IMT Asset Management AG
Austrasse 56 · P.O. Box 452
9490 Vaduz, Liechtenstein
asset@imt.li · www.imt.li

INVESTMENT OUTLOOK 01.2021

23 January 2021

In keeping with our annual tradition we are going to put our necks on the line in this first Investment Outlook of the year and make ten predictions for 2021. We will also review our last year's predictions, which — as we did not anticipate a global pandemic with all its implications — turned out to be less accurate than they otherwise might have been.

What will 2021 bring? We foresee a year which will still be dominated by the fight against the Covid-19 virus. Policymakers seem to be strongly committed to doing whatever it takes to stabilize the economy. Government debt levels have risen dramatically, central bank balance sheets have ballooned. In the medium to longer term – not necessarily in 2021 – we will need to shoulder the burden stemming from those support measures.

A new US government under the leadership of Joe Biden will for sure change the course of US politics. It remains to be seen what impact this will have.

We hope you will enjoy reading our Investment Outlook throughout 2021 and we look forward to your feedback.

Trauth

Thomas Trauth
CEO – IMT Asset Management AG

REVIEW OF LAST YEAR'S PREDICTIONS

What happened in 2020?

For all of us the year 2020 will remain long in our memory. The Covid pandemic has precipitated a threefold crisis. It has created a medical crisis, pushing many healthcare systems to their limits. New treatment methods have had to be evolved and innovative ways found to achieve the fastest possible development of vaccines. It has brought about a social crisis beset with multiple thorny issues. To what extent is the state able and empowered to curtail the rights of the individual citizen? Is there a limit to the economic cost we are willing pay for the protection of groups particularly at risk? And finally, the pandemic has created an economic crisis which threatens the continuing existence of significant sectors of the economy, which has furthermore caused a sharp increase in unemployment and has made it necessary to implement monetary and fiscal measures of hitherto unimagined magnitude.

These developments have naturally kept the financial markets on tenterhooks. Between 18 February and 23 March, the US S&P500 Index lost one third of its value. Since then, despite a deep recession and driven mainly by government support programs, the equity markets have more than compensated for the losses, even reaching new all-time highs. For the S&P500, for example, this was the case on 8 December.

European interest rates were already very low, in fact clearly negative, at the beginning of the year and they had little room to fall further. In contrast, in two unscheduled emergency meetings on 3 and 15 March, the US Fed cut interest rates by 1.5%-points, basically to zero. Thereupon, 10-year yields fell from around 1.6% to 0.6%. Also, real yields collapsed, sparking a strong rally in gold, pushing gold prices temporarily to USD/oz 2,064 in early August, a surge of 40% between March and August.

Last year's predictions

In the following, we review last year's predictions. For the details, we refer you to our Investment Outlook 01.2020.

Obviously, the outbreak of the global pandemic could not be predicted. The resulting lockdown measures acted as an emergency break on the global economy. Quite understandably, certain sectors were hit harder than others. Some sectors, especially online businesses, incl. entertainment, e-learning and health, even benefited.

After the first shock-wave in February and March, the policy response was swift and decisive. We clearly underestimated how strongly markets would recover, driven by a flood of liquidity and the expectation that the rapid development of vaccines would soon make the virus manageable.

As a result, our growth and inflation forecasts can be discarded. We were mildly positive on risky assets last year, which proved to be correct year-on-year. Our expectation that European stocks could outperform was clearly wrong since especially technology stocks, which dominate the US equity indices, outperformed by a wide margin.

Last year's prediction	Actual outcome	
1. Growth (real GDP)		
US: 2.1%	-3.7%	☹
Eurozone: 1.4%	-7.5%	☹
Japan: 0.5%	-5.3%	☹
China:5.8%	1.8%	☹
Note that GDP growth for 2020 is based on the latest estimates since official 2020 figures are not yet available.		
2. Inflation (end of period)		
US: 2.4%	1.4%	☹
Eurozone: 1.3%	-0.3%	☹
Japan: 0.2%	-1.2%	☹
3. Central Banks		
Central banks to remain dovish.	This assessment was correct but clearly understates the unprecedented amount of monetary stimulus in 2020, which by far exceeded the policy response during the global financial crisis.	(✓)
4. Rates (10-year yields)		
US: 2.5%	0.91%	☹
Eurozone: 0.25	-0.60%	☹
5. Credit		
Credit spreads to remain stable.	Year-on-year credit spreads did not move much. High-yield spreads widened 35 basis points while emerging market spreads tightened 22 basis points. However, volatility was huge with a massive widening in February and March, followed by a reversal thereafter.	(✓)
6. Equities		
Well supported equity markets with Europe outperforming the US.	Many equity markets performed positively in 2020, despite major volatility. However, most European indices exhibited losses and clearly underperformed.	(✓) ☹

Last year's prediction	Actual outcome	
7. Emerging markets		
Positive returns	The MSCI Emerging Markets index climbed 15.8% in 2020 and slightly outperformed the developed markets index, which rose 14.1%.	(✓)
but to underperform developed markets.		☹
8. Commodities		
Moderately positive on oil	The price for oil underwent a marked rise of 22.7%.	✓
Positive on industrial metals	Prices for industrial metals rose 7.0%.	✓
Moderately positive on gold	The price for gold rose 18.3%.	✓
9. Alternatives		
Positive for REITS	REITS lost 19%.	☹
10. Currencies		
USD stable to slightly stronger	The USD lost on average 6.7%.	☹
CHF to weaken	The CHF was on the strong side (vis-à-vis the EUR) for most of 2020, but ended the year only slightly (0.4%) higher.	☹

OUTLOOK 2021 – TEN PREDICTIONS

1. Growth

GDP fell dramatically in 2020. For example, US GDP fell 9% in Q2 compared with GDP in Q2 2019. It is widely expected that economies will recover in 2021. However, recent lockdown measures and strict social distancing rules will prevent the recovery from gaining momentum in the first half of the year. Growth will remain anemic in the first two quarters. Fiscal stimulus and support packages are designed to bridge this phase for companies and households and to prevent more lasting economic damage. If we can revert to a normal life in the second half of 2021, pent-up demand is likely to boost the economy. As a result, the recovery in Q3 and later could be quite strong.

Nevertheless, major uncertainties prevail regarding the speed and effectiveness of the vaccine rollout, potential virus mutations, and potential bankruptcies as the crisis could drag on for longer.

China's policy was highly expansive in 2020, boosting credit very substantially. In 2021, most likely in the second half, the credit impulse is likely to slow significantly, which represents another risk for the global economy.

We expect US real GDP growth of 3.2% (up from -3.7% in 2020), Euro area growth of 3.6% (up from -7.5%), Japanese growth of 2.3% (up from -5.3%) and Chinese growth of 8.0% (up from 1.8%).

2. Inflation

Despite concerted unseen monetary and fiscal measures, we think that inflation will be slow to pick up. Especially in 2021 we will still have underutilized resources and high unemployment. On a 2-3 year horizon, however, cost-push inflation, e.g., from rising energy costs plus excess liquidity, could eventually feed into rising inflation.

We expect US inflation to pick up somewhat to 1.5%, EMU inflation to rise to 1.0%, Japanese inflation to remain depressed at 0.3% and Chinese inflation to diminish somewhat to 2.5%.

3. Central Banks

All major central banks have taken the "whatever it takes" stance. Policy rates are zero (in the US) and clearly negative in the Euro area. In addition, central banks continue to provide liquidity very generously with large asset purchases and emergency lending facilities. Furthermore, central banks also committed themselves to stay expansionary even if the economies should start gaining momentum. The US Fed even changed its policy framework and would allow inflation to overshoot for a while. As a result, we assume that policy rates in the US and the Euro area will remain unchanged in 2021.

4. Rates

Short-term yields will remain well anchored for most of next year. The recent surge in inflation expectations reminds us that the market believes that government and central banks will succeed with their reflationary policies. This, in turn, exerts upward pressure on long-term yields. At the same time, however, massive bond buying by central banks will prevent bond yields from rising violently. As a result, we are positive for inflation-linked bonds, as real rates are likely to stay low for longer.

We expect US 10-year yields to be between 1.5% and 1.8% at the end of 2021 and European yields to tick up reaching levels between -0.2% and 0%.

5. Credits

High-yield spreads are wider than at the end of last year, while investment- grade spreads have tightened somewhat. Valuations are certainly rich in all credit market segments. On the back of massive policy support, improving fundamentals, and continued central bank buying we think that credit spreads will remain stable or may even tighten from here.

6. Equities, developed markets

Equity valuations in many sectors look stretched. The technology sector is a prime example. Nevertheless, unprecedented policy measures are supporting the markets. This, coupled with optimism that the fight against the pandemic will be successful in 2021, have been driving forces for the rally in equities. While this positive market environment can remain in place for an extended period of time, we see a heightened risk of corrections in the next couple of months and would use those to buy the dips. Overall, we see equity markets performing positively in 2021 and outperforming bonds. We expect the US to outperform Europe.

7. Equities, emerging markets

A weakening USD and a strong economic momentum in China should lead to a positive performance of emerging markets equities. China will be the key driver, despite our expectations that the Chinese government could slow the credit expansion in the second half of the year.

8. Commodities

We think that gold will remain well supported since real rates will remain low. At the same time a stabilizing economy will limit the upside for Gold. We expect gold to trade between USD 1,800 and 2,000 at the end of next year.

As China's stimulus may fade later in 2021 and Chinese demand for industrial metals may have peaked in 2020, prices for industrial metals should stabilize.

Our outlook for oil is positive. Demand for oil is likely to pick up as the global economy normalizes. Supply discipline on the part of OPEC 2.0 seems to be working. And US shale producers face capital constraints and a more environmentally friendly policy under President Biden.

9. Alternatives

REITS look oversold and should benefit from the economic recovery and a continuation of the low interest rate environment. Also, within REITS there are sectors which clearly benefited from the past crisis, such as logistics and data center REITS.

10. Currencies

Short-term the USD looks oversold and may recoup some strength in the next couple of months. During 2021 the USD is then likely to weaken further since interest-rate differentials are not supportive for the currency, and US inflation is likely to pick up sooner than in other countries.

Review of our strategic asset allocation

Every year we review our strategic asset allocation to investigate whether it needs amendments, given our rolling 5-year assessment of financial markets.

As a result of our analysis, we have concluded that we should remove (or clearly reduce) our exposure to nominal government bonds. First, we think that given current ultra-low and often negative interest rates the expected medium-term return of this asset class is negative. Second, since government debt has sky-rocketed in many countries, credit quality has deteriorated, which under normal market conditions would warrant a higher risk premium. Third, government bonds usually serve as a safe-haven asset in the portfolio and offset losses from risky assets like equities. Since we think there is little room for rates to fall even lower, this safe-haven asset function has diminished greatly in our view.

We had a hard time to find another asset to serve as a safe-haven for our portfolios. We concluded that we needed to introduce a long volatility strategy, which is expected to yield a gain in value when equity markets become disrupted.

Since this volatility strategy is designed to serve as a tail-risk hedge, and therefore will reduce portfolio drawdown risks, we feel comfortable in increasing our overall equity exposure. In our balanced portfolios, for example, we increased our equity quota from 40% to 46%. We also find this appropriate since medium-term equities are likely to outperform bonds.

Current tactical positioning

Since we have become more constructive on the outlook for equities, we have gone neutral on equities. Nevertheless, we expect 2021 to be a volatile year with a high likelihood of equity market corrections We remain underweight in high-yield bonds, since risk-reward looks unattractive, and overweight in insurance-linked bonds, since insurance premia went up last year.

ECONOMICS

After the outbreak of the pandemic, PMIs fell drastically but recovered strongly thereafter. China, which was first to be hit by the pandemic, managed to recover vigorously in 2020. This is also reflected in stellar stock market returns. Inflation also dropped during the first half of 2020. In the US inflation picked up in the second half of the year, whereas inflation in Europe, Japan and China remained depressed.

Fig. 1: PMIs

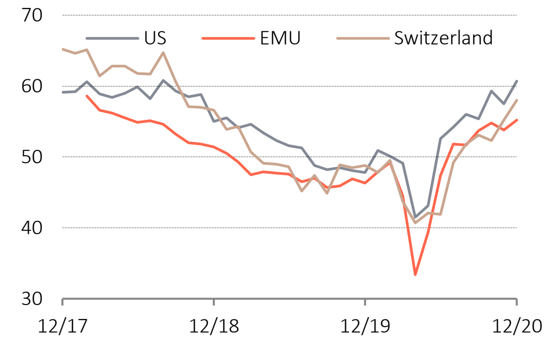


Fig. 2: PMIs

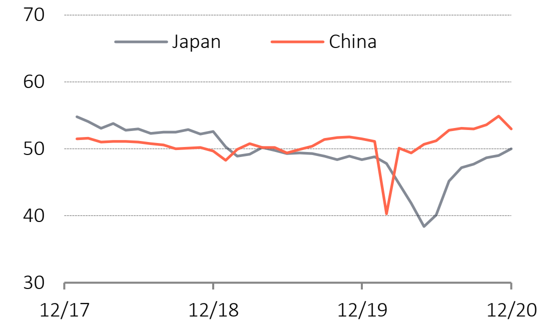


Fig 3: Consumer price inflation, in % YoY

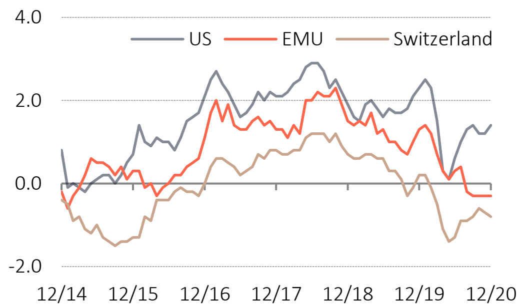


Fig. 4: Consumer price inflation, in % YoY

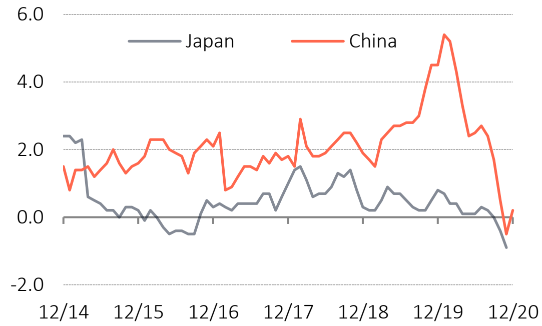


Fig 5: Unemployment rates, in %

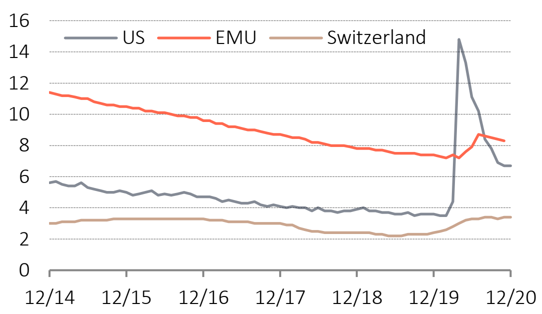
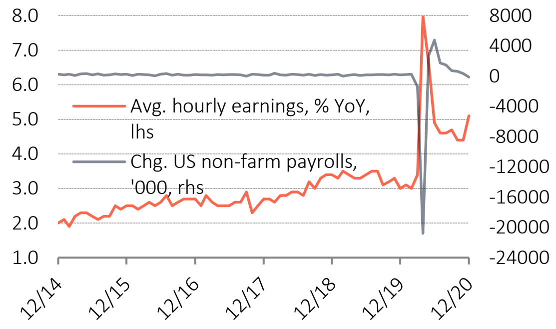


Fig 6: US labor market



FIXED INCOME

In 2020, due to extraordinary monetary policy measures and a deep recession, yields fell across the board. In Europe yields had little room to fall much further, whereas the US yield curve was pushed lower. In Q4 inflation expectations rose strongly, which led to a sell-off on the long-end of the curve. In line with other risky assets, credit spreads widened during Q1 and tightened back in thereafter.

Fig.7: 2Y government bond yields

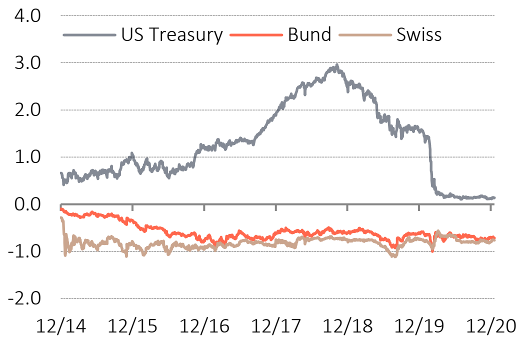


Fig. 8: 10Y government bond yields

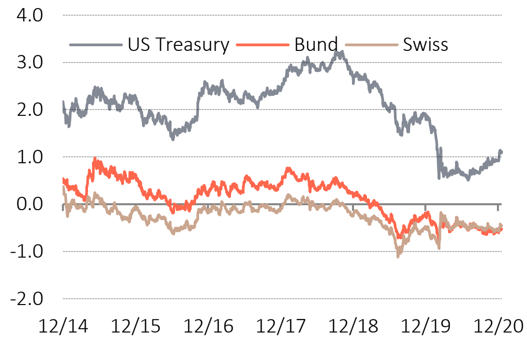


Fig 9: 10Y break-even inflation

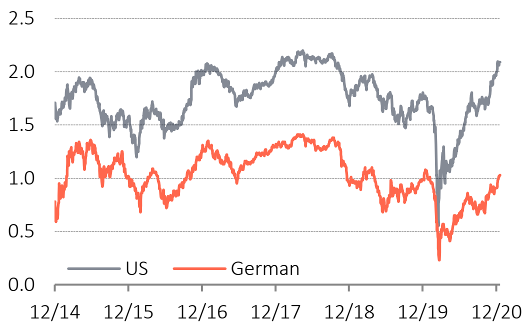


Fig. 10: Credit spreads, 5Y credit default swaps

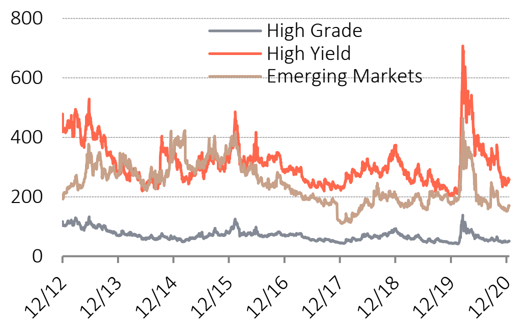


Fig 11: Money market spreads (3M-2Y)

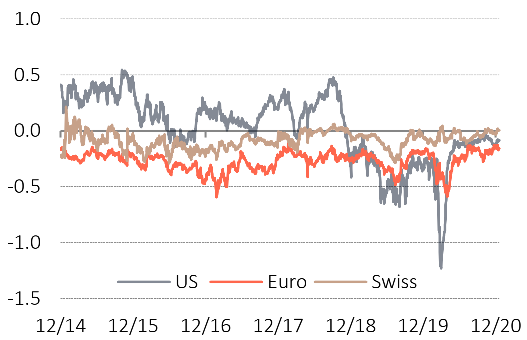
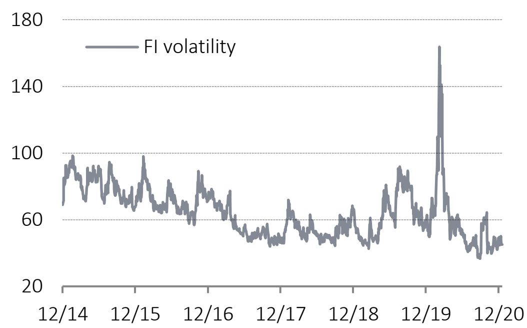


Fig 12: Merrill Lynch volatility index (MOVE)



EQUITIES

Between 18 February and 23 March, the US S&P500 Index lost one third of its value. Since then, despite a deep recession and driven mainly by government support programs, the equity markets have more than compensated for the losses, even reaching new all-time highs. For the S&P500, for example, this was the case on 8 December. Chinese and technology stocks clearly outperformed in 2020.

Fig. 13: MSCI equity indices – major regions

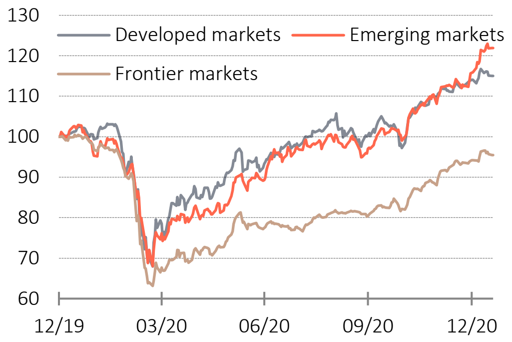


Fig.14: Equity indices – major developed markets

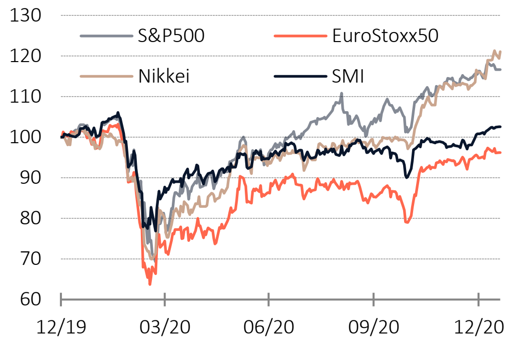


Fig 15: Equity indices – major emerging markets

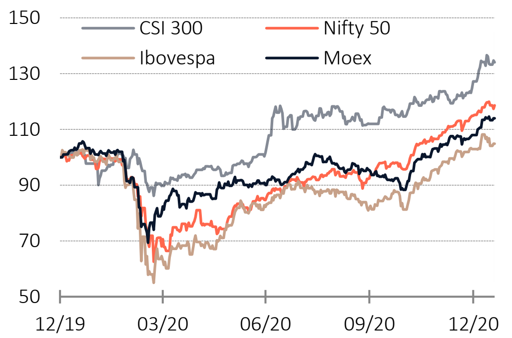


Fig. 16: Sector performance, MSCI Indices, 2020

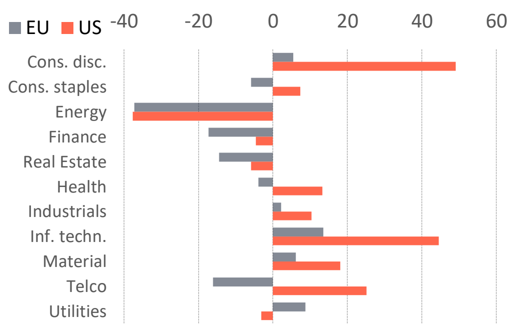


Fig 17: Price-earnings ratios

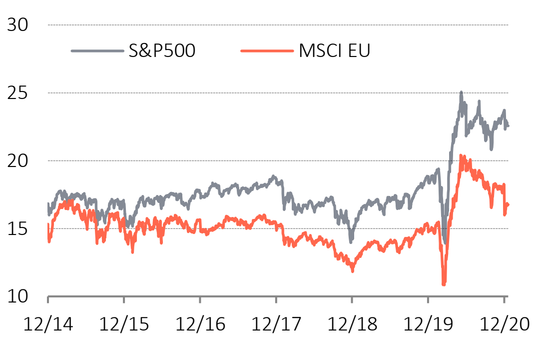
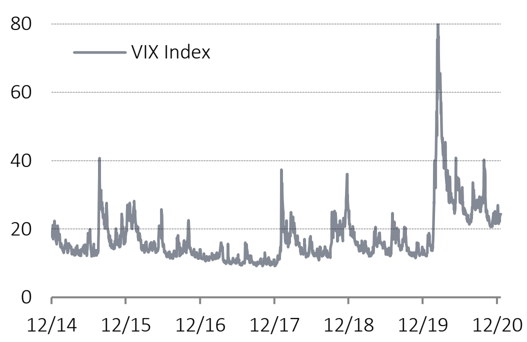


Fig 18: Equity volatility – S&P500 VIX index



ALTERNATIVE INVESTMENTS

On the back of falling real rates, the price for gold rallied strongly reaching USD/oz 2,064 in early August. This is tantamount to an increase of 40% between March and August. In contrast, oil prices collapsed to hitherto unseen levels. The futures price of oil even became negative, as growth concerns met with the collapse of OPEC talks in March and April. Since then, oil markets recovered. REITS were hit hard by the pandemic and were among the worst performers in 2020.

Fig. 19: Gold price, USD/oz

Fig.20: Brent oil price, USD/bl

Fig 21: Bloomberg commodity indices

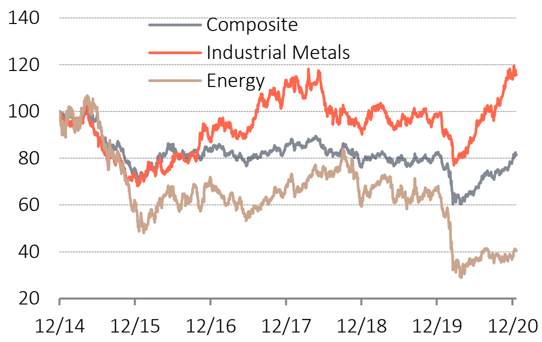


Fig. 22: HFRU hedge fund indices

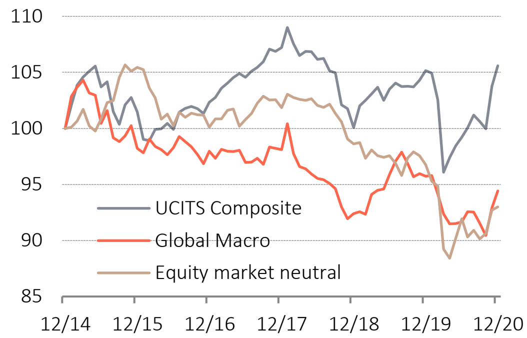


Fig 23: FTSE EPRA/NAREIT global REITS index

Fig 24: LPX global listed private equity

CURRENCIES

Currency volatility was very elevated throughout 2020. The USD appreciated until March, albeit with huge swings up and down. Thereafter, the USD depreciated across the board as its interest rate advantage shrank significantly. Overall, safe-haven currencies, like the JPY and the CHF, were on the strong side in 2020, whereas emerging market currencies, like the TRY and BRL, weakened. However, the Chinese CNY vigorously strengthened after May, as the Chinese economy recovered.

Fig. 25: EUR-USD exchange rate

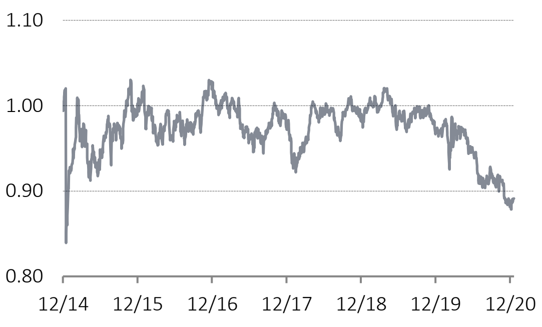
Fig. 26: GBP-USD exchange rate

Fig 27: USD-JPY exchange rate

Fig. 28: USD-CNY exchange rate

Fig 29: EUR-CHF exchange rate

Fig 30: USD-CHF exchange rate



COVID-19

The number of global cases has almost reached 100 m and more than 2 m people have died. Much stronger lockdown measures have been implemented in most countries as a second wave has emerged and new, more contagious virus variants are spreading. The rollout of vaccines started in December 2020. So far 57 m vaccinations have been administered globally. However, the speed of the rollout differs greatly. Israel has already vaccinated 38% of the population, whereas Germany only 1.7%.

Fig. 31: Total Covid-19 cases (x 1000)

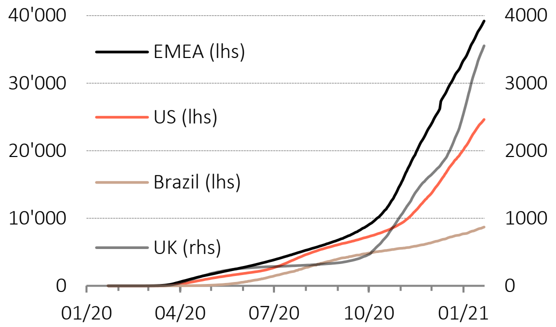


Fig. 32: New cases per day (7-day average)

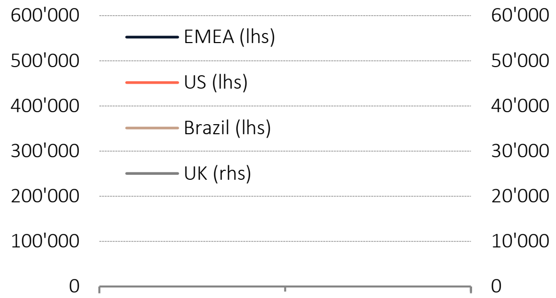


Fig 33: US bankruptcy index

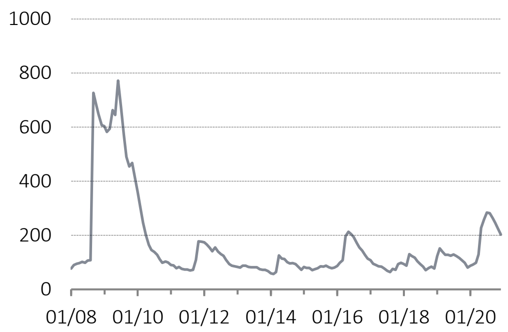


Fig.34: US personal income, excl. transfers (USD bn, 2012 prices)

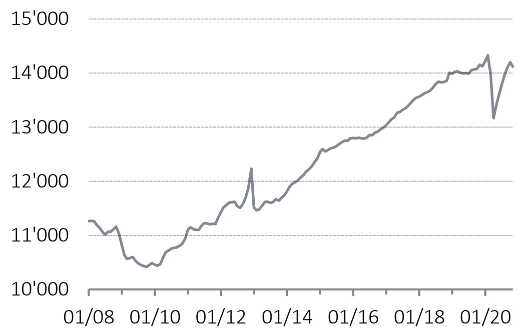


Fig 35: Central bank total assets, indexed

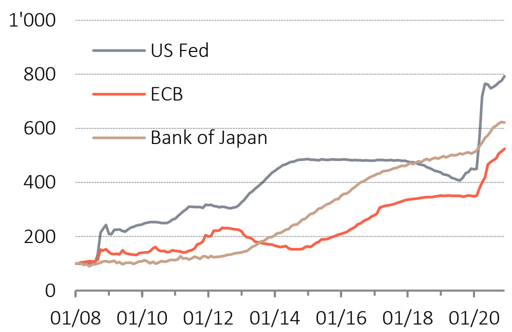
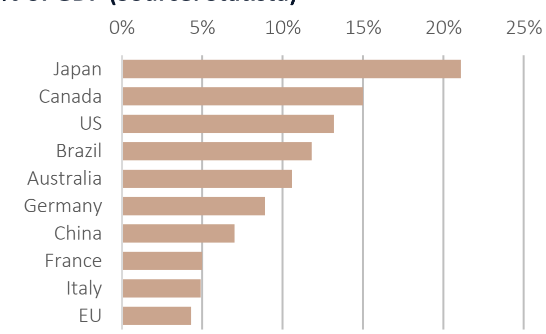


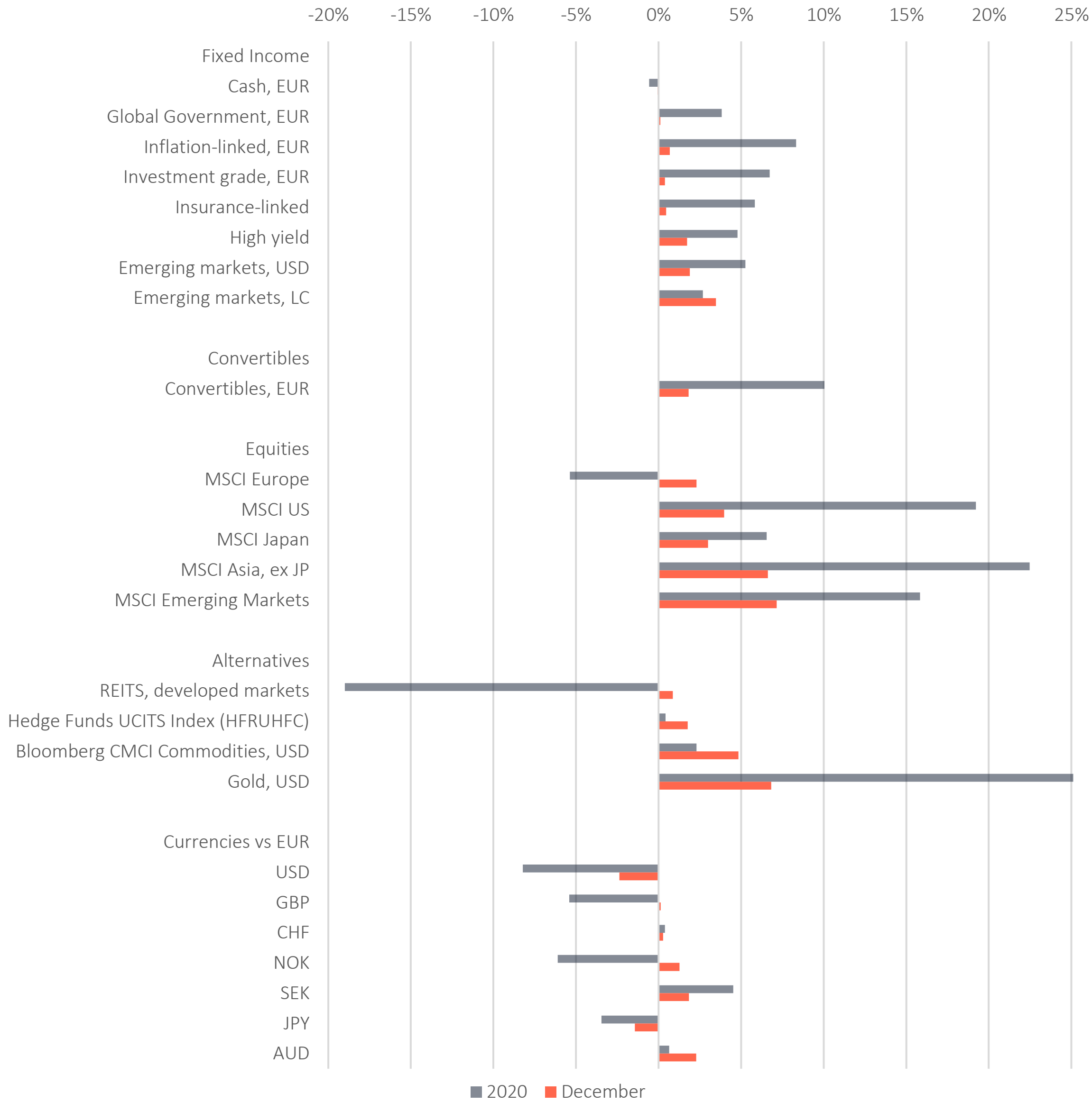
Fig 36: COVID-19 fiscal stimulus as of June 2020, % of GDP (Source: Statista)



ASSET ALLOCATION

Interestingly, most asset classes performed positively in 2020, driven by exceptional monetary and fiscal stimulus measures. This, however, disguises the huge volatility, violent swings in asset prices, and huge diversions between sectors. Meanwhile, European equity markets lost more than 5% and global REITS almost 20%. Overall the EUR strengthened in 2020, which led to currency losses for EUR-denominated portfolios.

Fig. 31: Performance of major asset classes, based on our EUR portfolio strategy

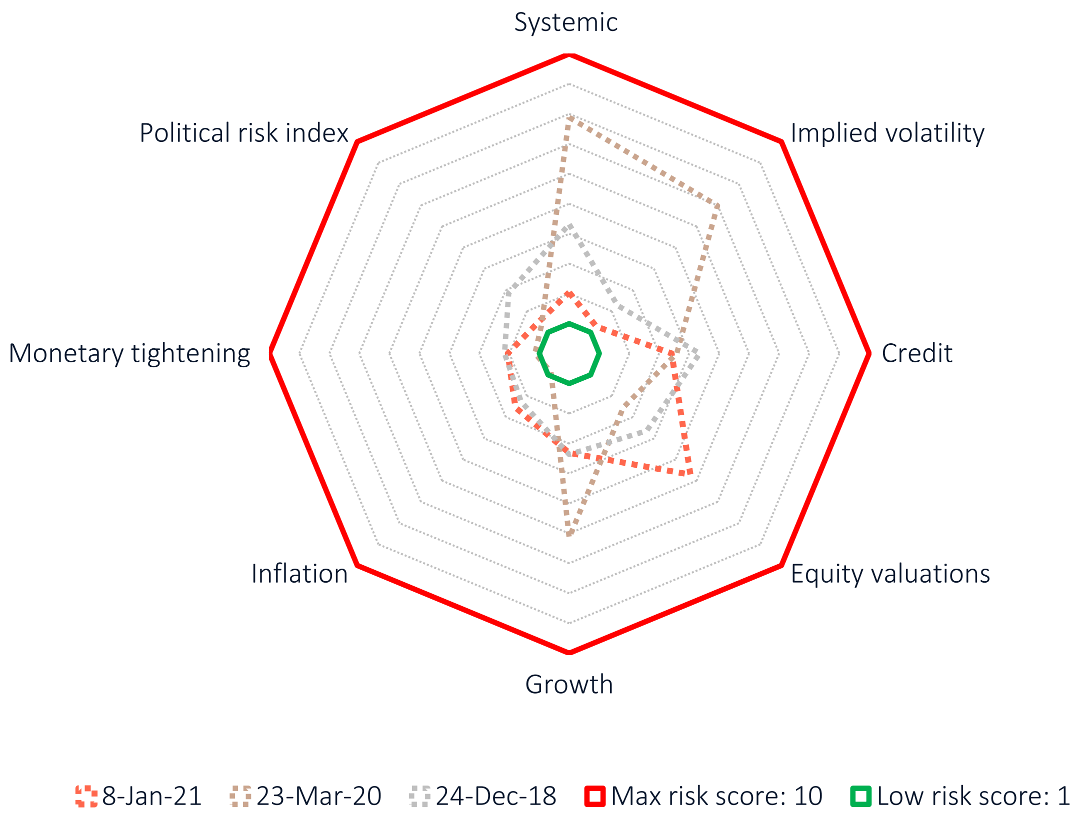


RISK MONITOR

Despite the ongoing recession and the recent lock-down measures, most of our risk indicators remain benign. The exception is the risk stemming from elevated equity valuations.

Fig. 32: IMT Risk Monitor

24-Dec-2018: Growth and monetary tightening fears
23-Mar-2020: Global pandemic



DISCLAIMER

This document is for information purposes only and is not a solicitation of an offer or a recommendation to buy or sell any investment instruments or to engage in other transactions. This document contains data and information which are prepared by IMT Asset Management AG. Although IMT Asset Management AG takes care to ensure that the information in this document is correct at the time it was collected, IMT Asset Management AG neither explicitly nor implicitly provides any assurance or guarantee of accuracy, reliability or completeness, and assumes no liability or responsibility for either its own or for third-party publications. IMT Asset Management AG is not liable for any direct, indirect or incidental loss incurred on the basis of the information in this document and/or on the risks inherent in financial markets. Investment in financial products should be done only after carefully reading the relevant legal requirements, including sales restrictions or any other risk factors. Any opinions represented in this document solely reflect those of IMT Asset Management AG or specified third-party authors at the time of publication (subject to modifications). The services mentioned in this document are addressed exclusively to clients of IMT Asset Management AG.

Source for all graphs: Bloomberg, IMT Asset Management AG.