Key investment issues in 2021

How we're managing our clients' portfolios

Paul Eitelman, CFA, Senior Investment Strategist

Sophia Wang, Market Analyst, Non-Profit and Healthcare

With a global pandemic, the shutdown of the global economy, and the deepest recession since the 1930s, 2020 was a year like no other. Fortunately, 2021 has gotten off to a somewhat more normal start. Major world economies have weathered the COVID-19 pandemic and associated lockdowns with relatively little long-term economic damage thanks to accommodative monetary policy and substantial fiscal spending. Moreover, the end of 2020 was marked by remarkable rebounds in equity markets; by December, global equities had gained around 12% since the beginning of 2020—an outcome few would have predicted during the depths of the market panic last March.

With positive COVID-19 vaccine prospects on the horizon, 2021 is predicted to be a year of global economic recovery. For the United States, we anticipate a year of two phases, with the first—over the crucial winter months—looking challenging as COVID-19 infections continue to erupt across the nation. However, once the vaccine is widely distributed, we believe that dislocated sectors (e.g., retail, travel, and hospitality) will bounce back strongly. Overall, we have a positive outlook for global economic growth and corporate earnings this year; the early recovery phase of the cycle means an environment of low-inflation, low-interest rate growth that should favor equities over bonds.

Here is how we are managing these economic and market shifts in our clients' multi-asset portfolios, using our cycle, valuation, and sentiment (CVS) investment decision-making process.

Equities: Preference for non-domestic equities and shift to value stocks

We maintain moderate risk-on positioning in our clients' portfolios relative to strategic levels, driven by overweight equities. We favor developed international equities (i.e., Europe ex-UK and UK) over domestic peers due to better relative valuations. We also like the value in emerging market equities—China's early exit from the lockdown and government stimulus measures should benefit emerging markets more broadly, as will the recovery in global demand and a weaker U.S. dollar (for which we maintain an underweight due to stretched valuations and our outlook for a cyclical rebound). Overall, we prefer non-domestic equities to U.S. equities. This is because, relative to the United States, the rest of the world is overweight cyclical value stocks. Notably, value stocks outperformed growth stocks in late 2020, for which our multi-asset portfolios were rewarded. We expect cheaper value stocks to continue to benefit from the return to more normal economic activity, an extension of the rotation that began in early November away from technology and growth leadership towards cyclical and value stocks.

Fixed income: Bonds universally expensive

We maintain our underweight positioning to high-yield credit in favor of equity risk; this was a net contributor to our clients' portfolios, as equities outpaced high-yield credit late last year. We continue to view government bonds as expensive—long-term government yields are likely to come under upward pressure from a vaccine-led recovery this year. However, dovish central banks and the lack of inflationary pressure in most countries (due to large output gaps) should limit the rise in bond yields. U.S. inflation-linked bonds offer good value with breakeven inflation rates well below the Fed's targeted rate of inflation. Bank loans and U.S. dollar-denominated emerging market debt, in our view, offer the best opportunities given that their spreads remain relatively attractive.

Currencies: Weakening U.S. dollar during recovery

We are holding on to our underweight to the U.S. dollar due to historically stretched valuations, as well as its countercyclical nature—it typically gains during global economic downturns and declines in the recovery phase. We believe the main beneficiaries of the global economic recovery should be the economically sensitive commodity currencies—including the Australian dollar, the New Zealand dollar, and the Canadian dollar, the former two of which are particularly attractive as Australia and New Zealand have been managing COVID-19 infection rates well.

Near-term risks

Investor sentiment has become very optimistic following the vaccine developments, making markets vulnerable to negative news. Potential risks we are taking into consideration include renewed lockdowns in Europe, the UK, and North America as virus cases escalate during the northern winter; logistical difficulties in distributing the vaccine; and negative economic growth early on if government support measures are unwound too quickly. On the geopolitical arena, there could also be negative surprises from Brexit or from China, Iran, or Russia as the new Biden administration takes power in the United States.

Our seasoned team of investment strategists and portfolio managers will continue to monitor the markets and dynamically manage risk within desired levels, helping our clients navigate the months ahead. At the end of the day, our focus is on empowering our clients, and making sure we're putting your money in the right place.

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