Re-opening

INVESTMENT STRATEGY

JANUARY 2021

Despite the highly unusual circumstances shaping 2020, many indices were up in the end, some even at historic highs. Since Covid-19 was an exogenous shock, it was the shortest bear market in recent history and the economic recovery was also faster than in previous recessions. With the approval of efficient vaccines, investors began to prepare for the post-Covid-19 era. After years of cautiousness, risk appetite is somewhat higher, though not yet exuberant. Where do things go from here?

Growth is back

The social and economic uncertainties stemming from the COVID-19 pandemic won't suddenly subside with the end of the 2020 calendar year. However, with the prospect of an end to pandemic-related restrictions, our central scenario is that the recovery should gain momentum in the second half of the year, though not yet as dynamic as before the pandemic. Consumers should make up for the enforced spending on travel or entertainment, and companies should invest more again. Mishaps in the vaccination campaigns or further lockdowns may delay this recovery, but not stop it entirely. Inflation will rise but stay below central bank targets due to excess capacity created by the recession. Fiscal and monetary policies in the US and the Eurozone will support the recovery: the money floodgates will be opened further with the Senate majority for Democrats in the US and the 750 bn Euro recovery programme passed before the end of the year. Central banks should also not stifle the recovery but support it with their bond purchases (with the ECB keeping an eye on the spreads of countries like Italy and Spain).

All roads lead to equities

Equities: To profit from the recovery phase, equities are the first choice. But due to the strong polarization between sectors, active management is more important than ever. Covid-19 has accelerated existing structural trends in technology, healthcare and ecology. Although some stocks within these sectors appear highly valued, we are convinced the long-term outlook for them remains intact. Of course, there are stocks like Tesla, whose market capitalization now matches that of the ten largest traditional car companies. It is quite late to invest here, but to spot such stocks early, the use of artificial intelligence and natural language processing (instead of only traditional fundamental analysis) can be helpful, as these tools enable us to sift through unstructured data for clues to future profiteers of long-term growth trends.

In addition to long-term growth stocks, those benefiting from the reopening of the economy should be considered too. The rotation into more cyclical sectors affected by the pandemic, which began last year, will continue. It is advisable to look for high EPS growth driven by the recovery, for example in automotive, construction and banking stocks. We continue to favor Europe over the US, where valuations are cheaper and there are more cyclical stocks. Small caps are likely to benefit disproportionately from government stimulus programs and still have catch-up potential in terms of valuations compared to large caps. Emerging markets that benefit from the recovery in China or rising oil prices could outperform in the short term.

Bonds: With low interest rates and a steepening yield curve, at least in the US, government bonds offer less potential. This leaves for investors with need for carry only corporate bonds (both High Yield and Investment Grade), where defaults still seem bearable by historical standards. Spreads are likely to remain within a narrow range. But investors should be flexible, as the short-term widening of spreads due to bad news from the Corona front could open opportunities.

Currencies: As soon as there is a recovery in global trade, currencies such as the euro will tend to be among the winners, while the US dollar is likely to weaken.

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Trends

In 2021, we will have to continue to live with a complex investment environment characterized by a lot of uncertainty. The interplay of disruptive technologies, structural and cyclical themes as well as megatrends with long term impact on the economy will make it necessary to combine traditional investment processes with innovative data-driven approaches, if you want to uncover interesting investment opportunities.

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