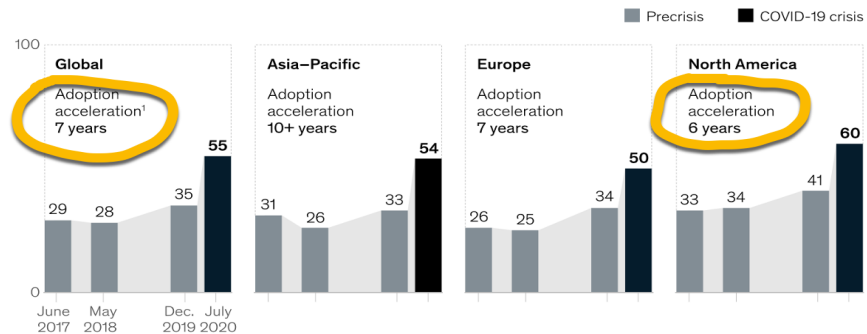


The "all-in" strategy can work with humans, but a virus has no mood, it just follows its evolutionary path without worrying about the rest.

If from an ecological point of view, the fact of betting on all electricity is not the viable solution in the long term, the same goes for any health policy solely focused on vaccines, without developing in parallel or the tests, nor the drugs ...

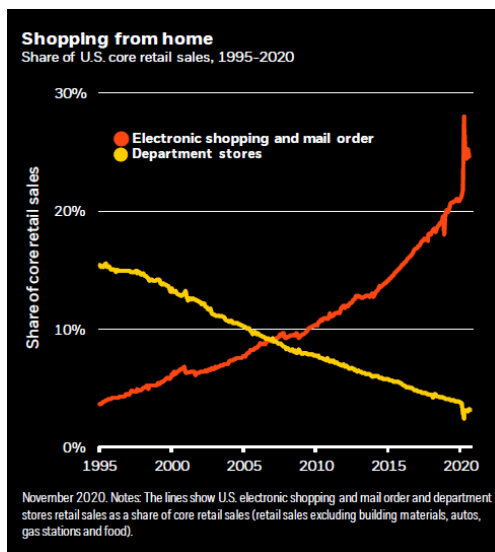
We will have a recovery, but it will be more chaotic economically and socially than that depicted by the rise in the prices of financial assets. The forced digitalization of our economies will leave traces socially as the movements have been violent, as shown by the following two graphs.

Average share of products and/or services that are partially or fully digitized, %



\*Years ahead of the average rate of adoption from 2017 to 2019.

McKinsey & Company



The recovery should therefore be in the shape of a square root with a risk of turning into a W if the vaccines are disappointing.

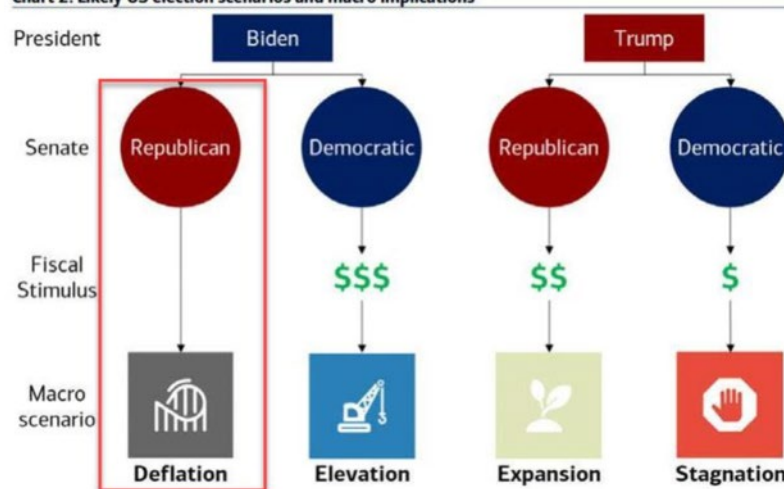
The infection in the global economy would not appear to be waning as quickly as strategists anticipate.

## 2 – Biden: Post-Trump Era = complete shift or simple transition? The USA are back in the game? (Dollar? US equities? Treasuries? Overweight ?).

Europeans still do not understand that the American political system is parliamentary and not presidential. This means that the senatorial elections of January 5 are almost as important as the presidential elections of last November.

The fear of deflation is already built-in and the smaller size of fiscal stimulus could push the dollar higher.

Chart 2: Likely US election scenarios and macro implications



Source: BofA Research Investment Committee

If the Tea-party imploded the Republican party, the current led by Bernie Sanders could implode the Democratic camp. Indeed, Camp Biden's seated majority is slim (29 seats) in the House of Representatives and we still don't know if the Republicans will be able to retain control of the Senate.

On some issues, Democrats may have to make concessions to the most extreme clans, causing a major reaction from financial markets.

To answer the question posed, we will have a transition rather than a political revolution. It was Congress (with the Democratic majority in the House) that voted for arms sales to Taiwan, the plan to ban Huawei, and above all, it was Congress that voted the Tariffs on Chinese imports ...

The only certainty is that the United States is back in the game and geopolitics will be at the service of the economy, and vice versa. This is the basis of your scribe's geopolitical concept: verticalization.

To schematize where the United States is, and part of the world, we have to draw a parallel with the 1970s. On a generational level, we will also experience a demographic earthquake with Millennials replacing Baby Boomers ...

70's	Now
<b>Géopolitics</b>	
<p>The period was the height of the Cold War. The world was emerging from the Warsaw spring, the Russian missile affair in Cuba, the Vietnam War was raging, the Khmer Rouge was reigning terror in Cambodia. China is largely absent from the international scene.</p> <p>The Gulf countries are using oil as a geostrategic weapon and are plunging the West into a wave of economic crises.</p>	<p>Geopolitical tensions are also at their peak. The US fears China will invade Taiwan; Iran and South Korea unleash their nuclear program; the number of populist leaders has reached a record high.</p> <p>We don't have the same military interventionism as in the 1970s, but the Tariffs have initiated the same kind of geopolitical tensions. Without forgetting, the war in Syria and its population movements.</p> <p>China's place is one of the only real differences. It replaced the USSR in the bipolar tension chessboard of the 1970s.</p>
<b>US Politics</b>	
<p>Nixon, a compulsive liar, gets re-elected, but Watergate provokes his "impeachment".</p>	<p>The current president could be re-elected and fall under the blow of impeachment launched by the Attorney General of New York ...</p> <p>In the end, he was not re-elected, but American political observers were so tense he seemed to cling to his seat.</p>
<b>Sociology</b>	
<p>These years are marked by ethnic clashes in the USA. The KKK attacks the black community (bombs in schools for example).</p>	<p>Many demands of the Black Panther Party are still relevant today and are taken up by the Black Lives Matter movement.</p>



<p>The Black Panther movement crystallizes the demands of the black minority in the USA. He hijacked a plane in 1972.</p> <p>The "red fear" distilled by the McCarthyism of the 1950s is still present, students are shot dead on campus by the police.</p> <p>The early days of computing allowed for large-scale population mapping, deploying the system set up by Hoover.</p> <p>IBM was 10 years old in 1971 and the first servers appeared to pose the problem of human/machine interaction.</p> <p>At the same time, the environmental movement is taking off. This marks the beginning of the fight against nuclear power and the more or less violent demonstrations for a more ecological world.</p> <p>Emancipation of women. Feminist movements are taking off.</p>	<p>White supremacists easily expose themselves in public. Interracial protests often result in deaths.</p> <p>The fear of China is distilled by the power in place. We have gone from "red fear" to "yellow peril".</p> <p>Facebook is becoming the logging and tracking software that Hoover would have loved. Also, it is fed by the population, and willingly ...</p> <p>AI is developing at high speed posing the issue of augmented man and man's place in a new uberized and robotic society.</p> <p>The environmental movement is experiencing a revival and takes an important place in politics. Global warming acts as a catalyst for decarbonization.</p> <p>The MeToo movement is born and the voice of women is equipped with legal organizations and weapons.</p>
<b>Economy</b>	
<p>The various oil shocks provoke repeated economic crises.</p> <p>This generates significant inflationary events.</p> <p>At the heart of the disarray in monetary policy in the 1970s was the tendency of a central bank like the Federal Reserve to pursue a "Stop &amp; Go" monetary policy.</p> <p>Monetary policy was a consequence of a central bank's tendency to be sensitive</p>	<p>The Covid caused an unprecedented economic shock, but the trade war between the US and the rest of the world had already paved the way.</p> <p>If central banks are omnipotent due to accommodative monetary policies, they are in the same difficult situation to reverse their monetary policies.</p>





to the shift in the balance of public concerns between inflation and unemployment. The Fed was boosting employment in the "Go" phase of the cycle until the public worried about rising inflation.

Then, an aggressive interest rate policy launched the "Stop" phase of the cycle to bring inflation down, while the unemployment rate rose with a lag. Public support for interest rate hikes evaporated once the unemployment rate started to rise, so it was politically difficult to reverse a high rate of inflation.

These years have laid the foundations for the rate cut policies that we are experiencing. They marked the beginning of the bond rally from the 1980s to the present day.

Financial markets have replaced public concerns, but they are still so dependent on non-monetarist considerations.

The fight against deflation replaced the fight against inflation of the time, which means that we could return to an inflationary environment, difficult to control in the event of "success" ... Besides, the reference basket measuring the inflation is biased, because it does not include health and school costs, as well as rents ...

The switch to negative rate is now causing certain disarray, raising the question of complete nationalization of global finance, or an end to the bond bull market (which means the end of the perpetual fall in rates) initiated in the late 1970s.

But the monetary "Stop & Go" is replaced by the procrastination of health policies, releasing and then confining the economy alternately ...

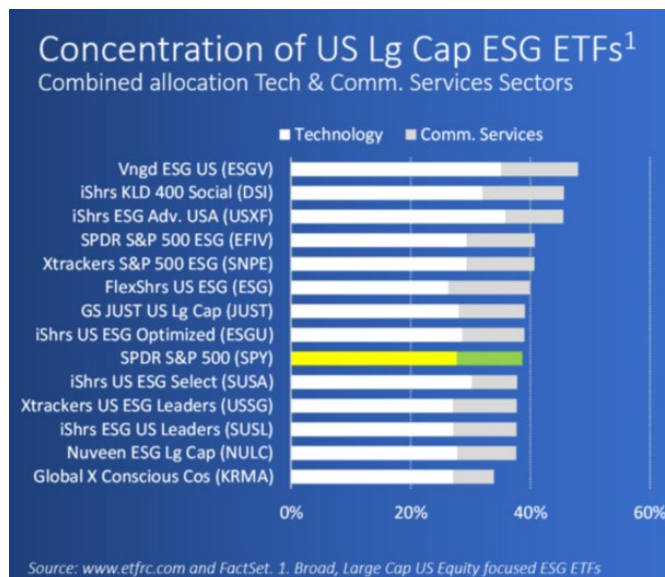
(Source GMI – 09/02/2020)

At the end of the 1970s, the USA became the world's leading power and the coming decade will see only China come to challenge this position and no other country.

Therefore, US equities are preferred, but not "long-only" due to the extravagance of valuations of certain technology groups and the concentration of these values in equity indices. This relative caution is only appropriate at the start of the year.

The difficulty in switching from plans to support the economy should not be diminished. 17 million Americans are not up to date with their mortgage payments (rent or loans) and 33% could lose their homes over the next two months ...





The main problem with the equity markets in the United States lies in attacks by regulators as well as parliamentarians against the FANG.

In a world where budgets are ravaged by the Covid crisis, it will be necessary to go find the money somewhere ... But the weight of FANG in the indices is enormous.

The Fed will have to manage a wall of bond maturities, in addition to the wall of zombie company debt it holds at arm's length. We must focus on short bond maturities and be selective in the High Yield.

The dollar is under tremendous pressure due to the near historic amount of short positions. However, it is not certain that the Democrats can control the Senate, which will reduce the scope of future tax plans.

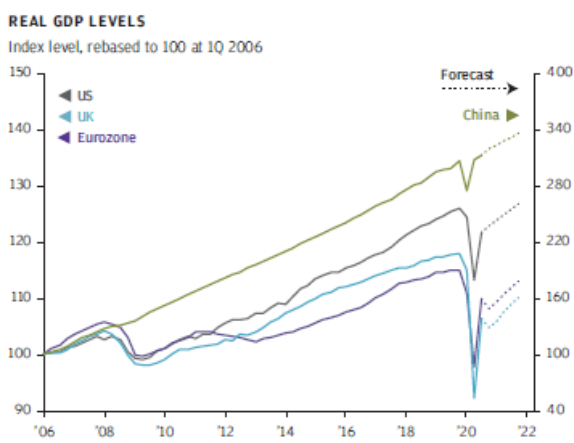
Moreover, the Fed cannot control the dollar as well as its bond and equity markets. If it wants to continue its accommodative policy, it cannot afford an inflationary shock caused by a fall in the dollar, for example, especially if it is the Yuan that benefits.

This vision of a momentary halt in the dollar's decline will raise the question of the allocation to emerging countries.

### 3 – China: The new leader or the eternal second? Taiwan? Xi Jinping’s targets (double the GDP, decarbonization)?

China is the big winner of this year 2020. It will present the only economy to be able to post a positive GDP in this year hit by the Covid crisis, and the trade balance with the United States will never have been so in surplus.

Exhibit 9: China's bounceback has been extraordinary



Source: BEA, Bloomberg, Eurostat, National Bureau of Statistics of China, ONS, J.P. Morgan Asset Management. Forecasts are from Bloomberg contributor composite. Data as of 17 November 2020.

China has finished the job started by the United States of partially erasing Europe from much of the geopolitical and technological chessboard.

Geopolitically, China has taken the place of Europe and in Asia, it will try to impose its presence. Beijing is considering a radical overhaul of the electoral committee that chooses Hong Kong's chief executive by removing the 117 seats likely to be controlled by opposition district councilors to wipe out their influence in the 2022 leadership race.

The American fleet is becoming more and more “invasive”, at least more visible, in the China Sea. The Chinese Foreign Minister has warned the Trump administration to stop the current policy targeting Chinese and Russian groups.

Taiwan is the point of friction between the two giants. The island has a gem, TSMC. The Covid crisis, and especially Trump's trade war, have highlighted a gaping hole in

China's sovereignty within its technological Supply Chain. However, the TSMC group alone can fill it.

The objective of doubling the GDP is logical as the lag of China in terms of GDP / inhabitants remains significant compared to the United States. Decarbonization is a political axis, but also a vital need, as the country is hit by climate change.

China's massive Three Gorges Dam was on track on August 20, 2020, to hit record water levels as torrential rains caused heavy flooding up the Yangtze River. China paid a high cost of at least \$ 29 billion. The floods affected nearly 70 million Chinese citizens in 28 provinces.

Because of Thucydides' principle, the place of China cannot be realized without tension on the geopolitical level. However, if it manages to manage the problem of its real estate sector, the next decade could well be in its favor, also supported by the economic strength of Asian countries.

For your scribe, Chinese real estate is the collateral for its GDP growth. This sector accounts for 60% of Chinese household assets and 58% of billionaires in this sector are from the Middle Empire.

For the moment, Hong Kong concentrates all the risks in the real estate plan and the authorities continue to regulate the sector in order to force the developers to be more rigorous as regards the financing of the projects.

Politically and economically, this sector cannot and must not fall. Beijing will do whatever it takes to keep it standing.

Regarding bonds, repayment defaults have fueled fears in this asset class. Your scribe would like to point out that these same worried investors did not ask themselves this kind of question when the country had no defaults ... Rather, it was the previous situation that was abnormal.

Here again, the authorities and regulators have forced companies to improve their reporting and above all, the fact that they are qualified as SOE (State Owned Enterprise) does not mean (except in the Western unconscious) that their debts are guaranteed. by the state...



The 3 main axes of the last plenum are clear:

**Dual circulation, reform of market factors, governance**

Expect to hear a lot more about some relatively new buzzwords, especially dual circulation, market factor reform, and governance, as well as older ones such as structural reform on the offer side that first appeared at the end of 2015.

President Xi Jinping unveiled the "dual circulation" strategy at a Politburo meeting in May. While no concrete details of the strategy have been released, broadly speaking, it is about making the economy more dependent on 'internal circulation', the domestic cycle of production, distribution, and consumption, for its own development, while being supported by "external circulation", which relates to international trade and investment, as well as to China's ties with the rest of the world.

**More GDP growth targets?**

The 14th FYP is especially important for the next stage of China's economic and social development, as 2020 marks the end of the country's decades-long goal of achieving a "moderately prosperous society in all respects." It is a traditional concept dating back to Confucian times to describe a society with a thriving middle class. It has been fine-tuned and updated over the years and it was fleshed out with concrete goals at the 18th Communist Party Congress in November 2012: to double gross domestic product (GDP) and per capita income from 2010 to 2020, and eradicate poverty. The goals will have to be achieved just before the 100th anniversary of the party's founding in 2021. And then double it again by 2035.

**More attention to consumption**

China has for many years emphasized the importance of increasing domestic demand, especially after the 2008-2009 global financial crisis. But the focus has been on infrastructure and real estate investment with much less support for household consumption, which is a longer and more complex problem to solve.

The most important thing during the last plenum is the lengthening of the temporality of the economic plans. The five-year plans remain, but they will form, as of the latest, part of a plan covering the next fifteen years.

Your scribe points out that the Chinese authorities will not have the same regard for digital giants as Westerners. Just look at what they did to the Alibaba Group and its subsidiary Ant Financial ...

This is to be taken into consideration when investing in China. This will remain our preferred investment zone through the China Better Life and China Decarbonization 2060 themes.



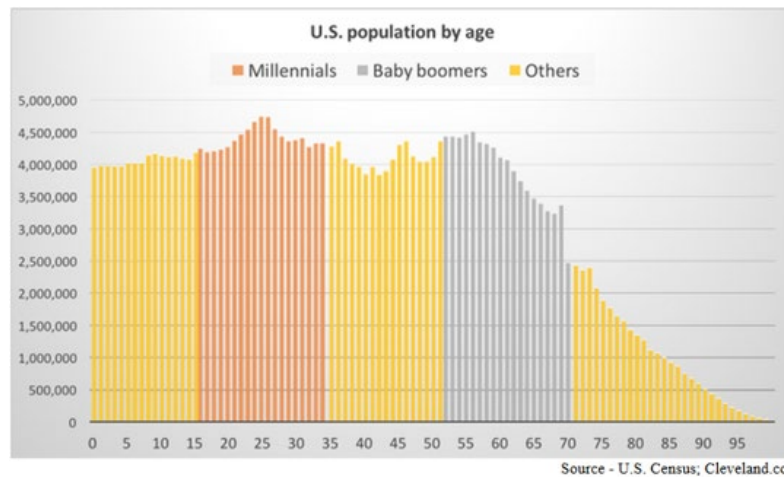
Due to the appreciation of the Yuan, Chinese A bonds and stocks should also be favored.

China is also helping to address the issue of cryptocurrencies. Your scribe still believes that BITCOIN and, why not, Ethereum, are interesting sources of diversification.

But China has moved to the next level by having carried out a double test of its Digital Yuan this year. Your scribe is convinced that central banks will impose such currencies in order to be able to trace and tax all the financial flows of the country.

#### **4 – Liquidity Binge: MMT or Reset? Good for all assets, including Private Equity?**

The question that the markets will ask themselves, in a few months, will focus on the switch to MMT, or not, of the monetary policies of central banks. In addition to the Covid plans to be funded, the demographics only accelerate the funding deficits of social security and pension schemes.



In this context, while money creation has peaked, velocity has collapsed. MMT, by distributing liquidity directly to consumers, could bring velocity back to life, but de facto creating an inflationary environment, thus pushing central banks to hike rates, causing the end of the bond bull market, and causing the Great Rotation towards actions ...

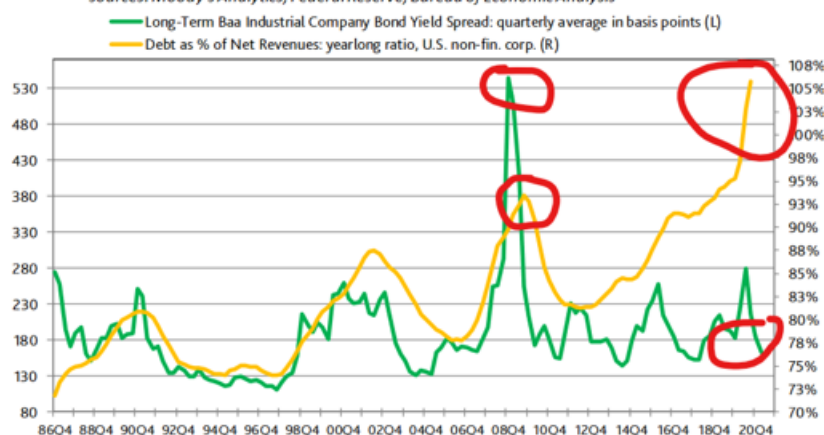


But, like in a car engine (with an "old" internal combustion engine, not electric), any change in speed is preceded by an explosion ...



**Figure 2: Drop by the Ratio of Debt to Net Revenues May Help to Contain Long-Term Baa Industrial Bond Yield Spread in 2021**

*sources: Moody's Analytics, Federal Reserve, Bureau of Economic Analysis*



It doesn't seem to worry anyone that leverage, represented by the Debt / Net Income ratio, is at an all-time high since 1986 and 12 percentage points above the record of 2008, while credit spreads are at their lowest. (see the graph above)...

While the leverage illustrated above will create opportunities for distressed debt managers, it should be noted that the amount of debt rated below Investment Grade has more than doubled since 2007, reaching \$ 5.3tn ...

But your scribe believes that Private Equity is a source of interesting returns on investments. Due to ever more restrictive regulations and the presence of private investors in listed markets, the number of companies using the stock market will continue to decline in favor of companies remaining in the private sector, or returning to it.

As a result of monetary policies pushing trillions of dollars in bonds into negative interest rates, investors will increase the share of the alternative. Equity risk should be considered globally, so if equities are preferred, Private Equity must also be.

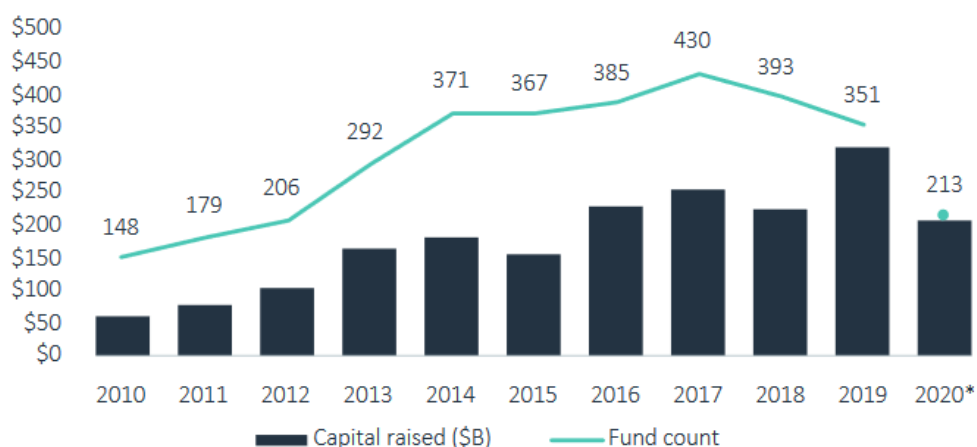
According to PitchBook, the Private Equity industry will have to raise more than \$ 330bn in 2021, surpassing its 2019 record. The boom in listed equities observed since March 2020 is likely to be a boon for PE managers, thanks to a mechanism known as the reverse denominator effect.

As the value of other parts of a recipient's portfolio increases in value, the commitments needed to maintain a target allocation to the PE increase along with it.



In November, the Federal Reserve affirmed its intention to continue its asset purchase program, which should encourage investors to turn to risky assets, including the PE.

### PE fundraising activity



Source: PitchBook | Geography: US

The two main reasons for the acceleration of PE deals are:

- Maintaining sustained valuations. The S & P 500 is now trading at a cycle-adjusted price-to-earnings ratio (CAPE) of 33.071 due to a plethora of factors including monetary easing, widespread risk appetite, and the emergence of large growth-driven companies that trade at high multiples of income, not to mention earnings. On the private side, the median EV/EBITDA multiple for buybacks was 12.7x until Q3 2020, tying its record. The use of leverage in 2021 will be propelled by low-interest rates, strong demand for high yield debt, and a glut of dry powder in direct loan funds.
- Hundreds of large listed companies are grappling with the economic burden caused by the pandemic. This economic strain has forced many companies to put all options on the table, including the sale of non-core businesses. Adding further to the tension, many of these large companies increased their debt load at the start of the pandemic, hoping that this leverage would get them through this crisis. These same companies see their revenues continue to come under pressure nine months later and do not want to risk becoming over-indebted. While many large companies are struggling, PE companies have raised hundreds of billions of dollars and are resting on around \$ 1tn of dry powder. These PE firms saw this available liquidity rise throughout the crisis as traditional LBO activity declined, but

fundraising remained healthy. PE firms are now looking for massive transactions to quickly spend that pile of cash. When releasing the company's third-quarter 2020 results, Carlyle CEO Kewsong Lee said the company is busy working on a lot of large divestments, which means there are plenty of other venture capitalists on the move, probably in the same boat.

For the first time since 2010, fundraising in Private Equity compared to those preceding the Great Financial Crisis of 2008. What is true in the USA is true for other regions in the EP.

Your scribe sees the advent of MMT as nationalizing the world economy, which is not to the liking of large multinationals. However, any political party needs funding... This means that we should go through a reset or a massive bear steepening.

Inflation is the only data that is difficult for central banks to manage (the BOJ has spent its last 20 years trying to create inflationary conditions without succeeding), yet debt and leverage have become so extreme that currencies could also serve as the last adjustment variable. These are also difficult to control by central banks, as the currency markets are so deep.

Due to the duration effect, multiplied tenfold by zero or even negative rates, the inflation/currency pair is explosive, raising fears that a small upward variation in rates could have serious consequences.

Thus, Private Equity, because of the long-term nature of its investment process, allows it to be decoupled from market cycles.

## 5 – Inflation: the awakening of the tiger?

This question was already in our 2020 strategy. Indeed, the pandemic linked to Covid-19 only revealed the problems that already exist, both in our societies and in our



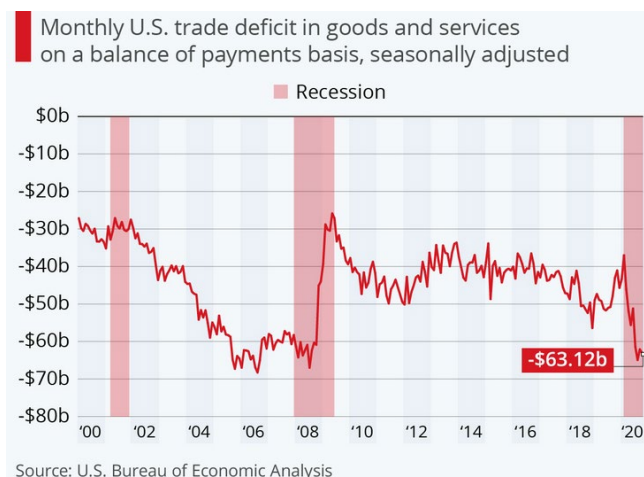
economies. The disconnection from the financial markets is solely due to the actions of central banks and the increase in retail trading.

Your scribe still believes that the three deflationary forces addressed in the 2016 strategy are still present:

- Aging of the population
- Uberization / Digitization
- Robotization

However, we have several new phenomena, some of which have been accelerated by the pandemic:

- Disruption of the global supply chain. For more than 20 years, multinationals across the world have taken advantage of globalization to optimize their Supply Chain. This coincides with the entry of China into the WTO at the turn of the century. But in 2018, the Trump administration launched a trade war against China in an attempt to reduce the trade deficit between the two countries.



Any disruption in the global supply chain inevitably leads to higher manufacturing costs.

- **Nationalism and reindustrialization.** The shock wave of the trade war between the USA and China encountered economic-political conjunction: that of the rise of populism with in parallel the awareness of the dependence of developed economies on certain emerging countries (China and India in

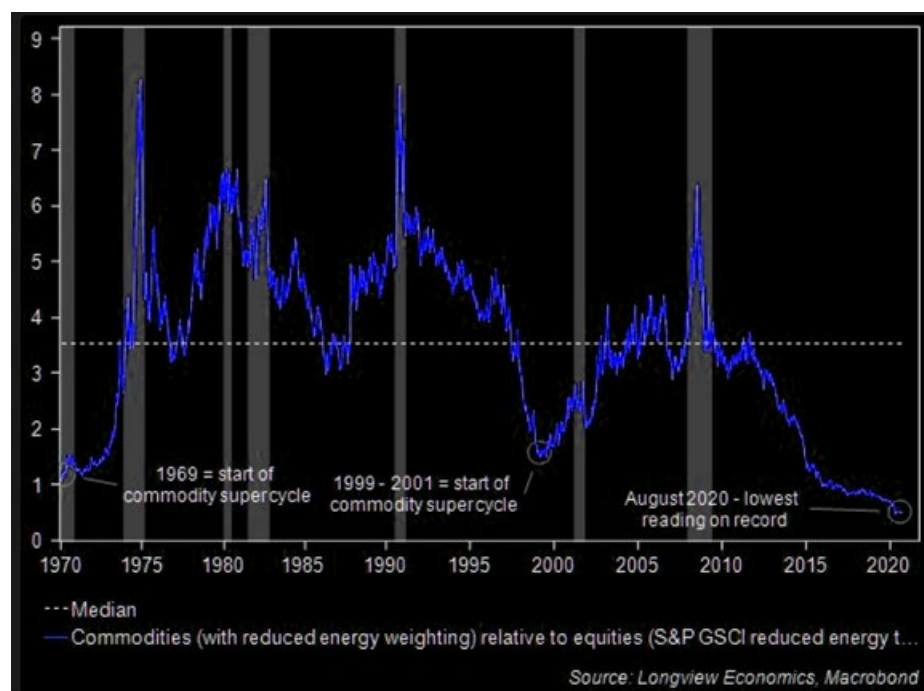
particular ) in sensitive areas such as high technology and the pharmaceutical industry.

Reindustrialization carries two important genes for inflation:

- o The emergence of smaller local actors, therefore less efficient in terms of economies of scale or supplies.
- o The reduction in the number of suppliers leading to less price competition, or even commercial agreements to “guarantee” margins.

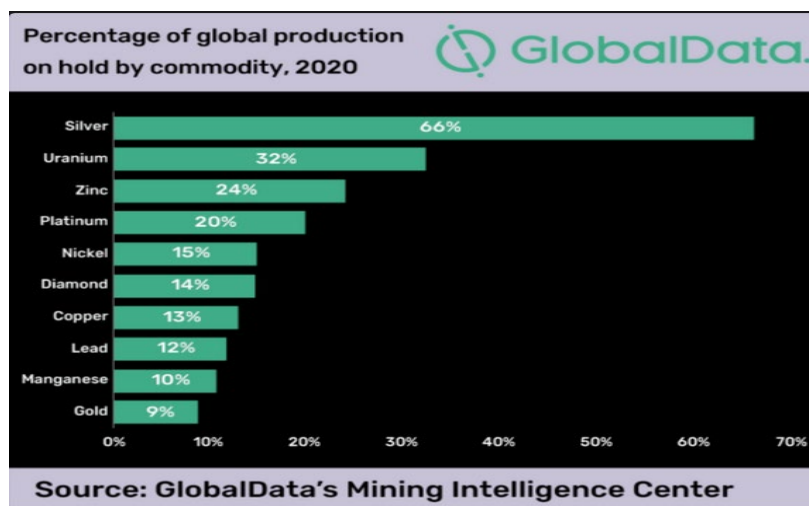
- **Rising commodity prices.** De-globalization and the emergence of new technologies will lead to an increase in the prices of raw materials. But the climate is not to be outdone.

Technically, the underperformance of commodities vs stocks seems to be coming to an end.



New technologies have increased interest in certain “non-traditional” commodities, leading to upward pressure on prices. Too often forgotten, due to the weight of services in our GDP, raw materials remain essential to manufacture our mobile phones, our server fields for the Cloud, and antennas for 5G for example.





The climate is also a component that should not be minimized. In addition to policies fighting against global warming, propelling renewable energies to the fore, climatic disorders induce uncertainties on crops, pushing up the prices of agricultural raw materials.

While fossil fuels have not finished undergoing pressure from climate policies, agricultural commodities and metals (including rare earths) will experience a new craze linked to three factors: low rates disrupting asset allocations; the advent of electrical energy (including hydrogen and uranium); infrastructure plans.

As we will see for the calculation of PPI and CPI, the construction of the global commodity indices is biased. Indeed, oil still accounts for 40% to 50% of the major global indices.

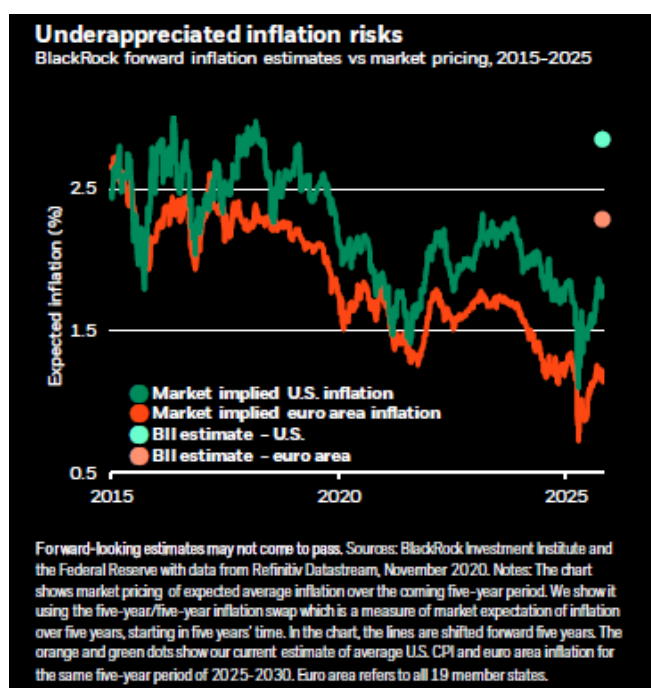
- **"Error" in calculating inflation.** We do not have the correct measure of inflation. Indeed, for political reasons, PPIs and CPIs are disconnected from the components that impact consumers around the world. Medical and insurance costs, the cost of education and real estate, and food prices do not have the representative weight of household budgets.
- **Impact of the ESG theme.** If the methodology for calculating ESG rankings has progressed to make both in the methodology (non-integration of the manufacture of batteries for Apple or Tesla for example) and its harmonization, the appeal is undeniable.

Your scribe has already written about the construction biases of these indices favoring growth stocks, and technology stocks in particular.

However, due to the generational shock (millennials and generation Z vs baby boomers), the appeal of this theme will only grow.

According to the SIF American Foundation's 2020 Biennial Report on Sustainable Investing Trends and Impact in the United States, sustainable investing assets now total \$ 17.1tn or 33% of total US \$ 51.4tn in assets under management in investment funds, a jump of + 42% compared to 2018, according to the MarketWatch report.

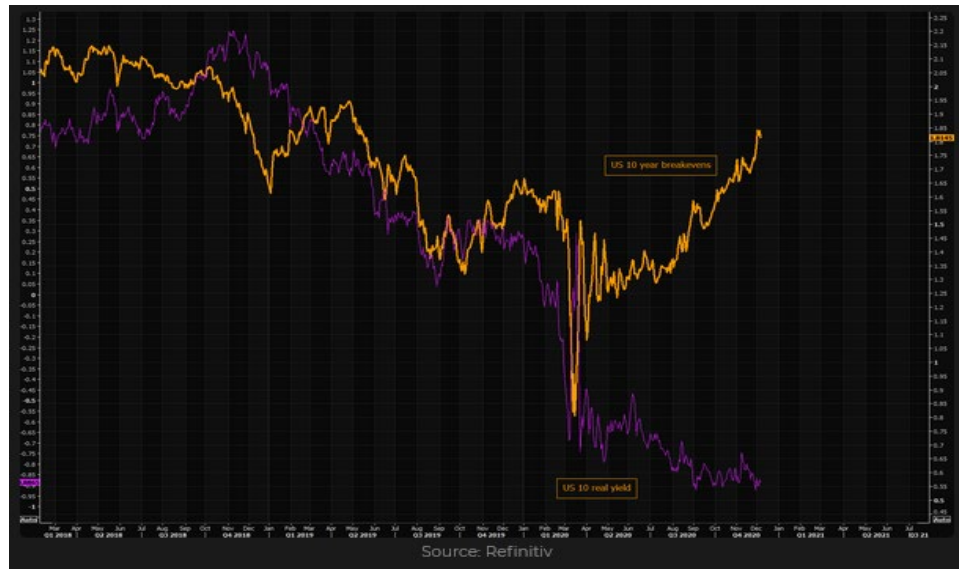
But looking at the world exclusively through ESG will force companies to adapt to this new dictate, pushing up production or service costs.



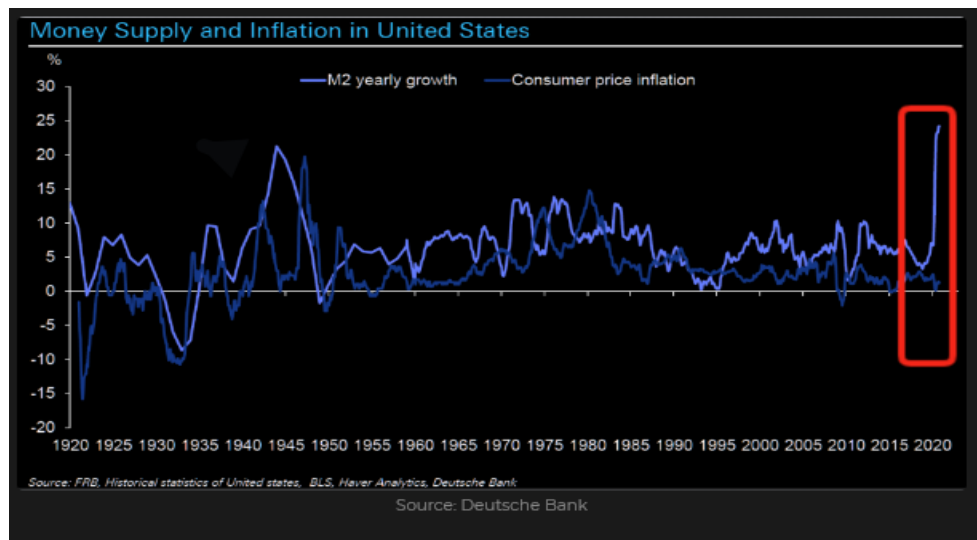
Inflation is a tiger in a cage that you want to get out of. Usually, the trainer has to get into the cage to dislodge it, which usually goes pretty badly. And once outside, in freedom, the tiger becomes difficult to control ...

History suggests that the risk of inflation is greatest when the conviction of low inflation is strongest and the view is entrenched in intellectual and political frameworks.

Already the Breakeven in the United States is beginning to incorporate a paradigm shift that neither PPIs nor CPIs, with the current calculation methodology, will indicate in time.



In addition to supply chain disruptions, reindustrialization policies and rising raw materials, monetary policies will have their share of responsibility ...



In addition to supply chain disruptions, reindustrialization policies, and the rise in raw materials, monetary policies will have their share of responsibility ...





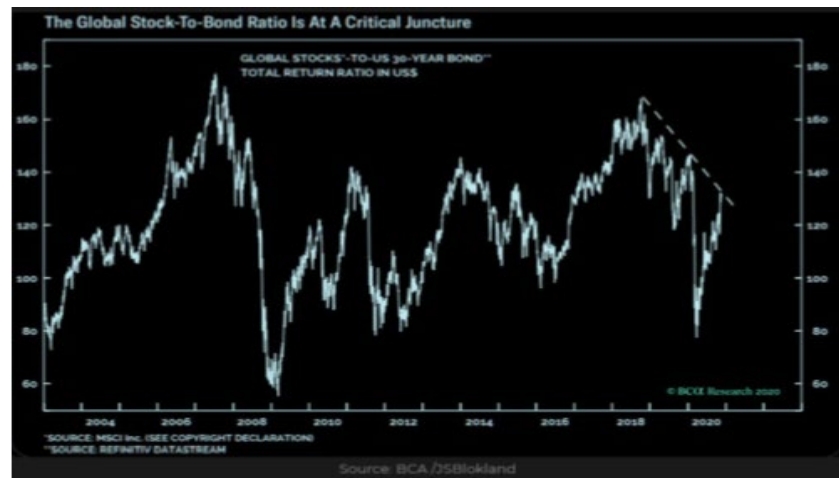
Breakevens and commodities are the main assets benefiting from rising inflation. Gold and silver are the metals to focus on in an allocation to accommodate rising inflation.

The currencies and financial assets of emerging countries exporting these raw materials are also to be favored: Brazil, India, Australia, Peru, Chile, Canada, South Africa, Malaysia, Indonesia, and Russia.



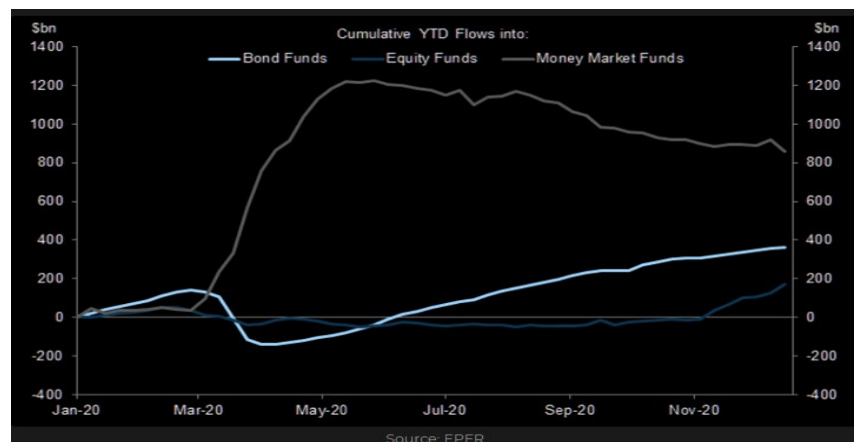
## 6 – Bonds/Equities: Crossroad or Collision course? Still, need to be Barbell?

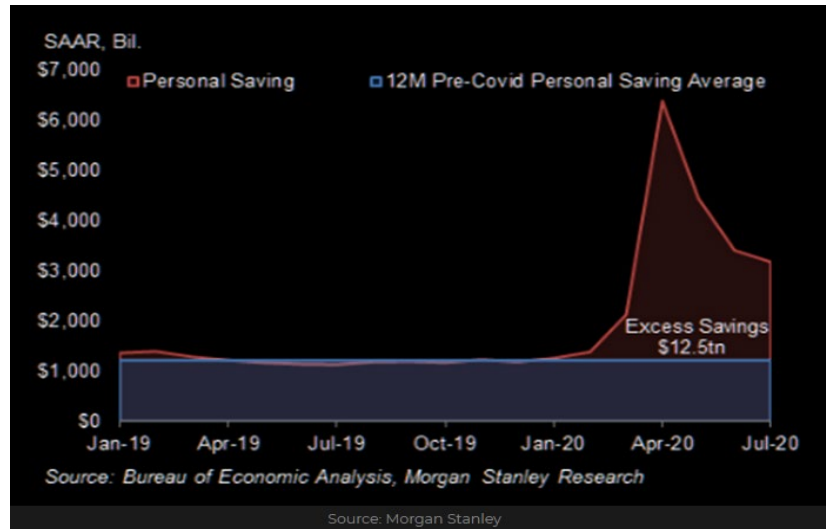
This is the most important graph of 2021 for your scribe.



The main problem with this question lies in the capacity of the future equity markets to supplant the bond markets without going through a massive correction.

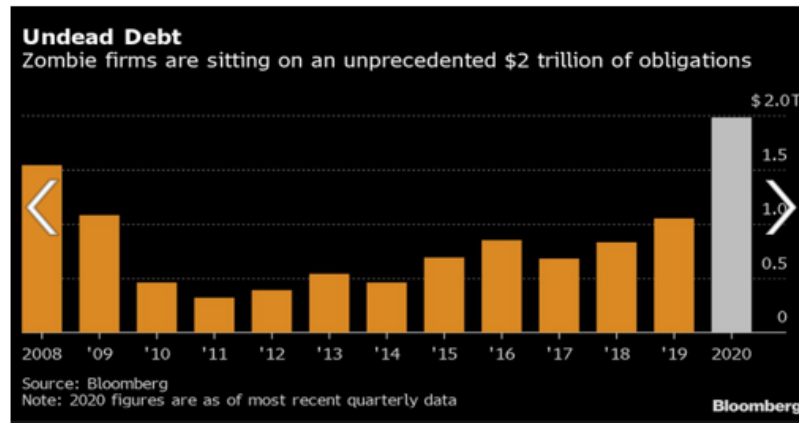
For your scribe, it is necessary to remain Barbell, a massive correction being to be feared at the beginning of the year, and this in spite of two important facts allowing to consider the risky assets as frequentable: the liquidity of the central banks (+ 25tn \$ of liquidity since 2008) and the excessive liquidity of corporate treasuries, money market funds and households.





Yet both the valuations of the S&P500 and the amounts of debt “supported” by zombie companies, are extreme.

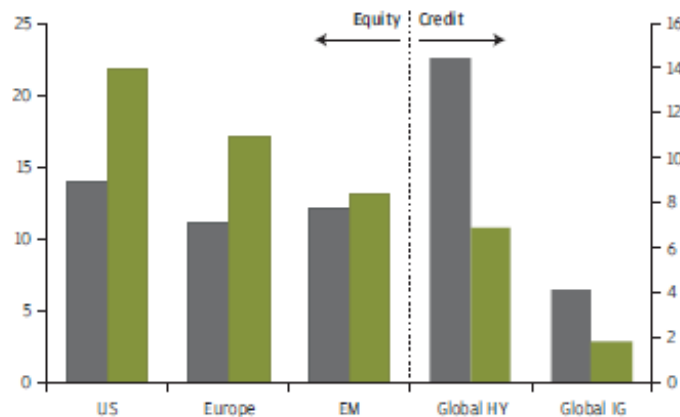




**EQUITY AND CREDIT VALUATIONS AT THE START OF THE CYCLE**

x, multiple (LHS); % point option-adjusted spread (RHS)

■ April 2009 ■ May 2020



Overall, valuations are richer than during the 2009 crisis, and this for all risky assets.

Source: Bloomberg Barclays, ICE BofA, MSCI, Refinitiv Datastream, Standard & Poor's, J.P. Morgan Asset Management. April 2009 and May 2020 mark the start of the last two US cycles as defined by the trough in earnings per share estimates. US: S&P 500; Europe: MSCI Europe; EM: MSCI EM; Global HY: ICE BofA Global High Yield; Global IG: Bloomberg Barclays Global Aggregate - Corporates. Data as of 17 November 2020.

The performance of gold and silver, combined with that of Bitcoin are signals that investors should not obey, this movement will continue into 2021.

As on the economic front, will we have a restart or a reset on asset allocation? The subject was discussed economically in the first point. But it looks like the 60/40 allocation may not work in such volatile markets.



This leads to an interest in bond assets with short durations.

#### Interest Rate Risk Potentially Makes Shorter-Duration Assets More Attractive

(Fig. 6) Yield versus interest rate risk (duration)



As of November 30, 2020.

**Past performance is not a reliable indicator of future performance.**

Sources: T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved, J.P. Morgan Chase & Co., and Bloomberg Barclays (see Additional Disclosures).

Floating Rate Bank Loans – J.P. Morgan Leveraged Loan Index; Global High Yield Bonds – Bloomberg Barclays Global High Yield Index; Emerging Market Bonds (Local Currency) – J.P. Morgan GBI-EM Global Diversified Composite Index; Emerging Market Bonds (USD) – J.P. Morgan EMBI Global Index; Global Ex-U.S. IG Corporate Bonds – Bloomberg Barclays Global Corporate IG Index; U.S. IG Corporate Bonds – Bloomberg Barclays U.S. Investment Grade Corporate (300MM) Index; Global Aggregate Bonds – Bloomberg Barclays Global Aggregate Index; 10-Year U.S. Treasury – US Benchmark Bond-10 Yr; 10-Year German Bund – Germany Benchmark Bond-10 Yr; 10-Year Japanese Gov't. Bond – Japan Benchmark Bond-10 Yr.

The debts of emerging countries, and companies in these countries, are also worthy of interest, provided you pay attention to the dollar effect or consider them in hard currencies.

The resurgence of inflation and fears of a slower-than-expected economic recovery (cf. the increase in the size of the Zombie planet) reinforce your scribe in his positioning on the Steepeners to protect himself against a brutal movement affecting mainly the long end of the yield curve (mainly the US).

It is necessary to integrate two new exogenous phenomena concerning Treasuries:

- Positive correlation with credit due to the regulation of Mutual Funds, forcing them to increase their liquidity reserves, invested mainly in Treasuries. Due to their daily liquidity, the slightest credit shock leads to massive and immediate sales of these reserves.
- The main buyer, China, has fallen behind in recent auctions.

To come back to stocks, we have to go back to 1950 to have such a large spread of the dividend yield of S & P500 stocks vs. bonds. If it is estimated that the trillions of liquidities will not be withdrawing anytime soon, it will be necessary to be imaginative about the asset allocations of this new decade.

On stocks, your scribe places visibility first. China, without question, offers the best visibility being a state-run economy. It is necessary to integrate:

- The appreciation of the yuan,
- The possible normalization of the monetary policy of the PBOC (which worried the OECD and the World Bank).
- Xi Jinping's desire to double the country's GDP over the next decades
- To decarbonize the Middle Kingdom from 2060

The United States comes in second place. We have developed the subject in a previous chapter. Even if Biden is not a magician, the elasticity of its economy and the labor market will allow the country to offer correct visibility to investors on the condition of being Barbell (long action / long Vix), or Long / short between sectors or styles.

In this context, "Value" stocks will represent protection in the event of a correction, but we will have to quickly come back to growth stocks as soon as the storm has passed. Themes such as renewable energy and infrastructure will also be appropriate for an exhibit in the United States.

Regarding Europe, your scribe is still not convinced of the consensual vision. The € 750bn plan is still not implemented, there are still gray areas in the Brexit agreement (validation by the European Parliament and this two months after its entry into force ...), and social tensions are only 'asleep. But the chaotic management of the pandemic could rekindle old European demons ...

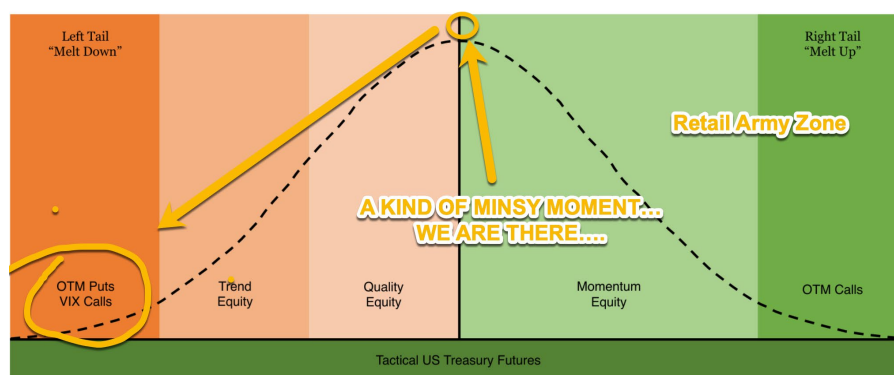
As a result of the ECB's action, which closely resembles what the BOJ has achieved, the government bonds of peripheral European countries may still have some performance reserve. Unlike the US, it would be interesting to extend the duration on European government bonds.

To sum up, and to use Moody's words, in 2021 bonds will be boring at best. And your scribe adds that they could become destructive very quickly if inflation escalates out of control, for example.

Through a "conventional" long-only allocation and our GTO, we will illustrate this investment strategy.

A graph nicely sums up your scribe's thinking about stocks.

#### EQUITY MARKET RETURN REGIME AND CORRESPONDING STRATEGIES



## In summary:

### **Overweighting in equities and commodities.**

#### **In Equities:**

Overweighting in China (long-only or Absolute Return for the GTO)

Neutral weight in the United States (long-short or Barbell for the GTO). Beware of the High Dividend Yield theme, which could suffer from a violent resurgence of inflation.

Overweight in emerging commodity-exporting countries.

Underweight in Europe (short for the GTO)

#### **In commodities.**

Overweight positions in agricultural commodities, gold, silver, and uranium.

Underweight in oil (short for GTO).

#### **Underweight in bonds:**

Underweight Short-duration for the United States (Govies), Long-duration for Europe (Govies).

Favor steepeners on the US curve.

Neutral emerging commodity-exporting country bonds in hard currencies.

Overweight Chinese bonds

#### **Overweighting on alternative investments:**

Bitcoin

VIX

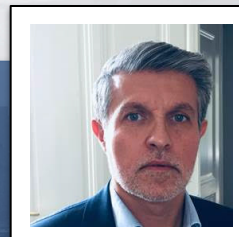
Private Equity by favoring Buyout strategies

**Jacques Lemoisson**



# Outlook 2021

12.28.2020



*Outlook 2021. Not to be forwarded. For professionals only. For personal use only!*

## **Outlook 2021 Disclaimer**

None of GATE Publishing LLC (“GATE Publishing”), GATE-IM LLC (“GATE IM”) or GATE Advisory is registered as an investment adviser under the Investment Advisers Act of 1940, as amended (the “Advisers Act”), or the securities laws of any state or other jurisdiction, or in any other regulatory capacity. GATE Publishing is responsible for the opinions and content in Outlook 2021. All opinions expressed by Mr. Lemoisson in or through the document are solely those of Mr. Lemoisson.

The investments and strategies discussed in the Outlook 2021 are impersonalized and do not take into account any reader’s particular investment objectives, financial situation, or needs and are in no way tailored to the specific investment portfolio of any single reader.

The information in the GMI is based on data currently available to Mr. Lemoisson, as well as various expectations, estimates, projections, opinions, and beliefs with respect to future developments, and is subject to change. Neither Mr. Lemoisson, GATE Advisory, nor any other person or entity undertakes or otherwise assumes any obligation to update this information.

The distribution and/or publication of the outlook 2021 should not be construed by any reader as GATE Advisory’s (i) solicitation to effect or attempt to effect transactions in securities, or (ii) provision of any investment-related advice or services tailored to any individual’s financial situation or investment objective(s). All content is provided for informational purposes only and should not be construed as investment, tax, accounting, or legal advice, as an offer or solicitation of an offer to sell or buy any security, or as an endorsement, recommendation, or sponsorship of any company, security, or fund... In making any investment decision, each subscriber must rely on its own examination of each investment, including the merits and risks involved, and should consult with its investment, legal, tax, accounting, and other advisors and consultants prior to making any investment. Past performance is not a guarantee of future results.

Capital at risk. This content has been prepared for professional investors only. All financial investments involve taking risk which means investors may not get back the amount initially invested.