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2021 Macro Outlook

A covid-19 vaccine is the best kind of stimulus

Samy Chaar, Chief Economist

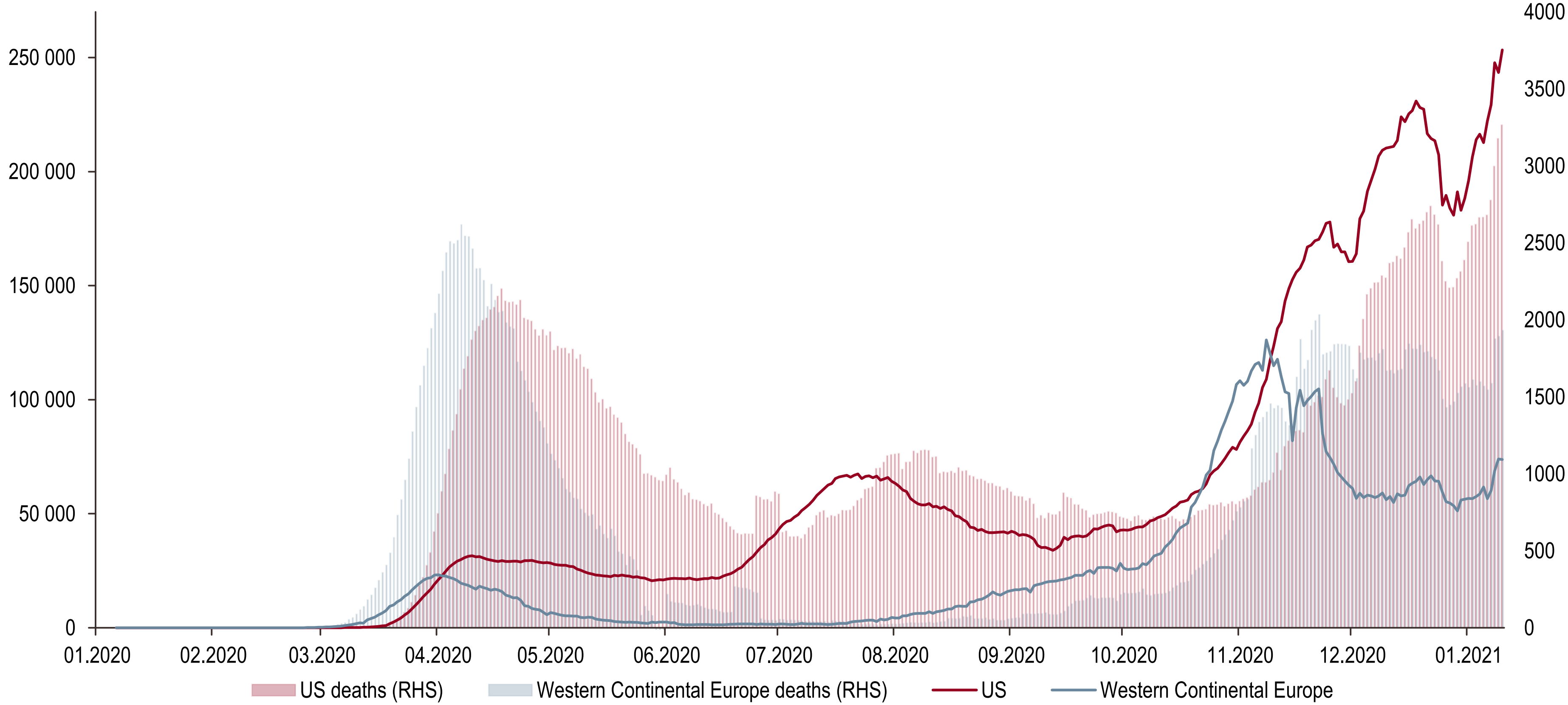
January 2021

Covid-19 cases and deaths still high

New Covid-19 strain triggers tighter restrictions on economic activity

Number of daily new confirmed cases in Europe and US versus confirmed death (7-day rolling averages)

As of 10.01.2021



Source: Lombard Odier

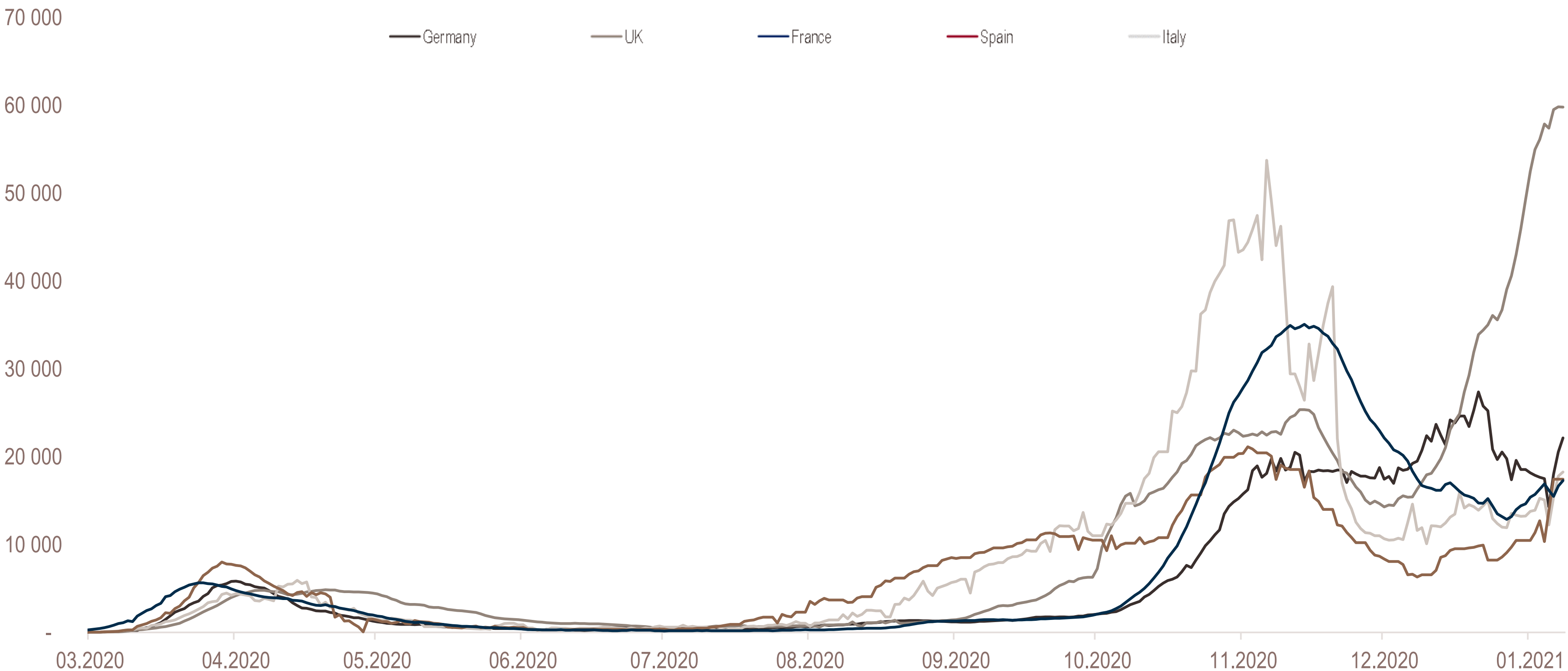
Please read the important information at the end of the document.

Renewed lockdowns: the UK situation stands out

Key near-term questions: international spread of new virus strain & holiday effect

Number of daily new confirmed cases in UK, Germany, Italy, France, Spain (7-day rolling averages)

As of 10.01.2021



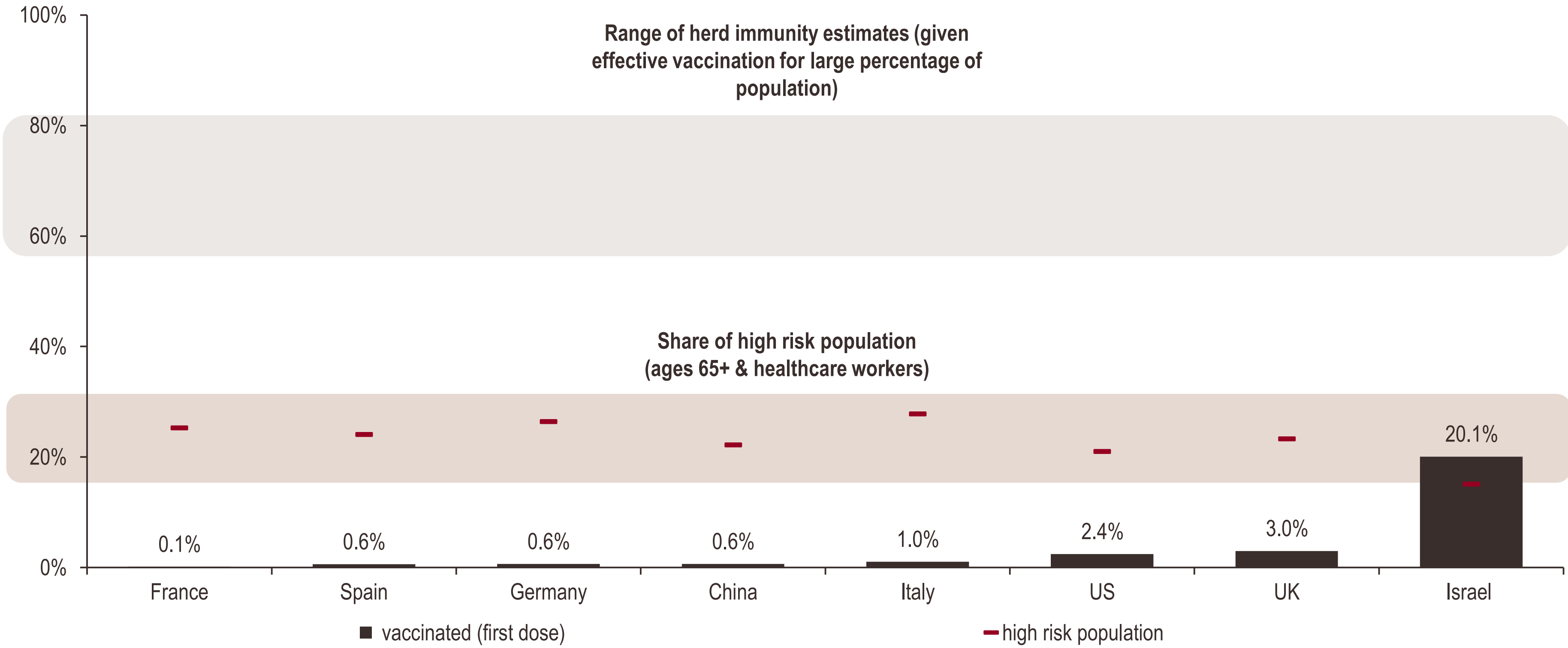
Source: Bloomberg, Lombard Odier

Vaccination campaign: under way - but progress is so far uneven

Approaching immunity around mid-2021 achievable; most countries need to accelerate

First doses administered as a percent of total population vs size of priority population (65+ & HC Workers)

Data as of 8-10/01 for all countries shown



Source: Lombard Odier Calculation

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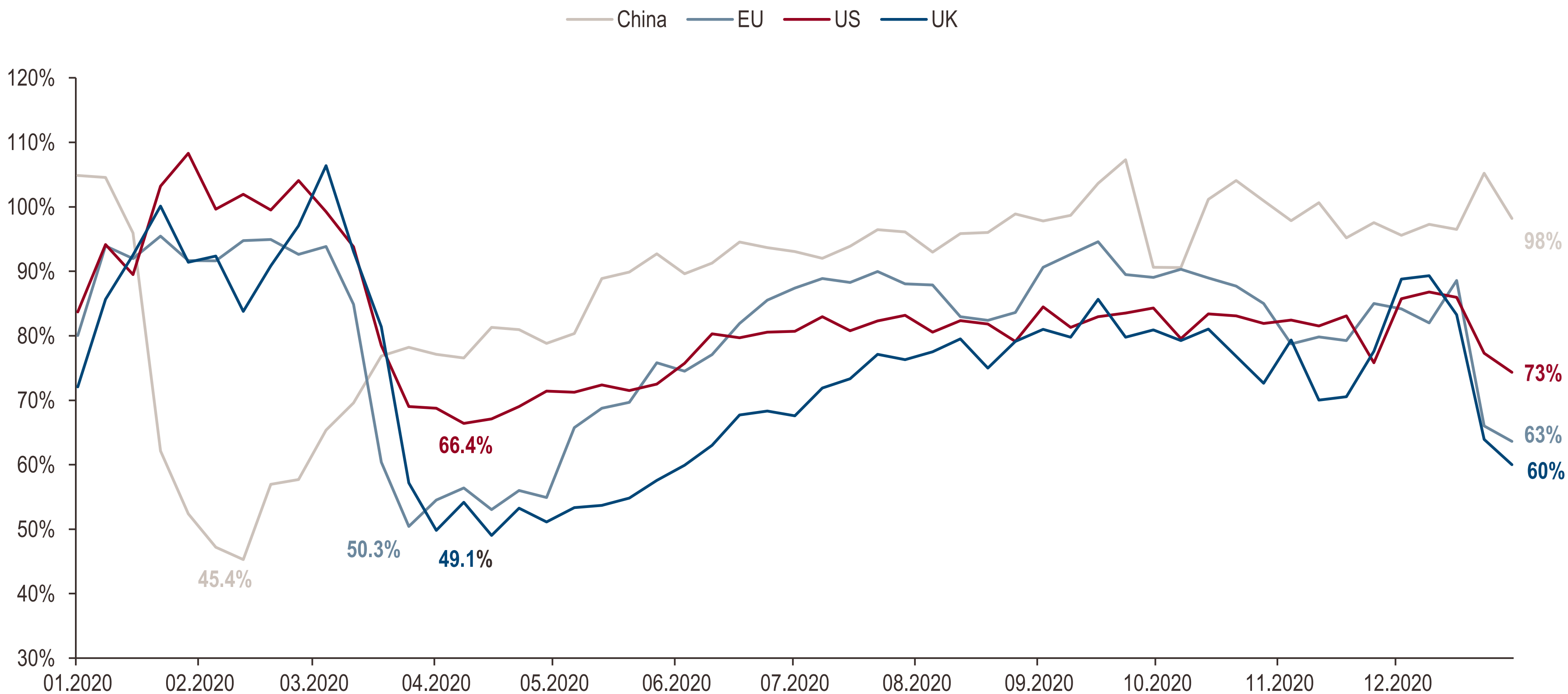
Real-time activity tracker for major economies

Average of eight indicators (business, trade, production, consumption, mobility) versus its past level

Normalisation of activity in US, Europe and China as of 03.01.2021

Damaged mostly contained despite substantial activity drawdown due to Christmas



Source: Lombard Odier calculations

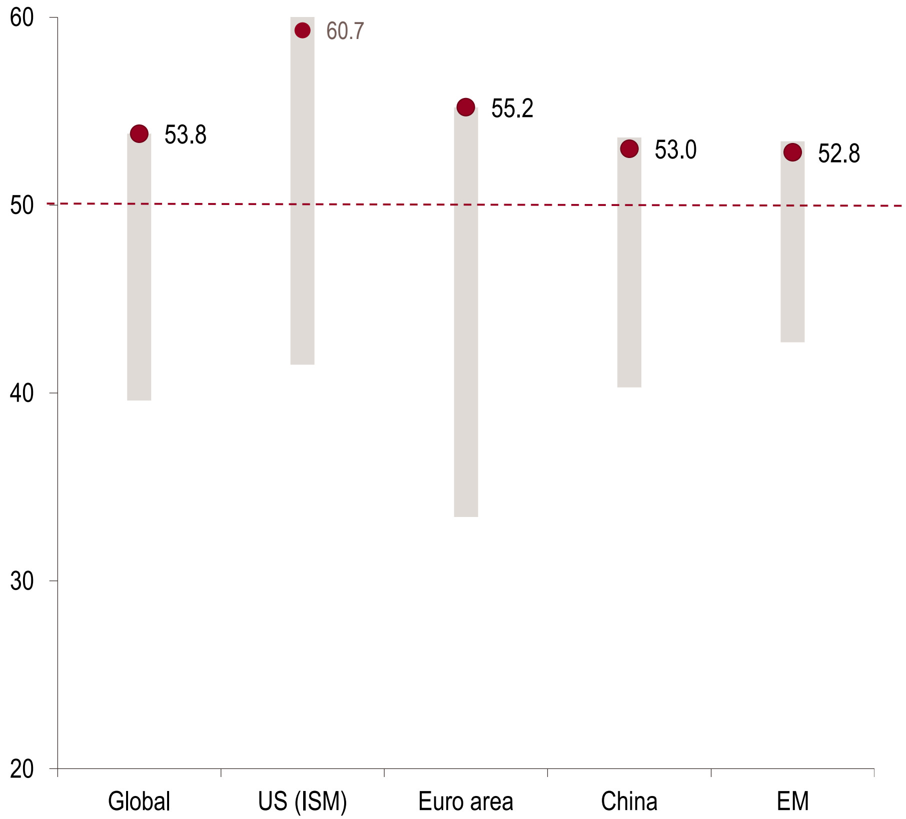
Please read the important information at the end of the document.

PMI surveys: recovery from deep contraction proceeds

Particularly strong performance for manufacturing (especially in the US)

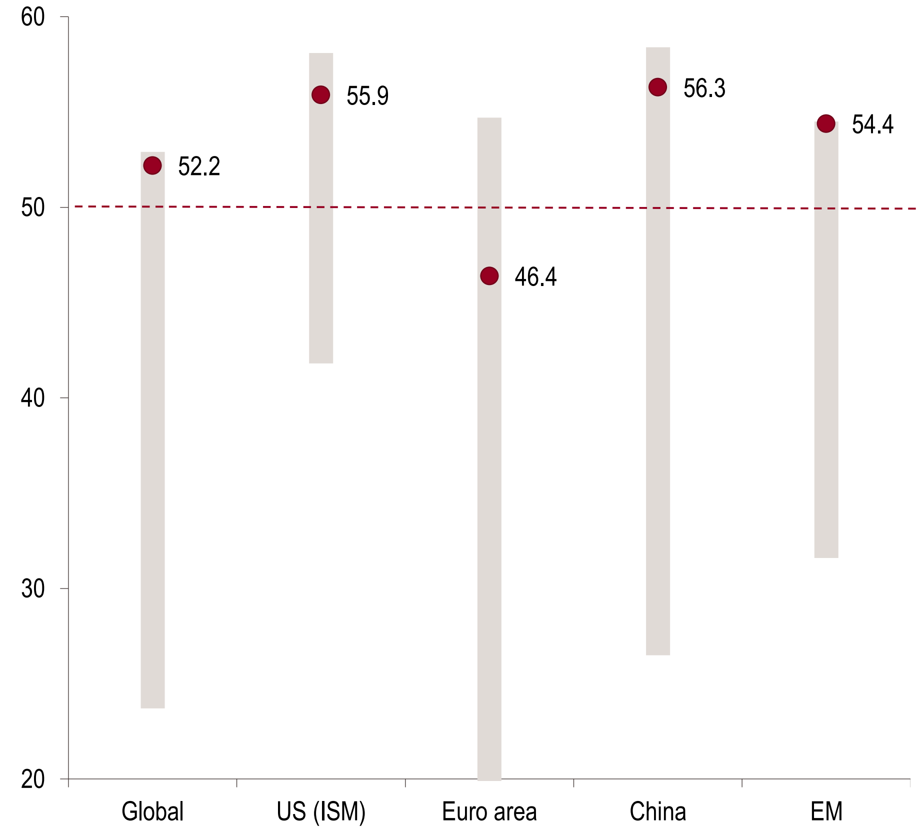
Manufacturing PMI by region (December 2020)

12-month range



Service PMI by region (December 2020)

12-month range



Sources: Bloomberg, Lombard Odier (December 2020)

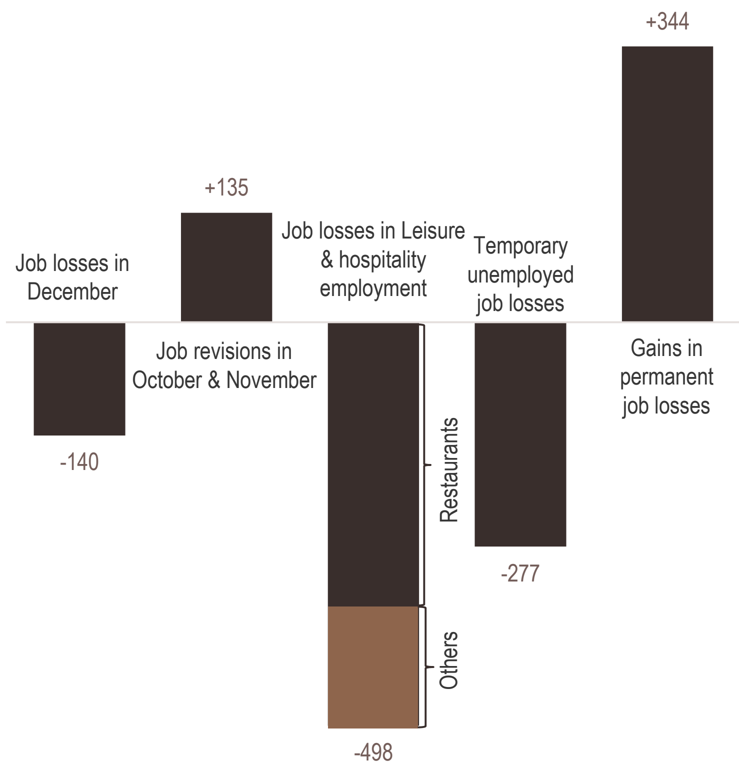
Please read the important information at the end of the document.

US payrolls: progress stalls in December, as the virus surges

Resurgent pandemic causes job losses, but hard-hit industries are set to grow again once Covid abates

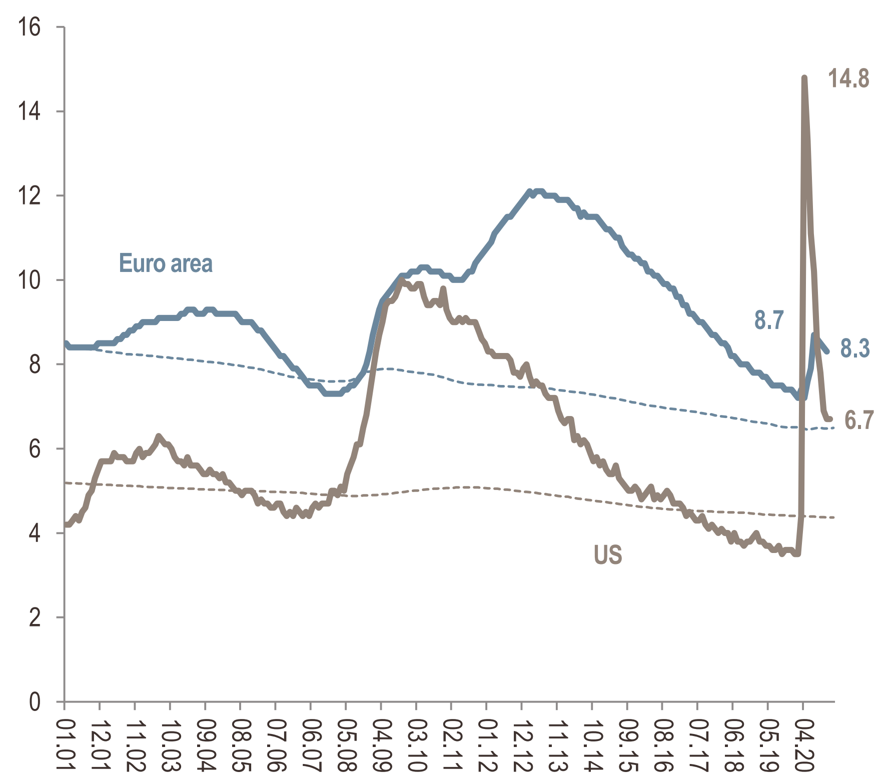
December US nonfarm payrolls

In thousands



Transitory stall in US employment recovery

Unemployment rate in % (December 2020)



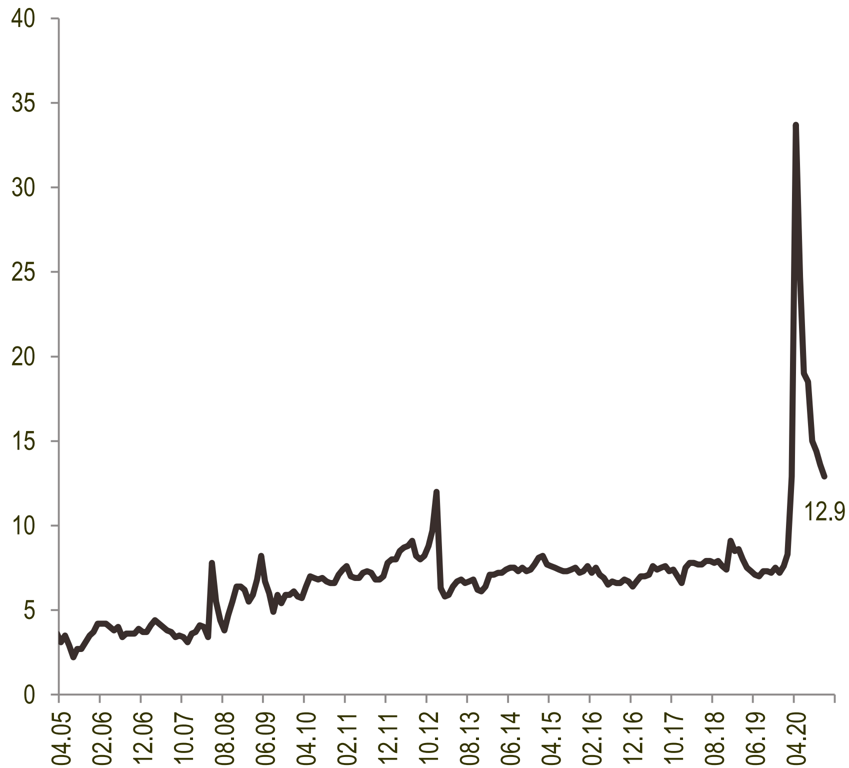
Source: BLS, Bloomberg, Lombard Odier

Consumption should continue to drive the recovery

High savings rate and resilient incomes (thanks to government transfers) have support potential

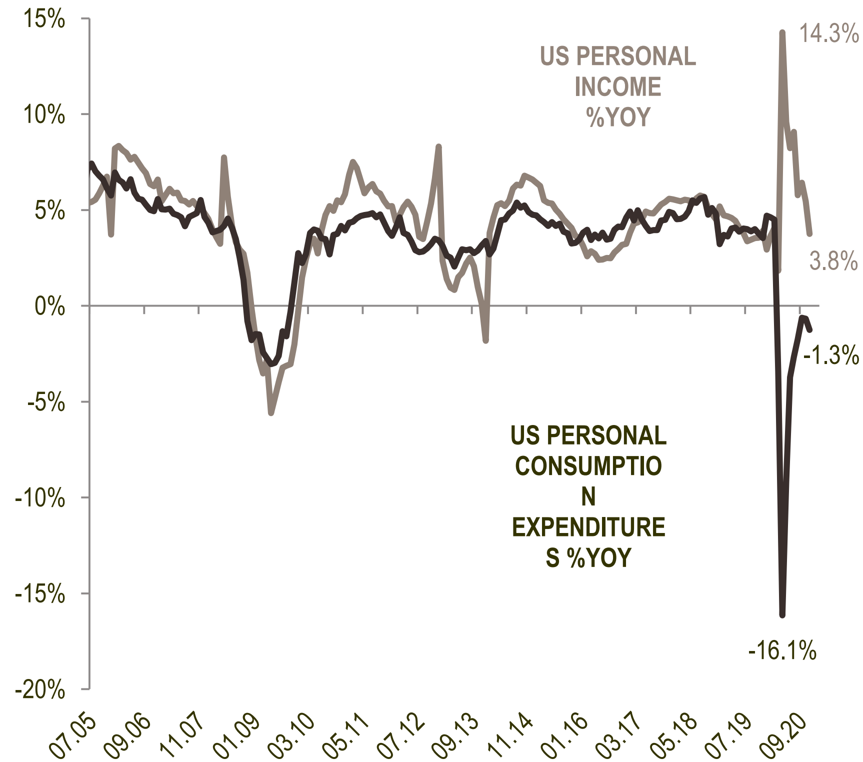
Stimulus has boosted savings, creating a large cushion…

Personal savings rate in percent of disposable income (December 2020)



…and has pushed up incomes, supporting consumption

Yoy growth in personal income and consumption (in %, December 2020)



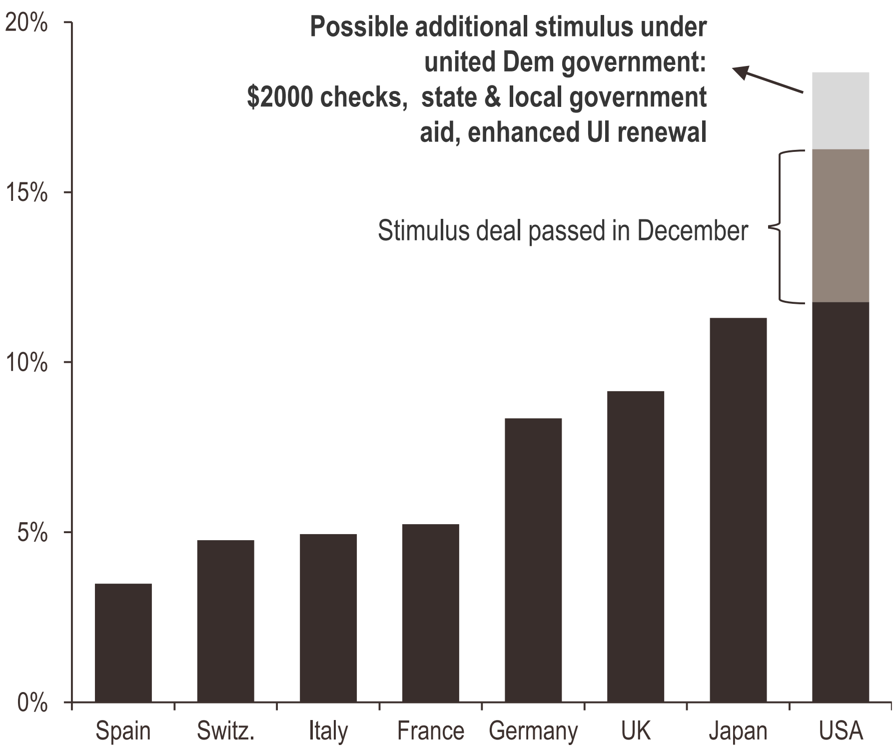
Source: Bloomberg, Datastream, Lombard Odier

An (even) more expansionary fiscal policy becomes likely

The December package removed risk of "fiscal cliff", providing additional stimulus

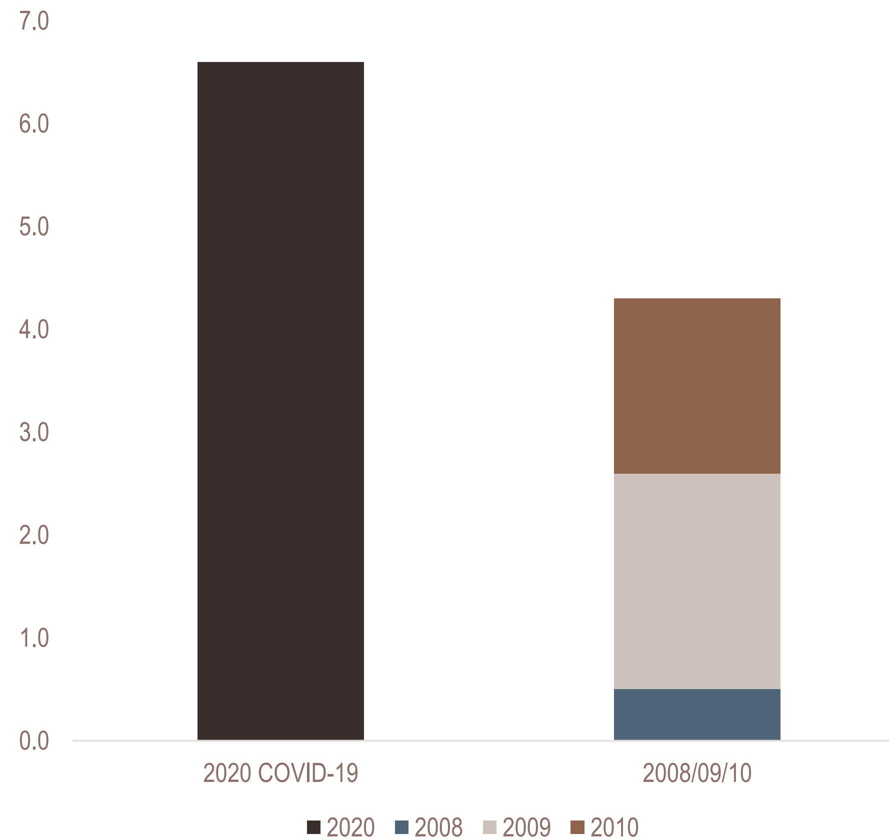
US fiscal response to Covid-19 crisis: a vast scale

Gov't spending increase and tax reductions in 2020 (in percent of GDP)



A comparison with the last crisis – G20 economies

Total spending and revenue measures as percent of GDP



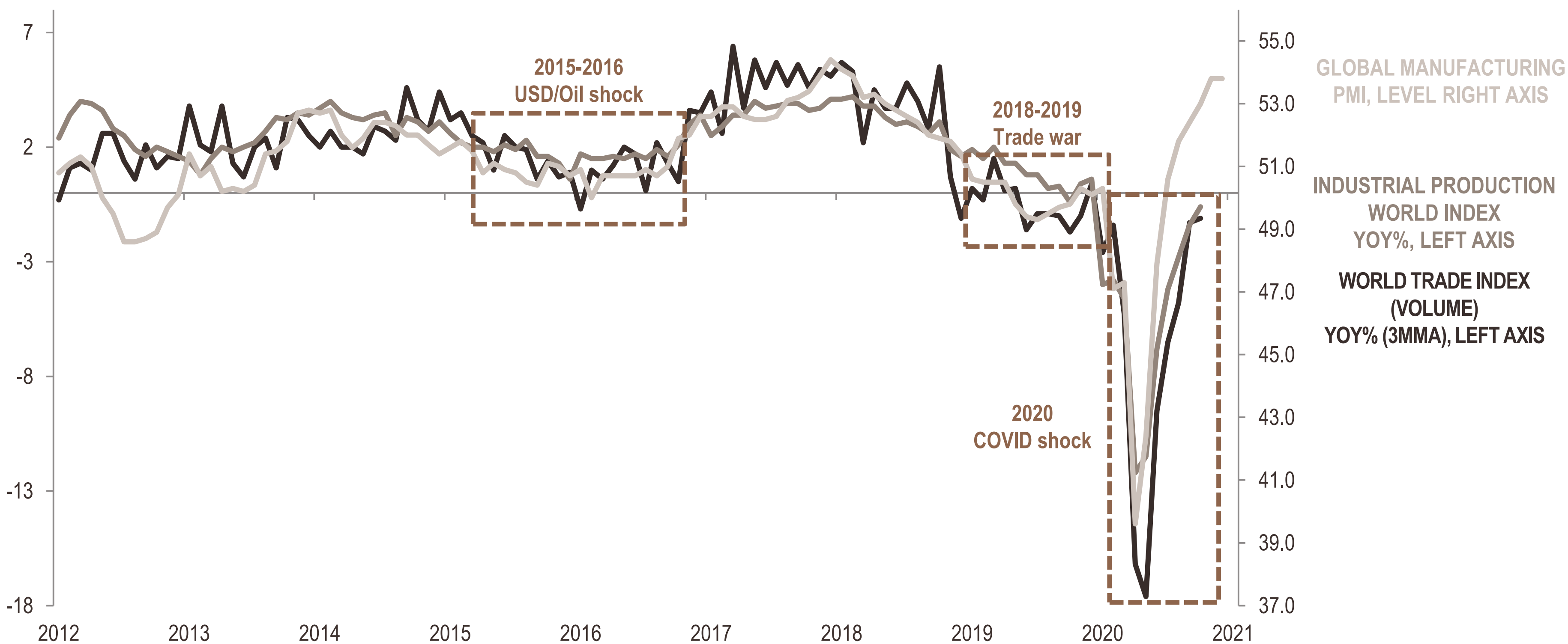
Source: IMF, national authorities, Lombard Odier calculations

Trade to outperform: back in expansion after 2 years of contraction

Vaccine led activity catch-up and a more pro-trade new US administration are two significant tailwinds

Global trade flows contracted due to US tariffs & COVID shock hurting production and manufacturing confidence

Trade volumes & industrial production in % YoY growth, PMI in level (December 2020)



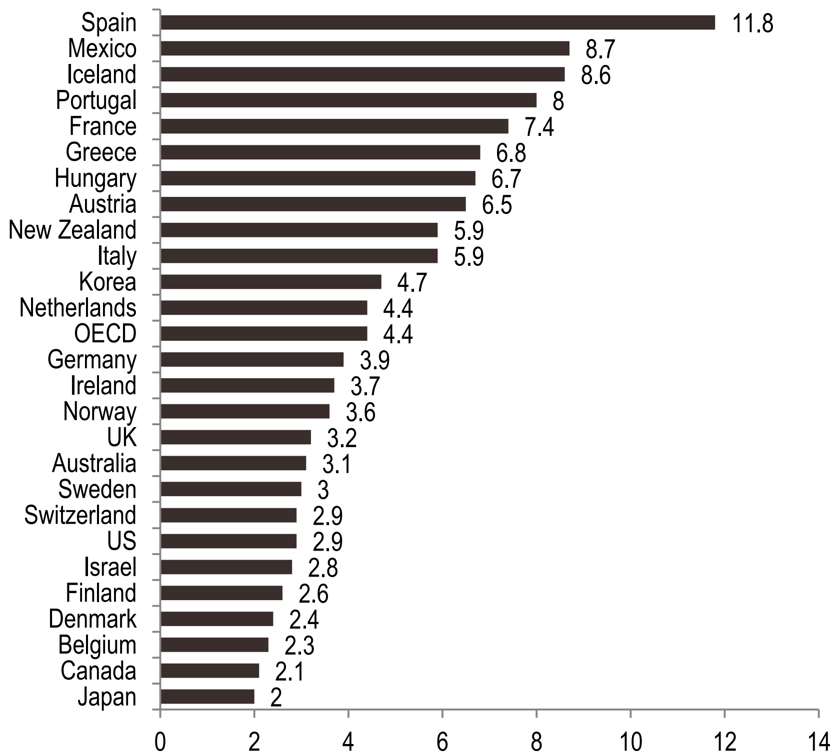
Source: Bloomberg, Lombard Odier

Uneven recovery : some sectors benefit while others suffer

Tourism and hospitality suffer from restrictions; housing benefits from low rates and work-from-home

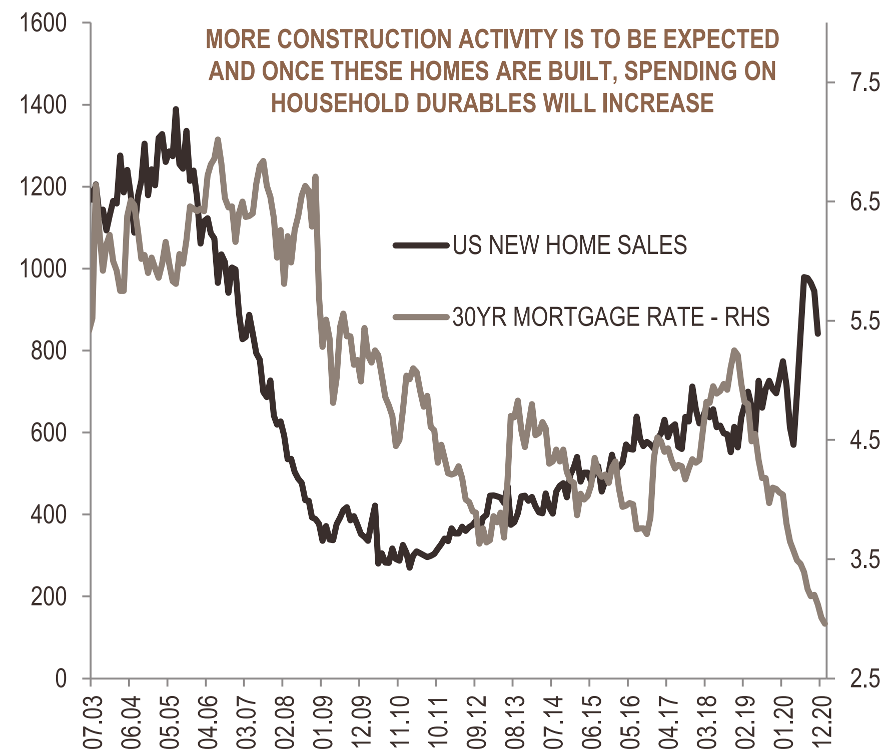
Tourism is an important driver of growth & employment

Tourism as a % of GDP, 2018



US New Home Sales (left scale) vs 30yr Mortgage Rate

In level & % - Strong support from all-time low mortgage rates (December 2020)



Source: OECD, Eurostat, Bloomberg, Datastream, Lombard Odier

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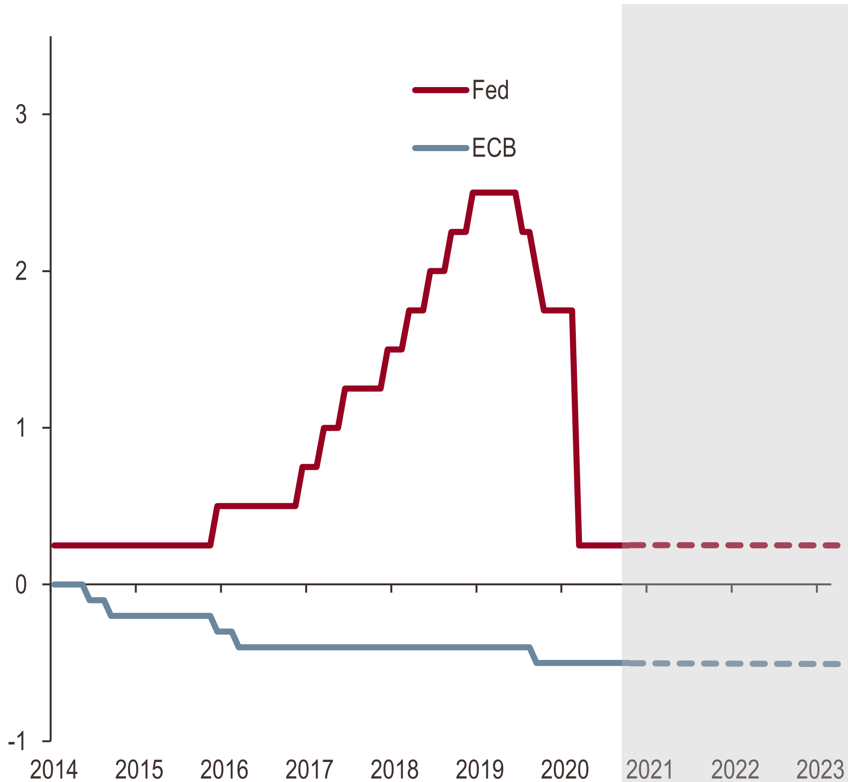
Monetary policy to continue playing a key role in stabilizing the economy

Rates to stay low while asset purchases and more targeted measures continue

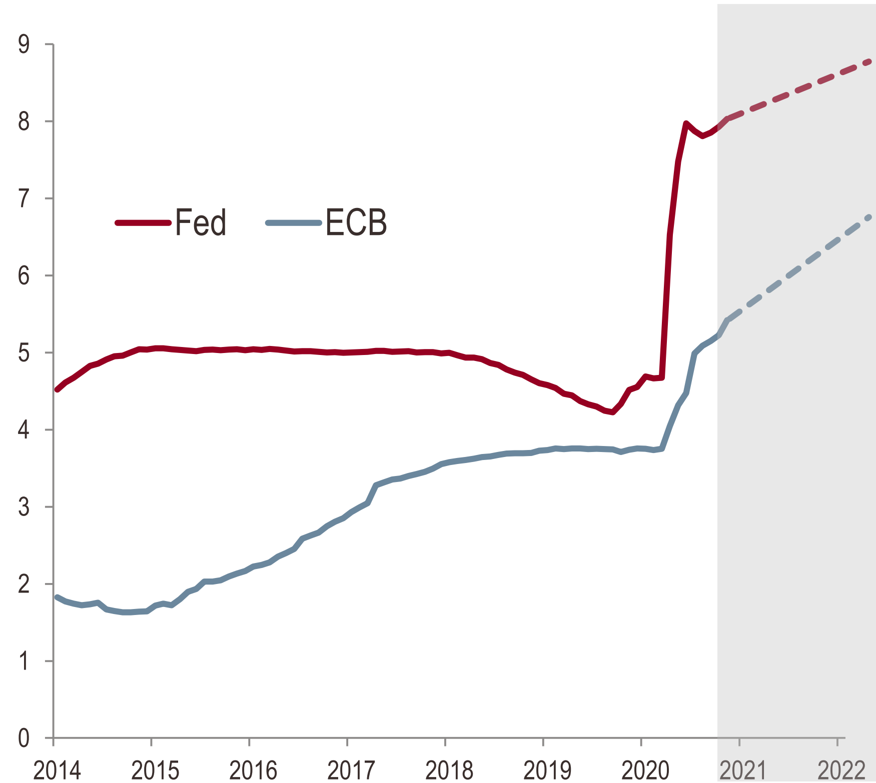
Key Fed and ECB policy rate, in percent (December 2020)

Central banks to keep rates at lower bound until 2023 and possibly beyond



Size of Fed and ECB balance sheets, in USD trillion (December 2020)

Fed LSAP running at USD 50bn/mo ; ECB APP + PEPP at EUR 80bn/mo



Source: Federal Reserve, ECB, Bloomberg, Lombard Odier calculations

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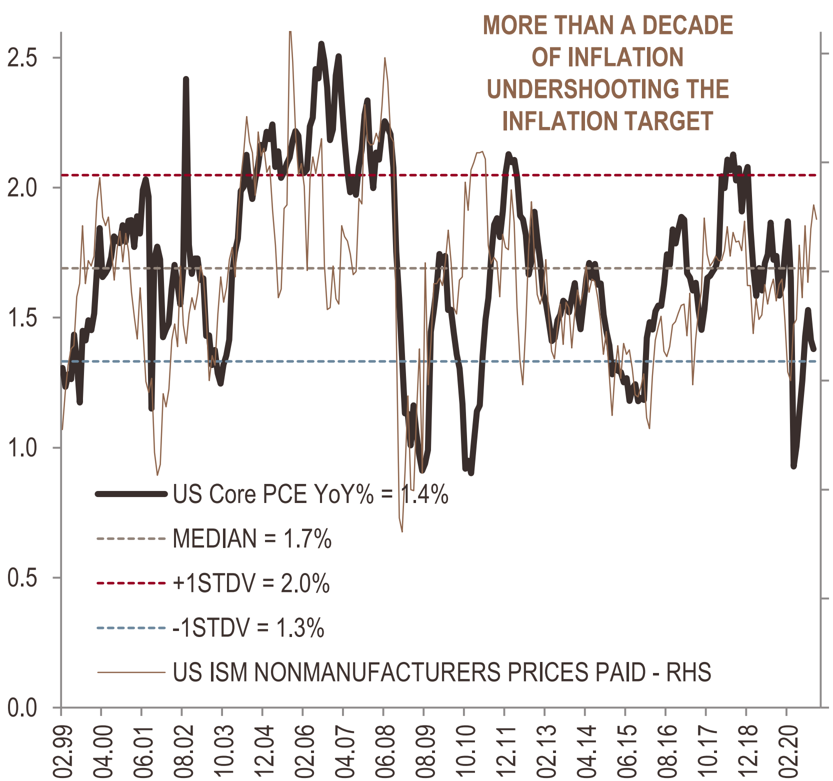
Inflation should recover from its current lows but stay below target

Activity pick-up should help lift prices but labour market slack to prevent an overshoot

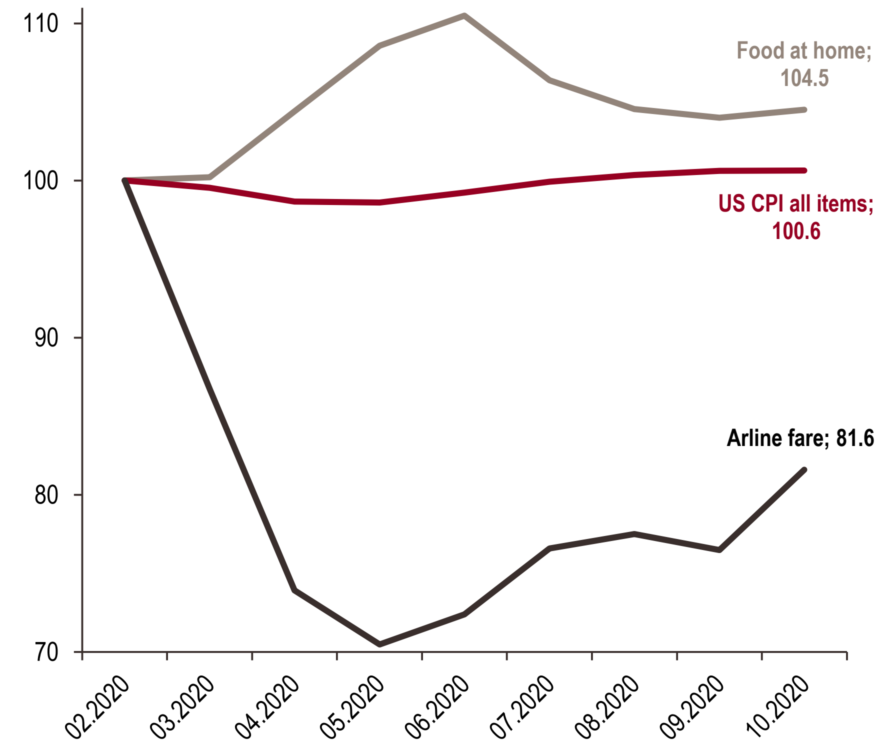
US core PCE versus ISM service prices paid (Feb 2020)

Year-on-year, in percent (with +/-1 standard deviation range shown)



US CPI vs food at home & airline fare components

Rebased at 100 at the start of the covid shock (October 2020)



Source: Bloomberg, Lombard Odier

On the road to global recovery, but path remains bumpy

As some key risks abate, focus on spread of the pandemic and progress on vaccination

Main working assumptions for 2021

Post-2020 Covid-19 shock

1. **A vaccine will be available** and begin to be widely distributed by Q2'21. This will allow to regain decisive control over the pandemic

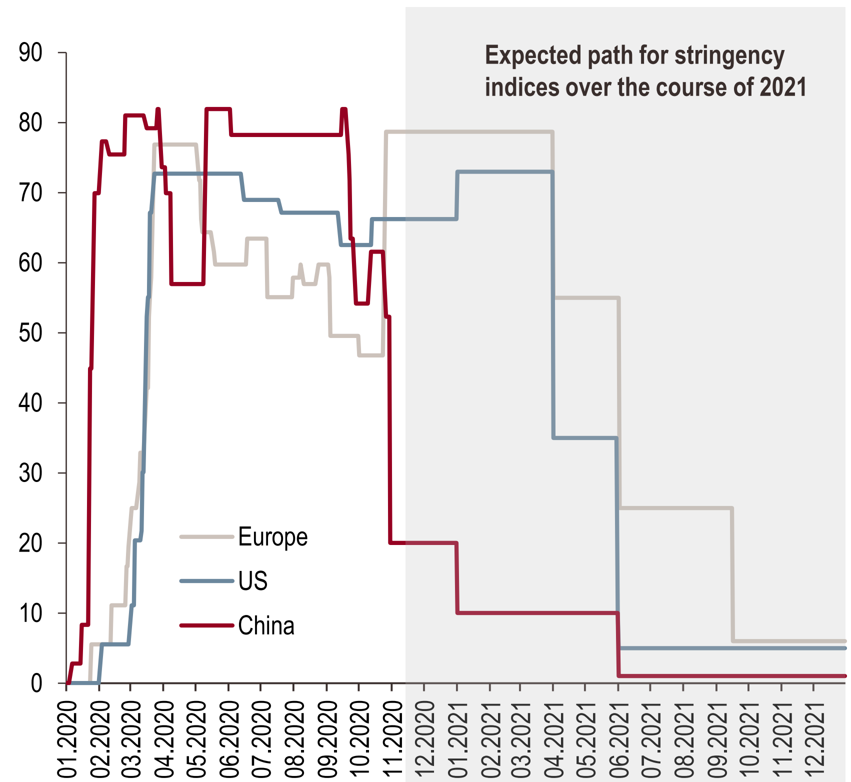
2. **The economic catch up should continue** - despite some bumps in the road. We expect an **uneven recovery**, with some sectors (housing, goods, trade) outperforming others (services, financials, energy)

3. **Inflation is unlikely to constrain central banks** despite some normalisation

4. **Still substantial policy support** to compensate for some of the income shortfall – at least until the vaccine is sufficiently deployed to allow a more decisive reopening

Covid-19 Government Response Stringency Index

Based on nine indicators including school closures, workplace closures, travel bans (0-100 scale; 100 = strictest; December 2020)



Source: Blatavnik School of Government, Bloomberg, Lombard Odier

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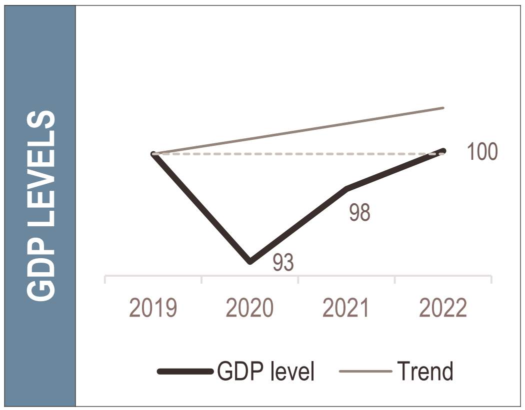
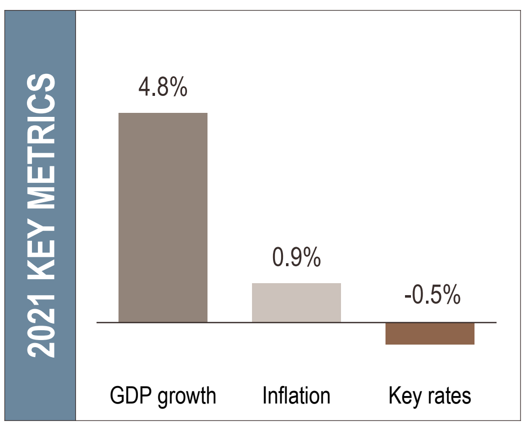
Baseline scenario: a sharp vaccine-led economic bounceback in 2021

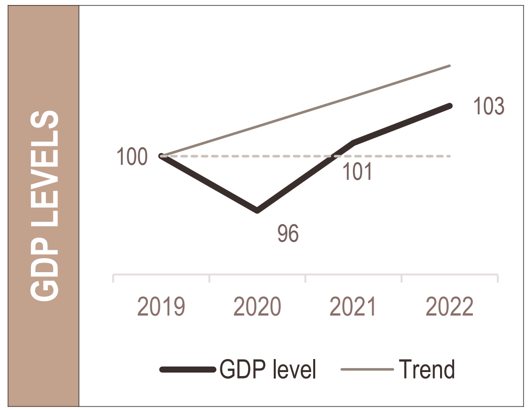
Pre-covid level of output reached in Q3 2021 in the US & Q1 2022 in Euro area

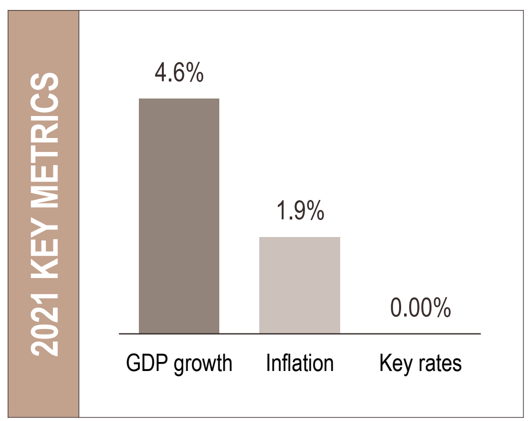
EUROPE



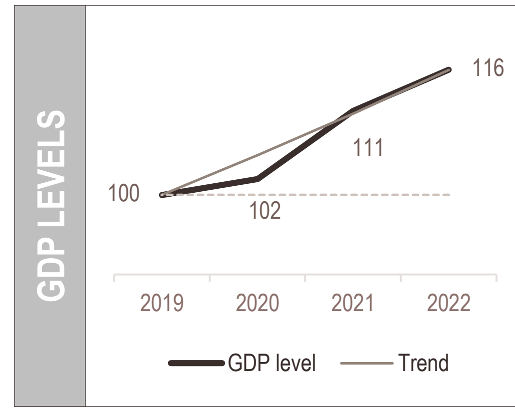


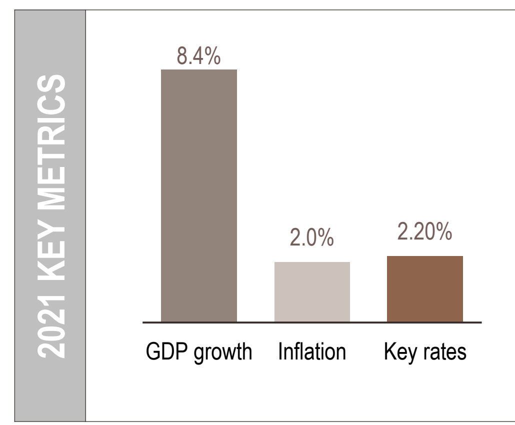
US





CHINA





Source: Lombard Odier

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2021 Market Outlook

We are cautiously optimistic

Stéphane Monier, Chief Investment Officer (Private Clients)

January 2021

Where do we stand?

Main reasons behind the 2020 performance

- Early 2020 marked the end of longest bull market due to exogenous shock ➞ the Covid-19 virus becoming a pandemic
- Record fast sell-off and sharp(est) recovery
- Unprecedented monetary and fiscal supports (global and very reactive)
- China resilience and strong rebound in H2
- Expectations of rapid vaccine approvals combined with liquidity pushed prices well ahead of earnings ➞ asset classes expensive

What to monitor in 2021

- Ongoing race between Covid cases / Vaccine distribution. Vaccine Roll-outs competing against virus mutations and lockdowns
- Economic recovery and earnings momentum:
  - Changes in leadership and rotation (cyclicals vs defensives, growth vs value, US vs ROW) ➞ alpha over beta?
- US/China relationship under the new US administration
- Additional fiscal stimulus, Democratic agenda/progress re tax increases and regulation
- Exuberant sentiment (retail vs institutional)
- Rates & policy guidance brought forward?
- Potential rise of inflationary pressures (in the long term)

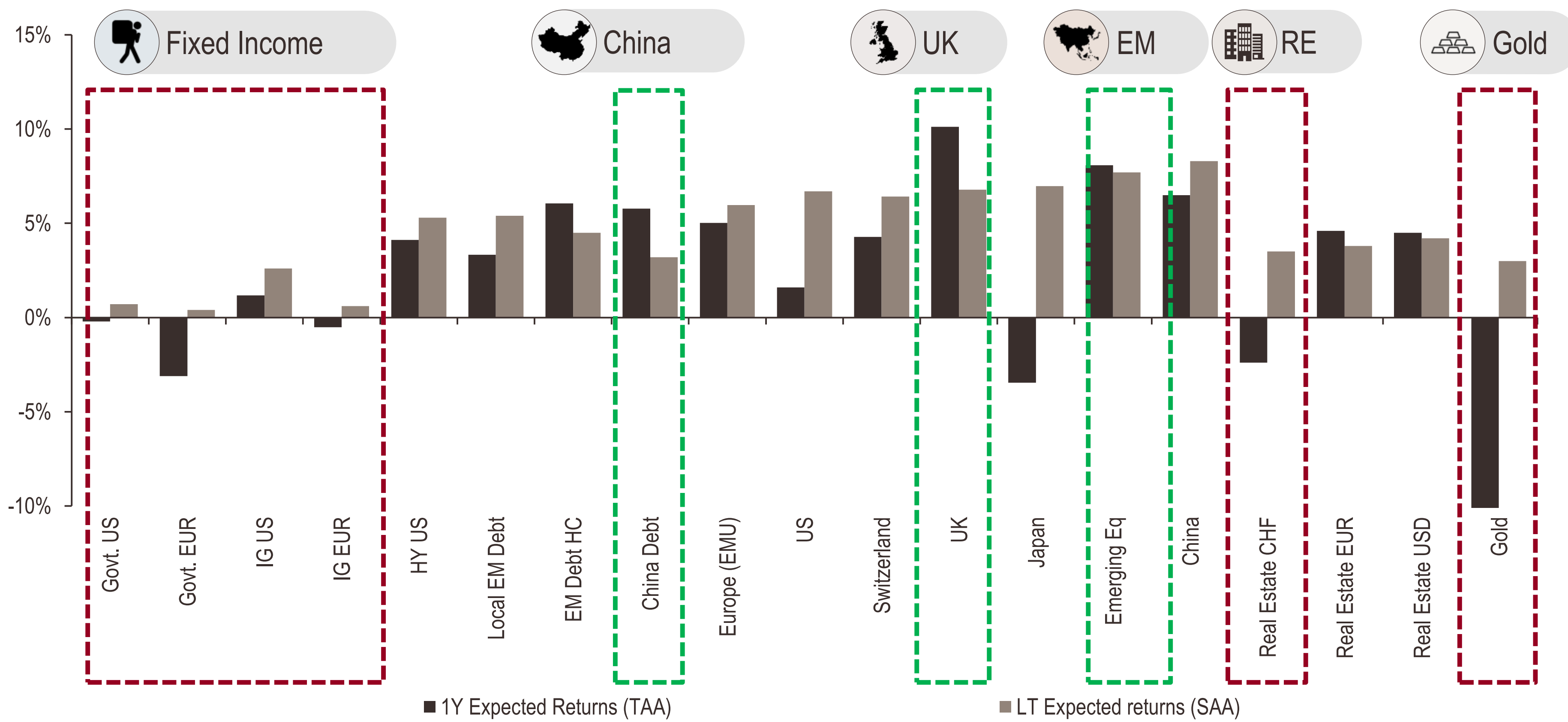
Conclusion

➢ We are cautiously optimistic.

Update on our 12M expected returns after the strong year-end rally

Still constructive but pockets of value are more rare

Expected Returns (12M vs 10Y horizon, January 2021)



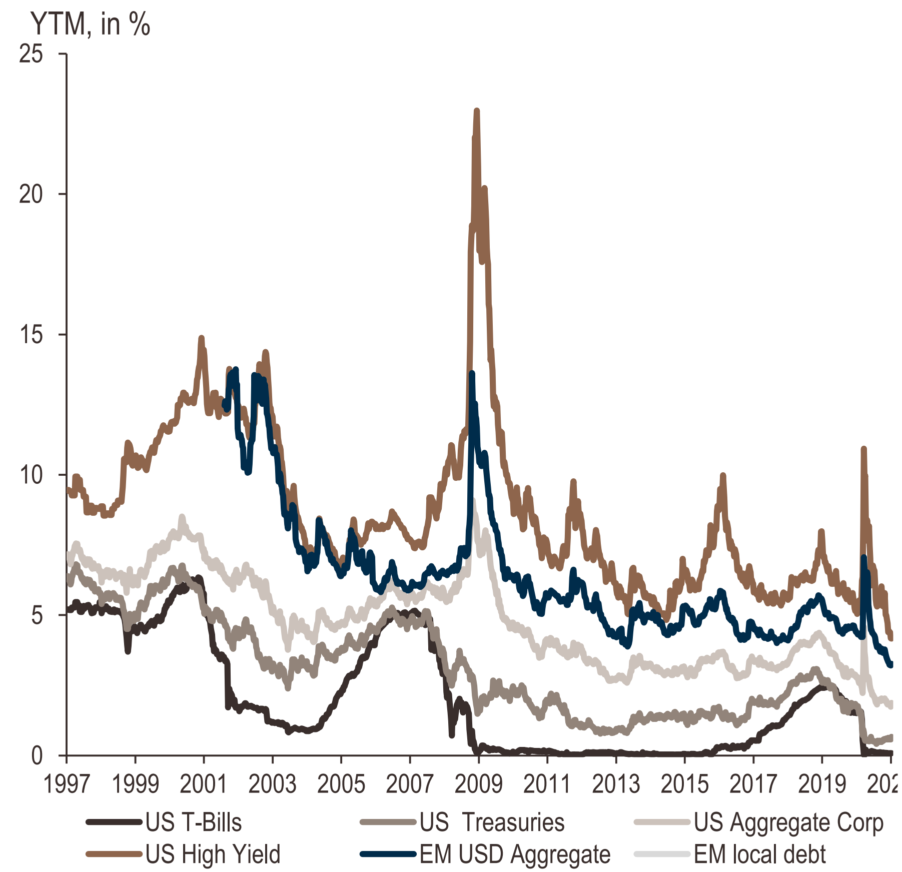
Past performance is not a reliable indicator of future performance. Source: Bloomberg, Lombard Odier Calculations

Please read the important information at the end of the document.

Interest rates risk tilted on the upside: IG spreads offer little protection

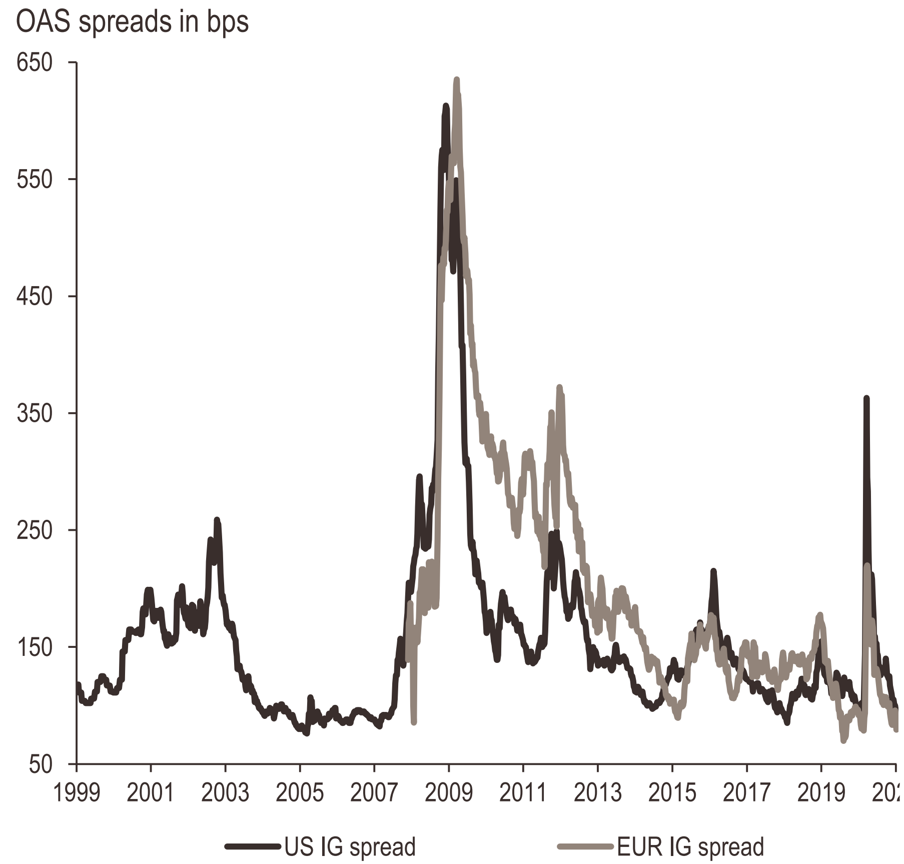
High-quality bonds a natural funding candidate

Search for yield to intensify (December 2020)



Source: Lombard Odier, Bloomberg

IG spreads close to all-times lows (December 2020)



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China debt still scores well both in terms of relative valuation and carry

A surge in yields should be avoided given strong inflows. Performance to be driven by carry and FX.

In our base case, the recovery leads to a less accommodative PBoC and moderately higher yields

Chinese rates and scenario analysis (December 2020)

Relative valuation: still a meaningful pick-up in yield vs UST (December 2020)

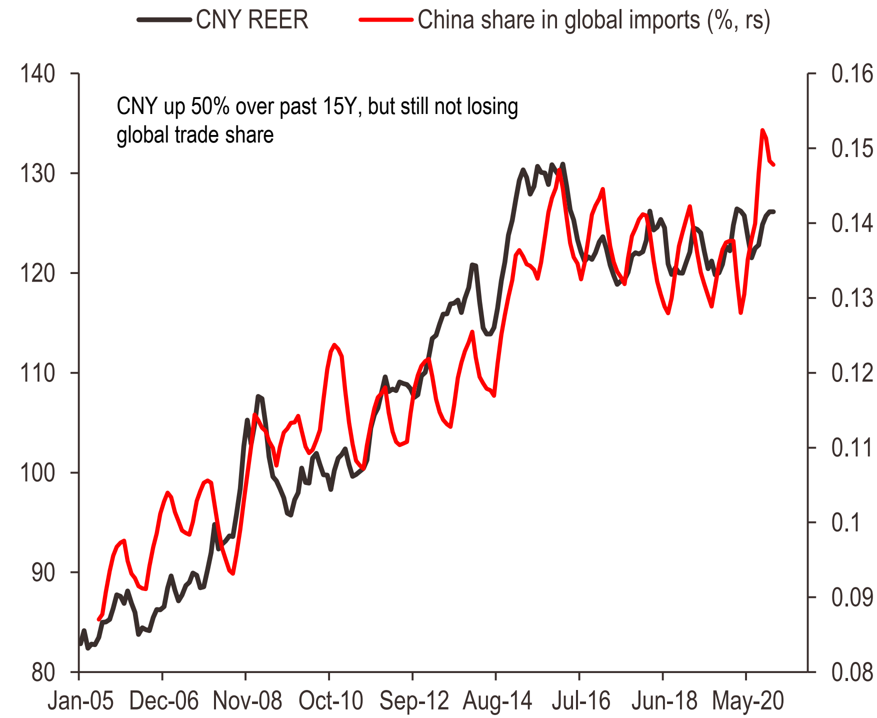
Spread China vs US Treasuries, 5Y maturity in bps

USDCNY: We revise our path to reflect a low point of 6.15 this year

This reflects a weaker USD as well as a 50% chance that Section 301 tariffs are reduced under a Biden administration

Recent PBOC FX liberalisation steps to see USDCNY fixings trade with higher beta to the USD (some "catching down" still to come)

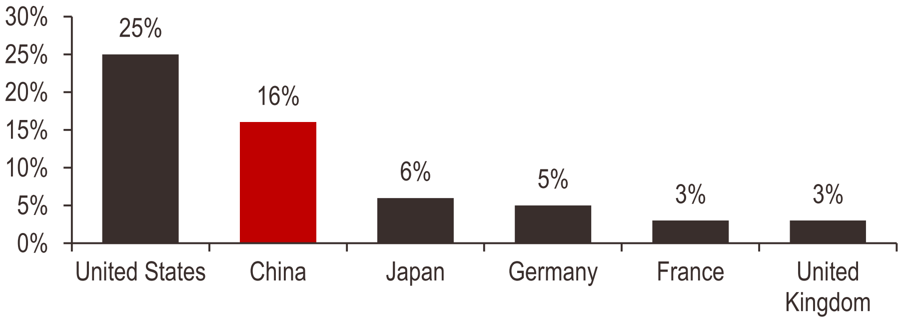
China still gaining share in world trade: no clear sign that strong CNY poses competitiveness problem



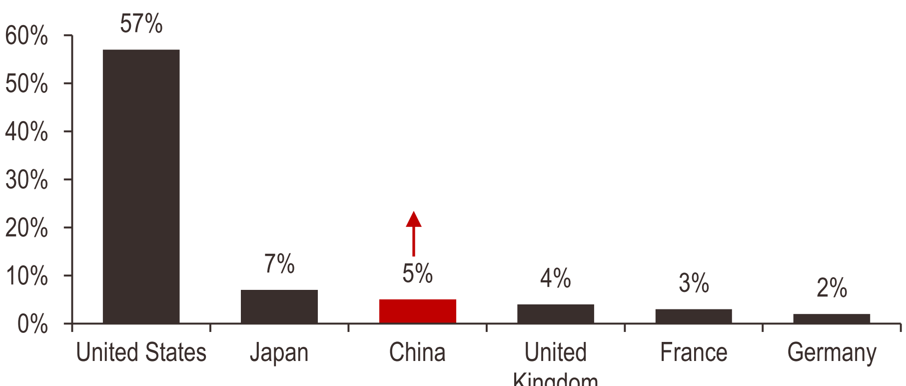
Past performance is not a reliable indicator of future performance.
Data as at 11 January 2021. Source: Bloomberg, Lombard Odier

Treating China as a standalone allocation in client portfolios to reflect the nation economic and geopolitical weight

Current Share of Global GDP – (World Bank, January 2021)



Composition of Global Stock Market (MSCI, January 2021)



WHAT HAPPENED?

US executive order on de-listing Chinese Equities

In early November, President Trump signed an executive order (EO) prohibiting Americans from investing in a list of 31 Chinese companies claimed to have links with the Chinese military.

Four more Chinese companies (China National Offshore Oil Corp, Hikvision, China Mobile, China Telecom) were subsequently added. The EO prohibits US persons from investing in US or foreign funds, such as ETFs or other mutual funds that hold publicly traded securities of the 35 listed entities.

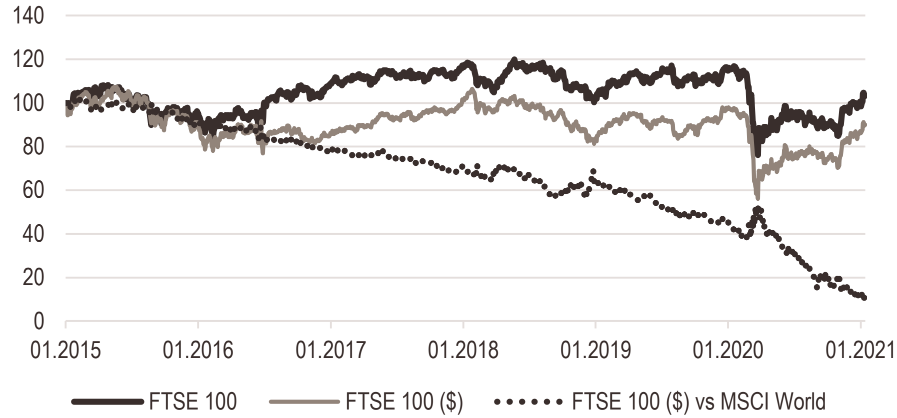
The order is effective starting 11 January 2021, and gives investors until 11 November 2021 to divest any investments in the stated 35 entities.

→ We believe the case for Chinese Equities remains strong
(Lombard Odier's Balanced EUR holds: 11% of its equity base in China)

UK – An unloved market since Brexit referendum in 2016

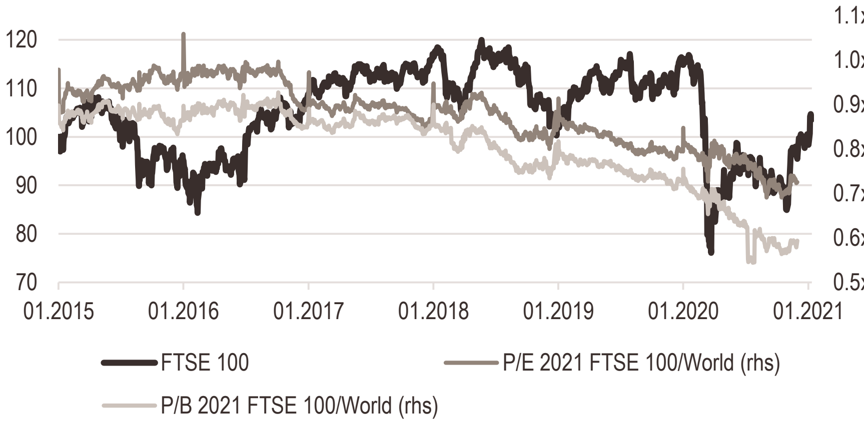
UK -14% in 2020, 25% behind MSCI World

UK absolute & relative performances over a long period (January 2021)



UK fwd P/E at a 28% discount to World, a 15Y low

UK relative fwd P/E & P/B (January 2021)



UK to benefit from:

- **EU trade deal**: even limited to goods, it will provide clarity,
- **Better global trade**: 76% of sales overseas (vs 49% EU/30% US),
- **Vaccine & reflation trade**: worst hit to 2020 EPS at -44% YoY (vs -18% MSCI World), with GDP expected -10/-11%.

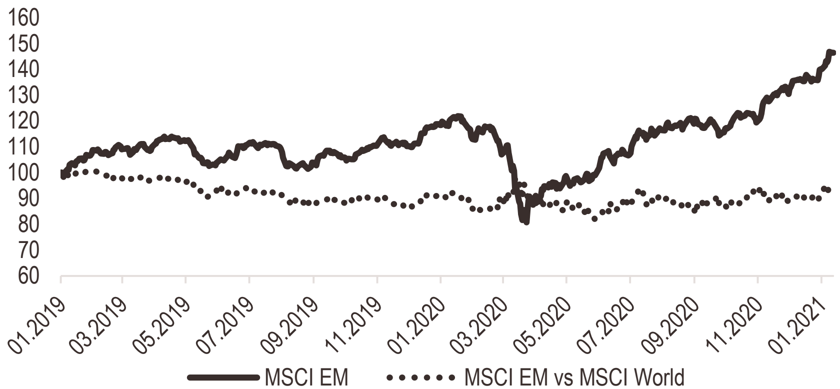
EPS and dividend momentum to look more favourable now.

Past performance is not a reliable indicator of future performance.
Data as at 27 November 2020. Source: Bloomberg, Lombard Odier
Please read the important information at the end of the document.

Emerging Markets: still far behind despite very recent catch-up

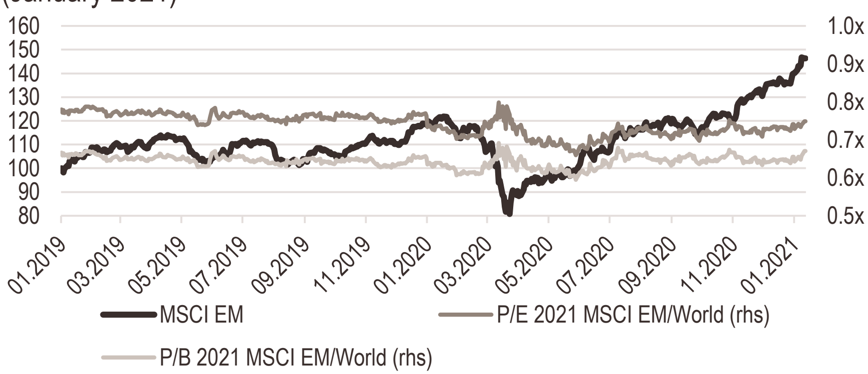
MSCI EM up 18% in 2020, close to MSCI World at +16%

MSCI EM absolute & relative performances (January 2021)



MSCI EM relative fwd P/E & P/B still at big discounts

MSCI EM relative fwd P/E & P/B – in-line with L2Y & L10Y averages (January 2021)



EM to benefit from:

- Chinese structural growth drivers (hence the low 0.8 beta),
- The ongoing rotation into Value (ex-Asia component),
- Positive earnings cycle supported by trade outlook
- Less confrontational and more predictable US trade policy,
- Positioning: still some room for further inflows
- Weaker USD / stronger EM currencies

Past performance is not a reliable indicator of future performance. Data as at 12 January 2020. Source: Bloomberg, Lombard Odier

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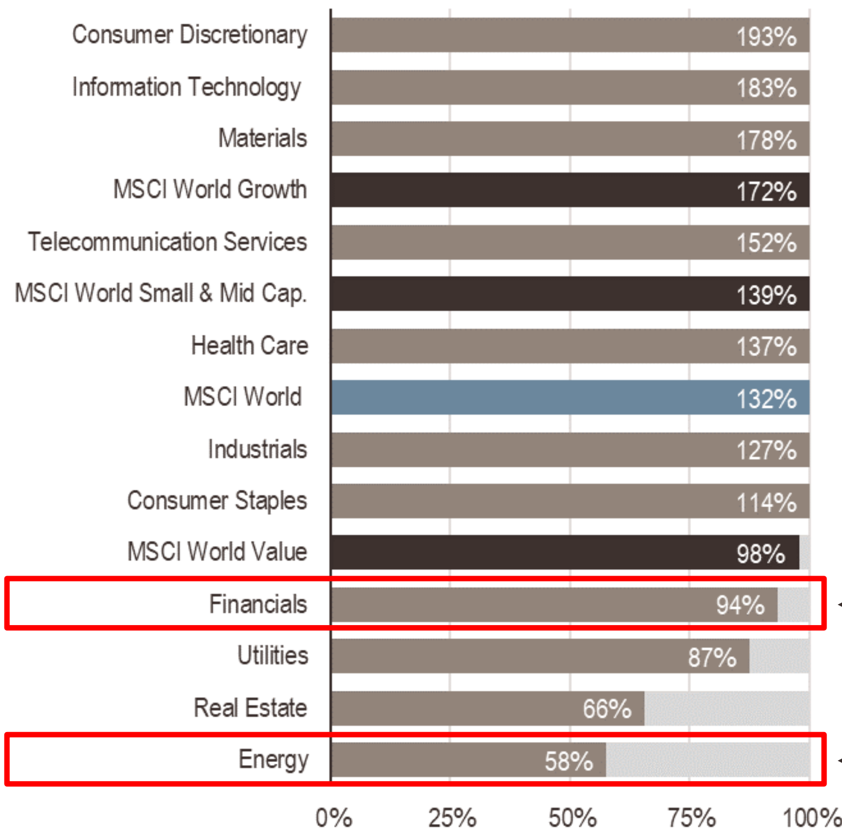
Cyclicals - Current environment remains favorable for a (partial) rotation

Financials and energy sectors have catched-up from the lows but are still lagging far behind…

Sectors and styles post the Covid-19 crisis trough

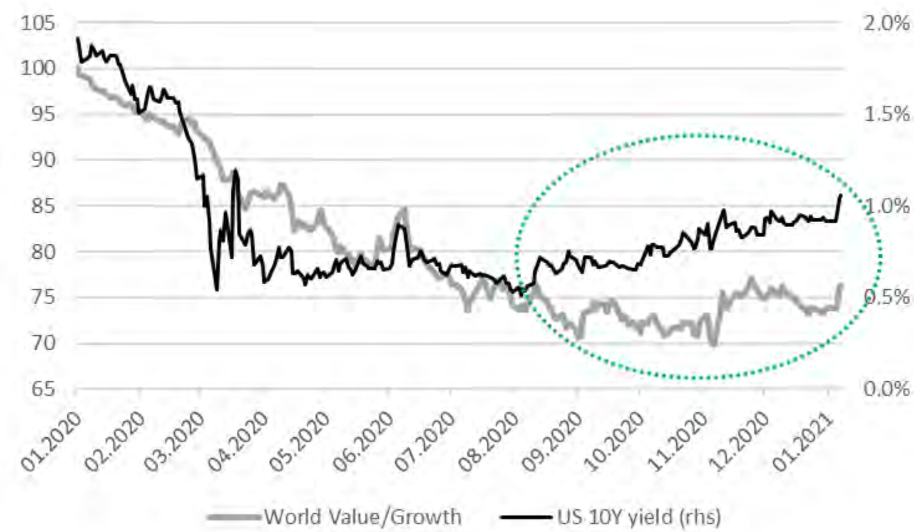
% drawdown retraced – 19.02.2020 high and 23.03.2020 low, MSCI World



Financials: Was 68% mid-Nov., 83% early Dec.

Energy: Was 32% mid-Nov., 49% early Dec.

Based on US 10-year yield relationship, gap has not yet closed (i.e. no need to assume a rise in yields)



Past performance is not a reliable indicator of future performance. Data as at 6 January 2021. Source: Bloomberg, Lombard Odier

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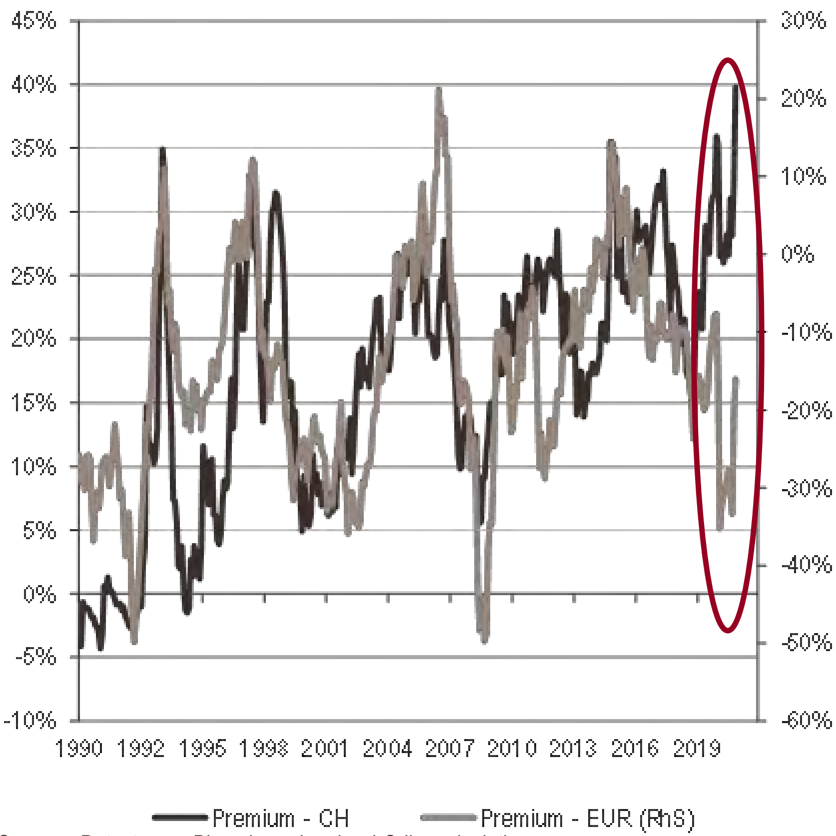
Swiss Real Estate Market

After a strong year-end rally, CHF RE is expensive and at risk of a correction

CHF listed real estate is expensive – a disconnect with EUR

CHF RE premium (December 2020) EUR RE premium



Sources: Datastream, Bloomberg, Lombard Odier calculations

Negative expected returns for CHF RE

		Probability	Performance
Optimistic scenario		**10%**	**3.2%**
Expected evolution			
Increasing net asset values	0.50%		
Stable dividend yield on NAV	3.40%		
Stable premium	40.00%		
Base scenario		**60%**	**-2.4%**
Expected evolution			
Stable net asset values	0.00%		
Decreasing dividend yield on NAV by 6%	3.15%		
Decreasing premium	35.00%		
Pessimistic scenario		**30%**	**-13.0%**
Expected evolution			
Decreasing net asset values	-1.00%		
Decreasing dividend yield on NAV by 10%	3.05%		
Decreasing premium	26.00%		
Weighted expected return			**-5.5%**

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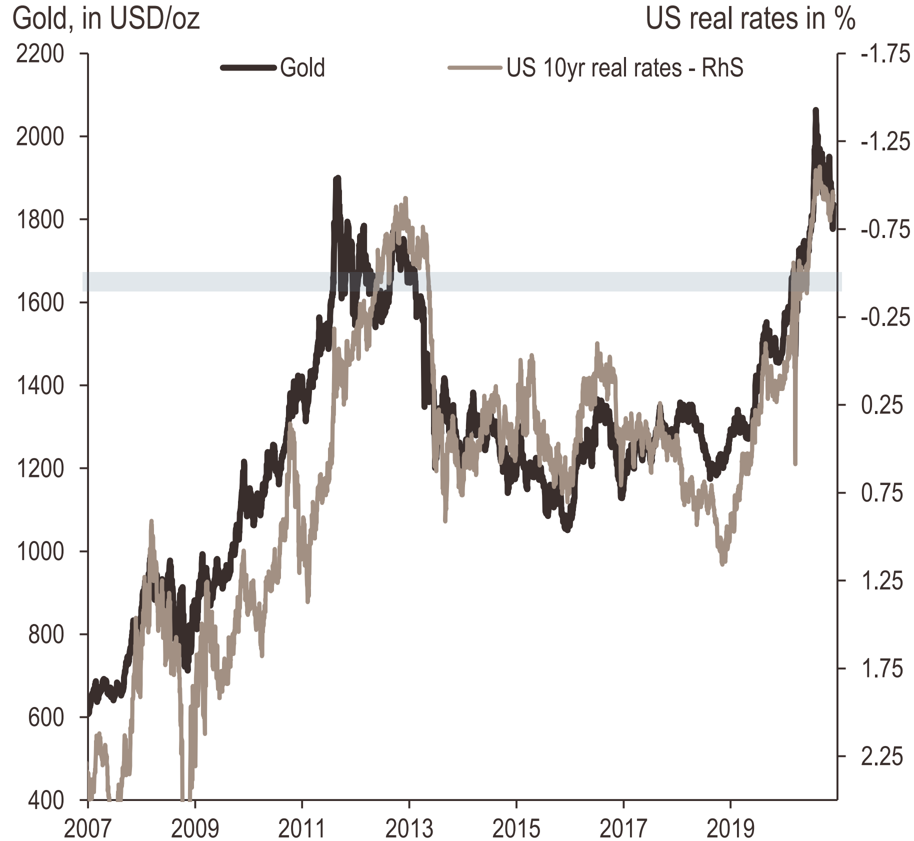
Hold onto Gold... for now

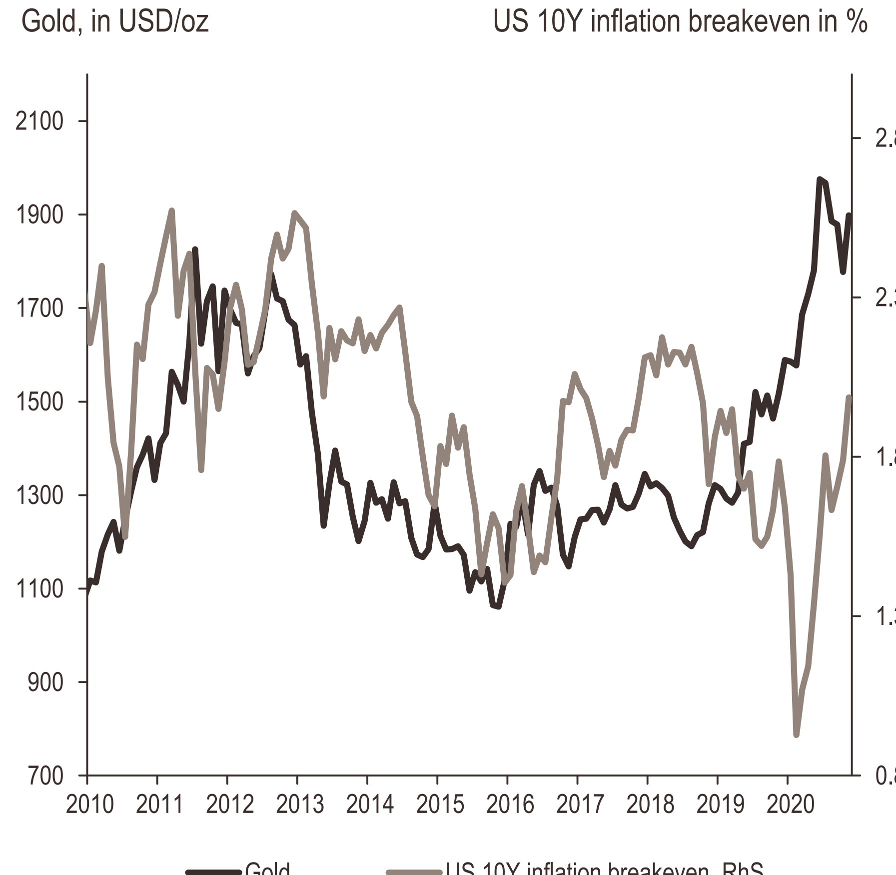
Gold prices look vulnerable in our mid-term forecast, but act as an immediate hedge against further Covid-19 outbreaks.

Higher real rates will push gold lower later this year, when the recovery materializes (As of 12.01.2021)



Source: DataStream, Bloomberg, Lombard Odier calculations

Rising inflation expectations can also be a driver, especially in early stage of the recovery (As of 12.01.2021)



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Sustainability is a key driver of portfolio performance

We favour companies working to tackle climate change, preserving nature and increasing bio-diversity

The transition from WILD to CLIC: To bring about this economic transformation, we must understand and address 8 key sustainability dynamics

THE ROOT CAUSE

Human development
Keeping up with a growing, changing world

SUSTAINABILITY CHALLENGES

Circular.

1 **Zero waste**
Embracing re-use, repair and recycling

2 **Regenerative nature**
Living within nature's boundaries

Lean.

3 **Dematerialisation**
Moving to a service-based economy

4 **Resource efficiency**
Achieving more with less

Inclusive.

5 **Fair society**
Ensuring a just transition

6 **Secure society**
Navigating social and political turmoil

Clean.

7 **Zero emissions**
Achieving the Paris Agreement

8 **Adaptive and resilient**
Adjusting to environmental change

SDGS

ENABLING TRENDS

Digitalisation
Enabling smarter solutions

Source: LOIM. For illustrative purposes only.

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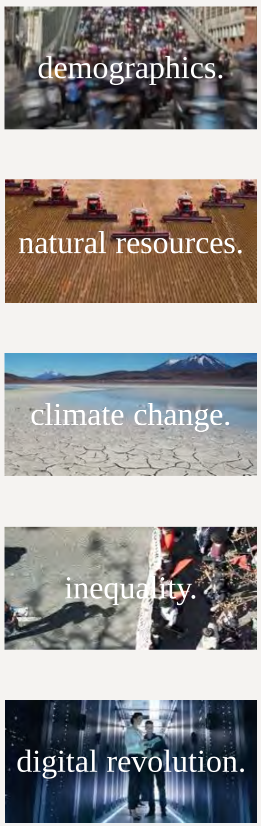
Implications of structural trends

How well are companies positioned to take advantage of the opportunities the transition presents?

Structural trends	Megatrends to Themes	Areas of impact



Cities
- Transport
- Construction
- Power
- Manuf.

Healthcare
- Cost
- Access
- Solutions
- Lifestyle

Food systems
- Agriculture
- Food quality
- Distribution
- Waste

Finances
- Cashless
- E-banking
- Blockchain
- Access

Smart Cities

New Mobility

Healthcare

Robotics

Cyber security

These examples are for illustrative purposes only and are not actual results. If any assumptions used do not prove to be true, results may vary substantially.

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Ten investment convictions for H1 2021

Manage Risk

1. Stay invested in risk assets
Given the continued monetary and fiscal support we favour **equities** and **corporate debt** over **sovereign debt**.

2. Maintain portfolio ballast
To shield portfolios from the unexpected we favor **US treasuries, Chinese government bonds, gold**, the **yen** or **put options**

3. Hold onto Gold... for now
Gold prices look vulnerable in our mid-term forecast, but act as an immediate hedge against further Covid-19 outbreaks.

Fixed Income

4. Use carry strategies to generate yield
In an environment of low inflation and anchored monetary policy, **EM hard currency bonds** look particularly attractive.

Equities

5. Capture the recovery with balanced cyclicals
With the vaccine news, the investment case for **cyclical stocks**, **small caps & industrial Europe** have greatly strengthened.

6. Don't miss Asian equities
China's strong and uncorrelated equity markets are attractive even in the light of potential US de-listings.

Diversification Sources

7. Invest in the real economy
Private equity & real estate offer resiliency. **Infrastructure assets** should benefit from massive levels of govt pandemic spending.

8. Factor in a weaker US Dollar
The currency remains overvalued and still includes some of the risk factored into US electoral chaos. We expect more **USD** weakness in 2021.

9. Expose portfolios to improving trade with emerging currencies
Many EM CCYs enjoy good external balances incl. the **Chinese yuan, South Korean won, Czech koruna** and **Chilean peso**

10. Sustainability is a key driver of portfolio performance
We favour companies developing **new technologies** while working to tackle climate change, preserving nature and increasing bio-diversity.

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