NG
NAHMANI GRUNDER
WEALTH MANAGEMENT & MULTI-FAMILY OFFICE

2020 Review

2020: A year for the history books with the first global pandemic since 1917

- 2020 ended up as a year for history books. We always remind ourselves that markets are forward discounting mechanisms and, equally important, counter-cyclical thinking frequently bears the best results when such fear/greed periods take hold in markets. 2020 was no different.

- In the face of the emergence of a completely unknown, the Covid-19 virus during Q1 2020 and the potential of an ensuing global pandemic, all governments and elected politicians around the world collectively panicked and shut down the global economy by mandating an enforced time-out for all their citizens and corporations during February/March. This was a classic external economic shock.

- Panic ensued in financial markets on fears of a global systemic meltdown during this 19 February – 23 March period. At that stage during those dark days, all one had to do was to believe in the FED embracing its role as lender of last resort to backstop the financial system, while a gradual normalization in the global economy into 2021 would also take place with politicians gradually reversing some of the mandated , strict lockdowns. One also had to completely disregard the R&D power of the medical science community on delivering on their promise of an effective vaccine.

- Ultimately, the FED did backstop the global financial system, first with 2 seperate emergency rate cuts during March taking the Fed Funds rate from 1.5% to 0% within the span of 2 weeks. It then shortly thereafter followed up by announcing a new QE Unlimited program on 24 March with an open-ended time frame and the extension of the scope to include corporate bonds. With this QE program, the FED was able to monetize nearly 50% of all new Treasury issuance in 2020, which was needed to support the $ 2.5+trillion US fiscal stimulus programs. The FED balance sheet in this process increased from $ 4.2 trillion at the end of 2019 to finish 2020 at $ 7.4 trillion (close to 35% of US GDP).

- At the same time, some of the strict lockdown measures started to be eased by the end of April/early May, resulting in the US economy bottoming out in late April and Europe following suit during summer. On the vaccine front, the medical community's immense R&D project (partially financed by the US government's Operation Warp Speed) led to the approval of 2 vaccines (PFE/Biontec, Moderna) by the FDA during December.

2020 marked by the shortest recession and shortest bear market in history

- Net net, against this overarching backdrop, the US/global economy experienced the shortest recession in history in 2020 (with the US economy bottoming out by late April), also leading to the shortest equity bear market in history. Since 1953, equity bear markets (as measured by the S&P 500) have resulted in an average drawdown of -37% over a duration of 10 months. In 2020, the S&P 500 dropped by -34% between 19 February – 23 March during the course of 5 weeks. The straight line recovery from that absolute low of 2,237 was also historic, with a 68% rise until the end of the year. The S&P 500 finished 2020 at an all-time high of 3,756.

- Naturally, realized volatility also peaked in 2020, reaching the second highest level for any year since the great depression in the 1930s at 35% for the S&P 500, versus a historic average of 16%. Looked another way, the high-to-low trading range of 1,500 points for the S&P 500 amounted to 50% of the mid-point of this range.

- In such a crazy year, developed market equities (MSCI World) ultimately returned an impressive +14.1% for the entire 2020, having been down -32.1% year-to-date as of 23 March! Global corporate credit also delivered a robust +10.0% return in 2020, with spreads finishing the year close to all-time low levels. The other key aspect of the 2020 was the stark bifurcation of the equity markets into resilient, structural growth stocks versus the economically sensitive cyclicals, which were hurt disproportionately from the pandemic lockdowns. The Technology industry was the space to be invested in. While the S&P 500 index generated a return of +16.3% for the year, the equal weighted S&P was up «only» +10.5%, due to the index large weighting of megacap Technology companies. The Nasdaq-100 delivered an impressive return of +47.6%, whilst the US Software index was up +52.0% driven by its recurring revenues, resilient high growth and high free cash flow (FCF) margins. US Software stocks are now seen as long duration bond proxies with higher yields and growing interest streams, in a low interest environment.

- The last point in our retrospective on 2020 has to be devoted to US long-term real rates. In a year during which there was record US Treasury issuance amidst a growing twin deficit (budget and current account), the FED's ongoing $ 120bn per month asset purchase program clearly capped the 10-year Treasury nominal rates to below 1.0%. This, combined with the gradual recovery in the 10-year US breakeven (as a proxy for inflation expectations) towards 2.0% during 2020, meant that US real rates finished the year at an all-time low of -1.06%, versus +0.13% at the end of 2019. This sharp decline in real rates provided a solid tailwind to Gold prices, finishing 2020 with a return of +24.4% at close to $ 1,900/oz. On the contrary, cyclically exposed commodities such as Crude Oil were down by around -20% for the year.

2020 standouts were clearly US Technology equities and Gold

Global Equities	Dec-19	Dec-20	% Change (USD terms)
S&P 500	3230.8	3756.1	16.3%
SMI	10616.9	10703.5	10.3%
EuroStoxx 600	415.8	399.0	4.5%
MSCI DM	2358.5	2690.0	14.1%
MSCI EM	1114.7	1291.3	15.8%

Global Bonds	Dec-19	Dec-20	% Change (USD terms)
Barclays Global Credit	276.2	303.9	10.0%
US BBB spread	1.25%	1.09%	
US HY spread	3.27%	3.27%	
10-year Treasury	1.92%	0.91%	
US yield curve 3Mo10s	0.34%	0.84%	
10-year inflation breakeven	1.79%	1.99%	
10-year US real yield	0.13%	-1.06%	

Currencies	Dec-19	Dec-20	% Change (USD terms)
EURUSD	1.121	1.222	8.9%
CHFUSD	1.033	1.130	9.4%
GBPUSD	1.326	1.367	3.1%
USDJPY	108.610	103.250	-4.9%

Commodities	Dec-19	Dec-20	% Change (USD terms)
Global BBG index	80.9	78.1	-3.5%
Gold	1523.1	1895.1	24.4%
Copper	6174.0	7766.0	25.8%
Iron ore	86.0	84.6	-1.6%
WTI Crude Oil	61.1	48.5	-20.5%

2021 Market Insights

2021: The year of economic normalisation after a large external shock

- There is no doubt that 2021 will be the year of economic normalization after the pandemic driven economic decline in 2020.

- We expect global GDP growth to come in at +5.5% year-on-year (YoY) in 2021, after a decline of economic activity by -3.8% YoY in 2020. The US economy showed its clear resilience in 2020 with GDP dropping by -3.5% only and we expect the US economy to be the first major developed market economy to regain its 2019 level during 2021.

Real GDP growth between the US and the rest of the G7 to reverse temporarily in 2021

	2017a	2018a	2019a	2020a	2021e
US	2.2%	2.9%	2.3%	-3.5%	4.5%
Japan	1.7%	1.1%	0.9%	-5.3%	3.3%
Germany	2.5%	1.9%	0.6%	-5.8%	3.9%
France	2.3%	1.6%	1.2%	-9.2%	7.0%
UK	1.7%	1.4%	1.3%	-10.5%	6.1%
Italy	1.5%	1.2%	0.6%	-8.7%	6.0%
Canada	3.0%	2.1%	1.5%	-5.5%	4.8%
G7-ex US	2.1%	1.5%	0.9%	-7.6%	5.1%
Developed Mkts.	2.3%	2.4%	1.7%	-5.5%	4.7%
Emerging Markets	4.7%	4.7%	4.2%	-2.6%	6.1%
Global GDP growth	3.7%	3.7%	3.1%	-3.8%	5.5%

Source: Nahmani Grunder

- This V-shaped recovery in 2021 from the external shock in 2020 also implies that the real GDP growth differentials in 2021 specifically between the US and the rest of the G7 will temporarily look less favorable to the US given how much harder the EU and Japan economies were hit in 2020.

- Despite the swift recovery in the US, we still expect core PCE to finish 2021 at 1.8%, below FED's mid-term target of 2.0%.

2021: FED backstop remains in place & the Blue Sweep boosts fiscal stimulus

- This base case economic scenario carries the following THREE background assumptions, which are key to our financial markets outlook and playbook:

- With 3 seperate vaccines already approved in developed economies, we expect wide-spread vaccinations to take place in the first half of 2020, despite a slow start in the US since December. Less than 3% of the US population has received the first dose of the vaccine by early January, according to CDC (9m people only, versus 25m doses already available).

- The FED has clearly communicated that it will continue its current super easy monetary policy well into a full recovery, allowing inflation (as measured by core PCE) to move beyond the 2% target before a rate lift-off. Accordingly, we assume that the Fed Funds rate will remain at 0% into 2023, with the current monthly $ 120 billion asset purchase program remaining in place until end-2022. The FED backstop will thus remain firmly in place during 2021 – 2022, and this will not be the time to test the omnipotence of the FED as the central bank behind the reserve currency of the world, in our view.

- Following the US Senate run-offs in Georgia on 5 January, Democrats have achieved a Blue Sweep. This implies that Dems will have full control of the Legislative agenda, communicated during the election campaign: (1) Boost Fiscal stimulus by $ 1.5 – 2.0 trillion, of which $ 900bn was passed by late-2020 already. The first immediate action point should be an additional tranche of $ 2,000 checks to every US household. (2) Reverse the Trump corporate tax reform from 2017. Corporate tax reform added $ 13 of EPS to S&P 500 EPS in 2018 (8% of total EPS in 2018). A complete reversal would be a large up to $ 20 EPS headwind to S&P 500 earnings in 2022e. There have also been discussions to increase capital gains taxes on individuals. (3) Stronger regulation of business, including potential increased antitrust scrutiny of Big Tech and heighted focus on pricing in Health care industry. (4) Reverting back to a leader role in championing globalization. This would entail rebuilding tarnished relations with China and also EU.

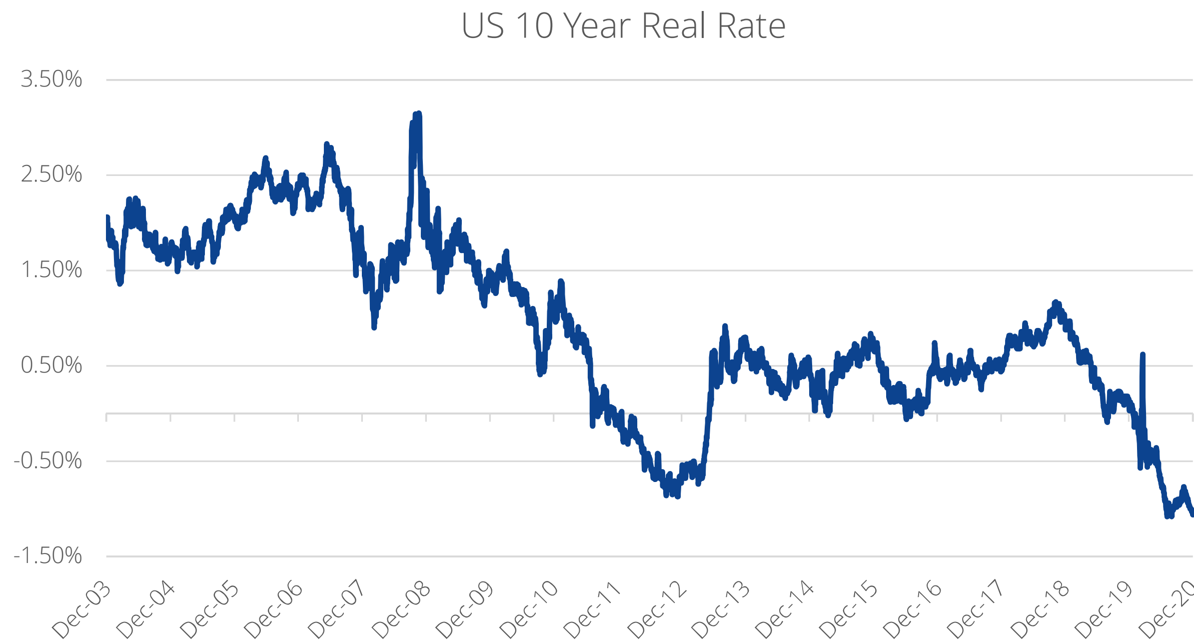
- HOWEVER, a split Senate with a slim majority means that many of these agenda points will need major compromises. We expect the Senate outcome to lead to greater fiscal stimulus in the near-term, while we could see incremental tax increases to finance part of the increased spending by late-2021 at the earliest. And, a divided Senate should only approve a fraction of the tax increases Biden has proposed. Increased regulatory scrutiny of Big Business should also not be the focus before 2023, after the Senate mid-term elections in November 2022.

We see US real rates remaining at or below -1.0% at least until end-2022

- The big contention points in markets now are whether the Blue Wave potentially alters expectations for FED's interest policy (when does the first rate hike happen?) and where long-term real rates go from here.

- Our base case, which also drives our financial markets playbook, assumes FED keeps the Fed Funds rate unchanged at 0% into 2023 while an unchanged FED QE program will cap any meaningful move in 10-year Treasury rates to 1.25% until end-2022 (versus 1.10% today). Taken together with a further march in the US 10-year breakeven higher towards 2.3% - 2.5% (see chart on next page), we believe US real rates should stay at or even lower than -1.0% for the foreseeable future.

- FED Chair Powell's current term ends in February 2022 and should be extended by 4 years. Hence we do not expect any change to FED's new flexible average inflation targeting (AIT) approach allowing for an inflation overshoot above 2.0%.



Source: Nahmani Grunder - Bloomberg

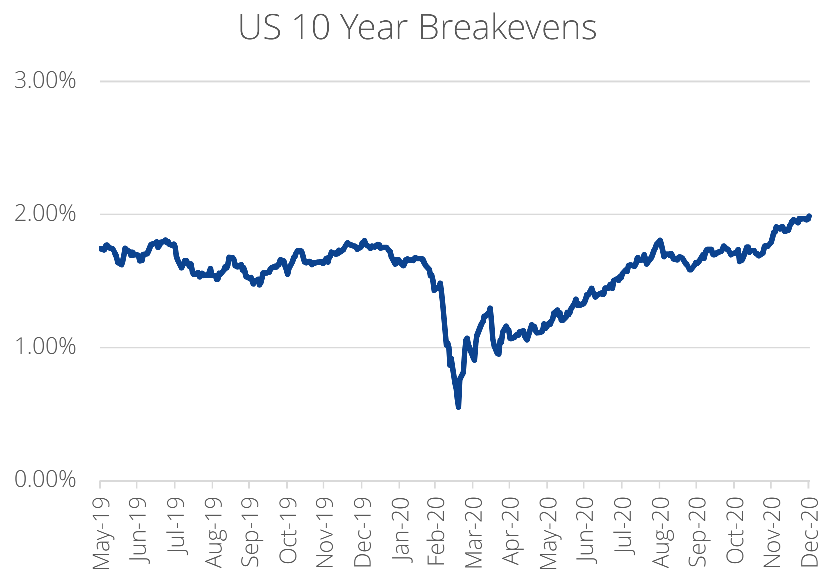
… with US 10-year breakevens continuing the march higher (2.07% today)

- US 10-year breakeven ultimately captures mid-term inflation expectations in the market.

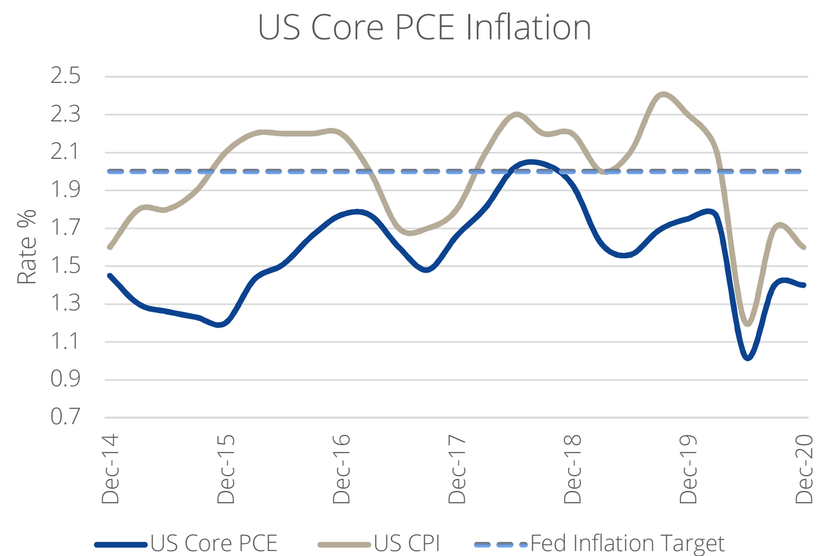
- It moved from a low of 0.56% in the panic days of March 2020 to grind higher during the year to finish 2020 at 1.97%, versus the core PCE at 1.4%.

- We see no reason why the 10-year breakeven can't move back towards 2.5% last seen in March 2013, while supporting real rates at current levels in the process.

- The risk to this base case would be an inflation overshoot, which would prompt the FED to embark on a rate lift-off much earlier than in 2023. This will a key factor to watch over the next 18 months.



Source: Nahmani Grunder



Source: Nahmani Grunder

The easy money post covid-crisis has been made in 2020

- The easy money has been made in 2020, and the risk/return is by far not as favorable as in Q2/Q3 2020 when market were worried about a longer, sustained global recession caused by the pandemic. Valuations are clearly much fuller now, both in Equity and Credit markets, following the significant re-rating last year. The economic normalization is already mostly priced in.

- Given our views on US real rates, we nonetheless continue to see some upside in equity markets as well as precious metals, with the upside in equities driven by earnings growth as opposed to further multiple re-rating. We would also advice investors to be opportunistic during 2021, and use eventual pullbacks as a buying opportunity to manage overall exposure levels. The volatility in US Technology stocks immediately after the US Senate decision in early January should be seen as such an attractive opportunity.

- Our 2021 equity market playbook is to continue focusing on bottom-up stock selection as a way of augmenting returns in excess of overall equity market returns which should be capped to 10% - 15% at best over the next 12 – 18 months. We see a wealth of attractive individual stock level opportunities, also in the Technology sector which already did very well in 2020. On the other hand, the backdrop should also be supportive of lower volatility in markets, with realized volatility for the S&P 500 declining from 35% in 2020 towards long-term averages around mid-teen levels.

- We continue to prefer equities over credit globally, and we are entering 2021 feeling even a tad more negative on credit, forecasting slightly higher long-term nominal rates with credit spreads at all-time lows already. Having said that, FED and ECB will continue to purchase IG corporate bonds as part of their QE programs into 2022, and this should cap the risk of wider spreads for now. USD-denominated BBB corporate bond spreads today trade at 1.10%, 80bps lower than the 20-year historical average.

- USD could continue to be weaker on a trade weighted basis, especially against EM currencies, in 2021 as we go through this normalization phase in the global economy and US GDP growth looks less differentiated in this current year only.

- On Gold, real rates remaining well anchored at -1.0% or even lower should act as a helpful tailwind to prices.

Global Equities: 10% to 15% upside potential over next 18 months

- We use S&P 500 as a global barometer for Global equities, since the US economic trends and FED policy continue to be the major drivers of global markets, and current valuation differentials do not justify meaningful regional differences in 2021, especially in the developed world.

- S&P 500 average year-end P/E was 18.2x between 2015a – 2019a but we closed 2020 at a P/E of 26.9x driven by FED policy as well as the pricing of a swift V-shaped economic normalization in 2021. On our EPS estimates, S&P 500 P/E 2022e currently normalizes down to 20.7x, which would still be a 14% premium to historical average, justifiable on terms that current incredibly easy FED policy remains in place into 2023.

S&P 500 EPS per calendar year with P/E bands

	2015a	2016a	2017a	2018a	2019a	2020a	2021e	2022e
Operating EPS	118.20	119.08	132.95	162.91	164.58	139.8	169.9	185.2
Growth (YoY)		*0.7%*	*11.6%*	*22.5%*	*1.0%*	*-15.1%*	*21.5%*	*9.0%*
Price low	1867.6	1829.1	2257.8	2351.0	2447.9	2237.4		
Price high	2130.8	2271.7	2690.2	2930.8	3240.0	3756.1		
Price close	2043.9	2238.8	2673.6	2506.9	3230.8	3756.1	3824.7	
P/E low	15.8	15.4	17.0	14.4	14.9	16.0		
P/E high	18.0	19.1	20.2	18.0	19.7	26.9		
P/E close	17.3	18.8	20.1	15.4	19.6	26.9	22.5	20.7
P/E range	15.8 - 18.0	15.4 - 19.1	17.0 - 20.2	14.4 - 18.0	14.9 - 19.6	16.0 - 26.9		

Source: Nahmani Grunder - Bloomberg

- Our new base case scenario for the S&P 500 by mid-2022 is 4,050 (+6% upside), with a bullish case of 4,350 (+14%) over the same 18 month period.

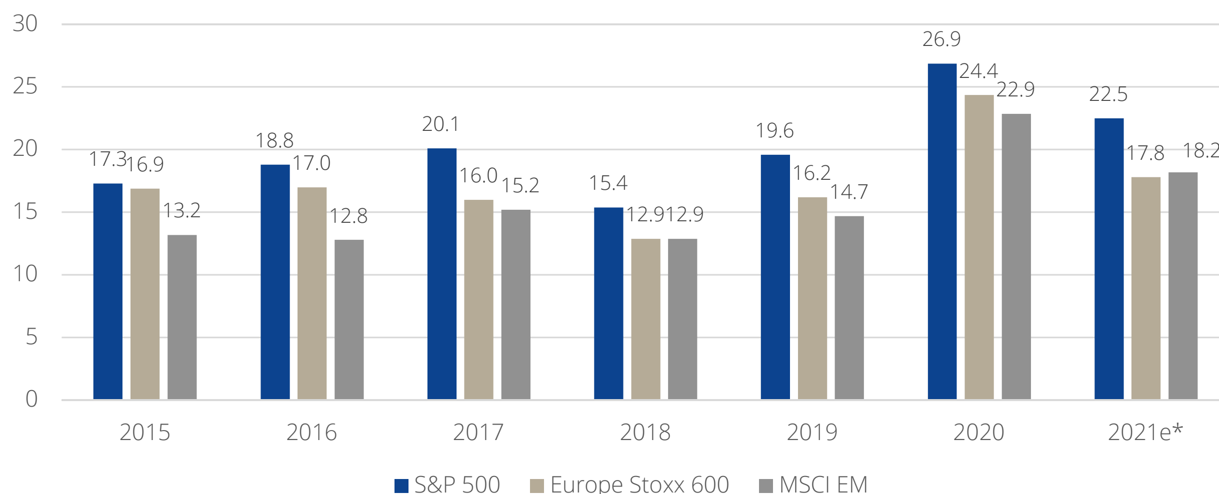
- This base price target of 4,050 assumes an EPS of $185 in 2022e (versus $140 in 2020e) with a P/E 2022e target multiple of 22.0x. This target multiple is a function of a 10-year nominal Treasury rates forecast of 1.25% by end-2022e (FED will cap any meaningful rise in nominal rates, as discussed before) with an equity risk premium (ERP) of 3.3% (versus 2.8% by end-2020 and a historical average of 3.8% between 2011 – 2019).

Global Equities: No meaningful regional differences in DM markets in 2021e

- The bullish case of 4,350 for the S&P 500 by mid-2022 uses an ERP of 3.0%, rather than the 3.3% in our base case, and indirectly implies that risk premiums over the next 18 months remain depressed at the levels of end-2020. As a useful benchmark, the absolute lowest level of ERP over thee last 10 years was 2.6% in 2017, albeit during a time of a genuine global synchronized global GDP growth acceleration and sizeable corporate tax cuts in the US.

- Regionally, we have had a strong preference on US equity markets over the last 5 years, and the S&P 500 has indeed outperformaned Europe and Emerging Markets (EM) by 75% and 17% respectively over this period, driven by superior EPS growth, higher ROIC and relatively attractive valuation multiples. We now see a temporary end to this outperformance by US equities during the catch-up year 2021.

- On a P/E basis, all equity markets are now trading above historical averages, including EM at P/E 2021e of 18.2x versus historical average at 13.8x. Moreover, EPS growth differentials between the regions will look much less stark in 2021, such that we do not expect gaps in returns between them. However, we also think the current consensus calling for a period of US equity market underperformance will ultimately prove to be wrong.



Source: Nahmani Grunder estimates as of 08 January 2021.

Global Equities: More bullish on EM equities since May 2020

- In our 2020 outlook publication last year, we had stated that «right time to turn more constructive on EM equities will be during the next global recession». The global equity bear market caused by the covid pandemic in March 2020 did indeed create this opportunity shortly thereafter. MSCI EM index returned +70% betwen 23 March and the end of 2020, outperforming MSCI World in this period. Since May 2020, our direct EM equity exposure has increased meaningfully with increased investments in China and Taiwan.

- At the same time, MSCI EM index is now back to its previous all-time highs from October 2007 and January 2018. In other words, EM equities are now again back to being flat after 13 years, while the S&P 500 had added more than 150% in this period.

- While EM valuations on an index level do not screen as cheap anymore, a 12-to-18 month period of USD weakness against EM currencies, coupled with best-in-class EPS growth globally, should continue to present EM equities as an attractive hunting ground for global investors. The China Technology sector is top-of-mind for us, in this regard.

- Net net, our regional pecking order on a global basis would be US and EM on top, followed by Japan, EU and Switzerland in this order. In terms of Europe specifically, the valuation of Dow Jones Stoxx 600 (SXXP) is also above historical precedence, with its P/E 2021e of 17.8x trading 2 full points above its LT averages. Moreover, its current discount of -21% to the US equity markets (S&P 500), versus a historical average discount of -14%, is justifiable by the expected mid-term EPS growth and ROIC differentials of these two indices. We would turn more bullish on SXXP versus S&P 500 in case real rates start a gradual recovery towards 0% and US yield curves do steepen from current levels. This is not our base case well into 2022.

- Sectorally, we remain with our positive bias to our long-term favorites Technology and Health care, while also now carrying a balanced barbell aproach to our stance with increased exposures in Consumer discretionary, Energy and Insurance sectors. As long as US real rates remain at -1.0%, Technology, and especially Software valuations, are well supported. We remain lukewarm on Banks, since we do not buy into the thesis that US and EU yield curves will steepen meaningfully from here. The US yield curve at 2/10 year node is at 100bps, with no further upside potential under our current base case scenario.

Fixed Income: With rates and spreads at lows, credit selection to be key

- Corporate credit spreads closed 2020 at or close to all-time low levels. For example, USD-denominated BBB corporate bond spreads today trade at 1.10%, 80bps lower than the 20-year historical average. USD high yield spreads at 3.04% are 80bps above all-time lows, but 200bps tighter than the 20-year averages. The EUR and CHF corporate bonds typically even have negative nominal yields, with investors betting on further central bank asset purchases driving yields into even more negative territory.

- Credit yields thus continue to be challenged by the fact that current rates should have bottomed with spreads at all time lows, even in the US. In this process, one should remember that whatever is positive for spreads will ultimately be a negative for rates with a 18 – 24 months view.

- With historically tight starting levels, for investors requiring exposure to credit, investment grade (IG) US corporates (Low A rated to BBB's) within the 3 - 5 year duration bucket stand out as being the most attractive together with tactical silos of IG issuer rated Perpetuals/Hybrids and short dated High yield when looking for positive yielding and fundamentally sound rated corporates in 2021.

Index (Local Currency)	2020 Return %	Yield %	Duration (Yrs)	Spread (Bps)
Global Credit	10.03	1.24	7.39	93
Global Aggregate	9.2	0.83	7.43	36
US Aggregate	7.51	1.12	6.22	47
US High Yield	7.11	4.18	3.58	360
Global High Yield	7.03	4.47	4.18	409
Emerging Markets USD	6.52	3.5	6.89	280
Euro Aggregate	4.05	-0.14	7.68	47
Pan European High Yield	1.76	3.4	4.02	357
Global Treasuries	0.19	0.49	8.81	10

Source: Nahmani Grunder - Bloomberg

Currencies: USD slightly weaker on a trade-weighted basis in 2021

- FX pairs are ultimately driven by real interest rate differentials in the mid-term, but also by real GDP growth differentials in the short-term as a short cut to gauge the direction of travel for future interest rates.

- On both metrics, USD will look challenged in the short-term during 2021, a year which will also coincide with a clear twin deficit in the US (budget and current account). In this regard, the incremental fiscal stimulus to come from the new Biden administration during H1 2021 will make the picture look even more . With US real rates having collapsed to -1.0% from around 0% at the end of 2019, USD currently carries no meaningful real rate differential versus other developed market currencies (German real rate at -1.8%). GDP growth differentials between the US versus the rest of G7 will also temporarily not be positive in 2021.

- On that basis, we see a viable scenario under which the trade-weighted USD can continue to decline in 2021, especially versus Chinese RMB and commodity exporting country currencies, such as AUD and CAD.

- In terms of EURUSD, while keeping our mid-term strong bias for the USD, we think it is highly likely that we are now in a new range of 1.20 – 1.25 at least for 2021, before the more attractive US GDP growth dynamics come back to fore as of 2022 and markets start to price in better interest rate differentials to the benefit of the USD as of 2023. Also important to note is that further EURUSD strengthening would be a big problem for the eurozone which continues to be griped by deflationary tendencies with a 5-year inflation swap rate at 1.3% only. A stronger EUR will not be welcomed by the ECB, in our view.

- In terms of CHF, it clearly benefitted from safe-haven flows in 2020. The likely scenario under our base case of a global economic normalization with 2021, overlaid on an enviroment of concurrent easy fiscal and monetary policy, would dictate CHF to weaken against EUR, while being in a tight range of 0.88 – 0. 90 in terms of USDCHF.

Precious Metals: We see upside in Gold and Silver from here

- Gold prices have historically been inversely correlated with US real rates. In this regard, our views on US real rates remaining at -1.0% or lower into 2022 should support higher Gold prices in 2021. A downward bias to the USD should also be a tailwind for Gold prices.

- We see Gold prices between $ 2,000 – 2,200 per oz. in 2021, versus an all-time high of $ 2,064 on 6 August 2020 when US real rates hit an all-time low of -1.08%. Any pullback below $ 1,850 would be a buying opportunity, in our view.

- In terms of other precious metals, Silver has the industrial use angle that Gold lacks, and that should create an addtional uplift to demand in 2021, as the world goes through the economic normalization with high year-on-year growth from a depressed 2020. Moreover, with Biden administration pushing for a greener energy policy agenda, Solar demand should also be supportive to overall Silver demand. Around 10% of annual demand for Silver goes into Solar panels. In our view, Silver should see higher returns than Gold during 2021, albeit with much higher volatility. Using the same average Gold/Silver ratio of 65x seen since 1997, Silver could thus reach $ 31 – 34 per oz. during 2021 under the above scenario.

Summary Outlook 2021

Asset Classes	Positive	Neutral	Negative
Fixed Income & Cash	USD IG - BBB	USD HY EUR IG/HY Corp EM $ Corp T-Bills	Money market US Treasuries EU Sov. Bonds
Equities (sectoral view)	Technology Healthcare Energy Insurance Metals & Mining	Consumer Discretionary Consumer Staples Banks Telecom	Industrials Chemicals Utility
FX	CNY EM	USD EUR GBP CHF JPY	
Commodities	Oil Precious metals	Iron ore Copper, Nickel	Coal

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