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GLOBAL INVESTMENT COMMITTEE OUTLOOK: A NEW REGIME AHEAD

The global economy's recovery should continue, but below consensus

Clearly, it remains difficult to predict events in this volatile environment, but in the interest of our clients, we do our best and fortunately this time, we had virtually unanimous agreement on a similar scenario as in June, both politically and economically. Firstly, we expect that virus deaths will continue to be contained through the winter in the developed world, even without widespread lockdowns. Secondly, we continue to expect a Biden victory with a split US Congress, leading to a mollified version of the Democratic agenda. Although we expect continued improvement, the G-3 and Chinese economies should moderately disappoint consensus in the coming quarters. We also still believe that the recovery should have a disinflationary tenor globally.

For the US, GDP should increase 8.0% Half on Half Seasonally Adjusted Annualized Rate (HoH SAAR, as used in all references below) in the 4Q20–1Q21 period and 1.4% in the 2Q21–3Q21 period, vs. the 9.4% and 3.0% consensus estimates. Personal consumption should continue to recover, especially as vaccines improve consumer sentiment, while private capex will likely remain quite subdued in some sectors, as pre-crisis projects finally get completed, but tech spending should continue to flourish. Government spending should contribute to growth as a result of the Democratic agenda, while net foreign trade will likely contract moderately. Boeing's aircraft production will likely be a major positive factor for economic growth after the 1Q21.

Eurozone GDP plunged the most in the 1H20, so its rebound should be the strongest among the G-3, but, at 15.3% HoH SAAR, it should trail the 17.1% consensus and should rise only 2.0% vs the 2.8% consensus in 2Q21-3Q21. Meanwhile Japan's GDP growth will likely be 6.8% and 1.8%, vs. consensus estimates of 7.5% and 2.7% for those periods. For CY20, growth for the US, Eurozone and Japan should be -4.5%, -6.9% and -5.4%, respectively, with CY21 at 2.2%, 3.0% and 2.0% vs. consensus of 3.2%, 5.5% and 2.5%. China's official GDP growth should be 8.3% HoH SAAR in 4Q20-1Q21 and 5.4% in 2Q21-3Q21, with CY20 GDP at 1% and CY21 at 9.3%. Overall, these G-4 GDP results should disappoint risk markets and keep fixed income markets relatively buoyant.

Non-economic factors remain a concern

There remain valid reasons for concern about many geopolitical issues, especially regarding China and the Middle East. Although now in somewhat of a truce, relations between the West and China remain fraught with danger. China's relations with India, Taiwan and many Southeast Asian nations remain very tense too, although it is trying hard to maintain positive relations with the technologically-advanced nations of Japan and South Korea. Meanwhile, the Middle East is even more a powder keg than usual, with Iran (and its regional proxies) becoming increasingly desperate, while Turkey is involved in several intense conflicts. However, we continue to expect wiser heads to prevail in these situations and, thus, not expand into major crises, especially under a Biden Administration. As for BREXIT, a relatively poor, but not traumatic outcome is likely, thus hurting investor and economic sentiment in the European region.

We continue to believe that Biden will win and that the Senate will remain Republican, although only narrowly so. We expect a few moderate GOP Senators will vote for moderate tax increases to pay for increased federal stimulus. For non-budgetary items, Biden will be less constrained; he will need to satisfy his left-wing by giving them important cabinet positions (except that the US Treasury may go to an experienced moderate like Lael Brainard so as to prevent financial markets from panicking) and by extensively issuing executive actions and regulatory mandates to achieve the Democratic agenda. The net result of political change should make risk markets and business leaders wary, but increased fiscal stimulus should prevent the economy from faltering too much.

Central banks: Still all-in, to fund increased fiscal stimulus

The Fed's massive, multi-pronged stimulus will likely rise further under a Democratic administration, indirectly funding fiscal deficits that will likely remain near record levels. The ECB and BOJ are similarly all-in, especially for QE related to high fiscal deficits. Perhaps the question now is what will the Fed not do? We still do not expect negative rates, but there is some chance (especially if its bond market become unruly) that it will adopt yield curve control, pegging 3-year maturities to about 0.3% in 2021, hoping, like Japan's case, for a gradually increasing yield curve in the longer part of the curve.

Mild yen appreciation and euro depreciation; flat G-3 bond yields

We expect G-3 bond yields to remain flat because they are pinned down by low central bank policy rates and continued QE. Also, while the global economic recovery should be negative for bonds, it will likely disappoint consensus. For US 10-year Treasuries, our target for end-December is 0.60%, while those for 10-year Bunds and 10-year JGBs are -0.5% and 0.05%, respectively, with no change through September 2021. Regarding forex, we expect the yen to rise a bit and the euro to decline a bit, at 104.0 and 1.16, respectively, at end-December and 104.0 and 1.15 at end-March. This appears to predict very little volatility for G-3 forex markets, but each region seems to be reasonably content around current levels.

This all implies that the FTSE WGBI (index of global bonds) should produce a 0.4% unannualised return from our new base date of 25 September through December in USD terms, and 0.3% through March. Thus, at this stage, **we have a relatively unenthusiastic stance on global bonds** for USD-based investors. For yen-based investors, this index in yen terms should return -0.1%, and -1.1% for those periods, with JGBs returning -0.4% for both periods; thus, quite far from inspiring.

Our Brent forecasts are $43 at end-December and end-March, but up to $47 next September, which contribute to our forecast of the US CPI of 1.9% YoY in March and 2.0% in September, with Core CPI at 1.7% and 1.8%, respectively. Similar moderate increases in CPIs in Europe and Japan should also occur. Thus, at least regarding the CPI, the global recovery will be dis-inflationary, in our view.

Global equities: AsiaPac very positive, but global Indices likely to stall in 4Q before rising in 2021

As concerns will increase regarding the new Democratic Administration and the global economy looks disappointing globally relative to consensus, global equity indices will likely decline slightly in the 4Q, but they should rebound moderately in the 1Q21. Higher taxes ahead in the US will hurt investment sentiment, but additional global fiscal and monetary stimulus should help cushion the blow for global equities. The surge in anti-business regulations and executive actions in the US, however, will clearly not be positive for investor or business sentiment, nor for profits or dividends, at least in many corporate sectors. Notably, many of the largest companies in Europe and Japan are multinationals with large US exposure.

A major factor worth watching, however, is 3Q earnings. The 2Q US earnings season was astonishing, with many companies beating consensus "by a mile". While there were a few important disappointments and continued confusion about how to record "adjusted earnings", 2Q aggregate earnings were marked upward, and CY20 guidance rose too. Thus, although PE ratios look high, 3Q earnings could also shock to the upside and boost CY20 and CY21 earnings estimates by a large amount. To reiterate, the ability of US corporations to beat profit expectations, especially on an adjusted basis, is very impressive and should not be doubted going forward, even under difficult circumstances.

It almost goes without saying that certain sectors will perform much better than others, especially given the increased global role of ESG considerations, the virus's economic effect given the new vaccines, and the US Democratic agenda. While each of our regional equity experts take such in consideration for their index targets stated below, it is the responsibility of our portfolio managers to explain their evolving strategy on this, rather than that of the Global Investment Committee. Please continue to visit our website for investment insights from our experts.

Highly noteworthy is that in developed markets, nearly any kind of company, barring the worst-afflicted or scandal-plagued ones, found it easy to issue bonds in the 3Q as investors' search for yield was intense, and as central banks' corporate bond purchases also helped sentiment. This, coupled with low interest rates, allowed rating agencies to decrease their downgrades and, thus, companies felt less compelled to cut their dividends. In this kind of environment, slashing interest rates also helps indebted companies lower their interest costs, thus, at least for some companies, disproving the long-held belief that central banks can only provide liquidity, not solvency.

In sum, we have a somewhat unenthusiastic view on global equities in the short run. Aggregating our national forecasts from our base date, we forecast that the MSCI World Total Return Index in USD terms will decline 0.5% through December but rise

1.3% through March (-1.5% and -0.1% in Yen terms, respectively). **Thereafter, however, we expect 4.8% through June (2.8% in yen) and +8.6% (6.5% in yen) through September, so it is probably worth maintaining equity holdings through the 4Q20 lull. As for the regions, we expect positive returns (in both USD and yen terms) throughout Asia Pacific in each quarter through next September, with US and European markets not performing very well through March, but the US should rise smartly thereafter.**

In the US, the SPX's PER on its CY20 EPS estimate is now about 25, and 20 on CY21 EPS, which is, by historical standards, quite expensive even given extended low interest rates. Buybacks have greatly diminished and are unlikely to return in many sectors, but enough will remain to provide at least some support to some major parts of the market. **Clearly, the tech sector is booming, although there are valid concerns about valuations once a vaccine quells consumer fears and life returns somewhat back to normal.** Besides the continuing improvement in the global economy, one positive factor is that even a moderate rise in oil prices will help aggregate earnings growth and the economies of producing regions. In sum, given no huge surprises in 3Q earnings, we expect, due to investor and economic worries about the new Democratic control, especially regarding taxes and executive/regulatory orders, the SPX to decline to 3258 (-0.7% total unannualised return from our base date) at end-December, before rebounding to 3313 at end-March (1.4% return), with yen-based returns being -1.7% and -0.1%, respectively, but rising 10.3% by next September (8.2% in Yen)

European equities should continue their long-term trend of underperforming the US and Japan in constant currency terms. Europeans have lower confidence in their intermediate term economic future, while the global economy disappointing consensus will also hurt investor, business and consumer sentiment. A rather hard BREXIT will be a negative factor in the year ahead, as well. The PER on CY20 EPS is high, at 22.8, and far from low at 16.4 times CY21 EPS. Importantly, dividends here are likely to be cut quite a bit, especially as there are many Fallen Angel risks and large oil industry exposure (most of which are not adequately covering their dividends). The downfall of one of Europe's highest profile fintech companies, and the on-going political scandals related to such, hardly helps sentiment either. Increased fiscal and monetary easing should provide some support for markets, but we expect the Euro Stoxx index will fall slightly to 333 at end-December and FTSE to 5,780, which translates to returns of -2.9% (unannualised from our base date) for MSCI Europe through then in USD terms (-3.8% in yen terms). Returns through March should slightly worsen, at -3.0% (-4.4% in yen terms) in our view, with both indices remaining flat (with the euro weakening a bit), and then just slightly recovering in the following quarters.

Japanese equities have performed quite well, with TOPIX on a firm upward trend even as the yen got a bit stronger vs. the USD. Year to date, they have underperformed MSCI World ex-Japan by only about 1% (underperforming the U.S. but massively outperforming Europe), as Japan's lockdowns were less severe, the BOJ has been supporting equities, valuations are low and leverage/credit excesses are minor. Importantly, the smooth and propitious transition of political leadership also continued Japan's reputation for low political risk, coupled with increased concentration on digitalization, financial sector and other structural (Third Arrow) reforms (Suga-Likely the most pro-Third Arrow reform PM in Japan's history). Valuations are reasonable, with TOPIX high at 21.4 times CY20 EPS, but only 15.1 times CY21 EPS consensus earnings, while dividends have not been cut much overall, so the market's dividend yield is highly attractive, even by global standards. Improvements in the global semiconductor and smartphone cycles (which previously hit Japanese semiconductor product equipment, electronic components and supplies very badly) and better Chinese demand for capex goods, especially for 5G infrastructure stimulus, should boost earnings and, thus, incentivize investors, especially foreigners, to return to Japanese equities, as did Warren Buffett. The auto sector's fortunes are improving with rapidly rebounding global demand, although a Biden Administration will likely push for more US production and higher emission standards, thus increasing costs for this sector. Lastly, the Biden Administration will likely agree to the TPP trade agreement, which should boost Japanese corporate and investor sentiment, and thus economic growth and corporate profits after 2021. However, due to disappointing global factors, we expect TOPIX only to rise marginally to 1,648 at end-December and 1,663 at end-March, for total unannualised returns of +2.5% in USD terms (1.5% in Yen terms) and 4.5% (3.0% in Yen terms), respectively, from our base date through those periods. **These are higher returns than the US or Europe, so Japan should be overweighted by global investors, and should be particularly attractive for domestic investors.**

Developed Pacific-ex Japan MSCI: the improvement in China's economy should clearly help this region. Although a Biden Administration will be far from easy on China, it will likely return to more normal trade relations and accept the multipolar global construct. Given this, it is highly likely that Australia will improve its relations with China too and, thus, improve its economic and corporate profit prospects. Clearly, vaccines and increased global tourism (and in the case of Australia, educational enrolment) will help these two economies tremendously. In sum, we are positive on both the Hong Kong and Australian markets, with the Hang Seng at 23,235 and 24,397 at end-December and end-March, respectively, and the ASX at 6,442 and 6,635. Thus, **we expect the region's MSCI index in USD terms to rise 6.5% through December and 10.3% through March (+5.5% and +8.7% in yen terms), so this region should clearly be overweighted.**

Investment strategy concluding view

Global economic growth will disappoint consensus, in our view, and a Biden Administration will instil a decent amount of market and economic concern in the 4Q, but with the help of vaccines, additional global fiscal and monetary stimulus, and more stable US economic and political relations with the world, equity markets should return to an upward trend thereafter, especially after the 1Q21. **For the 4Q, as both global equity and global bond indices are likely to show small losses, we suggest that medium to long-term global investors should be neutral on both, but with major overweights to Asian regional equities.** Obviously, **those not constrained to a globally diversified portfolio should take extensive exposure to Asia now,** in our view, and **longer term investors may wish to add global equity exposure during the lull to take advantage of significant gains further into 2021.** There remains, of course, a significant chance of major equity swings on either side, and as always, if any reader wishes to review the targets related to our other six scenarios, in which Trump wins or other factors, they are welcome to contact us.

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