**WEM MARKET NOTES**

**DECEMBER 2020**

**DRAFT**

**BLOCK 1:**

**GLOBAL VIEW**

The middle of the last quarter of 2020 for the markets was in a growth zone amid news of the results of vaccine trials, which, according to published data, demonstrated high efficiency rate. For example, Pfizer and Biontech stated that primary efficacy analysis shows to be 95% effective against COVID-19 beginning 28 days after the first dose. The news affected both developed and emerging markets as participants began investing more intensively in companies hit hardest by the pandemic in anticipation of further economic recovery.

ASSET CLASSES (TABLE) + PERFORMANCES for main benchmarks (CHARTS)

However, despite the vaccine outlook, the current pace of economic recovery has slowed, especially in countries where the coronavirus situation is forcing restrictions due to record levels of infections and hospitalizations per day. It was also noted by the International Monetary Fund before the virtual G20 summit: “while global economic activity has picked up since June, there are signs that the recovery may be losing momentum, and the crisis is likely to leave deep, unequal scars," officials at the Washington-based fund said in a report, “uncertainty and risks are exceptionally high". IMF Chair and Managing Director Kristalina Georgieva urged countries around the world to continue implementing economic aid programs and various incentives.

In the U.S. many states have re-introduced restrictions or seriously tightened the current regime. In November, the number of daily cases jumped in its record to 204 thousand per day (which were registered on November 20) and the average daily increase is kept at around 150 thousand cases per day. The COVID-19 spikes began to affect employment trends, the number of jobless claims has been growing for the second week in a row and is higher than the forecasts. According to data published on November 25 for the previous week (the week ended November 21st), their number was 778 thousand compared to 748 thousand earlier. In addition to that, retail sales for October rose less than expected (up 0.3% MoM in October, following a downwardly revised 1.6% gain in September and below forecasts of a 0.5%) and this may continue due to the expiration of the government programs providing benefits to the unemployed.

JOBLESS CLAIMS (CHART)

Market participants expect that the economic situation can get out of the mixed statistical zone by adopting a new stimulus package, which has been under negotiation for a long time. But the timing of the adoption still remains unclear, with Democrats pushing for a $ 2.2 trillion proposal, which Republicans consider as too expensive. The importance of adopting new incentives was reiterated by Jerome Powell, Chairman of the Fed, who stressed that in addition to the vaccine, the government should take other promised steps, since the risks remain high.

As for positive developments, it seems that the transfer of power to Joe Biden has begun, which removes concerns about possible problems with delay and the creation of serious obstacles on the part of Trump, which would take place at a very difficult moment amid a new wave of coronavirus cases. As we wrote in our previous issue, we view Joe Biden's victory as a positive factor for the markets and consider the possible tax consequences (which were part of Biden's program) unlikely due to the pandemic and the divided congress. The new President is already making changes in the state apparatus and former Fed Chairman Janet Yelen could become the new Treasury Secretary, if her candidacy is approved by the Senate. She will become the first woman to take this position.

Also, from the latest data, we should mention the release of the PMI for November, which in its composite version (both manufacturing and service sectors) jumped (57.9) to the highest in the last five and a half years, largely due to the end of uncertainty with the elections and progress regarding the vaccine.

PMI COMPOSITE (CHART)

In Europe, the situation remains tense and this puts more pressure on the economy. The number of new cases and hospitalizations is growing, countries keep the current ones and introduce new restrictions in order to stabilize the situation. All this makes it important to provide additional support to businesses and the public.

The recent and ambitious plan of support found resistance in the face of Poland and Hungary, who vetoed it. This development threatens the distribution of important aid flows amid the deteriorating situation with the virus in many European countries, largely because it will take time after the final decision is made until the moment when this help finally reaches those in need. The stimulus program is a combination of a seven-year budget made of 1074 bln EUR and an additional buffer of 750 bln EUR (to be raised from public markets), the latter will be divided into 390 bln EUR to be handed out in the form of grants, and 360 bln EUR in loans.

Most of the latest EU statistics came out worse than expected. For example, Eurozone Industrial Output in September unexpectedly showed negative dynamics (-0.4% MoM) in September after several consecutive months of growth. Mainly due to strong declines in countries such as Italy, Ilrandia and Portugal, as the bloc's largest economies Germany and France, demonstrated growth.

Euro Area Industrial Production MoM (CHART)

Also, a new wave of coronavirus cases is seriously constraining the labor market. As ECB President Christine Lagarde emphasizes, this crisis is extremely unusual and “a large number of people who lost their jobs in the spring left the labor force and stopped looking for work”. Recall that the latest unemployment figures published at the end of October amounted to 8.3% (a record for the last more than two years). Thus, 13.6 million people were unemployed in the Euro Area in September. In addition to this, the ECB is concerned that the impact and severity of the blow affect different population groups in different ways.

To summarize, the statistical data above shows the situation looking backward and in many ways, as noted earlier, now the economic recovery along with further movements in the markets will depend on the actions regarding the vaccine and the speed of its potential distribution. Therefore, for example, the Dow Jones IA index updated all-time highs, and the European aggregate benchmark STOXX 600 showed a jump of more than 13 percent. See the following parts of WEM Market Notes December 2020 for steps to consider for investors with a focus on the short and medium term.

COVID CHART + CURRENT STAT

COVID-19 Total

Cases (world) 63,135,973

Recovered (world) 43,612,353

Deaths (world) 1,466,289

**BLOCK 2:   
IN FOCUS: 2021 KEY THOUGHTS**

Economies around the globe are all set to experience a sharp rebound in the coming year. Unprecedented monetary expansion along with low interest rates create an environment, which is very supportive for stock markets at one hand but puts a pressure on yields for fixed income securities.

**Equity**

We believe that the stock market would be led towards new highs mainly by “fallen angels”. Fallen angels are by definition stocks, which used to perform in the past, but had been struck and experienced a massive decline in the value. These companies have (in general) healthy balance sheets and business models but experienced some sort of “black swan event”. Great examples of the recent fallen angels are companies belonging to sectors, which have been hit by coronavirus most. Oil and refinery, travelling, aircraft manufacturing or lodging are great examples of industries within which we expect to see significant equities appreciation once economies fully open up, restrictions on people movement cease down and effective vaccination against COVID-19 will start to take place.

In 2020 we witnessed similar volatility spikes as in 2008-2009, and the whole year was marked by elevated nervousness among investors. We expect that 2021 would be in much tranquil mood as problems caused by pandemic get vanished gradually. Also, in the preceding years, we experienced a continually increasing gap among “value stocks” and “growth stocks”. As we wrote these lines the gap starts to shrink already and likely, we would see significant outperformance of “value stocks” in comparison to “growth stocks” in coming months (especially in oil and heavy machinery sectors).

**Fixed Income**

Since the summer, yields are under enormous pressure. Not only lowering the key interest rates across the globe, but also massive quantitative easing policies push yields continuously lower. We expect this scenario to be in place for the whole 2021 and for the foreseeable future too. The Fed made it clear that it will think about raising rates only if long-term inflation is above the target level of 2% and if the labor market reaches full employment (unemployment at 4% and below).

With earnings recovery for distressed companies, the “yield chasing” playground shrinks even further. Investors would face a limited possibility to invest either in junk or investment grade corporate bonds as we expect that the so-called “spread” between government vs. non government bonds would get narrow. Possible options for these kinds of investors would be to take a look in the areas they didn’t do so yet. Emerging markets USD or EUR denominated debt could be viable candidates.

**Currencies**

With all the above mentioned we also expect to see a decline in the US dollar value. Among some of the reasons, we see it as the biggest driver to the recovering global economy and belittled interest rate differential. Due to these facts, foreign investors would lose a rationale to hold a US dollar exposure in their investment portfolios. We think that investors would rather diversify across assets and currencies of G10 countries or into particular emerging markets currencies (some of which have upside potential after an underperformance period).

**Selected topics**

Trends that are of primary consideration in our decision-making and which we advise investors to pay attention to when selecting new assets for their portfolios.

**Emerging Markets**

Emerging markets after the resolution of the crisis and the transition to the stage of full-scale recovery have every chance to demonstrate higher growth rates in comparison with the developed block of countries. The current difference in valuation is 32x P/E for MSCI World Index versus 23x for MSCI Emerging Market Index. The vaccine, the Biden presidency, the weak dollar, commodity markets and domestic support are reasons why we advise you to rethink your preferences only towards mature markets. Especially here we would like to highlight the Asian region, which is relatively successfully coping with the course of the pandemic and is actively continuing its expansion in various sectors of the global economy.

**ESG (Environmental, social and corporate governance)**

The Green Industrial Revolution is growing in the world. Joe Biden's campaign was partially built on the push for the green development and carbon-free future. Boris Johnson has announced the UK's plan to ban all combustion engines by 2030. Moreover, the governments have put $54bn of fiscal stimulus towards Clean Energy in 2020 with this number expected to increase enormously in 2021 (based on the JP Morgan estimate). The myth of sustainable energy being more expensive has been broken down, with JP Morgan reporting their costs actually be lower than fossil fuel alternatives. The development of hydro-engines & further advancements is likely to be at the forefront of 2021.

**Post-COVID Era**

Despite the fact that with the help of a vaccine, the risks of coronavirus should be significantly reduced for the population and business, returning the general condition to “normal”, the pandemic still made a number of serious changes and accelerated many disruptive trends, which most likely will remain with us for a long time. During the COVID-19 era, consumers changed their habits, businesses switched to digital, many industries were transformed, and countries adopted new plans for their development. Therefore, even with possible rotation and medium-term upside in value stocks, we recommend maintaining long-term exposure in portfolios for the tech sector, with its various topics from cloud solutions, 5G and e-commerce to video games and generation Z consumers.

**BLOCK 3:   
INVESTMENT STRATEGY**

The latest vaccine news is certainly calming the markets despite the number of new COVID-19 cases per day continues to rise in many countries. Claimed data on the effectiveness of various vaccines only strengthens the basis for further rallies in stocks that have lagged behind the tech sector. This is evidenced by the comparative dynamics of Russell indices for stocks of the value and growth classes over the last month.

(give a concrete size of a movement and spread, actual data)

RUSSELL 3000 (growth vs value) + AVG Valuation Comparison (chart)

November Dow Jones Rally

We view this reversal of investor attention in lagging sectors of the economy as just the beginning of a full-fledged market rotation that will only intensify as the fight against the virus and the vaccine progresses. Another relatively positive development is Joe Biden's victory in the US presidential election, which creates the environment for a more predictable policy line, which helps reduce overall uncertainty in the capital markets. The same logic applies to looking for securities in cyclical and non-cyclical industries.

Therefore, it is important to consider opportunities for tactical changes in portfolios in order to strengthen its positioning in front of this trend, which will determine the short and medium term movements in the stock market. Here, private investors can look at different geographies and even beyond developed countries and company sizes, because large market giants will find it more difficult to compete in terms of growth (recovery rate) in financial performance with mid-cap companies that are more sensitive to business reactivation.

Our efforts to work with existing portfolios are going in the same direction to rebalance accordingly after a long period of growth that has favored many companies since the beginning of the year. Also, it is worth noting that this task, with all its importance and obviousness of the value stocks trend, is quite difficult. This crisis affected many business areas and significantly changed (or seriously worsened the ability to build projections) their prospects in terms of strategic development, etc. Taking into account the fact that we always recommend investors to proceed from a long-term picture, here when looking for equities it is necessary to take this point into account and not fall into the trap.

In the general context of the effectiveness of wealth management, it is better for investors to have two components in their portfolios, one of which would take into account tactical realities, and the other was directly aimed at implementing a long-term strategy and participating in far-reaching trends in the digital economy.

As for the dynamics of the broad market, despite our more restrained scenario (which we published in the October issue) compared to the current level of S&P 500 index, we still expect the US market to consolidate by the end of the fourth quarter with a possibility to reach lower levels. Since the real virus situation requires more serious stabilization in order to pull the market higher and act as a strong trigger alongside vaccine news, we consider this scenario as the least likely to be realized by the end of the year. And now, stocks are likely to be under pressure from two different sides in terms of growth in cyclical companies with cases of corrections in the most bouncing names. Nevertheless, this is only a guideline and we leave some chance for the full implementation of the positive scenario, but in our approach we will prefer a more conservative short-term view.

Current valuations (TABLE)

Perhaps this year turned out to be very intensive for tactical portfolio management and it remains relevant at the moment. Consistent and competent rebalancing of the portfolio is important not only from the position of rotation from outperformers to underperformers, but also to bring asset weights in line with your strategic exposure, as now various imbalances can be observed (both in the stock / bond / commodity ratio and the weight of specific stocks in portfolio). The result of this exercise will allow investors to meet 2021 in the most prepared mode and with allocation to investment ideas of a short-term and long-term nature.