GLOBAL LONG-TERM UNCONSTRAINED

2021 INVESTMENT OUTLOOK

DECEMBER 2020 FOR INSTITUTIONAL, PROFESSIONAL AND WHOLESALE INVESTORS ONLY

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2020 has been exceptional in terms of the unprecedented global pandemic leading to a deep synchronised global recession coupled with the fastest bear and then bull market seen in decades – the latter the result of decisive early central bank intervention, followed by sizeable fiscal support.

For 2021, we are optimistic about the outlook for equities. We foresee a favourable backdrop for equity markets, as a result of ongoing loose monetary policies, a low interest rates environment, significant fiscal support, and a normalisation of economic activity once mass vaccination programs are under way and economies re-open fully. This should lead to a significant economic and corporate profits rebound in 2021, also helped by the low base effect of a depressed 2020. The low rates environment will remain a challenge for investors seeking yield, which is an additional support for equity markets, given their attractive earnings yields compared to bond yields.

Below we outline our key predictions for 2021, looking at the macro economic environment, monetary policy, earnings and valuations. Finally, we outline the opportunities and risks we see as investors.

OUTLOOK 2021 – KEY POINTS

Macroeconomic outlook – certainty in recovery, uncertainty in magnitude and timing

- 2021 will be a strong recovery from 2020 which will be the most severe recessions since 1929, although shape and therefore magnitude of the recovery remains highly uncertain
- Pace of recovery dependent on speed of channelling sizeable fiscal stimuli into the real economy
- Pandemic relapse risk remains an important contributor to the shape of recovery in the first part of the year, whilst we should be seeing a strong bounce in economic activity from Q2 onwards. This is helped by the base effect but also some form of normalisation in activity once vaccination programs become more widespread
- We maintain our scenario of a gradual recovery with no return to previous activity levels until the end of 2022
- Leading indicators remain supportive, although pace of improvement could be slowing down after the initial strong improvement seen this year
- Labour market deterioration is at risk of slowing down the economic rebound potential
- Forecast risk remains high, and the economic recovery remains fragile and highly dependent on successful fiscal policies implementation

Monetary and fiscal policies provide support – inflation is where the risk could lie

- Fiscal stimuli pledged are sizeable – equivalent to >13% of GDP on aggregate across a large part of the world. Speed of channelling the stimuli into the real economy will determine shape of the recovery
- Central banks are likely to remain accommodative, and keep rates low for a long time given the lack of inflationary pressures, growing debt burden and the underlying deterioration in the labour market
- Inflation could be an important focal point in 2021, and could be a source of bull-bear debate
- We continue to expect a lack of sustained pick up in inflation given the strong underlying deflationary trends coming from technological developments and ongoing disruption risks

FOR 2021, WE ARE OPTIMISTIC ABOUT THE OUTLOOK FOR EQUITIES.

Earnings growth in 2021 should show strong growth as recovery comes through

- Whilst the worst is likely behind us, the earnings momentum outlook is still uncertain from here, as a result of the uncertain shape of economic recovery
- Corporate earnings growth is likely to be strong in 2021E, with current consensus estimates pointing to a +23% YoY growth in MSCI World, helped by the base effect and normalising activity. Our own top down earnings estimates forecast +26% YoY growth in the MSCI World
- 2021 estimates carry a high forecast risk given the lack of visibility on shape of the recovery
- Mid-term risk of higher corporate tax rates will weigh on earnings – we already capture this into our forecasts

Valuations – less supportive versus history but still supportive versus bond yields

- Equity market valuations point to the US market being extended, whilst European and Asian valuations are supportive still versus their long-term averages
- A low rate environment however is supportive for equity valuations, providing attractive earnings yields vs bond yields
- Low rates for a long time creates a challenging environment for investors, but a supportive environment for asset prices, notably equities
- Growth vs Value valuation spread remains extended, which is likely to remain a talking point for short term investors – we believe long term prospects for Growth/Quality remain strong given the low growth & low inflation prospects that we foresee

Market focus on sustainability trends will continue to increase and likely accelerate

- The pandemic crisis has brought an increased focus on sustainability and responsible corporate citizenship
- ESG focus will remain center stage, with additional regulatory developments further emphasizing the ESG approach of investors in 2021
- Climate change policies momentum to accelerate with president elect Biden likely to bring the US back into the Paris accord
- Fiscal spending to favour green initiatives in order to decarbonise economies

Long-term opportunities across our three mega-trends and post-pandemic opportunities in green initiatives and infrastructure

- We continue to foresee support in the longer term trends across our three mega-trends: demographic change, future of technology and resource scarcity
- Infrastructure spending is likely to be an important theme, notably 5G telephony upgrades and high speed railways
- Green initiatives will be another important theme – including green energy, efficient buildings and electric transportation
- Healthcare infrastructure will be a key area of spending, in order to upgrade facilities post the pandemic crisis
- Robotics and automation is likely to accelerate post pandemic, as corporates make their production bases more efficient and if near-shoring becomes a strategic shift
- Cloud infrastructure investment will accelerate, whilst cyber security will be an important focal point
- Increased hygiene will become a permanent trend – both food hygiene, and personal and commercial hygiene, as the pandemic crisis shifts habits

2021 – a year of lower tail risks and more predictability, but the potential risk of bubbles forming

- Geopolitical risks expected to bring less volatility – US elections leading to the Biden presidency is taking tail risk out and reducing geopolitical related volatility
- Brexit remains a sizeable uncertainty as we write – probability of a disorderly exit remains high
- Successful and timely execution of fiscal stimuli critical to support the economic recovery and therefore the key source of risk to 2021 expectations
- Increased indebtedness raising the risk of lower growth beyond 2021
- Tax rates likely to be on the rise, both corporate and household tax, to fund fiscal expansion – this could be a risk that weighs on markets, although the issue could be pushed beyond 2021
- Asset price bubbles might be forming – lower rates for a long time are pushing investors into riskier asset classes, which leads to the increased risk of an asset bubble forming
- Inflation risk, should we see a sustained pick up, could lead to interest rates expectations shifting higher, which could ultimately weigh on equity markets sentiment
- Pandemic relapse risk still omnipresent – a dark case scenario would be a significant return into lock-downs as a result of pandemic relapse risk, which could be linked to a rapidly mutating virus making the newly discovered vaccines less effective. Whilst low probability as we write given what seems to be a low rate of mutation of the virus, it would be a sizeable tail risk event that would weigh on markets and sentiment.

YEAR 2020 IN REVIEW

Unprecedented pandemic crisis, human resilience and mobilisation the highlights

The year 2020 has been exceptional in many ways. The global pandemic crisis has brought a deep globally synchronised recession as a result of the forced lock-downs across most economies in Q1-Q2. The market responded with the fastest bear market since WW2 in the space of a few weeks in March. There were initial fears of a liquidity crisis, leading companies to withdraw dividend payments, and to secure credit lines during that crisis period. Decisive and sizeable central bank interventions ensued, which helped immensely to avert a liquidity and credit crisis. As a result, equity markets then experienced the fastest bull market since the early 1970's in the space of a few weeks in April. Fiscal policies also stepped in rapidly, with sizeable pledges of fiscal support, equating c.13% of GDP, with large economies pledging to spend 8-16% of GDP to support their economies shown in the table below (Table I). This contributed to continue to push the market higher throughout the summer.

Table I: Announced fiscal stimuli across the world

	Announced Fiscal Stimulus	2019 GDP (%)	Weight in global GDP (%)	Contribution to global fiscal stimulus GDP (%)
US	US$2.5trn	11.7	24.8	2.89
Japan	Yen 234 trn	42.0	6.0	2.50
China	CNY 8.5 trn	8.9	16.3	1.46
EU	€1.34 trn	8.0	15.8	1.25
EU recovery fund	€750 bn	4.4	–	–
France	€270-300 bn	11.5	3.1	0.36
Germany	€236 bn	6.9	4.5	0.31
Italy	€25 bn	1.4	2.3	0.03
Sweden	SEK300 bn	6.1	0.5	0.03
Spain	€17 bn	1.4	1.6	0.00
Norway	NOK 100 bn	3.4	0.4	0.01
UK	£350 bn	16.0	3.2	0.51
India	INR 20trn	13.6	2.3	0.31
Singapore	S$ 93 bn	23.3	0.4	0.10
Canada	C$82 bn	3.6	2.0	0.07
Thailand	THB 20 trn	10.0	0.6	0.06
Korea	KRW 100 trn	2.6	1`.9	0.05
Indonesia	IDR 260 trn	2.5	1.3	0.03
Russia	RUB 3 trn	2.2	1.4	0.03
South Africa	ZAR 500 bn	7.5	0.3	0.02
Saudi Arabia	SAR 79 bn	2.7	0.7	0.02
Hong Kong	HK$ 120 bn	3.5	0.4	0.02
Malaysia	M$ 270 bn	2.7	0.4	0.01
Australia	AUD 17.6 bn	0.8	1.6	0.01
New Zealand	NZ$ 12 bn	4.7	0.2	0.01
Taiwan	NT$ 50-55bn	0.3	0.7	0.00
Vietnam	VND 80 trn	1.3	0.2	0.00
Total		**13**	**80.4**	**9.35**

Source: JPMorgan Research as at 31 August 2020.

Earnings downgrades were sizeable in the first half of the year, as expectations had to be rebased for what has been a severe global synchronised recession. Corporates on the whole reacted well through the crisis, in terms of managing their cost base, but also taking more ethical actions to managing their way through this. Earnings momentum rapidly bottomed with the Q2 results over the summer leading to a more supportive results season and a shift in momentum which continued with Q3 results. This provided further support for equity markets.

Chart I: Earnings momentum

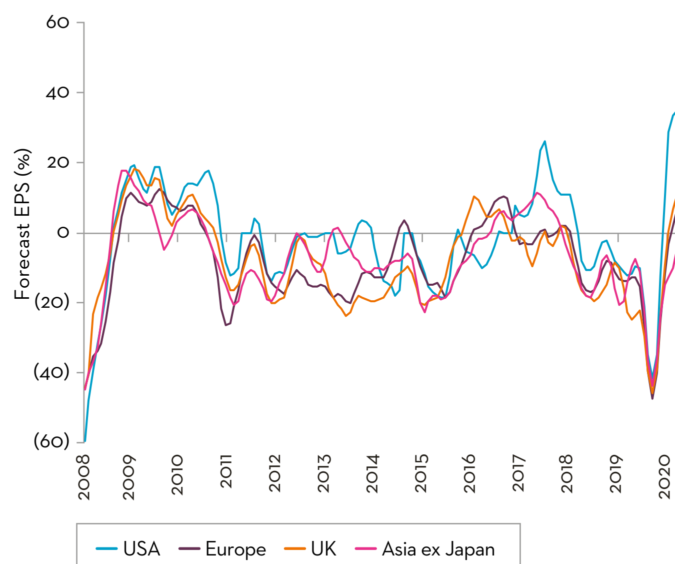
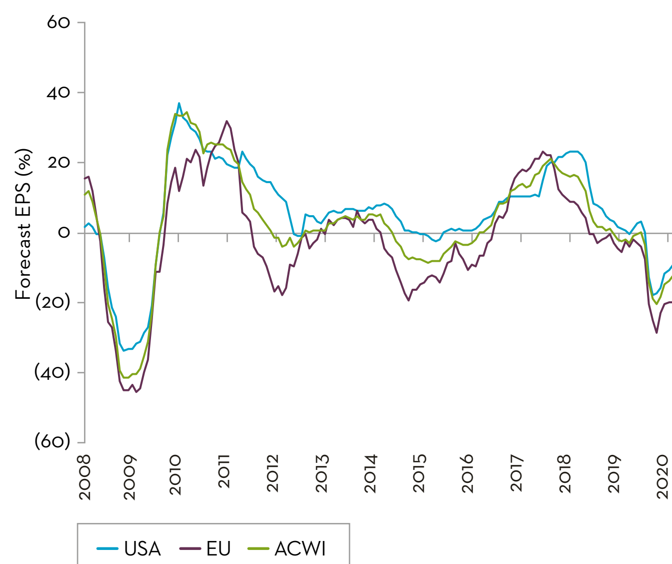


Chart II: Forecast EPS growth NTM



Source: FactSet and MSCI as at 30 November 2020.

On the geopolitical front, China-US tensions were de-emphasized during this pandemic crisis. Whilst in Q4, with the outcome of a Biden presidency in the US presidential elections, more optimism filled the market. This was on the belief that the approach to dealing with China will be more diplomatic and more constructive, and less inflammatory and unpredictable, as was the case under the Trump administration.

Recent strongly positive vaccine results in November and December provided further optimism to equity markets, pushing them towards all-time-highs, on the closer hopes of an ending to the pandemic crisis at some point in 2021. This also triggered the much anticipated rotation away from Growth into Value areas of equity markets, given the sizeable valuation spread that had opened previous to that.

On the human front, it has been a tragic pandemic crisis for all of us in some ways. Initial fear and hoarding in the early stages of the pandemic crisis made way to the biggest coordinated human effort since war time to ensure healthcare infrastructures were mobilised and focused on areas of need, and that scientific efforts focus on finding a cure to the pandemic. The rapid sequencing of the virus genome permitted fast progress in tackling the virus. With the recent strongly positive news of the various vaccines showcasing what medical scientists can achieve in record times in terms of breakthrough when knowledge gets shared rapidly and widely, and when scientific minds focus on one single issue to tackle. Perhaps this episode can give some interesting ideas to how humanity can look at tackling other diseases in future.

This crisis year has also shown us the importance of physical interactions with family, friends and colleagues, and indeed the reason why live events shared in big crowd venues, whether it is concerts, sporting events, or simply big celebratory gatherings are exciting to us all. The crisis has also put more emphasis on sustainability for corporates and households along with responsible corporate citizenships, leading more companies to pursue more sustainable growth strategies going forward. Finally, this crisis has shown that online platforms can be powerful disruptors, but also invaluable developments for both corporates and consumers, in terms of ensuring continuity in activity and in terms of access to goods and services.

Whilst the year has been challenging for all of us in some ways, we are ending with a strong sense of optimism that 2021 will be a year of strong recovery and growth. Going forward, it will be critical for policy makers to coordinate efforts to ensure that this pandemic is properly tackled, to put in place plans to address more efficiently any future pandemics, and to ensure that healthcare infrastructure gets upgraded to optimal levels.

2021 OUTLOOK

In our 2021 outlook we expand on our thoughts regarding the macro-economic outlook for 2021 and beyond, our earnings expectations, views on the geopolitical risks, and equity valuations. We also highlight the areas of risks that we foresee, alongside our high-level predictions.

Macro outlook – certainty in recovery, uncertainty in magnitude of recovery

Given the severe recession we experienced in 2020, the base effect and the sizeable fiscal stimuli being pledged to kick-start economies, and given the now more optimistic outlook post the vaccines news, it is a certainty of 2021 that the year will be one of strong rebound. Magnitude of the rebound is what could be the shape of the bull-bear debate about this topic next year: the outlook here is more uncertain. Current consensus GDP growth expectations can be seen below for the different regions.

Table II – GDP growth expectations

GDP growth YoY	2020E	2021E
US	-3.6%	3.8%
Eurozone	-7.4%	4.6%
UK	-11.2%	5.4%
China	2.0%	8.2%
Japan	-5.3%	2.6%
Emerging Markets	-0.8%	5.0%
Developed Markets	-5.3%	4.0%
World	**-3.9%**	**5.2%**

Bloomberg consensus as at 8 December 2020.

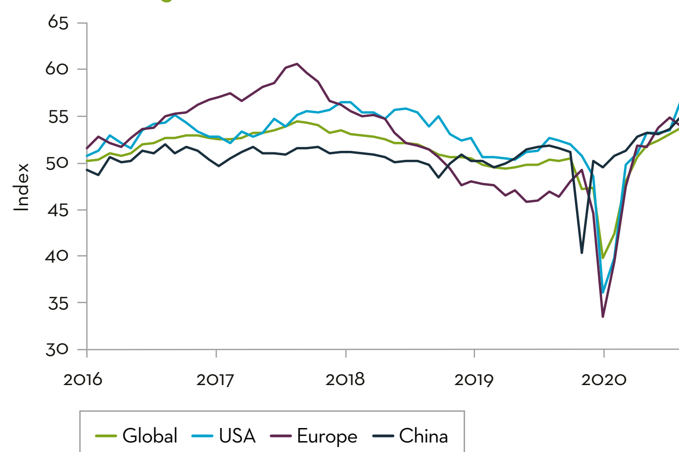
The year 2021 will also be a peculiar year, where we are faced with an air pocket of sluggish activity early on, before economies are fully re-opened, whilst vaccination programs ramp up. This means that activity might remain muted in the first quarter of the year, followed by a sharp rebound beyond that, depending on the speed of vaccinations programs being rolled out, and helped by the favourable base effect from March 2020 onwards. The question to focus on in our view is, for how long will markets rely on hope of an upcoming recovery, if that recovery takes longer to come or if it does, what if it is not as strong as expected?

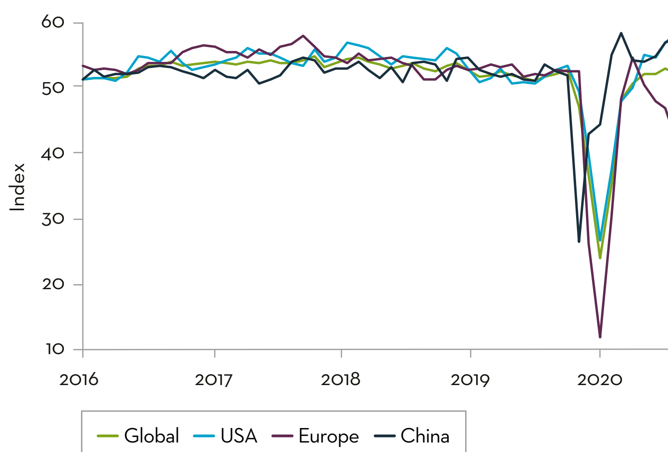
The magnitude of the rebound will, as we have mentioned before, depend on the speed of channelling the sizeable fiscal stimuli into the real economy. It therefore to a large extent depends on policymakers. This will need to be assessed on a case by case basis, based on the specifics of each of the large economies globally.

Leading indicators are for the time being moving in the right direction, and showing gradual improvements in manufacturing, and stabilisation in services after the sharp recovery seen post the Q1/Q2 slump of 2020 – all of which is encouraging.

> THE YEAR 2021 WILL ALSO BE A PECULIAR YEAR, WHERE WE ARE FACED WITH AN AIR POCKET OF SLUGGISH ACTIVITY EARLY ON, BEFORE ECONOMIES ARE FULLY RE-OPENED, WHILST VACCINATION PROGRAMS RAMP UP. THIS MEANS THAT ACTIVITY MIGHT REMAIN MUTED IN THE FIRST QUARTER OF THE YEAR, FOLLOWED BY A SHARP REBOUND BEYOND THAT

Chart III: Manufacturing and Service PMIs





Source: Martin Currie, FactSet and OECD as 30 November 2020.

Monetary and fiscal policies provide support – inflation is where the risk could lie

Fiscal support pledged throughout the globe in 2020 to tackle the recession brought by the pandemic crisis has been sizeable, as we mentioned in the year in review section of this report. There will potentially be a further increase in fiscal support in 2021, notably coming from the US. This fiscal support should help the recovery in economic activity in 2021 and beyond. The key will be to assess the speed at which these fiscal stimuli are channelled into the real economy, which will influence the pace of recovery.

At the same time, monetary policy support should continue, with key central banks signalling that rates will remain on hold at historically low levels for extended periods of time. The shift in the central banks' approach to targeting inflation is potentially supportive for risky assets, notably equities, given that it signals that central banks are willing to overshoot their previous inflation targets.

However, low rates for longer will not in itself mechanically generate inflation. Also, we wonder whether central banks signalling continued low rates could be seen as an indication of their internal inflation projections remaining low. We also question whether we are wrongly pre-conditioned to associate loose monetary policies and expansive fiscal policies with rising inflation. Perhaps we should question the base of that assumption: there is the possibility that the current loose monetary policies and expansive fiscal policies will simply avert what would have been sizeable deflationary pressures.

We continue to see many underlying deflationary pressures at play in the economy, notably from technological advances and from rapid disruptive trends impacting many parts of the economy. We also see limited wage inflation in general, which has typically been the biggest driver of inflationary pressures. The underlying deteriorations in labour markets from the pandemic crisis might have put a lid on wage inflation pressure in some parts of the economy for the time being – something that we will continue to monitor going forward.

We are also cognisant of the potential trend for corporates to near-shore or on-shore more of their production bases and shorten the supply chains as a result of the realisation since the pandemic crisis that their supply chains are vulnerable to global disruptions. Whilst this might indeed be a driver for inflationary pressures, we believe that such trends towards near-shoring might take time to implement, and could lead to corporates speeding up their investments in robotics and automation to make their product lines more efficient and more productive, which in itself could weigh negatively on labour market trends, which will ultimately reduce inflationary pressures.

WE CONTINUE TO SEE MANY UNDERLYING DEFLATIONARY PRESSURES AT PLAY IN THE ECONOMY, NOTABLY FROM TECHNOLOGICAL ADVANCES AND FROM RAPID DISRUPTIVE TRENDS IMPACTING MANY PARTS OF THE ECONOMY.

Earnings growth in 2021 should show strong growth as recovery comes through

Given the above macroeconomic picture, 2021 will be year of strong growth in corporate earnings. Consensus estimates point to a growth of +23% in YoY earnings growth in 2021E for the MSCI World index at the time of writing (7 December 2020), with the details of the different regions summed up in the table below (Table III). Our own top down forecasts predict a +26% yoy growth in 2021E, following a -23% we expect for 2020E.

Table III – Consensus earnings

Consensensus Earnings growth YoY	2020E	2021E
MSCI World	-18%	23%
S&P 500	-15%	22%
MSCI EU Index	-17%	36%
FTSE 350	-20%	42%
Nasdaq	-9%	34%
MSCI Asia Pacific ex-Japan	-4%	25%
Topix	**-31%**	**33%**

Source: Bloomberg and FactSet as at 7 December 2020.

Every year has tended to start with earnings estimates being too optimistic and having to be revised down. The year 2021 might be different in so much that the current consensus could have to be revised up strongly, should:

- the fiscal stimuli be channelled into the real economy in a timely manner and;
- the fiscal initiatives to stimulate the economies be frontloaded.

For the same reasons as macro forecasts, earnings growth expectations carry sizeable forecast risk. We believe that it might be useful for investors to look at the two year growth outlook as a way to both: navigate a significant forecast range and to smooth out 2021, which will show an explosive growth in large part driven by the base effect of such a weak 2020. Our forecasts assume that 2022 will be the year when earnings will be normalising to pre-pandemic levels.

Valuations – less supportive versus history but still supportive versus bond yields

The market has performed strongly since the lows of March 2020, driven by supportive monetary policies to avert a liquidity crisis, and significant fiscal stimuli programs to stimulate economic activity. Valuation levels on a stand-alone PE ratio look demanding vs historic levels, but we believe that given such unusual period in terms of earnings collapse and rebound in 2020 and 2021 respectively, cyclically adjusted valuation multiples are more relevant to use. On that basis, as can be seen in the charts below (Chart IV and V), European and Global equities valuations remain supportive, whilst the US equity market is closer to its historic highs.

Equity valuations in general remain attractive in terms of earnings yield they offer compared to the bond yields. This is likely to remain the main supportive argument for an ongoing rerating of equity markets, given the strong signalling by the main central banks that rates will remain low for extended periods of time. For investors, whilst the low yields environment provides a challenge, it is likely to continue to push investors into riskier parts of the markets in search for some yield attraction.

Chart IV: PE multiples FY1

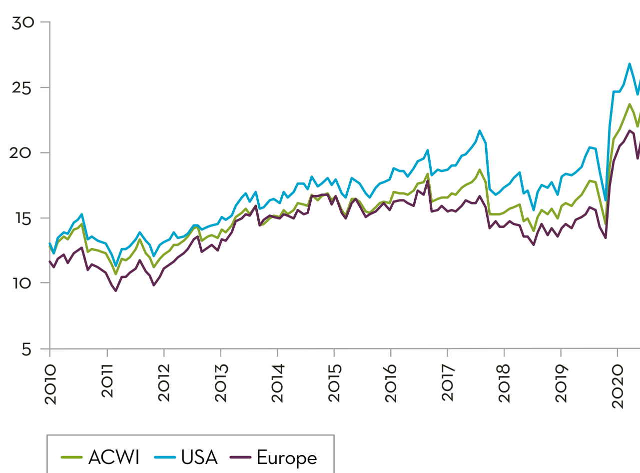
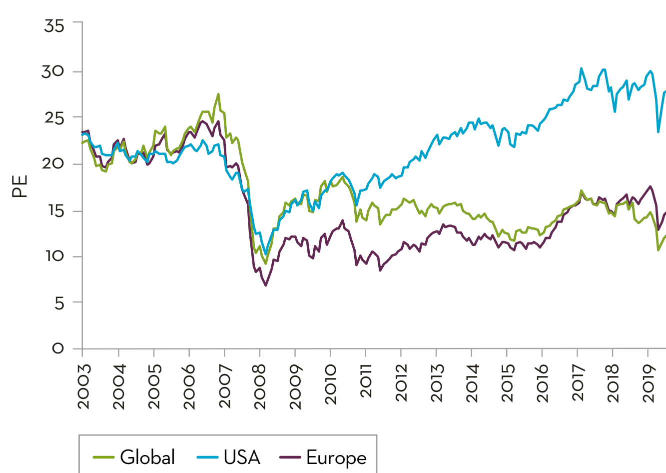


Chart V: Shiller PE multiples

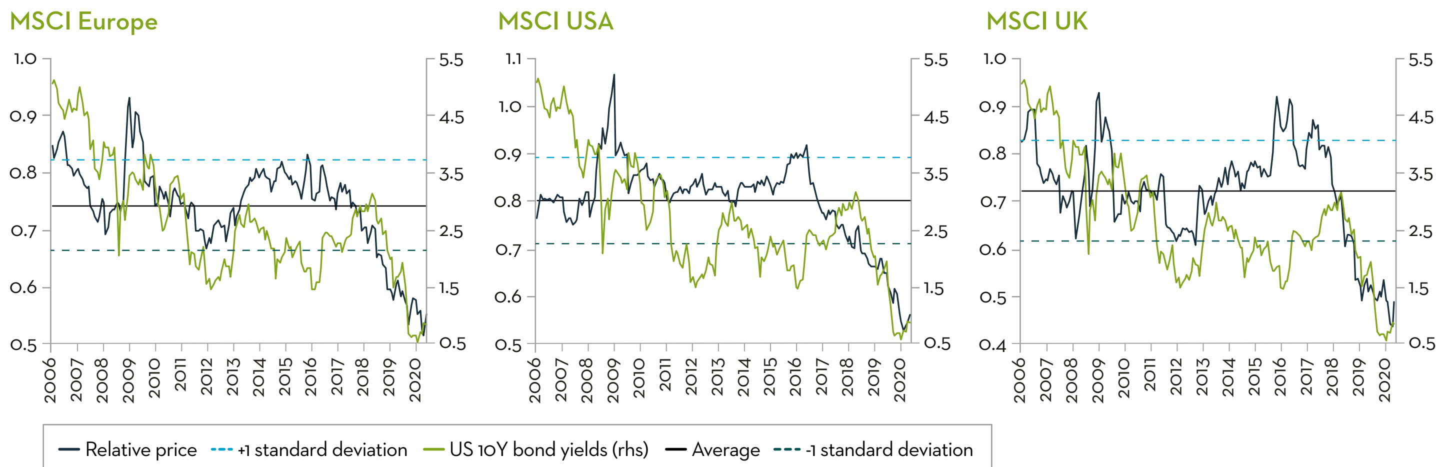


Source: FactSet as at 30 November 2020.

Style rotation could have longer to go in such supportive cyclical growth environment

With 2021 having the potential to be such a strong year of economic recovery, and significant earnings rebound, Value and High-Risk styles could lead the market higher. Typically, recovery periods of an economic cycle do favour these specific styles, alongside with Small-Cap. This could be further amplified by the valuation support that Value appears to show on an optical basis in terms of spread versus Growth. This spread has historically correlated closely to bond yields as can be seen in the chart below (Chart VI), so it is important to link this to the inflation expectations and therefore rates expectations.

Chart VI: Value versus Growth spread versus US 10-year Treasury bond yields



Source: FactSet as at 30 November 2020.

For us as long-term investors, we find the debate around style rotation to be too short-term a consideration, and prone to major uncertainty both in terms of magnitude, timing and duration of such rotations. Our focus remains on finding companies with superior growth and returns profile, and therefore strong earnings power over the long-term, with compounding cash flow characteristics underestimated by the market. If we prove accurate in finding these sustainable quality growth stocks, we believe these should perform over the long-term, no matter what market environment we are in.

Market focus on sustainability trends will continue to increase and likely accelerate

The nature of the 2020 recession triggered by the pandemic crisis has put more emphasis on sustainability, and responsible corporate citizenship. Investors have increased their focus on assessing ESG criteria in corporates that they are looking to invest in this year – we expect this to continue to gain momentum in 2021. Regulation is further driving the momentum in terms of ESG focus, and asset allocators are increasingly continuing to channel more of their exposures to ESG focused strategies. Carbon intensity assessment, and a drive to decarbonize economies by policy makers is further adding to the momentum. It is widely expected that President-elect Biden will take the US back into the Paris agreement in 2021, which will be material in terms of aligning all major economies globally towards reducing carbon emissions significantly over the next 30 years and beyond. So, it is pleasing and easy to forecast that 2021 will be a year on ongoing positive momentum in terms of ESG and Sustainability, both from investors, corporates, governments, and asset allocators.

Long-term opportunities across our three mega-trends and post-pandemic opportunities in green initiatives and infrastructure

Looking ahead into next year and beyond, it will be critical to focus on investing in companies with sustainable business models and that have strong pricing power. The strong pricing power will be important if we remain in a period of low inflation and will be critical to protect margins should we move into a period of rising inflation.

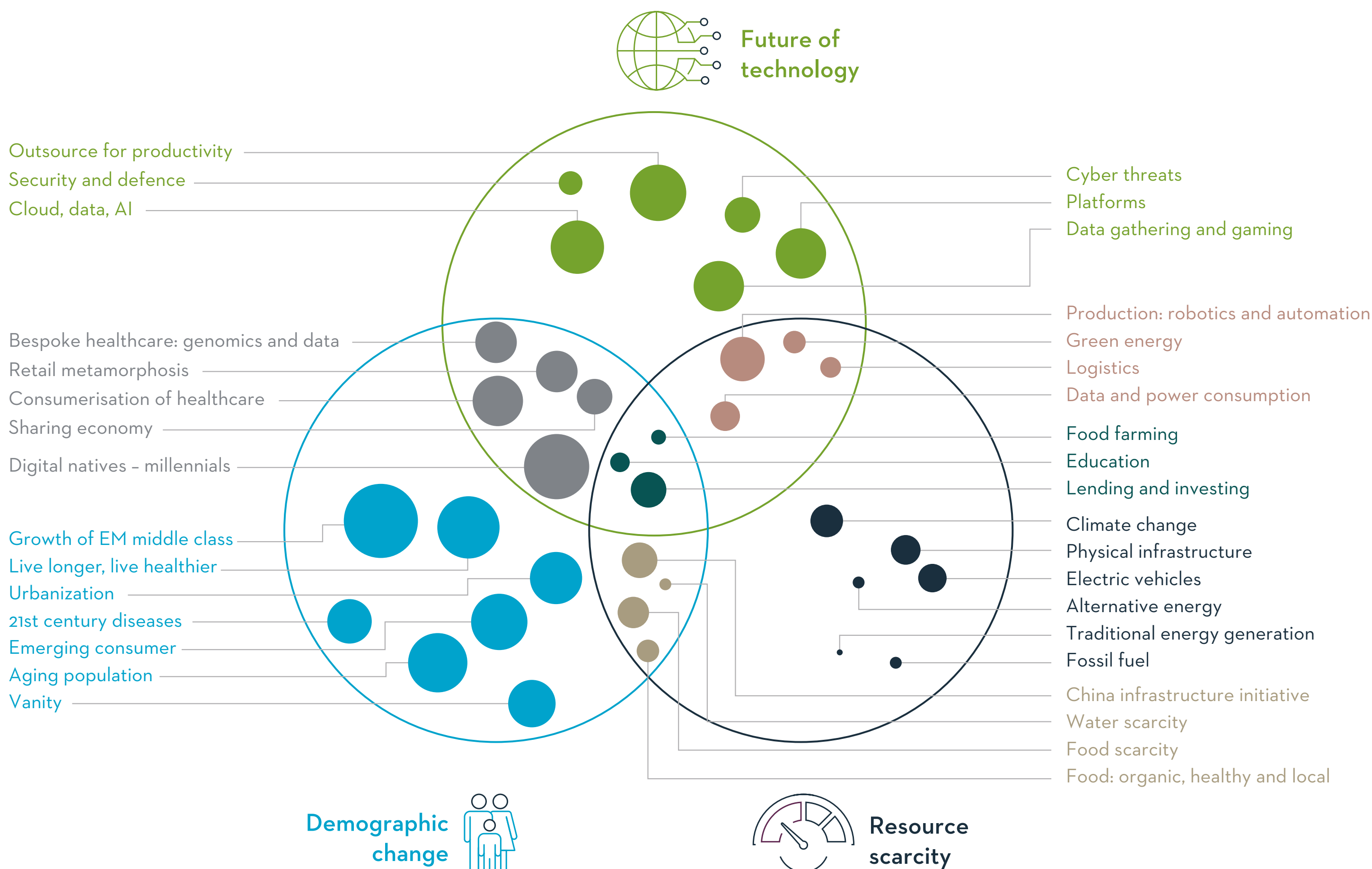
We believe that our approach of investing in sustainable business models that have

- strong leadership positions,
- operate in industries with high barriers to entry,
- have strong pricing power,
- low disruption risk,
- attractive structural growth prospects,
- generate high returns,
- have compounding characteristics and solid balance sheets, and;
- strong corporate governance and sustainability profiles, remains a prudent and valid approach to follow.

We believe that continuing to focus on finding attractively priced sustainable quality growth companies with a long-term investment perspective is the right strategy in order to capture the compounding cash flows characteristics of these companies.

Our focus remains on identifying the attractively priced long-term themes that will benefit our investors. We continue to do so through our Thematic mega-trends framework, focusing on the 3 mega-trends we have identified, which are (i) **Demographic Change**, (ii) **Future of Technology**, and (iii) **Resource Scarcity**. Our regular readers are familiar with our analytical framework that permits us to assess our portfolio exposures to the mega-trends and to the themes within those mega-trends, illustrated below.

Chart VII: Long Term Mega-trends exposure



Source: Martin Currie and FactSet as at 30 September 2020. Representative Martin Currie Global Long-Term Unconstrained account shown.

> OUR FOCUS REMAINS ON IDENTIFYING THE ATTRACTIVELY PRICED LONG-TERM THEMES THAT WILL BENEFIT OUR INVESTORS. WE CONTINUE TO DO SO THROUGH OUR THEMATIC MEGA-TRENDS FRAMEWORK, FOCUSING ON 3 MEGA-TRENDS

There are many interesting themes within each of these mega-trends, or indeed in the areas of overlap between the three which provide us with long-term structural growth opportunities. We believe that the post-COVID world opens some interesting opportunities within each of these fields which we detail below.

Post-pandemic world in 2021 and beyond opens opportunities for long-term investors such as us

Potential opportunities could materialise in the following areas:

(i) increased infrastructure spend to boost the economy, notably railway and 5G infrastructure;

(ii) increased spend in healthcare infrastructure to both make the public healthcare sector more prepared for future pandemics, and to increase investments in homecare and telemedicine;

(iii) increased incentives in sustainability, whether it is social sustainability or greener solutions in transport, energy generation, infrastructure and construction in particular;

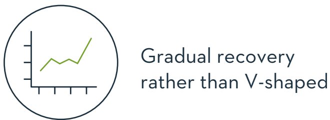
(iv) increased investment in cloud computing and cybersecurity given the acceleration in pace of migration to digital economies;

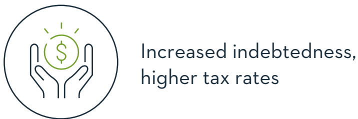
(v) increased investment in robotics and automation as corporates tackle the need to make their supply chains more robust; and

(vi) improvements in food hygiene and general hygiene (both household and professional premises).

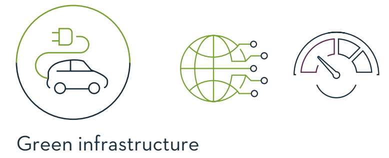
Chart VIII: Summary outlook and mid-term opportunities

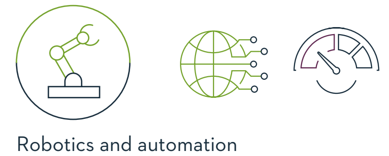
Outlook

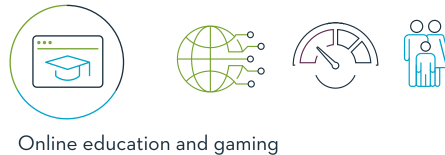




Mid-term opportunities







Future of technology
Demographic change
Resource scarcity

Risks for 2021 - a year of lower tail risks and more predictability, but the potential risk of bubbles forming

- **Geopolitical risks will remain omnipresent**, notably the China-US and China-RoW tensions. The tail risk has however significantly reduced in our view, with the US presidency shifting to a Biden administration, which will lead to a more diplomatic approach, which could end up being more constructive, and certainly less destructive and volatile. Trade tensions, whilst potentially remaining high on the agenda, could end up with less volatile implications for financial markets.
- **Brexit risk remains relevant at the time of writing this outlook**, with no agreement reached so far, and negotiations between the UK and the EU being protracted. With time running out before the deadline, there is a growing risk of a no-deal Brexit which will weigh negatively for both the UK, and to a lesser extent for the EU economic outlook. There is the potential of course for status-quo in trading terms between the UK and the EU to be extended whilst negotiations continue, should both parties be willing to remain constructive.
- **Forecast risk in economic and corporate earnings projections globally remains high**, but with economies on a path towards a sharp rebound from the lows of 2020, earnings momentum should remain supportive and continue to improve.
- **Pandemic relapse risk** – near-term pandemic relapse risk is happening as we write, which will weigh on the timing of global economic recovery in the first part of the year. The more significant tail risk is the event of a potentially mutating virus that leads to a less efficacious mass vaccination program and a higher risk of prolonged pandemic crisis is one that is worth highlighting – it would provide sizeable downside risk to equity markets, although it is a very low probability event, based on the understanding that the virus mutation rate is low.
- **Risks of pockets of bubbles in asset prices** is potentially the more relevant risk to consider in 2021 and beyond. The supportive monetary policies, with rates remaining low for extended periods of time, could lead to increased risk taking in the search for yield, which in itself could lead to excesses, especially given the access to cheap funding. Investors will therefore need to watch out for localised bubbles forming, which could lead to increased risks and higher volatility further down the line.
- **Increased indebtedness as a result of the sizeable fiscal spending** pledges across the globe is potentially also leading to a mid-term risk that investors need to watch out for. Higher indebtedness typically leads to periods of lower growth further down the line, which could prove challenging for investors. There is also a higher likelihood of increased tax on corporates and householders to fund the fiscal stimuli, which ultimately will weigh on corporates' earnings growth profiles, and could curtail personal household consumption in anticipation of higher tax rates.
- **Risk of rising rates expectations**: The final risk worth highlighting for us is whether we are in a period of market euphoria based on the uncomfortable assumption that inflationary pressures will be picking up, but interest rates expectations will remain low for extended periods of time. In other words, could the market be having its cake and eating it, as we mentioned earlier in the report. We would expect, if inflationary pressures start building, that interest rates expectations trend higher, which could weigh on financial markets sentiment and could bring a healthier bull-bear debate than the current one-way situation that we seem to be in.

Overall, and in conclusion, as we look at the year ahead, we believe it will be a year based on lower tail risks, and more optimism ahead. This will be a positive and much needed contrast to what has been an exceptional and highly unpredictable year on many fronts, and that will go down as an historically significant year for everyone across every corner of the world. We will be watching out for pace of deployment of fiscal stimuli into the real economies, and for any signs of inflationary trends picking up meaningfully.

Wishing our readers a joyous festive period, and a very happy and prosperous new year.

Zehrid Osmani

Head of Global Long-Term Unconstrained
Manager of the Martin Currie Global Portfolio Trust

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