

Countdown to 2021: starter for 10

After a roller coaster 2020, what will 2021 bring? As we hastily forge our new year's resolutions, our attention has turned to what's next.

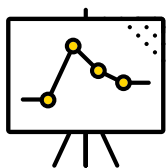
Here are the 10 themes our Asset Allocation team will be mulling over before welcoming 2021.



10 months

The United Nations Climate Change Conference (COP 26) will be held in Glasgow in November 2021. The event was pushed back from November 2020 due to the COVID-19

pandemic. Governments and businesses around the world are announcing new climate policies ahead of the conference, including the UK's goal of net zero greenhouse gas emissions by 2050. It's no understatement to say we are at the dawn of what is hopefully a new era, and LGIM is playing its part. We recently strengthened our [Climate Impact Pledge](#), expanding the number of companies and sectors that are assessed, with voting and capital allocation consequences for those not doing enough on climate change.



9 years

From 2030, RPI inflation will be no more in the eyes of the British government. Following a consultation, the government decided that from 2030 onwards, RPI inflation will be aligned

with CPIH inflation which is roughly 0.8 - 1% lower than RPI; great news for commuters with RPI-linked annual uplifts to rail fares and for student loanees with RPI-linked interest payments; not so much for investors in RPI-linked government bonds (a.k.a. index linked gilts).



8% unemployment

The UK unemployment rate is expected to peak at around 8% in 2021. While the roll out of the COVID-19 vaccine across the UK may have eliminated some tail risks, the economy

must now face the challenges of economic scarring. According to the IMF, economies fail to return to their previous shape after 70% of recessions.¹ This is because balance sheets are permanently impaired, confidence is dented, credit channels are tightened, and there is a mismatch of skills in the old economy compared to the new economy. So far, data suggests this time round could be no different although the impact is likely to be mild. The unprecedented level of 'extend and pretend' loans and fiscal support are new wildcards, which could help companies survive, but equally could prop up unprofitable firms.



7 months?

The Good Judgement Project's Superforecasters team assigned a 96% probability that the 2021 Olympic games will begin on time after being cancelled this year due

to COVID-19. What's changed in Japan over the year? Last year we wrote about Abenomics, this year it's Sukanomics, which we see as a broad continuation of previous policy. We have reason to be positive on Japanese equities in the medium term and we enter 2021 with Japan as a preferred equity region on the grounds of slowly improving structural drivers, but also cheap valuations. We are also increasingly looking towards defensive currencies like the yen, to offer protection, given the dwindling effectiveness of sovereign bonds for risk mitigation and return generation.

1. Source: LGIM and IMF Working Paper - Hysteresis and Business Cycles, May 2020.



6 out of 10 planes

It's been a difficult time for the aviation industry. 6 in 10 passenger airliners in the global aviation fleet were in put into storage at the worst point in 2020 according to Cirium.²

Markets are currently pricing in a substantial white elephant discount on the value of these super-jumbos.

But markets are forward-looking, or at least should be. We are optimistic on a recovery in global travel in 2021, in particular the non-business tourism segment, and we established a position to benefit from the re-opening theme in the travel and leisure sector a few months ago. Since then it has done well on promising progress towards developing COVID-19 vaccines, and we continue to look for under-appreciated ways to play this theme.



+5% growth

Our growth forecast for the largest developed economies for 2021 is almost +5%. After a negative shock to global growth in 2020 as governments shut down large parts of their

economies to try and control COVID-19, our forecast of a strong rebound of 4.8% growth in 2021 is more positive than the consensus.

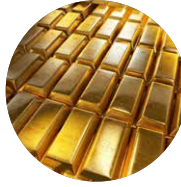
Our positive view of the economic cycle is tempered by what's priced in already. We see valuations as neutral and sentiment is starting to look a bit too exuberant - a recent survey of investors by BAML showed 91% of investors expect stronger growth in 2021, and about 44% expect it to get a lot stronger. We believe too much positivity is typically a negative.³



4 HK lawmakers

Four pro-democracy lawmakers were expelled in Hong Kong under Beijing's watch as they were deemed a threat to national security in the latest shift in the political tectonic plates troubling

the region. We believe on-going tension between the US and China will be the main geopolitical issue that will shape the world over the next decade, with proxy conflicts involving Taiwan, the World Health Organisation and other areas of interest set to continue. Joe Biden may change the style of the relationship, but not the substance of US foreign policy as there is bipartisan support for a tough stance on China. In our view this plays a part as a tailwind on our positive view on US technology stocks as we believe the government will not want to overly regulate the sector as the country battles to achieve tech supremacy over China.



3 drawdowns

In three of the last six large equity drawdowns of 10% or more, the price of gold has actually fallen. Therefore, can gold still be considered as the ultimate safe haven asset class?

We do still see gold as an important safe haven asset, particularly for insulating portfolios against geopolitical and inflation risks. However, given the fact that in half of the recent equity corrections gold has also lost ground, it's clear that investors cannot consider the precious metal to be a panacea.

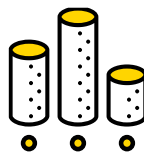


2 tech stocks

Just two stocks are worth more than the entire UK equity market. The combined market capitalisation of Apple* and Amazon* is greater than the entire FTSE All-Share, meaning investors who opt for a market cap-weighted approach to equity investing are exposing themselves to significant idiosyncratic risk through high individual stock concentration. We call this the concentration conundrum.

Market-cap indices are now dominated by the US technology giants, with an index of almost 4,000 individual stocks, almost 12% of the total weight sits in just 5 stocks (Apple*, Microsoft*, Amazon*, Alphabet* & Facebook*)!⁴

*For illustrative purposes only. Reference to a particular security is on a historic basis and does not mean that the security is currently held or will be held within an LGIM portfolio. The above information does not constitute a recommendation to buy or sell any security.



£1 trillion

We have seen record levels of quantitative easing this year as central banks around the world swooped in to provide support to markets as the pandemic took hold of market sentiment.

The Bank of England is showing no signs of slowing down asset purchases any time soon and at current pace, only a small addition to the purchase targets is needed to hit £1 trillion on its balance sheet in 2021. That figure is out of this world! In fact, if you were to stack that amount of money in £1 coins, you would get to the moon and back just under 4 times!

2. Source: Cirium, April 2020.

3. Source: BAML, November 2020.

4. Source: FTSE Russell, November 2020.

Contact us

For further information about LGIM, please visit lgim.com or contact your usual LGIM representative



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