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2021 Outlook

January 2021

Markets

Stretched stock valuations and flows into riskier assets are supported by the strong economic recovery, low interest rates, and additional fiscal stimulus.

With interest rates near historic lows, future bond market returns are likely to be challenged, especially for longer-term bonds. We prefer intermediate-term bonds, high-yield bonds, core real estate, and other alternative income sources.

Cash on the sidelines is a powerful force. Combined with a coordinated global economic recovery and limited alternatives, the stock market rally likely has further to run.

We expect emerging markets, cyclical sectors (energy, financials, industrials) and industries impacted by the virus (hospitality, retail, airlines) to do well in anticipation of re-opening, but they will likely face the same structural headwinds toward the end of the year and as attention turns toward the next phase of the cycle.

We expect an interim rise in interest rates and/or correction in stocks will be temporary within the longer-term uptrend. 2020 reminded us not to try to time these events, but to stay invested and have a long-term perspective.

In our view, the biggest risks to markets in 2021 include vaccination setbacks, overheated inflation, or a policy blunder.

Policy

With the Democrats capturing control of the Senate and House, a large-scale COVID relief and infrastructure plan is likely to pass in the next few months.

The Fed is unlikely to raise rates this year, although general credit conditions will likely start to tighten as the recovery progresses.

We believe tax increases are unlikely before mid-year and will not be retroactive.

With the small Democratic majorities in the House and Senate, moderate Democrats and Republicans have more sway and extreme reforms are unlikely.

More predictability from the incoming Biden Administration removes some trade and geopolitical risk. However, the new Administration will find it difficult to completely reverse the U.S. stance on trade with China.

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Post-COVID Investment Themes

Global interest rates will remain lower for longer. This supports higher valuations for risky, long-duration assets like growth stocks, large IPOs, and real estate.

Dominant companies will grow more dominant until, at some point, less competition leads to rising anti-trust penalties and break-ups.

Global growth will settle at a low level as supply chains and production shift away from globally interdependent networks and as countries reduce external debt, onshore production, and pursue self-sufficiency.

Digital transformation accelerated by the pandemic will continue to drive structural changes in the global economy, raising living standards and driving productivity growth.

Peak oil demand depresses oil prices, but not enough to offset the acceleration toward clean energy adoption.

Income and wealth inequality persist and likely worsen, driving political divisiveness and populism.
Colossal sovereign debt and deficits will continue. Taxes will likely move higher across the world in the medium-term, while aging demographics, productivity improvements, and slow growth keep a lid on inflation.

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