

Outlook for the capital markets

10 propositions for 2021

Frankfurt, 23 November 2020



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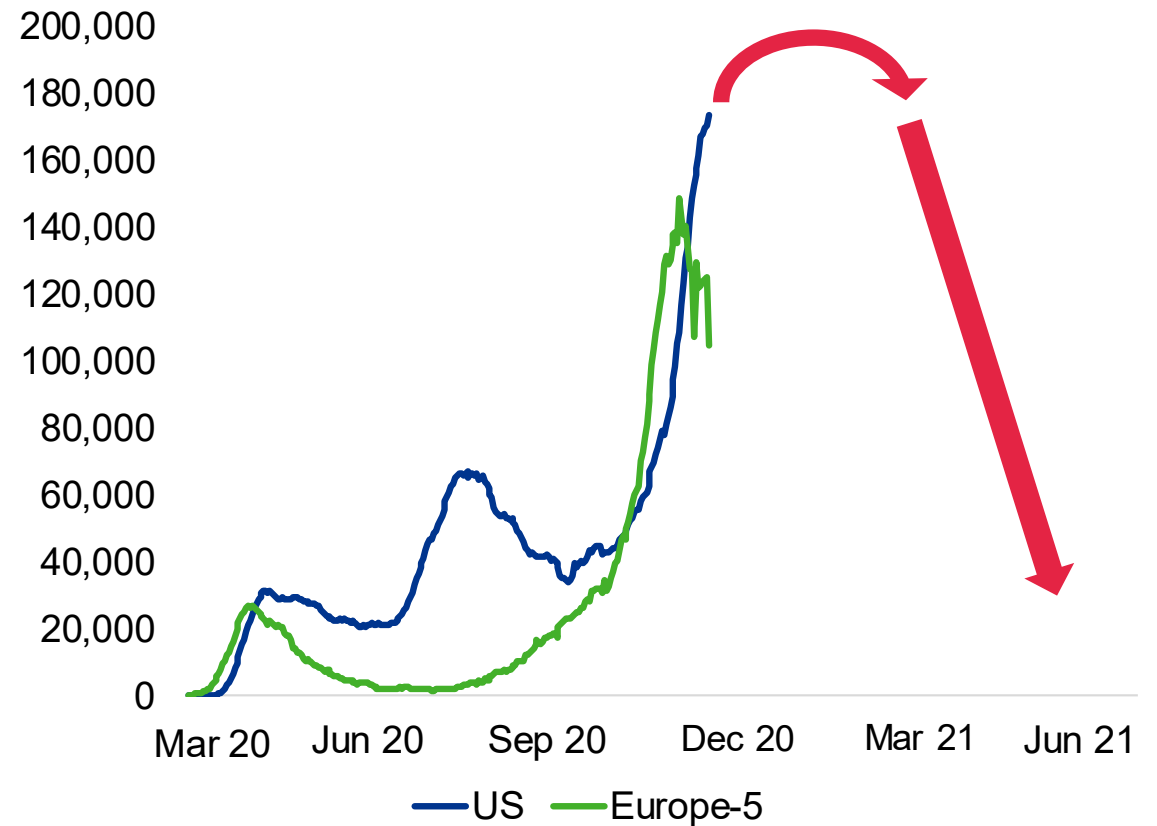
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Clear prospects: tough COVID winter, back to normal from summer

- We do not expect the pandemic situation in the US and Europe to ease over the winter.
- Contact-restricting measures and focused lockdowns, like those adopted in November, will probably remain necessary throughout the winter in order to prevent healthcare systems from becoming overwhelmed.
- We believe that life will not return to normal until a vaccine becomes widely available, which we expect to happen in the summer of 2021 at the earliest.

New infections: second wave is building up

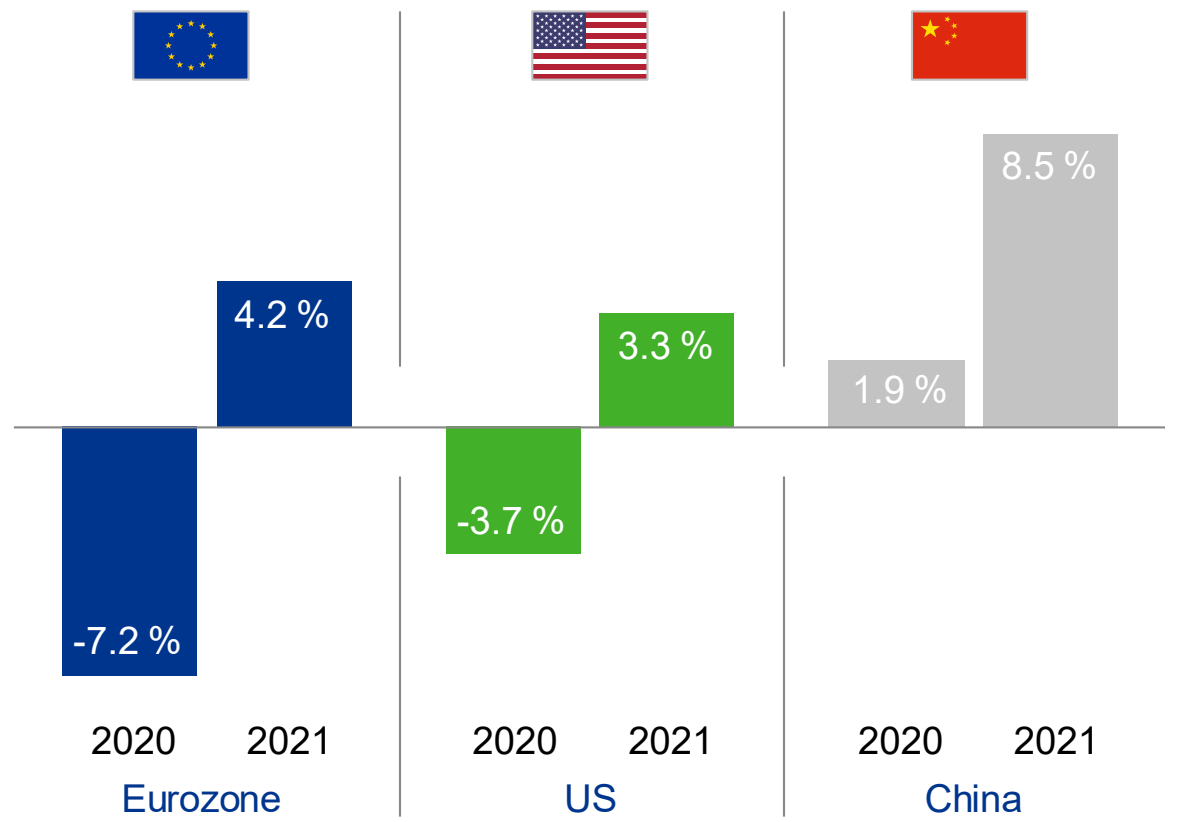


Sources: Bloomberg, Union Investment, as at 23 November 2020. Europe-5 = Ger, Spa, Ita, Fra, UK

Clear improvement: Rocketing growth from Q2/2021

- The partial lockdown has stopped the economic recovery in the eurozone in its tracks in the final months of 2020.
- The second wave of the pandemic is also weighing on economic growth in the US.
- We expect economic momentum to pick up noticeably in both economic areas from the second quarter of 2021.
- The US should be back at pre-crisis levels of economic output by the end of 2021. The eurozone will not be back in its pre-crisis shape until some time in 2022 at the earliest.

UI forecast: V-shaped recovery only in China
Year-on-year change in real GDP



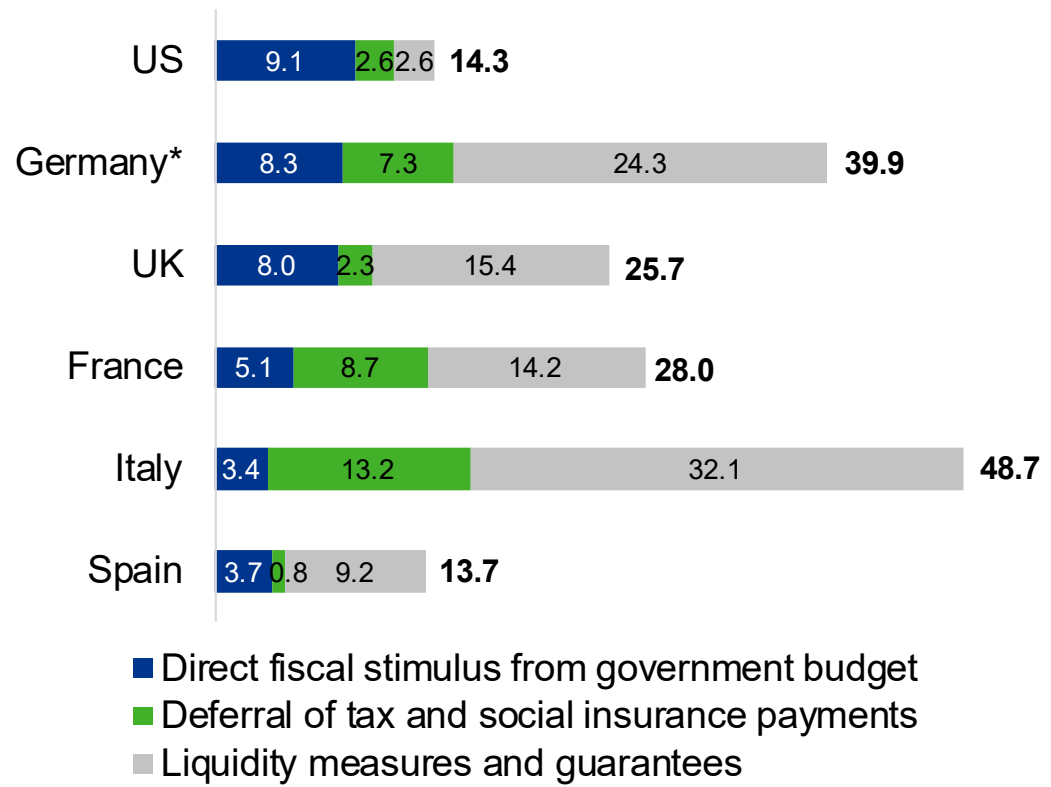
Source: Union Investment, as at 23 November 2020.

Clear direction: expansionary fiscal policy becomes second pillar

- Once the immediate crisis has been managed, the focus of fiscal policy will increasingly shift towards supporting the economic recovery.
- Austerity politics will be consciously avoided and growth stimulus will come from very low real interest rates and spending programmes.
- The central banks are expanding their role as lenders in the government bond market, and the environment of low and negative interest rates is here to stay. The Fed's change of strategy puts pressure on the ECB to adapt its monetary policy strategy too.

Coronavirus ends austerity

Support measures in different countries (% of 2019 GDP)



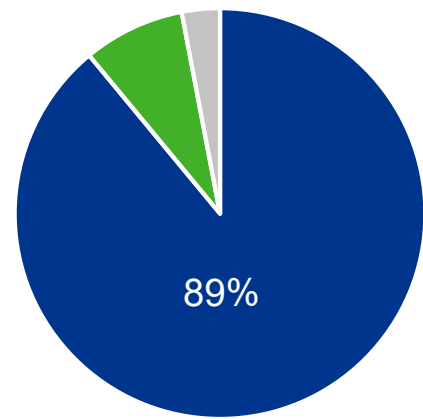
Sources: Bruegel, Macrobond, Union Investment, as at 23 November 2020.

Clear rivals: Trumpism continues, China remains US rival

- Joe Biden has been elected as the 46th President of the United States. The race for a Senate majority remains open until the run-off election in Georgia. The outcome will determine which parts of his agenda Biden is likely to be able to implement.
- It is already clear, however, that the fight against the pandemic and another economic stimulus package will be top priorities in the near term. The election has also shown that the US is not yet ready for fundamental social and economic change. The country is deeply divided. Trump's right-wing populist influence will linger for the foreseeable future.

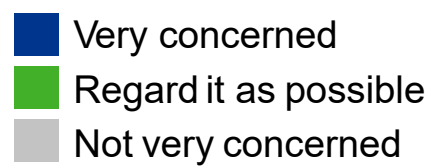
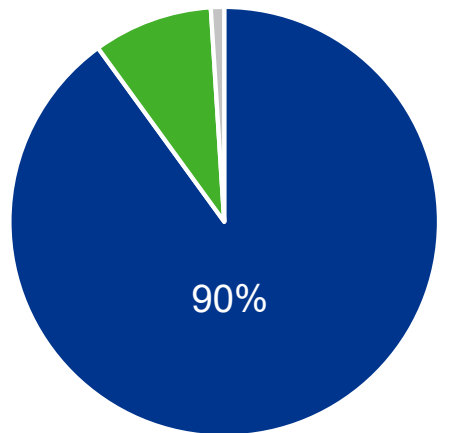
The 'Divided States of America'

US citizens from both camps deeply distrust their political opponents



Proportion of **Trump voters** who are concerned that Biden will severely damage the US economy...

...and the proportion of **Biden voters** who expect the same of Trump



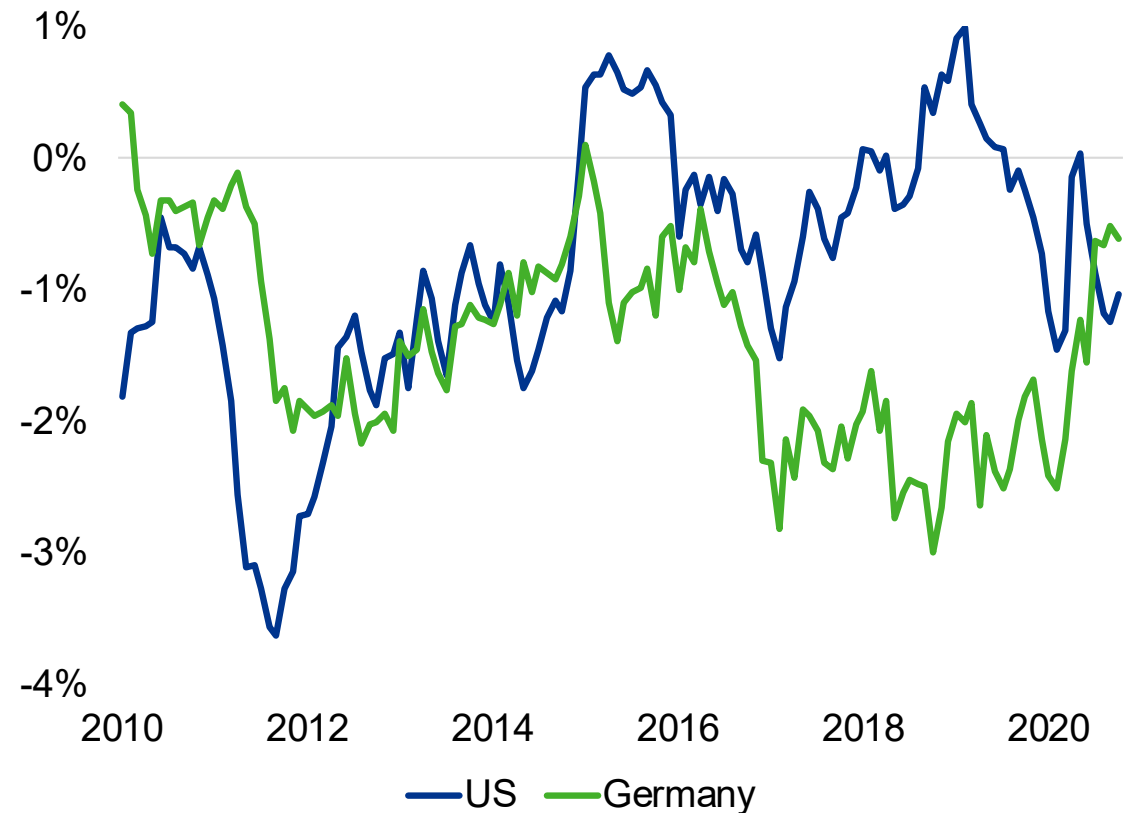
Sources: PEW Research Center, Union Investment, as at 23 November 2020.

Clear recommendation: green light for risk assets

- In the prevailing environment of negative real interest rates, equities are our preferred asset class, ahead of corporate bonds and other spread products and real estate. We still take a modestly positive view of commodities, despite the sharp oil price rebound.
- Government bonds remain unattractive due to the combination of low coupons and high valuations.
- Asset classes that benefit from the prospect of rising inflation will become increasingly sought-after over the course of 2021. For the first time in years, the dominance of the 'growth' and 'quality' investment styles is waning slightly.

Negative real rates of return will become the norm

Yields on 2-year government bonds net of inflation



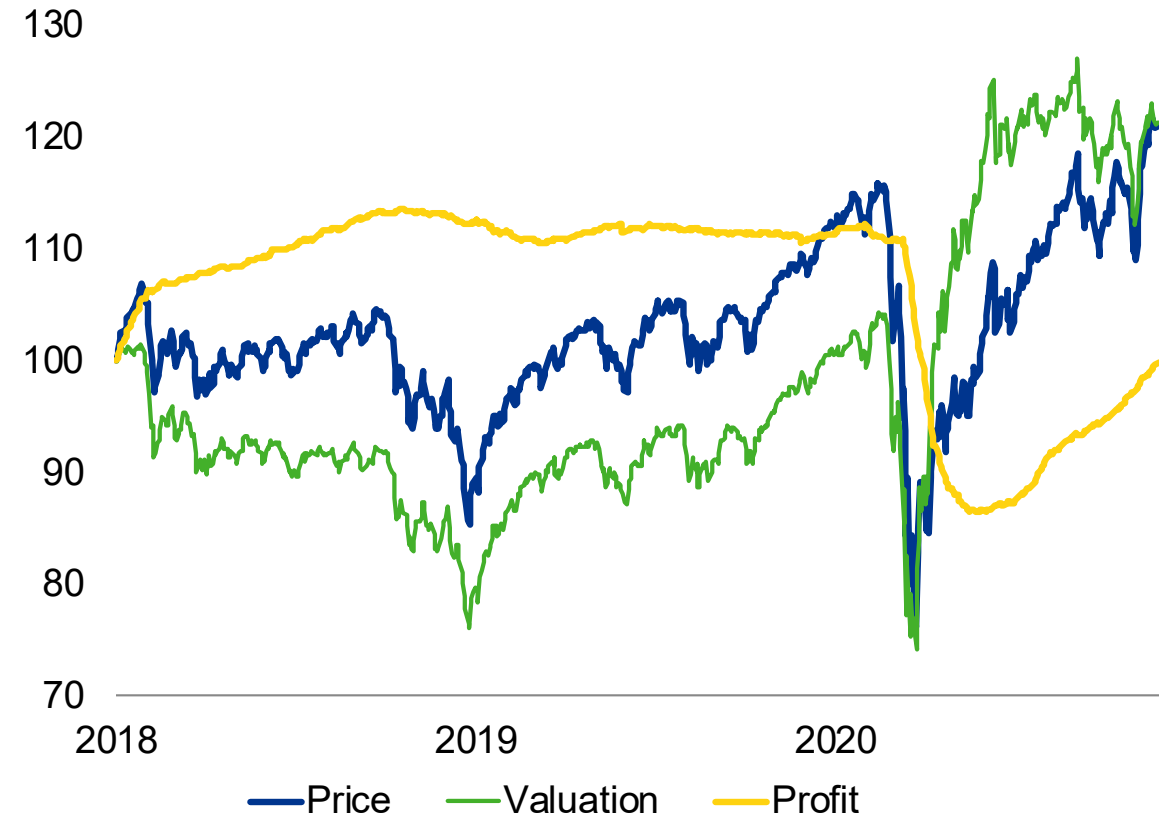
Sources: Bloomberg, Union Investment, as at 23 November 2020. Europe-5 = Ger, Spa, Ita, Fra, UK

Clear preference: strong year for equities, greater convergence

- We expect that 2021 will be a strong year for equities.
- In the early-cycle environment, corporate profits will be a share price driver. At the same time, low real rates of return will keep valuations high and push investors into this asset class.
- In the capital markets, companies that benefit from rising inflation will become increasingly attractive over the course of the year. The prime candidates will be in cyclical sectors.
- The 'growth' and 'quality' investments styles have been dominant for years. Going forward, we expect to see the performances of different styles converge.

Corporate profits will drive share prices in 2021

MSCI World, indexed performance



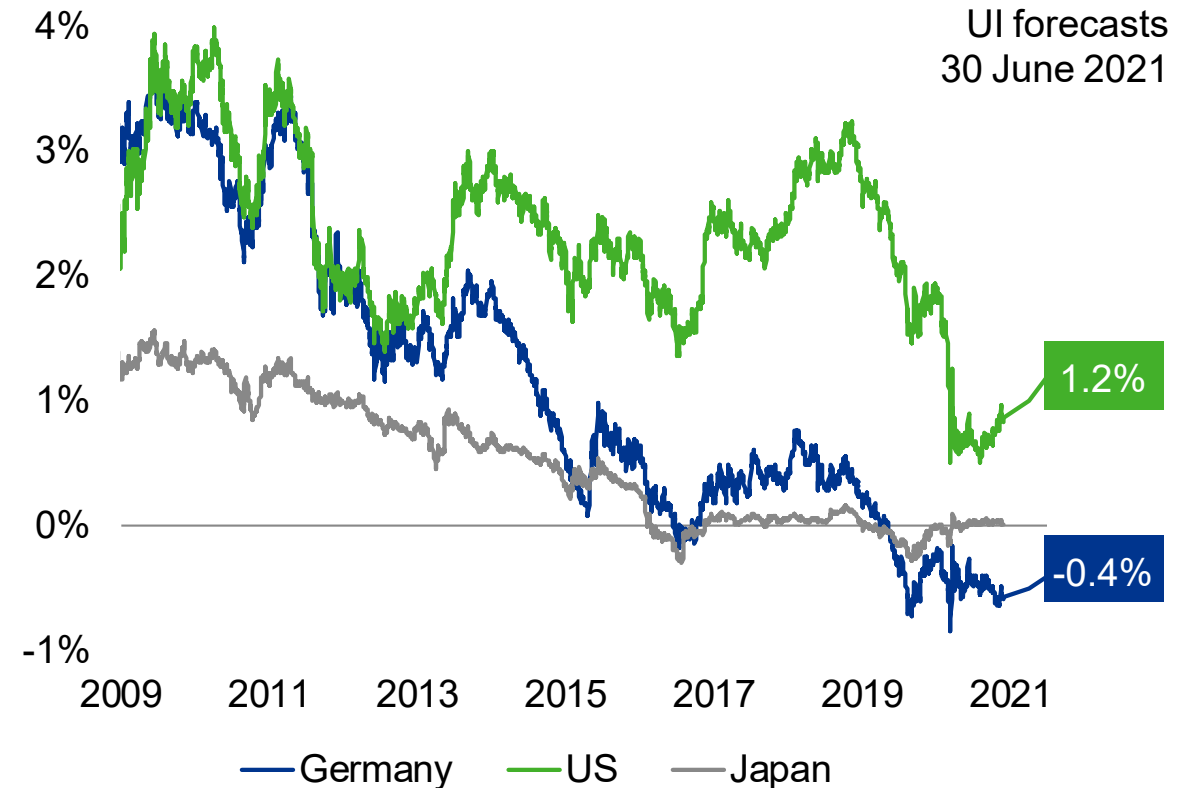
Sources: Bloomberg, Union Investment, as at 23 November 2020.

Clear challenges: government bonds under pressure

- The outlook for government bonds is muted.
- The combination of low coupons and slightly rising yields makes this asset class unattractive.
- Opportunities are provided by the steepening of the US yield curve and the widening of the transatlantic spread.
- Active country selection remains the key to success with emerging market bonds.

Safe havens are extremely expensive

Yields on ten-year bonds

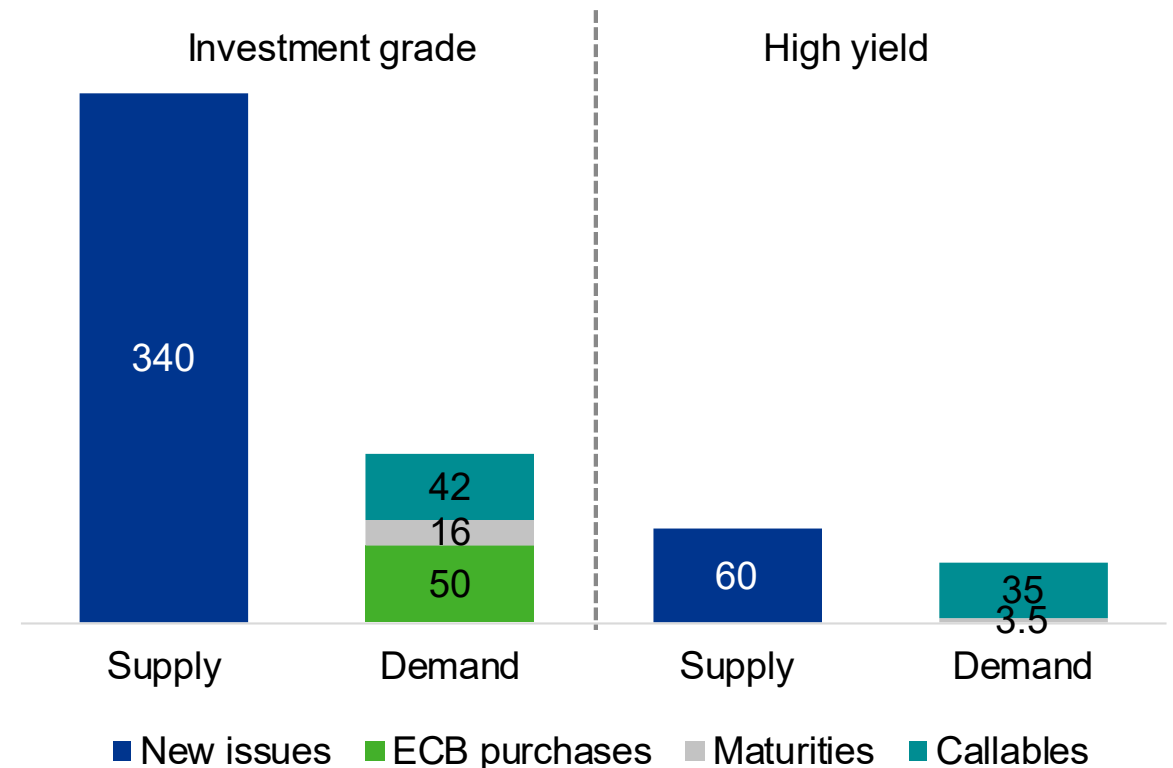


Sources: Refinitiv, Union Investment, as at 23 November 2020.

Clear perspective: successful selection makes carry king

- Following a strong performance in 2020, the potential for spreads on corporate bonds to narrow further is limited.
- Government support programmes and the ECB's purchases are keeping default rates in check.
- Duration is becoming a more important factor once again for investment-grade paper.
- Investors should opt for a mix of high-quality issuers and higher-yielding bonds.

Both supply and demand support credit
(€ billion) supply = average from 2008–2020

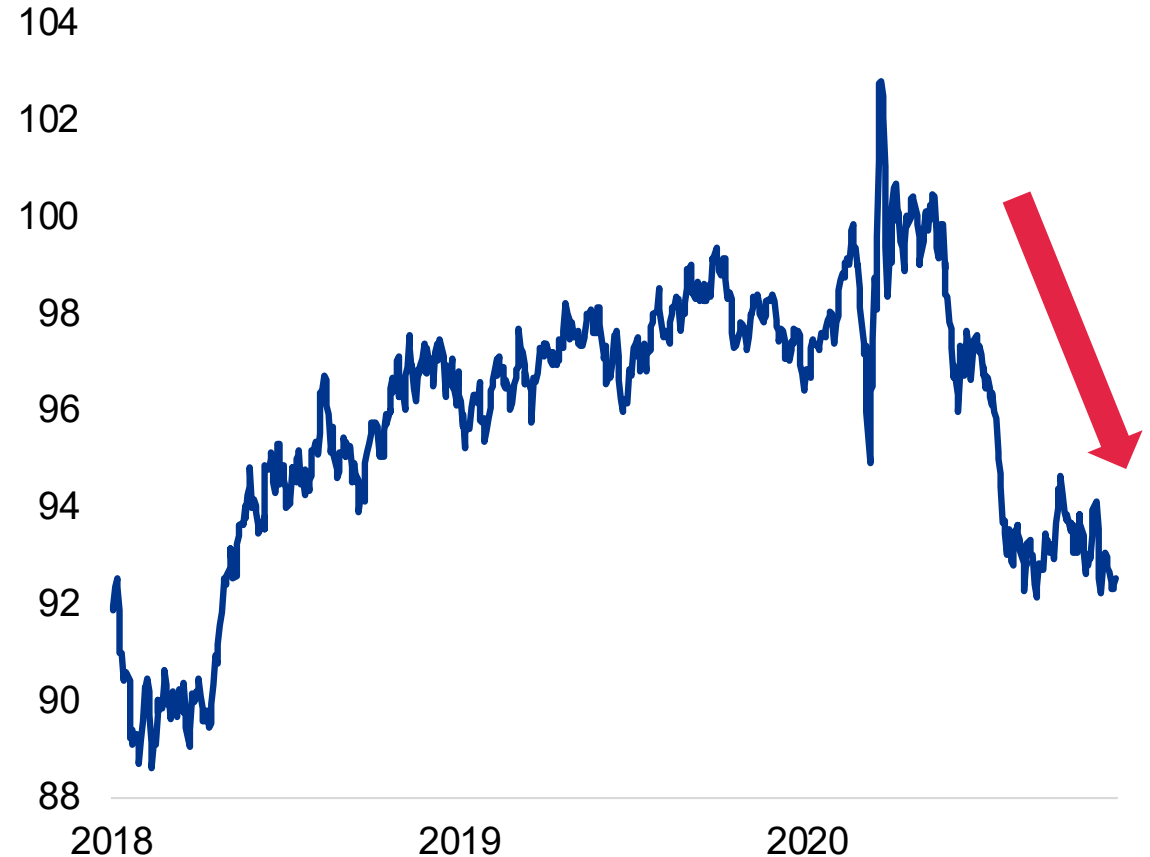


Sources: Creditsights, Bloomberg, Destatis, Union Investment, as at 23 November 2020.

Clear trend: weakness in the US dollar

- In what has become a more or less permanent low-interest-rate environment, the currency markets provide an outlet for differences in inflation and growth prospects.
- The diminishing edge of the US market in terms of real rates of return and the anticipated recovery of global trade will put pressure on the US dollar, while the euro and the Japanese yen are likely to benefit.
- In light of the United States' substantial trade deficit with China, the renminbi will become increasingly important as a reference point for the US dollar.

Trade-weighted US dollar



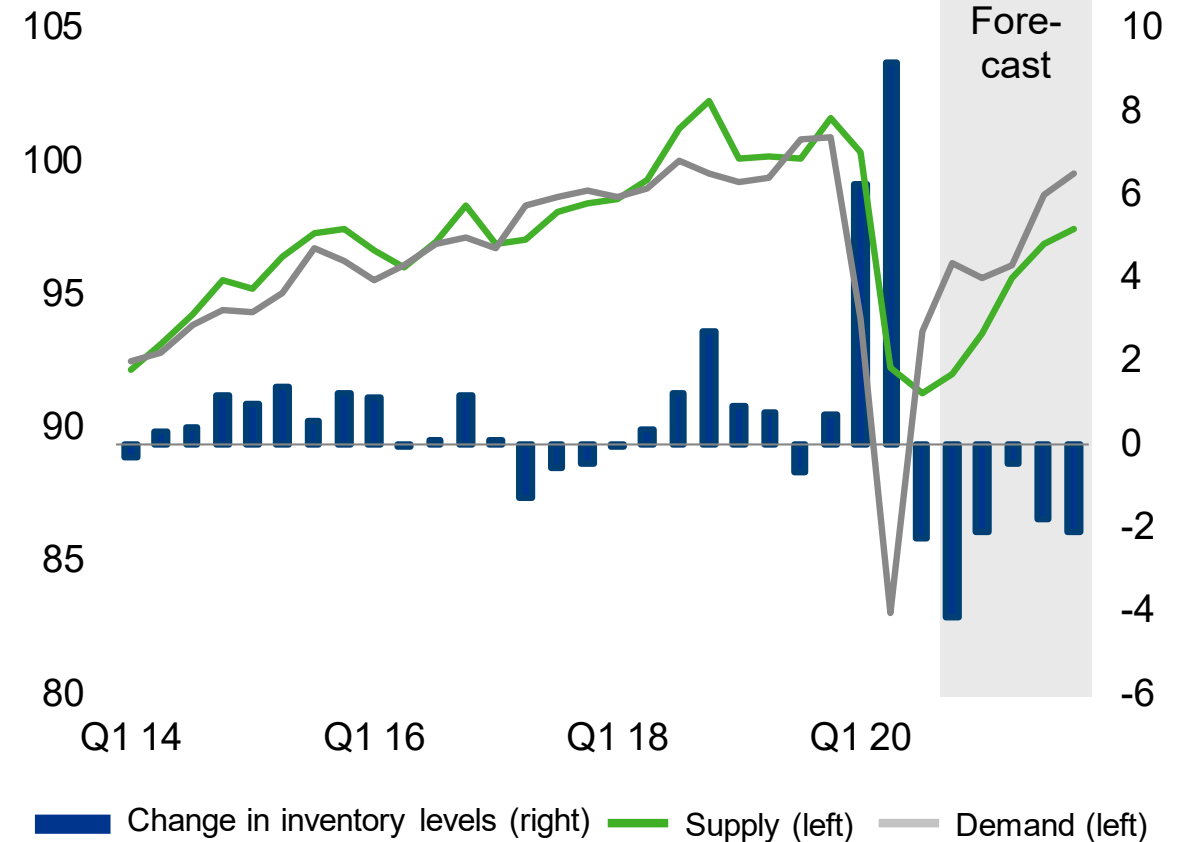
Sources: Bloomberg, Union Investment, as at 23 November 2020.

Clear timing: the time for commodities will come – later

- The slump in demand due to the coronavirus pandemic triggered a substantial rise in inventory levels and unutilised production capacity in the commodity markets.
- The early-cycle economic recovery – especially in Asia – is having a positive effect, but it is still too soon to celebrate.
- Prices in the energy markets could rise again significantly in the second half of 2021, whereas the upside potential of industrial and precious metals is limited.

Inventories are falling, but it will take a while

Oil supply and demand in million barrels per day



Sources: IEA, EIA, Bloomberg, Union Investment, as at 23 November 2020.

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