

Global Investment Strategy

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ANDREW JENNER
HEAD OF INVESTMENT STRATEGY

MUFG ASSET MANAGEMENT



Investment Summary

Covid vaccines have arrived and 2021 growth expectations look much better.

A number of vaccines have been announced, and some already approved by the necessary authorities.

A form of normality will return in 2021 and economic activity will slowly accelerate.

It will take time for confidence to return to all parts of the population, and there is winter to get through first.

However, the fundamental economic architecture remains in place, promising a return to normal at some point.

But we should remember 'normal' was low productivity, low real interest rates and zero bound problems.

Inflationary expectations have weakened alongside weak activity and job losses.

Inflation expectations have remained well anchored, and remain below target for most central banks.

The Fed's average inflation target means lower short rates for longer, but ultimately higher long rates.

Loose fiscal policy alongside loose monetary policy raises inflationary possibilities longer term.

An end to loose money is not in sight.

The short end of the interest rate curve remains at low levels and negative for several major countries.

Ten year yields remain below inflation targets for the next ten years, hardly suggesting a boom.

This is a damning view of the future, no growth, as well as concern that central banks are now powerless.

Equity markets are at highs, assuming earnings will recover strongly.

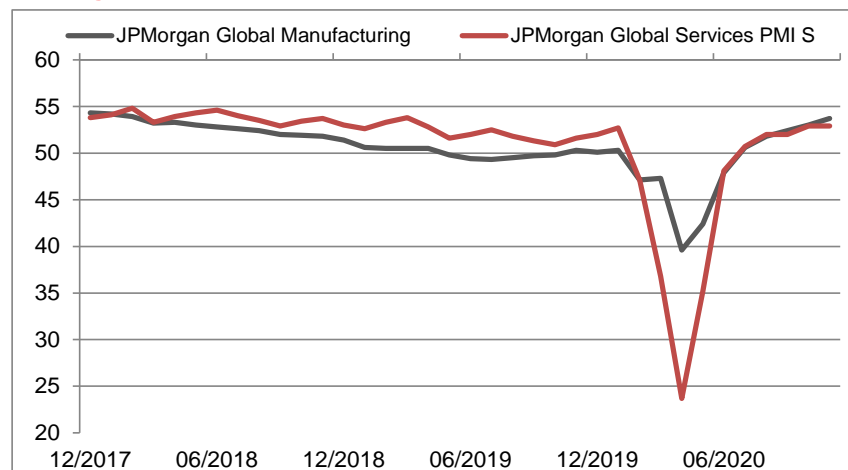
Equities already discount a return to normal economic activity, so pressure is on corporate earnings.

Is this the time to bite the bullet and buy cyclicals and value? And sell growth like technology?

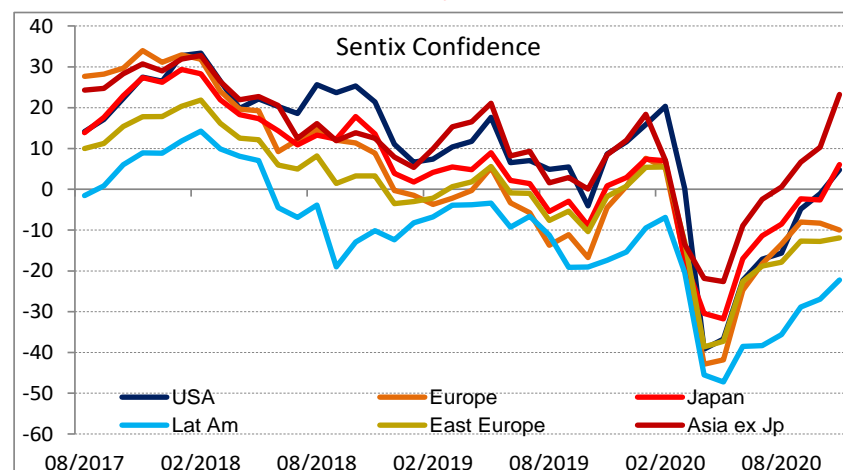
Growth and Inflation

Source: JP Morgan, Sentix, OECD, Bloomberg,

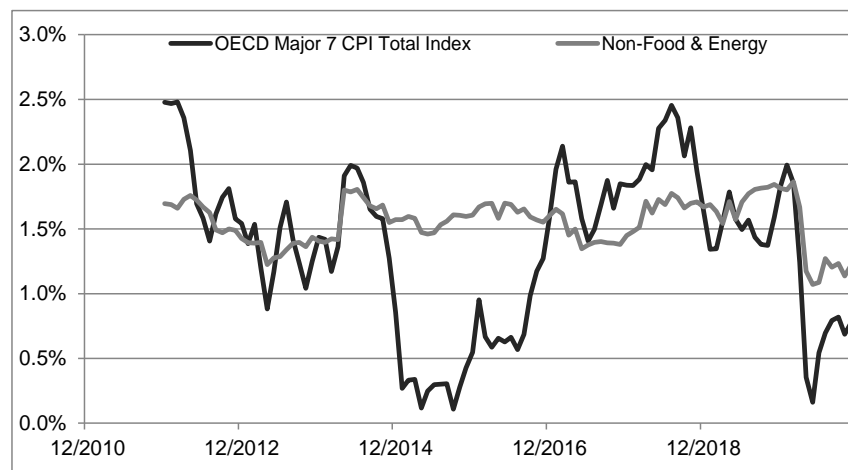
JP Morgan Global PMIs



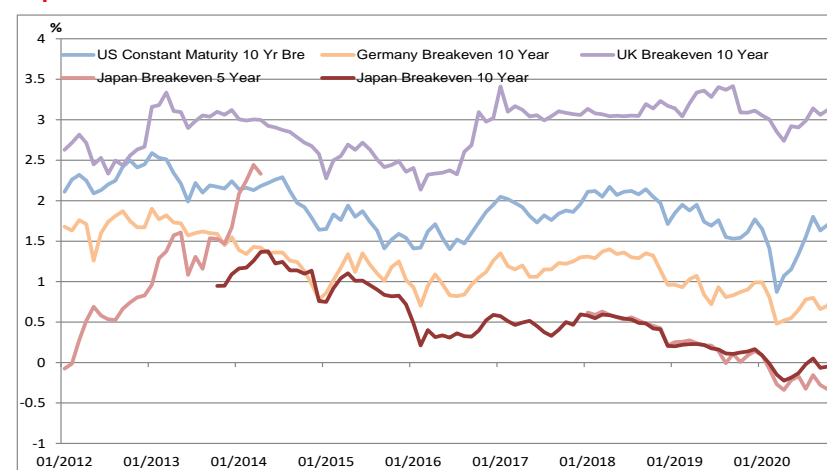
SENTIX Business Expectations Survey



OECD G7 Inflation



Implied Inflation from Index Linked Bonds



What are markets telling us?

Bond markets have had a limited reaction to the news of a vaccine, a slight steepening of curves but little else.

Investors expect inflation to remain at low levels for some time to come.

Central Banks are expected to keep monetary policy loose, until there are clear signs that growth is strong.

Real yields are low, bond issuance is high, this will not change soon.

Equities have moved up to new highs, discounting a return to normal economic activity.

It will take time to understand all of the impact from the pandemic.

For instance how long will it take for unemployment to fall back to previous levels?

Will fiscal spending plans go ahead, or will Governments retrench now that the vaccine is here?

What are we thinking?

The Western world is now in winter, hospitals will be under pressure, when will restrictions on activity end?

Central Banks have no ammunition left and negative rates are impacting the financial system.

Low real interest rates make bonds very poor value.

Equities have plenty of good news priced in and need to see an end to the profit downturn.

However there is scope for stocks hit hard by Covid to rebound and for the beneficiaries to retreat.

It is not the time to be short of Value.

Fixed Income

Fixed Income Strategy (1)

DURATION

We are neutral duration and only very modestly overweight to yielders.

Central banks were already struggling to meet inflation targets, the goal has moved further away.

There are now longer term worries about fiscal positions and central banks loosening targets.

The US Presidential Election: America will stay first, China will be seen as a problem, relations with Europe should improve, fiscal policy will be loose but no more so than it would have been.

Country spreads have narrowed and inflation targets shifted so we are less forceful in favouring yielders.

SPREAD PRODUCT

Spread product is attractive, but choose carefully.

The economic outlook, slow growth and supportive policy, favours spread product.

Despite this we have reduced our overweight for reasons given below:

Spreads have come in from 330 over to 100, basically back to the Pre-Covid level;

Corporate leverage has increased, so far for precautionary reasons but that could change.

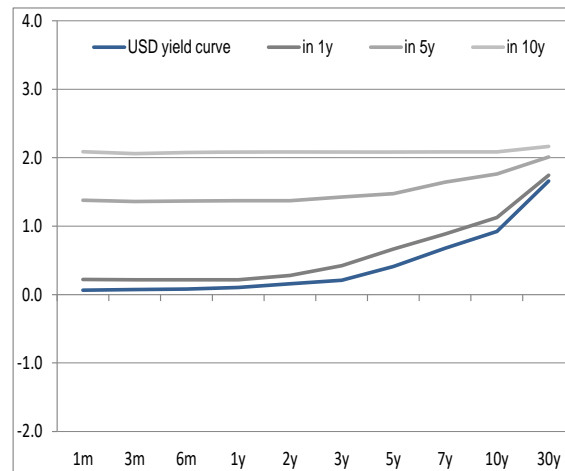
Governments are in weaker positions: debt levels are higher, monetary policy limited in efficacy.

We don't see another economic shock, but if there is one there is less ability to withstand it.

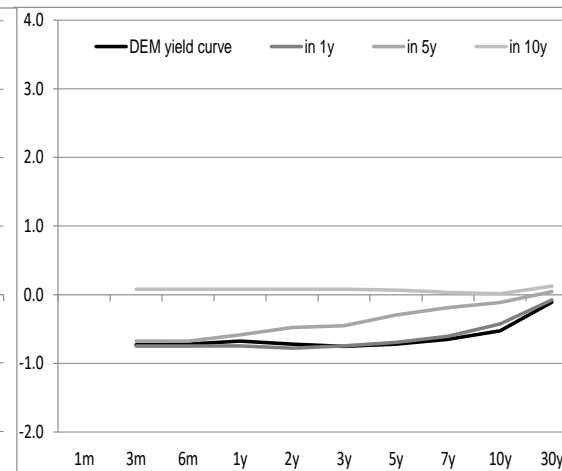
Forward Yield Curves

Source: Bloomberg,

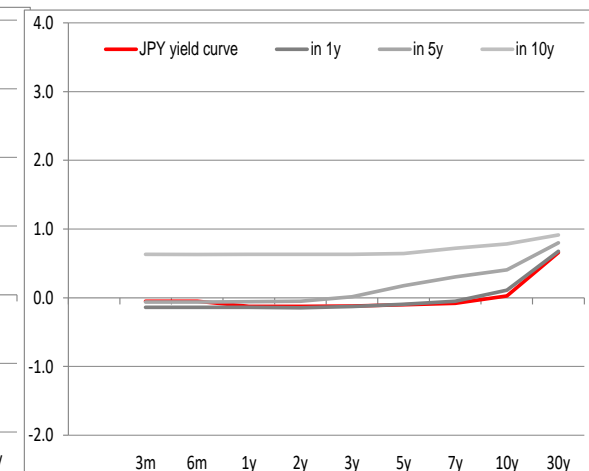
USA



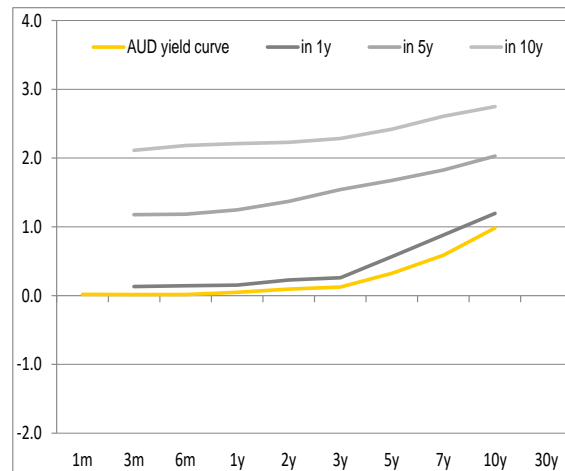
GERMANY



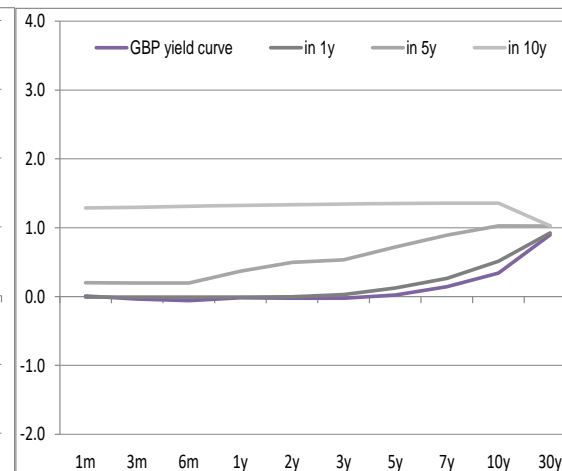
JAPAN



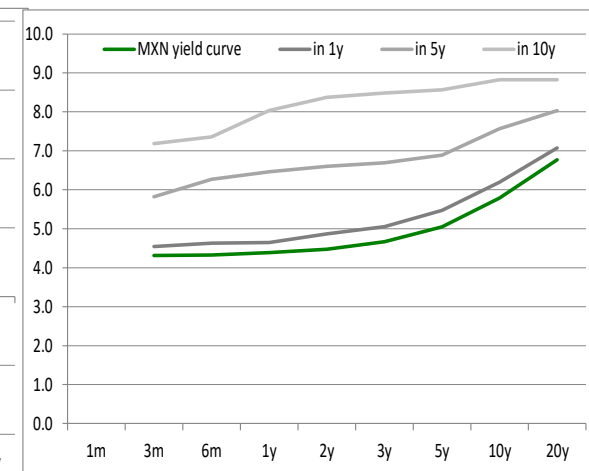
AUSTRALIA



UK



MEXICO



Fixed Income Strategy (2)

COUNTRY ALLOCATION

We prefer markets where yields are higher, but less so.

We mildly prefer the higher yielding markets (USD long end, CAD shorter end).

If growth disappoints yielding countries still have a bit of room to act.

Central banks will not anticipate and will keep rates low until targets are reached.

The world before Covid suggests that will be a long time coming.

Changes to inflation targets make nominal yield convergence less obvious.

The fiscal and monetary actions are raising some concerns longer term, worry about those later.

Negative yields are no longer rare.

Banking sectors are struggling in the negative yield environment creating a vicious circle.

Japan oddly now looks normal rather than an outlier.

German yields are poor value. If yield downside is negligible why risk suffering the upside?

CURRENCY

We have limited currency positions.

The USD has cheapened but is fundamentally a more robust economy.

The Euro is cheap on fundamentals, but rates are not rising and risks around the EU persist.

The dollar weakened because of rate cuts, but the US is still expected to return to normal more quickly.

Equity

Equity Strategy (1)

GLOBAL

The global profit cycle should be important to investors.

The 12 month forward global EPS drifts higher while current earnings fall – suggesting an earnings boom.

This month's news is supportive of this trend, but is probably in the price.

For markets to rise further requires confirmation in hard data and an end to the profit downturn.

With little room for disappointment we would not be rushing to buy equities.

Valuations are extended and still not the focus.

P/Es are related to future earnings growth in which confidence has improved.

The current historic P/E of 32x is expensive as announced earnings continue to fall.

Future earnings are not being revised down, which is keeping the forward P/E at 20x.

Dividends are under pressure and the current yield is low when one would expect it to be high.

Indeed the last time yields were this low was 2007, just before the financial crisis.

Profit forecasts are not too excessive at present.

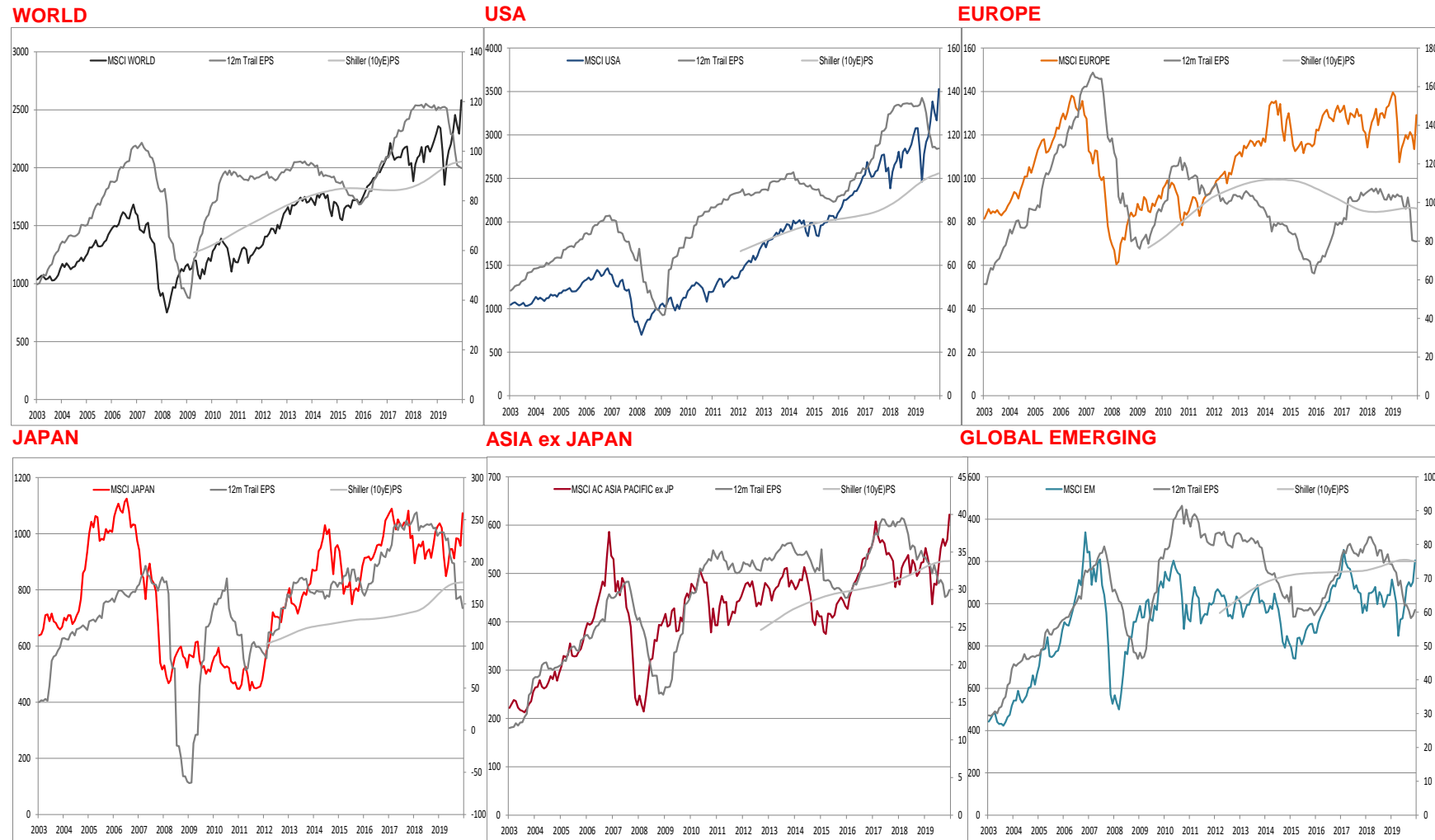
The next twelve months are forecast to see 35% profit growth, which is not ridiculous.

In 2018 before COVID appeared, MSCI World earnings were forecast to reach 140 on a P/E of 16x.

Currently forward earnings are at 125 on a P/E of 20x, if forecasts rise to 140 then the P/E would be 18.5x.

MSCI Equity Indices and Earnings (right hand axis)

Source: MSCI, Bloomberg,



MUFG Asset Management



Equity Strategy (2)

SECTORS

Improved confidence in growth expectations has caused trends to reappraise.

Cyclical sectors saw a rise while previous leader Technology had a set back.

Energy and Bank stocks though remain friendless hitting new lows relative to the market.

Other sectors are trendless at present.

What is clear is that “Covid beneficiaries” took a step back, while “Covid losers” were picked up.

FACTORS

Does a vaccine signal an end to the earnings downturn?

Value bounced strongly in most markets on the day of the vaccine announcement.

However there was limited follow through as there are still some tough months ahead.

Growth and Quality had a poor month, but so too did Profit factors.

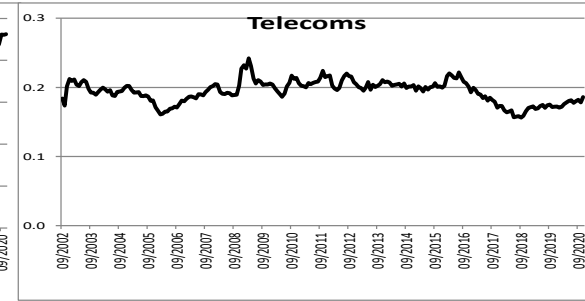
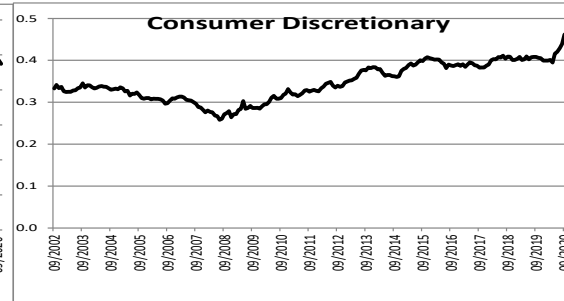
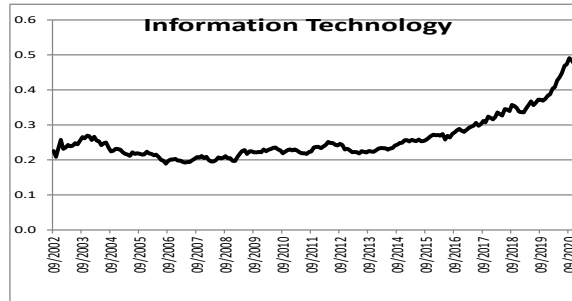
As we have said for some time forward earnings have not been revised much and may already be in the price.

Still it is a time for investors to reappraise portfolios and probably avoid a large underweight to Value.

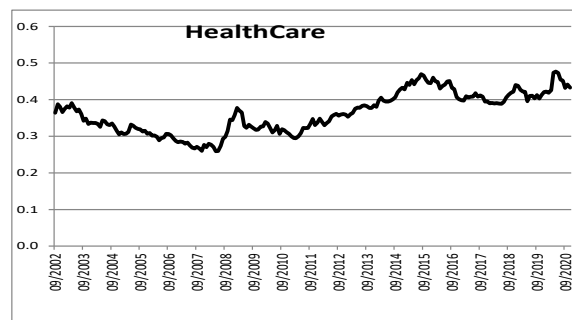
MSCI Equity Sectors Relative Performance (in USD)

Source: MSCI, Bloomberg,

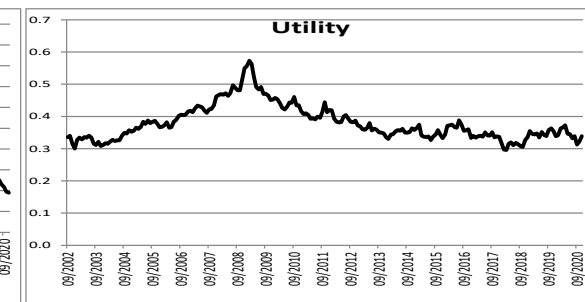
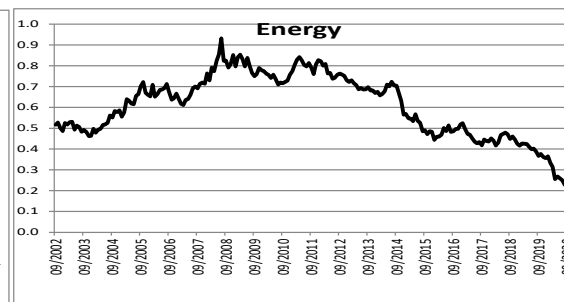
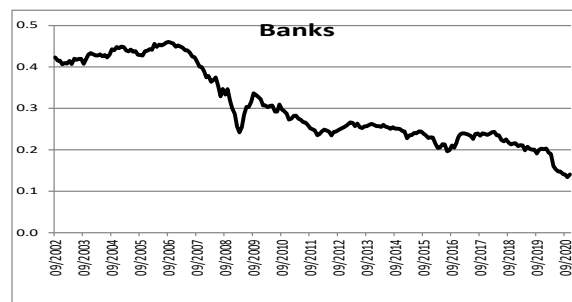
WINNERS



MAKING THEIR MINDS UP



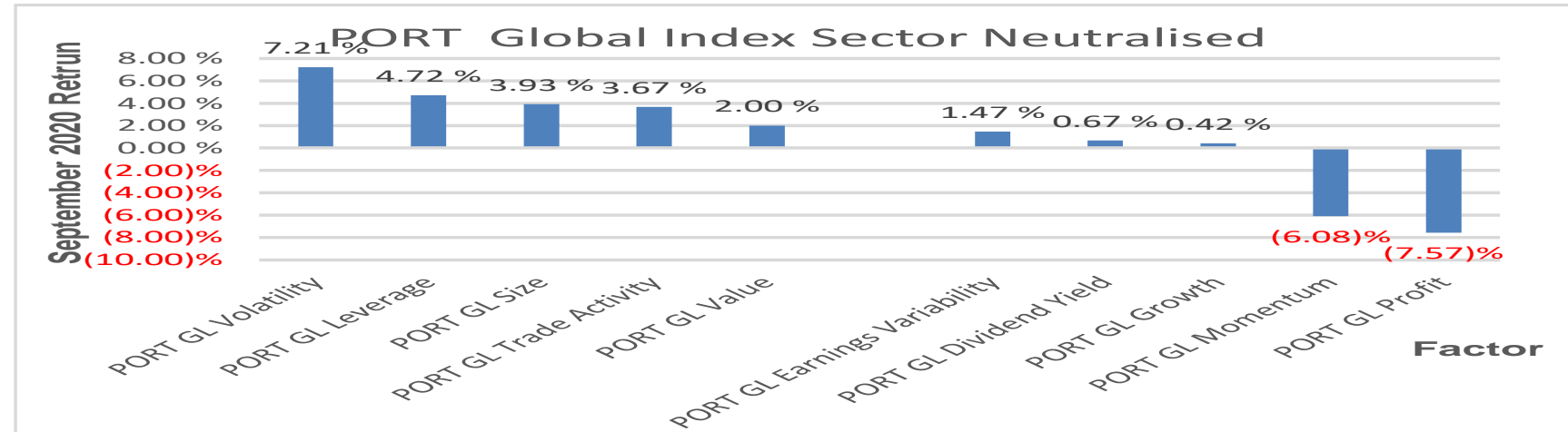
LOSERS



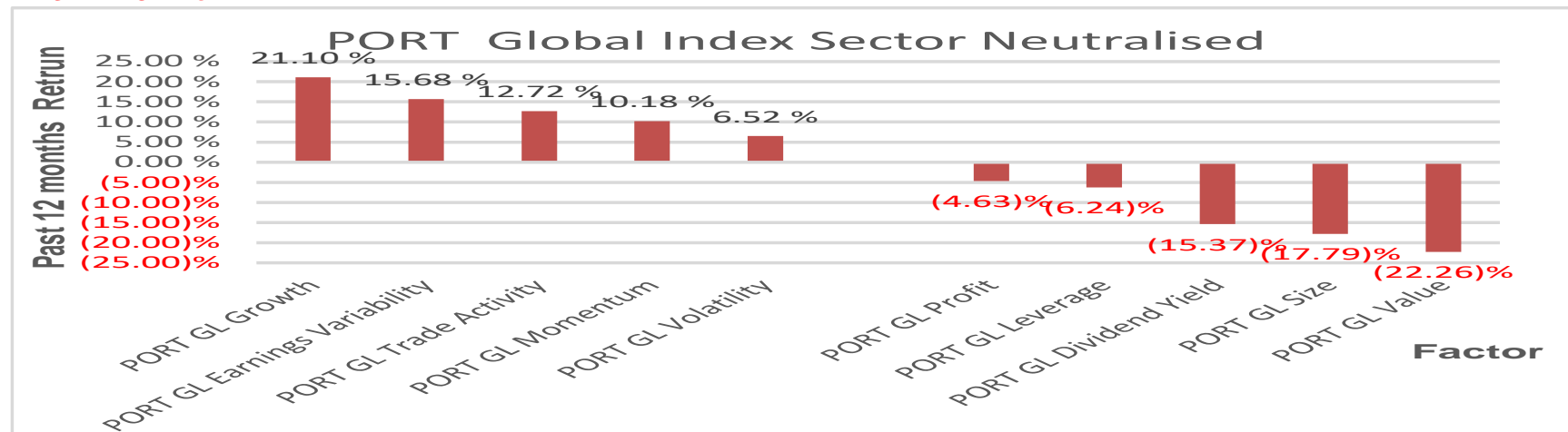
PORT Factor Analysis

Source: Bloomberg,

1 MONTH



PAST 12 MONTHS



MUFG Asset Management



Mitsubishi UFJ Asset Management (UK) Ltd.
24 Lombard Street
EC3V 9AJ London
United Kingdom

www.uk.am.mufig.jp
info.muamuk@uk.am.mufig.jp

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