2021

THE TIMES THEY ARE A-CHANGIN'

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The case for active portfolio management in 2021: Key takeaways

1. We expect the rollout of vaccines, combined with policy support, will precipitate economic growth beyond the mechanical catch-up following the re-opening from the Great Lockdown

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While the pandemic meant lost lives and lost jobs in 2020, a successful vaccine rollout during 2021 is set to be a game changer: governments will gradually lift mobility restrictions and societies will return to most pre-pandemic habits. The swift recovery during the third quarter in the Western hemisphere and the ongoing expansion in Asia, where a second infection wave has mostly been avoided, serve as a template for the near future. In the first stage, strong economic data should propel the catch-up following the Great Lockdown.

We are confident that fiscal and monetary policy accommodation will outlive the coronavirus threat and prolong the rebound. In Europe, the multi-year, multi-billion Pandemic Emergency Purchase Programme from the ECB and commitments made under the Next Generation EU envelope are new, and significant, steps towards solidarity. In the US, a Treasury led by former Fed Chairwoman Janet Yellen should ensure full alignment with the Powell Fed. These interdependent fiscal and monetary policy actions should foster the transition from a mechanical rebound to a genuine recovery and multi-year growth and profit expansion.

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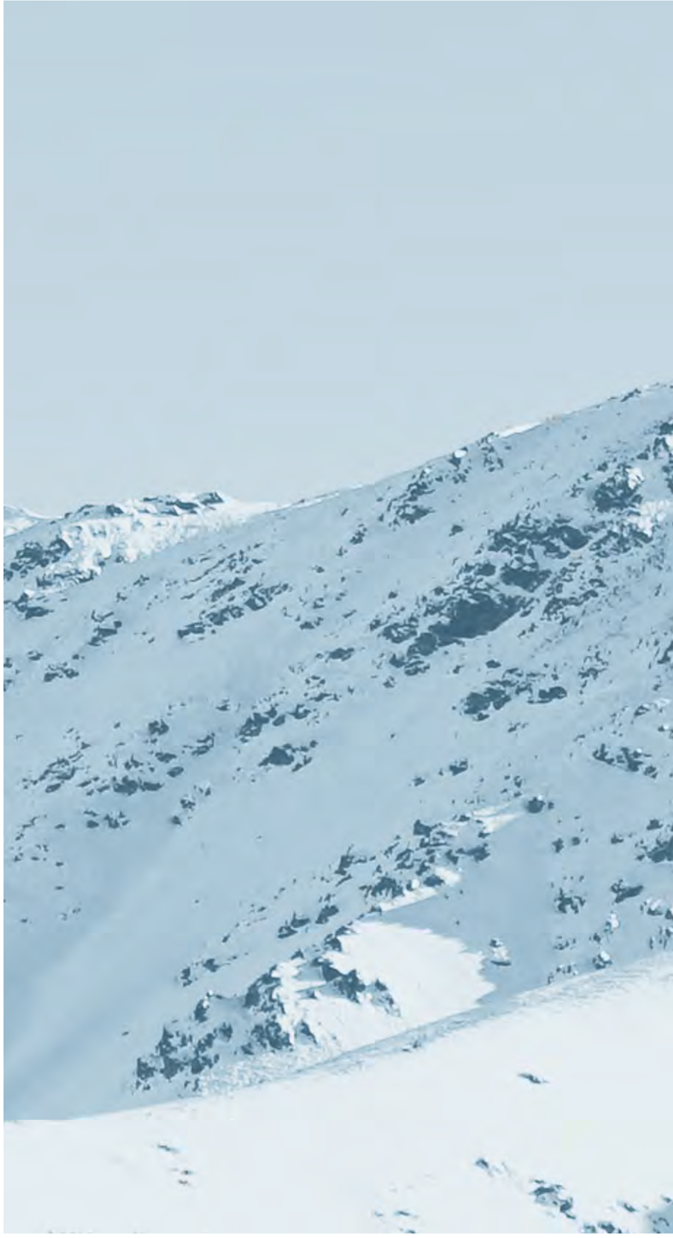
2. As we exit the pandemic, new challenges will need to be addressed quickly

Investors will quickly focus on the sustainability of profit growth beyond the 2021 rebound. New uncertainties will have to be addressed: first, political uncertainty will likely come back in Europe as Germany turns the page on the Merkel era as soon as next September, while France prepares for presidential elections in Spring 2022. In the US, mid-term elections in November '22 will be an important marker, not only for the Republican Party. Second, policy uncertainty will also be on the rise as new, incremental accommodation will become more unlikely as the economy recovers. Even premature tightening cannot be excluded, with China and Germany emerging as the most likely candidates for such actions.

3. Investors should start the year embracing a global economic recovery by putting more emphasis on small- and mid-caps and on value sectors, such as Banks, and position for a moderate steepening of the yield curve



Clearly, the economic recovery should favour the equity rotation already seen in the final months of 2020. The unprecedented USD 7Tn increase in central bank balance sheets (Fed, ECB, BoE and BoC) in 2020 has persuaded investors to embrace the equity rotation via economically-sensitive small- and mid-caps, and value sectors. The performance of value stocks is historically well-correlated with the slope of the yield curve and some sectors which have been badly hit, such as Banks, still have ample room for valuation re-rating during an expansion.

The expected pick-up in economic growth traditionally leads to a (bear) steepening of the yield curve. However, as already said, since the Great Financial Crisis of 2008/09, central banks not only control the short term rates through policy decisions but increasingly weigh on longer term yields through quantitative easing. In this context, Candriam estimates that net sovereign issuance in the Euro area will be negative in 2021, once adjusted for ECB buying! The accommodation programs put into place during the Great Lockdown of 2020 imply that the yield curve steepening should remain under control.

The US real rates differential with the Eurozone and persistent twin deficits suggest further softening of the US dollar through H1 2021. While supporting profit growth for the American corporate sector, this implies a preference for ex-US investments for the global investor. In particular, there is a strong case for the outperformance of emerging market assets, equities and local currency bonds. A weaker US dollar provides good news for Latin American countries due to their high dollar-denominated debt service, and a support for commodity markets.

4. The pandemic revealed that the inclusion of long-term investment trends are helpful in building a resilient portfolio – environmental solutions, digitalisation and healthcare are our strongest thematic convictions

The longer the investment horizon, the more resilience will be key in portfolio construction. Unfortunately, most of the investment themes benefitting from the so called “re-opening trade” are not ticking this box. The pandemic demonstrated that it is possible to build portfolio resilience thanks to long-term trends which have been further reinforced in 2020. Hence, we advise staying with the long-term “winners” of the crisis: a robust governance appeared to deliver better results during the pandemic, both at company and state level. The sector/country mix that has shown resilience during the pandemic and which will likely continue attracting investors beyond this year are Technology, Healthcare, China and Germany.

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We also believe that sustainability will continue to gain in importance for the social and environmental aspects: solutions for a cleaner future reveal high growth potential driven by innovation. In this respect, we welcome the alignment of the three major players – and polluters – the United States, China and the European Union in their aim to fight against global warming. We keep long-term climate and environmental themes as core portfolio holdings because we are convinced that this constitutes an inevitable building block during the first half of the 21st century. In particular, we expect clean energy and renovation sectors will be at the forefront of new investments to achieve the neutral carbon emission targets.

5. Let’s learn the lesson of 2020: The pandemic year demonstrated that human ingenuity prevailed. For investors, this implies being nimble and managing the portfolio actively

Active portfolio management should be rewarded again as a lot of good news have already been anticipated since the first announcement of a high vaccine efficacy early-November – witness record levels in stock market indices around the world from Korea to Wall Street. As a consequence, we believe that 2021 will be a year where portfolio managers will have to be nimble while active management will be rewarded.

With some major hurdles crossed, the investment horizon has opened up somewhat; our convictions have therefore evolved towards a more risk-on stance. This translates into a higher equity beta and an overweight equity stance. One of the lessons of 2020 is that human ingenuity prevailed in the most adverse conditions: the capacity to solve problems and the capacity to correct errors lead us to start 2021 with hope.

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