M.M.WARBURG & CO
BANK

# ECONOMIC SITUATION AND STRATEGY December 21, 2020

## Outlook for 2021: Summary

Anyone who went to sleep in January of this year and is now awakening from a deep sleep would not expect 2020 to have been a very unusual year when looking at the stock market indexes and portfolio levels. At the end of a year marked by the worst temporary economic slump in recent decades, it is hard to believe that so many stock indexes are above their levels at the end of 2019. This has been made possible by accommodative monetary and fiscal policy on an unprecedented scale.

The year 2020 accordingly also reveals the limitations of annual forecasts. Exogenous shocks such as a pandemic can hardly be anticipated, and the same applies to a very unconventional use of fiscal and monetary policy instruments. A bit of humility is therefore always a good thing when it comes to annual forecasts. Nevertheless, we have made great efforts again this year to answer questions about what might await us in 2021.

For, although markets seldom do us the favor of developing exactly as the scenarios lead us to expect, we cannot dispense with delving into the possible scenarios if we are to have a solid basis for assessing current developments. In the past few issues of this publication, we have stated our views in detail concerning various relevant topics. Today, we present a summary of those.

From a macroeconomic perspective, we foresee several V's for 2021. A dynamic, self-sustaining upswing will at least nearly, if not completely, make up the economic damage caused in 2020 in many countries and thus exhibit a ***V***-shaped trend, which will continue to receive huge impetus from ***v***oluminous monetary and fiscal measures and from ***v***accines that promise to ***v***anquish the coronavirus.

Atypically, but very importantly, there will be a synchronous upswing in the industrialized and ***emerging countries*** next year. Except China, the latter countries have suffered especially severe economic damage in 2020. That is partly because countries like India, South Africa, Mexico, and Brazil were long unable to prevent the spread of covid-19 effectively. Above all, however, ***China*** is a guarantor of positive economic development again next year. With daily new cases numbering about 50, economic life has almost completely returned to normal in recent months. Almost ironically, China is thus emerging stronger from the crisis and has narrowed the gap in economic ranking relative to the United States faster than it otherwise would have. The country's industrial production has grown strongly since last summer and become the engine of the economic recovery. Positive development of purchasing manager indexes shows that this trend will continue. In addition, domestic demand still has catch-up potential. Retail sales are only a bit more than 4% above last year's level, while the difference was a good 8% before the crisis. We therefore expect economic growth of 9.5% for 2021 (IMF: 8.2%), from which Germany as an export nation will especially benefit.

The ***United States*** will likewise experience a strong upswing next year. Besides continuing expansionary monetary policy, for which the Federal Reserve might even adopt additional measures before Christmas, additional strong impetus may be expected from fiscal policy. Despite significantly elevated unemployment, the financial situation of US households is also much sounder than it was during the economic and financial crisis of 2008-2009. The average American has much less debt, and that is subject to a significantly lower interest burden. With warmer temperatures and increasing availability of vaccines, economic momentum will start accelerating significantly in the second quarter. This conclusion may be drawn from the third quarter of this year, which showed that the economy has recovered on a return to "normal" conditions much more dynamically and quickly than was generally expected.

***Germany*** will also have an economically successful year in 2021. Of course, the partial lockdown of its economy in November will take a toll and lead to a slight decline of economic activity in the fourth quarter. However, the targeted and time-limited economic restrictions will cause significantly less damage than the general and very comprehensive restrictions imposed in April and May of this year. The latest economic data from Germany confirm this and once again prove how crisis-resistant market-based systems can be if assisted by appropriate fiscal and monetary policy instruments during temporary phases of weakness.

We expect economic growth of almost 6% for the ***euro zone*** in 2021, but that will not be enough to make up for all the economic losses suffered this year.

The crisis would have turned out much worse without the huge expansion of liquidity. In the euro zone, for example, the European Central Bank (ECB) has purchased bonds totaling almost EUR 1 trillion. The Pandemic Emergency Purchase Program (PEPP), set up last spring, accounts for almost EUR 700 billion of that. The bond markets have received further support from new EU programs called SURE (Support to mitigate Unemployment Risks in an Emergency) and NGEU (Next Generation EU), in which the EU even procures money on the capital market by way of its financing vehicles, thus incurring joint debts for the first time. The ECB's policy interest rates will continue to be a significant source of impetus for the economy. We consider it plausible that the ***refinancing rate*** will remain at its current level of ***0%*** at least until December 2022.

The situation in the United States is similar. All signs continue to point to very low interest rates there as well. The "dot plot" of the Federal Open Market Committee reveals that a great majority of its members expect the policy interest rate level of 0.00% to 0.25% will endure until the end of 2022 because economic conditions require it. Although unchanged policy interest rates need not entail an unchanged yield level, we expect capital market yields to remain low at least in 2021. The huge surge in demand created by central banks with their bond purchase programs will nip any large yield spike in the bud. For, governments will not be able to refinance the rise of debt due to covid-19 compatibly with budget constraints unless interest rates remain low. This applies especially to countries already struggling with high government debt before the crisis, like Italy. Even if nobody says so openly, this is precisely the goal of the ECB's accommodative monetary policy, to ensure financing of government debt at the lowest interest rates. We therefore see little room for rising yields in Europe. Our ***year-end forecast*** for the yield on 10-year ***German Bunds*** is almost unchanged at ***-0.5%***.

We also expect sideways movement of capital market yields in the United States, since strong central bank demand will prevent any sustained advance of yields.

***Corporate bonds*** present a somewhat better picture for investors, even though spreads for investment grade bonds have narrowed considerably and yields are already below levels at the beginning of the year. Since the ECB also purchases corporate bonds, there is little room for further yield declines, but yields are no longer very far from the absolute lows from the time of the Lehman Brothers bankruptcy. Moreover, the ongoing returns (coupons) attainable in absolute terms become ever smaller the more yields decline, which reduces attractiveness for private investors. We will therefore continue to overweight investment grade corporate bonds versus government bonds but not further increase their absolute weight in our allocation, since we estimate the performance potential of corporate bonds for next year at just over 1%.

In our opinion, the most interesting market segment next year will be that of ***high-yield bonds*** and subordinated bonds. We definitely see signs of potential for yield declines and positive performance there. The most substantial argument in favor of high-yield bonds is next year's significant economic recovery together with very accommodative monetary policy.

Although bonds often make up most of the assets in a portfolio, the stock market is ultimately more relevant for investors. Not only are the greatest risks there, but also opportunities for outstanding performance are significantly better. For, on close inspection, the yield level of most bonds does not support expectations of any large performance increases. The times in which we find ourselves are such that stocks will account for the greatest share of portfolio performance for the foreseeable future.

The coming year should be a good one for the stock market. In January, the powers of the US presidency will pass from Donald Trump to Joe Biden. We do not expect any big surprises from Biden in the early going of his term and therefore do not think US politics will give much impetus to the capital market. However, a new fiscal package is imminent, even though it might turn out smaller than what the Democrats initially wanted, if the Republicans retain control of the US Senate. But what will change is the way in which politics is conducted in the United States. We expect a return to more predictable and reliable political behavior there and a significant improvement of relations between the United States and many other countries. That will be a positive development for the stock markets, confronting them with less political uncertainty. Europe should benefit from this development, especially since the valuation of stocks appears even somewhat more attractive there than in the United States.

Moreover, although some stock markets already have valuations significantly above their historical averages, we believe a further widening of valuation ratios is not out of the question. The background for this assumption is, on the one hand, the very low interest rate level, which justifies a higher valuation for stocks due to the associated lower discount factor. If, on the other hand, we compare stocks with alternative asset classes like bonds or real estate, an even higher valuation would likewise be justified. Consequently, there is good reason to believe that stocks will perform well again in the coming year.

Special opportunities will presumably arise for those who invest in companies involved in further developing IT infrastructure such as the 5G network and water or energy supply systems. For, growth in the urban centers will remain above average, which should benefit such companies, especially since financing conditions are more than ideal even for very large infrastructure projects. Since the topic of sustainability plays an increasingly important role for many people, prospects are promising for investments that take into account renewable energy and electric mobility. Companies that already use production methods that save resources or incorporate recognized social norms should not be the only beneficiaries. An increasingly important role will also be played by the agencies that rate companies on their compliance with environmental, social, and corporate governance (ESG) criteria and put them together in segments or indexes for capital market investment purposes.

However, investors should gear themselves for price fluctuations again next year, since the high valuations and already achieved price levels are likely to be utilized at times for profit taking. Setbacks with respect to the coronavirus vaccines, possibly in their distribution and/or acceptance by the population, constitute further risk factors, in our opinion. Furthermore, a stronger rise of inflation than currently expected might lead to drawdowns, since that could call into question the abundant supply of liquidity from central banks. These risks play a subordinate role in our main scenario for the coming year, however.

Technical analysis also argues in favor of continuing positive stock market development. For example, Germany's blue-chip DAX index is in an upward trend that started from a low in 2003 and was confirmed again in the sell-off of March 2020. However, it is equally evident that the index has regularly run out of steam over the years in the area around 13,500 points. Consequently, its net movement has been sideways for years, which is confirmed by the sideways-oriented exponential 200-week line. However, a consolidation can also be a constructive gathering of forces. We may thus assume that the overcoming of the gap at 13,500 points that the index ripped in February represents an end of the consolidation. The medium-term minimum price target may be calculated as the difference between the top and bottom of the trading range, which is just over 1,800 points. This allows us to derive price targets of 15,000 points or so.

However we look at it, there is much to suggest that 2022 could be a successful year for investors. Let us hope that we will be spared another round of negative surprises and exogenous shocks in the coming year!

We wish you and your family a peaceful, relaxing, and healthy holiday season and all the best for the year ahead. We are already looking forward to being able to greet you in person again – not just virtually, but the old-fashioned way, face to face, because despite all the possibilities of digital technology, nothing beats a direct and trusting personal conversation. So, we hope to see you soon!

# Market Data Overview

| Stock marktes | As of 21.12.2020 12:07 | Change versus 14.12.2020 -1 week | 18.11.2020 -1 month | 18.09.2020 -3 months | 18.12.2019 -1 year | 31.12.2019 YTD |
|---|---|---|---|---|---|---|
| Dow Jones | 30179 | 1,1% | 2,5% | 9,1% | 6,9% | 5,7% |
| S&P 500 | 3709 | 1,7% | 4,0% | 11,7% | 16,2% | 14,8% |
| Nasdaq | 12756 | 2,5% | 8,1% | 18,2% | 44,5% | 42,2% |
| DAX | 13161 | -0,5% | -0,3% | 0,3% | -0,5% | -0,7% |
| MDAX | 29553 | -0,6% | 2,6% | 7,4% | 4,8% | 4,4% |
| TecDAX | 3124 | 0,4% | 3,5% | 0,2% | 3,0% | 3,6% |
| EuroStoxx 50 | 3419 | -2,4% | -1,8% | 4,1% | -8,6% | -8,7% |
| Stoxx 50 | 3001 | -2,4% | -2,6% | 0,8% | -11,3% | -11,8% |
| SMI (Swiss Market Index) | 10303 | -0,7% | -2,5% | -2,2% | -2,4% | -3,0% |
| Nikkei 225 | 26714 | -0,1% | 3,8% | 14,4% | 11,6% | 12,9% |
| Brasilien BOVESPA | 118024 | 3,0% | 11,2% | 20,1% | 3,2% | 2,1% |
| Russland RTS | 1331 | -4,8% | 4,3% | 8,4% | -12,6% | -14,0% |
| Indien BSE 30 | 45554 | -1,5% | 3,1% | 17,3% | 9,6% | 10,4% |
| China Shanghai Composite | 3421 | 1,5% | 2,2% | 2,5% | 13,4% | 12,1% |
| MSCI Welt (in €) | 2666 | 1,8% | 2,3% | 9,6% | 4,5% | 4,5% |
| MSCI Emerging Markets (in €) | 1268 | 1,5% | 2,5% | 11,4% | 4,5% | 5,1% |
| **Bond markets** | | | | | | |
| Bund-Future | 177,66 | -76 | 254 | 359 | 618 | 717 |
| Bobl-Future | 135,42 | -16 | 8 | 33 | 148 | 179 |
| Schatz-Future | 112,34 | -6 | 3 | 5 | 37 | 44 |
| 3 Monats Euribor | -0,54 | 1 | -1 | -3 | -13 | -15 |
| 3 Monats $ Libor | 0,24 | 2 | 1 | 1 | -167 | -167 |
| Fed Funds Future, Dec 2017 | 0,09 | 0 | 1 | 2 | -130 | -1 |
| 10 year US Treasuries | 0,89 | -1 | 2 | 19 | -104 | -103 |
| 10 year Bunds | -0,61 | 1 | -5 | -13 | -36 | -42 |
| 10 year JGB | 0,01 | 0 | 0 | 0 | 3 | 3 |
| 10 year Swiss Government | -0,52 | -2 | -5 | -4 | 3 | -5 |
| US Treas 10Y Performance | 713,34 | -0,5% | -0,6% | -2,1% | 12,3% | 12,2% |
| Bund 10Y Performance | 684,43 | -0,5% | 0,1% | 0,7% | 3,3% | 4,0% |
| REX Performance Index | 499,07 | -0,3% | 0,0% | 0,2% | 0,8% | 1,2% |
| US mortgage rate | 0,00 | 0 | 0 | 0 | 0 | 0 |
| IBOXX AA, € | 0,01 | 5 | -1 | -15 | -24 | -29 |
| IBOXX BBB, € | 0,55 | 3 | -8 | -36 | -32 | -36 |
| ML US High Yield | 5,07 | -4 | -36 | -81 | -97 | -97 |
| Convertible Bonds, Exane 25 | 8243 | 0,0% | 1,4% | 3,9% | 7,9% | 7,7% |
| **Commodities** | | | | | | |
| MG Base Metal Index | 366,98 | 1,5% | 8,7% | 15,5% | 23,6% | 22,3% |
| Crude oil Brent | 49,34 | -2,1% | 11,1% | 14,2% | -25,4% | -25,6% |
| Gold | 1873,61 | 2,6% | -0,4% | -4,1% | 27,0% | 23,2% |
| Silver | 25,87 | 8,2% | 5,4% | -4,0% | 52,2% | 44,4% |
| Aluminium | 2044,92 | 0,7% | 3,0% | 16,6% | 16,5% | 14,8% |
| Copper | 7968,75 | 3,1% | 12,7% | 16,3% | 29,7% | 29,6% |
| Iron ore | 152,49 | 1,9% | 24,7% | 20,0% | 65,8% | 66,6% |
| Freight rates Baltic Dry Index | 1325 | 7,3% | 18,8% | 2,2% | 8,5% | 21,6% |
| **Currencies** | | | | | | |
| EUR/ USD | 1,2157 | 0,0% | 2,4% | 2,7% | 9,4% | 8,2% |
| EUR/ GBP | 0,9180 | 0,8% | 2,8% | 0,3% | 7,8% | 8,3% |
| EUR/ JPY | 126,25 | 0,1% | 2,4% | 2,2% | 3,6% | 3,5% |
| EUR/ CHF | 1,0817 | 0,4% | 0,0% | 0,4% | -0,9% | -0,3% |
| USD/ CNY | 6,5536 | 0,1% | -0,1% | -3,2% | -6,8% | -5,9% |
| USD/ JPY | 103,33 | -0,7% | -0,5% | -1,2% | -5,7% | -4,9% |
| USD/ GBP | 0,76 | 0,6% | 0,5% | -2,1% | -1,3% | 0,0% |

Source: Refinitiv Datastream

Carsten Klude
+49 40 3282-2572
cklude@mmwarburg.com

Dr. Rebekka Haller
+49 40 3282-2452
rhaller@mmwarburg.com

Martin Hasse
+49 40 3282-2411
mhasse@mmwarburg.com

Dr. Christian Jasperneite
+49 40 3282-2439
cjasperneite@mmwarburg.com

Bente Lorenzen
+49 40 3282-2409
blorenzen@mmwarburg.com