CAMRADATA

Trends for 2021 Whitepaper

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Welcome to CAMRADATA's Trends for 2021 Whitepaper

With retirees living longer and the average age of pension scheme members getting older, some asset owners are finding it difficult to guarantee the cash flow required to meet payments to retirees. In this uncertain economic climate, some sponsoring companies are also finding it challenging to meet their funding commitments and to fulfil their employers' covenant.

In 2020, the UK Pensions Regulator introduced a review of the funding regime for company pension schemes, whereby employers will be required to clear a pension deficit within an agreed timeframe – typically 6 years for 'stronger' employers – when the trustees and plan sponsor identify a funding shortfall during a periodic valuation of the scheme.

In this environment, pension funds require an investment strategy that can fulfil their need both for cashflow and return. Confronted by a weak dividend outlook through 2020 and into 2021, some pension funds are increasing their allocations to investment grade, and sometimes high-yield, corporate debt to meet their cashflow needs. But pension funds need to be watchful of a spike in default rates in corporate bond markets as governments wind down their emergency support measures.

Traditional areas of fixed income are likely to return very little in the short to medium term. Consequently, pension funds are needing to assume greater investment risk to generate a similar level of return that, 10 or 15 years ago, they could generate from their core bond holdings.

More broadly, the Covid-19 pandemic has also forced the industry to re-examine its goals and its ways of working. It has forced pension funds, and the asset managers and custodian banks they appoint, to move to remote working and to apply technology in new ways to deliver business continuity.

So how will schemes refine their asset allocation to meet their funding and liquidity requirements in current investment conditions? And how will they optimise their investment choices within their equity, fixed income and alternative investment allocations?

Ensuring effective selection and oversight of asset managers, custodians and other service providers will become key, as will maintaining a transparent dialogue between parties. These are some of the questions we will address in this CAMRADATA whitepaper.

Trends for 2021
Roundtable

The CAMRADATA Trends for 2021 roundtable took place virtually in London on 3 December 2020.

CAMRADATA looked ahead to 2021 with a panel discussing which trends would shape the year ahead for investors. High on the list of considerations were ESG, the economic recovery from Covid and inflation.

Ajeet Manjrekar, co-head of client solutions at River & Mercantile, began with the biggest concerns for Defined Benefit pension schemes. He cited Responsible Investment strategies, long-term funding and thirdly, the deterioration of scheme covenants' impact on net cashflows.

Simeon Willis, chief investment officer at pension scheme consultancy, XPS, listed the recovery from Covid; climate change and inflation as his trio.

Anoop Kumar, manager selector at DB pension fund consultancy, Secor, agreed with Manjrekar on long-term funding and Willis on climate change.

His third trend was technology: he remarked how the record-breaking delivery of vaccines for Covid were in part due to advanced testing capabilities. Kumar's question was how investors get exposure to tech in all its profitable forms.

> *" US-China tensions are not going away simply because America has a new president "*

Steve Hooker, fixed income portfolio manager at Newfleet Asset Management, countered Willis's fears over inflation: "Central banks will remain accommodative," he said. "Inflation is not a problem in the near term."

Regarding the economy, Hooker was cautiously optimistic that the US is on track to get back to normal. He backed spread sectors, including Emerging Markets, to outperform Developed Market sovereign debt.

Craig Reeves, founder of Prestige Capital, a lender to small private businesses in the UK, said ESG was up there but misunderstanding remains because it means different things to different people. His second observation was that the adoption of alternatives is going to increase, driven by the hunt for yield. His third observation was that US-China tensions are not going away simply because America has a new president.

George Milling-Stanley, chief gold strategist at State Street Global Advisors, agreed with Reeves that asset allocations were going to change next year, but he predicted disinvestment from all risk assets, including some alternatives. The cause of this switch will be stagnant equity markets starting to reflect the underlying malaise in the economy, according to Milling-Stanley. He noted that Moody's predicts 10% unemployment in the US in the first half of next year.

The consequent trend for Milling-Stanley was that institutional investors will seek greater safety in gold.

In contrast, Daniel Booth, CIO of Border to Coast, the largest pool of local authority pension fund money in the UK, gave more bullish predictions. His belief is that equities will be one of the best-performing asset classes. The underlying rationale is that both households and corporates are sitting on huge amounts of cash. Booth noted that this is atypical for a large recession.

In fixed income he shared other panellists' concerns that credit yields will continue to compress (he noted that while corporates had issued a lot of debt, most had cut spending so had elevated cash levels broadly equivalent to increased debt loads).

On inflation, Booth foresaw a pick-up in the medium term from monetarization of fiscal deficits. He believes central banks are following a similar approach to the financial repression of the 1950s. However, he said it was difficult to know exactly when inflation would increase.

Andrew Pease, global head of investment strategy at Russell Investments, finished the opening exchanges with his observation that overconfidence is overflowing in financial markets. 'It happens at the end of every year but it's overconfidence squared right now," he said. In terms of market strategy, Pease shared much common ground with Hooker. He believed in Value over Growth and non-US over the US.

> *" The economy is in a mess while spread levels and equity levels are back where they were before Covid struck "*

Manjrekar agreed with Pease on overconfidence. Manjrekar used the term "overexuberance", perhaps referencing the "irrational exuberance" Alan Greenspan noted during the tech bubble of the 1990s. The FTSE is up 20% up since October's announcement regarding a likely Covid vaccine. Manjrekar questioned whether the news justified the increase, and warned that investors had to keep their eyes wide open on what is happening at a local level versus the markets.

"The economy is in a mess while spread levels and equity levels are back where they were before Covid struck," said Willis. "A natural conclusion is that markets offer less value now than they did then."

Kumar, however, was in the bullish camp and foresaw the gap between Wall Street and Main Street narrowing positively. "I am generally constructive on equities," he said. "I don't have a strong sense they will correct. There will be cyclical improvement now we have the vaccine." To benefit as investors from that cyclicality necessitated some rotation. But as with 2020, Secor will look to experienced managers to find opportunities from their own investment process. Kumar emphasised that different managers had profited in different ways as the effects of Covid unfolded.

Hooker likewise felt the gap between financial markets and the real economy was closing, not widening. He said that in 2020 monetary and fiscal policy had mattered more as policymakers reacted aggressively to combat the ravages of the pandemic. For 2021, he saw more fiscal support "because that's the bridge to healing the real economy."

In response to Milling-Stanley's sense that the pandemic has not been tamed, Hooker observed that all nations are now better prepared because of lessons learned in the past nine months.

Pease then weighed in. "As a former Central Banker, I don't see dislocation between Wall Street and Main Street," he said. "The markets are a prospective

discounting machine. Only when I see a bubble do I worry: we are not near that now."

Pease explained that policymakers schooled in the Volcker era were inflation fighters [In 1980, only months after Paul Volcker became chairman of the Federal Reserve, inflation in the US hit 14%]. "But this new generation of Central Bankers are about getting inflation up," said Pease. "They have learned from all the mistakes the Japanese have made. The odds of these policymakers stopping [their monetary support to markets] is low. People should have realised we never reach the end of that road."

Hooker noted that near-term liquidity has stayed in financial markets, not flowed into the wider economy. This has been a criticism of Quantitative Easing for much of the decade. For Hooker, the takeaway was that inflation will therefore stay low: "Central Bankers have had little success creating inflation," he said.

Milling-Stanley reiterated that this was one major reason why he was pessimistic about the US economy's prospects for 2021.

Pease, however, defended the record of Central Bankers. He noted that whenever inflation has got going, it has been derailed by a number of shocks, including the Global Financial Crisis and the Covid pandemic.

> *" There is a schizophrenia: are things genuinely getting better or is it just government stimulus? "*

Reeves then gave his thoughts on the effects to financial markets of easy money. "Tech stocks like Tesla have flattered but what is the rate of earnings growth? Their cost of funding has gone from 2-3% to zero in six months, which has flattered their balance sheets."

He warned that the next 24 months will expose those companies that have not grown earnings. And the uncertainty is not limited to financial markets. "Psychologically I think we are suffering," he said. "There is a schizophrenia: are things genuinely getting better or is it just government stimulus?"

Pease made similar comments. He noted that lots of tech spending has been brought forward by Covid. On out-of-favour Value stocks, he remarked that "critics complain that these companies never grow their earnings… until they do!"

Reeves said he could imagine more volatile markets testing new highs or mass unemployment creating deflation. "It will take us five years to fully recover from the impact of the pandemic."

But Milling- Stanley made some regional distinctions. He pointed out that Emerging Markets, led by China, have had the greatest success in reopening their economies. "That is good news for gold because they buy the most jewellery."

By contrast, Developed Markets, especially the US, have not done well. Milling-Stanley recognised that if these trends reverse, his predictions for 2021 will be upturned.

Covenants and cashflows

The CAMRADATA panel then examined the effects of Covid from the perspective of employers and their pension schemes. Many of River & Mercantile's DB scheme clients are relatively mature, paying out more in pension benefits than they are receiving in income. Manjrekar said he was concerned about what Covid has done to some employers and their ability to generate free cashflow.

"We look at high-quality investment grade as one means to support DB schemes given their need for high-quality stable cashflows," he said. Big questions for R&M right now are whether clients are getting paid enough for default risk across credit markets; and whether it makes more sense to harvest capital growth from portfolios in the near term.

Willis said that contractual income is helpful. "You need liquidity. But most pension funds have more liquidity than they need." He wasn't too panicked by growing maturity and saw it as natural. "Cashflow negative is what pension funds are made to be." He did see an increasing role in the search for stable income from private markets. "We are structurally moving in that direction. I speak to clients about private debt." He acknowledged the problem aired by Manjrekar that high-quality public debt is not going for cheap. ABS was one sector he described as unloved, and still somewhat stigmatised unfairly ever since the Global Financial Crisis.

For Secor, Kumar emphasised clients' Strategic Asset Allocation as the backbone of investment decisions, generating the risk-return profile clients expect.

Speaking on private equity, he said it was not as illiquid as people think. He shared Willis's warning that the trick is to incorporate wider margins in modelling returns from private assets for a pool that also includes public assets.

Both Pease and Hooker have a dynamic element to their roles, identifying relative mispricing opportunities. Pease made the fundamental point underlying the search by pension schemes for yield: ten-year gilts are offering 33bps [from 83bp at the start of the year]. Central banks have driven prices higher since Covid. "Betas aren't going to get you where you want to be," warned Pease.

Hooker said that this is where truly dynamic multi-sector fixed income goes to work. "Market conditions are changing rapidly in the current environment," he said. "We added risk close to the lows in March. This is characteristic of our approach."

Booth then explained further his bullish view on equities. He shared Pease and Kumar's belief in some style rotation. He picked out banks as a sector which saw price declines are similar to post GFC and yet Tier One capital ratios were three times higher. The flat yield curve and initial Non-Performing Loan provisioning were an initial drag but, on the whole, could have been absorbed through excess capital reserves. Booth noted that some banks were starting to release some of the earlier provisions. "I have been telling our internal portfolio managers to buy banks for the last couple of months," he said.

Hooker agreed with Booth on the attractiveness of banks' capital adequacy. Hooker said he was less concerned about defaults, in part because of central banks' ongoing policies. But also he felt confidence in Newfleet's ability to pick the right issues.

> *" You need liquidity. But most pension funds have more liquidity than they need "*

In its small business lending activity, Prestige is typically operating at a much lower ticket-size to Newfleet. Prestige loans to private businesses sums less than £50,000. This is a sector of finance that high street banks have deserted, according to Reeves. Now it is the likes of Prestige group companies that the British Business Investment Bank has turned to in order to reach small businesses with emergency Covid-interruption loans (CBILs). Prestige-owned Nucleus Commercial Finance is now the second largest non-bank lender in this scheme.

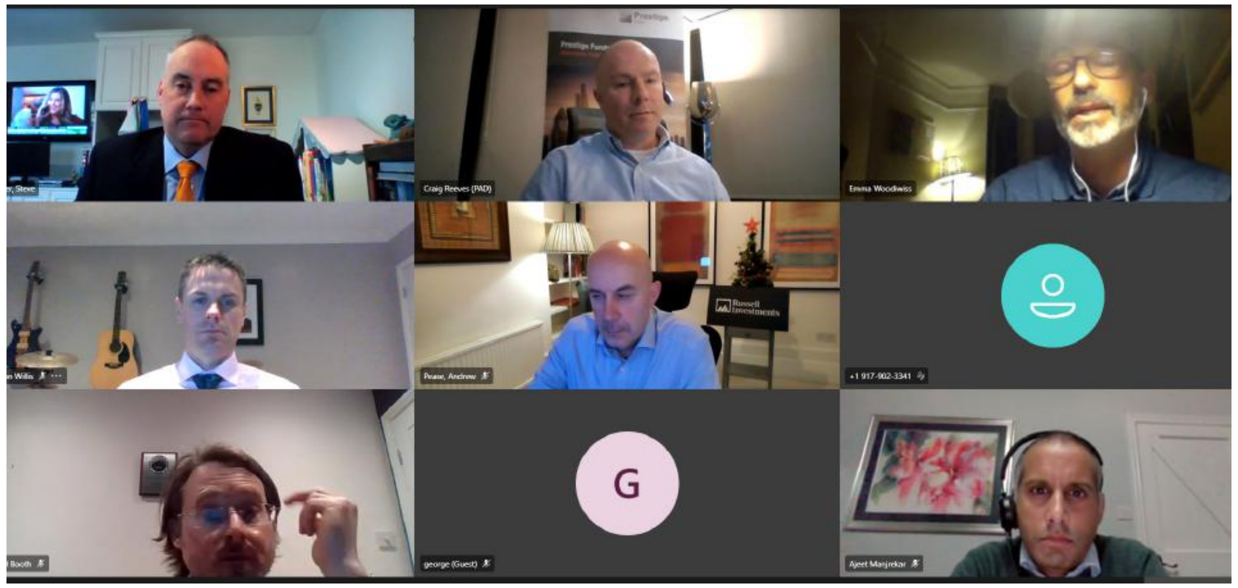
For investors, Prestige offers funds, managed accounts and co-funding options. Reeves suggested returns of 5-7% per annum.

Booth had mixed thoughts about private lending. "I'm hearing this time there are lots of restructuring of portfolios in private debt," he said. There were none before Covid."

Reeves replied that it was a lenders' market "like we haven't seen since the depths of the GFC." He described 2020 as a year of extremes. Some companies had their best year ever.

The value of gold

The CAMRADATA panel finished by discussing gold. Milling-Stanley claimed it would form a greater part of institutional investors' portfolios as 2021 proves to be another year of disappointments. Manjrekar said that R&M have used gold in the past, primarily as a hedge in times of stress to diversify the portfolio.



Pease said that gold has some nice correlation characteristics, including defensiveness. "You could make the argument for it as all-weather inflation-protection but my struggle is that I don't know how to value gold."

“ Gold is an insurance; you don't buy insurance after an accident. You buy it because you don't know the future ”

He noted that it has correlated with real interest rates, but only since 2006 and that is bottoming out.

Milling-Stanley acknowledged Pease's observations. For example, gold's correlation with equity markets used to be essentially inverse. While that has faded, the fact remains that when markets experience a shock, that old correlation reasserts itself. In times of panic, investors flock to gold to protect their wealth. As such, Milling-Stanley made the argument that gold is an insurance; you don't buy insurance after an accident. You buy it because you don't know the future. "That's why you always keep a small portion."

Which brought the conversation back full circle to the economic outlook for the year ahead. "I hope the optimists are correct but in the US I am very worried about COVID," said Milling-Stanley. "My big concern colours my whole outlook."

Roundtable Sponsor

Stephen H. Hooker, CFA, Managing Director and Portfolio Manager

Personal Profile

Stephen Hooker is a managing director and portfolio manager at Newfleet Asset Management. Mr. Hooker is a member of the multi-sector portfolio management team with primary responsibility for institutional accounts. He also serves as co-portfolio manager and assists in the management of several open-end and closed-end mutual funds. He joined Newfleet in 2011 to serve as sector manager for emerging markets, where he was responsible for researching issuers in Europe, the Middle East, and Africa.

From 2005 until 2011, Mr. Hooker was vice president, senior credit analyst at Aladdin Capital Management and Global Plus Investment Management, respectively, both of which specialize in high yield and structured credit products. Prior to 2005, he was at Phoenix Investment Counsel for 12 years, serving in various capacities, including as a senior credit analyst and emerging markets sector manager on its fixed income team. Mr. Hooker earned a B.A. in psychology from Trinity College. He is a CFA® (Chartered Financial Analyst®) charterholder. He began his career in the investment industry in 1993.

Newfleet Asset Management

Company Profile

Newfleet is a fixed income specialist in multi-sector investing that actively rotates across 14 sectors of the investable bond universe. Identifying relative value is the foundation of Newfleet's process, applied across all multi-sector and dedicated strategies at the sector, industry, and individual security levels. We believe that active sector rotation, based on relative value across the full fixed income universe, combined with rigorous security selection and disciplined risk management, is the most effective means of achieving competitive returns over time. As a result of Newfleet's approach, a large portion of our investable universe is out-of-index, which may result in low correlations to investors' other fixed income allocations.

Newfleet has been managing multi-sector fixed income for over a quarter of a century. The firm offers a range of mandates that vary in duration, credit quality, and return/risk profile. A highly integrated and collaborative team approach enables cross-fertilization of ideas to maximize ability to identify best opportunities. Through its tactical approach to spread sector investing, Newfleet has demonstrated a keen ability of generating excess returns versus the broad market index over a full market cycle. While this approach considers and analyzes a variety of macro factors, Newfleet is interest-rate agnostic, defined as not betting clients' money on timing (or miss-timing) interest rate movements. Newfleet is a wholly owned, independent subsidiary of Virtus Investment Partners (NASDAQ: VRTS). Newfleet is not registered with or licensed by any financial authority outside of the United States of America. Any investment management services would be provided on a cross-border basis from the U.S.

Roundtable Sponsors

Craig Reeves, Founder

Personal Profile

Craig established Prestige group in 2007 and has raised almost USD 2 billion in private credit based strategies. He has nearly 25 years' experience as a professional investment manager, trader and investor in alternative investments, capital market instruments and regularly contributes to financial journals.

As well as being a board director of Prestige Capital Management, he is also a Director of Nucleus Holdings and is a Co-Founder and NED of Swiss based, OpenFunds Investment Services. Craig was formerly a Managing Director and Co-Founder of Platinum Capital Management (a fund management group). Formerly, he was Head of Portfolio Management at Titan Capital Management (a fund management group). Prior experience includes serving as a Proprietary Trader at Gaiacorp Trading (a hedge fund group).

Craig graduated with a BA (Hons) in Business Administration from Huddersfield University and has a Higher National Diploma in Business and Finance from the University of Greenwich (London). He also attended the New York Institute of Finance where he studied financial markets and derivatives and is a member of the Chartered Institute for Securities and Investment.,

He is regulated by the FCA (UK), MFSA (Malta), CSSF (Luxembourg) and FINMA (Switzerland) and is a certified individual by FCA.

Prestige Funds

Company Profile

Established in 2007, just months before the beginning of the financial crisis, Prestige group manages approximately USD 1.3 billion in assets, employs over 100 people and is entirely owned by senior management and operates with several offices in the UK and international financial centres.

The group consists of four related business verticals: Fund Management specialising in alternative investment strategies with a focus on direct lending, UK Agricultural and Renewables-specific lending, UK-specific SME lending and USA-specific SME lending.

The team consists of a diverse group of investment professionals who, including the board of directors, board of advisors, affiliates and retained consultants, have served on numerous boards of international financial institutions, fund groups and asset management groups. Combined, the team has many decades of experience in various sectors of finance including commercial banking, investment banking, stock broking, fund management, private equity, financial markets trading and extensive experience in the management and operation of regulated alternative investment vehicles.

Prestige is committed to providing innovative investment solutions that are sustainable and have a positive social impact. Their reputation has been built upon our expertise across the credit spectrum and particularly in private debt, real assets and alternative lending strategies. They are squarely focused on producing consistent and positive risk-adjusted investment returns with limited volatility. Diligent, tenacious and resourceful, Prestige work at the centre, not the edge, of every transaction they do.

George Milling-Stanley Chief Gold Strategist

Personal Profile

George Milling-Stanley is Chief Gold Strategist with State Street Global Advisors. He joined SSGA as a Vice President and Head of Gold Strategy in November 2014. Before joining SSGA, George ran the independent consultancy George Milling-Stanley on Gold, LLC. He retired from the World Gold Council in 2011 after a 15-year career there. Most recently he had been responsible for all programs involving central banks, governments, and regulatory authorities. Before that, he was a key member of the small team that pioneered the development of gold-backed Exchange Traded Funds. His earlier career included six years on the precious metals trading desk of Lehman Brothers. Previously he worked for Consolidated Gold Fields in London, and before that spent 10 years as a reporter and columnist with the Financial Times. An acknowledged authority on all aspects of the gold business, George Milling-Stanley is a regular speaker at international conferences.

State Street Global Advisors

Company Profile

For four decades, State Street Global Advisors has served the world's governments, institutions and financial advisors. With a rigorous, risk-aware approach built on research, analysis and market-tested experience, we build from a breadth of active and index strategies to create cost-effective solutions. As stewards, we help portfolio companies see that what is fair for people and sustainable for the planet can deliver long-term performance. And, as pioneers in index, ETF, and ESG investing, we are always inventing new ways to invest. As a result, we have become the world's third-largest asset manager with US $3.05 trillion* under our care.

*This figure is presented as of June 30, 2020 and includes approximately $69.52 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated

Roundtable Participants

Daniel Booth

Chief Investment Officer

Daniel Booth joined Border to Coast in September 2018 as Chief Investment Officer following 8 years at Saudi Aramco where he was Head of Portfolio Management. Daniel is responsible for Border to Coast Internal management (Equity & Fixed Income), External management (Equity & Fixed Income), Alternatives (Infrastructure, Private Debt & Private Equity), Real Estate, Research and Investment Risk teams and the lead executive on Product Design. At Saudi Aramco, he successfully set up their alternative asset programs (Absolute Return, Private Markets & Real Assets) and restructured Public investments (Listed Equity and Fixed Income) and then span-out the corporate investment department into a standalone investment subsidiary. Prior to this he worked in Germany as a senior founding member of Prime Capital investment team and as an Investment Director at consultancy FERI. He started his career as an Interest Rates dealer and also worked as a Global Macro Derivatives Portfolio Manager.

BORDER TO COAST
PENSIONS PARTNERSHIP

Ajeet Manjrekar

Co-Head

Ajeet is co-Head of River and Mercantile Solutions and has responsibility for the quality and evolution of client-driven services. He focuses on working with trustees to understand their specific investment and governance needs in order to design innovative solutions to achieve their funding objectives.

RIVER AND MERCANTILE

Andrew Pease

Global Head of Investment Strategy

Andrew Pease is the global head of investment strategy for Russell Investments. He is responsible for the cycle, value and sentiment asset allocation framework that guides the tactical positioning of Russell's actively managed funds. Andrew oversees Russell's global team of investment strategists in Seattle, London and Sydney. He joined Russell in 2006 and has been based in London since 2013.

Prior to his current role, Andrew was Russell's Chief Investment Strategist for the Asia-Pacific region.

Andrew began his career as an economist at the Reserve Bank of Australia. He has also worked at the funds management division of Macquarie Bank, been the Australian head of research at Nomura Securities and was the Chief Economist for JPMorgan in Australia.

Russell Investments

Simeon Willis

Partner, Chief Investment Officer

Simeon leads XPS's thinking on journey planning and asset allocation, along with being responsible for research across the investment team. Simeon is an experienced investment specialist with 19 years' experience, advising trustee and corporate clients on a full range of investment related matters, with a particular emphasis towards strategy and risk management. Simeon is frequently quoted in the press on matters relating to investment opportunities and topical debate.

XPS Pensions Group

Roundtable Participant

Anoop Kumar

Principal

Anoop leads public equity, private equity, and equity-related alternative beta manager research at SECOR. He has over 20 years of investment management industry experience, including time at IBM Retirement Funds as the head of global equities, SEI Investments and General Motors Asset Management. Anoop holds a BS in Electrical Engineering from Birla Institute of Technology & Science, Pilani, India and an MBA and MS from New York University.

Moderator

Brendan Maton

Freelance Jounalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.
Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE. Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

Multi-Sector Credit in Times of Uncertainty

While we expect spread sectors to outperform developed market sovereign debt in 2021 given a favorable macroeconomic backdrop, bouts of volatility necessitate a tactical approach to credit.

Newfleet is a fixed income specialist and a multi-sector manager that actively rotates across the entire investable bond universe. Identifying relative value is the foundation of Newfleet's process, applied across all multi-sector and dedicated strategies at the sector, industry, and individual security levels. An integrated team of experienced sector specialists and analysts carry out disciplined and rigorous credit research to find relative value opportunities. Years of collective experience provide an overlay of sound judgment on systematic processes. Newfleet has been managing multi-sector portfolios with a relative value approach for more than a quarter century, with key members of the team and essential aspects of the process in place over this entire period. Our process is time-tested and repeatable. We build our portfolios through in-depth credit analysis and active portfolio management, both critical in volatile market environments.

" COVID-19, like other events that trigger market volatility, can affect valuations and create opportunities that we can take advantage of "

Newfleet has always believed the optimal approach to fixed income investing necessitates adaptability, flexibility, diversification, a willingness to learn, to fail, and to change direction. For example, the 2020 credit selloff driven by the COVID-19 pandemic allowed our multi-sector management style to rotate across sectors to capture the most attractive relative value opportunities. We shifted our weights from commercial mortgage-backed securities to corporate investment grade bonds to take advantage of explicit government support for the corporate bond sector. We also increased our historically low exposure to corporate high yield and bank loans to take advantage of price dislocations. Most recently, to take advantage of a low rate environment and a positive residential credit story in the housing market, we increased our allocation to non-agency residential mortgage-backed securities (RMBS) to the higher end of our allocation range and we have eliminated any meaningful exposure to the highly rate-sensitive agency MBS universe.

The global pandemic has had a major impact on the lives and livelihoods of all people globally. Uncertainty still remains despite promising news on the vaccine front as we end the "year of the shutdown." COVID-19, like other events that trigger market volatility, can affect valuations and create opportunities that we can take advantage of in the course of implementing our multi-sector relative value approach. Newfleet believes that spread sectors will offer better value than developed market sovereign debt and other government-related debt in 2021.

Newfleet continues its "up-in-quality" bias across portfolios while currently constructive on the macroeconomic outlook. Stabilizing economic fundamentals, combined with continued provision of excess liquidity (beyond the real economy's needs) by the major central banks should support further appreciation of risk assets. Credit selection, a major driver of performance last year, once again is in focus based on valuations.

Concerning global macro expectations for 2021, we expect stabilizing economic fundamentals, continued provision of excess liquidity, and growth in China to support appreciation of risk assets.

We view the shift of executive power in the U.S. administration as neutral. We anticipate the balance of forces to result in the executive branch pushing for additional fiscal stimulus to be positive for sustained growth outperformance versus other G-7 economies.

" U.S. Treasury rates and credit spreads to remain range-bound, but with Treasury rates drifting slowly higher balanced by the slow economic recovery "

Credit spreads (averages versus historical) remain cheap relative to rich equities (defined by high P/E ratios) and low U.S. Treasury yields. We maintain an expectation for U.S. Treasury rates and credit spreads to remain range-bound, but with Treasury rates drifting slowly higher balanced by the slow economic recovery, but still suppressed aggregate demand and continued central bank purchases.

With at least two vaccines expected to be mass distributed by Q2 2021 in the U.S. and elsewhere, and global central banks intent on supporting economies in the interim, the second half of 2021 could see strong GDP growth as global economies open up more fully.

The global macro environment clearly is not without risks. Some of the key risks next year are the following:

- Similar to the start of 2020, lower starting points for spreads leave less room for bond prices to absorb unexpected shocks.
- The impact of COVID-19 on public health and global economies will remain a key risk in 2021 until vaccines are fully approved and easily accessible to the general public.
- Energy volatility, interest rate distortions created by global central bank accommodation, and a new U.S. government administration may create pockets of volatility during the year.
- U.S./China relationship under the new administration is an uncertainty. President-elect Biden is viewed more favorably than Trump, however, anti-China sentiment is popular on both sides of the aisle and there is potential for further deterioration of the relationship.
- Republicans not holding onto the U.S. Senate majority, and a further rise in the already high government debt burden, may jeopardize the U.S. status as a "risk-free" credit.

Risks aside, Newfleet is confident that in this environment, we can exploit inefficiencies within sectors and take advantage of dislocations.

Sectors we currently favor include:

- Out-of-index/off-the-run asset-backed securities vs. short corporate investment grade bonds
- Non-agency RMBS vs agency MBS
- Focused credit selection within leveraged finance (bank loans and corporate high yield)
- Corporate investment grade with a focus on BBB rated securities
- High yield emerging markets over investment grade emerging markets
- Municipal bonds tactically – taxable equivalent yields are attractive and taxes in the U.S. are going up

While there is no doubt that COVID-19 has proven disruptive to economies, we are confident that the crisis will be resolved with time. Our multi-sector approach to fixed income investing, honed over nearly three decades, enables us to scan the bond market for the most attractive investment opportunities wherever they may be and is ideally suited for the current environment.

Stephen H. Hooker
CFA, Managing Director and Portfolio Manager

UK SME sector: A lot tougher than it looks in the headlines

As we move into 2021 many of the unknowns of 2020 have become the knowns of 2021 - the US election has taken place and we have a new president about to be sworn into office. An initial Brexit treaty has been negotiated and the UK has left the European Union. The UK is also leading the way in the deployment of new vaccines which signal the possibility of the end of the pandemic this year.

As a private debt manager, we have to look to the fundamentals, however, and we see much to be encouraged about, with huge fiscal stimulus programs being rolled out in both the UK and US, our core markets. According to Goldman Sachs, the US is en route to 3%-4% GDP growth in 2021, with the UK forecast to see 5%-7% GDP growth.

A year of change and opportunity

The UK market sets out in 2021 with manufacturing PMI at a three year high. Preparations are afoot to host a G7 summit in the country as well as the important UN Climate Change Conference. It is going to be a year of change and of opportunity for businesses on both sides of the Atlantic.

“ For every two businesses that have cut jobs during the pandemic, another has increased its employee base ”

Investors often ask us about job losses in the UK and the state of the SME economy. The UK government has recognised the importance of the SME sector for economic growth and employment, hence the headline-grabbing stimulus packages that were rolled out by the Chancellor in 2020.

According to the UK’s Office of National Statistics, aggregate national profit share (gross trading profits of the corporate sector) rose 23% to a record GBP126bn in the three months to September. For the first nine months of last year, according to the ONS, total corporate profits averaged GBP116bn a quarter, compared with GBP115bn in 2019. In other words, *companies in the UK were more profitable during the pandemic than before it*.

While turnover has fallen, so have the bottom lines for many UK companies. Grants, tax deferrals and tax cuts, not to mention the employee furlough scheme, have all had a substantial impact on the UK corporate bottom line. This leaves many UK companies with the prospect of making considerable savings - the Office of Budget Responsibility expects UK companies to have saved around GBP30bn in cash in 2H 2020. Profits may be subdued, but many UK firms are now seeing bigger cash margins they can potentially deploy in 2021.

UK small businesses are resilient

The UK small business sector has proved very resilient under the twin threats of both Brexit and the pandemic: according to Goldman Sachs, for every two businesses that have cut jobs during the pandemic, another has increased its employee base. Although 44% of firms have cut jobs last year, 62% have continued trading without interruption. This can be attributed in part to the fact that more than 80% of the UK economy is serviced based and it is also the world’s second largest exporter of services after the USA.

Prestige Funds’ lending partner Nucleus Commercial Finance was one of a small number of private lenders selected by the UK Government owned British Business Bank to deploy government guaranteed loans to small businesses last year. Since September 2020, Nucleus has lent almost GBP200m / USD 270m in this scheme. This was testament to our internal expertise, processes, technology investment and considerable UK relationship network.

Financing of small businesses through government-backed schemes has played a critical role in helping to support small businesses through these trying times - 98% say government support has had a positive impact on small businesses, with 80% telling Goldman Sachs that the current support on offer from the government is enough to ensure their business survives. Not only that, but 59% say that current support levels are equipping them to growth their business in the future. Four out of five UK SMEs now feel they no longer require further government support to prevent further redundancies[1].

How has the SME sector proved so resilient? Business owners have demonstrated their readiness to take on external finance, and they have proved dynamic enough to change their business models to meet the new challenges presented by the pandemic. Many business owners tell us that these changes are likely to prove permanent, as they further embrace new and dynamic operating models.

“ For the vast majority of UK SMEs Brexit will make little or no impact on the way they do business ”

Brexit: removal of uncertainty will be beneficial for SMEs

Brexit has also captured many headlines in the UK and Europe in Q4 of this year. For SMEs this has presented an additional challenge, and it is true there are some companies with heavy exposure to EU trade flows. But for the vast majority of UK SMEs Brexit will make little or no impact on the way they do business. Uncertainty has probably been one of the biggest worries for business owners.

At Prestige we focus our lending activities on companies with little to zero exposure to EU trade. But it is heartening to say that despite fears of a no deal with the EU throughout the course of 2020, less than 25% of SMEs were concerned about the negative impact of Brexit[2]. According to a survey from accounting software provider FreeAgent, almost 60% of SME owners are not worried about their future, and the number that thought Brexit would have a negative impact on the economy has fallen steadily in the course of 2020.

SME owners are refocusing their efforts on either trading within the UK, or trading with countries outside the EU itself. From the government, they want to see a further trimming of red tape and additional financial support in terms of grants and tax reductions.

This positive narrative for SMEs is now being described as ‘surthriving’ - describing those firms that have embraced the changes forced upon them and have become more dynamic - according to data from FreeAgent only 21% of UK SMEs are now worried about the impact of Brexit, and 10% say the pandemic has *actually opened up new opportunities*.

Craig Reeves
Founder

Last year was a testing time for many small business owners, but it has also proved that in the UK we have a diverse and opportunistic small business sector with the strategic support of a government that is prepared to do what it takes to shelter SMEs from the worst of the pandemic and pave the way for future successes in this sector.

[1]Small Business Britain - The Impact of Covid 19 to Date (Goldman Sachs) Small Business Britain: The Impact of COVID-19 To-Date (goldmansachs.com)
[2]Survey data based on 500 SME interviews by FreeAgent, October 2020

Gold Nuggets: The Post-Election World and Gold's 2021 Outlook

Volatility, low rates, and rising risks supported gold's price and investment demand in 2020, driving it to reach a new all-time high during the year. Despite some moderation on the volatility front post-election, the new year is looking poised to serve up more uncertainty for investors.

Setting the Stage for Gold with the Changeable Global Road Ahead

SCENARIO 1: THE BEAR CASE: $1,600 to $1,800. Probability rating: 20%

What needs to happen for this bear case scenario to occur?

This hypothetical scenario assumes a sudden reversal of many current positive trends in China and the rest of the emerging markets, with these players encountering additional major challenges in reopening their economies. There could be substantial renewed outbreaks of COVID-19, and countries in the region could be faced with persistent strict nationwide lockdowns. The nascent economic recovery currently forming in emerging markets would stall, and there would be no rebound in emerging market demand for gold jewelry.

"Under this bear scenario, gold prices could fall from current levels due to dwindling safe haven demand in the West"

By contrast, in the US and Western Europe, the pace of development of safe and effective vaccines may accelerate, and effective distribution mechanisms could be developed. These vaccines could rapidly become widely available in the industrialized world, leading to the swift emergence of herd immunity. These regions could be in a position to reverse recent lockdowns and reopen, and economic activity would rebound. With a faster-than-expected economic recovery in the developed countries, equity markets would likely soar to fresh all-time highs, and we could see aggressive steepening of the yield curve, coupled with renewed strength in the US dollar.

Under this bear scenario, gold prices could fall from current levels due to dwindling safe-haven and investment demand in the West, and no recovery in jewelry demand in Asia and other emerging markets.

SCENARIO 2: THE BASE CASE: $1,800 to $2,000. Probability rating: 40%

What needs to happen for this base case scenario to occur?

This hypothetical scenario assumes little change from the current circumstances. The pace of economic recovery in the emerging markets would remain slow, with widespread prosperity proving elusive, and collectively, suppressing any significant rebound in gold jewelry demand. Emerging market central banks could begin reversing their decade long buying trend and slow their net purchases of gold for official reserves as they begin to lose confidence in their view that further US dollar depreciation is inevitable.

In the US and Western Europe, the impact on the spread of the virus as a result of recent lockdowns and mask mandates remains patchy. A recent Pew Research[1] poll suggested that almost half of Americans surveyed would not get vaccinated immediately, even if supplies were available. That raises the possibility that there might be no rapid development of herd immunity as a result of the introduction of vaccines.

Therefore, the economic recovery in the industrialized world that began in Q3 2020 would continue but remains slow, so there would be no significant growth in gold jewelry demand. With progress toward economic recovery remaining slow, the US dollar could stay flat to perhaps somewhat lower. Real yields would likely stay negative as inflation — higher yet benign — exceeds any rise in nominal yields. There are, however, enough encouraging signs of impending economic recovery that safe-haven investment demand for gold may suffer.

SCENARIO 3: THE BULL CASE: $2,000 to $2,300. Probability rating: 40%

What needs to happen for this bull case scenario to occur?

This hypothetical scenario assumes continued unevenness in reopening of economies throughout the world. A continuation of current positive trends in the emerging markets could see a powerful recovery in economic activity in those regions, with China leading the way. The resulting rapid return to prosperity could lead to a significant rebound in jewelry demand. In addition, emerging market central banks may resume their decade-long trend of strong net purchases of gold after slipping briefly into net sales in Q3 2020. That unexpected development primarily came about as a result of one emerging market outlier — Uzbekistan — reducing its exposure to gold from two-thirds to approximately 50% of its total official reserves.[2]

"The global situation seems poised somewhere between the base and bull case scenarios"

In the US and Western Europe, this scenario assumes continued problems and delays in reopening economies as a consequence of growing virus cases and renewed widespread lockdowns, placing additional pressure on these already delicate economies. For the US specifically, the four main priorities of the incoming Biden administration – more effective tackling of the COVID-19 pandemic, economic stimulus focusing on infrastructure to fulfill the "build back better" campaign promise, health care for all, and aggressive action to combat climate change — are all seen as likely to lead to higher deficits, generating dollar depreciation and fears of rapidly rising inflation. This scenario could lead to continued strong demand for gold as a perceived defensive investment.

Expectations for the Post-Election World and the Outlook for 2021

At the time of this writing, there seems little chance of the bear case scenario coming to pass. Right now, the global situation seems poised somewhere between the base and bull case scenarios. The one condition that seems likely to be a given as we move toward some level of economic recovery — while at the same time, treading the difficult evolutionary path toward whatever the "next normal" turns out to look like — is an elevated level of volatility across all financial markets. Gold's diversification properties may help investors seeking to preserve value in their portfolios during that difficult navigation ahead.

Bottom line, based on the probability ratings above, it seems that there may be more potential upside than downside factors stacking up for gold in the new year. Interesting times certainly lie ahead.

George Milling-Stanley
Chief Gold Strategist

[1] https://www.pewresearch.org/science/2020/09/17/u-s-public-now-divided-over-whether-to-get-covid-19-vaccine/
[2] World Gold Council – Gold Demand Trends Q3 2020, date as of October 29, 2020.

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