

31 Dec 2020

10 Predictions

2021:

The world improves, but do markets already know?

2020 RECAP:

2020 will go down in history as a year we all wish we could forget, but never will. The unprecedented coronavirus pandemic changed everything. While the economic and earnings recession was short but deep, the humanitarian crisis remains devastating. The U.S. alone has already seen more than 15 million cases (over 75 million globally) and 300,000 fatalities (over 1.5 million globally). Around the world, global GDP has declined by \$10 trillion, and in April alone more workers lost their jobs than gained jobs in the 10 years following the Great Recession. The pandemic has also left what may be permanent scars on many service industries.

For the first time in the 30 years we have been issuing our annual 10 Predictions, we developed a second “revised” set in April to reflect how much the world had changed. And yet, on the day the stock market bottomed, our March 23 weekly investment commentary noted, “technical factors suggest stocks are bottoming. The number of new lows has been very high, put/call ratios are at extremes, volatility appears to have peaked and forced selling by leveraged hedge funds and risk parity funds may be exhausted.”

After making an all-time high on February 19, stocks collapsed 35% by March 23, making it the quickest and sharpest bear market in modern history. From there, thanks to extremely aggressive global monetary and a number of fiscal “whatever it takes” policy responses, stocks climbed nearly 70%, resulting in yet another double-digit annual percentage gain for the S&P 500 Index. For the first two-thirds of the year, U.S., large-cap and growth stocks outperformed non-U.S., small-cap and value stocks. For the rest of the year, however, the latter group outperformed. Political division was rampant in 2020, leading to a bitter November election with Joe Biden being elected over incumbent Donald Trump. Perhaps the year’s biggest miracle was the development of COVID-19 vaccines in just a few months, compared to a more normal period of years.

We enter 2021 with investor optimism running high and equities discounting a lot of good news, raising the question as to whether 2020 has already “borrowed” some of 2021’s returns. With this backdrop, we unveil our best educated guesses for 2021 forecasts in the form of our 10 Predictions.



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Bob Doll serves as a leading member of the equities investing team for Nuveen, providing reasoned analysis through equity portfolio management and ongoing market commentary on behalf of Nuveen’s Equity Investment Council.

2021 10 Predictions

1	U.S. real GDP increases at its fastest pace in twenty years.
2	Inflation approaches 2% as the 10-year U.S. Treasury yield reaches 1.5%.
3	The U.S. dollar sinks to a five-year low.
4	Stocks reach a new high for the twelfth consecutive year, but fail to keep pace with strong earnings growth.
5	Stocks outperform cash, but cash outperforms Treasury bonds for the first time since 2013.
6	Value, small and non-U.S. stocks (especially EM) outperform growth, big and U.S. stocks.
7	Health care and financials outperform energy and utilities.
8	U.S. federal debt rises to more than 100% of GDP on its way to an all-time high.
9	The U.S./China cold war continues, but the conversation becomes quieter and more multilateral.
10	Despite polarization, President Biden, Sen. McConnell and moderate forces achieve some compromise legislation.

2021 OUTLOOK

Our 2021 theme is, “The world improves, but do markets already know?” This reflects a somewhat divided outlook between the global economy and our market outlook. Investors have grown increasingly bullish as the market has reached new highs, and extreme sentiment readings could represent a near-term risk for equities. But, in general, as the population gets inoculated and large parts of the economy reopen, a virtuous cycle of increasing consumer and business confidence should boost GDP and provide for strong corporate profit growth.

KEY INVESTMENT QUESTIONS FOR 2021

- 1 How long will economic normalization take?
- 2 Will inflation and interest rates move higher gradually or more abruptly?
- 3 Will the Fed move away from “rates are zero forever”?
- 4 Can earnings exceed expectations?
- 5 Can stock valuation levels stay high/move higher?
- 6 Will the U.S. dollar decline further, finally passing the baton to non-U.S. markets?
- 7 Will technology stocks outperform yet again?
- 8 Will the U.S./China cold war remain calm?
- 9 Will geopolitical hot spots erupt?
- 10 Will a divided government get much done?

This backdrop should be a positive for equity markets. Stocks should get a boost from an economic recovery combined with continued hyper-accommodative monetary policy, fiscal support for households and businesses and negative real returns on government bonds. We also expect the exuberance will lead to modest increases in inflation and interest rates further out the Treasury yield curve, causing stocks to rise, but also to underperform strong earnings growth.

This calls for an environment where stock market performance will no longer be driven by P/E valuations, but instead by earnings. Economic and earnings growth will undoubtedly be strong over the next year or two. The passing of the leadership baton will likely be an uneven

shift from growth, big and U.S. stocks to value, small and non-U.S. stocks. Perhaps the biggest near-term risk to the financial markets is a larger-than-anticipated increase in inflation and interest rates. Will the debt/deficit picture for the U.S. cause problems for the dollar? Will a divided government accomplish much? And how will a Biden administration deal with an ambitious China? These are the big questions in our view. Hopefully, earnings growth from a continued reopening of the economy powered by vaccinations will keep stocks rising in 2021.

Longer-term returns for financial assets are likely to be more challenging in the coming decade. With high starting valuation levels for stocks and bonds, a normalization process is likely in the years ahead, limiting longer-term returns. Security selection within most asset classes will likely become more important. And alternative assets will likely contribute to returns as they provide risk-reduction properties. Meeting long-term portfolio return objectives will prove challenging.

KEY THEMES FOR 2021

The economy

- *The U.S. and global economies should move from a recovery to an expansion phase once vaccines are widely available and the economy can reopen.*
- *With the Fed remaining ultra-accommodative, inflation and interest rates could rise modestly.*
- *The U.S. and global political environment grows more fractious and creates financial market headline risks, but shouldn't derail economic growth.*

The markets

- *Corporate earnings should be strong in 2021, and we expect stock prices to advance modestly.*
- *Equity market leadership could shift toward value, small and non-U.S. stocks.*
- *Long-term returns across asset classes could be lower than many expect, which will require diligent research and careful selectivity.*

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Endnotes

Sources

All market data from Bloomberg, Morningstar and FactSet

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