Active is: Anticipating what's ahead

2021 outlook: portfolios need a broader mix as the pandemic prolongs the uncertainty

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Explore our view on what 2021 has in store

While investors can approach 2021 with optimism that an effective Covid-19 vaccine will be available, the path of the economic recovery remains unclear. A broader toolkit of investments is needed – not just the regions, sectors and strategies that have recently done well.

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Key takeaways

- The recovery from the recession sparked by Covid-19 will likely level off in 2021 – but the projected 5% global growth rate could be higher, depending on whether promising new vaccines are successful globally

- Given the massive amounts of monetary and fiscal stimulus, investors will feel side effects – notably high valuations in several major asset classes – emphasising the need for careful selection among securities and regions
- In an uncertain equity market, seek overall balance: equities in Europe and Asia may provide better value than the US winners of 2020, and value stocks may begin to catch up with growth stocks
- The Covid-19 pandemic reinforced the importance of sustainable investing; public/private partnerships, a focus on impact investing and alignment with the UN's Sustainable Development Goals can help investors achieve meaningful real-life change as countries address vital environmental and economic development issues
- Longer-term US government bonds may be less attractive if the yield curve steepens as expected; corporate bonds, Asian debt and inflation-linked bonds provide interesting opportunities

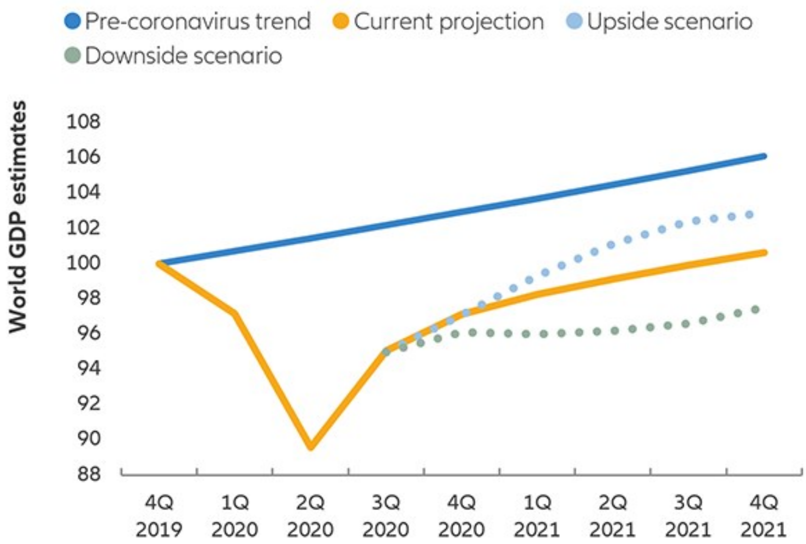
While the worst of the recession is behind us, returning to the pre-coronavirus growth trajectory could take years

The global economy has recovered from the depths of the Covid-19 recession even as some countries grapple with new infections and lockdowns. Investors may want to seek out new sources of return potential that could benefit from the evolving recovery story – in addition to sectors that have prospered through the crisis.

Much depends on the successful deployment of an effective vaccine and drug therapies. New vaccines appear to hold promise, but we will be watching key macroeconomic data points for signs of momentum – and we expect wide differences in how regions perform. If the coronavirus is contained, attractive areas may include European and Asian equities, value sectors and corporate bonds. For institutional investors, private markets offer potential – infrastructure in particular could see increased spending, thanks in part to stimulus measures meant to boost economic activity. There are also an increasing number of opportunities to support a sustainable, resilient recovery of the post-coronavirus economy in ways that address climate change and other vital issues.

But if the pandemic is not brought under control, economic activity seems likely to reach pre-coronavirus levels only by the end of 2021. Economies might not return to their pre-coronavirus trend path for several years. This uncertainty is reflected in the OECD's unusually wide range of growth forecasts (see Exhibit 1), with scenarios for 2021 varying from 7% to -2%.

Exhibit 1: this recovery isn't V-shaped – it's likely closer to a reverse square root sign
World GDP estimates (quarterly since 2019, indexed to 100)



Source: Allianz Global Investors, OECD. Data as at September 2020.

Countries have used stimulus to fight the coronavirus – but there may be economic casualties in the long term

In response to the recent recession, governments and central banks provided vast amounts of monetary-policy stimulus and fiscal stimulus (see Exhibit 2). But although this support was necessary and helpful, it may also result in painful long-term side effects that include:

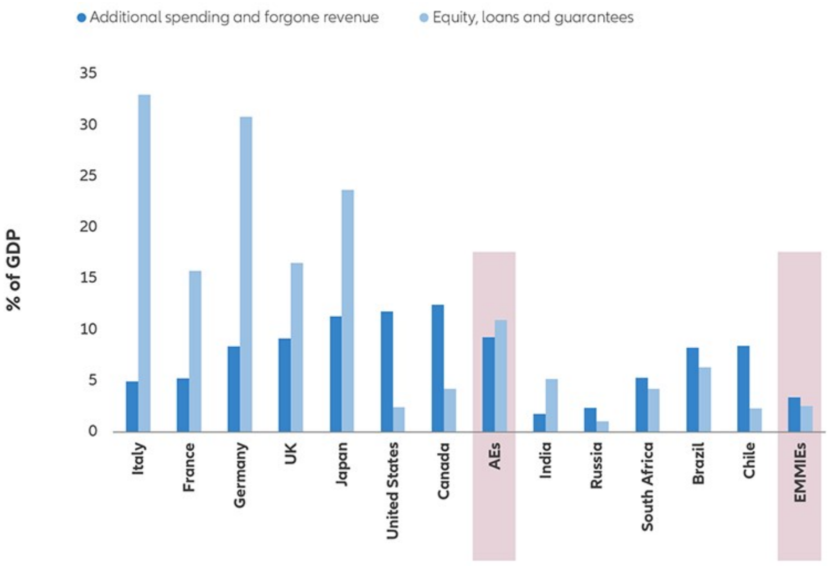
- *High asset prices in some markets.* Excess liquidity from monetary stimulus (essentially, too much money in circulation relative to economic activity) lifted asset prices – even some that already appeared overvalued. We think this is particularly true with government bonds and US equities, while non-US equities appear more moderately priced.
- *High leverage.* Public and private debt levels are elevated. If the recovery weakens significantly,

companies might struggle to maintain their debt burdens – raising the risk of defaults. In addition, weak companies that renew cheap bank loans can turn into "zombie companies" – businesses with low productivity, high debt and a high risk of default if rates normalise.

- *Rising inflation volatility.* Risks are mounting that the prices for goods and services will grind higher in the medium term due in part to the excess liquidity from monetary stimulus, but also due to supply-side shocks related to the coronavirus shutdowns and ongoing trade wars. A continuation of the deglobalisation trend – as countries seek to be self-sufficient with essential goods – would be a drag on long-term economic growth and, consequently, on productivity growth. All else being equal, this could point to higher price volatility globally in the coming years.

Exhibit 2: massive discretionary fiscal response to the Covid-19 crisis

Announced measures in percent of GDP



Source: IMF Fiscal Monitor. Data as at September 2020. Country group averages are weighted by GDP in US dollars adjusted by purchasing power parity. AEs = advanced economies, which includes Italy, France, Germany, the UK, Japan, the US and Canada, plus other advanced economies as defined by the IMF. EMMIEs = emerging market and middle-income economies; this group includes India, Russia, South Africa, Brazil and Chile, as well as other emerging economies as defined by the IMF.

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