

2 December 2020

The Investment Outlook Under Biden



Agenda



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Part 1

ELECTION RESULTS

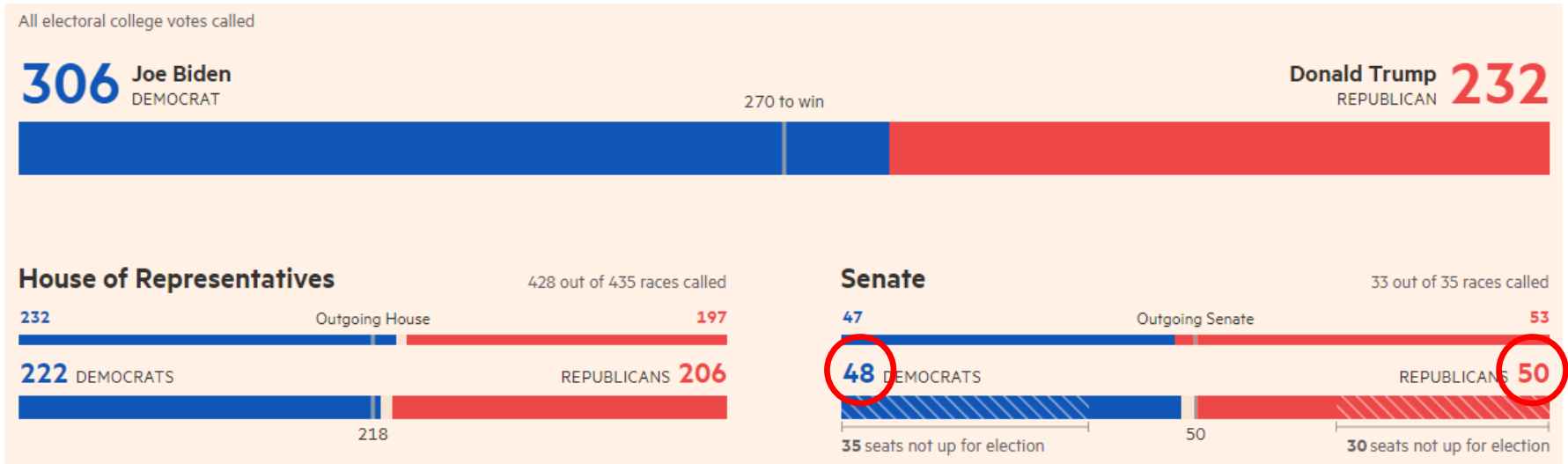
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BIDEN'S ECONOMIC POLICY PROGRAMME



Who will take control of the Senate?

The Near Final Score Line



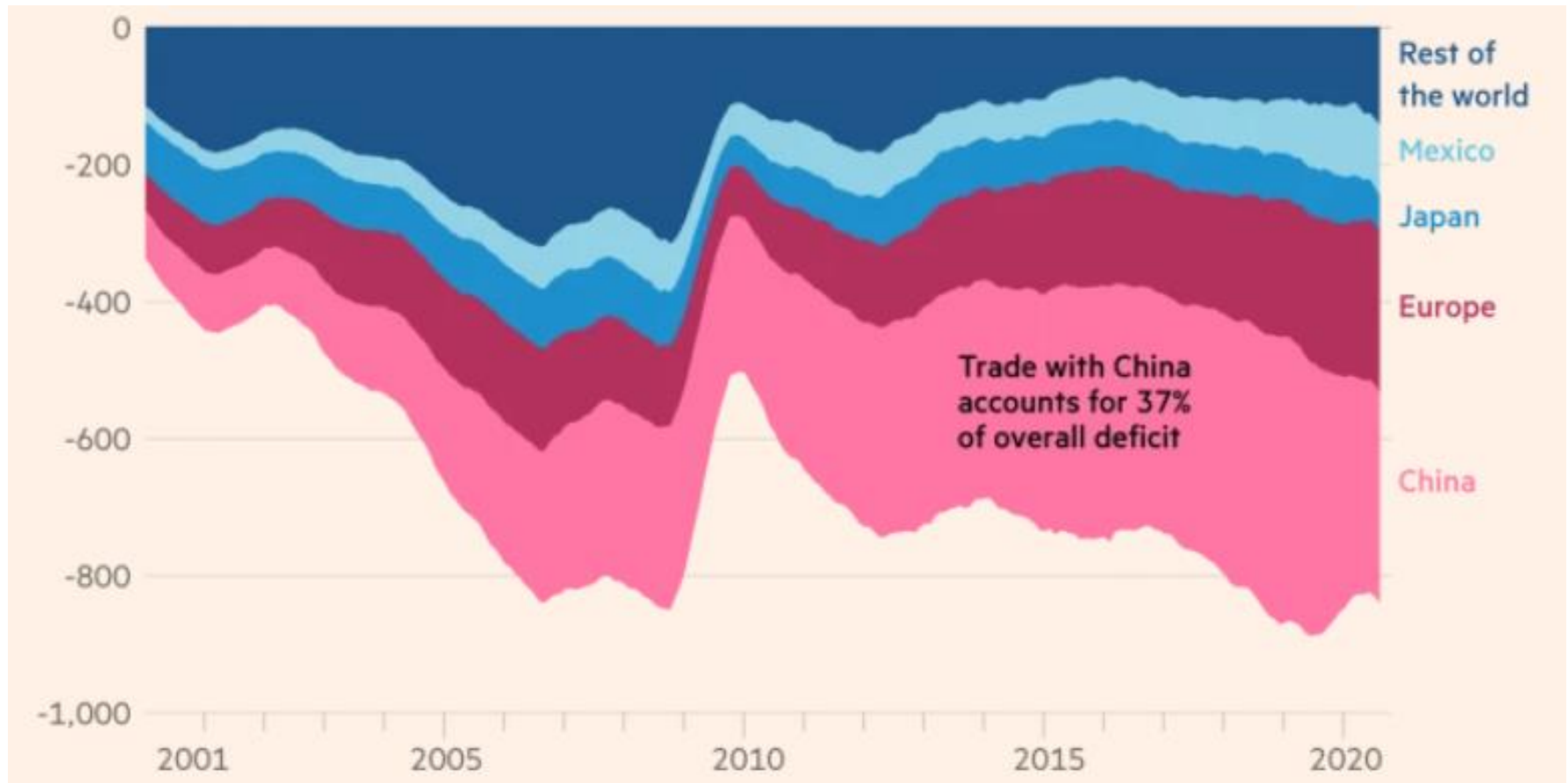
The two remaining Senate seats:

- GA: David Perdue (R) beat Jon Ossoff (D) by 88,000 votes, but Shane Hazel (a Libertarian) received 115,000 votes on the 3rd November. The run-off between Perdue and Ossoff will take place on the 5th January, and it is impossible to predict the outcome.
- GA: Another run-off set for the 5th January. Voters had two Republican candidates to choose from in this election so, although Raphael Warnock (D) got most votes, he probably won't win, assuming Kelly Loeffler (R) attracts all Republican votes in the run-off. The two R candidates between them got 635,000 more votes than Warnock did.



TRADE POLICY – Biden has indicated he wants to build bridges to Europe but that he will be tough when dealing with China.

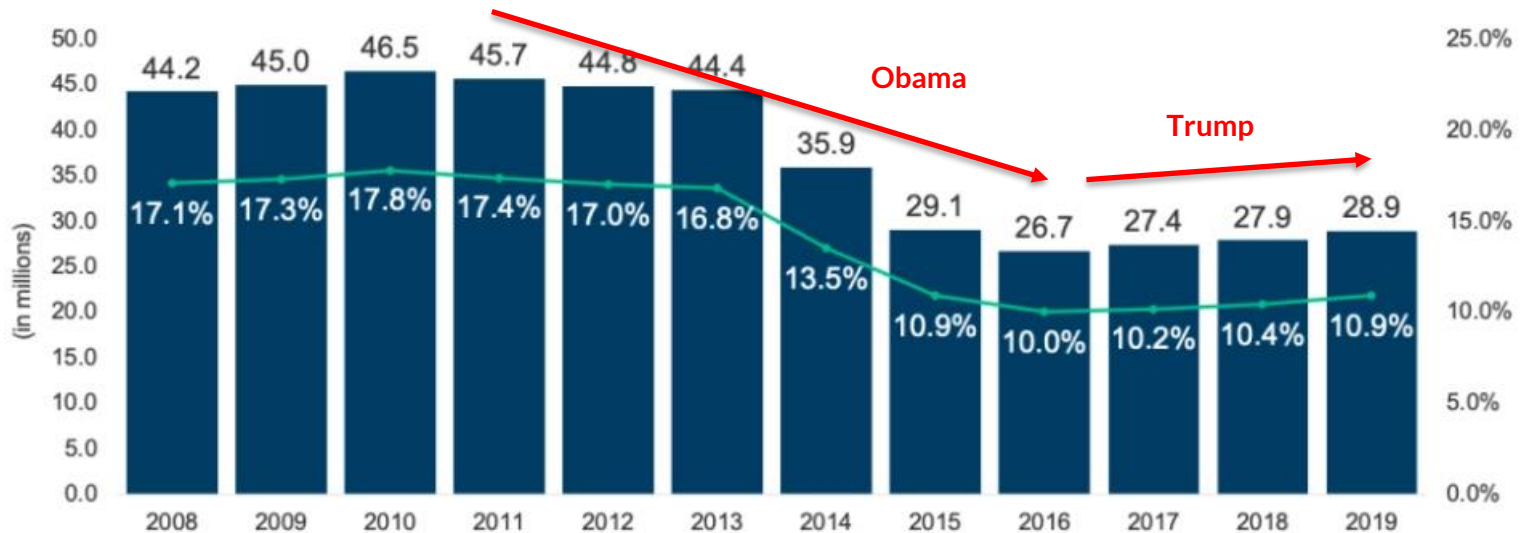
US Trade Deficit in Goods
Rolling 12-Month Total (\$Bn)





HEALTHCARE POLICY – Biden can use his executive power to reverse Trump’s under- mining of the Affordable Care Act but won’t be able to make more drastic changes.

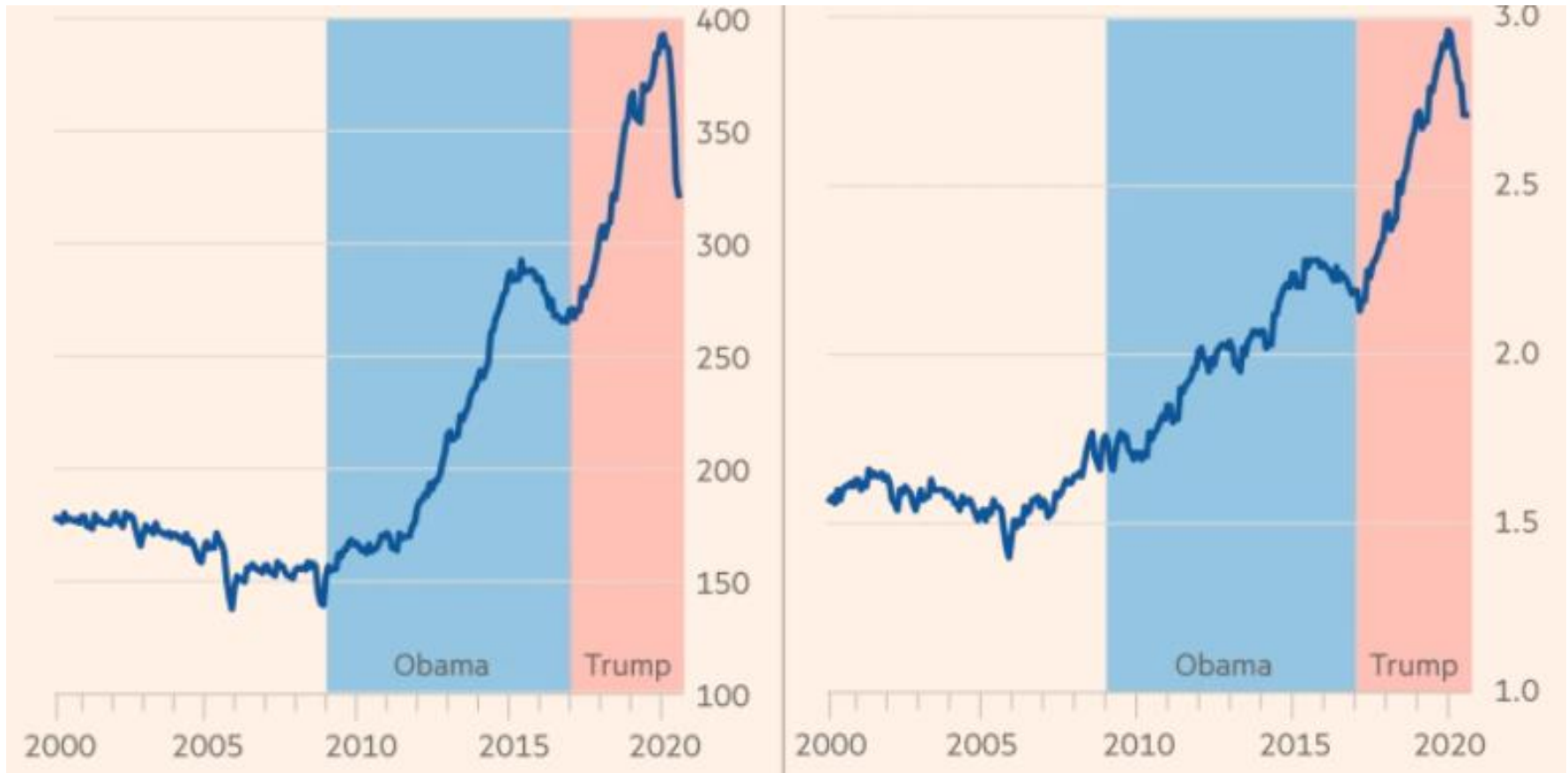
Number of Uninsured Non-Elderly Americans, 2008-19
 Total Number & Percentage of Non-Elderly Population



↑
 Obama introduced the
 Affordable Care Act

CLIMATE POLICY – Biden has pledged to re-join the Paris climate agreement, to decarbonise and to promote investments in green technologies.

Crude Oil (LH) & Natural Gas (RH) Production
 3-Month Rolling Average (Million Barrels a Day / Trillion Cubic Feet)





Can Biden realistically implement any part of his climate policy programme?

- Under US law, the so-called Senate cloture rule requires for at least 60 senators to vote in favour to prevent filibustering, i.e. a slim Democratic majority (50:50 at best with Kamala Harris casting the decisive vote) will not be enough to make sweeping changes.
- Biden can make a footprint of a certain size, but he wouldn't be able to make decarbonisation mandatory without the support of at least 60 senators. It is estimated that through his executive powers, US carbon emissions can be reduced by about 35% from 2005 levels, but climate experts agree that this wouldn't be sufficient to prevent the temperature from rising further.
- Biden's best opportunity may be to seek the support of the public, who are (in general) more climate conscious than most US politicians are. With 22 Senate seats currently held by Republicans up for grabs in 2022, the second half of Biden's term could be when big changes become possible.

Part 2

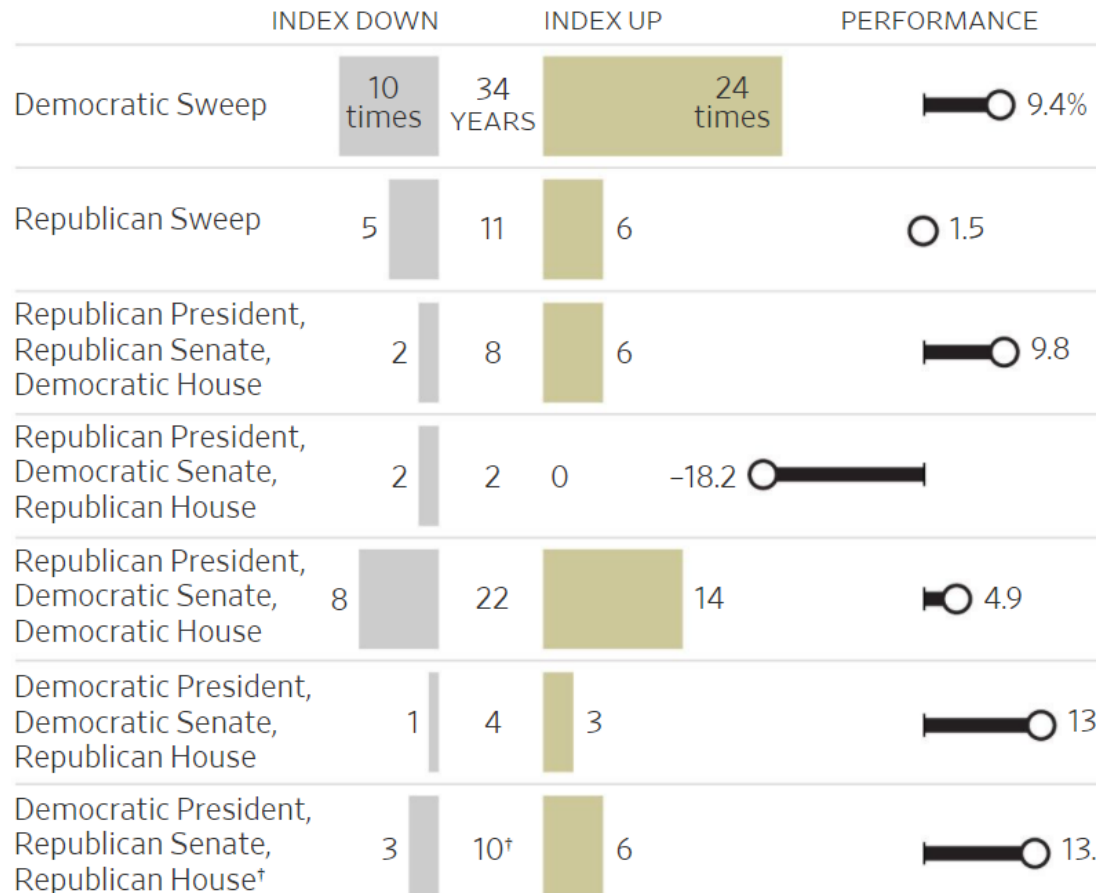
THE TACTICAL CASE FOR RISING
EQUITY MARKETS IN 2021





Historically, equity markets have been the strongest when the Democrats have been in power.

Performance of S&P 500 under Different Leaderships





The most likely outcome this time is a D president, a D-controlled House of Representatives but an R-controlled Senate. What does that imply?

- Markets do not like sudden and dramatic policy changes. A Republican majority in the Senate is the best insurance against that.
- With a very consensus-seeking Democrat in the Oval Office, and with the Republican Party likely to keep control of the Senate, the 'radical left' in the Democratic party is effectively powerless to make sweeping changes.
- A gridlocked Capitol Hill will probably force the Fed to provide more stimulus, which should further boost financial asset prices in the short run, but which will most likely also lead to more pain further down the road.



- In September, I recommended you focus on lowly correlated investment strategies in the years to come, so why this more bullish tone now?
- My recommendation was (and still is) founded on a view that equity returns will be much lower over the next ten years than they have been in the great equity bull market of the last 40 years.
- This month I am going to stick my neck out; despite an uninspiring long-term outlook, I believe equities could actually do quite well in 2021.
- That view is almost entirely dependent on the outcome of the ongoing vaccine race. There are two critical questions:
 1. *When will the first vaccine be available in volume?*
 2. *How effective will it be?*



If an effective vaccine is just around the corner (as we are led to believe), 2021 stands to be a good year for the global economy.

Global GDP Growth Forecasts

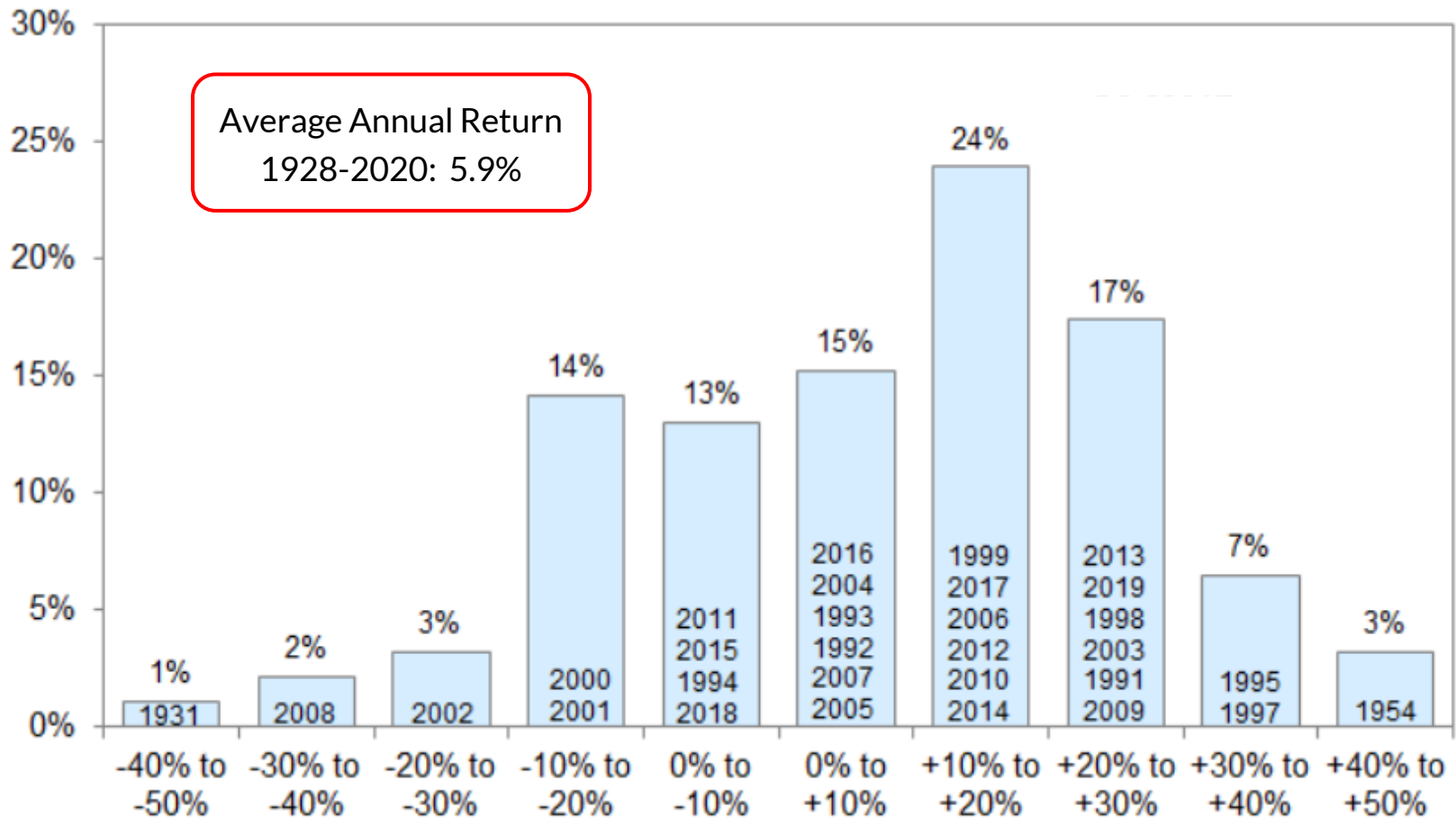
Goldman Sachs vs. Consensus

Real GDP Growth Percent Change yoy	2019	2020 (f)		2021 (f)		2022 (f)	
		GS	Consensus	GS	Consensus	GS	Consensus
US	2.2	-3.5	-3.9	5.3	3.8	3.8	2.8
Japan	0.7	-5.3	-5.6	3.3	2.5	2.0	1.5
Euro Area	1.3	-7.2	-7.7	5.3	5.2	4.3	2.6
Germany	0.6	-5.8	-5.8	3.7	4.4	4.2	2.7
France	1.5	-9.2	-9.5	7.0	6.6	4.7	2.7
Italy	0.3	-8.7	-9.8	6.0	5.5	3.6	2.6
Spain	2.0	-11.6	-12.0	7.1	6.4	6.4	4.3
UK	1.3	-10.5	-10.0	6.1	5.5	7.3	2.9
China	6.1	2.0	2.0	7.5	8.0	5.7	5.4
India	4.9	-8.9	-9.0	10.0	7.4	7.2	6.9
Russia	1.3	-4.0	-4.0	5.0	3.0	3.0	2.3
Brazil	1.1	-4.6	-5.2	4.0	3.5	2.9	2.5
World	3.0	-3.9	-4.0	6.0	5.2	4.6	3.7



Such powerful GDP growth should result in attractive equity returns next year.

Frequency of S&P 500 Calendar Year Returns Since 1928



Part 3

THE KEY RISKS TO MY 2021 OUTLOOK





RISK #1: Big Tech is in dangerous territory with retail investors accounting for much of the recent rise in tech stocks, and retail investors are always late to the party.

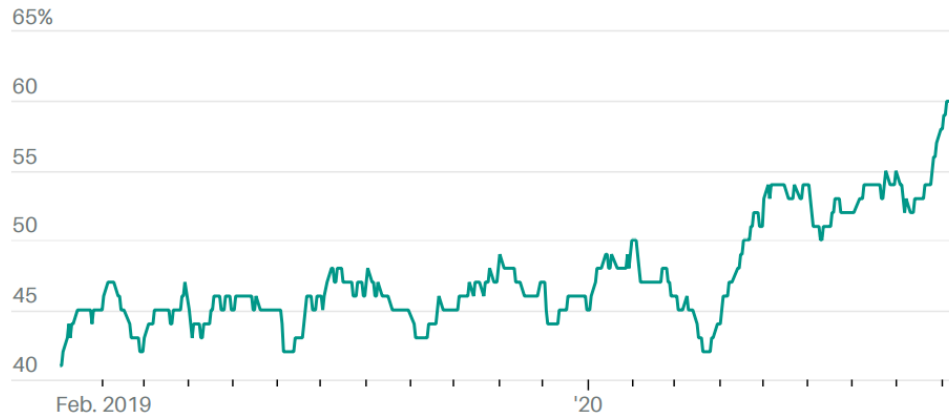
Flows in Global Tech, 2002-2020



Performance of Stocks Favoured by Retail Investors vs. Others



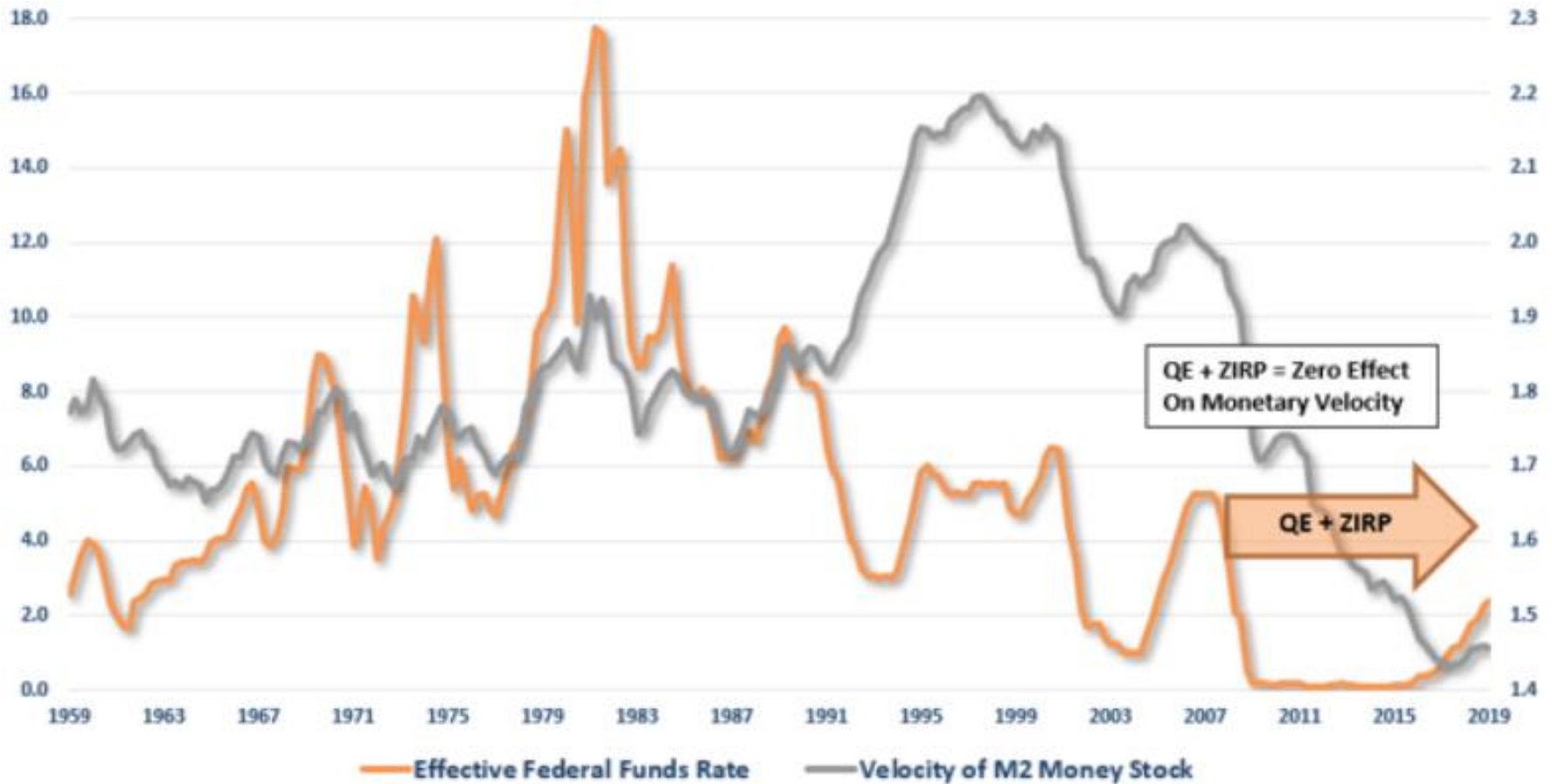
Percentage of Single-Stock Equity Option Volume with Less than Two Weeks to Expiration





RISK #2: Low interest rates will prevent economic growth from gaining momentum as low interest rates slow the velocity of money.

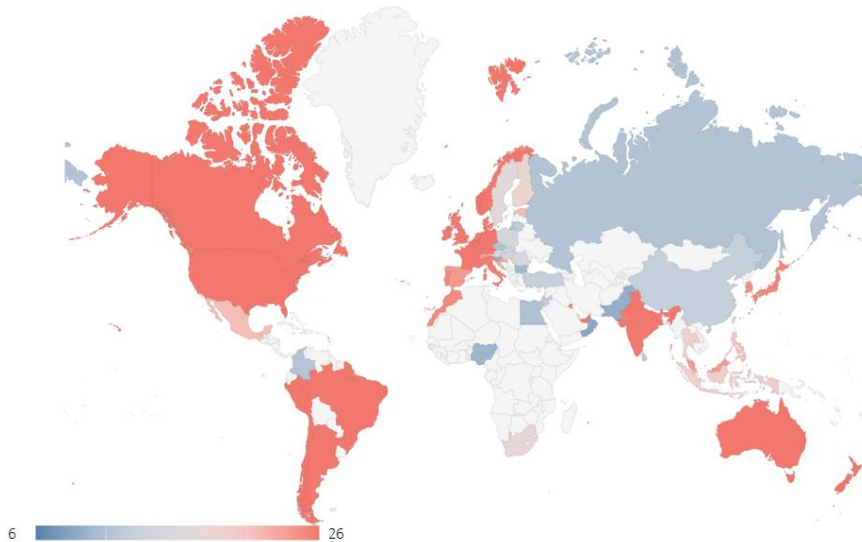
Fed Funds Rate vs. Velocity of US M2 Money Stock



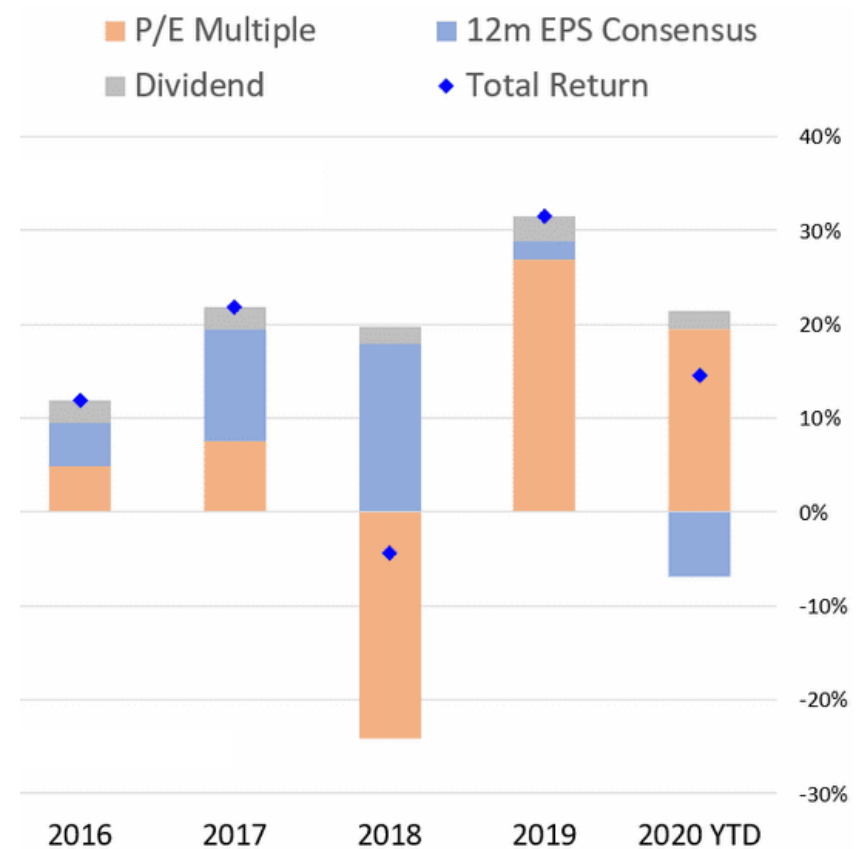


RISK #3: After nearly two years of exceptional equity returns, many equity markets around the world are now uncomfortably expensive.

Global Equity P/E Ratios



S&P 500 Total Return Attribution



(Risk #3 continued): Even on a cyclically-adjusted basis, the S&P500 looks very expensive.

S&P 500 CAPE Ratio Since 1881





(Risk #3 continued): The P/E you pay at the entry point is a very powerful driver of long-term equity returns.

Starting P/E multiple vs. ensuing 10-year US equity returns



Part 4

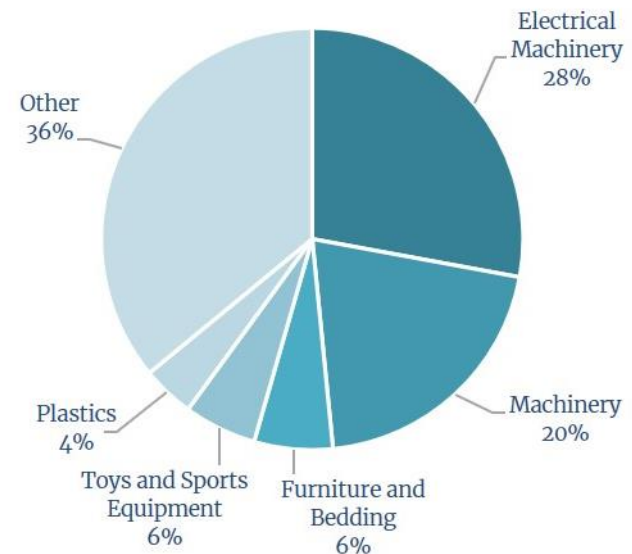
INVESTMENT OPPORTUNITIES



Investment opportunity #1: The forthcoming change in trade policy.

- The Biden administration will re-engage with WTO almost immediately.
- More pressure on Beijing to reform China's economic policy programme is likely, as Biden is under pressure from both sides of Congress to reduce the reliance on imports from China.
- Certain tariffs introduced by Trump (e.g. steel tariffs) will probably not be removed.
- Biden may feel he owes the Rust Belt a favour after they supported him, so machinery is an obvious target for higher tariffs.

US 2019 Imports of Goods from China by Industry



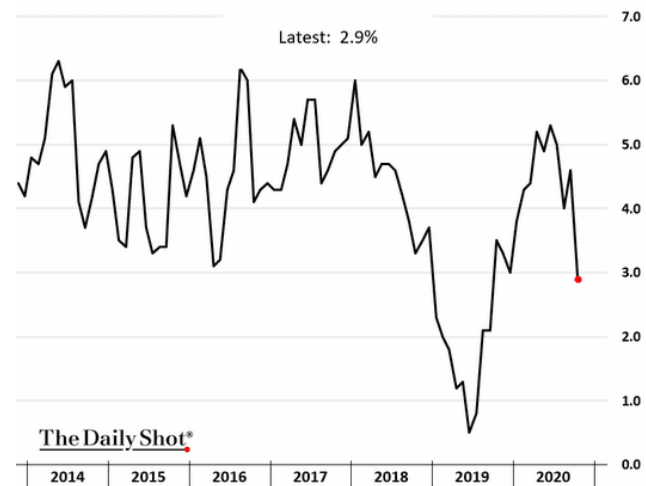
Investment opportunity #2: Affordable healthcare for everybody.

- Trump has largely dismantled the Affordable Care Act introduced by Barack Obama, but Biden will do everything in his power to resuscitate it.
- CPI on prescription drugs and hospital services are currently under pressure. Is that a tactical move by the industry?
- Do *not* invest in healthcare companies that depend on robust price increases every year to grow earnings. Biotech, for example, is likely to do much better under Democratic leadership.

US CPI on Prescription Drugs (YoY)

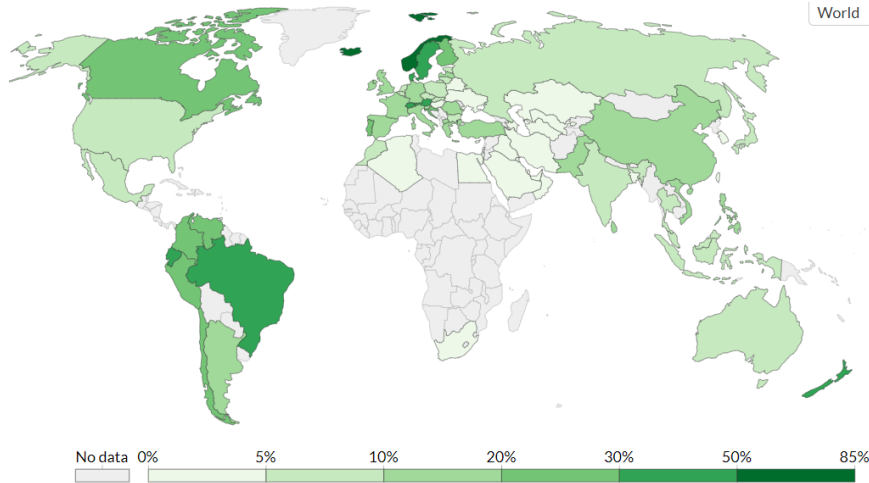


US CPI on Hospital Services (YoY)

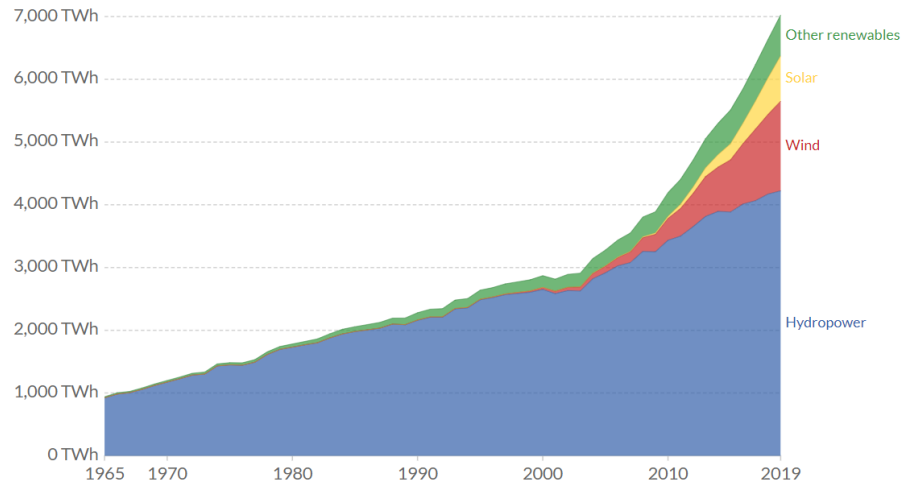


Investment opportunity #3: The Green Revolution.

Share of Primary Energy from Renewable Sources, 2019

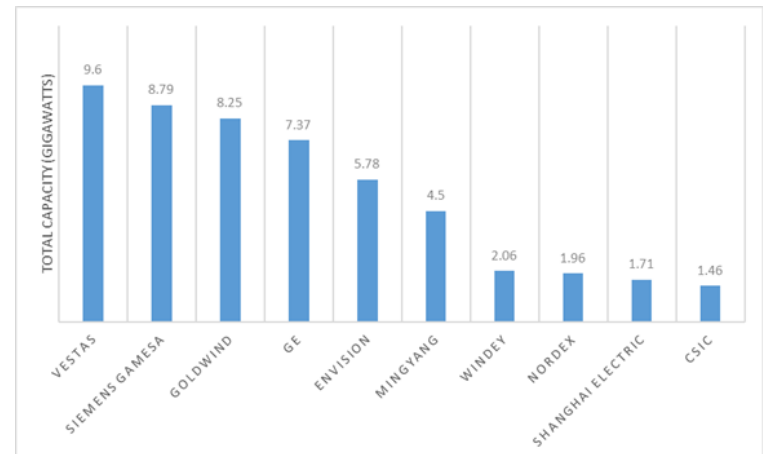


Type of Renewable Energy over Time



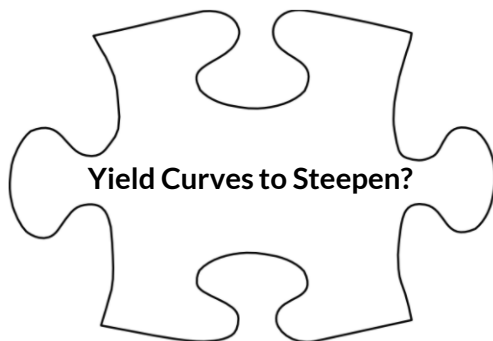
- From a carbon footprint point-of-view, wind is the most attractive primary energy form there is, so expect wind to continue to grow faster than solar.
- The global windmill market (ex. China) is dominated by Vestas, Siemens Gamesa and General Electric.
- With both Siemens Gamesa and General Electric having significant problems at present, Vestas has a unique opportunity to grow faster than its peers.

Top-10 Windmill Manufacturers





Other near-term investment opportunities.



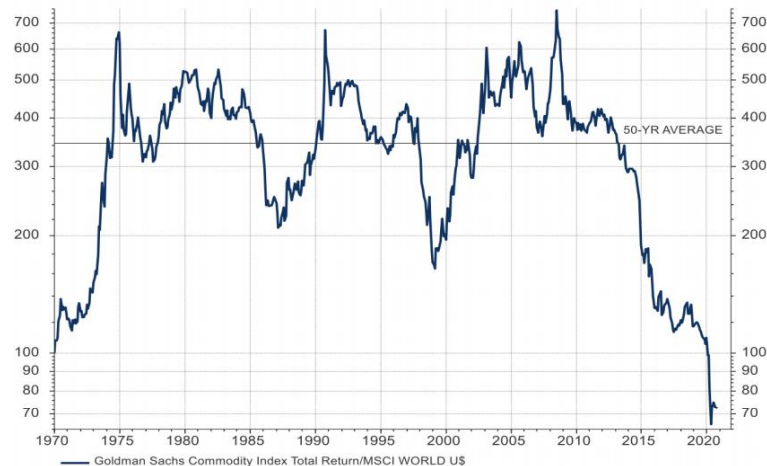
Don't think of gold as a hedge against inflation but against *an acceleration* in inflation. If you seek a hedge against inflation, look at industrial commodities instead.

US Consumer Price Inflation vs. Percentage Change in Gold Price



Gold now pricing in CPI~3.5%

GS Commodity Index Relative to MSCI World Equity Index



GS Commodity Index at a 50-year low!



Conclusions.

- At least in the short term, a gridlocked Capitol Hill will likely lead to more stimulus from the Fed, which will probably drive equity prices even higher. Therefore, from a tactical point of view, one should probably take more equity risk over the next few months.
- Having said that, equity valuations are topy (see slide 19 again) and, as we have learned over the years, long-term equity returns are negatively correlated with earnings multiples at the starting point (slide 20).
- Consequently, adding to equity risk at this point can only be justified from a tactical point of view. Long term, it will still most likely end in tears (but that is a 10-year view!).

Appendix

THE SIX MEGATRENDS



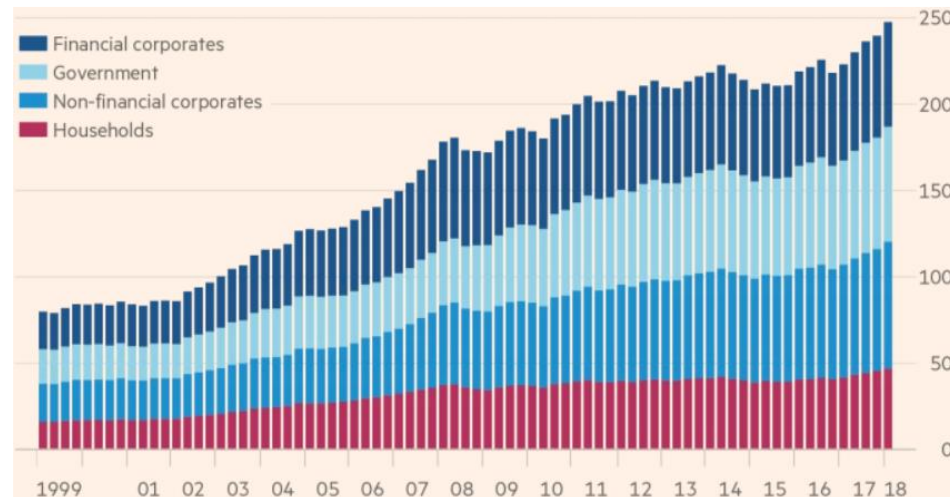
Megatrend #1

Last Stages of the Debt Supercycle



- In the early stages of a typical debt supercycle, GDP and debt grows 1:1, but that ratio deteriorates as the cycle matures. All prior debt supercycles have come to an end when GDP grows only \$0.20-0.25 for every dollar of added debt. China is now at 0.21 and the US at 0.28.
- The fact that Δ Productivity and Δ GDP are both struggling to gain momentum at present are powerful indications that we are fast approaching the end of the current debt supercycle.

Total Global Debt (\$Tn)

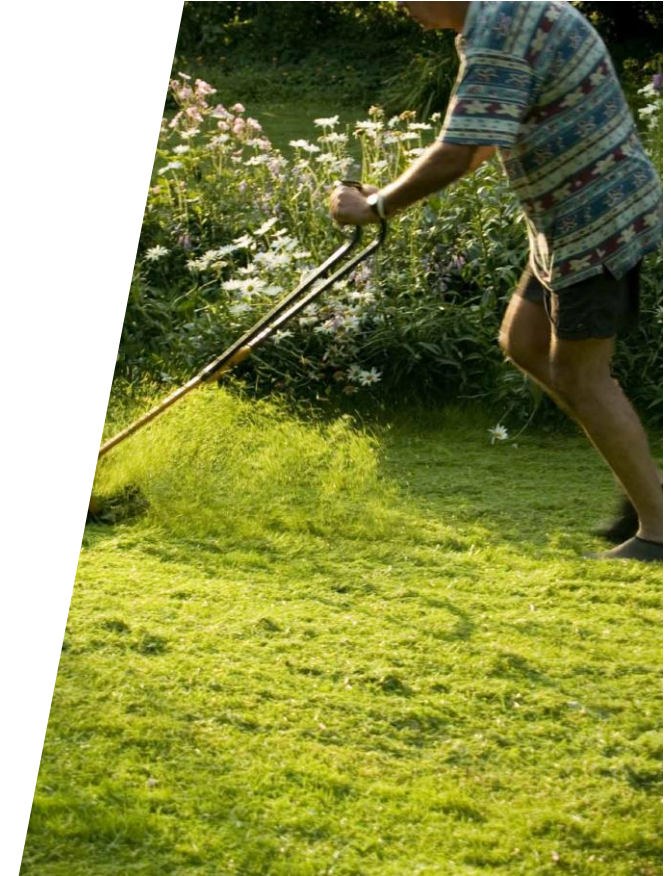
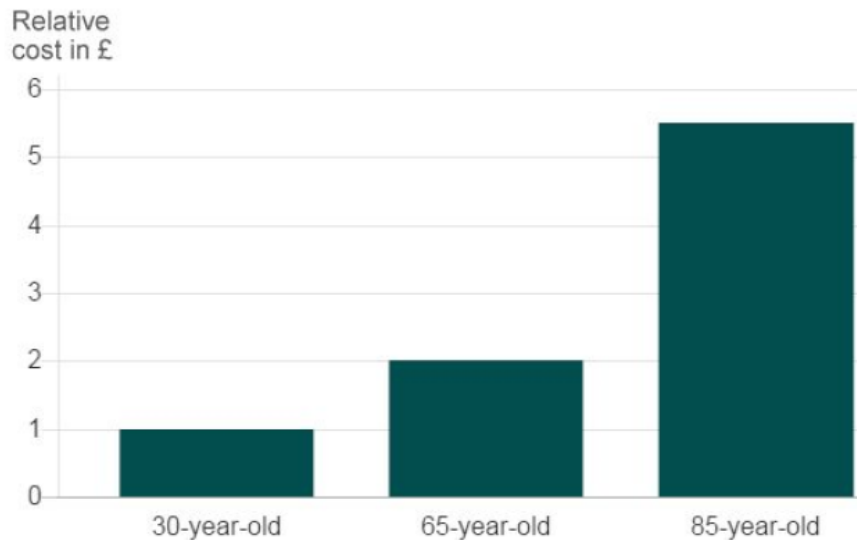


Megatrend #2

Changing Demographics

- 150 million OECD workers will retire between now and 2050.
- Servicing the elderly is extremely costly. According to the NHS, servicing a man in his mid-80s is 5-6 times more expensive than servicing a man at the age of 30 (see below).

NHS Spending on People by Age



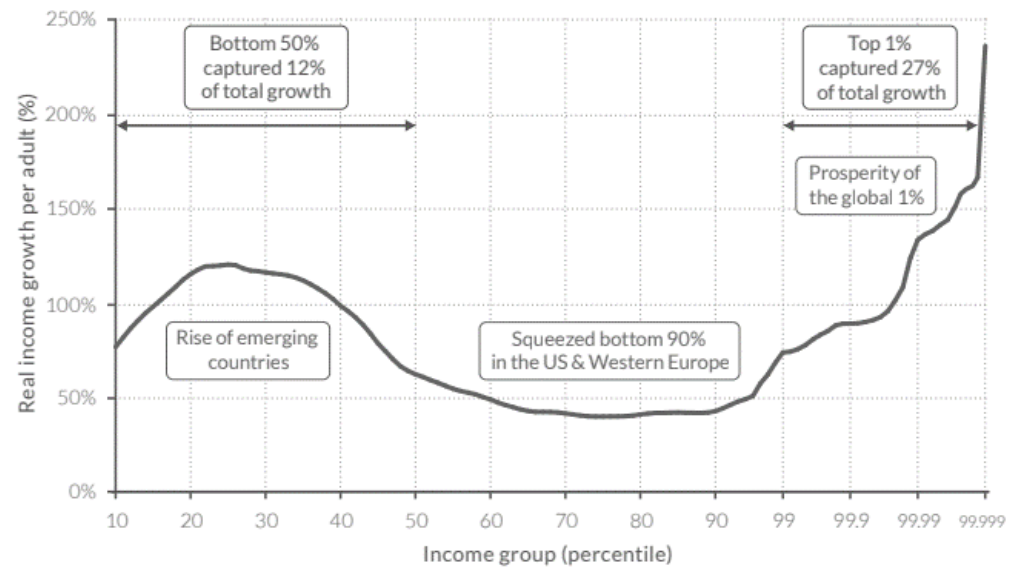
Megatrend #3

The Rising Gap between Rich and Poor

- Workers in many countries have not experienced any meaningful growth in real wages for years.
- Low or no real wage growth negatively affects aggregate demand and partly explains why GDP growth is so low everywhere.



Global Inequality



Megatrend #4

Rise of the East

- In PPP terms, China has more middle class families now than the US.
- The first thing people spend more money on when living standards rise is more and better quality food – almost always more protein-rich food.
- One should seek exposure to the phenomenal growth in the Chinese economy without being exposed to the over-leveraged financial system in China.



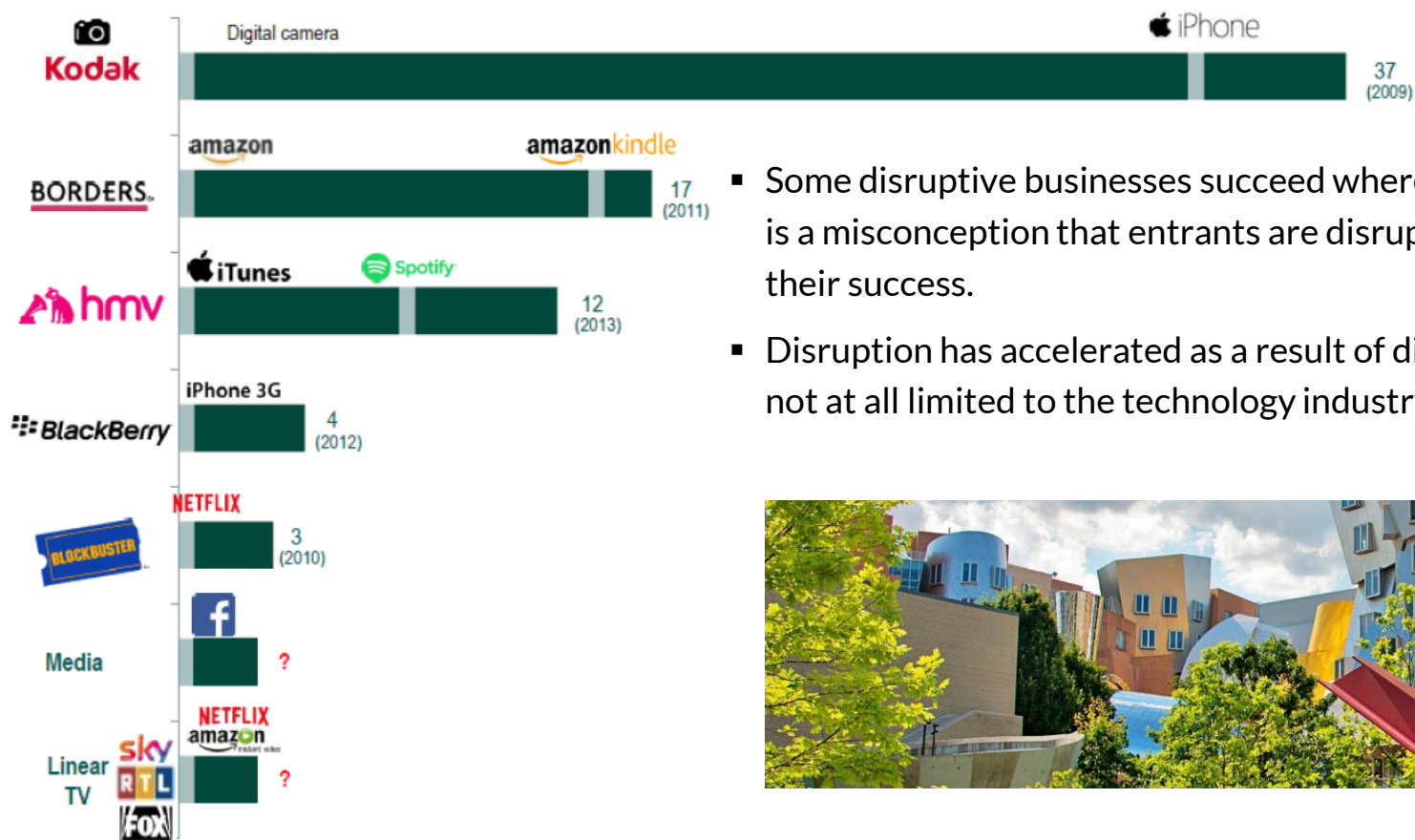
Chinese GDP Catch-Up under Various Assumptions

		Annual Chinese GDP Growth		
		3.00%	5.00%	7.00%
Annual	1.00%	2047	2032	2027
US GDP	1.50%	2057	2034	2028
Growth	2.50%	n/a	2041	2030

Megatrend #5

The Era of Disruption

No. of Years to Disrupt Incumbent's Businesses



- Some disruptive businesses succeed whereas others don't; it is a misconception that entrants are disruptive by virtue of their success.
- Disruption has accelerated as a result of digitisation, but it is not at all limited to the technology industry.

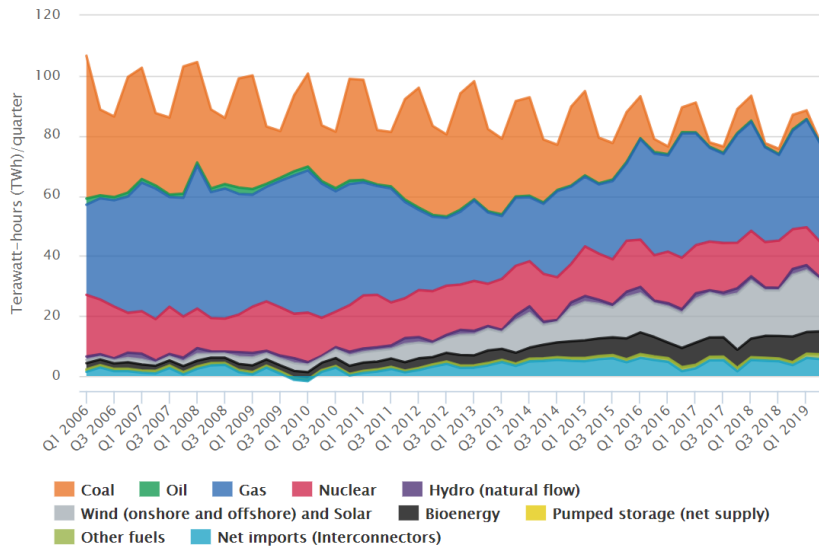


Megatrend #6

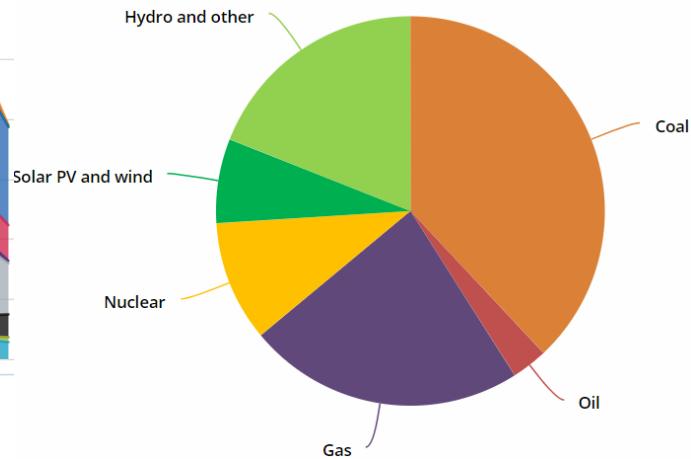
Climate Change

- The fight against global warming will drive governments all over the world to electrify most transportation and heating, dramatically reduce demand for fossil fuels.
- Food production must rise 60% in the next 20 years, and food production accounts for nearly 70% of all freshwater consumption globally. With the climate change doing damage to our water supplies, how will this pan out?

UK Fuel Mix in Electricity Generation



Global Fuel Mix (2018)



... and the aggregate result of those six megatrends

Mean Reversion of Wealth-to-GDP

- Asset prices have grown much faster than GDP since the mid 1980s and, in the long run, one *cannot* outgrow the other.
- Every single time wealth has deviated meaningfully from its long-term mean value, it has regressed to the mean, and US wealth is now 545% of US nominal GDP against a long-term mean value of 380%.



Total US Household Wealth-to-GDP since 1950





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