Mackenzie insights on 2021 and beyond

Where might the world be heading as the pandemic situation evolves?

We kicked off the 2021 Mackenzie Exchange Event Series, presented by Mackenzie Institute, with our **2021 Market Outlook**. Todd Mattina (SVP, Chief Economist, Portfolio Manager and Co-Lead of the Mackenzie Multi-Asset Strategies Team) and Dustin Reid (VP, Investment Management, Chief Fixed Income Strategist, Mackenzie Fixed Income Team) provided their insights on how the economy and markets may unfold in 2021 following a year unlike any other.

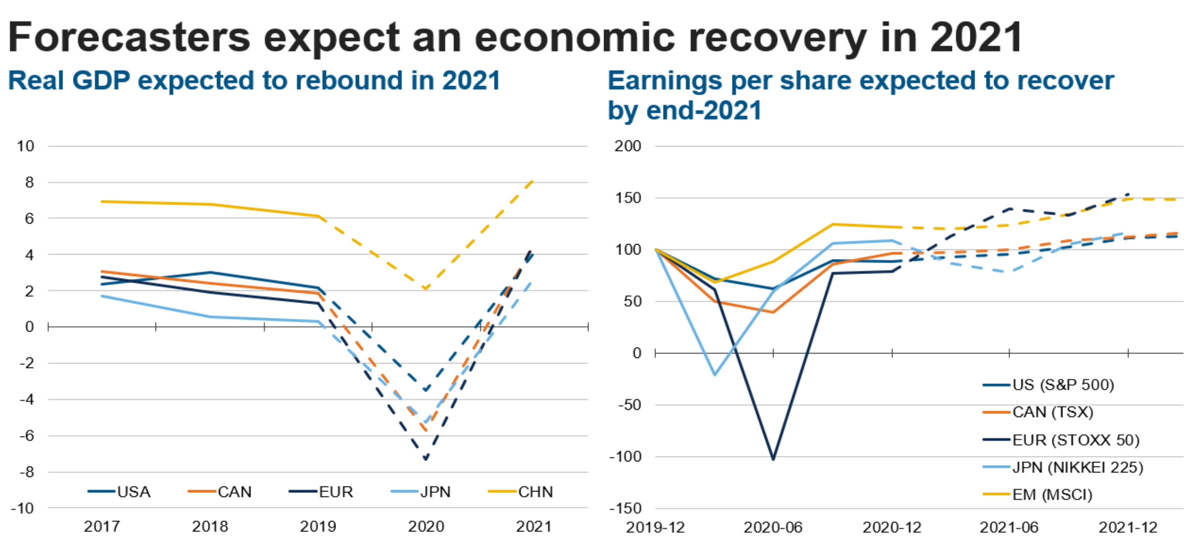
Event highlights

The pandemic has wreaked havoc on economies worldwide. For instance, the global economy as a whole contracted by roughly 4.4% in 2020. It was even worse in Canada (5.6% decline) but economic growth was more resilient in the U.S. (-3.5%) and in China (2%).

What might 2021 have in store for economies and markets? Here's what our two experts see:

- With COVID-19 vaccinations beginning to ramp up, economic growth may be subdued for the first part of 2021, particularly if restrictions and lockdowns persist and hard-hit industries like travel, hospitality and personal services continue to struggle.
- As vaccinations reach greater penetration, we expect a stronger economic rebound in the second half of 2021, especially among cyclical industries.
- Governments remain committed to providing ample fiscal and monetary stimulus to support fragile economies as they recover from the pandemic. This additional liquidity, coupled with pent-up spending demand from consumers who have accumulated larger-than-normal savings in 2020 (estimated at US$1.6 trillion by Harvard Professor Larry Summers), may lead to higher inflation in 2021.

As the image below illustrates, economies worldwide should recover in 2021 with a sharp "V-shaped" rebound that will bring real GDP and corporate earnings back to around pre-pandemic levels sometime in 2022.



Sources: Realized GDP growth is from BEA (US), Eurostat (Eurozone), National Bureau of Statistics (China), Cabinet Office (Japan), Statistics Canada (Canada), all via Datastream. 2020 and 2021 growth forecasts are from Consensus Economics as of January 4. Earnings per share (realized and expected) is from Bloomberg as of January 4.

5 things to watch for in 2021 that may impact the economy

1. **Central bank policies.** Currently there is roughly US$17 trillion in negative-yielding debt worldwide. Although both the Fed and Bank of Canada will likely continue with massive stimulus measures (bond buying programs, low interest rates, direct financial aid for citizens), this accommodation likely won't lead to negative rates in North America. The challenge for central banks is to strike a balance between supporting the economy and avoiding an overheating that would lead to inflation. Higher rates may hurt businesses and individuals that are highly indebted, and they may be unable to service their debt.
2. **U.S. politics.** The election period may be over, but controversy and question marks remain. Will there be an orderly transition of power or will the U.S. be plagued by more turmoil, protests and rioting? With undivided control of Congress, how will the Biden administration manage major issues like fiscal and monetary policy, the environment and social inequality? How will markets react to all the change?
3. **Oil market.** Demand for oil declined dramatically as the pandemic ensued, given severe travel restrictions. While OPEC members like Saudi Arabia have been trying to balance oil markets with production cuts to create a floor on oil prices, future demand for oil still hinges on the course of recovery from the pandemic.
4. **China.** The Chinese economy is becoming a bellwether for the world as it was the first major region to deal with COVID-19 and the first to emerge from the virus-related downturn. China's growth in 2021 is expected to be stronger than that of most other countries, including Canada and the U.S. If China starts falling short of expectations, it could be a warning sign to the world.
5. **COVID-19.** Vaccinations are expected to help economic activity return to normal, but what if the current vaccines are not as effective as anticipated (notably against new virus strains), or what if there is resistance to mass vaccination? The longer economies remain in some form of lockdown, the worse unemployment will be, the longer it will take for an economic recovery and the more markets will remain volatile.

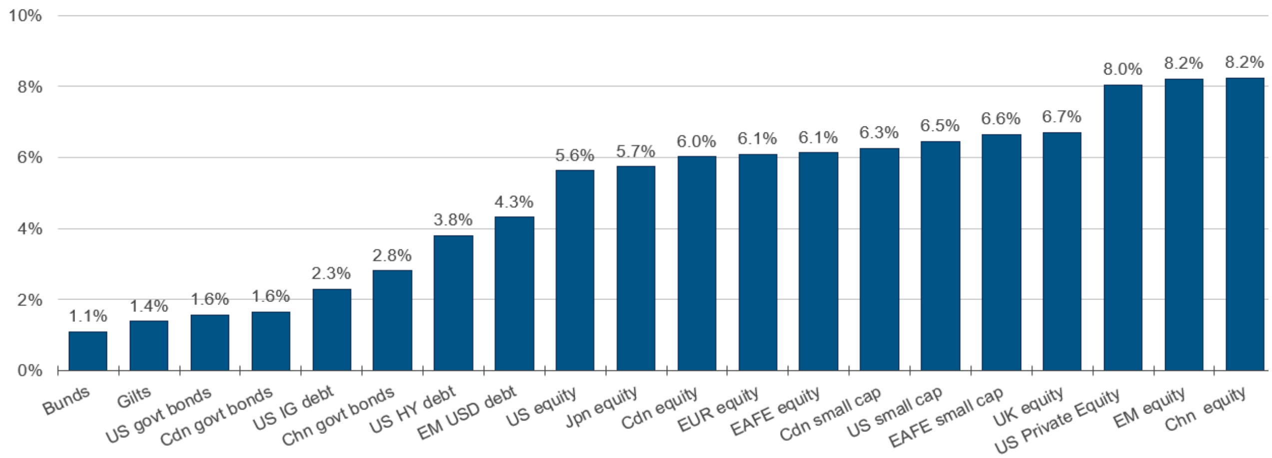
Long-term market expectations

Given the low-rate environment, expected returns should be relatively moderate for most asset classes in the next decade compared to recent years. As long-term inflationary pressures remain subdued and bond yields remain near generational lows, the return on sovereign 10-year bonds in the Canada and the U.S. is expected to be roughly 1.5% for the next decade, considerably below average.

Stock markets are largely valued based on expected earnings growth and the prevailing discount rate for future earnings. An environment of recovering economic growth and "lower for longer" discount rates supports higher stock market valuations compared to historical averages. The tech-driven U.S. stock market has already discounted significant revenue growth in the future, helping to deliver strong performance in recent years but also pointing to lower expected returns in the next decade. Other stock markets with more attractive starting valuations are expected to outperform, including emerging markets, China and the U.K.

The following graph shows the long-term expected returns of major asset classes.

Long-term expected returns in Canadian dollars
(geometric average expected return over 10 years hedged back into Canadian dollars)



Sources: Mackenzie Multi-Asset Strategies Team, December 2020. Equity markets refer to national benchmark large-cap indexes unless otherwise stated. Government fixed income refer to 10-year bonds on a constant maturity basis. All expected returns are expressed in Canadian dollar terms after incorporating our FX hedging assumptions.

Viewpoints on portfolio positioning in 2021

- Economic growth is expected to accelerate, especially through the second half of 2021. Investors have reacted to the improving economic outlook with “reflation trades” in which global equities are expected to perform well, although with a style rotation from growth-sensitive and technology stocks to cyclical sectors (i.e., industrials, banks and energy) and markets (i.e., emerging markets, the U.K. and EAFE).
- Real yields in emerging markets are higher than in Europe, Japan and other parts of Asia and developed markets. Not hedging currencies when investing in fixed income gives investors the opportunity to capitalize on potential enhanced gains related to currency movements. We continue to like emerging markets local-currency debt as part of a well-balanced global fixed income portfolio, particularly markets that offer high real rates, such as China or Mexico, in addition to holding Canadian and U.S. duration.
- High-yield and credit markets also have good potential in 2021, but investing in these areas requires deep and specific expertise.
- We typically favour a steady long-term approach to portfolio construction and management. Timing equity sectors, styles, inflation and long-term interest rates is challenging even in normal market conditions. For most long-term investors, it’s important to stay invested through periods of market stress to avoid missing the recovery. Also, stick to your desired long-term asset mix by rebalancing periodically back to the target mix when weightings have shifted in volatile conditions. Stay focused on long-term financial and investment goals, ensure risk is calibrated to your investment time horizon, and remain well diversified across asset classes, geographies and foreign currency exposures.

For more information and insights about topics discussed in this webinar, or to learn about specific solutions and strategies that you may be considering for client portfolios, please contact your Mackenzie Sales Team.