PACIFIC ASSET MANAGEMENT

PACIFIC MULTI-ASSET SOLUTIONS

INVESTMENT OUTLOOK

2021: 1st Quarter Insights

OUTLOOK SNAPSHOT: (Estimated reading time 60 seconds)

1. What happened over 2020?

A year of superlatives: Fastest fall in equities from a peak on record | Largest global stimulus package | Biggest fall in UK GDP for 300 years

Importance of staying invested: Not getting spooked when headlines and market volatility are at their most extreme

Portfolio characteristics: Highly Diversified: Gold & Gov bonds strong Q1, Equities remainder of year| Liquid: Enabled portfolios to be repositioned to reflect evolving risks and opportunities

2. Looking Ahead

Equity Market Rotation from Growth to Value: Vaccine optimism | Democrats control US Senate, world finally takes on "big tech" | US tech valuation very high

UK Equities: Biggest discount versus US in 20 years | Brexit deal done | Opportunities as uncertainty fades

Portfolio Status: Genuinely multi-asset approach remains essential | Focus on liquidity | Most importantly, stay the course and remain invested

OUTLOOK: (Estimated reading time 5 minutes)

And so, an extraordinary year comes to an end. 2020 was a year of superlatives: the fastest fall in equities from a peak on record; the largest global stimulus package; the biggest fall in UK GDP for 300 years. We hope and expect that markets will be less volatile in 2021.

2020 demonstrated the importance of staying invested

In many ways, 2020 was a crash course in investing: diversify, ensure that portfolios are liquid and dynamic and perhaps most importantly, stay the course and remain invested. Whilst in the teeth of the gale in the middle of March asset returns were unusually correlated, diversification was still effective in 2020: safe haven assets such as gold and government bonds performing strongly in the first quarter of the year whilst risky assets such as equities recovered sharply in the remainder of the year after plunging in the first quarter.

As a result, multi-asset investors' year was much less volatile than for those focused on just equity markets. Ensuring that portfolios remained liquid enabled portfolios to be repositioned to reflect evolving risks and opportunities. Finally, perhaps the most important lesson for investors was the importance of staying invested and not getting spooked when headlines and market volatility are at their most extreme.

NAVIGATING RISK IN Q4 2020

The last quarter of 2020 saw three important sources of risk navigated: the US election, a Brexit trade agreement and, most importantly, the positive results of vaccine trials for COVID-19.

US Election

Despite fears of a disorderly election, the US presidential election passed without the turmoil that some feared, despite Trump's completely unsubstantiated claims of fraud. A Biden government promises a more rational leader of the world's most powerful and influential country. This should be positive for global trade and emerging markets in particular.

Brexit Trade Agreement

A trade agreement between the UK and Europe was agreed at the final hour, affording the UK better trading terms with its biggest partner than the default WTO policies.

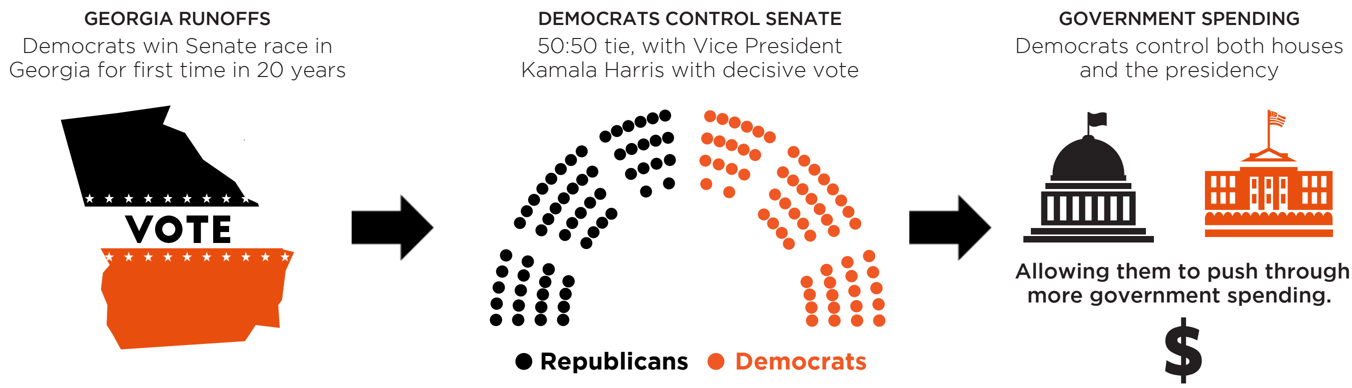
COVID-19 Vaccine Trials

However, the game changing news for markets over the quarter was the announcement of three successful vaccine trials, from Pfizer/BioNTech, Moderna and AstraZeneca/Oxford. This allowed investors to regard the loss of corporate earnings from the shutdowns as a one-off event, rather like a natural disaster, rather than an ongoing impact on profits.

2021: STARTED WITH A BANG

2021 has already started with a bang. Although the shocking scenes of the storming of the Capitol in the US have made the headlines, it is the result of the US Senate runoff elections in Georgia that will have most impact on markets.

A Democrat had not won a Senate race in Georgia for 20 years, but on 5th January, both candidates won a seat in a runoff that saw a record turnout. This means the Senate is now a 50:50 tie, with Vice President Kamala Harris having the decisive vote. As a result, the Democrats now have control of both houses and the presidency, allowing them to push through more government spending.



OPPORTUNITIES IN MARKETS IN 2021

We think that we are in the early stages of a significant rotation in the leadership of equity markets. 2020 saw the US and growth companies in particular build on the performance of the past decade. Ever lower long dated bond yields pushed up the value of growth stocks whilst monopolistic behaviour ensured that the largest, most powerful technology companies' earnings grew unchecked. This combination has encouraged investors to push up the valuation of the US stock market, leaving it looking stretched. It remains to be seen how forcefully the Democrats take on these companies, but we have already seen government bodies around the world finally take on "big tech". So where are the best opportunities? We think they are in the cheapest parts of the market, both from a regional and stock perspective.

The long-term returns of equities are driven by two factors: earnings and valuations

We see this favouring the areas of the stock market that will benefit most from the cyclical upswing in the economy in the second half of 2021 and where valuations have room to expand. This leads us to have a bias towards emerging markets, Japan and the UK. Emerging market stock markets have gone precisely nowhere (excluding dividends) since 2007. Japanese stocks markets are at the same levels they were in 1987. Both illustrate what can happen to markets that get too expensive – they must work off this overvaluation before moving higher. Today, however, they both trade at a marked discount to US markets, with valuations offering the prospect of being a tailwind rather than a serious headwind.

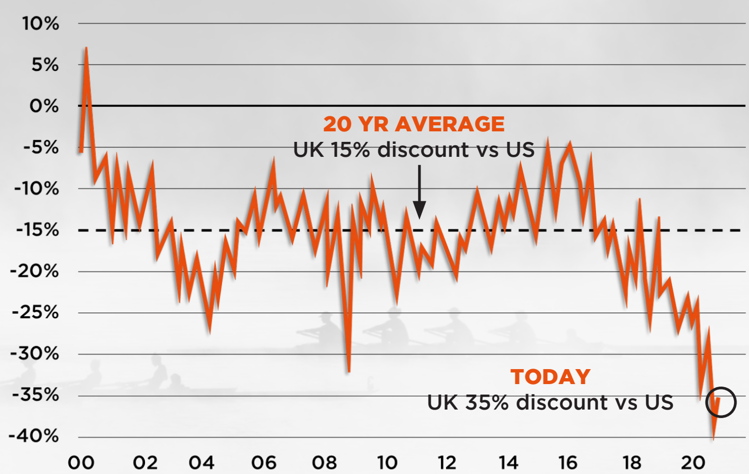
From a regional perspective, we think the prospects for UK equities look attractive

VALUATION UK EQUITIES VERSUS THE US OVER THE LAST 20 YEARS

This chart shows a comparison of valuations of UK equities versus the US over the last 20 years. On average the UK has traded at a 15% discount whilst today it stands at 35%.

The uncertainty surrounding Brexit has led global investors to shun the UK, even for companies whose exposure to the domestic economy is limited. We think that there is an opportunity for UK equities to move higher as the uncertainty fades.

Source: Bloomberg



We doubt that 2021 will pass without some bouts of volatility and so adopting a genuinely multi-asset approach remains essential. Whilst developed government bonds offer little in the way of returns, their diversification benefits remain whilst emerging market government bonds offer significantly higher yields. Gold remains an important asset class whilst central banks hold interest rates below inflation. Finally, diversifying assets, whose returns are uncorrelated with both equities and bonds have a valuable role to play in portfolios.

CONCLUSION

2020 was an unforgettable year with markets reflecting some of the fear and hope felt by most people last year. 2021 offers the prospect of a return to normality and a strong recovery in economies and corporate earnings in the second half of the year. Risks remain, with new strains of COVID-19 clearly presenting a threat. We think that the lessons of last year will remain important in 2021: diversify, focus on liquidity and, most importantly, stay the course and remain invested.

PLEASE GET IN TOUCH

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