2021 IN FOCUS
THE NEW NORM

TINTRA

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EXECUTIVE SUMMARY

Thank you for taking the time to look through our report as we have enter a new investment order.

The Covid-19 pandemic has accelerated shifts in how economies and societies operate. We are seeing transformations that affect sustainability, inequality, geopolitics and seemingly macro policy. This is reflected in our 2021 investment themes. The new investment order is still evolving, and investors will need to adapt. Yet the features are becoming clear, and we believe this calls for a fundamental rethink of portfolio allocations – starting now.

The traditional business cycle playbook does not apply to the pandemic. How it will play out is yet to be seen. Early in the crisis, we assessed that the ultimate economic losses – what matters most for financial markets – would likely prove to be much less than during the Global Financial Crisis of a decade ago.

This view was predicated on the need for robust policy support to tide households and businesses over during the length of the pandemic. The early results of Covid-19 vaccine trials give us greater confidence in this framework. They suggest the economic restart can re-accelerate significantly in 2021 as pent-up demand is unleashed. We believe markets will likely be quick to price in a full economic restart given the improved visibility on the outlook. If indeed they aren't already priced that way.

The U.S. and Europe face challenges this year: A third or fourth wave of virus cases may result in outright economic contraction. Risks of policy fatigue are rising, especially in the U.S., and ongoing policy support is vital to limit any permanent economic damage. Not to mention the downstream impact that it is causing on the US political system as voters vent their frustrations in abstract ways. Yet positive vaccine news is a game changer in that we now know we have visibility on exit, providing clarity for policymakers, businesses and markets about getting to a post-Covid stage.

As a result, we favor looking through any near-term market volatility. We increase our overall pro-risk stance by upgrading equities on a tactical basis, and take a sectoral approach.

We like tech and healthcare due to the pandemic's transformative shifts. We balance this with a preference for prime potential beneficiaries of the economic restart, such as Tintra's main focus, emerging market (EM) equities and U.S. small caps. We overweight Asia ex-Japan equities and Asia fixed income on the region's effective virus response, and favor assets exposed to Chinese growth.

The policy revolution has big implications for strategic views as we see a more muted response of nominal yields to a higher inflation environment. Central banks appear committed to limit any rises in nominal yields even as inflation picks up. Investors will need a new playbook to navigate this. We are not so sure about government bonds and maintain a higher strategic opinion to equities than in typical periods of rising inflation.

Sustainability is a key component of our views as we see a tectonic shift to sustainable assets playing out over decades. Contrary to past consensus, we expect this shift to help enhance returns. Private market exposures are one way to pursue portfolio resilience with a sustainable lens and that is where we see large value.

THE FUTURE LOOKS DIFFERENT

Covid-19 has done many things to change the global landscape in ways that may not all yet be completely understood.

IN an investment sense the virus has shined a light on underappreciated environmental, social and governance (ESG) factors that include employee safety, while support for combating climate change has swelled amid extreme weather events.

Secondly, rising income, wealth and racial inequalities are fueling dissatisfaction with the status quo, and could drive tax increases for HNWI's and higher minimum wages – as well as threats to central bank independence.

Thirdly, Covid has accelerated geopolitical trends such as a bipolar U.S.-China world order and a rewiring of global supply chains. We don't see this as deglobalization – it is more about the world adapting to this new order. Lastly, the unprecedented cooperation between fiscal and monetary authorities has upended the policy landscape.

There is no political appetite for fiscal austerity, even as debt ratios hit historic highs globally. Not least as it seems not to have worked since the GFC. The politics of inequality will likely keep deficit spending high.

New central bank policy frameworks are likely to keep interest rates low – even in the face of rising inflation. And we are already seeing signs of a risk that central banks become more politicised in the new investment order.

This comes as rising production costs amid a focus on supply chain resilience and greater pricing power of large companies in this environment. Taken together, it seems that markets underappreciate inflation risks – and that the coming higher inflation regime will be very different from the reflation debates of the last expansion.

This has significant implications for strategic asset allocations. Key components include a rethink of the role of developed market (DM) government bonds, given the implications of the policy revolution will mean a drop in real yields.

That implies – unusually in a more inflationary environment –a favorable backdrop for equities as discount rates are contained by policy. It also means a preference for inflation-protected bonds.

These are bold statements that may well be wrong but our view is that this is the trend that we are setting toward.

THE NEW NOMINAL

Likely there will be stronger growth and lower real yields ahead as the vaccine-led restart accelerates– even as inflation expectations climb. Inflation will have different implications to the past.

Strategic implication: We are negative toward government bonds and see equities supported by falling real rates.

Tactical implication: The low-rate outlook keeps us pro- risk. We like US equities and real estate

GLOBALISATION 2.0

Covid-19 has accelerated geopolitical transformations such as a bipolar U.S.-China world order and a remaking of global supply chains – placing greater weight on resilience and less on efficiency.

Strategic implication: We, as always are strong on deliberate jurisdiction diversification and above-benchmark China exposure.

Tactical implication: We are strong on EM equities, especially Asia ex-Japan, and less so Europe and Japan.

LIGHTENING TRANSFORMATIONS

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A LESS SEVERE SHORTFALL

The timing of effective and widely available Covid-19 vaccines will be a key driver of the restart.

This is particularly true in the face of increased risks to U.S. fiscal stimulus needed to sustain households and businesses through the virus shock. Encouraging news on the vaccine front strengthens the base case of a full restart by late 2021.

The vaccine game changer is knowing we are building a bridge to somewhere. It provides more clarity for governments, companies and households about the shape of a post Covid-19 economy.

This anchor should help limit any economic scarring and justify deploying further policy support. All this should make it easier for risk assets to absorb any near-term disappointments but also to quickly price in the accelerated restart, in our view.

The restart faces challenges in the near term as rising hospitalisations and fatalities globally trigger renewed lockdowns. The euro area economy may now contract in the fourth quarter of the year, with the U.S. close behind.

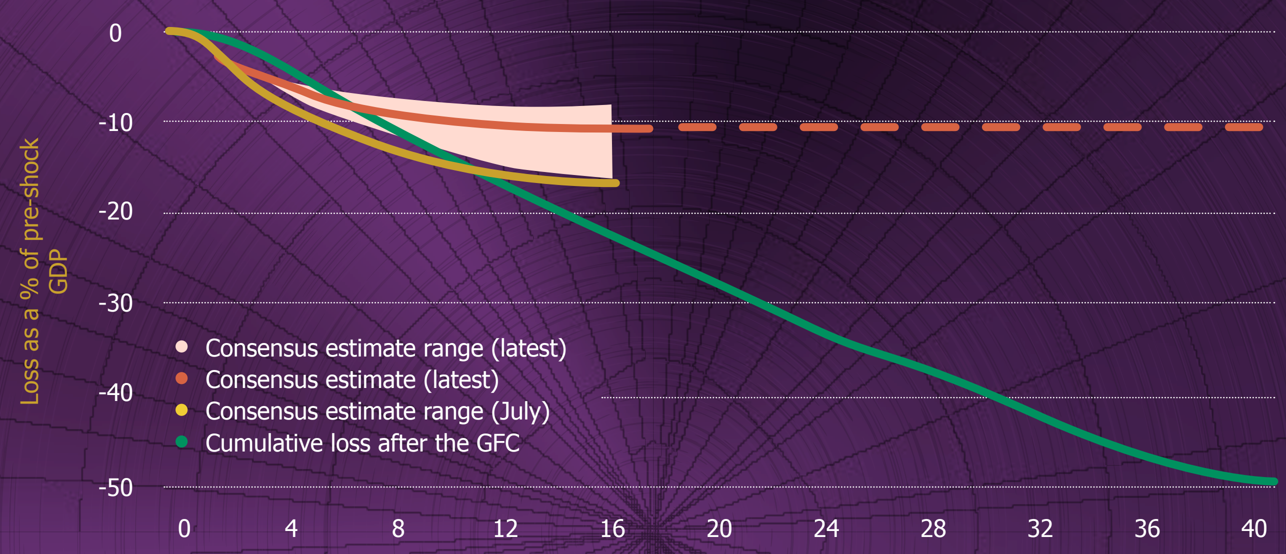
This setback would not materially increase the ultimate GDP shortfall from pre-virus levels we feel. Consensus growth estimates suggest the shortfall – what ultimately matters for financial markets – is now on track to be a fraction of the post-GFC one and smaller than what had been expected in July. See the chart.

Traditional business cycle analysis doesn't apply in the wake of the Covid shock, in our view. We see it as akin to a natural disaster, which is typically followed by rapid economic restart with little permanent economic damage, and expect it to speed up structural changes. This is very different from the 2008 crisis, which was followed by a "lost decade" of deleveraging and declining trend growth.

This view underpins our view that investors should be pro-risk during this year, particularly in US equities. It includes overweights in selected cyclical exposures such as U.S. small caps, and EM and Asia ex- Japan equities. We also are bearish against investment grade credit to fund a tilt toward more cyclical exposures such as high yield and Asia fixed income.

RESTART + RESET

U.S. GDP shortfall after the GFC vs. estimated loss from the Covid shock



Sources: BlackRock Investment Institute, with data from Reuters News - November 2020

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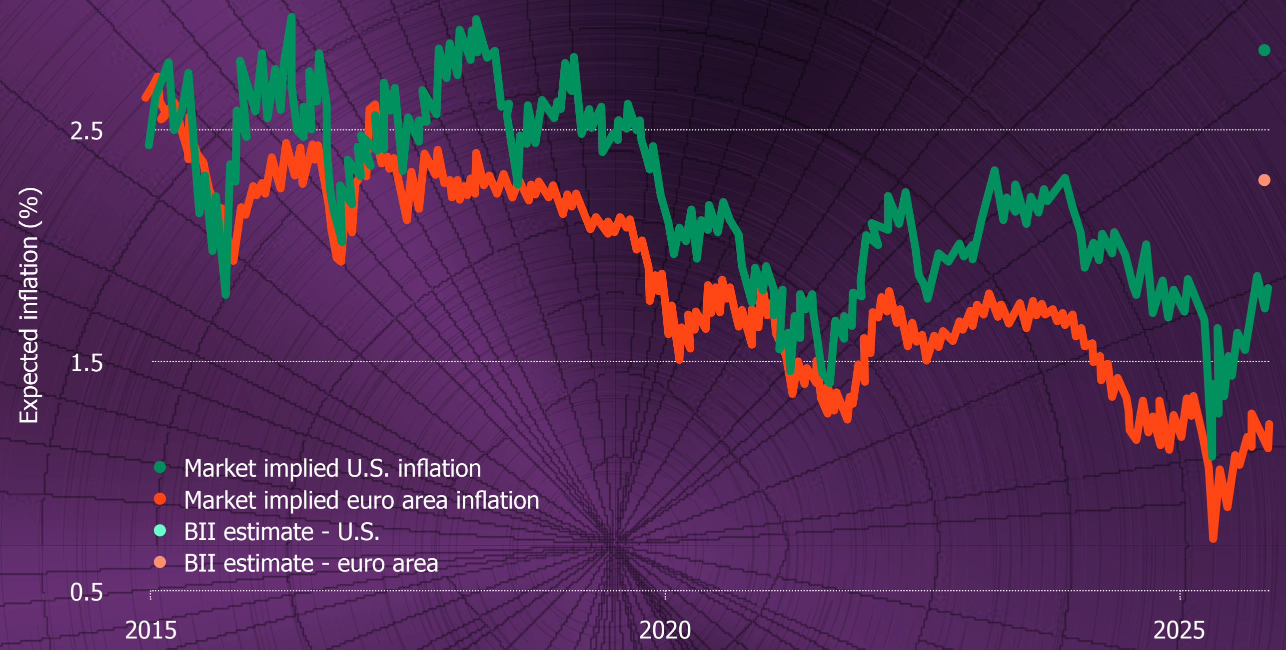
UNDERAPPRECIATED INFLATION RISKS

Forward inflation estimates vs market pricing, 2015-2025



Forward-looking estimates may not come to pass. Sources: BlackRock Investment Institute and the Federal Reserve with data Refinitiv Datastream, November 2020. Notes: The cart shows market pricing of expected average inflation over the coming five-year period. We show it using the five-year/five-year inflation swap which is a measure of market expectation of inflation over five years, starting in five years' time. In the chart, the lines are shifted forward five years. The orange and green dots show our current estimate of average U.S. CPI and euro area inflation for the same five-year period of 2025-2030. Euro area refers to all 19 member states.

HISTORY SUGGESTS INFLATION RISK IS HIGHEST WHEN LOW-INFLATION CONVICTION IS THE STRONGEST – AND THE VIEW IS ENTRENCHED IN INTELLECTUAL AND POLICY FRAMEWORKS.

THE NEW NOMINAL

The "new nominal" is not simply about our expectation for a higher inflation regime in the next five years.

It means stronger growth in the near term, and eventually higher inflation - without the typical rise in nominal bond yields. As a result, we see very different market implications than in the past.

Previous episodes of rising inflation were costly for investors, leading to higher interest rates that pressured valuations across asset classes via rising discount rates. Yet the policy revolution means any rise in inflation from today's levels will be better for risk assets than in past episodes, in our view.

Central banks have signaled they will be more willing to let economies run hot with above- target inflation by changing their policy frameworks to make up for prior inflation undershoots. At the same time, the fiscal-monetary policy revolution – a necessary response to the Covid-19 shock – risks greater political constraints on central banks' ability to lean against inflation. We see central banks likely curbing nominal yield rises to prevent an unwanted tightening of financial conditions.

We see other reasons for higher inflation, as detailed in Preparing for a higher inflation regime.

Production costs look set to rise on the rewiring of global supply chains, while we see scope for companies to exert their pricing power to protect profit margins. Corporate cost cutting may mitigate inflationary pressures in the near term.

But even the moderately higher inflation in our base case – around 2.5-3% annually – would surprise markets after a decade of undershoots. See the Under- appreciated inflation risks chart.
DM government bonds in portfolios are challenged; with yields near effective lower bounds and central banks limiting yield rises even as growth picks up, we believe they will be less effective as portfolio diversifiers.

Real yields look to be headed lower – one reason why we favor inflation-linked securities on a strategic basis. Importantly, we believe The new nominal of constrained nominal bond yields will support risk assets.

As a result, our view is that investors should be more pro-risk and maintain a higher strategic allocation to equities than they would if higher inflation were to have its historical impact on nominal yields.

CHINA'S GROWING SHARE

China annual growth and share of world GDP, 2000-2025

Sources: BlackRock Investment Institute and the International Monetary Fund (IMF), with data from Haver Analytics, December 2020. Note: The yellow line shows China's annual real GDP growth rate. The dotted lines are IMF forecasts. The orange bars show China's past and expected share of global GDP. There is no guarantee any forecasts made will come to pass.

WE SEE CHINA AS A DISTINCT POLE OF GLOBAL GROWTH – AND AS AN INVESTMENT DESTINATION SEPARATE FROM EMERGING MARKETS.

REWIRED GLOBALISATION

Covid-19 has accelerated geopolitical trends such as a bipolar U.S.-China world order and a rewiring of global supply chains for greater resiliency – with less priority on efficiency.

Strategic U.S.-China rivalry looks here to stay, with competition and bifurcation in the tech sector at its core. We are likely to see an increased emphasis in both countries on seeking self- sufficiency in critical industries of the future.

China is looking to master foundational technologies such as semiconductors, in which it has traditionally lagged the U.S.

This is why we believe investors need exposure to both poles of global growth.

We may see a changing U.S. emphasis on the relationship with China: more focus on climate and human rights and less on the bilateral trade deficit. This is not a simple story of deglobalization as China is opening up its capital markets to global investors.

China's share of global GDP has been steadily growing even as its growth has slowly trended down as the economy matures. Growth now is on track to return to its pre-virus trend, just as it bounced back quickly in the post-GFC period. See the China's growing share chart.

We see assets exposed to Chinese growth as core strategic holdings that are distinct from EM exposures.

There is a clear case for greater portfolio allocations to China- exposed assets for returns and diversification, in our view. We expect persistent inflows to Asian assets as many global investors remain underinvested and China's weight in global indexes grows.

Risks to China-exposed assets include China's high debt levels, yuan depreciation and U.S.-China conflicts.

But we believe investors are well compensated for these. How to implement such exposures will depend on investor constraints, including political and legal ones.

TURBOCHARGED TRANSFORMATION

Covid-19 has acted as a great accelerator of structural trends that were already in place – an increased focus on sustainability; widening wealth, income and health inequality; and the dominance of e-commerce.

The pandemic has focused attention on underappreciated sustainability-related factors and supply chain resilience. The euro area, for example, is putting green infrastructure and digitalization spending at the center of its economic restart efforts – helping speed up the transition to a low- carbon economy.

The pandemic has heightened the focus on inequalities within and across countries due to the varying quality of public health infrastructure – particularly across EMs – and access to healthcare.

And Covid-19 has hastened the dominance of e-commerce and the demise of struggling brick-and- mortar retailers. See the Shopping from home chart.

The pandemic has accelerated "winner takes all" dynamics that have led a handful of tech giants to dominate equity market index performance in recent years.

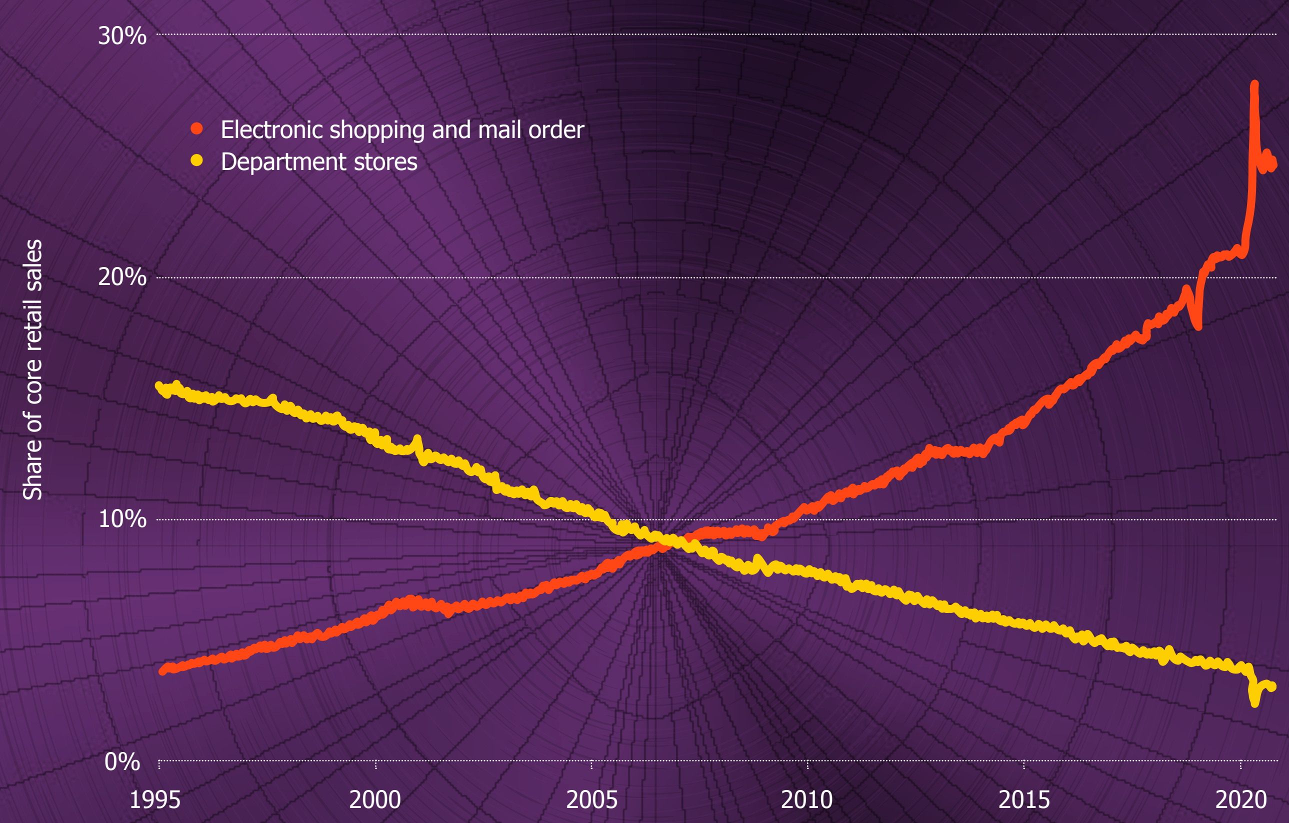
Despite this year's runup in valuations, we see tech exposures as having long-term structural tailwinds. The quality factor, U.S. equities and Asia ex-Japan equities are ways of gaining such exposure.

Sped-up transitions also support our strategic preference for sustainable assets as portfolio building blocks. We see persistent flows into sustainable assets in the long transition to a less carbon-intensive world (see page 11).

Accelerating structural changes should trigger a wholesale reassessment of the strategic portfolio, rather than just a tweaking at the edges, in our view. We believe asset class diversification alone is not going to be sufficient: Granular analysis at the country, sector and security level is crucial.

SHOPPING FROM HOME

A telling tale 1995-2020



THE PANDEMIC HAS ACTED AS A GREAT ACCELERATOR OF STRUCTURAL TRENDS SUCH AS A RISING FOCUS ON SUSTAINABILITY AND THE DOMINANCE OF E-COMMERCE.

VARIABLE OUTCOMES

The Covid-19 shock is creating winners and losers across sectors.

Our view is that companies basically fit into three categories using a bottom-up framework: those in trouble that may fall further; those that are hurt but should recover; and strong companies getting even stronger.

Airlines are in the first bucket. Business travelers account for a disproportionate share of profits. And business travel may recover more slowly than leisure activity as many companies have discovered they can save costs by holding events virtually. Housing, materials and autos fall in our middle bucket.

Most were hit hard in the initial market selloff, but they have been among the biggest market surprises as the interest rate-sensitive parts of the U.S. economy came roaring back.

Tech is in the third category, and we see it maintaining its strengths: leveraging accelerated trends and offering scarce growth amid rock- bottom yields. The sector boasts the highest profit margins in the global equity universe. See the Not all sectors are created equal chart.

These high margins should stay intact amid low rates, we believe. Our base case of a divided U.S. government would make tax increases unlikely. And many technological trends, such as cloud computing, online advertising and digital payments, are still in early stages of adoption, leaving a long runway for growth ahead.

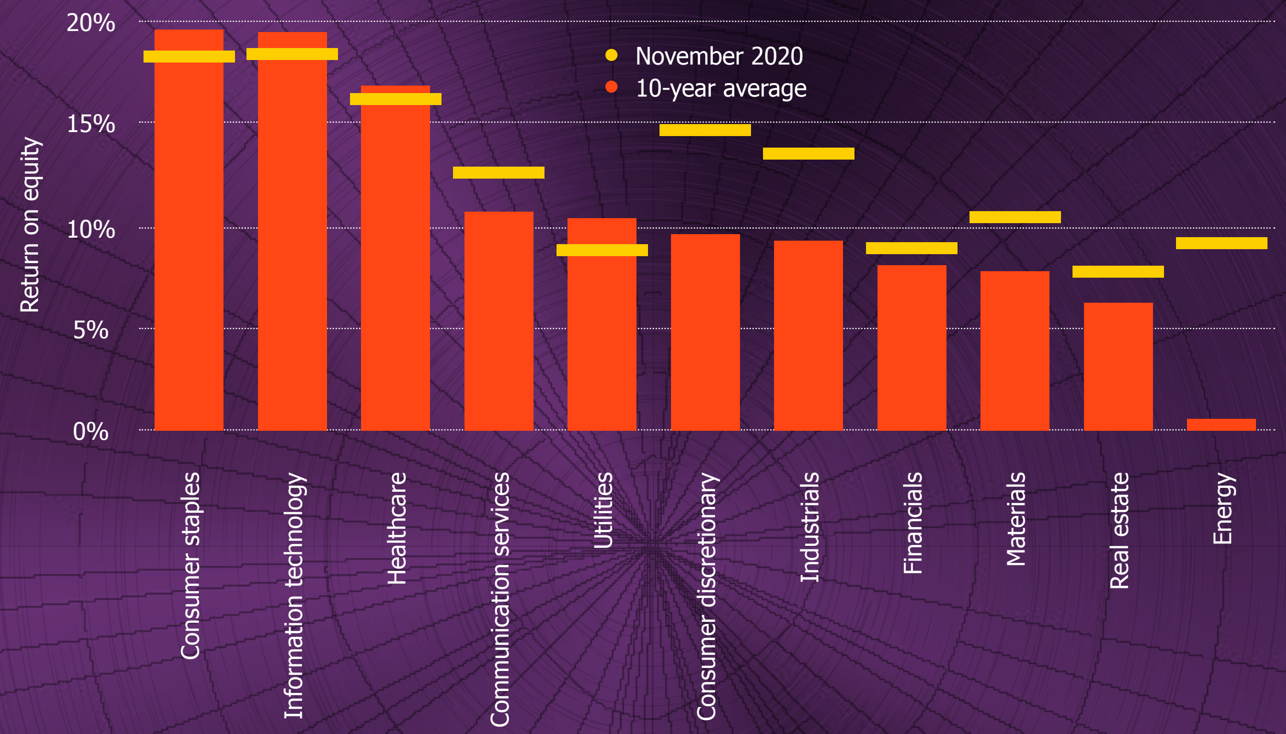
The concentration of recent market gains in tech is a risk. Yet we see potential for leadership within the sector to broaden to a wider set of beneficiaries across different themes, including 5G connectivity.

Software and semiconductors could lead the charge, as they face fewer regulatory risks and enjoy long-term growth trends.

“DIFFERENT SECTORS WILL HAVE VERY DIFFERENT OUTCOMES”

NOT ALL SECTORS ARE CREATED EQUAL

MSCI All-Country World equity sector return on equity, November 2020



Past performance is no guarantee of the future results. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index. Sources: BlackRock Investment Institute, with data from MSCI and Refinitiv, November 2020. Notes: The chart shows the return on equity by sector of the MSCI All-Country World Index as of November, compared with its 10-year average.

WE SEE THE TECH SECTOR MAINTAINING ITS STRENGTHS – BENEFITING FROM ACCELERATED TRENDS AND OFFERING SCARCE GROWTH AMID ROCK-BOTTOM YIELDS.

GEOPOLITICS

U.S. President-elect Joe Biden faces an ongoing pandemic, a weakened economy and a deeply polarized country. A Democratic Senate which looks increasingly likely.

Policy under a divided government – if Republicans retain control of the Senate– would have to reflect compromise rather than sweeping change, in our view. Big-ticket legislation – including large-scale fiscal stimulus and public investment, would face hurdles. Yet there may be some room for bipartisan compromise on issues such as R&D spending to meet the technology challenge from China.

The chief geopolitical implication is a more predictable U.S. approach to trade, foreign affairs, and working with allies. Tensions with Europe, particularly over trade, will likely ease. Reduced trade tensions and U.S. support for multilateral debt relief efforts should help EMs. Market attention to geopolitical risk has eased from 2018 peaks, as the A less tense world chart shows.

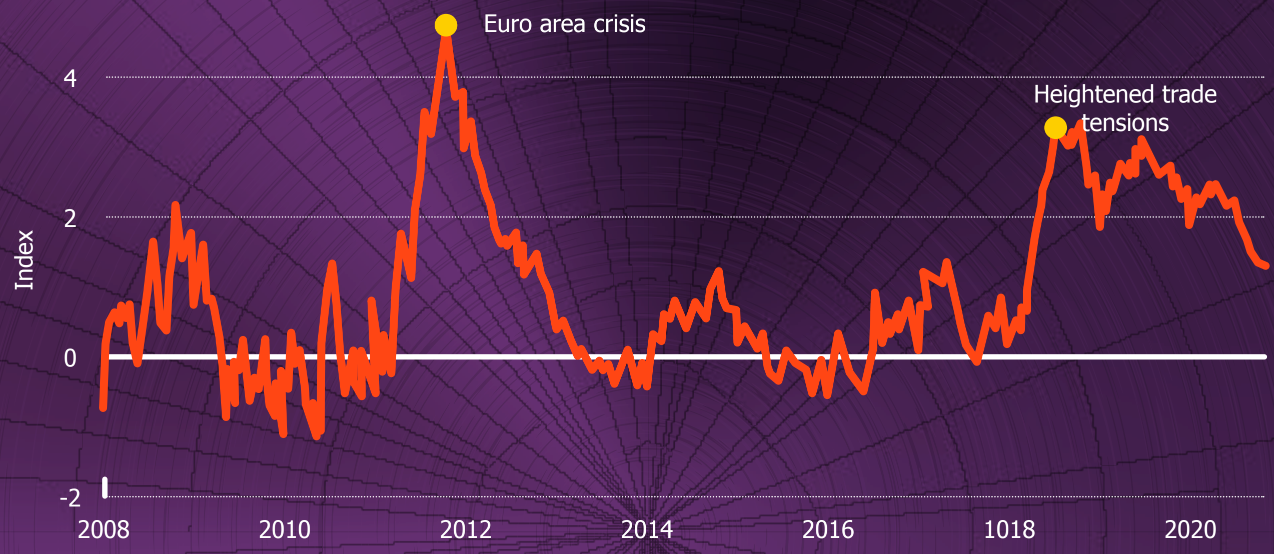
Climate looks set to play a central role in U.S. foreign policy, as flagged by the naming of former Secretary of State John Kerry as U.S. climate envoy, and a planned rejoining of the Paris Agreement on climate change. We expect to see U.S. support for continued peacebuilding between Israel and Arab nations and with the Qatar Blockade now at an end the region will be turned on.

The Biden administration looks set to launch a diplomatic effort to rejoin the Iranian nuclear deal, although a recent rise in tensions may complicate this. U.S.-China relations will continue to be marked by intense rivalry, particularly in the tech sector, in our view. Frictions may extend to the financial arena and human rights, even as we see room for the countries to cooperate on climate and public health policies.

THE IMPACT OF THE INCOMING BIDEN ADMINISTRATION SHOULD NOT BE UNDERESTIMATED, ESPECIALLY IN THE GULF & ASIA

A LESS TENSE WORLD

BlackRock Geopolitical Risk Indicator, 2008-2020



Sources: BlackRock Investment Institute, with data from Refinitiv. Data as of Nov. 13, 2020, Notes: We identify specific words related to geopolitical risk in general and to our top risks. We then use text analysis to calculate the frequency of their appearance in the Refinitiv Broker Report and Dow Jones Global Newswire databases. We then adjust for the whether the language reflects positive or negative sentiment, and assign a score. A zero score represents the average BGRI Level over its history. A score of one means the BGRI level is one standard deviation above the five-year average. We weight recent readings more heavily in calculating the average.

WE ARE LIKELY TO SEE A MORE PREDICTABLE U.S. APPROACH TO FOREIGN AFFAIRS AND TRADE POLICY, BENEFITING EXPORT-DRIVEN EMERGING MARKETS.

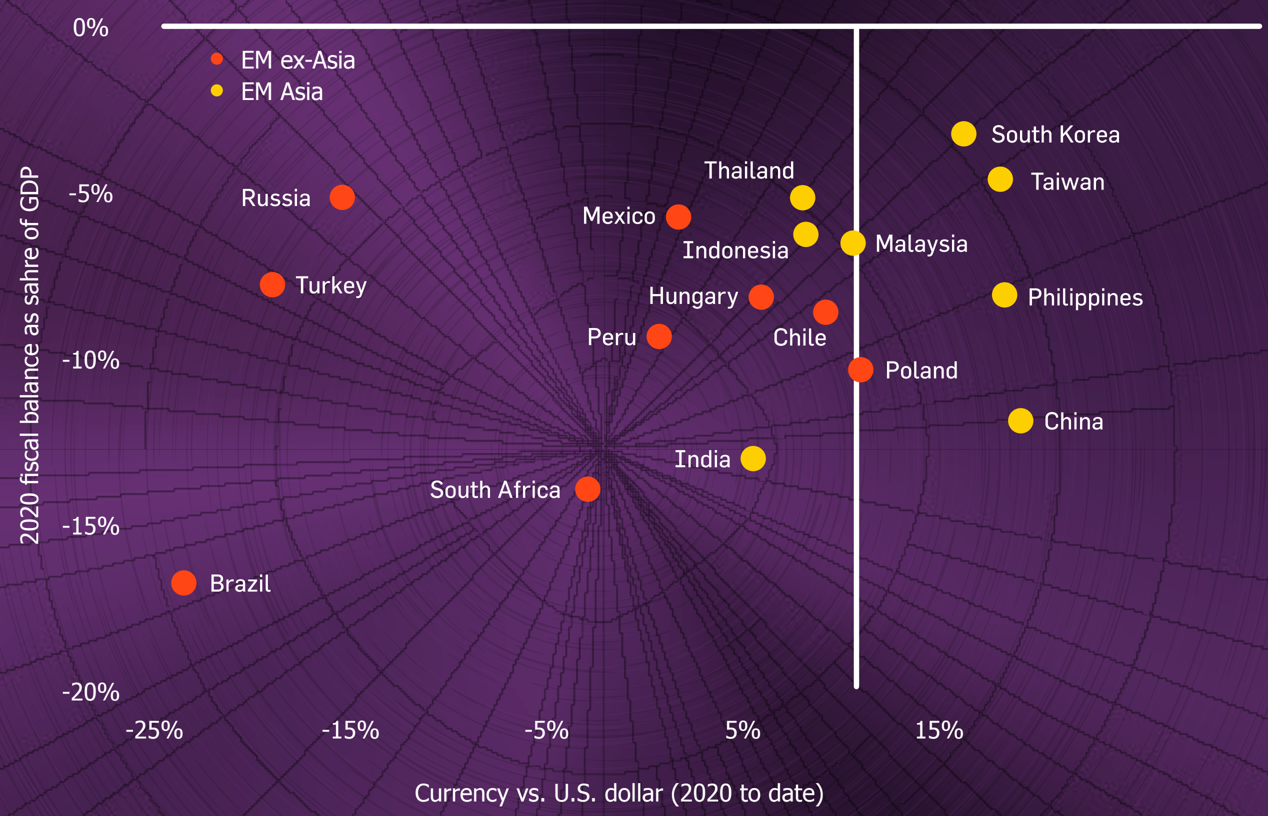
EMERGING MARKET

Winners & Losers

EM government fiscal balance and currency performance, 2020

EM winners and losers

EM goverment fiscal balance and currency performance, 2020



Sources: BlackRock Investment Institute and the International Monetary Fund, with data from Refinitiv, November 2020. Notes: The chart shows the top-20 countries in the MSCI Emerging Markets Index. Excluding those with currencies pegged to the U.S. dollar. The 2020 government fiscal balances are IMF estimates. Yellow dots are Asian economies; orange are other EM.

EMERGING MARKETS

The powerful stimulus delivered by developed market central banks has supported emerging markets.

The policy revolution implies that it will remain in place for longer – even as inflation starts to rise. We believe this should underpin investment flows into EMs, drawn by the allure of coupon income in a yield-starved world. EMs also stand to benefit from a cyclical global uptick in 2021 – and more predictable U.S. trade policy under the Biden administration.

Yet differentiation between and within countries is key in such a disparate asset class. There are significant vulnerabilities that have been exacerbated by the pandemic. Much of the EM world faces structural growth challenges and rising debt levels. Some EM countries may face a day of reckoning over the next few years, in our view.

We see this leading to greater dispersion in returns: EMs with stronger fundamentals may disproportionately benefit.

This is already playing out. Countries that sport the worst fiscal deficits have seen large currency depreciations. Asian currencies backed by stronger fundamentals have been more resilient. See the EM winners and losers chart. A stable to weaker U.S. dollar – the result of declining real yields and renewed global risk appetite, should underpin EMs in 2021, in our view.

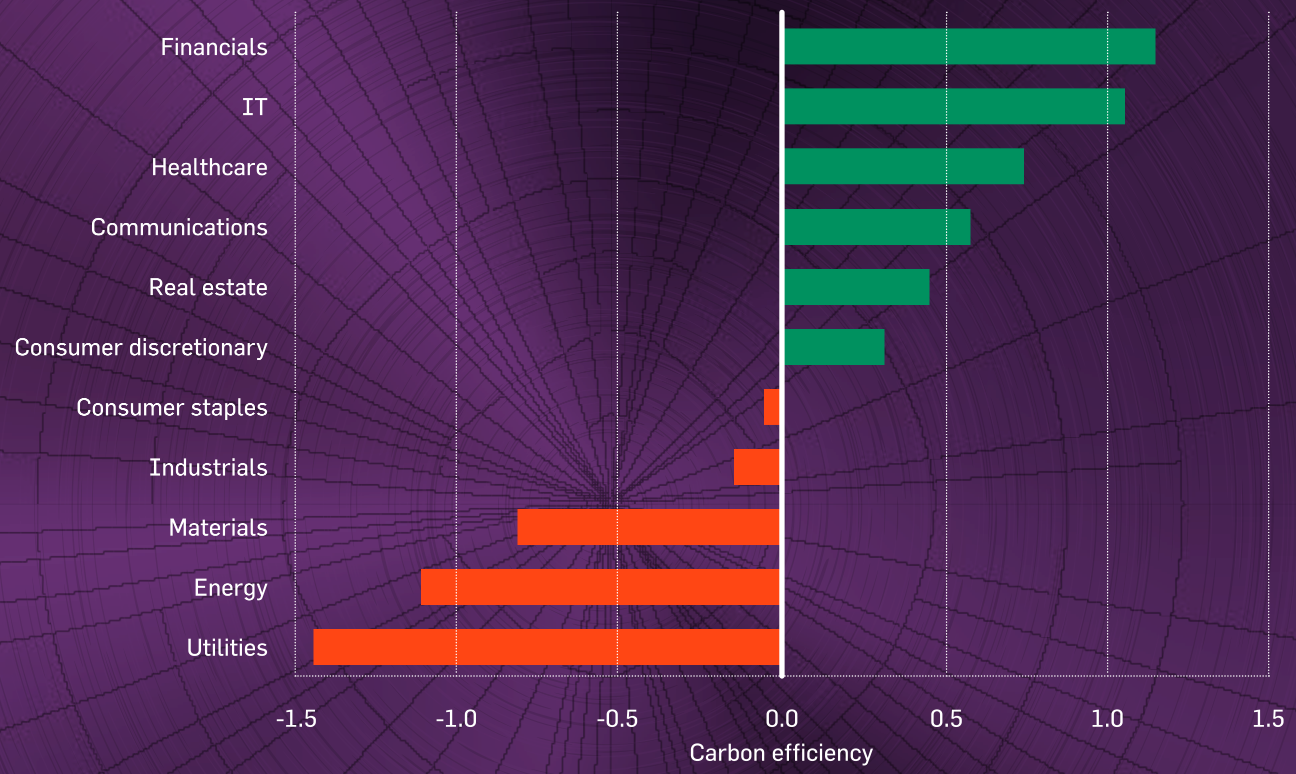
We recognize the need for nuance because of the complexities of EM as an asset class to the uninitiated. The lines between developed and emerging markets are also starting to blur. China and some other Asian countries have largely contained the virus – and are further ahead in the restart.

> “IN MANY WAYS WE’VE SEEN AN INVERSE CORRELLATION BETWEEN STIMULUS HEAVY ECONOMIES AND THEIR CURRENCY’S PERFORMANCE”

SEEING GREEN

Estimated carbon efficiency for MSCI sectors, December 2020

EM winners and losers
EM goverment fiscal balance and currency performance, 2020



THE DEBATE ABOUT SUSTAINABLE INVESTING HAS BROADENED. RATHER THAN TALKING ABOUT TRADE-OFFS, WE ARE FOCUSED ON RETURN POTENTIAL AND ALPHA.

SUSTAINABILITY

We have reached an inflection point in sustainability.

The European Union and China recently released more ambitious targets for reaching net-zero emissions. This will require major investment to make the green transition happen.

The tectonic shift toward sustainability is reflected in shifting preferences and flows into sustainable assets. Tintra's view is that this trend will play out over decades, as detailed in Sustainability: the tectonic shift transforming investing of February 2020. This is why sustainability has become a key component of how we think about investing – and we are incorporating it into our return expectations across asset classes.

Many argue that a costly green transition will weigh on growth, yet we believe this framing is misguided. The reason: We expect extreme weather and other effects of climate change to reduce potential growth in future decades.

Efforts to mitigate the damage from climate change should boost economic growth relative to this new baseline.

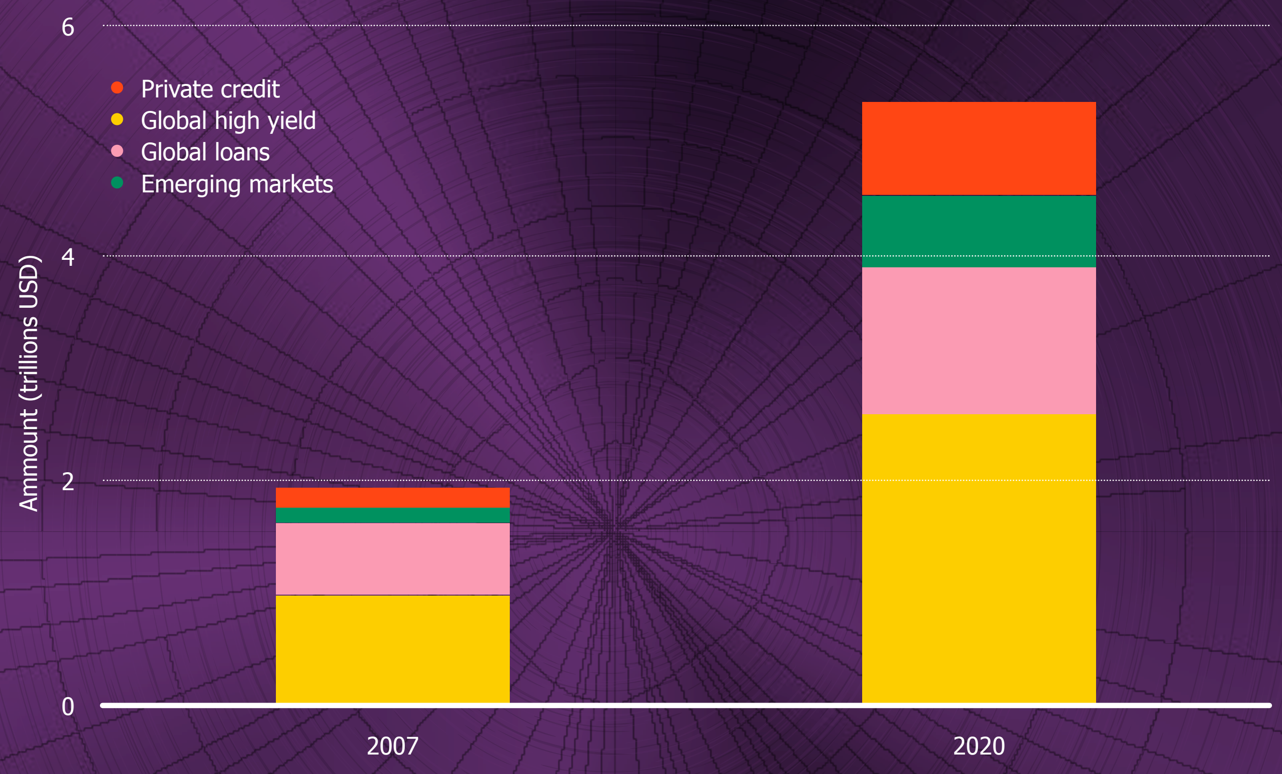
We see carbon efficiency – or the volume of carbon emitted as a share of firm value – as a key differentiator that will drive a repricing across sectors and companies. See the Seeing green chart.

High emitters may face regulatory penalties, higher taxes and financing costs. Companies that use carbon most efficiently will likely have greater resilience against risks such as carbon taxes and enjoy richer valuations as investor preferences shift toward sustainable assets.

Does sustainable investing mean giving up returns? This may become true eventually once "green" assets trade at a premium and "brown" ones at a discount. But Tintra sees a long transition period over which green assets can potentially outperform.

RESTRUCTURING OPPORTUNITIES

Sub-investment grade debt outstanding, 2007 and 2020



Sources: BlackRock Investment Institute, October 2020. Notes: Private credit data are from Preqin. Indexes used are Bloomberg Barclays Global High Yield Index, S&P/LSTA Leveraged Loan Index + S&P European All Loans Index, and JP Morgan CEMBI Index (emerging markets). Index data are as of June 30,2020, and the private credit data as of Dec.31, 2019. Indexes are unmanaged and do not account for fees. It is not possible to invest directly in an index.

WE SEE PRIVATE MARKETS PLAYING AN IMPORTANT ROLE IN PORTFOLIO RESILIENCE IN A WORLD WHERE GOVERNMENT BONDS MAY NO LONGER SERVE AS DIVERSIFIERS.

PRIVATE MARKETS

Many companies may need to turn to private credit to restructure for a post-Covid world.

We see potential for such investments to serve as growth assets and diversifiers.

Private markets are relatively illiquid and not suitable for all investors but play a key role in strategic portfolios, in our view.

The scale of restructuring needs could exceed the previous peak after the GFC. The amount of sub- investment grade debt outstanding has more than doubled to U.S. $5.3 trillion since 2007, as the Restructuring opportunities chart shows.

Private credit has been an especially fast-growing segment.

As debt markets grew and the overall cost of debt fell, companies became increasingly leveraged. This has left many vulnerable as revenues come under pressure from Covid-related disruptions.

This creates opportunities for restructuring and distressed debt specialists.

It is vital to pick private market managers who can assess credit risk and structure resilient investments. Restructurings typically involve complex negotiations between creditors.

Many institutional investors remain under-invested in private markets, we believe, and may underappreciate their ability to take on liquidity risk.

We see private markets playing an important role in portfolio resilience in a world where government bonds may no longer serve as diversifiers. They allow investors to build exposures to underlying trends not always available in public markets.

We also find that alpha opportunities can be greater in private markets than public markets which is of course a Tintra speciality. Such alpha can possibly be achieved by managers who have the ability to negotiate stronger debt covenants.

So the return potential is not just about taking higher risk to receive higher returns, in our view.

To learn more please contact us at
InFocus@Tintra.com

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