For professional investors

ROBECO
The Investment Engineers

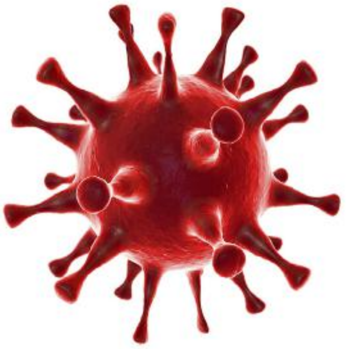
TACKLING THE TRILEMMA

INVESTMENT OUTLOOK 2021

Sustainable Investing Expertise by ROBECOSAM

Executive summary

Tackling the trilemma



Investors face a 'trilemma' in 2021 as policymakers try to balance three issues arising from the Covid-19 crisis, our annual outlook believes.

SPEED READ

- Trilemma of public health, normalizing economy and personal freedoms
- Most positive scenario sees a vaccine paving the way to a new normal
- Equities and commodities should generate the best returns in 2021

Restoring public health, returning to normal economic functioning and maintaining personal freedoms will figure highly in the post-coronavirus response, which is likely to begin next year, Robeco's multi-asset team says in the 2021 outlook.

And there are many other headwinds investors may face, from unemployment in the Eurozone to a new US political landscape. However, the eventual end of the economically damaging measures to contain the pandemic, thanks to a future vaccine, is really the ultimate tailwind, the team says.

This makes Robeco's multi-asset team more positive about equities than government bonds, since stocks should benefit most from any economic recovery, while sovereigns are set to generate negative returns except in the worst-case economic scenario. Commodities, high yield bonds and emerging market debt should also shine in 2021, though there are bull and bear cases for all asset classes.

We need to find a vaccine

Much will depend on the availability of a working vaccine for the Covid-19 crisis, which claimed more than one million lives in 2020 and infected more than 50 million people. The world will also continue to rely on close cooperation between governments and central banks, continuing coordination that has so far mitigated much of the economic damage, says strategist Peter van der Welle.

"Only a few times in the last century have we experienced such strong cooperation between fiscal and monetary authorities: this is the main reason why financial markets recovered so strongly after the fastest downturn in history back in March," he says.

Coronavirus vaccine tracker

PHASE 1	PHASE 2	PHASE 3	LIMITED	APPROVED
38	17	12	6	0
Vaccines testing safety and dosage	Vaccines in expanded safety trials	Vaccines in large-scale efficacy tests	Vaccines approved for early or limited use	Vaccines approved for full use

The state of play at November 2020 of a vaccine becoming available. Source: New York Times.

"The problem is that we haven't yet solved this 'trilemma' – finding an acceptable trade-off between public health, the economy and personal freedoms. It is precisely this trade-off and the easing of it that will shape the economic, market and social circumstances in 2021."

Base, bull and bear cases

Robeco's multi asset team has have determined a base, bull, and bear case scenario for each asset class based on the progress likely to be made on solving that trilemma. In the base case, an effective vaccine is expected to be widely available in the first half of 2021; markets rose strongly on news in early November that a candidate from Pfizer was 90% effective. Distributing it will be a mammoth task, however, requiring an estimated 15 million deliveries in cooling boxes on 15,000 flights around the world just to make an inroad. Once a vaccine is available, the journey towards normality can begin.

The bull case sees multiple effective vaccines arriving much earlier; logistical challenges in vaccine distribution dealt with effectively; and the economy freed from the pendulum swing between lockdowns and re-openings, with less infringement on personal freedom. "Thus, the policy trilemma is largely solved, and a quicker return to a new normal takes shape," Van der Welle says. "Here we see room for what Keynes called 'animal spirits', which he defined as the 'spontaneous urge to action rather than inaction'."

In the bear case, vaccine development experiences persistent setbacks, with a very limited number on the market by only the end of 2021. Here, the public misery continues, with the overall impact on the economy profound, as the collective belief in tackling the trilemma in the medium term becomes elusive.

A good year for risky assets

"For the asset classes, in general, we believe 2021 will be a good year for risky assets, with equities realizing above average returns in our base case," says Jeroen Blokland, Head of the Multi-Asset team. "However, in a scenario in which a working Covid-19 vaccine is not readily available to a large part of the global population, all bets are off, and all risky assets will realize negative returns."

The team's base case for equities is that combination of a timely, effective vaccine with ongoing fiscal and monetary stimulus means GDP growth and, more importantly, company earnings growth continues to improve. Earnings per share levels near those seen before the Covid-19 outbreak implies growth of about 20%, which would be very healthy for share prices.

Expected returns outlook 2021

	Base	Bull	Bear
Equities	10%-16%	>20%	<-10%
High yield	6%-8%	>10%	<0%
Investment grade	2%-3%	4%-6%	<0%
Emerging market debt	5%-7%	>10%	<0%
Commodities	8%-12%	>20%	<-10%
Government bonds	>-3% - <-1%	>-5% - <-2%	2%-4%

Predictions for the major asset classes in the 2021 outlook. Source: Robeco.

For high yield bonds, the base case is that such a recovery in company earnings means defaults would dwindle, the coverage ratios of high yield companies would improve, and spread levels would tighten. Spreads on investment grade credits would also tighten in the base case, with some rotation out of government bonds into corporate bonds by investors looking for better yields.

The base case for local currency emerging debt is constructive as well, as the team believes there is ample room for emerging currencies to recoup heavy losses against the US dollar. Commodities should benefit greatly from the return to normal trading. The rebalancing of commodity supply and demand that started a couple of months ago is expected to continue, and a resurgence in oil demand as people get moving again should raise oil prices.

The asset class expected to continue to deliver negative returns is government bonds, as massive quantitative easing continues and yields continue to grind higher, especially in the US.

The 2021 outlook also contains three special reports on investing in the Sustainable Development Goals, Chinese equities, and the 5G mobile communications trend.

IMPORTANT INFORMATION

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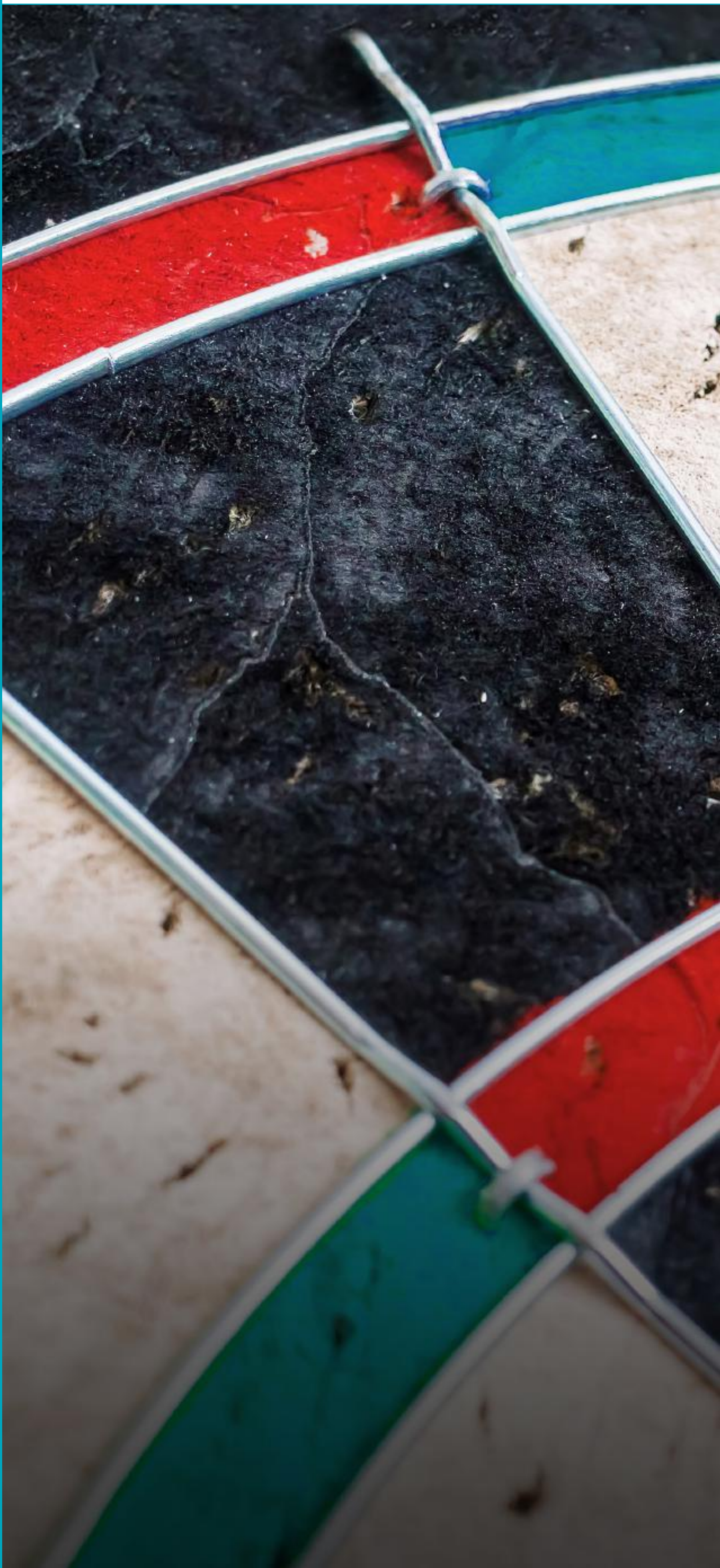

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