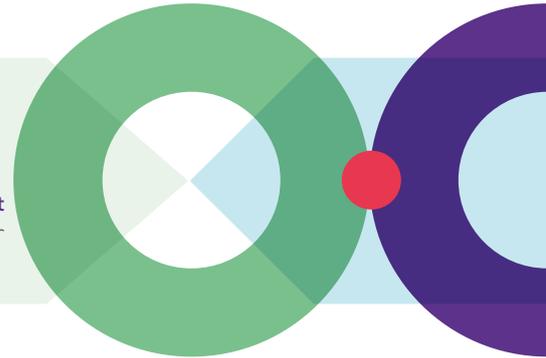




View from Psigma 2021 Outlook

Tom Becket
Chief Investment Officer



I'm sure that my family and my colleagues are starting to feel that I complain about everything. I would claim that view to be unfair. I'm very thankful, as we end this extraordinary year, that my family are all well and that our business has fared soundly in these unforgiving times. All of us at Psigma Investment Management send our best wishes to you and your families, and hope that you have not been badly affected by recent events. We also thank you for the support and interaction that we have received over the past months; our relationships with clients and business partners have been the brightest spot of a deeply uncertain year.

However, whilst I am very grateful with my own personal lot, being asked to detail our expectations for the global economy and asset markets next year is surely worthy of complaint, given the probability that one ends up looking very wrong in a year's time! As I sit here at the start of December and try to create a cogent view of the months ahead, I am reminded of the words of the 19th Century Danish philosopher Soren Kierkegaard, who once said that "life can only be understood looking backwards, but it must be lived forwards".

Looking back to a year ago

With those words in mind, at the end of each of the dozen years that I have written the next year's

outlook as Chief Investment Officer, I have forced myself to go back and review what was written the previous year, sometimes for good or indeed sometimes for bad. It is very clear that we have ended up with a very different outcome in 2020 than we had expected at the end of 2019. Indeed, I would argue that we had some of the highest conviction views that we had ever held towards the end of last year, and started 2020 with a great deal of confidence in our synopsis of the economic and market environment ahead of us. As a reminder, we expected the global economy to fare relatively well this year, with a recovery probable in many of the economically sensitive investments that had lagged in the last few years.

"All change, please. All change."

COVID-19 forced us to completely reevaluate the economic reality, as you might expect, whilst the unprecedented actions of governments and central banks to stem the financial losses afforded us an opportunity to buy very cheap assets and to enjoy the resurgence we have seen in asset prices since the March lows. Over the last eight months, we have tried to keep one step ahead of the market rollercoaster and have been very active in our investment strategies, trying to make money from a situation that we had admittedly not expected as we started this year. This approach continues today, as we try to use our mantra that "volatility is our friend, not our enemy" to our advantage, and we recalibrate our clients' investment strategies to reflect the ever-changing investment reality in front of us.

Our "base case" for 2021

The overarching view that we have for the year ahead is that the economic outcome in 2021 will be better than that of 2020 (it wouldn't be hard, in all honesty), but that we should not immediately assume



that the expected economic improvement will neatly translate into an "easy" backdrop for financial markets.

We should remember that in a year of economic strength and rising corporate profits in 2018, markets performed poorly, whilst during a period of general stagnation in 2019, markets soared, and investors were richly rewarded for loading up on risk. In very simple terms, the only assessment that investors have needed to make over the last few years was what the major central banks, and in particular the US Federal Reserve, would do with regards to monetary policy. In 2018, the talk was of rate hikes and tightening policy; markets fell during this episode. By the time 2019 started, the towel had been truly thrown in on any further monetary tightening measures, and central banks once again started to guide to looser policy in the future; markets soared through the year. In 2020, we have seen interest rates hammered to zero by nearly every central bank, with the cast-iron promise that they will be kept there until the future is veritably brighter. "Savers be damned", is the view of the modern-day central bankers; desperate times call for desperate measures. The combination of zero interest rates and the creation of c\$10 trillion of monetary stimulus has forced investors to reach out for risk to try and source any form of income in a world of financial repression. The central bankers have created a "through the looking glass" world of financial alchemy and made it obvious to investors that there is no alternative to taking higher levels of risk.

What could possibly go wrong?

It is therefore very important to state that the overriding dynamic that has propelled many financial markets and asset valuations higher in 2020 is not going to change next year. Indeed, the likelihood is for ever more "creative" monetary and fiscal stimulus measures, as governments try to deal with their COVID-19 response, pay for financial promises to their citizens that they can't keep and try to help boost growth in a low growth environment. The central banks will need to continue bailing out debt-laden governments, as there is no other realistic alternative. Interest rates simply cannot rise in the near future, so we will all need to find ways to generate as healthy a return as possible, without taking levels of risk that are not suitable in a world where economic and financial risks have not been entirely eradicated by the generous hands of central banks.

Too much of a good thing

It is undeniable that we would have been in a very dark and difficult economic and market situation were it not for the emergency actions taken by the central bankers. Arguably, the speed and the seriousness of the response saved the global economy from the grip of a genuine economic depression. For that, they should be thanked. The problem is that these institutions have form in applying the emergency medical treatment for too long, as we saw in the post-financial crisis years, where the failure of central banks to "normalise" interest rates when they had the chance in the middle of the last decade set us up for the distorted economy that we live in now. We are worried that they will make the same mistake again. We are also concerned that they could be stoking the fires of inflation for later this decade with the sheer size of the response that they have thrown at the COVID-racked global economy.

"Don't worry, be happy"

It has become inescapably obvious over the last few months that the actions of the central banks are also encouraging levels of investor complacency that have rarely been seen over the last few decades. To be clear, this doesn't mean that investors aren't correct in expecting further gains from asset markets, but whenever we see such unbridled enthusiasm, we start to become more sceptical ourselves. Whilst we believe that the economic outlook for the next year is brighter, and that all of the authorities will do their utmost to keep asset valuations elevated, we would stress that there are still plenty of things for us to worry about as we head into a new year. For a start, the COVID-19 crisis is not yet over. Markets have taken further relief from the expectation that vaccines will be delivered and distributed quickly, and that "herd immunity" will soon be created through mass uptake of a vaccine. In truth, we do not know whether this will be the case, despite the forecasts from many governments that this will be achieved efficiently in the coming months.

Can the economy heal quickly?

If we take the government forecasts at face value and assume that the major developed economies can fully reopen quickly and that life can go back to "normal" during 2021, does that mean the economic patient will be fully cured? Certainly, we should



expect a vigorous economic recovery, as “pent up” demand comes through and those who are able to spend money on travel and discretionary consumer items. Next year should be positive from that perspective.

However, we also worry that we are yet to see the severity of the economic hit that has been dealt to the various economies around the world, from repeated lockdowns and structural job losses. There will be many who might want to take an overdue holiday or splash out on a new wardrobe, but simply don't have the means to do so. Certainly, government assistance will help (we expect further announcements from the new US administration) and jobs will come back as the economy fully reopens, but we are not as convinced as most seem to be that we will see a complete economic improvement until we head into 2022. We hope we are wrong, but believe it is right to be prudent and continue to expect different parts of the world to be performing at varying rates of growth depending on the success of each region in dealing with the COVID-19 situation. This variant performance will be reflected across different investment markets and is one reason why we have increased our exposure to Asian assets, given the success that those regional authorities have had in containing the COVID-19 virus.

A new regime?

It is also necessary that we think about just how much the recent US election has changed the outlook for the global geopolitical backdrop. Most commentators and investors have assumed that, with Biden now likely to occupy the White House, there will be a total shift lower in global geopolitical tensions. We agree that it is likely the new US administration will be less hawkish on China and strive to repair the wounded relationships with Europe. In all fairness to Trump, his policies on both were not entirely misguided, but that will be irrelevant in the coming years, as the Democrats quickly try and sweep any memory of him away out of sight. But do we envisage a total shift away from an increasingly fractured world, where there is more of a nationalist focus and less trust? No, far from it. The themes of “deglobalisation” and the “balkanisation” of global supply chains remain central to our view of the world in the “turbulent twenties”. Moreover, with the gap between the rich and the poor getting ever wider, caused in no small part by the asset-price inflating actions of central bankers,

we worry about the potential for significant social unrest as this decade progresses. The change in the US presidency has not reduced this threat, as some seem to suggest. Indeed, there are many disaffected US citizens who have seen their economic situation tragically decimated and, in their view, their President having the election stolen. This is a potentially incendiary situation if not handled carefully.

What do asset markets imply?

To say there has been a disconnect between asset markets and the economy this year would be a major understatement. If we had said a year ago that in twelve months' time we would be suffering a global pandemic, had experienced the worst economic shock since the end of the Second World War and that many asset markets would be at record high levels and trading at valuations rarely seen before in history, you would have thought we were mad. This is making our role as asset allocators and investment selectors particularly challenging. Our response is to cast our net as wide as possible and to eke out precise pockets of value from global asset markets.

Our current strategy is to focus in on specific assets that still offer reasonable growth potential at justifiable valuations, with industries like healthcare, elements of the technology sector and specific plays on infrastructure and “green” technology all favoured within our portfolios. We also have certain investments in the less popular parts of global equity markets, including the UK and Japan, where valuations are simply too cheap and the opportunity for recovery returns is on offer. Assuming that there is some sensible conclusion to the never-ending Brexit saga in the coming months, which is our expectation even if there is a delay until early next year, then UK equities could continue their recent pattern of improved performance.

The equity investments that we own across our portfolios have been blended with a range of fixed interest investments, including those that we own for “defensive” returns and others that are priced appropriately for the challenging economic situation we are dealing with. We continue to be able to source attractive fixed interest investments where we are being suitably compensated for the risk that we are taking, and that gives us confidence that we will be able to achieve our clients' ambitions in the coming years.



Conclusion

As I read through last year's Outlook, it was another famous Dane whose words appeared relevant. Niels Bohr, the famous physicist, once said that "prediction is very difficult, especially if it is about the future". He wasn't wrong. There is every chance that our view that the economy will gradually recover next year and that markets will be subject to frequent fluctuations in fortunes could need to be revised as the months play out. We simply cannot state with any certainty what will eventuate in the months ahead, but we can state definitively that we are comfortable with the balance across our client portfolios and we are excited about the potential for returns in the coming years.

We wish you and your families a happy and healthy end to this year and all the very best of luck for the year ahead. Thank you again for all your support.

Tom Becket

Chief Investment Officer

For further insights from our CIO Tom Becket check out the [Psigma Voice](#), our communication platform providing you with a variety of investment and market commentary.

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