DECEMBER 2020

MONTHLY INVESTMENT OUTLOOK

UBP

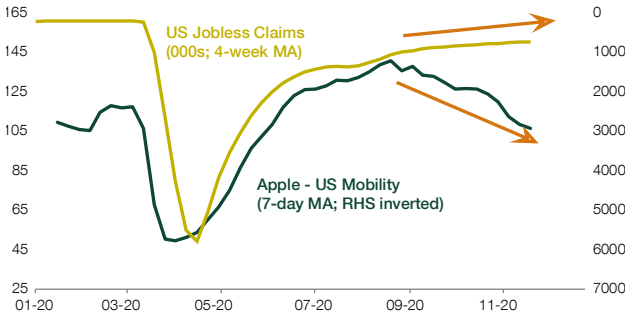
UNION BANCAIRE PRIVÉE

MONTHLY INVESTMENT OUTLOOK

LOOKING AHEAD TO A BRAVE NEW WORLD

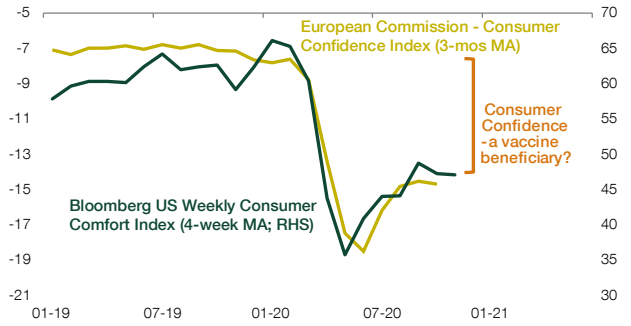
- Global equities had their strongest month of 2020 rallying on the back of the coming prospects for vaccine deployment and reduced risks of rising corporate taxes in the US with the incoming Biden administration.
- This investor optimism has come amidst renewed national lockdowns in Europe and local lockdowns in the United States. In spite of this, mobility trends in Europe have stabilised as have new US jobless claims filings indicating economies are adapting to this new world. This comes against the backdrop of outright economic expansion in China which has broadened to include the consumer.
- With the sooner than anticipated and better than expected vaccine announcements and with economies adapting to this latest infection/lockdown cycle, many of the risks that concerned us entering November have begun to dissipate. As a result, we pivoted our portfolios in late-November to accommodate the prospect of a 2021 cyclical rebound.
- We have eased our portfolio protection strategies in futures and options. We have also closed our long-held underweight in European equities which added significant value for portfolios having lagged our preferred US equity exposure by 21% year-to-date.
- Though this cyclical recovery dynamic will be a helpful tailwind for a number of value-oriented sectors, we suggest instead a selective approach in the value space, focusing on higher quality value names unencumbered by some of the secular pressures present in segments like traditional energy or even banking. High quality mining companies and select industrial names offer tactical opportunities.
- We pair this tactical opportunity in cyclicals with continued long-cycle transformation stories beyond the technology and healthcare narratives of 2020. We expect climate change, digital finance/fintech, and China's domestic transformation to be durable and investible growth storylines in the decade ahead.
- With zero/near-zero interest rates around the developed world, we believe emerging and Asia credit are anchors to income-oriented portfolios looking into 2021. With the dollar weakening story of 2020 set to continue in 2021, investors can also enhance returns via FX markets in the year ahead. For USD investors, EUR strength can augment the attractive carry offered in the European bank hybrid market. Similarly, Chinese sovereign bonds offer a 3% yield combined with currency appreciation potential for attractive total returns for investors.

Diverging activity/unemployment claims = economies are adapting to the pandemic



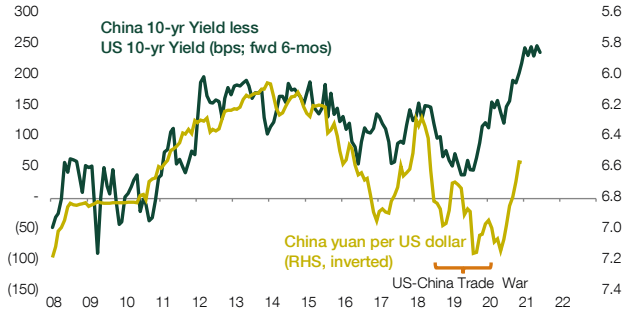
Sources: UBP Economic & Thematic Research

Vaccine deployment may allow for a rebound in consumer confidence in 2021



Sources: Bloomberg Finance L.P. and UBP

Look for FX gains in a USD bear market to augment fixed income returns in China



Sources: Bloomberg Finance L.P. and UBP

GLOBAL TACTICAL ASSET ALLOCATION

REPOSITIONING PORTFOLIOS FOR A BRAVE NEW WORLD

Global economy / Asset allocation

- Global activity should continue to slow down in the remainder of Q4, due to renewed lockdowns, with services the most impacted sector.
- Europe, in particular looks like facing a double dip in Q4, and a significant slowdown is also expected in the US. However, more visibility on US politics, a gradual end to European lockdowns and prospects of a vaccine should fuel a rebound in 2021.
- Budgetary decisions remain in the pipeline, but appear to be held back by political blockage in the US and the EU. In the meantime, central banks look set to continue reinforcing their monetary support as 2020 ends to buy some time for fiscal authorities to act.
- Despite the level of short-term uncertainty, we have pivoted portfolios to accommodate the prospect of a 2021 cyclical rebound.
- As a result, we have shifted from previously favoured asymmetric strategies to more directional strategies. We exited our futures and options strategy as well as some hedge funds to fully deploy our risk budget into equities. We seek to increase our credit exposure as well.

Fixed income

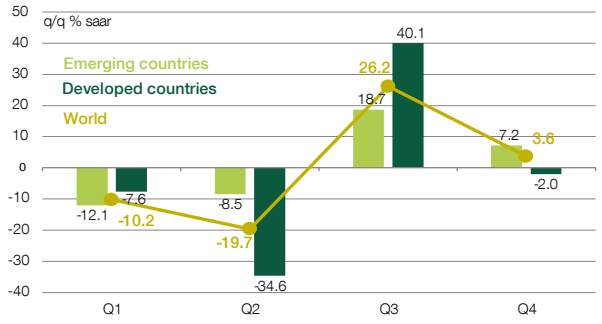
- With the ECB signaling in its latest statement that it would 'recalibrate its instruments' at its December meeting, it may indeed be looking to broaden its toolkit to include the high yield bond market. However, should it not take that step, investors are increasingly asymmetrically exposed to spread widening in the face of a continued default cycle on the continent.
- The global environment strengthens the case for outperformance of the emerging debt market. Existing positions in Asia credit and Chinese government debt have already benefited from the anticipation a global recovery as well as a weaker USD. We expect this trend to continue in 2021.

Equities/ Alternatives

- We have added European equities in portfolios to benefit from their greater exposure to key cyclical stocks and to take advantage of expected EUR strength.
- Gold continues to be favoured with interest rates approaching zero and renewed monetary support expected in 2021.

Double dip in developed countries in Q4-20

World growth in 2020



Source: UBP

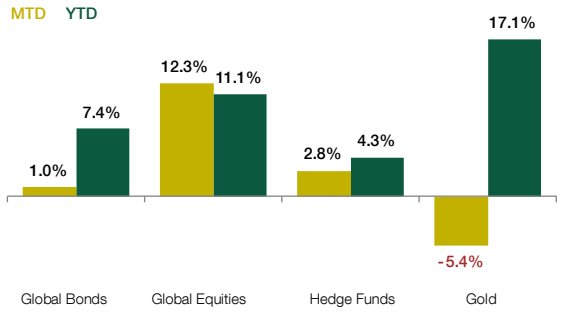
Positive vaccine news led to a rotation into cyclical plays

US Value relative to Growth vs US 10-year yield

Sources: Thomson Reuters, UBP

All assets turned positive for the year

Major Asset Classes Performance



Performance is as end of November 2020
Sources: Refinitiv, UBP

UBP ECONOMIC OUTLOOK

EUROZONE FACING A DOUBLE DIP RECESSION IN Q4-20

Key points

- Downside risks weigh on Q4 growth in several countries due to rising contagion and pressure on hospitals; European activity should contract in Q4, and a parallel slowdown is expected in the US, while Chinese growth remains on a rising trend.
- Despite this, a 2021 sustained recovery is still expected, driven by the US, China and Germany. Vaccines should boost the global economic outlook once deployed and contribute to a more sustained medium-term trend.
- Economic policy is expected to remain highly supportive, even with the arrival of vaccines. More budgetary decisions are expected in the US and accommodative monetary policy seems set to stay in place.

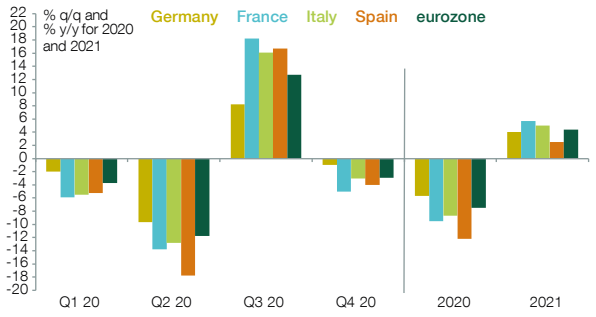
US and China to perform better than Europe in Q4

- With a second pandemic wave, a sharp contraction in activity is expected in Europe where GDP growth is expected to contract in a -2.5%/-1% q/q range in Q4 in the eurozone, UK and Switzerland. A progressive recovery is expected in Q1 as restrictions are gradually eased.
- In the US, activity is losing momentum in Q4, particularly in consumer and services sectors. Nevertheless, Q4 GDP growth should remain positive, in a 1.5%-4% range, and a progressive rebound is expected in H1-21 thanks to more visibility on politics and lower constraints from the pandemic.
- In China, activity remains on a positive trend; after a rebound in exports and in industrial activity over past quarters, consumption should gain further traction, leading to GDP growth potentially above 6% y/y in Q4-20.

Economic policy: further supports in the pipeline

- More budgetary support is expected from the new US administration, initially extending measures in favour of labour, health and local states.
- The Recovery Fund should be available for euro-members in early 2021, while the latest lockdown has cost each country EUR 10-20 bn.
- The Fed and the ECB should extend further duration and purchases of assets at year-end. The delivery of their policy to provide credit to corporates and households is in need of improvement.

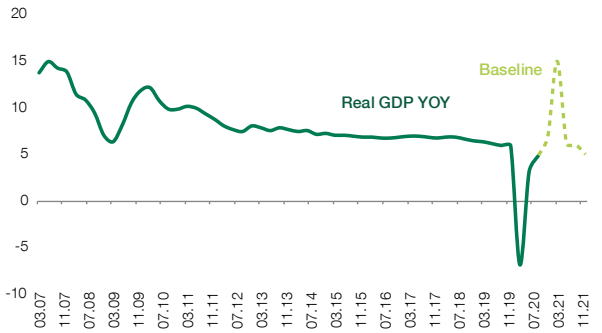
Eurozone GDP to contract in Q4-20



Sources: EUROSTAT, UBP

China growth to accelerate further in 2021

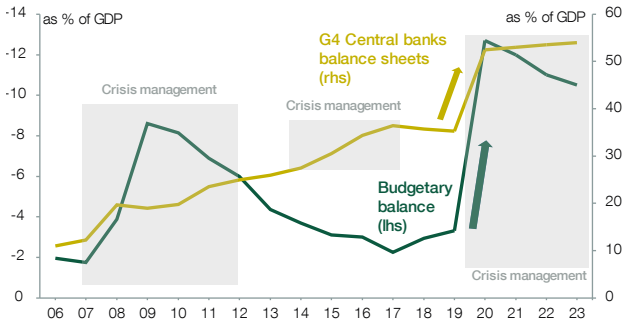
China: GDP YOY and growth scenario



Sources: NBS, UBP

Budgetary and monetary supports to remain in place

Global monetary and budgetary policy



Sources: OECD, Central banks, UBP

UBP ECONOMIC OUTLOOK

A BRIGHTER 2021 ECONOMIC OUTLOOK AS VACCINES ARRIVE

A vaccine to reach full herd immunity

- Virus waves and lockdowns had a deflationary impact on growth and required extreme policy measures from governments and central banks.
- Recent vaccines have brought optimism. However, distribution and acceptance challenges may slow their deployment and the potential benefits to growth.
- Several quarters will be needed to vaccinate populations to achieve full herd immunity. If a vaccine is available in Q1, vaccination will begin with priority groups (health sector, older people) and then extend further to the other groups through the quarters.

A major boost to the economic cycle

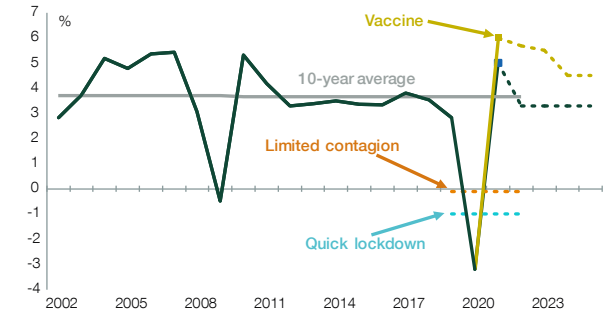
- With a vaccine, world growth can expect a boost amounting to 1 pp of additional growth, on a full year projection based on our scenario. If vaccination begins rapidly, positive effects on growth should be seen globally in H2-21 and more fully in 2022.
- Western countries, and Europe in particular, should benefit the most from vaccine deployment in the current scenario. Services and commodity related countries should also draw support from a brighter outlook. US prospects should also improve, benefiting from local vaccine production and after only a relatively limited recession in 2020.
- In Asia, a vaccine would benefit India, Indonesia and the Philippines, given the number of cases and the share of consumption in GDP terms. Thailand should receive a boost given its wide exposure to tourism. Finally, China should see limited upside potential (0.5-0.8 pp) as a result of existing virus containment and its mature expansion process relative to other countries.

Supportive economic policies to stay in place

- Economic policies should remain accommodative despite the vaccine; budgetary measures adopted should reinforce the recovery and prolong the cycle; public investment into new IT infrastructure and environmental sectors can boost potential growth and so sustain a longer expansion cycle.
- Monetary policy will remain accommodative until growth and employment is firmly anchored. Worries about inflation from central banks are unlikely before 2022.

Impact of a vaccine on full-year global growth prospects

World GDP growth



Sources: IMF, UBP Economic & Thematic Research

Impact of a vaccine on a full-year growth scenario by region

GDP y/y %	2020	2021 Current scenario	Vaccine scenario
WORLD - *MER*	-4.2	*4.6*	*5.6*
- on PPP basis*	*-3.3*	*5.0*	*6.0*
USA	-3.6	4.4	6.0
Japan	-5.1	2.5	3.5
Eurozone	-7.4	4.4	6.1
China	2.1	8.0	9.0
Developed countries	-5.5	4.2	5.6
Emerging countries	-2.0	5.5	6.2

Sources: UBP - Economic & Thematic Research, Bloomberg consensus
MER: market exchange rates; PPP: purchasing power parity

Potential vaccination phases programme for US population

Phase 1: 45 Millions	Phase 2: 105 Millions
Health Workers First respondents Severe comorbid situation Over age 65 (crowded areas)	Comorbid situation Other over age 65 Teachers Workers essential sectors Incarcerated + staff Homeless
Phase 3: 145 Millions	**Phase 4: 33 Millions**
Children Young adults 18-30 Workers important industries and services	Remaining population

Sources: US National Association of Medicine, Goldman Sachs

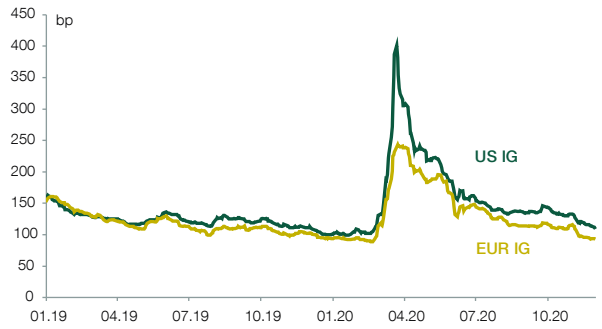
GLOBAL BONDS

SEEKING OPPORTUNITIES TO REDEPLOY CREDIT RISK

- Following the announcement of positive trial results on a COVID-19 vaccine and a reduction in US political uncertainty, sovereign bond yields rebounded in early-November before falling on the prospect of further global monetary easing at year-end. In contrast, corporate credit has been resilient with further spread compression despite a slowdown of credit flows.
- Given the direct intervention of the European Central Bank in investment grade credit markets, the lack of movement with spreads near cyclical troughs is somewhat understandable. However, with EUR high yield spreads still near post-pandemic tights, markets are either pricing in just a passing impact on overall credit quality or the prospect of the ECB following in the footsteps of the Federal Reserve by expanding its bond buying programmes to the fallen angel / crossover market.
- With the ECB signalling in its latest statement that it would 'recalibrate its instruments' at its December meeting, it may indeed be looking to broaden its toolkit to include the high yield bond market. However, should it not take that step, investors are increasingly asymmetrically exposed to spread widening in the face of a continued default cycle on the continent.
- In the US, commentary from Fed officials made a somewhat dovish pivot, as Powell indicated that the Fed may need to ease further. However, with the Fed unlikely to lower rates and policy guidance indicating they will remain low for years to come, extending the average maturity of asset purchases is the FOMC's main option.
- In credit, investment grade and high yield bonds have rallied. Spreads are now approaching the tightest levels seen this year despite the Treasury's request to return unused funds meant to act as a backstop to five emergency lending programmes, including credit programmes. Nevertheless, the visibility provided by the vaccine timeline has allowed the market largely to shrug off this negative development.
- Looking forward, the global environment should remain supportive for credit and strengthens the case for relative outperformance of the emerging debt sector, notably in the Asia credit market which should benefit the most from a global recovery as well as a weaker USD.
- The change in US administration is likely to add some country-specific risk considerations, but overall should contribute to reduce uncertainty and lower volatility, favouring pro-cyclical and higher-yielding EM assets.
- Existing positions in Chinese government bonds have benefitted as well via the continued strengthening in the Chinese yuan.

Corporate credit has been resilient with further spread compression

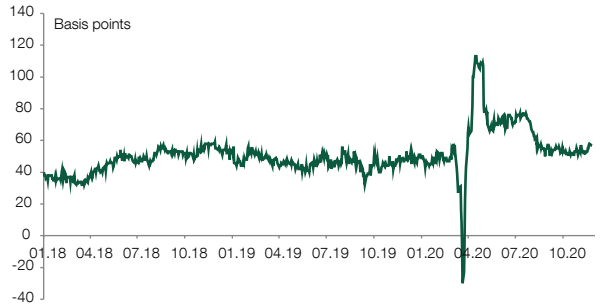
Investment-grade OAS spreads



Sources: ICE, UBP

Emerging market corporate bonds continue to be relatively attractive vs. US

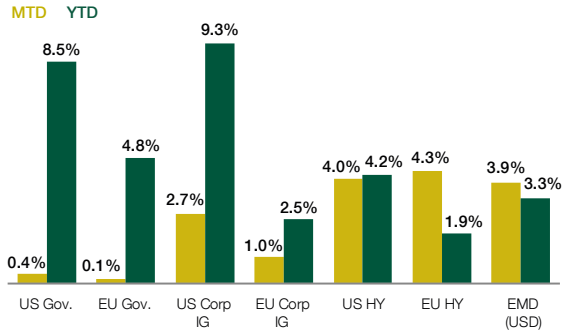
Relative value: EM IG vs US IG



Sources: ICE, UBP

Sharp rally in risky segment

Fixed Income Performance



Performance is as end of November 2020
Sources: Refinitiv, UBP

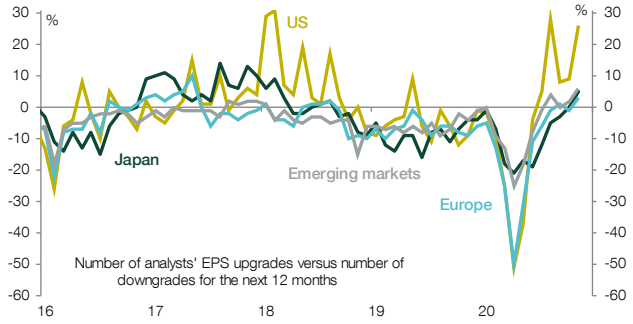
GLOBAL EQUITIES

BOOSTED BY HOPE OF A QUICK RETURN TO NORMALITY

- Equities surged in November, with the major catalyst being the positive vaccine news in recent weeks.
- After the announcements of much better-than-expected Q3 earnings across the globe, revision ratios moved into positive territory in all regions, with the US again well above other markets, back to the same level as after the Q2 reporting season.
- Over the last month, the expected EPS growth rate for global equities in the current year moved slightly higher to -17% from -19%, while the same rate for next year tilted lower to 28% because of the higher base.
- With the rising probability of seeing an effective vaccine being distributed by mid-2021, the downside risk to global 2021 earnings has clearly receded. Upgrades are even likely for the sectors which have been most impacted by the virus like energy, financials as well as travel & leisure even though profits in these sectors will not get back to their 2019 levels before 2022 at the earliest.
- With the recent rally, equity valuations are back close to a near two-decade high. Consequently, earnings will be the key driver of equity markets next year. Valuation multiples are likely to move lower, but this should be more than offset by the expected earnings recovery.
- In addition, above trend GDP growth next year will lead to a sharp rebound in sales so some value sectors will give opportunities for investors. However, because of those fundamental changes that will last even after the pandemic, some deep value stocks will not recover. Hence, selectivity will be key, and we will retain a quality bias to our pro-cyclical equity exposure.
- In portfolios, we prefer a barbell approach between quality cyclicals that should see earnings recovery in 2021 paired with long-cycle stories that offer earnings growth anchored in the transformation to a post-pandemic global economy including climate change/impact investing, China's turn inward, fintech/digital finance and digital health.
- We have already built exposure to Europe which should disproportionately benefit from the global cyclical recovery via a sharp recovery in domestic economic activity as lockdowns ease, but also thanks to its sector composition. Japan and emerging markets are other regions with a cyclical bias which could offer opportunities going into next year.

Positive earnings revisions after strong reporting season

Earnings revision ratio: US, Europe, Japan & EM



Sources: Thomson Reuters

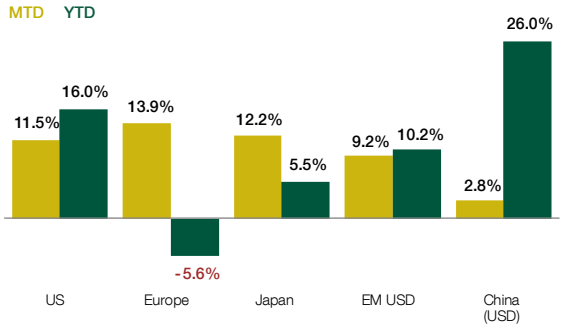
Valuation multiples close to historical highs

MSCI All Country World: 12-month forward PER

Sources: Refinitiv and UBP

Europe and Japan outperformed other markets

Equities Performance



Performance is as end of November 2020
Sources: Refinitiv, UBP

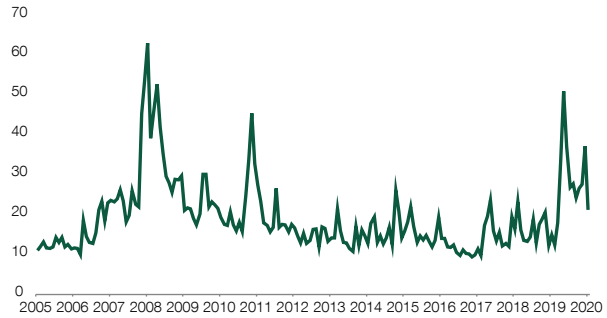
RECENT VIEW CHANGES

PIVOTING FROM ASYMMETRY TO DIRECTIONAL STRATEGIES

- Throughout the year, we favoured asymmetric strategies including options, futures and long-short hedge fund strategies to shield portfolios well from the extremely volatile markets of 2020 while continuing to participate market upside.
- Entering November, many of the risks that worried us began to dissipate with the earlier than expected vaccine announcements as well as the result of the US election.
- As a result, we started to exit our long-favoured asymmetry and pivot our portfolios to more directional strategies to accommodate the prospect of a 2021 cyclical rebound.
- We exited our option and futures holdings as well as some hedge fund strategies.
- Alongside our long-term transformation thematic such as technology, innovation and healthcare, we made a tactical allocation to European equities which should benefit from the expected cyclical rebound, given their relatively more cyclical nature.
- Last month, we rotated some of our US equity holdings into Chinese equity. With Chinese economic growth expected at 6.9% in Q4 and 8% for 2021 and a potential earnings upgrade, we believe the risk reward profile is attractive despite somewhat elevated valuations.
- We are also assessing high quality value stocks. While the catch-up potential is appealing, we suggest a highly selective approach to avoid a potential value trap if only valuation metrics are used.
- In the fixed income space, we are seeking to reinforce our credit exposure going into year-end. Selective high yield bonds, the European hybrid market as well as an expansion of our existing emerging and Asia credit are attractive looking into 2021.

Volatility came down sharply in November

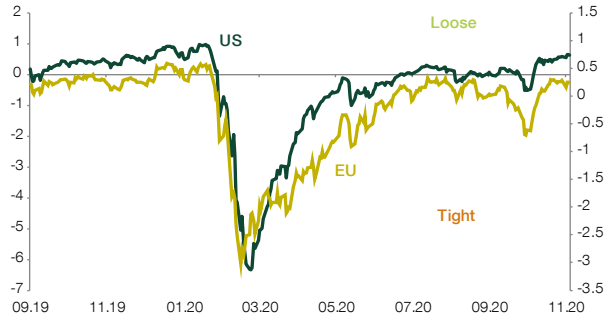
Implied Volatility Index



Sources: Refinitiv and UBP

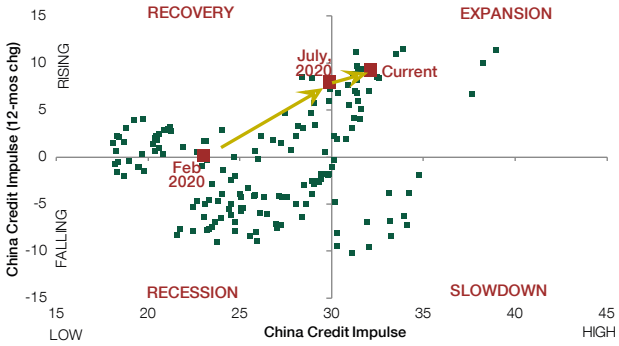
Monetary policy should stay supportive

Financial condition



Sources: Bloomberg Finance L.P., UBP

China has moved more firmly into expansion territory



Sources: Bloomberg Finance L.P. and UBP

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