The Macro-Market Outlook
Looking beyond the Covid-19 disruption

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Economies versus Markets in 2020

**Big difference**

The Covid-19 havoc - plunge, recovery, relapse

Markets raced ahead...after a brief swoon in March
(MSCI All Country World Index - US Dollars)

<table>
<thead>
<tr>
<th>Equities, Bonds, Credit all did well</th>
<th>2020 Return</th>
<th>USD %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Equity (MSCI AC World Index)</td>
<td>16.8</td>
<td></td>
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<tr>
<td>US Credit (Bloomberg-Barclays)</td>
<td>7.8</td>
<td></td>
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<tr>
<td>US Government (Bloomberg-Barclays)</td>
<td>8.3</td>
<td></td>
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<tr>
<td>US Treasury: TIPS (Bloomberg-Barclays)</td>
<td>11.0</td>
<td></td>
</tr>
</tbody>
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Sources: Bloomberg, FactSet
Economy Getting Better but Some Losses to Linger

Vaccines winning but ‘scarring’ effects?

Vaccines are winning
(US confirmed cases and vaccines given)

3 year economic 'scarring' significant...
but better than in 2008 crisis
(GDP 'loss' over 3 years, %)

Sources: Johns Hopkins, Fulcrum Macroeconomics
The Biden Factor
How bullish can you be?

<table>
<thead>
<tr>
<th>3 market sensitive Biden measures</th>
<th>Impact</th>
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<tbody>
<tr>
<td>Covid-19 relief package and 100m vaccine admin target in 100 days with production step-up</td>
<td>Faster economic reopening later in year</td>
</tr>
<tr>
<td>$2 trillion infrastructure, climate and clean energy infrastructure plan to make US carbon neutral by 2050</td>
<td>Boost to economic growth, boost to carbon transition-friendly stocks/sectors</td>
</tr>
<tr>
<td>Pledge to raise corporate tax from 20-28%</td>
<td>Some negative impact on corporate EPS but down the road</td>
</tr>
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US budget stimulus (red ink) to remain large
(Federal deficits as % of US GDP)

US monetary expansion continues and zero rates to continue through to 2022
(Federal Reserve balance sheet, $m)

Vaccine optimism, and this backdrop ... little not to like
US Rates – A Risk to Market Exuberance but Manageable

...inflation surge unlikely

US Treasury Yield Curve...through time
(...eventually yields cross 2%!)

Federal Reserve inflation indicator not alarming
(5 year forward inflation average in 5 years time)

Sources: Bloomberg, Aon
Equities: Support vs Bonds and Cash
….but richly valued standalone

A still quite high equity risk premium
(US vs 10 year bonds)

Equities Cheap

Equities Expensive

Full valuations on the S&P 500
(Price to Earnings and Price to Sales ratios)

Relative valuations critical to current support for equities

But it is not possible to ignore high standalone price levels and what they are discounting

Sources: Aon, FactSet
Hard to Keep the Market Running Up Now…
‘Growth’ concentration and herding

Value needs to come back to keep market rising

MSCI World Value
MSCI World Growth

Source: FactSet

How US trading volume rose in lockdown
(New York Stock Exchange total volume)

..To ease high concentration risk in the US market
(S&P 500 weightings of top stocks, %)

Our 2021/22 equity market view:

Vaccine/economic recovery and Biden narrative and bonds help support markets.

But not enough to keep market rising. Reward for equity risk is sharply lower now.

Volatility spikes will keep coming back.

But what of the longer term outlook?

Sources: FactSet, Bloomberg
Credit: Spreads Look Asymmetric

... but returns squeezed by duration risk, too

Credit moves extend to all segments
(spreads versus government bonds, %)

Low yields on investment grade bring twin risks
(Bloomberg-Barclays US corporate yield, %)

Our 2021/22 credit market view:
Fed intervention, policy support and vaccine narrative are big supports. Corporate hedging activity too.

Spreads look increasingly asymmetric at current levels. But returns squeezed by duration risk too.

Returns look at risk.
Summary: Low Return Environment with Several Tripwires

Risk-asset allocations need careful balancing

Risky assets are moving together too closely!
(12 month rolling correlations across 9 risky asset indices across equities, credit and commodities)

10 year expected return per unit of risk (%)
(Aon capital market assumptions)

Longer-term asset allocation view:

Longer-term focus is on returns per unit of risk.

Equities on an absolute basis still offer good long-term returns but adjusted for risk are now at less of an advantage.

How assets co-move with each other is also important for resilience now given many assets are moving together recently.

Fixed income is now very low return but still has the advantage of less or (with treasuries) negative co-movement with equity risk.
3 Longer-Term Investment Risks: Globalization Reversal, Identity Politics and ‘Japanification’ Risk from Current Policy

World trade now only keeps up with global GDP

US corporate leverage goes through the roof (Debt to ebitda)

US: Average tariff rates for the world & China

Zombie firms on the rise (% of Worldscope companies with ICR of <1 for 3 years)
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