

A SECULAR OUTLOOK

2020

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Overview

It gives me great pleasure to introduce our 8th Secular Outlook, which explores the trends we believe will have the greatest impact on financial markets over the next five years. Readers won't be surprised to learn that this edition has been the most difficult of the eight to produce. The Covid-19 crisis has made our task, which was never straightforward in the first place, far more complicated. Whatever their vantage point, investors will find there is no escaping the pandemic's effects. For the most part, the health crisis will reinforce or accelerate trends that were already unfolding in both financial markets and the economy. Even so, it will still change the way countries are governed, businesses are run and people live their lives.

The long-term effects of the pandemic are our focus in Chapters 1 and 2.

In Chapter 1, we reflect on how the coronavirus will influence government finances, consumer and corporate behaviour, and economic growth. We also explain why we believe Covid-19 will accelerate the transition to a more inclusive and sustainable form of capitalism. In Chapter 2, we turn our attention to monetary policy and how it might evolve in a post-pandemic world. Central banks, we argue, will inevitably venture further into unfamiliar territory in their attempts to engineer a sustainable recovery.

We move beyond Covid-19 in Chapters 3 and 4.

The possibility of a global technological Cold War is the subject we explore in Chapter 3. As China redoubles its efforts to loosen the US's grip on the tech industry, the fear among many investors is that an intensification of Sino-US rivalry will lead to geopolitical instability. But that is not the only possible scenario. Our view is that growing competition may give rise to an acceleration of technological development and diffusion, providing a much-needed boost to global productivity. Asia is likely to be the winner in the tech race, in the long term.

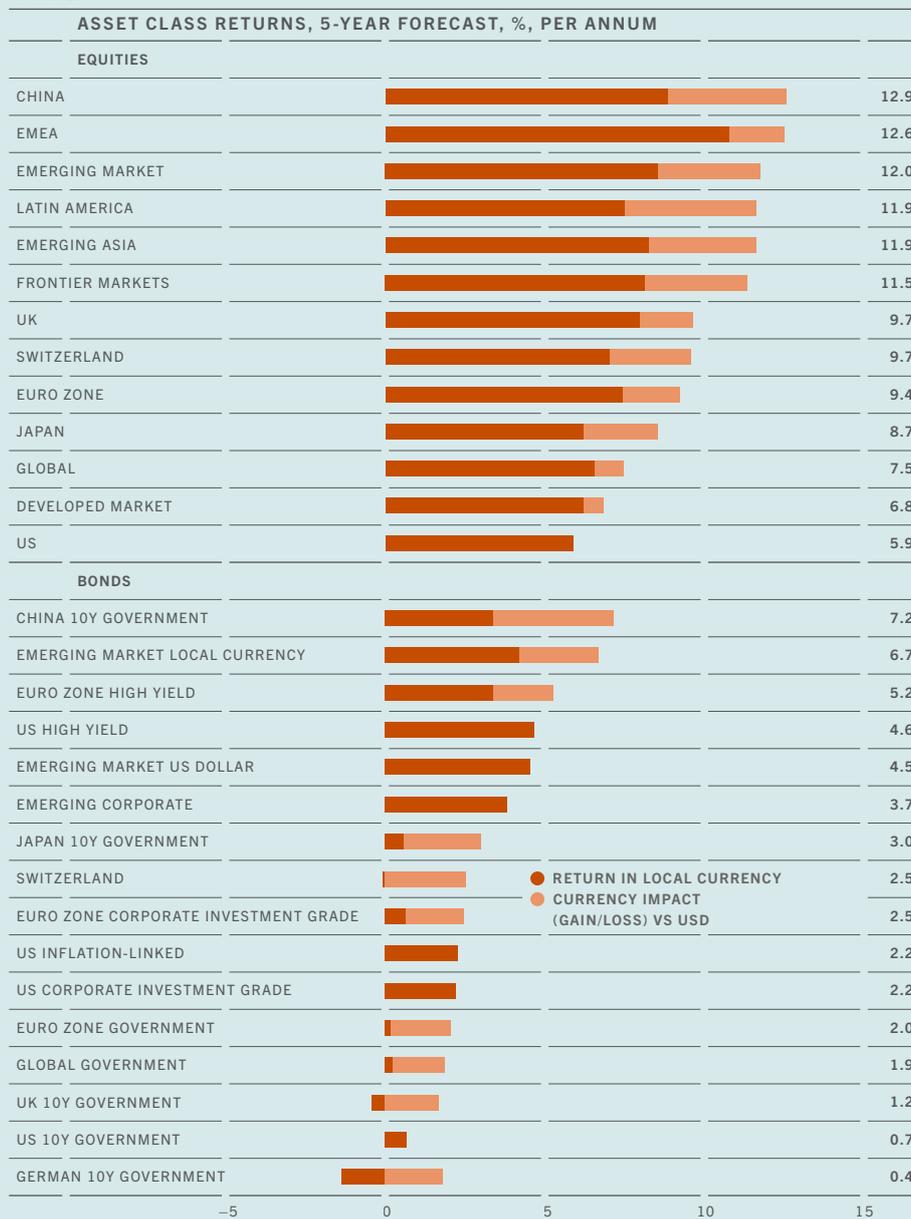
Chapter 4 analyses the prospects for passive investment and private equity. We believe that after experiencing stellar growth in recent years, the “two Ps” will enter a more mature and challenging phase of their development.

In section 2 of the Secular Outlook, we detail our return projections for the next five years; these encompass equities, bonds, currencies and a range of alternative assets. We expect returns for investors to be well below average over the next five years—but believe there remain some particularly attractive investment opportunities, especially in emerging markets and some alternative asset classes.

We very much hope that, on reading this year’s edition, you find yourself better equipped to deal with the uncertainties that lie ahead.

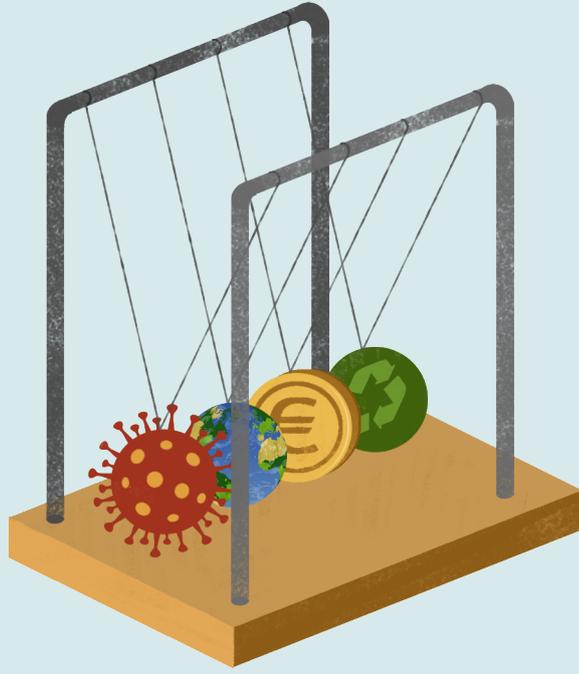
LUCA PAOLINI,
CHIEF STRATEGIST

FIG.1



Source: Pictet Asset Management
Forecast period: 30.06.2020 – 30.06.2025

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The legacies of Covid-19

Every global shock leaves a legacy. The hyperinflation and labour unrest of the late 1970s and early 1980s, for instance, gave birth to Reaganomics and Thatcherism while the 2008 credit crisis ushered in an era of ultra-low interest rates that persists to this day. The Covid-19 pandemic will have similarly disruptive effects. Business models will be overhauled, consumer behaviour transformed, and regulations and laws rewritten (see FIG. 2).

Our observations chime with the science. Even if a vaccine is developed, epidemiologists expect Covid-19 to remain a persistent threat to public health. Coronavirus infections, the World Health Organization has said, will ebb and flow for at least four or five years, which means many of the measures introduced to stem the pandemic will have to remain in place for some time.



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More public debt

Perhaps the most glaring economic legacy of the public health crisis is that it leaves the world even more deeply mired in debt. Relative to GDP, the median debt load of developed economies now stands at 120 per cent – the highest since the Second World War.

That is the price governments and central banks have been willing to pay to contain the economic and social upheaval caused by lockdowns. Still, the economic consequences of the borrowing binge could be severe. Higher debt levels will be a drag on growth over the long run even if interest rates remain low. There is a risk that government borrowing might crowd out private investment, which may fall in any case if companies opt to repair balance sheets rather than allocate capital to large projects.

Low growth the price for a stakeholder economy

Higher debt and lower growth, though, might be the trade-off a society accepts in return for more responsible forms of capitalism.

The pandemic has brought into sharp relief some of the failings of market economies. Deep-rooted problems such as social inequality, dilapidated public health care systems

and an inability to address environmental damage have become lightning rods for political dissent worldwide. But there are no easy fixes.

The immediate priority will be to ensure that the cost of rebuilding economies is borne by those with the broadest shoulders — especially now that those on the bottom of the ladder have been hardest hit by the virus. The least well-off also make up a big proportion of “key” workers, from carers to cleaners, bus drivers and community support officers who have put themselves on the front line in the battle against the pandemic.

Governments will be pressed to address these inequalities by enhancing workers’ rights, boosting minimum and living wages and expanding job protection schemes — perhaps going so far as to introduce radical measures such as universal basic income. Demands for improvements to public medical and social care provision will be hard to resist, not least in the US, where calls for European-style universal health care could well influence the outcome of the 2020 presidential election. Elsewhere, the health sector will acquire strategic status.

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Environmental policies are due an overhaul, too. It’s sobering that even as the pandemic tipped the world into the deepest recession in more than a century, annual carbon emissions fell by just 6 per cent, according to the International Renewable Energy Agency — a reduction it says will have no effect on greenhouse gas concentrations or global warming. As ever more people experience the damage caused by climate change, policymakers will be pressed to engineer a clean economic recovery.

Building a greener economy demands radical thinking. The European Union has taken a significant first step by pledging to mobilise some EUR1 trillion in sustainable invest-

ment over the next decade, as part of its Green Deal. Central bank-financed green bonds are also being mooted, as is a plethora of new environmental taxes and regulations. Fossil fuel producers have seen which way the wind is blowing and are responding: BP slashed the value of its oil reserves by some USD18 billion and said it expects the cost of emitting CO2 to rise to USD100 a ton from an earlier estimate of just USD40.

Companies will need to play their part. Prioritising shareholders’ needs above those of a broader range of stakeholders is no longer tenable. Firms will have to be more sensitive to the requirements of their employees, society at large, and the physical environment in which they operate. Many are already being judged by “what they did during the pandemic”. Clients, shareholders and regulators are likely to be ever less forgiving of transgressions.

Even if the world manages to contain and ultimately defeat Covid-19, it will emerge from that victory utterly transformed.

FIG.2

HOW COVID-19 WILL RESHAPE THE WORLD		
	PRE-COVID	POST-COVID
ECONOMY	Low growth, low inflation	Low growth, low but rising inflation
SAVINGS RATIOS	Average savings ratios	High precautionary savings
LABOUR	Underpaid, low security, commute	Minimum wage, working from home, automation
BUSINESS	Low-tax, winner takes all	Zombification, National Champions
INVENTORY MANAGEMENT	“Just in time”	“Just in case”
GOVERNMENT	Regulation, privacy, private interest	Dirigistic, priority of public interest
POLITICS	Shareholder capitalism	“Smart populism”, technocratic, centrist
ECONOMIC SYSTEM	Populism, polarisation	Stakeholder capitalism
INDUSTRIAL POLICY	Selected state participation	Nationalisation
FISCAL POLICY	Fiscal responsibility, budget rules	MMT, deficit spending; “print and spend”
TAXES	On income, focused on households	On wealth/capital
MONETARY POLICY	Lower for longer	Lower forever, “opportunistic deflation”
ECONOMIC POWER	US global leadership	Regional blocks, power shifts to the East
TRADE	“Slowbalisation”	De-globalisation, duplication supply chains
INTERNATIONAL RELATIONS	Fading cooperation	Confrontational, focus on national autonomy/interest
TECH	Global tech titans, linear tech adoption	China-US decoupling, exponential tech adoption
FINANCE	Short-term, profit-maximising, financial engineering	ESG, sustainable investments
CIVIC LIBERTIES	Extensive, protection of privacy	Restricted in case of emergency

Source: Pictet Asset Management

Conversely, businesses that make the grade are likely to be rewarded. Already, a growing body of evidence shows that companies that behave responsibly enjoy lower capital costs. Recent experience tells a similar story. Investment flows into equity funds that prioritise high environmental, social and governance (ESG) standards have proved resilient throughout the pandemic.

The return of Big Government

The post-Covid world will also spur Big Government. The state's influence in economic affairs, which had already been growing in the years following the credit crisis, is bound to expand further.

This more muscular interventionism will take many forms, with far-reaching consequences.

To begin with, in seeking to repair and protect "strategic" industries ravaged by the coronavirus, the state could end up with large stakes in a wide range of businesses.

During the credit crisis, government takeovers of struggling corporations were limited to the financial sector. In the wake of the Covid-19 shock, however, state intervention will be of an entirely different magnitude. Nationalisations cannot be ruled out.

Airlines, automakers, steel manufacturers, semiconductor companies, food producers and medical equipment firms are among the companies governments now view as "strategic" and therefore ripe for state involvement of one

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kind or another. France and Germany have wasted little time in building public stakes in their airlines and car manufacturers. Other nations, such as Australia, are seeking to introduce new rules to prevent foreign takeovers of strategically important companies. If such measures prove temporary, the side effects will be manageable. But if the governments end up being long-term shareholders, innovation risks being stifled and capital misallocated.

Governments will also seek a bigger share of corporate profits. The re-invention of the welfare state will not be cheap. While public borrowing will pay for part of it, tax will also have a role. And with both corporate tax rates and the

labour share of income having fallen sharply worldwide in recent years, company profits are an easy target. Data from S&P Global show that the median effective tax rate for companies in the S&P 500 has dropped from 35 per cent to below 20 per cent since 1990. Over the same period, the rate for FTSE100 firms has dropped from about 32 per cent to 22 per cent.

By also hiking capital gains and property taxes, governments could engineer a significant redistribution of wealth and power from capital to labour.

Higher tax rates won't be corporations' only headache. Building a more inclusive economy will require new regulations, too. Without them, companies will lack the incentives to ditch unsustainable practices and businesses.

Technocrats to supplant the populists?

While a bigger state is inevitable, it is not clear what type of government might oversee the transition. Targeting inequality and taming capitalism are normally the preserve of populists. Yet there is every chance that voters will shun populism as they confront the fallout from the pandemic,

———— Lockdowns are an experience no-one will want to relive. Which is why the post-pandemic world is likely to see households, businesses and governments prioritise their own resilience above all else.

not least because populist leaders have been criticised for what has been perceived as their poor handling of the pandemic.

Experts, by contrast, have been revered. The scientific and medical establishments have won plaudits for their guidance and the independence they have shown.

All this suggests politics could be about to enter a new era in which policy is entrusted to technocrats rather than those who offer easy solutions.

A new-found resilience

Perhaps the most valuable lesson that the pandemic holds is that it pays to prepare for the worst.

Lockdowns are an experience no-one will want to relive.

Which is why the post-pandemic world is likely to see households, businesses and governments prioritise their own resilience above all else.

For consumers, this will translate into higher savings and a reduction in discretionary spending. For businesses, it will mean repairing balance sheets, dispensing with just-in-time manufacturing processes and complex global supply chains and re-shoring production from abroad. Governments have also had to confront a harsh truth. Comparative advantage makes economic sense under normal conditions but is of little value when citizens cannot get the medical supplies or food they need once the borders close.

Lower potential growth worldwide

The combination of higher debt, a decline in global trade, lower business investment and reduced consumer spending will exact a heavy toll on the world's economic prospects in the next five years. Taking these developments into account, we expect the global economy to recover far more slowly than is usually the case immediately after a recession. GDP across the developed world will expand at an annual rate of approximately 3 per cent over the next five years—in line with the long-term average but, crucially, 0.5 percentage points below what has historically been the case in the years following an economic slump. The US and the euro zone will both experience sub-par recoveries—2.2 and 1.3 per cent annualised growth respectively—but with the single currency bloc gaining ground on the US, benefiting from supply-side reforms and deeper fiscal integration. The positive effects from the US's fiscal stimulus will begin to fade towards the end of our five-year investment horizon and we expect inflation to build in the mid-2020s.¹ Emerging economies will see GDP expand at 4.6 per cent annualised over the period, with China's growth rate falling below 5 per cent, reflecting a decline in global trade and its continued re-orientation towards domestic consumption.

So, even if the world manages to contain and ultimately defeat Covid-19, it will emerge from that victory utterly transformed. The state, society and the economy will have different priorities to address and new risks to confront. Although the virus may fade from view, its legacy will live on.

¹ Our analysis shows that even before Covid-19 struck, the US government risks overstimulating the economy by an amount equal to 2.6 per cent of GDP, the highest since 1973. Running a very expansionary fiscal policy brings some inflation risks: in the past, a 1 per cent excess fiscal stimulus has resulted in a rise in the inflation rate of 1 percentage point above trend over the following one to two years. "Excess Fiscal Stimulus" is a measure of how much a government budget deficit (surplus) is over and

above (below) what is deemed appropriate when taking into consideration where an economy is in the cycle (i.e. the output gap). To calculate the Excess Fiscal Stimulus we regress the government budget balance (as % of GDP) on the output gap. The residual, based on the simple regression, is the excess (or restraint) a government is taking with its fiscal policy based on the cycle. When a government stimulates an economy beyond what is "required" by the output gap, it is inflationary.

Central bankers' brave new world

Are central banks running out of ammunition to combat the next recession? In a word: no. In two words: no, but...

The global financial crisis drove central bankers to open the Pandora's box of unconventional policy tools. The coronavirus pandemic has unleashed even more extreme measures. Quantitative easing, forward guidance and subsidised loans to banks have been supplemented with the purchases of risky loans, bonds and equities. But it won't stop there. As economies struggle to recover from an epic deflationary shock and governments labour under burgeoning debt, central bankers will be forced to do yet more.

Indeed, there are no real limits to what they can do, short of triggering political or inflationary crises. Unfortunately, the tipping point isn't always clear.

Unlike the financial crisis 10 years ago, governments have also acted with alacrity, adding their own huge fiscal boost to monetary stimulus. Economies have been underpinned. But that's come at a cost. As they have absorbed much of governments' new issuance, central bank balance sheets have ballooned (see FIG. 3).

Damage to productivity will depress long-term economic growth. This, in turn, will make it difficult for countries to grow out of their debt. At the same time, austerity fatigue will limit the degree to which they can cut spending or raise taxes. As a result, high debt loads will persist for a long time.

These debt loads would probably be unmanageable for most governments without the help of their central banks, which will push existing asset purchase programmes to their limits. But they are unlikely to defeat deflationary pressures over the next couple of years, falling short of inflation and growth targets.

The next step for central bankers will be to cap bond yields—known as yield curve control—by essentially committing to unlimited QE if required. There could yet be a 1 per cent yield ceiling on long-dated US Treasury bonds. Lifting central bank inflation targets or expanding the range would turbocharge this approach.

In effect, this is financial repression, which risks market instability and misallocation of capital. By the end of 2020, the Bank of Japan will hold 40 per cent of outstanding Japanese government bonds, with the other major central



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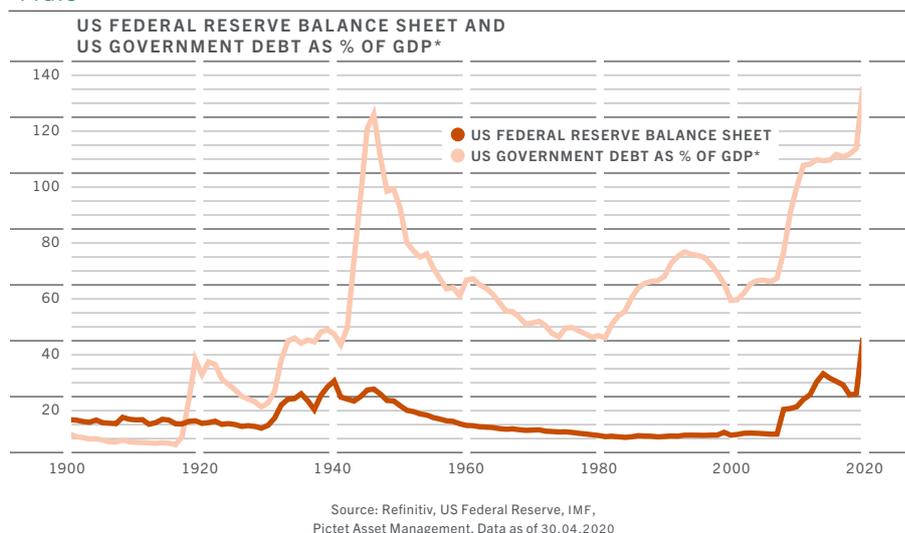
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SENIOR MACRO
STRATEGIST

banks holding 20 per cent each of their own government debt. And while there's no limit to how much debt they can own, we feel that central bankers will flinch once that proportion reaches some critical limits. Those limits will be determined by a combination of what's politically acceptable and the degree to which the overwhelming presence of a price-insensitive buyer distorts the market. At some point, investors may flee government bond markets with artificially negative real rates, undermining the corresponding currencies in the process. Rolling currency crises in the weakest emerging markets cannot be ruled out.

The US is in a privileged position here. No other central bank will want to suffer a sharp erosion of their terms of trade against the US and will thus keep pace with whatever the Fed does. As a result, we expect there to be the same degree of financial repression in the US over the coming five years as the country faced during and just after the Second World War, with bond yields limited to around a quarter of trend GDP growth, or around 1 per cent.

As central banks have absorbed much of governments' new issuance, their balance sheets have ballooned

FIG.3



* forecasts: Fed's balance sheet: Pictet Asset Management; US government debt: IMF Fiscal Monitor; Fed's balance sheet proxied by narrow money before 1951.

A more significant hurdle could well be public opinion if Main Street were again to feel that central banks' priority was to rescue Wall Street by inflating asset bubbles. Imagine the public response if the S&P 500 jumped from one record high to another while unemployment is stuck above 10 per cent.

On the other hand, financial repression should drive down the average return on financial assets over the long term. A portfolio whose assets are split evenly between US equities and bonds now provides a yield below trend infla-

tion for the only time ever apart from the run-up to the 1987 stock market crash. That's painful for investors given that initial yields account for around half of total returns on balanced portfolios.

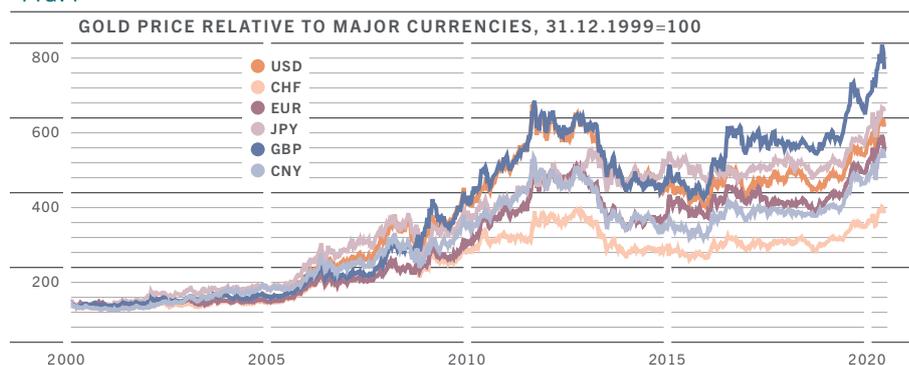
At the same time, the Fed's bruising experiences since the 2008 crisis have made it a more politically astute institution. This time round it has introduced policies that are aimed at the wider public—its Main Street Lending Facility, Paycheck Protection Program Lending Facility and Municipal Liquidity Facility were rolled out with ordinary Americans in mind.

Should yield curve control fail, central banks could be forced by debt deflation into the “nuclear” option of direct monetary financing of government spending. Nuclear because, unlike all the other measures in their toolkit, this one is irreversible. Monetisation tends to generate rapid inflation, which crushes asset prices and creates severe economic uncertainty.

It's a policy that has always been anathema to independent central bankers. Yet they've started to flirt with it. The

Gold prices have climbed amid concerns about loose monetary policy

FIG.4



Source: Refinitiv, Pictet Asset Management.
Data as of 05.06.2020

Bank of England has introduced de facto monetisation with a recently announced “temporary” facility. And, generally, major central banks are buying between 75 and 90 per cent of public debt issued by their governments this year.

There's a fine line between monetisation and closer coordination between fiscal and monetary policy—which seems the way of the future. Here, the US, as a reserve currency country, is in a particularly advantageous position, though China has a good track record of combining policy levers and has the most fiscal and monetary room for manoeuvre. By contrast the European Central Bank is likely to come up against formidable legal and political constraints.

At some point, aided by the deployment of more unconventional monetary tools, central banks will succeed in generating inflation. Our best guess is that major central banks would be comfortable with a rate between 3 and 4 per cent—a moderate overshoot would compensate for recent periods when it was too low, allowing them to retain their sound credibility. Crucially, inflation of this magnitude would also help debt to GDP ratios to shrink even if governments were running primary budget deficits of around 5 per cent.

However, huge amounts of spare capacity in the economy mean that inflation is very unlikely to spring up significantly over the next year or two. It is only over a longer time horizon that a 3–4 per cent rate is a distinct possibility. Ultimately, policymakers face the choice between higher inflation and some form of direct or indirect restructuring of public debt. In which case, it won't be government bonds but gold and other alternative forms of money that will be winners.

A new world order: the Sino-US battle for tech supremacy



LUCA PAOLINI,
CHIEF STRATEGIST

One world, two systems? From semiconductors to artificial intelligence, China is loosening the US's grip on the global technology industry. It is a development that investors view with a mixture of hope and trepidation.

Their worry is that an intensification of Sino-US rivalry could plunge the world into a tech Cold War, creating an entangled web of technological standards and ushering in a period of geopolitical instability.

But competition from China could deliver a positive outcome. History shows that rivalries can serve as a powerful spur for human ingenuity. Just as the US-Soviet space race in the 1970s led to numerous scientific and engineering breakthroughs, competition between the US and China could deliver a renewed burst of technological progress. That would be positive for global productivity.

It is indeed in the interests of China and the US to find common ground. The two economies are too interconnected: total traded goods between them — imports and exports — are worth more than half a trillion US dollars.

But even under this more positive scenario, not everyone stands to benefit. China's inevitable rise will bring an end to US tech hegemony and the exceptional profitability that American tech firms have enjoyed in the past decade.

This will have implications for investors. Capitalising on the tech industry's next phase of growth will require venturing beyond Silicon Valley. A little less US, a little more Asia.

Technationalism: inching closer

The tech battle has been brewing for some time. In 2015, China unveiled an ambitious blueprint to develop high-tech industries to reduce its dependence on foreign — and especially US — technology.

Under what was previously known as its "Made in China 2025" programme, it hopes to become 70 per cent self-sufficient in several tech-related industries, such as electric

cars, next-generation information technology and telecommunications, advanced robotics and artificial intelligence.

Yet it is China’s ambition in semiconductors that worries the US most. Not only do US chip firms employ more than 200,000 Americans, they also wield enormous market power. Their semiconductors are the backbone of every electronic device – from laptops and smart phones to electric cars and factory robots.

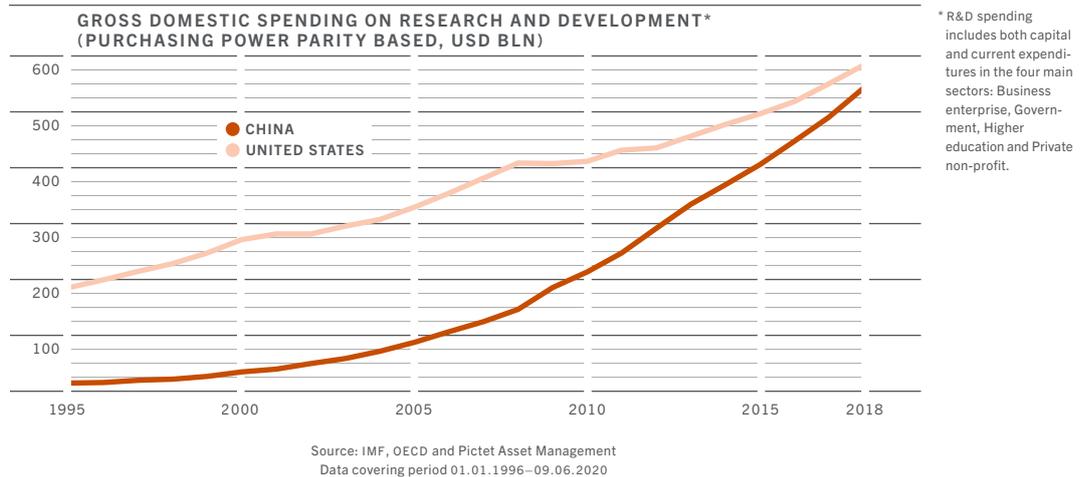
Currently, US chip firms have a 47 per cent share of the global market. By contrast, China accounts for about 60 per cent of world demand while its homegrown suppliers can barely meet a third of what it needs.

But the landscape is changing fast. When combined, the market share of China, Taiwan and Korea now stands at 30 per cent, compared with just over 20 per cent a decade ago.²

China recognises that chip self-sufficiency won’t come cheap. It understands that investing heavily in research and development is essential if it is to produce state-of-the-art

On a purchasing power parity basis, China’s R&D spending is about to exceed that of the US

FIG.5



semiconductor components. That’s why it has unveiled a new USD29 billion investment programme to develop the domestic chip industry.

The surge in semiconductor-related R&D testifies to the benefits of competition. Rivalries are, after all, an essential element of a dynamic economy. The challenger, armed with a strategic vision, brings much-needed investment and confronts lazy thinking. The incumbent, meanwhile, is forced to address long-neglected problems and increase research budgets, too.

² Semiconductor Industry Association 2020 Factbook

The semiconductor industry isn't the only market where China is asking difficult questions of its rivals.

China's R&D expenditure—a good proxy for tech-related spending—has more than tripled in the last 20 years to 2.1 per cent of GDP in 2018.³ On a purchasing power parity basis, its R&D spending is almost on a par with that of the US.

The US is beginning to mount its response, but it has to move aggressively, and quickly. Federal research spending has declined to 0.8 per cent of GDP from 1.2 per cent in the late 1980s, when the government gave generously to institutions like Stanford University to help build Silicon Valley.

If the US raised R&D investment to a level that matched China's, that would be a welcome development for a world economy whose productivity is suffering as its working-age population dwindles.

Academic studies have found that the benefits of R&D investment extend well beyond both the firms and industries that incurred such expenditure in the first place. A discovery made by one firm, sector or country can lead to new avenues of research, inspire new projects or find new applications. The social rate of return can be as much as seven times as large as the return on investment in equipment and services that support R&D.⁴

R&D spending can boost productivity by improving the quality of existing goods or reducing production costs. Another benefit is the spill-over effect. Studies show that other countries can also boost their productivity by trading with those that have large “stocks of knowledge” from their cumulative R&D activities.⁵

Tech race: key battlegrounds

Thanks to China's world-changing ambitions, competition is intensifying in several key areas of the tech industry:

5G

Next-generation mobile phone networks are the new frontline in the battle to control global information technology infrastructure and set international standards. With pandemic-induced lockdowns stretching data capacity to its limits, 5G tech has taken on greater global importance. China's Huawei, which has a 30 per cent share of world

³ European Commission

⁴ Lichtenberg, F., R&D Investment and International Productivity Differences, NBER Working Paper No. w4161

⁵ Hall, BH., Mairesse, J., Mohnen, P. Measuring the returns to R&D, Handbook of the Economics of Innovation, vol. 2

telecoms equipment, has taken the lead in the global roll-out, but has since faced a clampdown in the US. In response, Huawei is developing an alternative supply chain with rival firms such as Taiwan's MediaTek.

Cloud computing

This market is growing nearly 20 per cent annually to be worth USD661 billion by 2024: Behemoths such as Amazon, Google, Alibaba, Tencent and Microsoft are vying for dominance.⁶ Each sees Asia as the main engine of growth. In aggregate, they have increased their data centre footprint in the region by almost 70 per cent over the past three years.⁷

E-commerce

The Covid lockdown encouraged millions of people to embrace online shopping. That was especially the case in China, where e-commerce represents more than half of total retail sales, compared with just over 10 per cent in the US.⁸ China is said to be "a good four or five years" ahead of where the West is in terms of logistics and digital commerce and retail.⁹ China's advantage here lies in the sheer scale of the mobile ecosystem — a population of 1.4 billion — which integrates everything from online shopping, messaging,

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gaming and digital payments in one app. What is more, Chinese firms are better positioned than their peers in the US and Europe, where growing concerns about misuse of personal data and anticompetitive practices could lead to greater regulation.

Artificial Intelligence

AI represents one of the biggest commercial opportunities, poised to provide USD15.7 trillion of global economic growth by 2030.¹⁰ Already home to the world's largest AI companies, Baidu, Tencent and Alibaba, China filed more than 30,000 public patents for AI in 2018, a roughly 10-fold jump in five years and about 2.5 times more than the US.¹¹ The US, meanwhile, is doubling its AI R&D spending in the next two years from the current USD974 million.

⁶ Compound Annual Growth Rate between 2019 and 2024. Source: GlobalData

⁷ FT, Synergy Research

⁸ Marketer

⁹ Michael Zakkour, *New Retail: Born in China Going Global*

Europe should not be written off as a mere observer in the global tech race—the region also vies for a slice of the pie. Specifically, Europe is launching Gaia-X, a new joint cloud initiative among some 100 leading companies and organisations to challenge the likes of Amazon and Alibaba on data infrastructure. The UK is also home to big chip companies such as ARM.

If China and the US find a way to co-exist as global tech powers, the next decade promises genuinely exciting technological advances.

Tech may seem ubiquitous to those who live in the digitalised world, but less than 60 per cent of the world’s population has access to the Internet. What is more, cloud penetration stands at a paltry 20 per cent, while only 12 per cent of the global consumer spending of USD24 trillion takes place online.

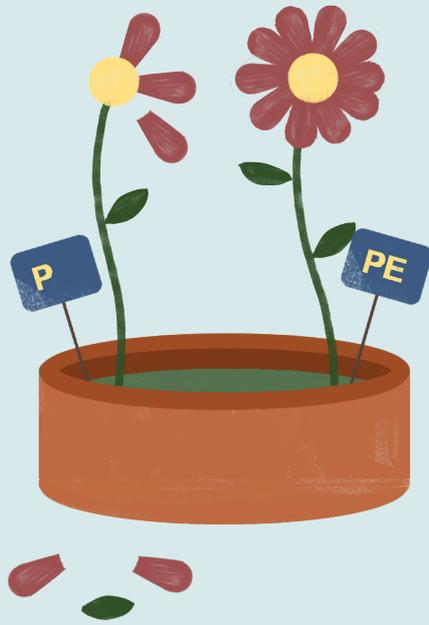
For investors, this new world order will throw up new challenges. To capitalise on tech’s long-term growth potential they will need to look further afield. They should cast

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¹⁰ PwC

¹¹ Nikkei Asian Review



Where now for private and passive investing?

Two powerful forces have shaped the global equity landscape in recent years — passive investing and private equity (PE). A broad range of investors have turned to index-tracking funds for low-cost exposure to the broader market. Meanwhile, a somewhat smaller but growing group have gravitated towards PE, attracted to its potentially higher returns and diversification benefits.

The growth of passive and private investment has been such that, together, the assets under management of the ‘two Ps’ have quadrupled over the past decade to some USD12 trillion, overtaking the traditional active equity market (at USD11 trillion).¹²

In our view, passive and private investing might take different paths over the next five years.

When it comes to passive funds, their best days may now be behind them. Investors and regulators are becoming increasingly aware of—and concerned by—the risks that come with the expansion of index trackers. Research shows passive investing poses threats to market stability and sustainable investing.

The prospects for PE look brighter, though whether it can continue to grow its share of the pie is contingent on it becoming more widely accessible and less opaque.

Historically, PE has been considered too much of a risk for all but the most experienced, professional investors. But that’s no longer the case. One reason is the sheer size of the market. Because private equity-owned companies are proliferating while the number of listed firms is falling, the arguments for opening up PE to individual investors have become too loud to ignore. This speaks to the democratisation of finance.

That’s not to say passive investment will go into reverse, just that the pace of expansion may slow as investors and regulators discover that passive strategies, while cheap and easy to access, are far from risk free.

Re-pricing risks and benefits

While passive’s low fees might look attractive in an era of post-pandemic belt tightening, that comes at a price: index trackers follow the entire market, rather than picking the best bits at any one time. That’s a problem because the



SUPRIYA MENON,
SENIOR MULTI ASSET
STRATEGIST

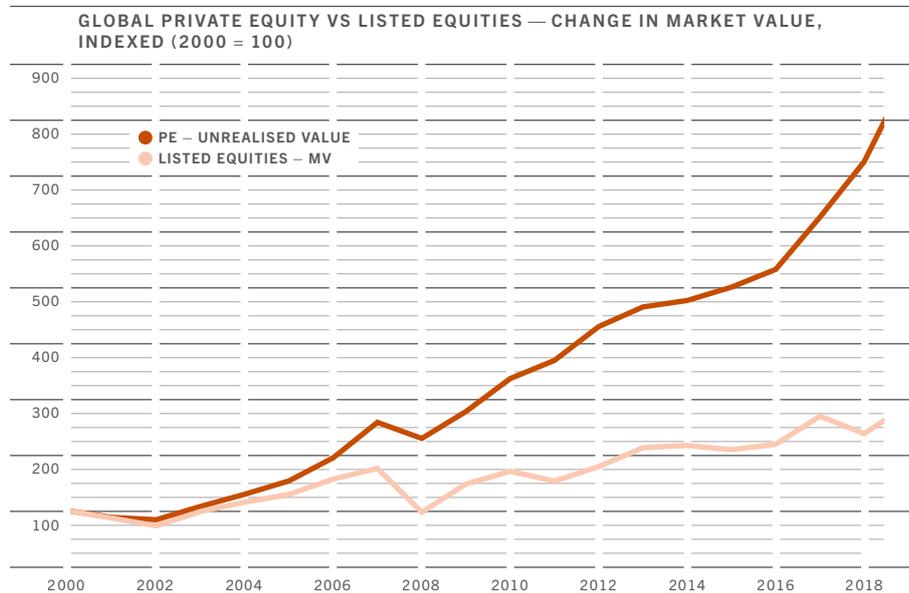
¹² Morningstar, Preqin, data as of June 2019

mispricing that has occurred during recent bouts of volatility has created fertile ground for stock pickers. The gap between winning and losing stocks will only widen as companies that embrace innovation and technology thrive and the strength of balance sheets becomes ever more important.

More generally, the rise of passive investing threatens efficient market pricing. The stock market relies on active investors to determine an equilibrium value. Yet under index-tracking, the shares of companies with large weightings attract more capital irrespective of their financial performance. So if the system is dominated by passive investing, the price of a security ceases to function as a gauge of a firm's underlying prospects, leading to capital misallocation. Potentially making matters worse is the concentration of the passive market. There are growing concerns that as index-tracker funds continue to accumulate assets, the lion's

Investors have gravitated towards PE, attracted to its potentially higher returns and diversification benefits

FIG. 6



Source: Pictet Asset Management, Prequin, McKinsey Private Markets Report 2020. Data for Private Equity is to June 2019.

share of that money will flow to the three large asset managers that control the passive industry. Already, the big three passive fund houses collectively own more than 20 per cent of US large-cap stocks;¹³ they also hold 80 per cent of all indexed money. Should those proportions continue to rise, the resulting concentration of shareholdings—known as common ownership—could reduce competition and threaten the efficient functioning of markets. There is a growing body of research attesting to these negative effects. A 2018 study¹⁴, for instance, found that when big insti-

¹³ "The specter of the giant three", Bebchuk, L. and Hirst, S. 2019 http://www.law.harvard.edu/programs/olin_center/papers/pdf/Bebchuk_1004.pdf

tutional investors were large shareholders in firms producing both brand-name and generic drugs, the generic manufacturers were less likely to produce non-branded versions. This increased prices for consumers. Similar trends have been documented in other industries where common ownership is high, such as airlines and the banking sector. This is causing alarm among regulators in Europe and the US — the Federal Trade Commission and the US Securities and Exchange Commission have both said they are monitoring developments closely.

Passive investing does not necessarily aid the development of responsible capitalism, either. Passive funds, by their nature, do not choose the companies they invest in. That reduces the potential for investors to engage with the companies and to encourage them to embrace responsible and sustainable business models aligned to environmental, social and governance (ESG) principles. Passive portfolios tend to invest in so many companies as to make direct engagement with them impractical, and the small share of each holding within the portfolio reduces the incentive on an individual company basis.

————— Because private equity-owned companies are proliferating while the number of listed firms is falling, the arguments for opening up PE to individual investors have become too loud to ignore. This speaks to the democratisation of finance.

Private equity, of course, is also far from risk free, but we would argue that many of its issues may be better understood and reflected in pricing.

First, there is the problem of transparency. PE has a patchy track record on ESG, for instance, and the requirements for transparency and disclosure for privately held firms are far less stringent even if a few are now trying to change that.

Then, there is debt. PE also has high leverage (just under 80 per cent of buyout deals in 2019 were carried out at over six times EBITDA relative to roughly 60 per cent at the prior peak by this measure in 2007)¹⁵. PE investments are

¹⁴ 'Common Ownership and Market Entry: Evidence from the pharmaceutical industry, Newham, M., Seldeslachts, J., Banal Estanol, A., 2018 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3194394

also primarily in small and mid-sized firms, whose business models are less well established. These factors could weigh on PE returns in a period of pandemic-induced economic weakness. Furthermore, PE-owned businesses are excluded from some government bailout schemes, while those that are available tend to come with complex conditions that may relegate them to a last resort.

In the longer term, though, the PE sector can help to finance businesses in a period when public markets may be less open. We may see more public companies taken private, as well as PE funds gaining minority stakes in listed companies, with an eye to increasing these later.

Dry powder

Crucially, PE has plenty of dry powder, some USD1.46 trillion according to latest available data.¹⁶ That can be used to shore up balance sheets and, later, to make new investments, supplemented by additional money that major investors have signalled they would like to allocate to PE. (The reported gap between actual and intentioned allocations stands at over 2 per cent of private sector pension funds' total assets.)¹⁷

A potential game changer will be the drive to democratise finance. Historically, PE has been the preserve of institutions and the ultra-wealthy—a disparity that regulators are now looking to fix by opening up the market to individual investors. The US has led the way, laying the foundations for ordinary savers to invest in PE funds through employer-sponsored 401(k) retirement accounts, which analysts forecast could bring in USD400 billion of fresh cash.¹⁸ The US Labor Department, meanwhile, sanctions the use of PE in professionally managed multi-asset-class investment vehicles, such as target-date, target-risk, or balanced funds. Other countries, including the UK, are considering similar moves.

Potential attractions for PE current and future investors include diversification benefits and a broader opportunity set—not because PE companies are somehow inherently better, but because they tend to have different characteristics to listed equities.

For a start, they are younger. The median age of a company going public in the US has risen from an average of seven years in the 1980s to 11 years between 2010 and 2018. The private market also includes a large number of

¹⁵ Bain Private Equity Report 2020

¹⁶ Preqin, as of June 2019

¹⁷ McKinsey Global Institute, “A new decade for private markets”

¹⁸ Evercore

small but rapidly growing companies with significant intangible assets. Typically such firms do not want to disclose their early stage research publicly and therefore favour a closed group of shareholders. What is more, in the US at least, the pool of private investments is deepening. Private companies are proliferating while listed ones are in decline. Since 2000, the number of listed companies has fallen to 4,000 from 7,000.

PE also offers the possibility of benefiting from operational improvements in the way businesses are run. When executed well, this can lead to impressive returns.

However, choosing the right PE investments is far from straightforward. The fees are relatively high and investment structures are complex. Moreover the sector lacks transparency, so opening it up to less experienced individual investors (such as 401(K) holders) presents challenges for regulators. Indeed, the US Security and Exchange Commission has recently rebuked PE and hedge fund managers for charging excessive fees and appearing to favour some clients over others.²⁰ There are calls for reform of the fee structure to make the industry more sustainable, and a few firms have already started to move in that direction.²⁰

———— PE has the potential to continue to capture an ever-growing share of the equity market — as long as it succeeds in opening up to a wider range of investors and proves its potential to add value.

Due diligence is much more important in PE than in public markets. According to our research, in 2018 the difference in performance between the 5th and 95th best-performing funds was 60 per cent in the US PE universe, versus just 8.5 per cent for US small/mid-cap equity funds. Studies also suggest the high persistence of manager returns, which was a feature of private equity — has declined, meaning yesterday's winners are now less likely to top the tables tomorrow.

Due diligence is paramount: there are some signs in the US that, in aggregate, the returns gap between listed and private equity is starting to narrow. Indeed, over the next five

¹⁹ SEC, June 2020

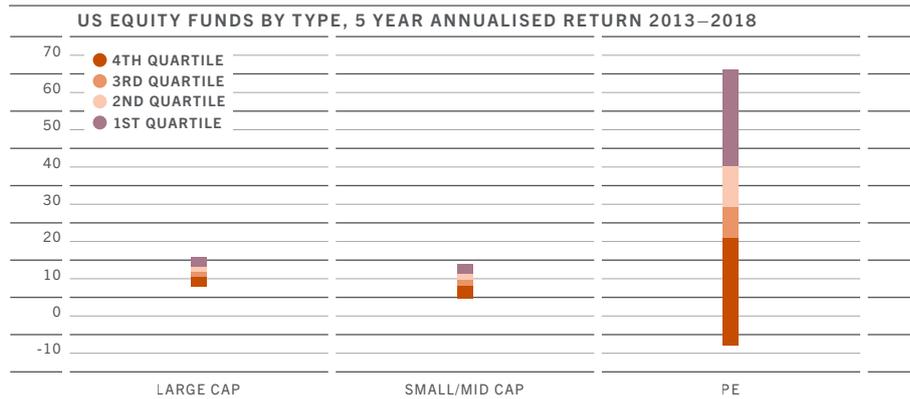
²⁰ "An inconvenient fact: private equity returns & the billionaire factory", L. Phalippou, 2020

years, we forecast global private equity returns of 10.3 per cent per annum in dollar terms, which represents a premium of just 2.8 percentage points over public equities, almost half its long-term historical average. That’s partly because of the sheer weight of capital chasing potential opportunities. Of course, the high dispersion means that some will do much better while others fare much worse. And, at a time when bond yields are very low, even a lower-than-average excess return may be attractive to many.

PE has the potential to continue to capture an ever-growing share of the equity market—as long as it succeeds in opening up to a wider range of investors and proves its potential to add value. Passive equity has already shown what can be achieved with a democratic approach and will continue to do well, but, having grown faster and for longer and attracting greater scrutiny from regulators, it may now be nearer its natural plateau as a proportion of equity AUM.

Due diligence is much more important in PE than in public markets

FIG.7



Source: Pictet Asset Management, Morningstar. PE performance is based on IRR by vintage year



Equities: strength after the virus?

From the rubble of economic devastation that Covid wrought—the worst global downturn in nearly a century—we expect most stock markets to extract a degree of comfort over the next five years.

Global equities should generate annual returns of 7.5 per cent over our forecast horizon, two percentage points better than we anticipated last year. The fallout from Covid should narrow the range of returns across countries and regions, while at the same time increasing sector dispersion to unprecedented levels.

Once again, we believe the biggest rewards will come from emerging markets. They should deliver a 12 per cent annual return in US dollars, with Asia particularly strong while US equities are likely to underperform.

These high single- to low double-digit returns will in part reflect the continued effects of unprecedented monetary and fiscal policy.

Worldwide, fiscal stimulus during 2020 will be roughly 5 per cent of potential global GDP: ramped-up government spending will continue to be felt for years. Central banks will remain focused on keeping yields at rock-bottom levels, ensuring risk premia stay low for a long time yet, albeit in an environment of weak growth and heightened risks of market instability.

This means equity valuations will come under less pressure than we expected last year, accounting for around 1 percentage point of our upward revision to global returns. The balance comes from a combination of better revenue prospects as the global economy emerges out of a recession and more stable corporate profit margins, especially outside the US.

Indeed, if there is a weak spot, it is US equities. We think they will be limited to an annual return of just under 6 per cent, which suggests the S&P 500 index will be at 3,800 in five years' time from around 3,300 at the end of July. Indeed, now is the best time ever to diversify away from US stocks, which already make up 58 per cent of the MSCI All Country equity index. The US market is expensive

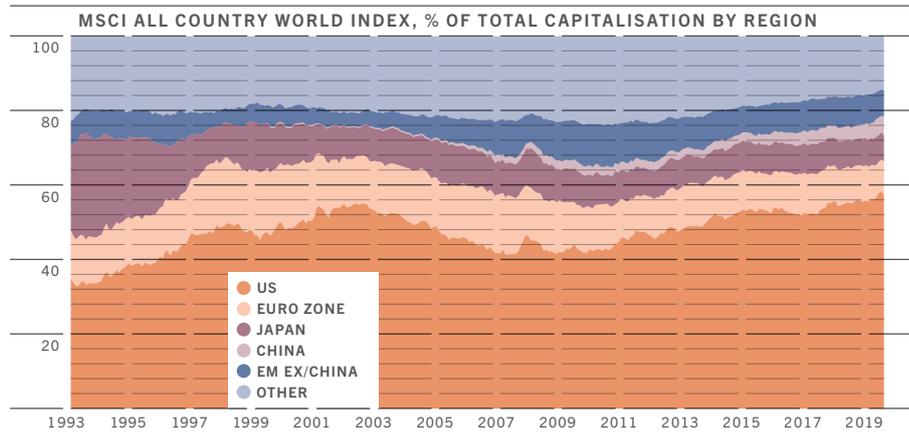
on any measure—even adjusted for its higher tech weighting—and priced in an expensive currency that faces heightened political uncertainty. (see FIG. 8)

In US dollar terms, US equities outperformed European stocks by a considerable 8.7 per cent a year in the decade to December 2019. But the trends that accounted for these excess gains are now fading.

As the US pace of economic expansion slows towards European rates over the coming five years, the US corporate sector will lose a major tailwind. The relative speed at which sales are growing will slow, profit margins will come under pressure from a much less business-friendly tax regime and buybacks could fall away sharply as companies stung by the pandemic turn their attention to balance-sheet repair. This “safety first” strategy could prove a significant dampener on returns from US equities, not least because stock buybacks accounted for around a fifth of US market gains over the past 10 years, according to our calculations.

The US market is expensive on any measure

FIG. 8



Source: Refinitiv, MSCI.
Data covering period 31.12.1992–30.06.2020

And crucially, the dollar will depreciate, in turn making the US market less attractive for foreign investors.

As a result, the valuation premium that US stocks have built over the past 10 years looks set to shrink over the coming years.

Other developed equity markets should do much better as they play catch-up to the US. The dispersion of returns among markets—whether by region or by country—is likely to be fairly narrow as they all face reasonably similar fundamentals in a post-Covid world (see Chapter 1 in Section 1).

We expect annual returns in US dollar terms to range between approximately 8.5 per cent for Japan and 9.5 per cent for the UK and Switzerland, with the euro zone sitting roughly in the middle. Although much of the shared currency region still faces unattractive demographics and subdued long-term growth, prospects for its equity markets have taken a boost from the monetary union's big first stride towards becoming a fiscal union as well. This reduces a significant risk for investors: that of the euro's fragmentation.

Crucially for investors, Europe's stock markets do not yet discount the region's improving economic prospects. Particularly when compared with their US counterparts. At current levels, the gap in US and European price-to-book ratios (3.7 vs 1.7) implies American corporations' return on equity will further outpace that of European firms, widening from a differential of 5 percentage points to over 10 percentage points. Such an outperformance looks highly unlikely.

We believe the bright spot in equities will be emerging markets, with China and EMEA outperforming within those regions. Such markets make up nearly half of the global economy but still represent only around 13 per cent of worldwide market capitalisation. Their equities are cheap, trading at a 33 per cent discount to developed markets. With a GDP growth rate expected to run at around 2.5 percentage points faster than the US over the next five years, there's plenty of scope for that imbalance to be corrected. Historically, a 1 percentage point acceleration in the developing world's economic growth relative to the US has tended to lead to a 10 per cent increase in the price-to-book differential between EM stocks and their US counterparts.

Emerging Asian markets are of particular appeal because of their solid fundamentals. The region has negotiated the pandemic effectively and its young and tech-savvy population make keen consumers. Governments have largely followed a sensible policy mix, offering fiscal stimulus where possible, but largely avoiding imbalances. Although global trade has taken a hit recently and elements of protectionism are likely to be adopted in large parts of the world, this should be mitigated by more regionally based supply chains and China's rapid return to trend growth, thanks in no small part to aggressive credit expansion driven by the government. We expect Chinese equities to return 12.9 per cent a year over the coming five years in dollar terms, with about a quarter of that coming from renminbi gains against the greenback. (see Chapter 3 in Section 2).

Dispersion dynamics

While Covid looks set to narrow dispersion in performance between countries, the fallout from the pandemic is likely to exacerbate it on the corporate level as some sectors do considerably better than others. Also, within sectors, environmental, social and governance (ESG) factors will open gaps between the best and worst.

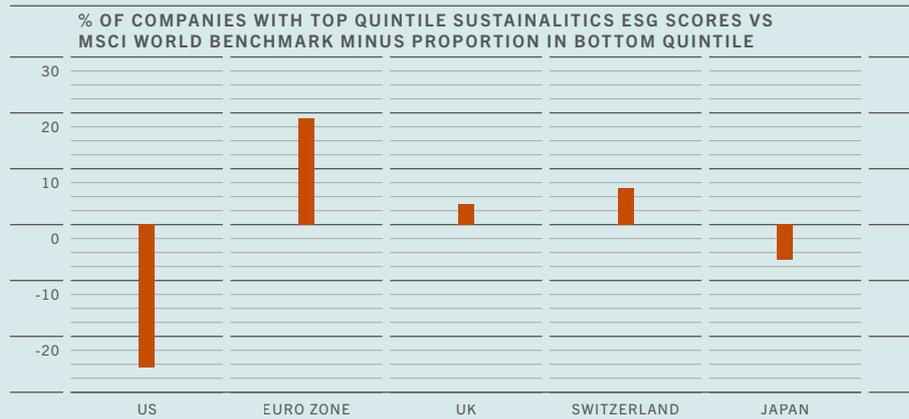
We believe that corporate margins will contract further as governments look to tax businesses to pay for their Covid largesse, while also implementing higher minimum wages. Costs associated with newer, more stringent public health requirements will also eat into margins. However, an already high degree of concentration within industries²¹ and few new entrants to offer price competition should keep profit margins at relatively high levels.

Financial repression by central banks and stable if unspectacular economic growth will lead to earnings growth based on strong fundamentals attracting an even greater premium. This, along with structural tailwinds, lead us to expect consumer staples, healthcare and tech sectors to show the best annual returns, respectively some 11 per cent, 10 per cent and 9 per cent.

We expect utilities and financials to perform poorly, with 1 per cent and 4 per cent annual returns respectively. Utilities will suffer from a lack of growth, limited downside to bond yields and very high levels of leverage. As for financials, lower interest rates are likely to eat into returns, as are rising corporate default rates if unemployment remains consistently higher over the coming five years than it did in the previous five.

Europe leads the way on ESG

FIG.9



Source: Refinitiv, Sustainalytics; data as of 30.06.2020

ESG investing has seen an exponential rise in interest – we think it will follow a similar trajectory to the adoption of exchange-traded funds during the past decade. A wall of ESG money should boost euro zone and Swiss equities, as well as healthcare and tech sectors, as investors reallocate funds from companies with bottom quintile ESG scores to those in the top.

²¹ Renaud de Planta and Supriya Menon, “The Indexation Wave”, Pictet Asset Management https://www.am.pictet/-/media/pam/globalwebsite/the-indexation-wave_white-paper_201710.pdf



Bonds: at the mercy of financial repression

Lower for even longer. The economic shock of the pandemic has effectively extended the duration of ultra-loose monetary policy across the world by several years.

Central banks are projected to pump a record USD8.4 trillion of stimulus into the financial system in 2020. This is equivalent to more than 14 per cent of world economic output – far greater than the 8 per cent of GDP delivered at the height of the global financial crisis in 2009.

Meanwhile, the implementation of aggressive fiscal stimulus worldwide will serve to increase government spending by record amounts and at blistering speed. The Institute of International Finance estimates that the global debt to GDP ratio hit a new record of 331 per cent in the first quarter of 2020 – up 10 percentage points from pre-pandemic levels.

So, as we explain in Section 1, there is little doubt that policymakers will be incentivised to loosen the monetary reins further. Central banks will keep interest rates low – or

————— Bond investors are about to experience the sort of repression seen in the US in the 1940s, when the central bank kept bonds yields low to fund a post-war recovery.

below zero – and buy bonds in vast amounts over much of the next five years. Their experiment with unorthodox policies such as yield capping – currently under consideration in the US – will keep the yield curve flatter than that typically seen in the post-recession period.

Bond yields will consequently remain well below nominal GDP growth rates across the developed world for the foreseeable future. Normally, bond yields converge towards nominal GDP growth over time. But this gap, which began to form in the wake of the 2008 financial crisis, testifies to the power of financial repression, the policy through which governments channel savings to the public sector to lower their funding costs and cut debt.

In our view, bond investors are about to experience the sort of repression seen in the US in the 1940s, when the central bank kept bonds yields low to fund a post-war recovery.

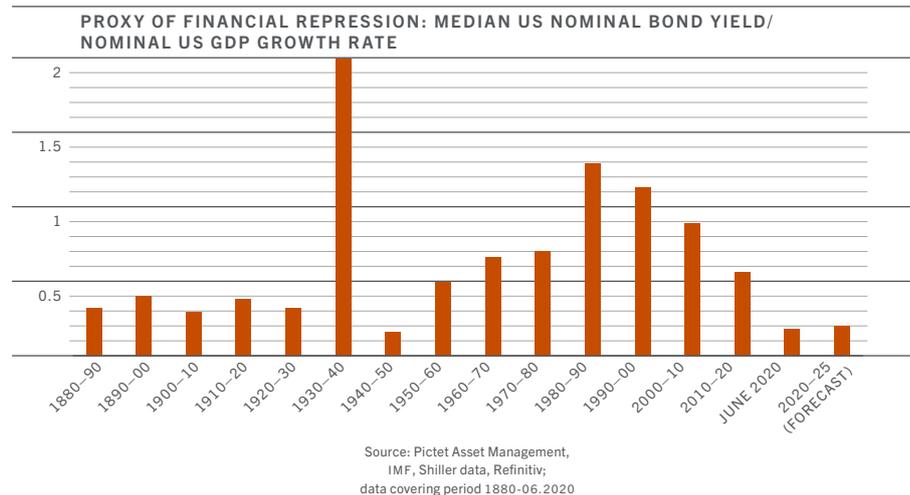
If history repeats itself, investors should expect capital losses from developed market bonds once adjusted for inflation.

Of course, the risk of a spike in inflation is low in the short term. But that is not to say investors can expect price pressures to remain contained for years on end. Unprecedented amounts of fiscal and monetary stimulus will stoke demand for goods and services at a time when supply is restricted because of a deceleration in global trade and post-pandemic strategic realignment of supply chains (from “just-in-time” to “just-in-case”). The upshot is that inflation should begin to rise towards the latter part of our five-year investment horizon.

Against this backdrop, US Treasuries should deliver an annual return of some 0.7 per cent over the coming half

Bond investors are about to experience the sort of repression seen in the US in the 1940s

FIG.10



decade. We do not expect to see any interest rate hikes from the Fed over the next five years; 10-year Treasury yields will only rise to 1 per cent in 2025.

But that does not mean US bond markets will remain calm: quite the opposite. The “taper tantrum” of 2013 and more recent bouts of volatility are standing reminders that even the largest and most liquid markets are vulnerable to panic selling.

The return of inflation could, however, provide a boost to US Treasury Inflation-Protected Securities (TIPS). We expect them to outperform all developed market nominal bonds; real yields should remain close to -1 per cent over

the next five years as inflation expectations gather momentum towards the end our forecast horizon. What is more, we think the Fed will tolerate inflation temporarily running above its target.

German government bonds are perhaps the most vulnerable of all developed sovereign debt markets — not least because their initial yields are deeply negative. Bunds, for example, would have to see their yields drop another 50 basis points to deliver a positive real return in the coming half a decade — a highly unlikely prospect. At the same time, the growing possibility of closer fiscal co-ordination among euro zone countries under the EUR750 billion Covid recovery fund could reduce Bunds' appeal as defensive assets relative to other euro zone bonds. We project a return of -1.3 per cent per year, with Bund yields rising towards 0.4 per cent by 2025.

Our forecasts for Japanese government bonds assume that the Bank of Japan continues targeting a 10-year government bond yield of zero. The policy measure has helped cap bond yields while scaling back large-scale asset pur-

————— [China's] USD 15 trillion market is also gaining strategic importance for international investors, thanks to market reforms and the inclusion of Chinese debt into global bond benchmarks. The appreciation potential of the renminbi is also part of the investment thesis.

chases but as yet has failed to stoke inflation as intended. We expect the average inflation rate to remain subdued at 0.1 per cent over the next five years.

Elsewhere in the developed world, prospects for corporate bonds are moderately positive.

The asset class should benefit from low interest rates, a mild economic recovery and central bank bond purchases.

Corporate bond default rates will rise, but not by as much as the current economic slump would suggest. We expect five-year average default rates to rise to 5.5 per cent from the current 4.1 per cent for US high-yield bonds

and to 3 per cent from 2.5 per cent for their European counterparts. Spreads on corporate bonds will tighten marginally. We expect the US high-yield bond spread to tighten to below 500 basis points in five years' time, roughly in line with its long-run historical average.

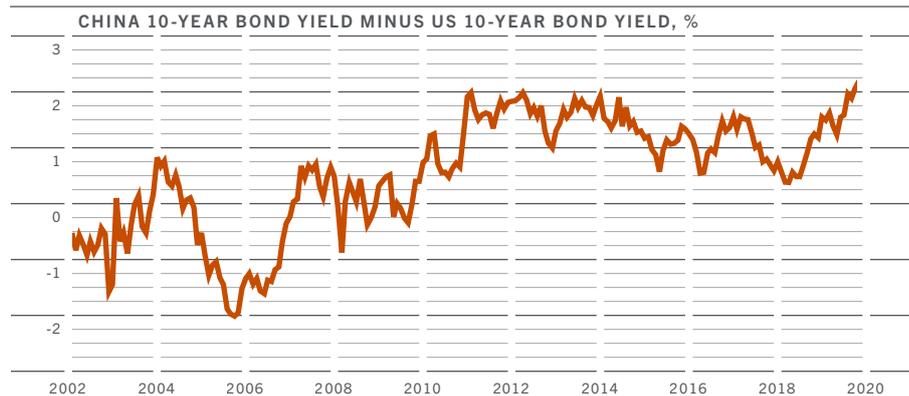
That said, investors should expect the total return from corporate bonds to be well below its long-run average. With yields on such debt already at or near record lows, the scope for a further fall is limited.

Prospects for distressed securities look better. This is an asset class that tends to prove its worth when the economy contracts. Over the past 20 years, investing in distressed fixed income has achieved annual returns of 6.1 per cent against 5.1 per cent for global corporate and high-yield bonds.²² Returns are typically uncorrelated with major asset classes; a valuable diversifier in times of uncertain economic conditions.

Emerging market debt should also do better than most fixed income asset classes. Developing countries will bene-

Chinese bonds should benefit from a low inflation rate and currency appreciation versus the dollar

FIG.11



Source: Refinitiv; data covering period 31.12.2001-30.06.2020

fit from historically low inflation, better growth than developed economies and a weaker dollar. This should support their bond markets.

Emerging market bonds are expected to deliver an annualised total return of 3–5 per cent in local currency terms. Within this universe, Chinese government bonds look set to deliver the strongest returns.

²² ICE BofA Global Corporate & High Yield Index and HFRI Distressed & Restructuring HF Index both in USD 31/05/2000 to 31/05/2020

We expect renminbi (RMB)-denominated bonds to deliver a total return of 7.2 per cent annualised in dollar terms. The asset class should draw support from several fundamental trends – among them China’s low inflation rate and the fact that the People’s Bank of China has managed to avoid financing government expenditure to the same extent as other major central banks. What is more, Chinese bonds have displayed defensive qualities. During the worst of the pandemic outbreak – the first quarter of 2020 – they delivered a total return of nearly 4 per cent in dollar terms.

This USD15 trillion market is also gaining strategic importance for international investors, thanks to market reforms and the inclusion of Chinese debt in global bond benchmarks. The appreciation potential of the renminbi is also part of the investment thesis – we expect the currency to gain considerably against the US dollar over the next five years.

Currencies: the greenback's fading allure

Whichever way you look, the dollar's prospects are getting gloomier.

Four trends have supported the US currency in the nine years since it hit an all-time low in trade-weighted terms: superior economic growth, yield support from higher interest rates, a cheap valuation and strong international demand.

The greenback's problem now is that three of these have already reversed while the remaining one is about to do so.

Take the US economy. It should continue to grow faster than the rest of the developed world, but the gap will narrow steadily over the next five years. A decline in the size of the labour force, falling immigration and a potentially less business-friendly environment will dent the potential for growth.

Even before the pandemic, the US fiscal deficit was on a worrying trajectory. We expect it to hit 20 per cent of GDP this year in the US, compared to 13 per cent in Japan and just 8 per cent in the euro zone. This suggests the Fed will continue to print money for longer than its counterparts. The US current account also remains in deficit, despite a now positive oil trade balance (we forecast a deficit of 2.5 per cent this year on the current account). Our historical analysis suggests these twin deficits could lead to a significant depreciation of the dollar in the coming years (see [FIG. 12](#)).

The dollar will also have to contend with reduced yield support. The differential between US rates and those in the rest of the developed world has shrunk from 200 basis points in the summer of 2019 to nearly zero. There is now no yield advantage to holding the dollar and we do not expect this to change in the next five years.

Valuations are not in the greenback's favour, either. According to our models, the dollar is about 15 per cent overvalued against a basket of currencies.

Furthermore, the dollar's status as the world's reserve currency — a reflection of the dominance of US financial markets — is very slowly starting to erode. Its share in global

central bank reserves, for example, has fallen to 62 per cent now from 71 per cent in 1999, at the start of Economic and Monetary Union.²³

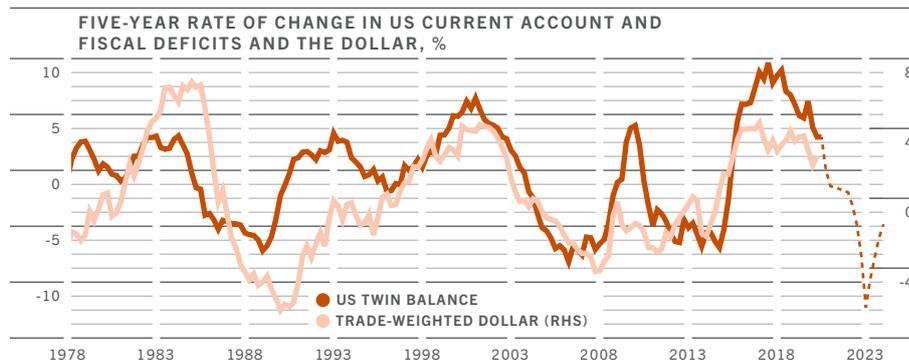
All signs thus point downward for the dollar in the medium to long term. However, we expect the correction to be a fairly gradual one, with the US currency weakening by some 1.5 percent per annum on a trade-weighted basis between now and 2025.

Among the currencies set to appreciate most against the dollar – in the developed world at least – is the euro. We expect it to strengthen by some 1.8 per cent per year.

Although Europe's complex political make-up continues to weigh on foreign investors' appetite for the euro, a solid current account surplus, a nascent economic recovery and an ambitious recovery plan, funded by jointly-issued bonds, point to an improvement in the region's long-term prospects. The recovery fund in particular should help reduce redenomination risk – the risk of the bloc breaking up.

Dollar's double trouble

FIG.12



Source: Refinitiv Datastream, Pictet Asset Management.

US twin balance is calculated as the sum of current account and government balance as % of GDP, and is expressed with a 2-year lead and includes IMF forecast. Data covering period 31.12.1977–30.06.2020

Prospects for sterling also look positive over the long run even if Brexit causes turbulence in the short run. It is one of the cheapest currencies in our valuation grid and the global nature of the UK economy means it is well placed to benefit once world economic growth accelerates. However, Brexit will leave scars and for that reason we expect sterling to reach only USD1.34 in five years' time – well below its fair value of USD1.44.

²³ Based on IMF Currency Composition of Official Foreign Exchange Reserves (COFER) data, at constant exchange rates https://www.ecb.europa.eu/pub/economic-bulletin/articles/2019/html/ecb.ebart201907_01~c2ae75e217.en.html#toc2; <https://www.reuters.com/article/global-forex-reserves/update-1-u-s-dollar-share-of-reserves-up-in-1st-qtr-amid-virus-pandemic-imf-idUSL1N2E72Q7>

Appreciation of the Japanese yen and the Swiss franc will, respectively, be capped by a de-facto debt monetisation in Japan and the Swiss National Bank's aggressive currency management policies.

Against emerging market currencies, the dollar's downside will be more pronounced, supporting EM assets more broadly. We expect the Chinese renminbi to strengthen to 5.9 per dollar — a level last seen at the end of 1993, just before the 33 per cent depreciation of January 1994.

The list of conditions favouring the Chinese currency is as long as the list of doubts weighing on the dollar. Valuations are cheap, according to our models, China's inflation is under control, monetary expansion will slow over the coming years, while there will also be a significant rise in the international use of the renminbi as both a reserve and an investment currency. The internationalisation of the Chinese currency will occur via both trade and financial links; the renminbi's sphere of influence will expand across Asia and beyond.

Alternatives: opportunities abound

With only modest returns — at best — forecast for global stocks and bonds, investors may look to raise their allocations to alternatives. However, here too, the options are limited.

Of the five major alternative asset classes for which we prepare forecasts, only private equity is expected to deliver returns comparable to global stocks in absolute terms (though not when adjusted for volatility). That is partly due to the changes in expectations for monetary policy — in the wake of the Covid-19 pandemic, interest rates are now likely to stay persistently low for far longer than anyone could have predicted a year ago.

That should benefit PE in two ways. First, low rates contain the cost of borrowing in what is a highly leveraged universe; second, depressed yields encourage investors to expand their reach in pursuit of higher returns. At the last count, PE had some USD1.46 trillion waiting to be invested.²⁴ At the same time, moves to open up the market to a wider range of investors — including non-professional investors with company pension plans — could result in sizeable additional inflows (see Chapter 4 in Section 1).

This much dry powder puts PE in a strong position to take advantage of any attractively priced opportunities that emerge in the aftermath of the pandemic and the consequent economic slump. However, the wall of money also means more competition for potential investments in a market where valuations are already stretched.

In aggregate, we expect PE to deliver returns of some 10.3 per cent per annum in dollar terms, which represents a premium of 2.8 percentage points to public equities. While this additional return is modest by historical standards — roughly half the long-term average — it is superior to what investors can expect from the other alternative investments we analyse.

Furthermore, the dispersion of returns within the PE universe is considerable: the best strategies can outperform the worst ones by more than 70 per cent.²⁵

On the face of it, the performance prospects for hedge funds may look weak — we expect them to deliver just above 3 per cent total return per year. However, this is better than

²⁴ Preqin, as of June 2019

²⁵ Based on Morningstar data on 2018 performance of US PE.

the returns hedge funds have managed to achieve over the previous half a decade. Given that virtually all traditional assets look expensive, alpha will be more important than beta over the next five years, which favours market-neutral strategies. Adjusted for volatility, we expect hedge funds to be among the best-performing alternative asset classes because they typically have more flexibility to mitigate the effects of market slumps.

This characteristic will become particularly valuable as stock and bond markets become more volatile. We expect the volatility of a global 50/50 equity and bond portfolio to rise from circa 7 per cent in the past 10 years to about 10 per cent on average in the next five years.

Gold also offers investors some protection from increased turbulence in traditional asset classes. Quantitative easing, negative real rates, a weakening dollar and persistent geopolitical tensions should underpin demand for the precious metal. Inflationary pressures could also boost the gold price. Although we expect global inflation to remain modest over

————— This much dry powder puts PE in a strong position to take advantage of any attractively priced opportunities that emerge in the aftermath of the pandemic and the consequent economic slump. However, the wall of money also means more competition for potential investments in a market where valuations are already stretched.

the next five years, monetary and fiscal stimulus will at some point begin to push prices higher. And when inflation finally arrives, there's a substantial risk that central banks will be reluctant to step on the brakes for fear of causing another severe recession. In such circumstances, gold will come into its own as a store of value. We expect gold to reach a new all-time peak of USD2,500 per ounce by 2025, up from around USD1,960 at the end of July 2020.

Real estate also offers a degree of inflation protection, not least because rents tend to be linked to consumer price indices. With interest rates and bond yields around the world very low or negative, real estate will continue to attract strong inflows from investors looking for a positive real

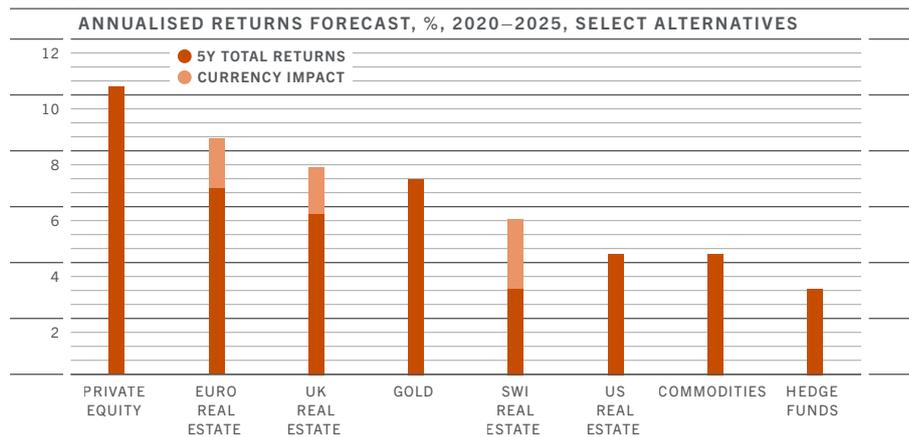
return. However, the influx of money may make it harder to find attractive investment opportunities – it is not yet clear, for instance, how the pandemic might affect demand for residential and commercial real estate, particularly in urban areas.

We are also positive on industrial metals, which could deliver a return of 5 per cent per year thanks largely to a sharp reduction in supply. Mining exploration has collapsed, with capital expenditure having fallen to levels of a decade ago. Production in Australia, meanwhile, is barely growing year on year.

We are particularly bullish on copper. Not only is copper in short supply but demand is sure to rise in tandem with the adoption of electric cars, for which the metal is essential. Prospects for cobalt are also positive, too. The metal is the most expensive component of an electric battery but is difficult to source – not least because more than half of known reserves are located in the politically unstable Democratic Republic of Congo.

Private equity returns to remain in double digits

FIG. 13



Source: Pictet Asset Management.
Data at 16.07.2020. See Appendix for forecast methodology.

CONCLUDING REMARKS

Concluding remarks

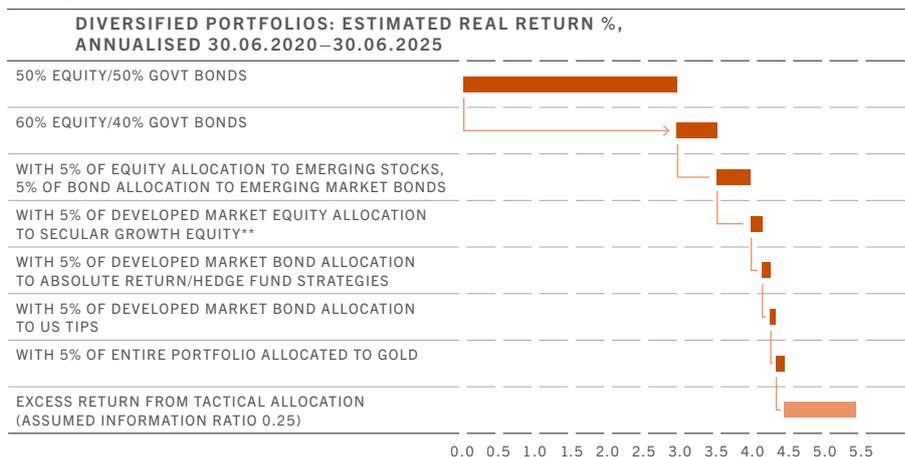
The Covid-19 crisis turned the world on its head, creating major challenges for investors.

Lockdowns around the world plunged many economies into their deepest recessions since at least the Second World War. Governments and central banks launched massive waves of stimulus, continuing and extending the sort of extreme measures first implemented wholesale during the global financial crisis (GFC) a decade earlier. This will ultimately determine how investors fare over the next five years.

Central banks will aim to put a ceiling on bond yields along the curve, in order to reverse deflationary pressures by closing output gaps that opened up during the crisis and then to keep growth on trend. We forecast that they will have pumped liquidity equivalent to 14 per cent of global

Portfolio returns – Investors will need to move away from a traditional balanced portfolio to secure attractive returns

FIG.14



Source: Pictet Asset Management.
 Hedging costs are based on 5-year forward currency returns and not applied to absolute return and tactical asset allocation calculation.
 For a detailed methodology see Appendix.

GDP during 2020, compared with 8 per cent during the GFC decade: they have plenty of firepower to keep monetary policy loose for a long time yet.

Given several asset classes are already trading at expensive valuations – central bank policies have contributed to asset price inflation – investors face returns well below long-term averages over the next five years. That is especially the case in the fixed income market, as interest rates stay lower for even longer.

Bond markets have already priced much of this in, leaving fixed income investors with little upside but plenty of downside risk if policies work and spark growth and inflation. Negative real interest rates mean that inflation-protected bonds will outperform.

Equities are also likely to underperform relative to the past decade. Valuations are expensive for this stage of the cycle; economic growth will be lukewarm; and corporate margins remain under pressure as governments look to less business-friendly policies.

Nonetheless, stocks will benefit from stimulus and the fact that some of the froth was blown out of markets during the Covid-19 crisis. Investors will have to be wary, however, as pressure grows for governments to address deep-rooted problems such as social inequality, inadequate public health systems and environmental damage. The burden of paying for solutions will fall increasingly on corporate shoulders.

While we expect less performance divergence across markets than in the last decade, the US is likely to underperform. This owes to the rotation in market leadership at a country level, which typically takes place in a new bull market. US equities trade at record premiums in an expensive currency – we expect the US dollar to weaken over the coming years – at a time when the economy’s pace of growth is likely to slow towards that of other developed economies. European and emerging Asian equities will do better in our view, with China set to be the star performer.

Asia’s relative strength is likely to be played out in tech stocks where the region looks ready to take over leadership from the US. Overall, technology, staples and health care companies, which tend to be relatively well capitalised and are good at generating cash, are likely to be the best-performing sectors.

Prospects for developed market corporate bonds are mixed. Government support for the market has been huge. But high levels of corporate leverage and record bond issuance at a time when profitability is under pressure point to rising default levels. Instead, investors should look to emerging market debt for bargains, especially at a time when EM currencies are trading at up to a 25 per cent discount to fair value.

Given the poor outlook for traditional asset classes, we favour alternatives with good diversification potential, such as gold and hedge- or market-neutral funds. For instance, we expect gold to rise to USD2,500 as the dollar depreciates and policy rates stay near zero at a time of rising geo-

political uncertainty. In [FIG. 14](#), we set out the extent to which an investor will need to move away from a traditional balanced portfolio to secure attractive single-digit real returns over the next five years.

A portfolio whose assets are split evenly between developed market equities and government bonds will no longer deliver adequate returns: investors will need to boost allocations to emerging markets, alternatives, TIPS and absolute return strategies. Only then can they hope to secure a real return of 5 per cent per year. Given the great uncertainty of these times and the base from which we start, that would be a creditable performance.

Asset class return forecasts

Our bond yield forecasts are based on a ratio of bond yield-to-nominal trend GDP growth of 0.75 times for US and UK and 0.7 times for Germany (using euro zone GDP); for Japan we assume the bond yield rises in line with trend inflation by 2025. To calculate the future annualised roll, we take Bloomberg curve data and adjust the roll for year 5 based on where we expect the 10-year policy rate to be. Return forecasts assume a recovery rate of 40 per cent for developed-market bonds, 50 per cent for EM sovereign debt and 30 per cent for EM credit.

The following benchmarks are used: JPMorgan indices for developed/emerging government bonds and emerging corporate bonds; SBI Index for Swiss bonds; Barclays Euro Aggregate Corporate Index for euro zone investment grade; BoFA Merrill Lynch indices for euro zone/US high yield, US 10-year TIPS.

For equity market forecasts, sales growth is proxied by our forecast of nominal GDP growth (average 2020 to 2025), adjusted for regional revenue exposure. Our profit margin change forecasts assume a reversion to long-term mean over the next 10 years, adjusted by business cycle (output gap) and expected currency appreciation. Earnings per share growth is adjusted for dilution effects.

Fair value is based on 12-month PE for the S&P 500 index, with the model incorporating forecasts for bond yields, inflation, and trend GDP growth. The forecast assumes P/E ratio reverts to long-term average discount to US (post-1999 for euro zone, Switzerland and Japan). Frontier market PE is the same as emerging market PE.

Economic forecasts

Our GDP forecasts are based on estimating countries' current potential growth, and adjusting that by current production factors – which determine how effectively economic inputs are being translated into outputs.

Potential output is defined as the highest real GDP level that can be sustained over the long run. First, we decompose raw GDP data into cyclical and trend components. Then we apply the Phillips curve approach to determine the natural level of output, which is consistent with stable inflation (NAILO) and/or with a stable unemployment rate (NAIRU).

Production factors such as the state of the labour market, the availability of private capital and the degree of technological advancement are then applied to the potential output figure to determine the pace of potential – or trend – economic growth in five years' time. We then use linear interpolation to determine growth estimates for the preceding four years. To forecast inflation, we combine three approaches. The first is based on the current inflation trends, using the Hodrick-Prescott filtering method. The second calculates optimal inflation based on the assumption that neutrality of money prevails over the long run. The third considers the variations in the transmission dynamics between money supply and inflation depending on the state of the economy (expansion, financial crisis). Our final inflation forecast is an average of the three calculations.

ASSET CLASS RETURNS – 5-YEAR FORECAST, PER ANNUM, %					
	EQUITIES		IN CHF		IN EUR
	CHINA		10.1		10.9
	EMEA		9.9		10.7
	EMERGING MARKET		9.2		10.0
	LATIN AMERICA		9.1		9.9
	EMERGING ASIA		9.1		9.9
	FRONTIER MARKETS		8.8		9.6
	UK		7.0		7.8
	SWITZERLAND		7.0		7.8
	EURO ZONE		6.7		7.4
	JAPAN		6.0		6.8
	GLOBAL		4.8		5.6
	DEVELOPED MARKET		4.2		4.9
	US		3.3		4.0
	BONDS				
	CHINA 10Y GOVERNMENT		4.6		5.3
	EMERGING MARKET LOCAL CURRENCY		4.0		4.8
	EURO ZONE HIGH YIELD		2.7		3.4
	US HIGH YIELD		2.1		2.8
	EMERGING MARKET US DOLLAR		1.9		2.7
	EMERGING CORPORATE		1.2		1.9
	JAPAN 10Y GOVERNMENT		0.5		1.2
	SWITZERLAND		0.0		0.7
	EURO ZONE CORPORATE INVESTMENT GRADE		0.0		0.7
	US INFLATION-LINKED		-0.3		0.4
	US CORPORATE INVESTMENT GRADE		-0.3		0.4
	EURO ZONE GOVERNMENT		-0.5		0.2
	GLOBAL GOVERNMENT		-0.6		0.1
	UK 10Y GOVERNMENT		-1.3		-0.6
	US 10Y GOVERNMENT		-1.8		-1.1
	GERMAN 10Y GOVERNMENT		-2.0		-1.3
		-6%	0%	6%	12%
		-6%	0%	6%	12%

Source: Pictet Asset Management
Forecast period: 30.06.2020 – 30.06.2025

INDUSTRY SECTOR RETURNS – 5-YEAR FORECAST, PER ANNUM, %								
%	WEIGHT	YIELD*	TREND & VALUATION**	MACRO ADJUSTED***	QUALITY PREMIUM****	RELATIVE RETURN	TOTAL RETURN	
							LOCAL CURRENCY	USD
ENERGY	3.6	3.6	-2.1	0.9	-4.7	-2.7	3.5	4.8
MATERIALS	4.6	0.7	-3.8	2.4	-1.6	-2.6	3.3	4.9
INDUSTRIALS	9.4	-0.1	0.9	0.4	0.3	1.3	7.6	8.7
CONS. DISCRETIONARY	11.8	-1.3	1.3	0.7	-1.4	-1.0	5.3	6.5
CONS. STAPLES	8.1	0.5	0.5	0.9	2.3	3.8	10.0	11.3
HEALTH CARE	12.9	-0.4	1.8	0.5	1.1	2.7	9.3	10.1
FINANCIALS	13.4	1.4	0.8	-5.3	-0.5	-3.9	2.4	3.6
REAL ESTATE	2.9	1.6	-0.2	1.0	-1.9	0.3	6.9	7.7
IT	20.7	-1.0	1.6	0.0	1.6	1.9	8.7	9.3
COMMUNICATION SVS.	9.4	-0.6	0.6	0.0	-0.7	-1.0	5.6	6.5
UTILITIES	3.2	1.7	-1.9	1.2	-7.3	-6.6	0.0	0.9
MSCI ACWI	100.0	2.3					6.5	7.5

Source: Refinitiv Datastream, MSCI, Pictet Asset Management. As of 30.06.2020.

Communication Services, Consumer Discretionary and IT are adjusted retrospectively at industry group level to reflect current classification for price Trend, valuation and macro-economic adjustment

* Dividend yield based on IBES consensus forecasts for 2021 divided by the price as of 30.06.2020.

** Re-rating per year assuming each sector reverts to log trend relative to market over 5-year forecast period.

*** Macroeconomic adjustments: Macroeconomic factors are based on our secular forecast of LOWER CAP factors: oil LOWER CAP for energy, commodity LOWER CAP for materials (Bloomberg index), US GDP for industrials, US inflation for consumer discretionary, US GDP and US dollar for health care, US GDP for consumer staples, US yield Curve for financials, US real bond yield for real estate, US nominal bond yield level for utilities. No adjustment for information technology and communication services.

**** ESG Premium: applies to median stocks excess return versus market return over last 5-year adjusted for our secular return forecast to the market value of first and bottom ESG quintile and backout the annual excess return. Final premium an average result using Refinitiv, Sustainalytics and RobecoSAM ESG score on MSCI World constituents.

Quality Premium: Quality Score is an average of profitability (return on assets) and prudence (asset growth & leverage) at industry group level from our quantitative equity model, normalised cross-sectionally: premia estimated as 10-year average co-efficient of price-to-book ratio as valuation vs. quality score, controlled for trend and valuation.

ECONOMIC GROWTH AND INFLATION – 5-YEAR FORECAST			
%	AVERAGE REAL GDP GROWTH 2020–2025	TREND REAL GDP GROWTH BY 2025	AVERAGE INFLATION 2020–2025
WORLD	3.1	2.8	2.2
DEVELOPED ECONOMIES	1.9	1.6	1.5
EMERGING ECONOMIES	4.6	4.2	3
DEVELOPED ECONOMIES			
UNITED STATES	2.2	2.1	1.4
EURO ZONE	1.3	1.2	1.7
GERMANY	1.5	1.5	1.7
JAPAN	2	0.8	0.1
UNITED KINGDOM	1.3	1.3	1.7
SWITZERLAND	1.5	1.4	0.3
EMERGING ECONOMIES			
CHINA	4.9	4.7	2.2
INDIA	7.7	7.4	4.2
ASIA EX-JAPAN	5.1	4.7	2.5
BRAZIL	4.2	2.1	3.6
LATIN AMERICA	3.4	2.6	3.3
RUSSIA	2.1	2.4	4.5

Source: Pictet Asset Management
(forecast horizon 31.03.2020–31.03.2025)

GOVERNMENT, CORPORATE AND EMERGING-MARKET BONDS – 5-YEAR FORECAST							
	DURATION (YRS)	CURRENT YIELD (%)	FORECAST YIELD IN 5 YEARS' TIME*	ANNUALISED ROLL**	OUR RETURN FORECAST %	CURRENCY GAIN P.A. %	USD RETURN P.A. %
US TREASURIES	9.6	0.7	1	0.6	0.7%	0.0%	0.7%
10-YEAR GERMAN BUNDS	9.6	-0.5	0.4	0.6	-1.3%	1.8%	0.4%
EURO ZONE GOVERNMENT	8.6	0.3	1.1	0.5	0.2%	1.8%	2.0%
SWITZERLAND BONDS	7.6	0	0.3	0.4	0.0%	2.5%	2.5%
10-YEAR JAPAN GOVERNMENT	9.7	0	0	0.5	0.6%	2.4%	3.0%
10-YEAR UK GOVERNMENT	9	0.1	0.9	0.6	-0.4%	1.6%	1.2%
10-YEAR CHINA GOVERNMENT	8.7	2.8	2.5	0	3.4%	3.7%	7.2%
US INFLATION-LINKED	4.8	-0.7	-1	0.1	2.2%	0.0%	2.2%
US INVESTMENT GRADE	8.2	2.3	2.5	0.6	2.2%	0.0%	2.2%
US HIGH YIELD	4.8	7	5.9	0	4.6%	0.0%	4.6%
EURO ZONE INVESTMENT GRADE	5.4	0.9	1.6	0.1	0.7%	1.8%	2.5%
EURO ZONE HIGH YIELD	4.1	4.7	4.5	0	3.4%	1.8%	5.2%
EMERGING MARKET USD	7.8	5.5	4.8	0	4.5%	0.0%	4.5%
EMERGING MARKET LOCAL CURRENCY	5.4	4.5	4.7	0	4.1%	2.4%	6.7%
EMERGING CORPORATE	5	4.7	4.4	0	3.7%	0.0%	3.7%
GLOBAL GOVERNMENT	8.7	0.4	0.8	0.5	0.3%	1.6%	1.9%

Source: Refinitiv Datastream, JP Morgan, Barcalys, BoFA Merrill Lynch, Pictet Asset Management. As of 30th June 2020

* Assuming a bond yield to nominal trend GDP growth ratio of 0.2X trend nominal growth rate in 5 years' time in the US and the UK, 0.1x for Germany (vs. euro zone GDP), 50 bps spread below Germany in Switzerland, 60bps spread above Germany for EMU (assuming 175 basis point BTP spread, 140bps ODE spread), and Japan bond yield in line with BoJ target of 0%

** Adjust roll for year 5 based on whether we expect 10y-policy rate to be and the relative steepness of the curve. Investment grade corporate bond roll assumes curve steepens proportionally with government bond curve

US high yield bond spread fair value based on 10-year bond yield forecast, VIX and default rate estimated by yield curve and real yield as well as yield ratio vs. government bond. US investment grade fair value spread based on yield spread ratio vs. high yield

Euro zone high yield bond yield spread forecast based on fair value estimate and spread vs. US high yield. EU investment grade yield spread forecast based on spread vs. US investment grade bonds and spread ratio vs. euro zone high yield

High yield forecasts incorporate our default rate forecasts and an assumed recovery rate of 40%, except for emerging market dollar and local currency bonds, for which we assume a recovery rate of 50%; For emerging market corporate bonds we assume a recovery rate of 35%

Our forecasts for emerging market local currency, dollar and corporate bond yield spreads are based on our fair value model.

EQUITY MARKET RETURNS – 5-YEAR FORECAST									
%	YIELD	SALES GROWTH*	MARGIN CHANGE**	EPS GRWOTH***	12M PE	ON TREND EPS****	SECTOR ADJUSTED	FORECAST IN 5Y	PE CHANGE P.A.*****
UNITED STATES	1.9	5.1	-0.7	4.3	21.5	19.3	18.4	19	-0.4
EURO ZONE	2.9	4.5	0.6	4.5	17.8	14.3	16.9	14.3	0.0
SWITZERLAND	2.9	4.6	-0.8	3.8	19.5	20.3	21.1	20.6	0.3
UNITED KINGDOM	3.7	4.0	0.6	4.1	15.7	12.6	15.2	13.3	1.1
JAPAN	2.4	3.4	0.0	2.9	17.3	11.4	16.9	11.9	0.9
DEVELOPED MARKETS	2.2	4.8	-0.4	4.2	20.4	17.8	18.1	17.6	-0.2
CHINA	1.8	7.1	-0.6	5.9	14.1	14.7	20.1	15.5	1.1
EMERGING ASIA	2.2	7.0	-0.6	5.8	14.8	14.2	17.8	14.4	0.2
LATIN AMERICA	2.9	6.6	-0.1	6.0	16.1	14.3	20.6	13.4	-1.3
EMEA	2.5	7.1	-0.3	6.3	10.8	10.2	11.9	11.2	1.9
EMERGING MARKETS	2.5	7.0	-0.5	5.9	14.3	13.7	18	14.1	0.5
FRONTIER MARKETS	3.0	6.1	-0.5	5.0	11.2			11.2	0.0
GLOBAL (MSCI ACWI)	2.2	5.0	-0.4	4.4	19.3	17.3		17.2	-0.1
LAST YEAR (MAR 2019)	2.6	4.7	-1.5	3.4	15.2	15		14	-1.3

%	TOTAL RETURN		
	P.A., LOCAL CURRENCY	VS USD	IN USD
UNITED STATES	5.9	0.0	5.9
EURO ZONE	7.4	1.8	9.4
SWITZERLAND	7.0	2.5	9.7
UNITED KINGDOM	8.0	1.6	9.7
JAPAN	6.2	2.3	8.7
DEVELOPED MARKETS	6.2	0.6	6.8
CHINA	8.8	3.7	12.9
EMERGING ASIA	8.2	3.4	11.9
LATIN AMERICA	7.5	4.1	11.9
EMEA	10.7	1.7	12.6
EMERGING MARKETS	8.5	3.2	12.0
FRONTIER MARKETS	8.1	3.2	11.5
GLOBAL (MSCI ACWI)	6.5	0.9	7.5
LAST YEAR (MAR 2019)	4.7	0.8	5.6

Source: Refinitiv Datastream, Pictet Asset Management. As of 30th June 2020

* Proxied by our forecast of nominal GDP growth (average 2021 to 2025), adjusted for regional revenue exposure and trend sales growth.

** IBES net profit margin, based on reversion to mean (60% weighting in calculation), world average (20%) and trend (20% weight) over next 10 years. Initial margin average of current and consensus 2021

*** Adjusted for dilution effects (0% in US and Swi, 0.5% in rest of world)

**** Log trend of trailing 12-month earnings per share for the decade ending 31.12.2019

***** For US: price-earnings (P/E) ratios on trend earnings per share based on our forecasts for bond yields, inflation, trend growth. Regional P/E ratios to revert to long-term median discount to US (in sector-adjusted terms for developed markets; for emerging markets sector impact is limited to 25%). Frontier PE = 90% of EM PE, in line with history



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