

» *Managed Futures: Outlook for 2021*

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Outlook for Managed Futures 2021: Dynamic action is key

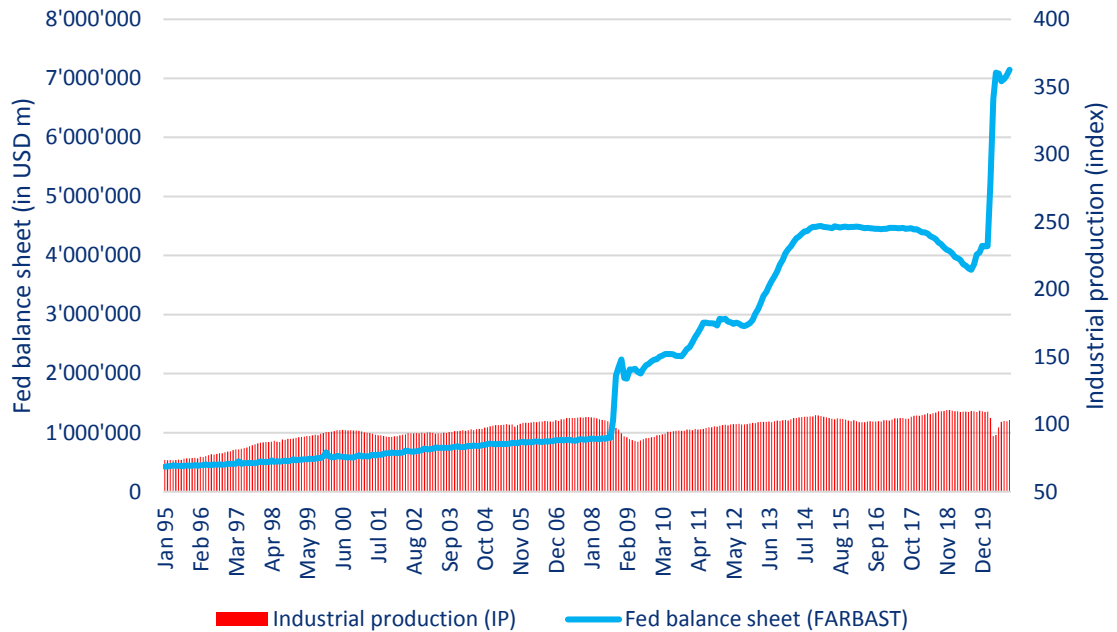
Summary:

- The world economy fell into recession in 2020 due to the Covid-19 crisis. Although the outlook with regards to a vaccine is now very positive, the consequences of the ordered lockdowns are likely to be felt for a long time. The economic slowdown has entailed a rise in unemployment and a decline in consumer spending in all industrialised nations.
- Central banks have reacted decisively to the crisis. The balance sheets of the major central banks have once again grown substantially. This policy of cheap money has led to governments' and companies' debt levels reaching new highs. Prices of financial assets have been inflated and the average credit rating of outstanding corporate bonds is progressively worsening.
- Governments have also reacted proactively in order to avoid an even more severe recession. In addition to conventional fiscal policy, governments have found a new instrument in the form of bank loan guarantees as a way of influencing the money multiplier.
- The political risks – in particular an escalation of the trade war between the US and China – have hardly been reduced with the outcome of the US presidential elections.
- It is difficult to anticipate how this pent-up energy will be released. All scenarios, from high inflation to a technology crash, have a non-negligible probability to unfold. In this environment, a dynamic strategy with the flexibility to tap into new trends is key.

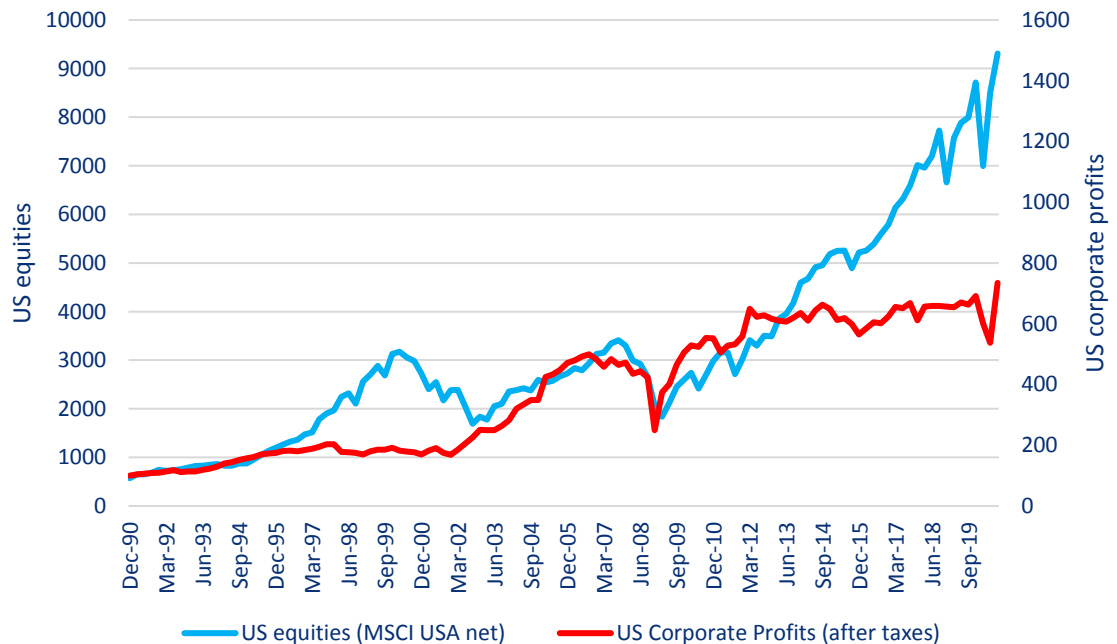
Central banks printing money

The Covid-19 virus has been raging since the start of 2020. Central banks have reacted decisively to this global crisis and flooded the economy with liquidity. The amount of money creation can be seen on their balance sheets. Particularly striking is the development of the balance sheet of the US Federal Reserve (see Chart 1), which, since the financial crisis, has pursued an extremely expansionary monetary policy. Since the Covid-19 crisis began, the Fed's balance sheet has doubled in size and currently stands at 33.9% of GDP. In Europe (ECB), this level is significantly higher at 61.7%. The money supply is around six times higher than before the 2008 financial crisis, while economic output (industrial production) is only slightly higher.

Central banks' actions initially influenced interest rates, which reached record lows worldwide in March. Because of deteriorating liquidity, the Fed also felt compelled to take various measures to support credit markets. In particular, it now accepts a broad range of corporate bonds as collateral for its credit facilities, and, since the end of March, has been able to act directly as buyer of investment grade corporate bonds on the secondary market. Although the Fed is still rather restrained in the usage of this new way of intervention, its announcement has already led to a noticeable easing in credit spreads. Ultimately, with lower interest rates (or bank rates), central banks also inflated share prices, which are decoupling increasingly from company profits (see Chart 2).

Chart 1: US Federal Reserve balance sheet total vs. US industrial production

Source Bloomberg, November 2020

Chart 2: Share price performance vs. company profits in the US

Source Bloomberg, November 2020

Governments' fiscal policy

Governments have also supported the economy in reaction to the crisis with a wide variety of measures. These include in particular the various forms of furlough schemes in Europe, as well as direct cash transfers in the US. As a result, government debt has once again shot up dramatically. According to the IMF Fiscal Monitor (October 2020), worldwide fiscal spending as a result of Covid-19 amounts to USD

11.7 trillion. In view of the stimulus packages already decided, the International Monetary Fund expects worldwide government debt to rise to over 100% of GDP (83% in 2019).

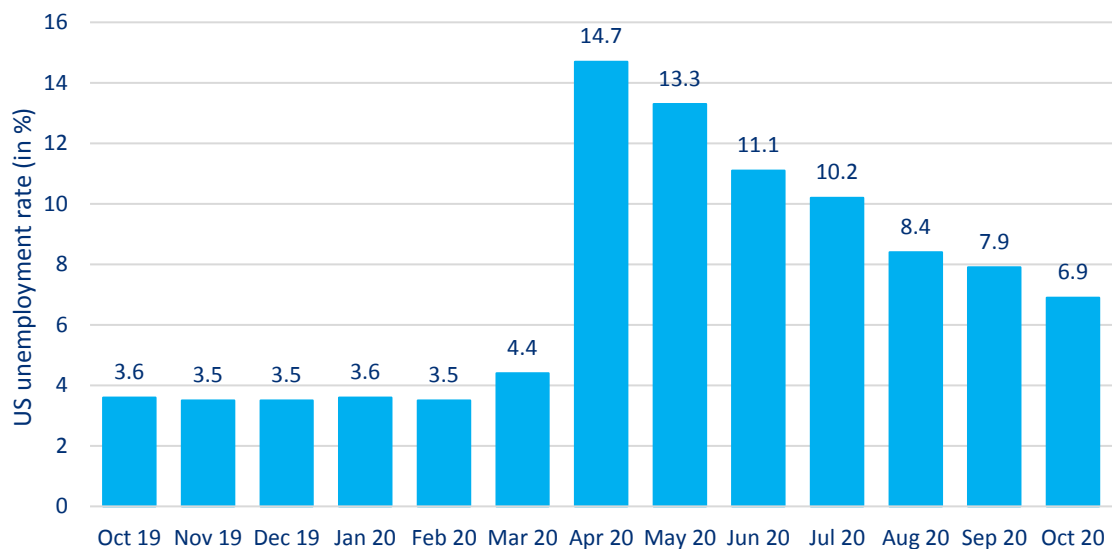
Governments have also found a way to play a direct part in increasing the money supply. They hand out guarantees to commercial banks, so that they can provide loans to businesses and private individuals. This results in money being created that no longer lies within the control of central banks.

It is likely that government debt will continue to rise and that these debts will be bought up by central banks. This means that the huge government deficits will simply be financed by printing money. Furthermore, governments – unlike central banks – have an interest in rising inflation. We believe that after the crisis, they will hardly give up the instrument of loan guarantees.

Higher unemployment, poor consumer sentiment

The unemployment rate in the US has risen sharply as a result of the coronavirus crisis since April 2020 to nearly 15% (see Chart 3). Analysts' fears that the unemployment rate could even reach 25% have luckily not come true. The relaxation measures in many US states have allowed employment levels to rise again and the official unemployment rate dropped to 6.9% in October. The situation in Europe is similar: The rise in unemployment in the spring was stemmed by various government support measures. In addition, relaxation measures implemented since the summer have helped to ease the situation on the job market in Europe.

Chart 3: Development of unemployment in the US



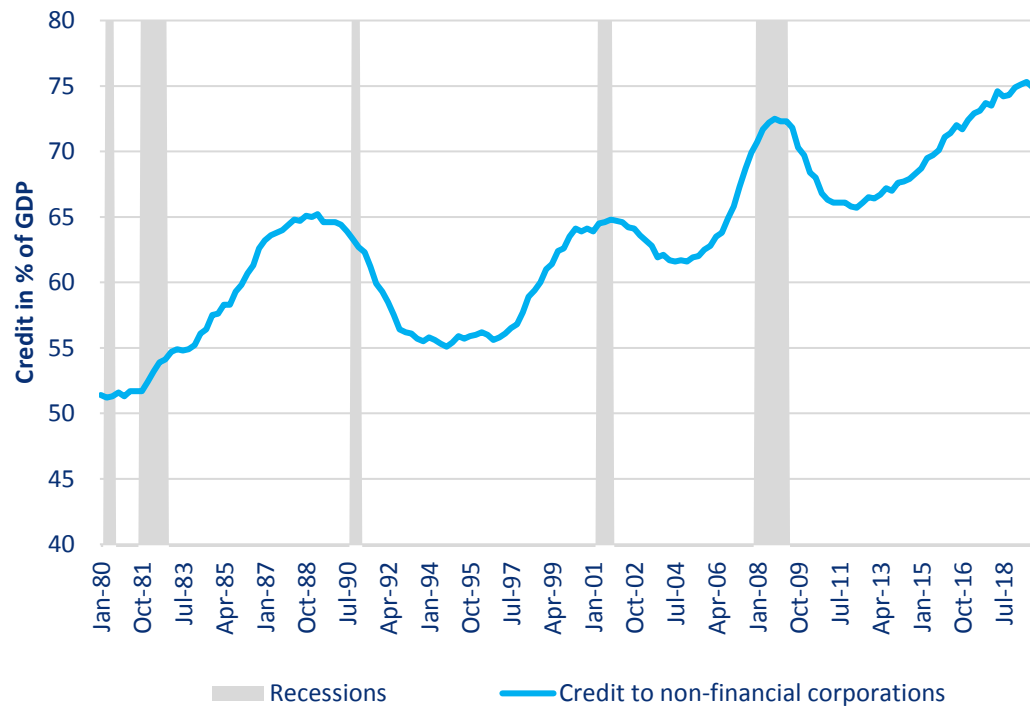
Source U.S. Bureau of Labor Statistics

The positive trend of the last few weeks is unlikely, however, to incite excessive optimism. Unemployment rates in most countries are still much higher than in January 2020 and many companies have not yet reorganised themselves in the belief that this is merely a short-term economic slowdown. Figures for the US are already showing an increase in initial jobless claims (U.S. Bureau of Labor Statistics). The uncertainty on the job market inevitably affects consumer behaviour. In most industrialised nations, the savings rate has shot up in the wake of the Covid-19 crisis. We expect consumer spending to remain sluggish in 2021 due to job insecurity.

Corporate debt levels, zombies

As a result of central banks' loose monetary policy, corporate debt has been rising for some time. In this regard as well, the trend can best be seen in the US market. Chart 4 below shows how corporate debt has virtually exploded in the last few years. Figures from the Federal Reserve Bank of St. Louis show that in January 2020, the level of corporate debt in the USA was already at 78% of GDP. It can be assumed from this that the level has once again risen sharply this year.

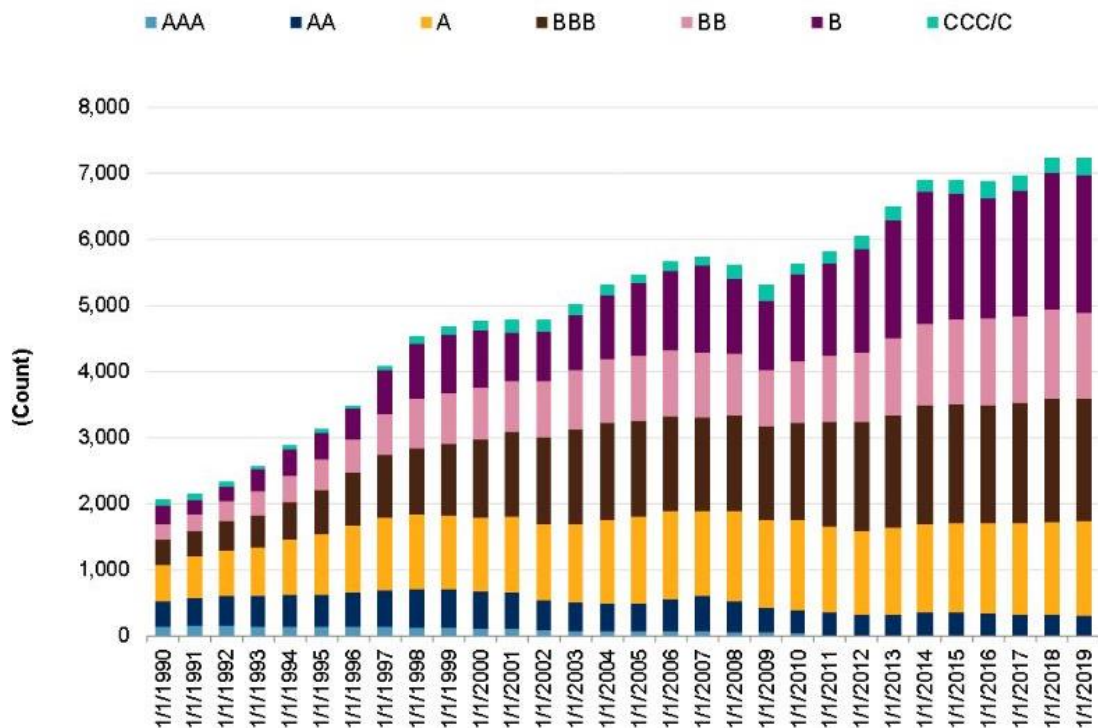
Chart 4: Corporate debt relative to GDP in the US



Source: Federal Reserve Bank of St. Louis

Debt is fundamentally not a problem if it is used for investments that make economic sense. However, a cause for concern in this regard are the major share buyback programmes in the US, which are hardly expected to boost companies' productivity. Furthermore, the average credit rating of corporate bonds is deteriorating steadily. This trend is clearly shown in the following figure.

Chart 5: Trend/distribution of global corporate ratings



Note: Chart shows the distribution of Global corporate ratings by count of issuer credit rating. Sources: S&P Global Ratings and S&P Global Market Intelligence's CreditPro®.
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Source: Standard & Poor's

There is reason to fear that the combination of central banks' policy of cheap money and government support measures have resulted in many companies being kept going artificially with an unsustainable business model (so-called "zombie companies"). The corresponding cleaning up will have to occur at the latest when the next crisis hits.

Political risk: Trade conflict with China

The ongoing considerable tensions between the US and China have almost disappeared from the radar in terms of concerns. Four years ago, newly elected US President Trump promised easy success in the trade war with China and threatened punitive tariffs of over USD 600 billion (of which USD 370 billion still remains in effect).

According to data from the United States Census Bureau, the US has not yet managed to reduce its current account deficit – not even with China. But anyone who hopes that, with Joe Biden presiding, the trade conflict with China will quickly begin to ease off is likely to be disappointed. There is also a high level of scepticism among Democrats about China's asymmetrical business policy, which on the one hand strives for a global presence for its businesses, while tightly controlling its domestic market on the other. It is only likely to be a matter of time before tensions between the two superpowers flare up again.

Outlook: The pent-up energy could soon be released, which would be advantageous for Managed Futures.

The world economy seems to be at a crossroads. On the one hand, the long-term effects of the coronavirus crisis threaten pushing the economy into deep recession. This could prove a deathblow for many struggling businesses, with major effects on the job market. On the other hand, central banks are providing the economy with ever more new money in order to swiftly overcome the crisis with access to a new phase of growth. However, in so doing they are creating the conditions for galloping inflation in the future. These powers are still in balance, with 2020 having been a difficult year for Managed Futures, shaped by hope and fear, reversals in trend and sideways movements. It is still not clear whether the next few years will be defined by a severe recession, inflation or new growth.

We expect the pent-up energy to be released in the coming years, and one of the scenarios outlined above to materialise. Regardless of which scenario occurs, we believe that strong trends will develop, which should fuel the performance of Managed Futures. In our opinion, it is not possible to predict when these upheavals will begin and what consequences they will have for the financial markets. It may be possible to maintain this unstable balance in the short term. However, during times of categorical uncertainty, investors are more reliant than ever on convex investment products, which benefit from both rising and falling markets in all asset classes and can offer real diversification in times of crisis.

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