TENDERCAPITAL
The Investment House

Outlook.2021

DECEMBER 2020

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Contents

Summary

1.

The pandemic crisis has been hardly hitting GDP growth in Europe and US and the ensuing output gap sent the inflation to new lows and further deteriorated the outlook. The dynamic thus triggered an unprecedented synchronized monetary and fiscal response across all major economies. In the current state of affairs, Eurozone and US GDP will likely take several years to reach again pre-Covid output path, with the former expected to return to previous level in 2022 while the latter, one year earlier, in 2021.

In the fixed income market, the interest rate curve highlights expected weakness in Eurozone economy. In 2020, the whole interest rate curve went into negative territory for the first time ever and the yield differential 10y-2y stabilized at 20 basis points at a level seen in financial crisis. Expected market returns look lower than those realized in the past and capital appreciation potential is stretched, favoring research for carry.

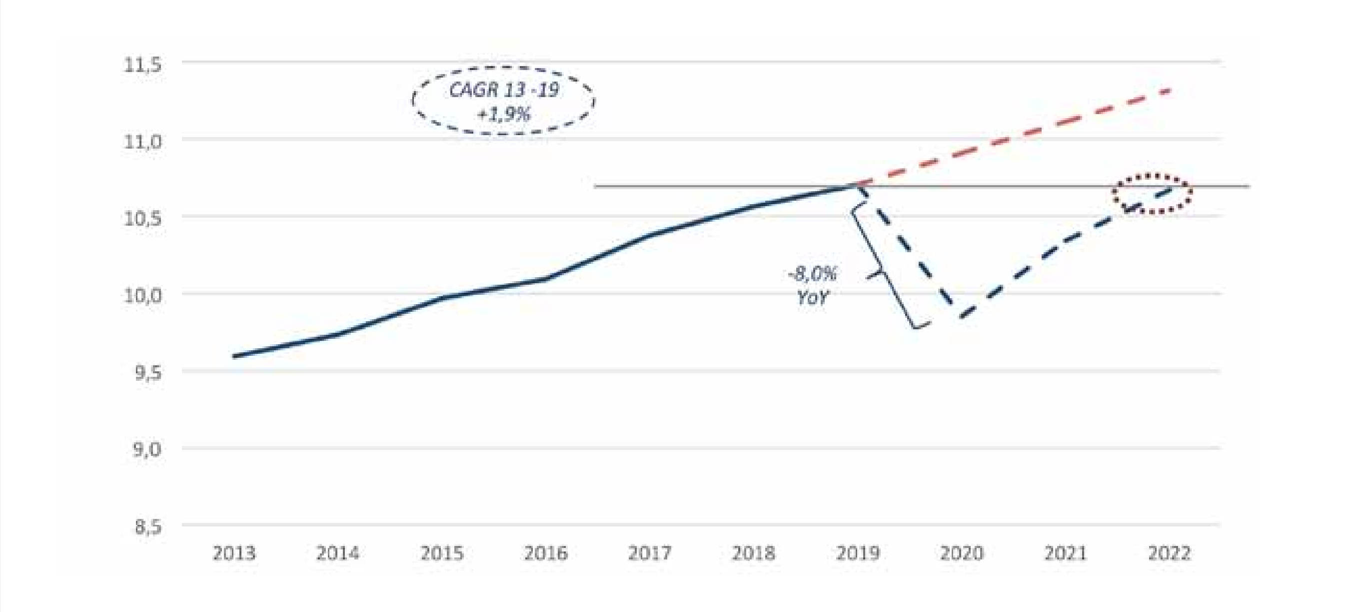
In the equity market, the fallout experienced in March has been followed by a sharp rebound in the subsequent months. A common «script» across all major indexes characterized by the outperformance of the growth segment, further favored by the dynamics of the interest rates market. In this context, stretched valuation has led to the lowest level of perspective returns in decades. Coupled with the uncertain economic environment, we advocate for a defensive stance going into 2021, favored by the reach for yield across underappreciated and uncrowded trade across the value segment.

Euro Area GDP Recovery is Expected to Take Place in 2022 while in the US in 2021

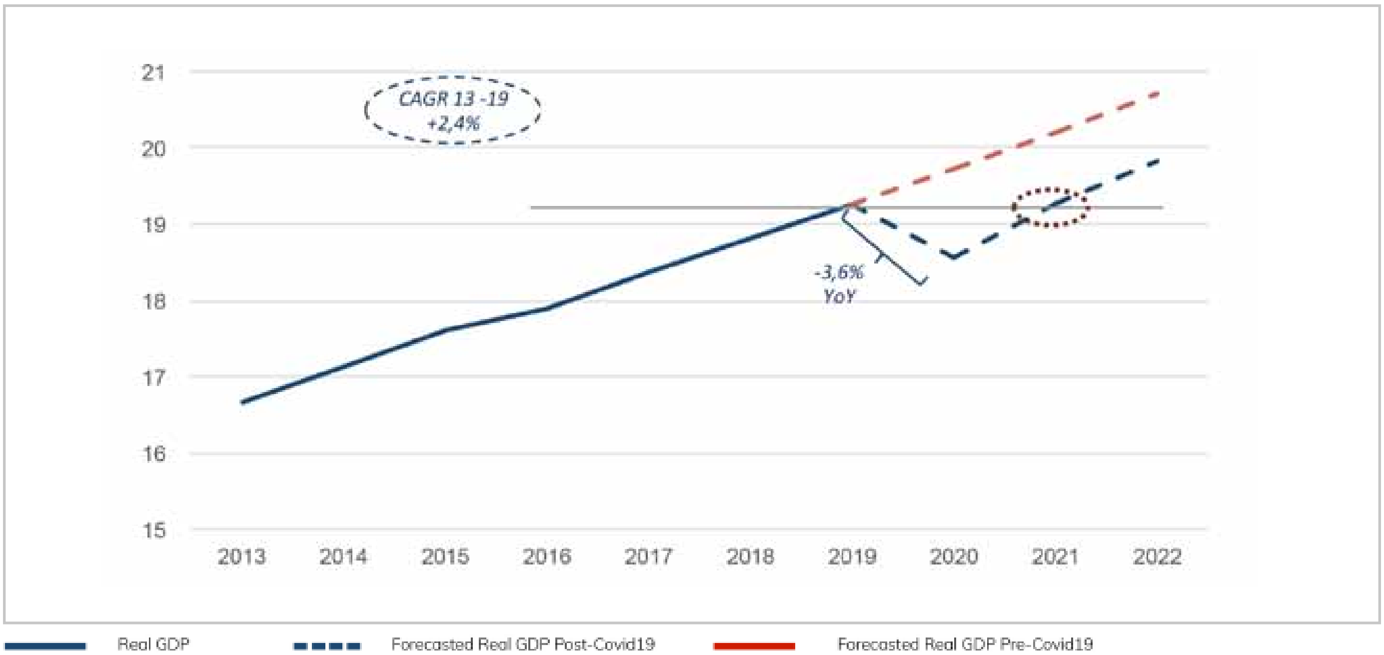
2.

GDP has recovered quickly but it will likely take several years before pre-Covid19 output path will be reached

HISTORICAL AND FORECASTED EUROZONE GDP
Amounts in EUR/Trillion; figures in real amount



HISTORICAL AND FORECASTED USA GDP
Amounts in USD/Trillion; figures in real amount



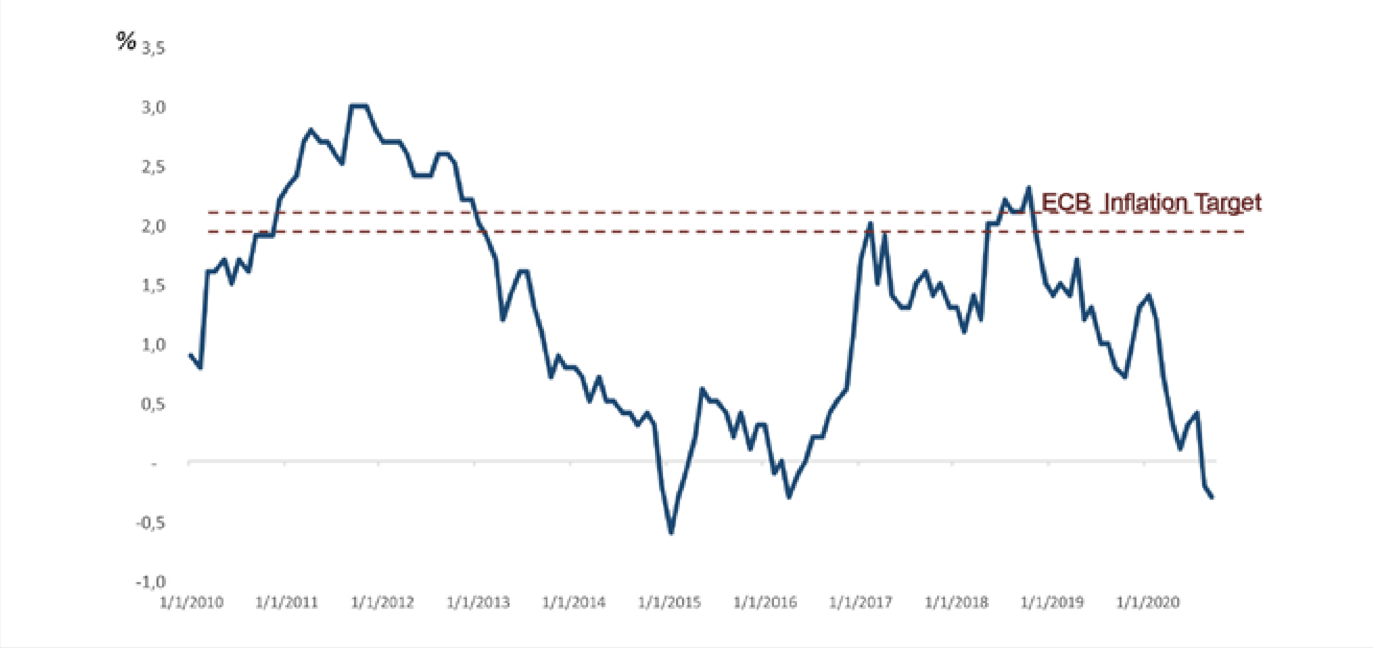
Source: Bloomberg; Tendercapital Analysis.

The Output Gap Created by the Pandemic has Sent the Inflation to New Lows

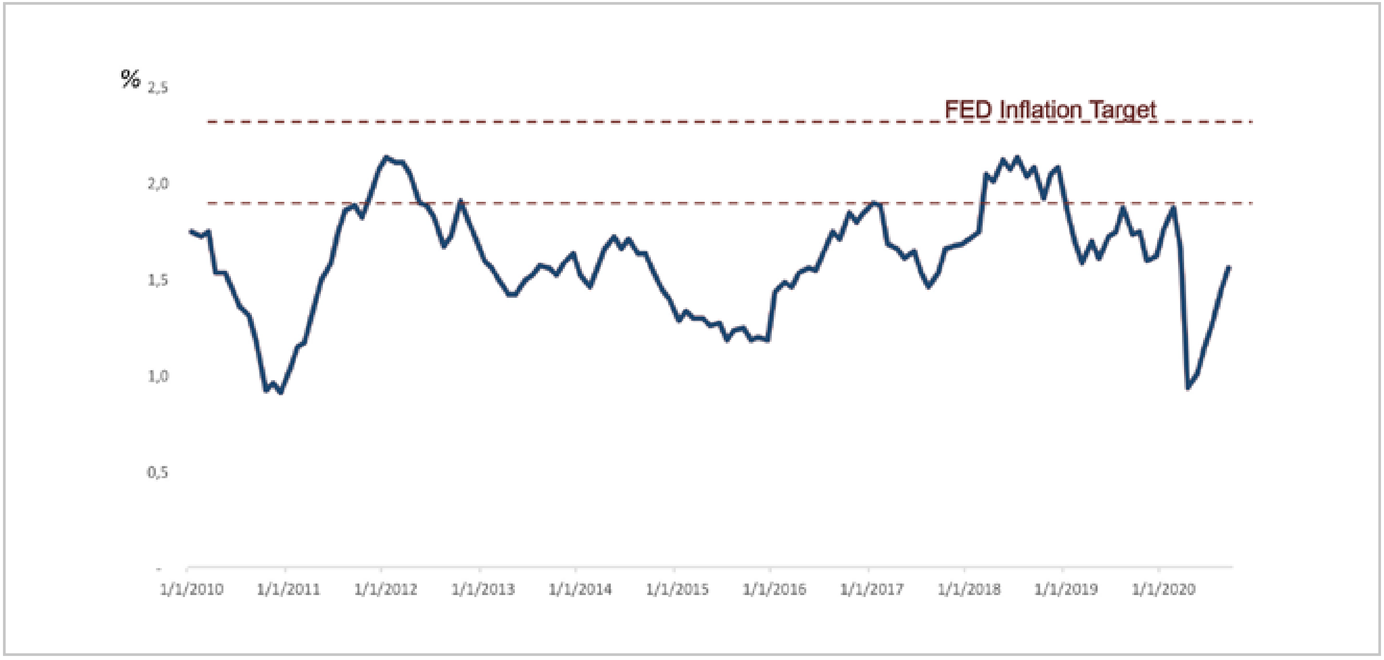
2.

Central Banks failed to reach the inflation target in the current cycle. The pandemic has further deteriorated the economic outlook

EUROZONE INFLATION (CPI)



US INFLATION (PCE)



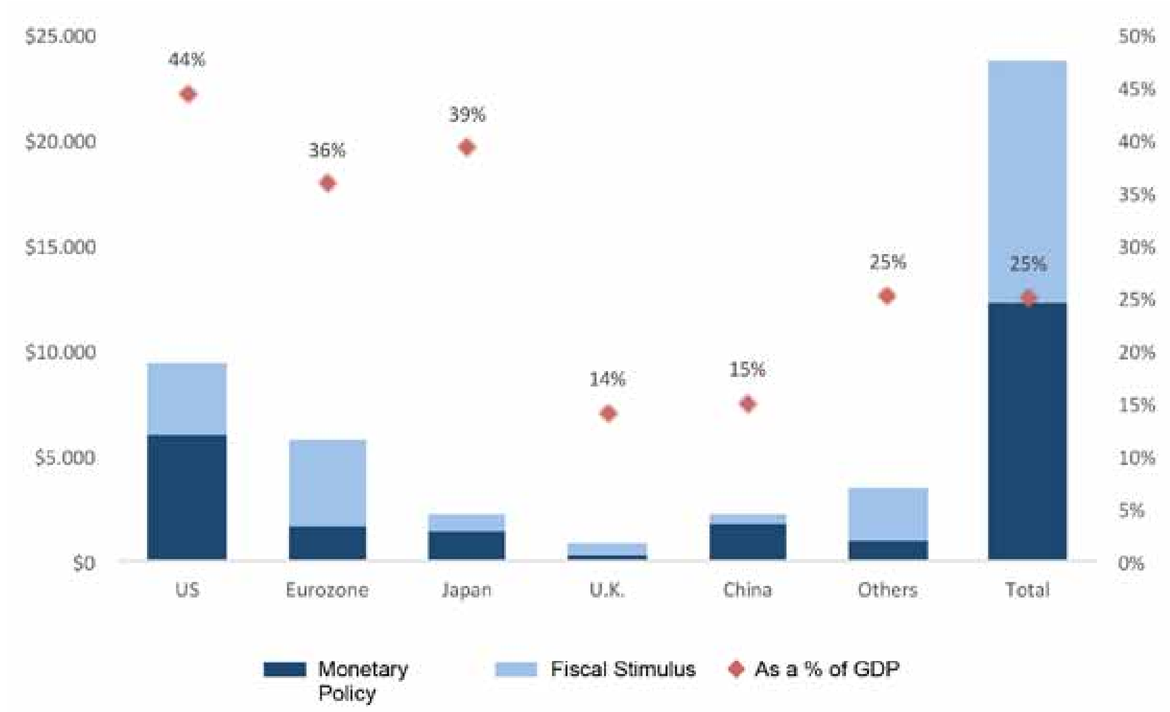
Source: Bloomberg; Tendercapital Analysis.

The Pandemic has Fueled a Synchronized Monetary and Fiscal Intervention Across All Major Economies

2.

US and Europe have displayed the biggest policies sending the total expenditure at ~40% of GDP, as per Japan

GLOBAL MONETARY POLICY AND FISCAL STIMULUS
Amounts in EUR/Trillion; figures in real amount



The pandemic recession triggered the adoption of fiscal stimulus, which became much more attractive over the time due to the failure of monetary stimulus in the last few years.

- Even if in the past decade governments adopted fiscal austerity, **monetary stimulus** became the dominant policy lever, as result fiscal and monetary measures often pulled in opposite direction

- In the next decade the past scenario is likely to change and follow a different trajectory, with **monetary and fiscal policy complementing each other**

- In the medium to long term, both fiscal and monetary polices are likely to increase the upside risk to inflation, in this way closing the output gap in the coming years

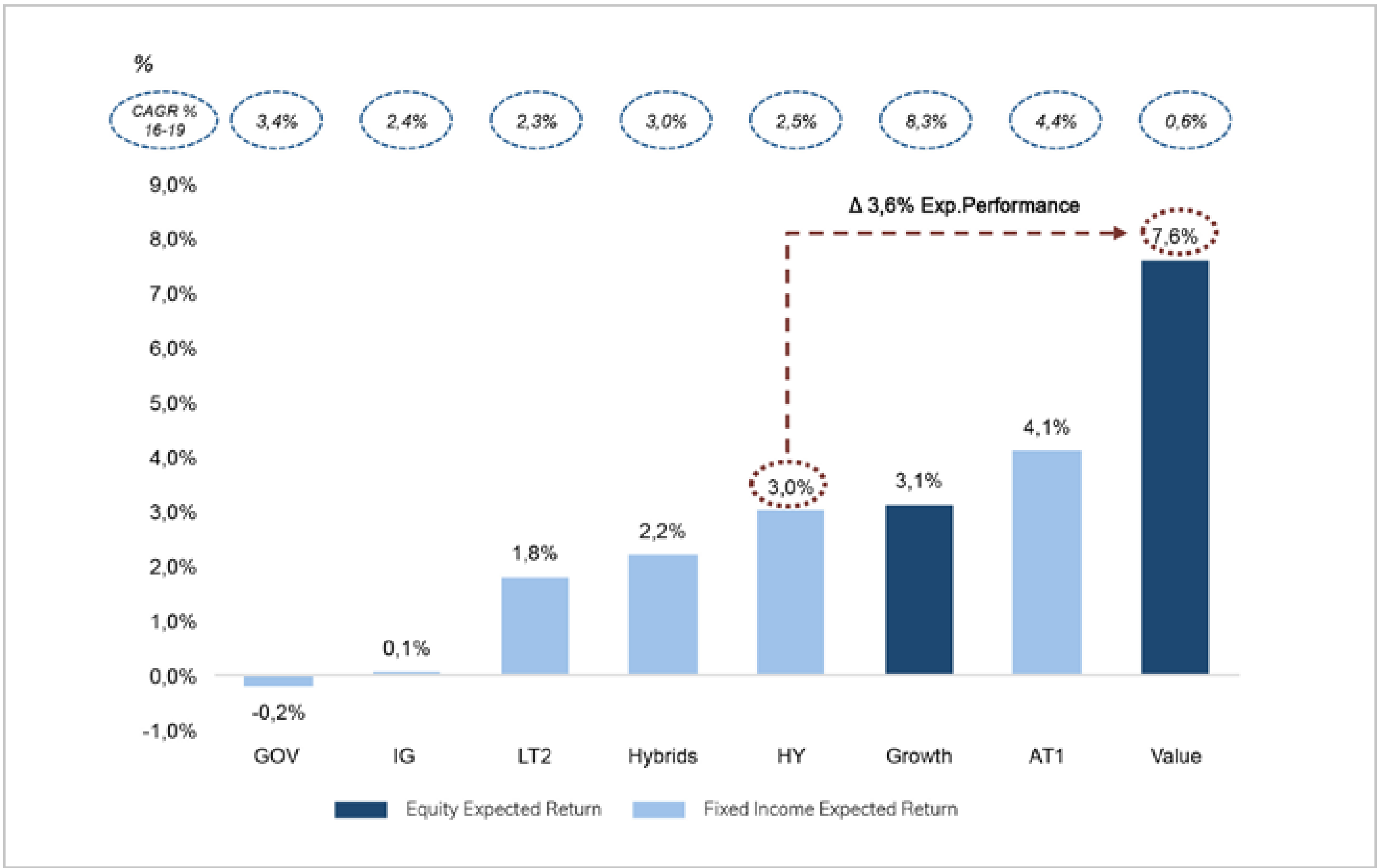
Source: Bloomberg; Tendercapital Analysis.

Despite the Uncertain Environment, All Asset Classes Exhibit the Lowest Perspective Return in the Last Decade

2.

The reduction in the risk-free rate has acted as a vacuum for all the other asset classes

EXPECTED RETURN OF DIFFERENT ASSET CLASSES IN 2021



Main Takeaways:

- Central Banks' coordinated intervention generated yield compression across different asset classes
- The vast majority of government bonds present deeply negative real interest rates
- Expected return on corporate credit is the lowest at record, with investment grade component barely positive
- Subordinated debt still incorporate an expected yield in line with returns obtained in last three years
- High Yield is the single fixed income asset class presenting a higher potential return than what achieved in previous years
- Interest rate curve flattening favored growth stocks increasing divergence of valuation vs. value stocks

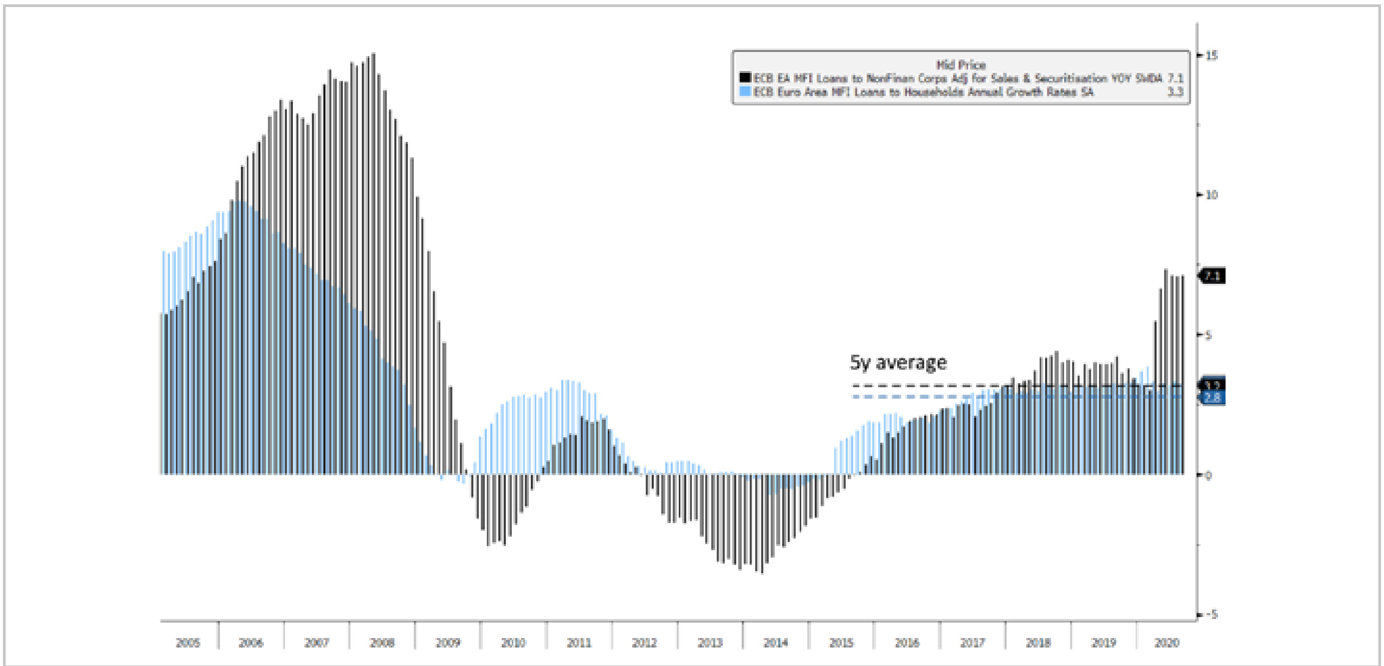
Source: Bloomberg; Tendercapital Analysis.

Public Debt Issuing to Grow 10-fold in 2020

3.

Eurozone indebtedness to the rise: corporate leverage growing at strongest pace since financial crisis

CREDIT SYSTEM SUPPLY: BANK LOANS TO CORPORATE & HOUSEHOLD SECTOR



- Corporate funding through banking system kept strong pace through the Summer stabilizing at a growth rate of 7% YoY
- Household loans growth flat-lined at 3% YoY at same level with 5y average pace

EURO DENOMINATED DEBT ISSUING GOVERNMENT AND CORPORATE

- **Bond issuing** in Euro currency **approaching ~2,7 Trillion year-to-date** with ~200 B additional issuing in last month. The total amount is >45% higher than the whole debt issuance of 2019 (highest data ever)
- **The mix of issued debt changed with a surge in government debt** at 1,8 T, covering more than 10% of Eurozone GDP. Corporate debt issuing path abated at 860 B (~55% FY19) due to market turmoil in 1H20 and banking financing channel becoming stronger
- **ECB as main actor in public debt**. Since H1 the ECB increased asset portfolio by more than 450 B reaching ~3,8 trillion. Last month purchases cover more than half of the public debt issued

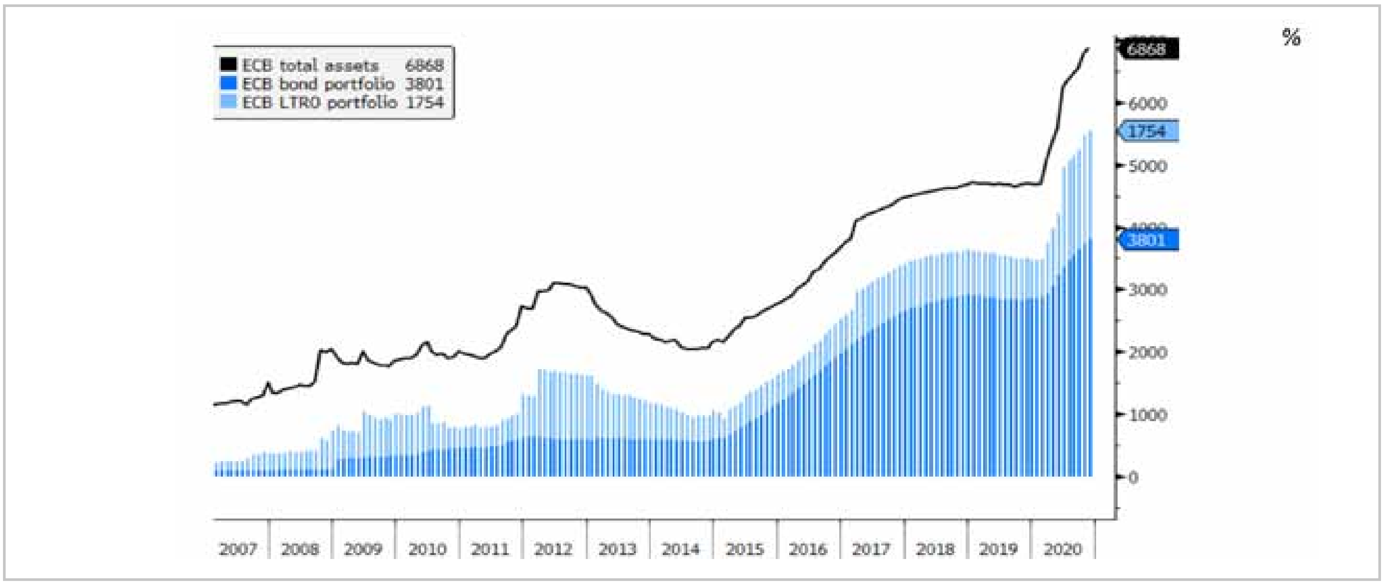
Source: Bloomberg; Tendercapital Analysis.

ECB Balance Sheet Expansion Boosts Europe's Money Aggregates

3.

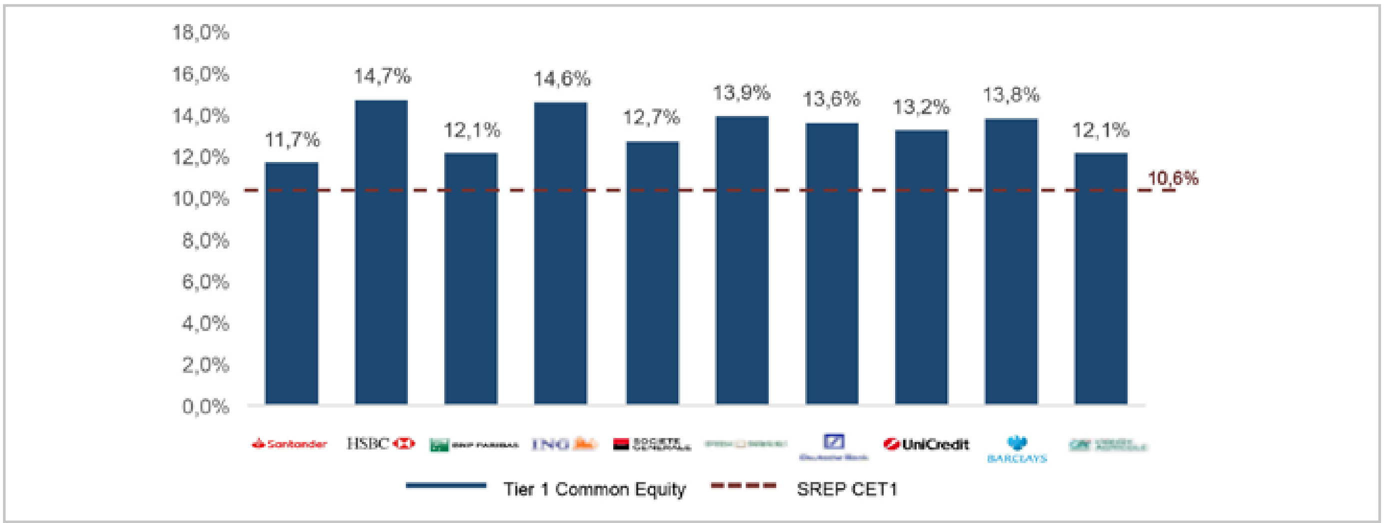
Banking system massively increased sourcing of funds through ECB

BREAKDOWN ECB BALANCE SHEET



- ECB balance sheet surges at ~7 T Euro, reaching >60% of Euro Area GDP
- 1.35 T Euro PEP Program is expected to be raised by the end of the year
- Banking system stability managed through LTRO program

EUROPEAN BANKS COMMON EQUITY TIER 1 RATIO COMPARISON



- European banking system shows up stronger than last financial crisis
- Average Common Equity Tier 1 for major European Banks at 13.2%
- ECB capital requirements and guidance stood at 10.6%

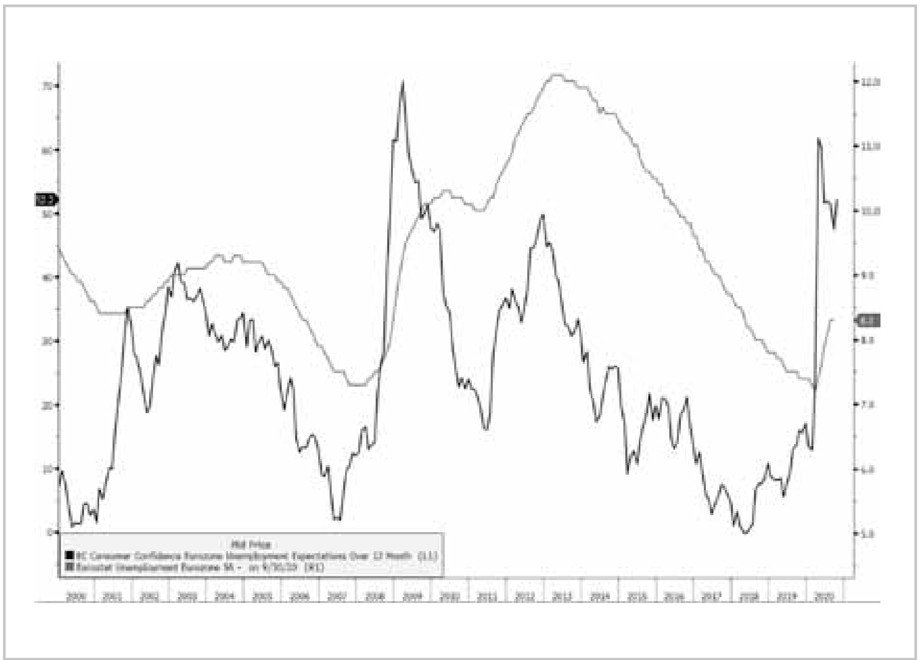
Source: Bloomberg; Tendercapital Analysis.

Unemployment Expectations Affect Discretionary Consumer Expenditures

3.

Unemployment moderated by furlough schemes granted by local governments

CREDIT SYSTEM SUPPLY: BANK LOANS TO CORPORATE & HOUSEHOLD SECTOR



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- Household loans growth flat-lined at 3% YoY at same level with 5y average pace

CONSUMERS INTENTION OF BIG TICKETS PURCHASES AT PRESENT AND FOR NEXT 12 MONTHS

- Consumer current expectations for major purchases rebounded but still show subdued appetite, with indicator at lowest level since Eurozone debt crisis
- Expectations for next twelve months look modestly brighter, indicating improving sentiment on economic and sanitary normalization

Source: Bloomberg; Tendercapital Analysis.

Global Currency Equilibrium - U.S. Dollar Insight

3.

FED monetary policy loosening and a ramp-up in cycle could act as a catalyst to a structural depreciation of the USD

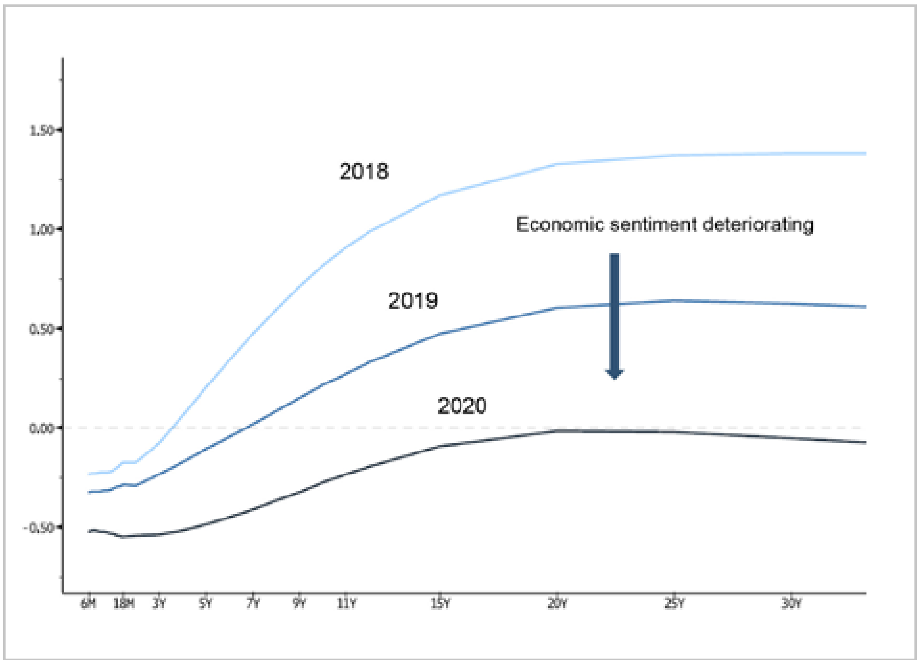
USD/EUR & USD TRADE WEIGHTED INDEX

Source: Bloomberg; Tendercapital Analysis.

Interest Rate Curve Highlights Expected Weakness in Eurozone Economy

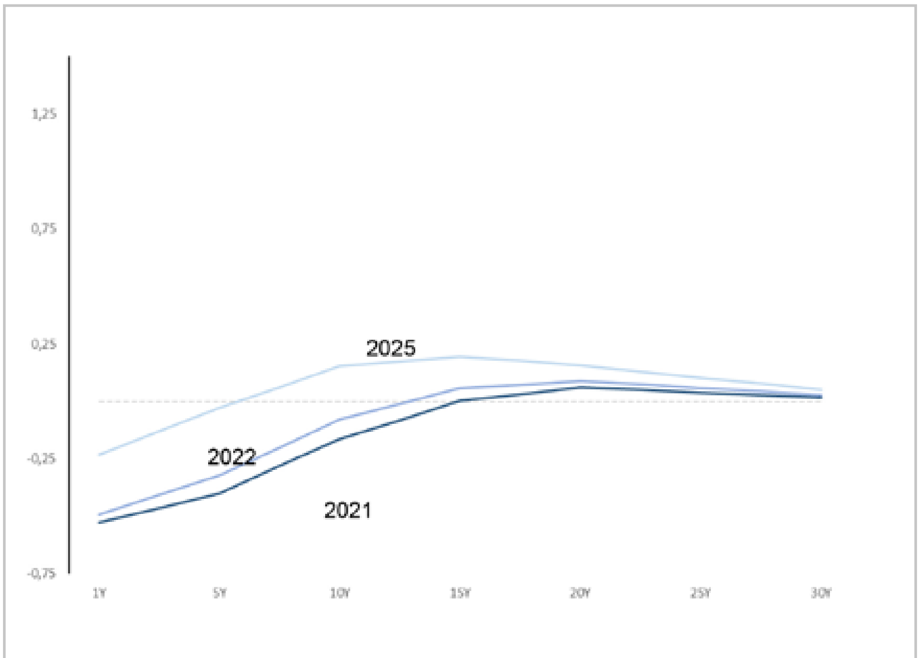
4.

EURO SWAP CURVE – LAST 24 MONTHS MOVE



- Eurozone interest rate curve flattened due to weakening economic sentiment after «Goldilocks» era in 2017/18
- In 2020, the whole interest rate curve went into negative territory for the first time ever
- Yield differential 10y-2y stabilized at 20 basis points at level seen in financial crisis

EURO SWAP CURVE – MARKET EXPECTATIONS BASE ON FORWARD RATES



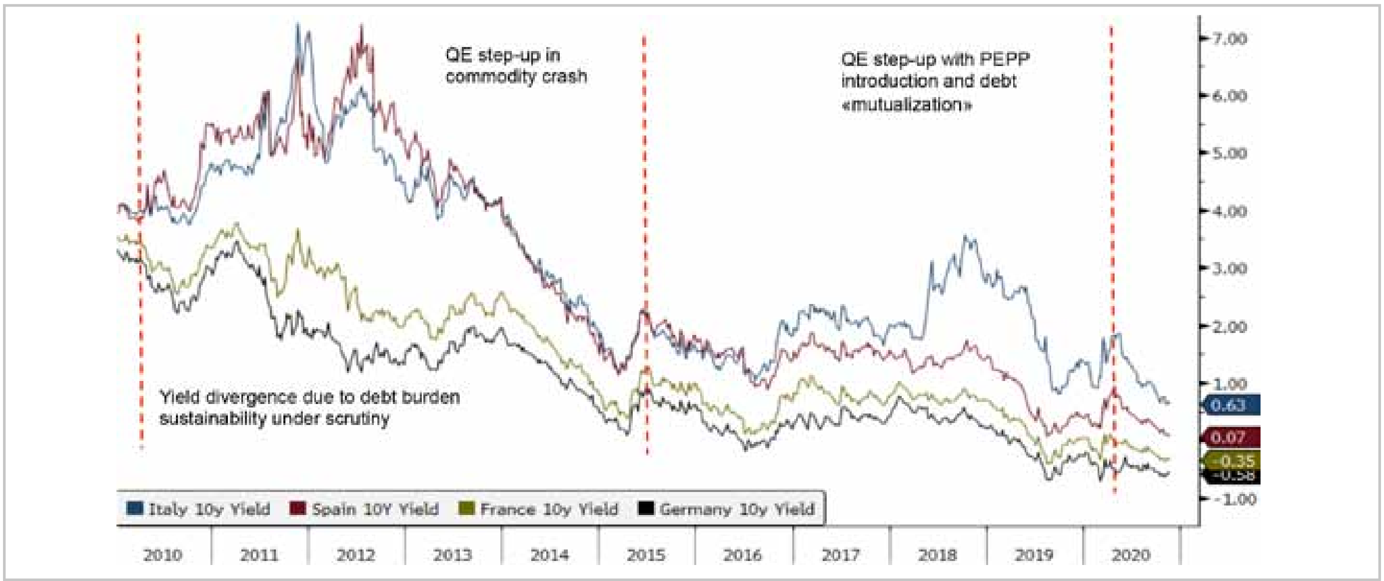
- Market expectations for interest rates indicate a persistent flat path through next five years. No interest rate raise expected before that time horizon
- 10Y yield expected to stay in negative territory for the next three years

Source: Bloomberg; Tendercapital Analysis.

Peripheral Countries Benefitted the Most from Fiscal Cooperation and Monetary Stimulus

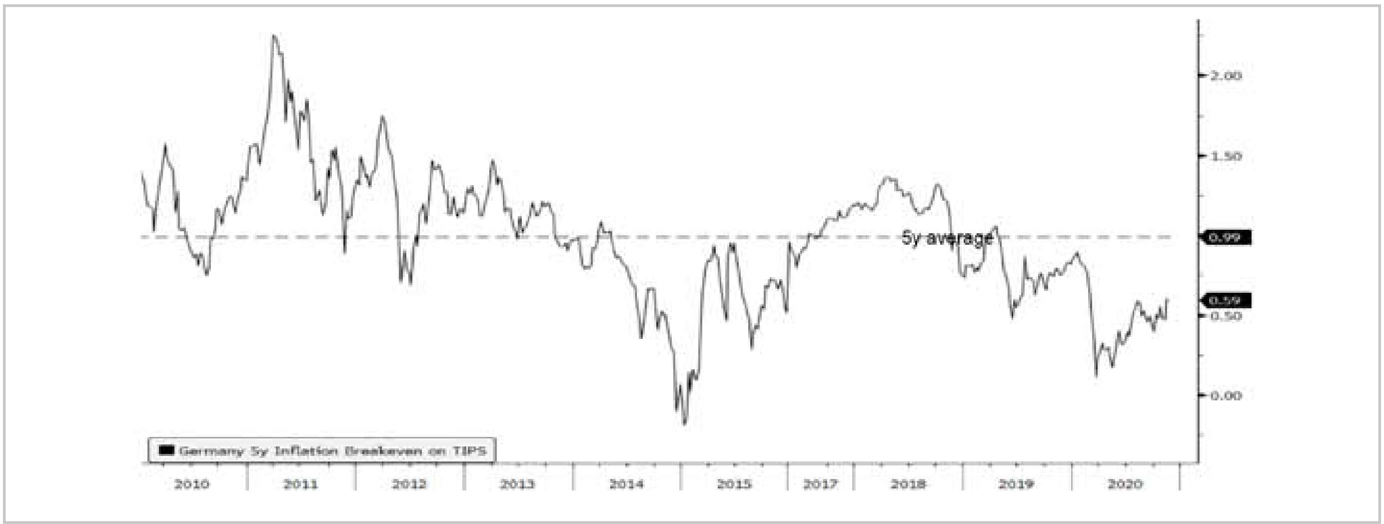
4.

COUNTRY RISK PREMIUM – GERMANY, FRANCE, ITALY, SPAIN 10Y YIELD



- Eurozone peripheral countries reached lowest cost of debt ever
- Unprecedented fiscal cooperation represents a bias for spread convergence
- ECB balance sheet expansion through asset purchases and banking system financing crossed 60% of gross domestic product

TIPS – 5Y GERMANY INFLATION BREAKEVEN BASED ON INFLATION-LINKED BONDS



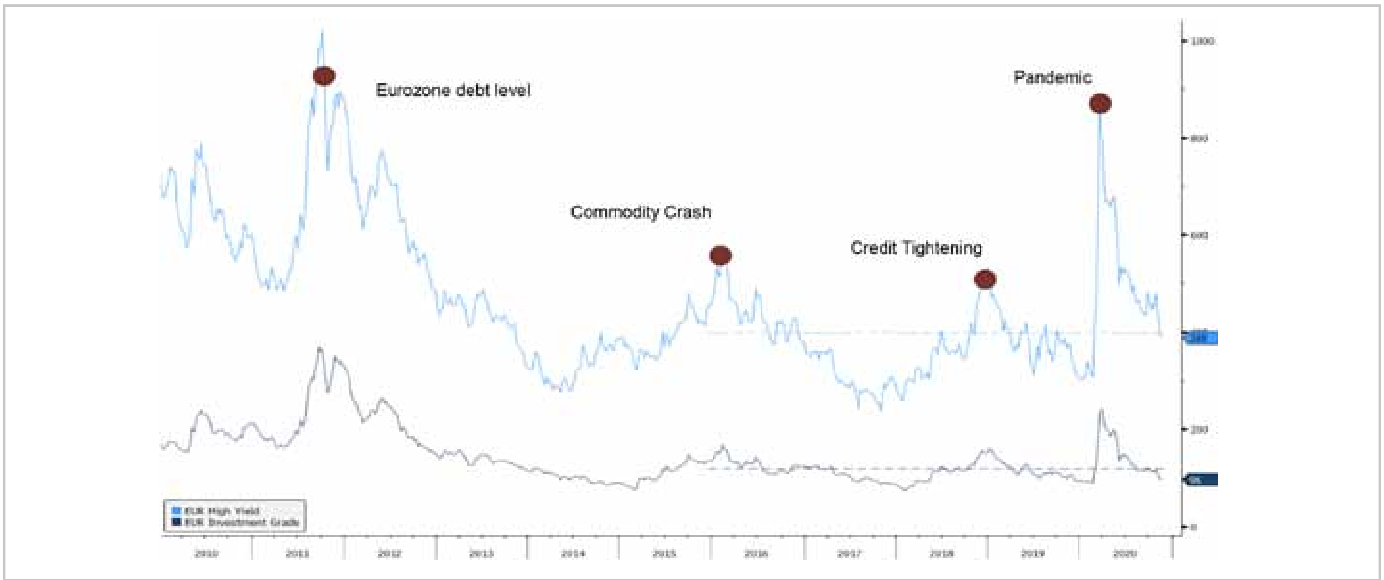
- Short-to-mid term implied inflation expectations in inflation-linked bonds highlights a lower level of prices, in line with a view of struggling economic recovery
- Long-term market expectations recovered Covid blown down although remaining at lows and significantly lower than ECB target level

Source: Bloomberg; Tendercapital Analysis.

Corporate Cost of Debt Recovered pre-Covid Despite Economy Weaknesses

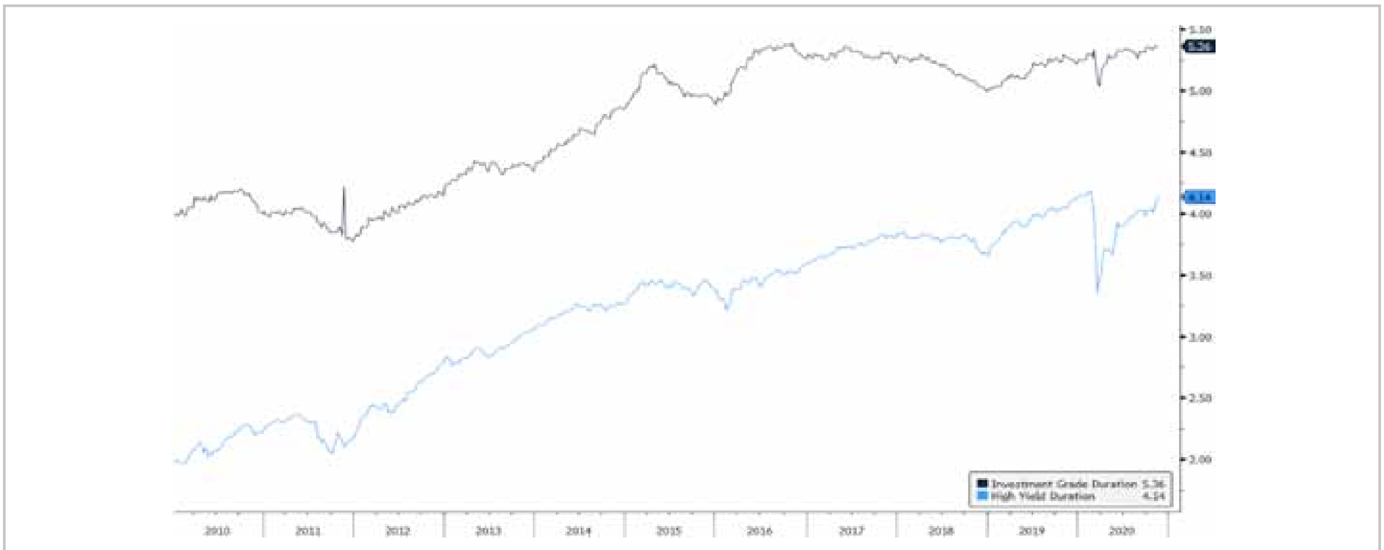
4.

EURO CORPORATE SPREAD – INVESTMENT GRADE & HIGH YIELD BASKET



- Corporate credit premium widening in March has been the highest since debt crisis
- Central Banks intervention with primary and secondary market purchases generated strong recovery with premium below average despite economies in recession

EURO CORPORATE DEBT DURATION – INVESTMENT GRADE & HIGH YIELD BASKET



- European corporates do not fully benefit from low interest rate since duration remained anchored between 5/5,5 years through the QE cycle
- Investment grade issuers' low cost of debt can push to the upside maturity of new issue

Source: Bloomberg; Tendercapital Analysis.

Fixed Income Markets Between Lower Expected Returns and Deteriorated Fundamentals

4.

BACKGROUND

- **Shape and size of Central Banks intervention in fixed income markets has been the strongest on record** with purchases on corporate side reaching «falling angels» high yield uncharted territory. The response to financial credit crunch and market illiquidity has been prompt and just-in-time for avoiding a financial melt-down with long-term consequences.
- **Fiscal intervention have so far avoided an upsurge of corporate defaults with «State Aid» veto waived by EU** in order to let government the rescue of troubled businesses.
- **Level of indebtedness ballooned with government deficit and debt issue increased ten-fold, while corporates heavily relied on banking system with strong loans growth**. Corporate bond issuing can surge in 2021 with companies targeting refinancing at low cost for longer.
- Debt relief measures brought to high level of loans under moratoria for banking industry with potential for loan losses surge anticipating a non-performing loans wave.

MARKET MOVERS

- Weak economic expectations and Central Banks backstop generated a **strong compression in yields with a bull-flattening path of interest rate curves. Maturity premium lays at lows** since Great Financial Crisis with 10y-2y differential barely positive.
- Country **level cost of debt at historical lows as a «must have» for debt sustainability**. Potential for yield curve controlled by Central Banks in case of turmoil. Low inflation expectations can trigger further monetary policy expansion.
- **Corporate credit spread recovery highlights confidence in economic recovery with narrowing yield for unit of risk**.

MAIN TAKEWAYS

- An increasing duration of fixed income baskets imply additional potential volatility.
- **Low to negative real rates pose investors to high sensitivity in inflation expectations**.
- **Expected market returns look lower than those realized**. Capital appreciation potential is stretched, favoring research for carry.

TACTICAL ALLOCATION

- Low risk remuneration and maturity premium advocate for portfolio with underweight duration.
- FOMO distortion in risk/reward pose high selectivity in high yield issuers. We'd rather play lower seniority in higher quality issuers.
- Hybrid corporate debt as a long-term attractive growing niche market.

In a Persistent Low Rate Envinronment We Favor Quality and Limit Portfolio Duration

4.

Strong selectivity needed in a pricey market advocate for active fixed income portfolio management

TENDERCAPITAL STRATEGY BY STYLE		
OVERWEIGHT	**NEUTRAL**	**UNDERWEIGHT**
CORPORATE HYBRID — HIGH YIELD — GOVERNMENT INFLATION-LINKED (EURO/USD)	INVESTMENT GRADE — LOWER TIER 2 (FINANCIALS) — ADDITIONAL TIER 1 (FINANCIALS) — CONVERTIBLES (SENIOR) — US DOLLAR DEBT (CORPORATE)	GOVERNMENT (EURO/USD)
PATIENCE WILL BE KEY, STEEPENING MOVE FROM OVERSEA CAN EMERGE THROUGH THE YEAR GENERATING INVESTMENT OPPORTUNITIES		

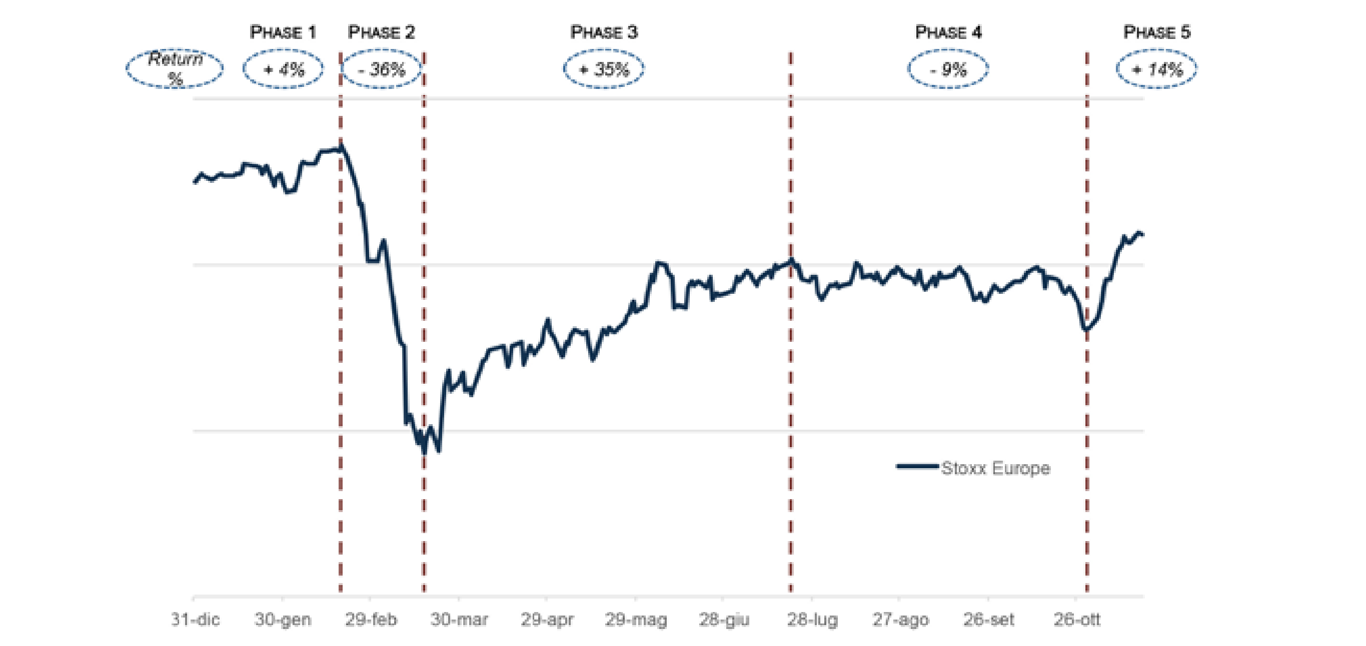
Notes: Where not differently stated positioning refers to Euro currency fixed income market

The Crisis Played Out in 5 Phases Commonly Shared Across all Major Market Indexes

5.

The fallout experienced on the onset of the crisis has been offset by a swift recovery in the subsequent months and by a transition phase in the Summer months. Just recently the positive newsflow rekindles the market upturn

STOXX EUROPE 600 YTD PERFORMANCE



INDEX PERFORMANCE

Main Index	Phase 1 31/12 - 19/02	Phase 2 20/02 - 18/03	Phase 3 19/03 - 21/07	Phase 4 22/07 - 30/10	Phase 5 30/10 - today	YTD
MSCI ACWI	3%	-31%	38%	-1%	11%	8%
Euro Stoxx 50 Pr	3%	-38%	43%	-13%	17%	-8%
STXE 600 (EUR) Pr	4%	-36%	35%	-9%	14%	-6%
S&P 500 INDEX	5%	-29%	36%	0%	10%	11%
NASDAQ COMPOSITE	9%	-29%	53%	2%	9%	32%
MSCI EM	-1%	-29%	38%	2%	9%	9%
Average Return	**4%**	**-32%**	**40%**	**-3%**	**12%**	**8%**

Last Update: 23/11/2020

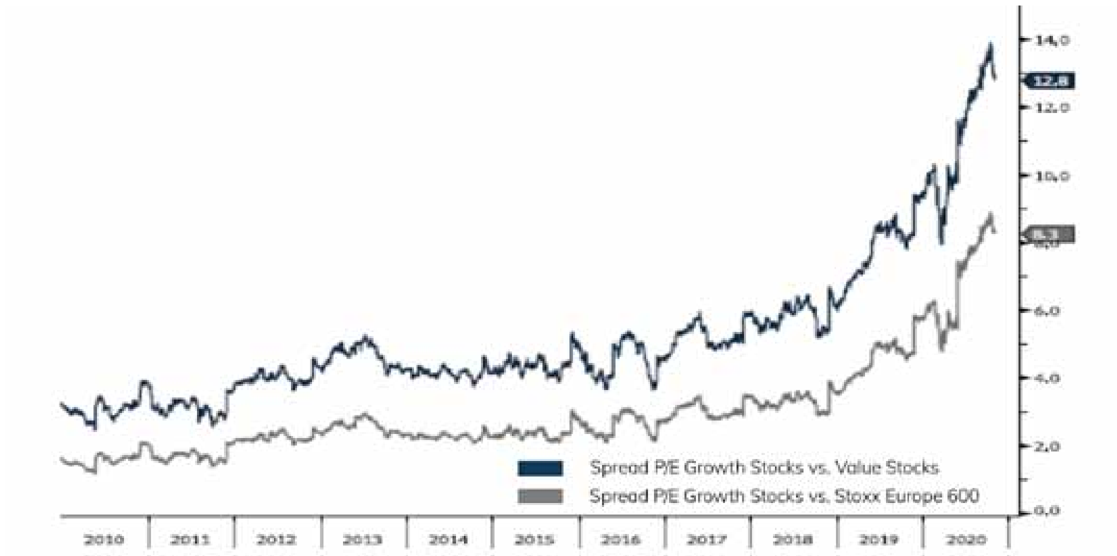
Source: Bloomberg; Tendercapital Analysis.

The Growth Segment has Driven the Market Higher Especially During the Recovery Phase

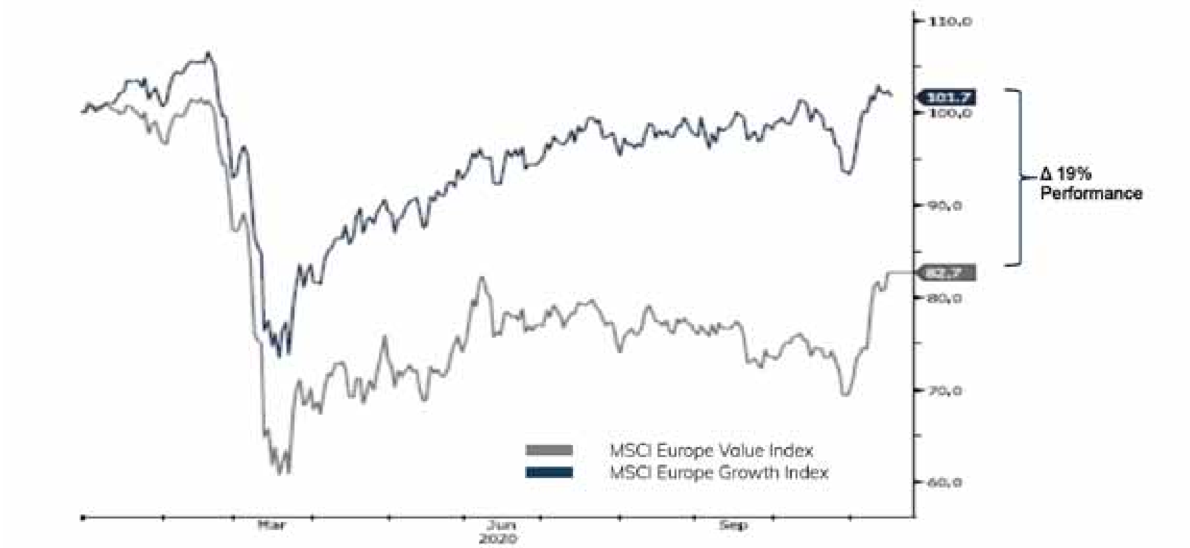
5.

Growth stocks relative valuation reaches all times high in the current cycle outpacing the value segment and the broader market

GROWTH STOCKS VALUATION GAP HAS REACHED NEW HIGHS...
Data for P/E Forward 12M



...THANKS TO THE IMPRESSIVE PERFORMANCE DURING THE MARKET REBOUND
Normalized data as of 31/12/2019



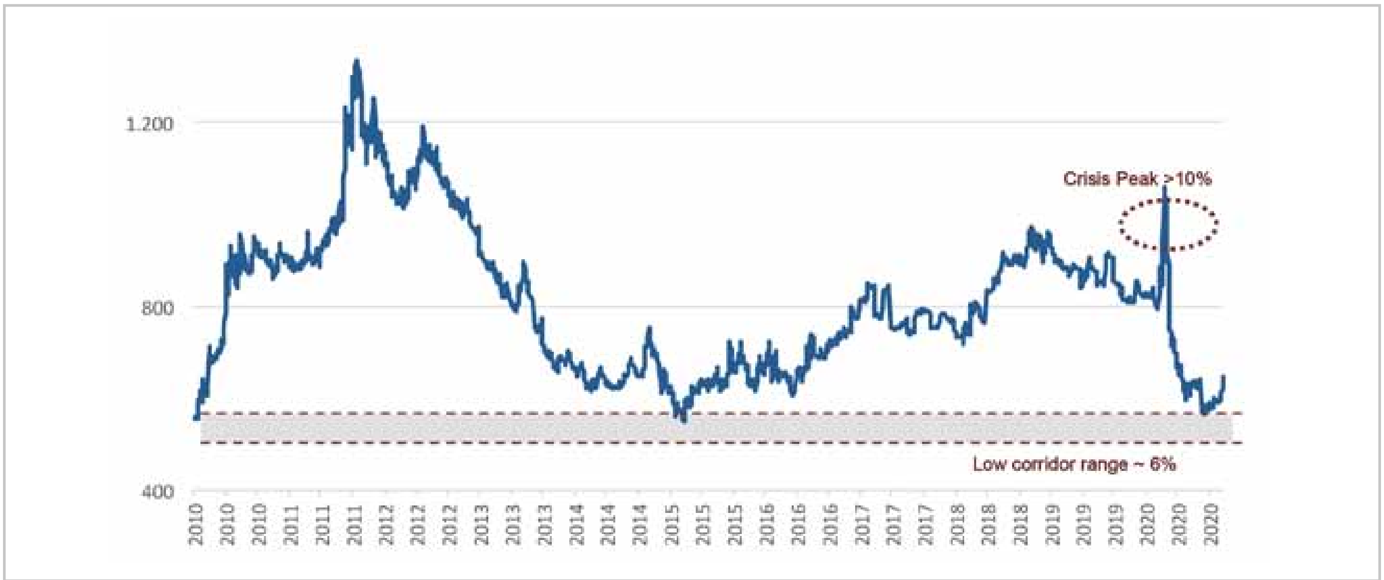
Source: Bloomberg; Tendercapital Analysis.

Market Equity Risk Premium Remains at Multi-Year Lows

5.

ERP fell to the lowest level of the current cycle in the recovery phase after a brief spike during the market fallout. Growth and Value experienced a divergent trend

EQUITY RISK PREMIUM IN EU IS IN THE LOW RANGE OF THE CURRENT CYCLE...
Amounts in basis points; updated as of 16/11/2020



Notes: Growth Stocks referes to MSCI Europe Growth Index; Value Stocks refers to MSCI Europe Value Index; Bloomberg Data

...AS GROWTH STOCKS EARNINGS YIELD TOUCHES NEW LOWS
Amounts in basis points; updated as of 16/11/2020

Source: Bloomberg; Tendercapital Analysis.

We Advocate for a Defensive Exposure and the Search for Yield Across the Value Segment

5.

Technical and macro factors could herald the end of the growth segment and the dominance of the US markets

CURRENT PHASE

- **The Rational Recovery...** The quick recovery in the equity market has led some to believe that the market has ignored the crisis but this is not true. In fact, despite equity values having recovered globally, there has been a significant shift in value across regions, sectors and styles leading to an exaggeration of long-lasting themes
- **...has supported the Growth Stocks...**: Growth companies, namely tech and health care, received two benefits from the crisis. The first is the decline in interest rates as typically regarded by investors as long duration assets. The second refers to the lockdown rhetoric as consumers went online and the race for the vaccine began
- **...and the US market...**: This in turn led to the over performance of US indexes given, their high exposure to aforementioned segments. The well-known FAANGs account for roughly 25% of the S&P500 and are responsible for all the gains realized by the index. Without them, S&P500 would have declined single digit. In the other side EU indexes are more exposed to cyclical/value stocks as financials and industrials
- **...lowering perspective return**: As these themes have been played out, perspective return in the growth segment appears non-existent and valuations are stretched in relative and absolute terms
- **The Value Segment is the «forgotten» spot..**: To the other side, value/cyclical segment looks attractive and could result in an appealing opportunity for investors in the desperate need in the search for yield. Notwithstanding, above average return is due to above average risk resulting in a fair adjusted return for risk
- **but sentiment is there for the rescue**: Positive news surrounding the discovery of a vaccine could temporarily lift the market sentiment Technical and macro factors could herald the end of the growth segment and the dominance of the US markets

KEY VARIABLES

- **Economic Growth & Output gap**: Current estimates point to 2 years of economic recovery to close the gap created by the crisis
- **Inflation vs. Deflation/disinflation**: In this period, deflation/disinflation pressure could overcome inflation as economic slack persist and economic activity is «artificially» kept alive by fiscal intervention
- **Monetary stimulus**: Any disappointment down the road could stimulate further intervention from the side of Central Banks across the world further increasing the money supply
- **Technical factors**: reach for yield, TINA (There Is No Alternative) effect, Present Value Effect

MARKET POSITIONING

- **Defensive stance**: Economic uncertainty and high valuation call for a defensive stance supported by selective allocation and higher-than-usual «cash dry powder» to deploy in cash of market downturn and/or hedging factor
- **Value Exposure**: Relative valuation supports the idea of more interesting risk/reward opportunity in the value segment
- **EU exposure**: Consequential to the point 2) the high exposure of the EU index to the Value segment should support the case for an over-performance of the Euro area vs. US area

Value sectors remain the preferred choice

5.

TENDERCAPITAL STRATEGY BY STYLE		
OVERWEIGHT	NEUTRAL	UNDERWEIGHT
VALUE	MOMENTUM	GROWTH
YIELD	LIQUIDITY	
CYCLICAL	QUALITY	
	SIZE	
	DEFENSIVE	

TENDERCAPITAL STRATEGY BY SECTOR		
OVERWEIGHT	NEUTRAL	UNDERWEIGHT
OIL & GAS	HEALTHCARE	BANKS
CONSTRUCTION & MATERIAL	FOOD & BEVERAGE	FINANCIAL SERVICES
INDUSTRIAL GOODS & SERV.	MEDIA	PERSONAL & HOUSEHOLD
BASIC RESOURCES	RETAIL	TECHNOLOGY
AUTOMOBILE & PARTS	UTILITIES	TELECOMMUNICATIONS
CHEMICALS		INSURANCE

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