Quarterly Market Letter

December 2020

A Happy New Year?

Macroeconomic Developments

Looking through the recovery: Growth expected to roar back in 2021… but not inflation. A China-led recovery, improving global cycle and ample liquidity are a powerful mix that gives support to Emerging Markets.

- 2020 was the year we lived in danger, but Wall Street set records. The rapid recovery in the global economy owes in large part to policy support from China. China fiscal policy boosted GDP by close to 5 percentage points this year and was amplified by an equally impressive degree of monetary accommodation. What awaits us in 2021? The interesting questions about 2021 are not whether growth and inflation will rise. Regarding growth, the question is, following such an unusual, services-driven recession, what will recovery look like? Investors are anticipating further stimulus while keeping a close eye on the rollout of vaccination programs (According to FactSet[1] U.S. equity investors expect the S&P index to gain 10% this year, targeting the 4,000 level). Continued support from central banks and optimism that coronavirus vaccine developments will sustain a global economic recovery have fueled a rush to riskier assets, sending developing-nation stocks, currencies and bonds to six straight weeks of gains. Regarding inflation, the question is whether the rise in inflation will be temporary, and **whether low neutral policy rates will persist.**

- Some **certainties:** vaccination has begun, although the road to herd immunity is likely to prove more challenging than expected[2]; the U.S. presidential race was resolved, Trump gave the green light to the extra aid package to deal with the COVID-19 and to finance the government; and Brexit will have a deal behind it. The Federal Reserve is going to maintain its accommodation throughout 2021. We know Biden´s New Deal will probably only start to have an impact from the second half of the year.
- **Democrats prevail in the battle of Georgia.** Control of Congress is within their reach. A stock market runaway was feared, however,

[1] FactSet Research, Earnings Insight, January 8, 2021

[2] Until it is proven that the vaccine not only protects the vaccinated person, but also additional asymptomatic spread, many assumptions could prove too optimistic

the Dow Jones and the S&P 500 set new records. What is the reading? There will be more fiscal stimulus and it will be on the streets sooner. A Congress controlled by the Democrats would open the floodgates for all kinds of spending programs. Biden's promise to America could more easily be fulfilled. Fed chair Jay Powell and former Fed chair and incoming Treasury secretary Janet Yellen would collaborate like hand-in-glove and, for probably the first time, truly channel newly created funds into the real economy and put America back to work, instead of having excess liquidity slosh around the financial system and drive asset prices ever more into the stratosphere. If Biden were to get the economy into sustainable gear again while the Fed manufactures a further depressed yield curve, a stock market correction could well be short-lived and equity prices quickly return to the prospect of improving fundamentals again. **Technology stocks** – especially the largest Big Tech – may suffer more taxes and/or more regulation.

- **Market conditions indicate Yield curve will be steep. The 10-year rate** has already crossed the 1% threshold and the Fed, in principle, will stand put. The profit margin of commercial banks, in their traditional activity, is mounted on this "carry trade". The 10-year UST yield surpassed 1% for the first time since March 2020 in reaction to the outcome of the Georgia election, which secured Democrats a tiny majority in the U.S. senate.

- No calm for **EM bond inflows**. Flows into local- and hard-currency funds both contributed to the strong EM fixed income inflows. The cyclical recovery will continue to support emerging market currencies at the expense of the traditional safe haven of the U.S. dollar, which has been in almost continual decline in recent months. EM capital flows were weak during most of last year; the lagged impact of global liquidity and a better growth outlook will likely maintain solid inflows earlier in the new year. Likewise, positioning in local currency assets does not look that crowded.

- A **second wave** of infection is triggering additional lockdowns and likely output declines. Economic weakness might persist until vaccines are widely available. Continued monitoring, and if necessary, support is critical to maintain lending to the real economy as the COVID-19 crisis unfolds. The news about effective vaccines has improved the global economic outlook.

- **The U.S. dollar depreciation** has been especially noticeable vis-à-vis the Chinese currency. There is a consensus call for the dollar to depreciate entering 2021 despite its reserve currency status and the lack of viable alternatives.

- **U.S. Jobless claims have been rising** against previous and better forecasts. The economy lost 140,000 jobs in December, the first job loss since April, as the unemployment rate remains at 6.7%.[3] Retail sales have gone from flat in October to decline in November, and December will almost certainly be in the red as well. **U.S. debt levels** are projected to hit WWII peaks by the end of 2021. The projected 2020 U.S. fiscal deficit is 16% of GDP, the largest deficit since 1945. In July 2020, the CBO projected the 2021 deficit at 8.6% (between 1946 and 2019, the deficit was only larger twice). Updated deficit forecasts for 2021 require assumptions on growth, the latest stimulus bill and the interplay between the

[3] Twitter, The Spectator Index, January 8 2021

two; our sense is that the deficit will exceed 10% of GDP in 2021. On top of such deficits, Biden's tax and spending proposals entail another $3 trillion in taxes and another $8 trillion in spending over the next decade, which would drive the U.S. federal debt to even higher levels.[4] Investors pay close attention to corporate taxation; its decline since the 1980's has been a key driver of expanding S&P 500 profit margins. Biden's agenda doesn't just increase corporate tax rates; the plan also includes base broadening and a wide range of industry-specific taxes.

- President Trump signed a $900 billion stimulus bill that includes $600 stimulus checks and an extension of the Paycheck Protection Program and unemployment benefits.
- **Central banks maintained their accommodative stance** as the second wave of COVID-19 arrived. With continued central bank support, government bond yields in major advanced economies remained unusually low. Long-term U.S. yields continued the upward trend started after the Treasury's August announcement of another increase in long-term bond issuances. Investors seemed to be expecting further policy easing on the back of low inflation and a weak economic outlook. **The total of global negative-yielding sovereign debt reached a ⅓ of developed countries sovereign debt, and 75% if negative in real terms.** This intensified search for yield.
- **Regional Comprehensive Economic Partnership (RECP):** Ongoing opening up of its capital markets and currency flexibility should continue to position China as a regional anchor. RCEP adds to the deepening of regionalization. The upshot is that the global and regional integration looks to be moving further ahead with the adoption of the RCEP following its initial negotiations in 2012. The signatories include the 10 members of ASEAN (Brunei-Darussalam, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam) and five regional countries with which ASEAN has existing free trade agreements (Australia, China, Japan, South Korea, and New Zealand). Although India has not signed the RCEP, a fast track accession process has been established should India wish to re-join the RCEP in the future. While the RCEP is expected to eliminate a range of tariffs and reduce non-tariff barriers on imports, there is potential for greater inroads for intellectual property, telecommunications, financial services, e-commerce and professional services. This could catalyze the broader standardization of cross border services, including payments over the medium term. The other potential benefit of the RCEP is the broader realignment of supply chains, under the streamlining of the "Rules of Origin" (ROO) provision.
- UK and EU negotiators have reached agreement on a trade deal to be applied as of January 1st 2021, after the post-**Brexit** transition period ends. The text of the deal has not yet been released, but it includes tariff-free and quota-free goods trade, but no provision for financial services.

Global Drivers

Global Growth

The prospect of a rebound in the global economy has fueled optimism despite the economic damage from the pandemic. Retail investors led the dramatic equity market recovery from the

[4] JP Morgan, Eye on the Market Outlook 2021, January 1, 2021

COVID-19 shock. But now they are increasingly joined by the investment industry's heavyweights, which are helping reinforce and broaden out the most remarkable bull run in financial history. Per the Financial Times, the MSCI All-Country World index climbed another 12.33% in November — its best month on record — to touch new all-time highs. It has become what some analysts have termed an "everything rally", with junk bonds, copper, oil and even bitcoin climbing sharply. The only major markets to have taken a hit are classic havens, such as U.S. Treasuries and gold. The backdrop to such a frenzy seems improbable. The second coronavirus wave is unravelling some of the tentative economic recovery from the brutal March shock. All told, the global economy is likely to shrink 4.4 % in 2020, according to the IMF. Effective vaccines could eventually suppress COVID-19, but for now it continues to linger and the monstrous damage it has already inflicted will take a long time to heal. Financial markets are forward-looking, and will probably be able to shrug off a tricky few months by focusing on the brighter outlook for 2021. The IMF has penciled in a 5.2 % expansion for the global economy in 2021. But with an economic recovery already factored into stock markets, even a modest disappointment next year might upset markets. The scale of the shock caused by the pandemic may make the usual GDP data misleading: 2021 is likely to see one of the fastest rates of global GDP growth on record, but this needs to be viewed in the context of the huge slump in GDP in 2020. The correct way to intercept the recovery is to focus on levels of output.

Monetary Policy Outlook

The Federal Reserve committed to providing all the liquidity needed to restore stability in the financial markets. The FOMC (Federal Open Market Committee) has set a high bar for any prospective increase in its benchmark interest rate, and the so-called dots (the FOMC's projection of the fed funds rate over the forecast period) are expected to show that no rate hike is expected until 2023. Investors are correct in assuming the Federal Reserve will maintain its accommodative monetary policy through 2021 so no surprises are likely. Government bond yields remain unusually low on the back of supportive monetary policy, sustaining a search-for-yield environment. The U.S. dollar weakened overall, particularly after the news on vaccine progress. The FOMC doesn't expect to succeed in getting inflation above 2.0% in the next 3 years, after holding below 2.0% for much of the last decade. For the long term (whatever that means), every FOMC member thinks the funds rate will eventually reach 2.0% with a majority estimating that the funds rate will top at 2.50% during the current business expansion. The FOMC provided its quarterly projections for GDP, the Unemployment rate, and PCE and PCE Core inflation for 2021, 2022, 2023, and the longer run.

Percent

Variable	Median[1]				
	2020	2021	2022	2023	Longer run
Change in real GDP	-2.4	4.2	3.2	2.4	1.8
September projection	-3.7	4.0	3.0	2.5	1.9
Unemployment rate	6.7	5.0	4.2	3.7	4.1
September projection	7.6	5.5	4.6	4.0	4.1
PCE inflation	1.2	1.8	1.9	2.0	2.0
September projection	1.2	1.7	1.8	2.0	2.0
Core PCE inflation[4]	1.4	1.8	1.9	2.0	
September projection	1.5	1.7	1.8	2.0	

Source: The Federal Reserve

The minutes of the FOMC meeting, which concluded on 16th December, reveal that Fed officials were in no rush to change either the monthly pace or the composition of the large-scale asset purchases. Only a "couple" of participants were "open to" skewing the purchases toward the long end of the curve.

Officials acknowledged that the "recovery thus far had been stronger than anticipated"... "but viewed the more recent indicators as signaling that the pace of recovery had slowed." On the upside, however, "the positive vaccine news received over the intermeeting period was viewed as favorable for the medium-term economic outlook." The high frequency data has deteriorated since that mid-December meeting. But Congress also agreed on a $900bn stimulus, which could be expanded now that the Democrats won control of the Senate too. That additional fiscal stimulus will ease the pressure to provide more monetary accommodation. All participants agreed to adopt the qualitative guidance that the asset purchases would continue "until substantial further progress" has been made in achieving the Fed's full employment and price stability goals. Unfortunately, the minutes do little to tie down what that actually means in practice, offering only that "this judgment would be broad, qualitative, and not based on specific numerical criteria or thresholds." At least, according to the minutes, participants want to provide the markets with updates on the perceived progress toward those goals "well in advance" of the time when a change in the pace of purchases would be required. In addition, once they judged that this mysterious "substantial further progress" had been achieved, that would trigger a "gradual taper'' resembling what happened in 2013 and 2014.

Is i**nflation** returning? For the better part of a decade, the Fed was wrong about where the economy was going as it consistently overestimated inflation risks, the strength of the recovery and the path of future policy rates. After a decade of forecasting futility, the Fed will wait to see a four-alarm fire of inflation before raising rates. Other central banks will likely take the same approach; output gaps, which measure unused labor and industrial capacity, are large everywhere but China. The U.S. manufacturing ISM shows a sharp jump in the input price index. Inflation, which has been below 2% for years, should rise; it is what central bankers want. The Fed has already said that it will accept it above 2%.[5] The key is that long-term inflation expectations do not lose the 2% anchor. The likely scenario: more activity, more stimulus, the rapid fall of the dollar, a rapid transmission towards the prices of raw materials, and central banks on the sidelines.

U.S. – What will happen to the promised tax hike in Biden's original campaign agenda? Not so soon. Many questions require 60% of the vote. And on tough issues, Democrats aren't sure to give perfect attendance. To pass laws you will have to negotiate and convince people on both sides of the aisle. Nothing new for Biden. It's what it has done for more than 36 years in Washington. Georgia gives him a stronger position. Those that are more "saleable" will come out.

Commodities

With the majority of investors expecting additional weakness in the Dollar and a significant rebound in the global economy in 2021, commodities are expected to benefit. Some of this optimism is built on the performances in many commodities in 2020. Iron ore and copper prices are at seven-year highs, oil prices are rising too, after hitting multi-decade lows. The rise is supported by mainland China's metals- intensive stimulus, global vaccine optimism and low interest rates. An upswing in

[5] Federalreserve.gov, Press Release: Federal Reserve issues FOMC statement, November 5, 2020

[6] FAO.Org, World Food Situation, Food Prices Index

commodity prices appears to be well supported. Food prices are at 3-year highs.[6] The housing market has been strong in the U.S. and lumber prices have soared.

Energy: Global oil demand is rebounding after hitting a short term trough. Crude remains strong on OPEC+ intervention and constructive EIA report. OPEC+ agrees on only a 75kbd supply increase for Feb/Mar. Bigger news is the 1mbd voluntary cut from Saudi Arabia, which should help offset demand effects of latest lockdowns. This news skews the risks to USD50/b 2021e Brent price assumption to the upside.[7]

EM Investment Outlook

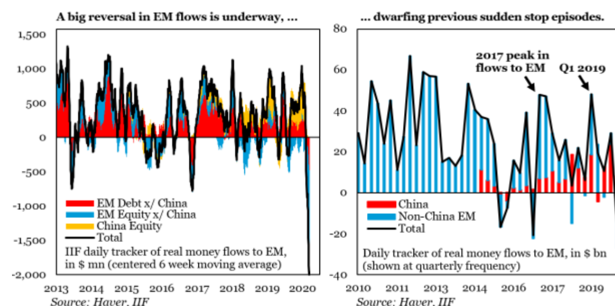
In love with Emerging Market Equities

Sentiment towards EM Economies improved. China-led recovery and weak USD mean a great scenario for commodities as well as for, high-carry EMFX from producer countries such as the Mexican peso, South African rand and Brazilian real. One of the reasons so many fund managers like EM equities is their expectation that the Dollar will decline more in 2021.

Emerging markets offer value:

- Improved external accounts, because of a reduction in imports to emerging market countries during the pandemic,
- Undervalued currencies.
- Lower equity valuations.

The past few years have been difficult for EM equity investors: China growth slowdown, commodity price collapse, U.S. trade tensions, COVID-19, etc. However, as COVID-19 risks subside, EM recoveries are underway, U.S. real interest rates remain low, China is recovering rapidly and many EM economies are running simulative policies as well. One striking observation from the latest EM goods trade data is that exports have continued to rebound faster than imports, causing trade positions to improve further. While EM valuations are fairly stretched, they remain more in check than those in developed markets.



Earnings set to rebound, but a lot of good news is already priced in. We still think the future looks bright for EM assets: Risky assets have continued to rally, but we do not think this reflects excessive optimism. Value assets could rally further still. Theoretically, faster inflation benefits stocks at the expense of nominal bonds. Inflation erodes the value of bond coupons, while lower real yields flatter price/earnings ratios by reducing the discount rate. Company earnings should also be relatively inflation-proof.

Risks

- **The stock market growth sector seems priced for perfection:** With the S&P 500 trading above 3700 it is sporting a forward P/E of 22.00 which is the second most expensive level since 1929. The Federal Reserve's extraordinary monetary accommodation and negative real interest rate policy coupled with unprecedented fiscal stimulus has created a one-way mentality for call option traders and stock investors in the extreme. Whether it is called a Mania or a Bubble doesn't matter to those who believe monetary policy is a form of immunization from any negative news. As long

[7] HSBC, Macro Matters – Americas 06 January 2021

as momentum remains positive, this 'investment strategy' will continue to work. Investors are completely onboard assuming that vaccinations will proceed without any meaningful issues and herd immunity will be achieved by mid-year. How quickly and effectively the situation can be brought under control going into the year? Joe Biden said, it will be a long and dark winter still, before we will spot that light at the end of the tunnel. The distribution of the vaccines will be more difficult in many EM countries.

- A second risk is the **early rollback** of the fiscal and monetary largesse which has sustained markets over the past year. Following an aggressive easing cycle last year, EM's risk premium cushion is very low (if not negative in terms of real rates), leaving it vulnerable to any premature pullback in global liquidity. Even a slight repricing for the first Fed rate hike in the market and/or an unexpected rise in DM rates could easily send ripples across EM. Should additional policy support from EM economies be needed, the unprecedentedly loose monetary conditions leave little room for maneuver, while fiscal financing needs and debt service ratios will remain elevated.
- **Dollar "gloom and doom" in fashion:** The dollar fall versus EM is good, as it reflects big capital inflows & looser EM financial conditions. It's fall vs G10 is harmful, as core inflation in the Euro zone & Japan is lower than the U.S. The dollar fall may be destabilizing.
- Global Leverage: Policies implemented encourage increased risk-taking, and they may have, if unintentionally, increased medium- and long-run macro-financial vulnerabilities. COVID-19 has left borrowing at all-time highs. Early in the pandemic, it became clear that the global economy would require a massive extension of public and private debt to avoid an extraordinarily deep and persistent depression. Because this unprecedented explosion in debt provided a "bridge" over the collapse in world output, corporate bankruptcies and economic hardship for households have been significantly mitigated. In light of the progress on vaccines, investors can be more confident that the end of the debt bridge is in sight. Nevertheless, this year's surge in borrowing has been called the largest wave in a great "debt tsunami". The Institute of International Finance recently reported that the ratio of global debt to gross domestic product will rise from 320% in 2019 to a record 365% in 2020. Macroeconomic conditions offer some support for higher debt ratios. The forces of secular stagnation have created a further excess of global savings over investment, reducing equilibrium real interest rates and inflation. This has encouraged central banks in advanced economies to purchase about 63% of the rise in their government debt, mitigating the risks of funding crises. Market-maker of last resort functions have prevented liquidity problems that would otherwise have tightened global financial conditions. These actions have made debt crises far less likely. The immediate provision of large-scale dollar swaps to emerging economies has reduced the severity of dollar shortages. Many emerging market central banks have started their own quantitative easing, despite weakening currencies that might trigger inflation. The Fed has also provided direct lending to corporates, state and local governments, and households, supported by capital injections from the U.S. Treasury. China has also been a dominant contributor to the 2020 debt surge, and the authorities are trying to dampen a property boom by restricting credit growth, thus

slowing the expansion in GDP. Other EM debt is clearly a potential problem, especially in the low-income group. A far more dangerous, systemic debt crisis probably requires a reversal of secular stagnation, and a rise in world inflation, forcing the Fed to tighten monetary policy significantly. Luckily, that still seems a very long way off.

- The main risk for U.S. bond markets, and global markets generally, is a **return of inflation**. Equity prices and real estate prices are already increasing. U.S. money supply growth is currently a record 24%. What is missing is signs of inflation in goods and labour markets given wide output gaps and relatively high unemployment rates. Demand for Treasury inflation-protected securities has surged. One thing seems certain is that the Fed, is unlikely to tighten policy at the first sign of inflation. If anything, Fed Chair Powell has made it clear that the Fed remains accommodative. Against this background, one might wonder why further or extended monetary accommodation is needed – especially as there are numerous examples of "bubble" conditions in the financial system that can cause financial instability. For the most part, inflation remains a low level threat. In Asia, Chinese and Korean prices remain generally subdued, similarly in South Africa. Russian online prices continue rangebound, but this cannot mask upward online prices trends in Brazil and Turkey, with negative real rates arguing for hikes in the former and tightening already under way in the latter. Part of the story in Brazil and Turkey is currency weakness and pass-through, but this should also not disguise a continued trend in EM towards rising food prices, a factor that will prove particularly problematic to markets with a high food weighting in price baskets. To put this into some perspective, the PriceStats EM Food indicator is running at nearly 11% yoy.

- Equity market sentiment are at extreme levels. This is **a warning signal of an impending correction in equity markets**, where a combination of the "reflation and normalcy trade" and a strong investor belief in "Don't Fight The Fed" has led to record net long positions in the S&P500. Record foreign investor inflows into US equities YTD. If the U.S. equity market is due for an impending correction, then the immediate assumption is that the Fed would step in, as it has done before, to stabilize equity markets. "Where do I put my money?" Answer: buy the dip when an equity market correction or crash comes around. Assuming, of course, that you know where the dip will be.

- The **Sino-US.. relationship**: Conflicts between the U.S. and China re-escalated on the financial front. New measures include an investment ban which prohibits U.S. investors from owning or trading Chinese companies that are military-linked (35 in total), and passing the Holding Foreign Companies Accountable Act which may force a delisting of non-compliant Chinese companies from the U.S. stock exchanges. From a broader perspective, the U.S.-China relationship would be characterized by a mixture of competition and cooperation under the Biden administration. Target restrictions on individual Chinese tech companies may continue, which in turn will accelerate China's transition to technological self-sufficiency. Areas with increasing cooperation may include clean energy, climate change, and capital market openness. Overall, while the foreign policy of the U.S. could return to normalcy somewhat and to a more multilateral

approach, the relationship between the U.S. and China will still be the focus for next year.

- **Tech facing regulatory risk:** Facebook in the U.S., Digital Markets Act in the EU, Ant Group in China.

Emerging Market Equities

The overall setup for emerging market equities is very favorable heading into the new year. From a top-down perspective, there are a plethora of tailwinds. First, the rollout of a COVID-19 vaccine means that global economic activity will steadily return to a growth path, which is a positive for emerging markets as they are generally leveraged to global growth. The only caveat is that conditions on the ground in many countries could get temporarily worse before they improve. Second, lower interest rates in the developed world have allowed the central banks in EMs to lower their rates as well. This is a double-positive as borrowing costs drop and more credit becomes available for these capital-starved economies. In addition, there is the supportive effect of investment flows out of what had been high-yielding domestic fixed income markets into the equity markets, which are typically under-owned by domestic EM investors. Third, a weaker U.S. dollar is generally a constructive environment for emerging markets as assets in non-U.S. markets become relatively more attractive – in fact, we are already seeing large capital inflows into emerging market investment vehicles. The stronger local currencies also lessen the burden of any U.S. dollar debt owed by companies and governments. Finally, rising commodity prices are a positive for numerous countries within emerging markets. In addition to giving a boost to the local economies via a trickle-down to greater services demand and higher incomes, it also helps improve the governments' fiscal balances.

In terms of sector positioning, there will be an increased focus on identifying companies that will benefit from growth of their respective domestic economies. Due to their weaker healthcare systems, the COVID-19 mobility restrictions were often more severe in these poorer countries compared to those in the developed world. As a result, companies that had revenues from exports fared relatively better, leaving consumer discretionary and financials as relative underperformers. With the re-opening of the economies, we expect this trend to reverse to some extent.

Looking at country positioning, we will seek opportunities in countries that will benefit from the combination of lower interest rates and higher commodity prices, both of which are a boost to domestic economies. Specifically, Brazil will be a country of interest. The equity market there has only recently surpassed it 2020 high mark, while its currency remains relatively cheap. In addition, domestic interest rates have dropped to historically low levels over the past year and many sectors of the economy will benefit from higher commodity prices. Two other countries who have this similar profile are Indonesia and Russia. On the other hand, exposure to the tech and export driven economies of Korea and Taiwan will likely be reduced. Even though there are some world-class companies in each of these markets, the valuations have reached relatively expensive levels.

Country Updates

China

Pulling global growth along

Post the sharp contraction in 1Q, China's GDP has rebounded strongly since 2Q and marked China as the only nation with positive 2020 growth across major economies. This was mainly powered by China's first-in first-out condition and proactive policy supports. The growth recovery was broad-based, led by the production (investment and exports) activities initially, and extended to the consumption space in recent months. On the policy front, implementing the dual-loop theory under the five-year plan will be a key focus. It's expected to see further policy supports on fostering domestic demand (new urbanization, higher income, and reduce inequality), technology innovation (digitization economy, big data, AI, 5G), green environment (carbon neutrality), and capital market reform (further market openness, expand the registration IPO system to mainboard).

The domestic economy is not completely recovered to the pre-pandemic level, thus, accommodative policy support will be required for a while. A neutral, prudent but accommodative monetary policy will be the main monetary policy stance in 2021, while the authorities will postpone the beginning of a real tightening cycle and "proactive deleveraging" to a later stage. Amid the ongoing strong RMB appreciation trend, hiking interest rate would lead to RMB further appreciation, giving pressure on exports in 2021. China's easing monetary measures in the pandemic time has been already much prudent and restrained compared with what the authorities did in 2008-2009 Global Financial Crisis, let alone the flooding liquidities injected by the central banks of the advanced economies this year, thus the room for normalization is not that large in China.

CNY: appreciation will continue in 2021, with USD/CNY forecast standing at 6.25[8] in 4Q21. The key supporting factors are the favorable growth and interest rate differentials, comfortable levels of current account surplus, and diminishing risk of an abrupt tariff escalation under a Biden administration. Meanwhile, the PBOC appears to be more willing to tolerate CNY flexibility.

Expect a rotation of growth drivers from public to private investment, and from investment to consumption. Expect modest fiscal consolidation and credit normalization. Continuation of U.S.-China competition, but change in tactics. 2021 is also the start year of the 14th Five-Year-Plan.

Brazil

IP expanded for the sixth month in a row. Fiscal accs improving.

Industrial production (IP) continues reflecting the resilience of the goods-producing sector in Brazil after the first hit of the COVID-19 pandemic, a result of the domestic stimulus and solid external demand.

The persistence of historically low interest rates — the benchmark Selic is at a record 2% a year[9] — which will help corporates bring down leverage next year. If inflation remains muted, low interest rates could allow the economy to grow faster and could boost confidence in the sustainability of the public debt.

The consolidated government registered a 9% GDP primary deficit in 12 months. Regional governments presented another primary surplus in the month. Gross debt fell to 88% of GDP. Approval rates of the Bolsonaro administration increased to 35%, compared to 29% in December 2019.[10] Tensions increased between the Minister

[8] JP Morgan

[9] REDD Latam, REDD Insight: Brazil's prospects for 2021 shaped by vaccine rollout, December 22, 2020

[10] PM, Brazil Revision in Fiscal Forecasts with resilient tax revenues in November, December 30, 2020

of Economy Paulo Guedes and the President of the Chamber of Deputies Rodrigo Maia.

Mexico

GDP ending year on high note; 4Q now seen at 8.2%.

Favorable tailwinds will likely come from stronger U.S. growth, particularly in 2H21. Mexico will recover only partially, given the lack of any meaningful policy stimulus in 2020. Headwinds, however, will come from the net loss of over 340,000 firms in the formal economy in the past 18 months (and the close to 2.2mn jobs associated with them)[11] subdued business confidence, a more risk-averse banking system given the lack of material official support throughout the pandemic, and the enormous challenge of securing and administering COVID-19 vaccines for a population of close to 130mn people. Investor attention will likely center on any additional interest rate cuts the central bank may be willing to undertake. On the fiscal front, however, the room for stimulus will be constrained by limited fiscal revenues and by the President's commitment to austerity. On the political front, investor attention will likely center on the June elections. Ruling party MORENA and its allies should maintain more than one-half of the seats in the House that are required to enact secondary legislation in Mexico.

Turkey

Markets greet orthodox monetary policy.

Turkish forex reserves slump almost 40% in 2020 to USD 50b, their lowest level in history.[12]

Positive market environment that has followed a reshuffle of top personnel at the CBRT and the Ministry of Finance. The Central Bank of Turkey raised the policy rate by 200bps to 17%, exceeding the median expectation (150bps). Adopting a medium term perspective against inflation and taking the end-2021 forecast target (9.4%) as guidance confirm the decisiveness of the CBRT to initiate a disinflation process.[13]

Russia

Recovering along with oil.

Positive growth mostly driven by the oil sector and dictated by the caps agreed with OPEC+. Strong export expansion: oil production to reach pre-COVID levels in 2021H2.

Constructive commodity markets, leveraging its superpower status in the Middle East and elsewhere, and further proximity with China will secure Russia a global player status and a seat at the table. Vladimir Putin's record over more than the last 20 years grip on power is unimpaired.

The pace of recovery in economic activity will depend on the revival of global demand and OPEC+ restrictions on oil output recovery. The ruble will strengthen to its fundamentally justified level, at 65-70 against the U.S. dollar. Although CPI inflation may surprise to the downside in 2021, the central bank will refrain from a cut in the policy rate in 2021. (In an extreme-case scenario of an abrupt drop in inflation alongside a sharp contraction in economic activity, the CBR will cut just once, by 25bps, to 4.00% in 2021.)

South Africa

The COVID-19 shock led to one of the strongest improvements in South Africa's external balance in its history.

[11] Credit Suisse
[12] Dunya.com
[13] BBVA Research, Turkey, The CBRT Reinforces its hawkish stance, December 24, 2020)

According to the South African Reserve Bank's (SARB) seasonally adjusted and annualized estimate, the current account was at a surplus of 5.9% of GDP in 3Q, the highest level in four decades. The improvement in the current account has helped the rand to strengthen since the COVID -19 shock. This may bring substantial inflows into the local bond market, especially at the long end of the curve that yields more than 10% in nominal terms and 6% in real terms.[14]

A successful wage bill negotiation will open the door for debt stabilization and inflows into the local debt market. This will support the rand. Downside inflation risks in 2021, mainly from aggressive fiscal consolidation and a stronger currency.

The COVID-19 shock has accelerated an inevitable deterioration of the country's fiscal position. Without fiscal consolidation, the general government debt will increase from 63.3% of GDP in March 2020 to above 135% in March 2029. The government's debt service costs had already approached 5.0% of GDP last year, or more than 20% of the main budget revenues. On October 28th, in its medium-term budget policy statement (MTBPS), the government outlined a plan to address the problem of rising debt. This plan boils down to a painful fiscal consolidation that rests on the shoulders of public sector workers, whose wages will be frozen for the next three years. Alongside other fiscal reforms, which include a restructuring of fiscal spending, this would open the door to hopes for stabilization in the public debt at below 100% over the next decade.

The monetary policy of the SARB will remain accommodative for longer. As disinflation risks should prevail in 2021, accommodative monetary policy will be the only available option to offset tighter fiscal policy. Fiscal consolidation will contain any recovery in consumer demand for the next two years at least.

[14] Credit Suisse

We thank you for your continued support.

The RVX Team
RVX Asset Management LLC
20900 NW 30th Avenue, Suite 401
Aventura, FL 33180
www.RVX-AM.com | Phone: +1-305-363-6890
Fax: +1-305-675-0394

Important Additional Disclaimers and Other Legal Information

This material is distributed for informational purposes only. This material is confidential and is not to be shown or given to any person other than the person who is an intended recipient and is not to be forwarded, copied, transmitted, distributed, or otherwise reproduced in any manner whatsoever. The discussions and opinions in this newsletter are for general information only, and are not intended to provide investment advice. While taken from sources deemed to be accurate and reliable, RVX Asset Management, LLC (“RVX”) makes no representations concerning the accuracy of the information in the letter or its appropriateness for any given situation. Any statements regarding future events constitute only subjective views or beliefs, are not guarantees or projections of performance, should not be relied on, are subject to change due to a variety of factors, including fluctuating market conditions, and involve inherent risks and uncertainties, both general and specific, many of which cannot be predicted or quantified and are beyond our control. Future results could differ materially and no assurance is given that these statements are now or will prove to be accurate or complete in any way. RVX shall not be responsible for the consequences of reliance upon any opinion or statements contained herein, and expressly disclaim any liability, including incidental or consequential damages, arising from any errors or omissions. Information and references to RVX’s Emerging Markets Equity Portfolio pertain to RVX’s Emerging Markets Model Portfolio. Information and references to RVX’s Global Opportunity Fund (“RVXGO” or the “Fund”) pertain to RVX’s investments and customer allocations in the related Fund. RVX provides investment management services primarily to the Fund, as such it shares common ownership with RVX Clients of RVX who pay RVX a fee for all assets under management and who also invest in the Funds are not charged additional fees directly by the Fund.