Asset Management One Co., Ltd.

Market Outlook 2021

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Global Equity Market Outlook

Global Equity Market

Although accommodative monetary policy will continue to provide support, we project equity returns in 2021 to be generally moderate, after stock prices in all regions have risen in anticipation of economic recovery and the normalisation of the economy to pre-COVID-19 levels. However, we believe the manufacturing sector to recover strongly, particularly in the first half of the year, due in part to inventory shortages, particularly in the automotive and semiconductor sectors. In this context, we project higher equity returns in Japan and China compared to those in the U.S. and Europe. Expected delays in a change of China's monetary stance to tightening will also lend support to the market.

We expect rapid vaccine rollout in the U.S., but equity returns are likely to be lower than in other regions, as the large growth stocks that have been attracted funds in the past may experience a short-term correction, driven by market speculation about higher interest rates.

Market Forecast Summary

Calendar Year		2018 (Actual)	2019 (Actual)	2020 (Actual)	2021 (Forecast)
US	S&P500	2,507	3,231	3,756	3,900
	10-year Yield (%)	2.69	1.92	0.92	1.20
Eurozone	Eurostoxx50	3,001	3,745	3,553	3,700
	Germany 10-year Yield (%)	0.24	-0.19	-0.57	-0.40
China	Shanghai Composite	2,494	3,050	3,473	3,700
Japan	TOPIX	1,494	1,721	1,805	1,900
	10-year Yield (%)	-0.01	-0.02	0.02	0.00

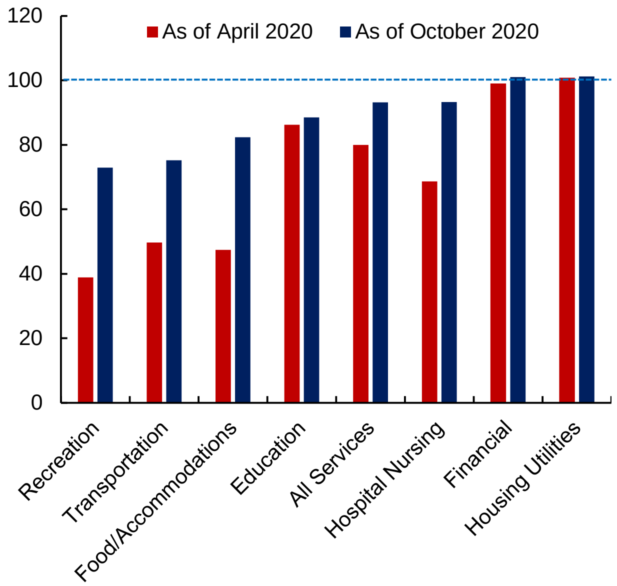
Source: Bloomberg, FactSet, Asset Management One

U.S. Economic Outlook

U.S. Economy

The U.S. economy rebounded sharply during the July-September quarter in 2020, largely recovering from the worst plunge in economic activity since WWII during the April-June quarter caused by the outbreak of the COVID-19 pandemic. After September, the V-shaped recovery phase ended and the economy entered a gradual recovery phase, which is expected to last until the January-March quarter in 2021. With the rollout of vaccinations and wider availability in early 2021, we expect a rebound in the consumption of face-to-face services, which had been restrained by businesses since the outbreak of the pandemic. In 2021, we expect inflation to remain low, in the lower half of the 1% range, and the Federal Reserve Board to maintain an accommodative monetary policy, not starting to tighten policy rates until the end of 2022.

Level of the Recovery in Service Consumption*



Data: October, 13, 2020 – December , 15, 2020
Source: Good Judgement
*Compared to February 2020

Economic Forecast Summary

Calendar Year		2018 (Actual)	2019 (Actual)	2020 (Estimate)	2021 (Forecast)
US	Real GDP (YoY%)	3.0	2.2	*-3.5*	*4.1*
	Core CPI (YoY%)	2.1	2.2	*1.6*	*1.4*
Eurozone	Real GDP (YoY%)	1.9	1.3	*-7.3*	*2.5*
	HICP (YoY%)	1.8	1.2	*0.2*	*0.7*
China	Real GDP (YoY%)	6.6	6.1	*2.2*	*8.5*
	CPI (YoY%)	2.1	2.9	*2.6*	*1.5*
Japan	Real GDP (YoY%)	0.6	0.3	-5.3	2.8
	Core CPI (YoY%)	0.8	0.7	-0.2	-0.4

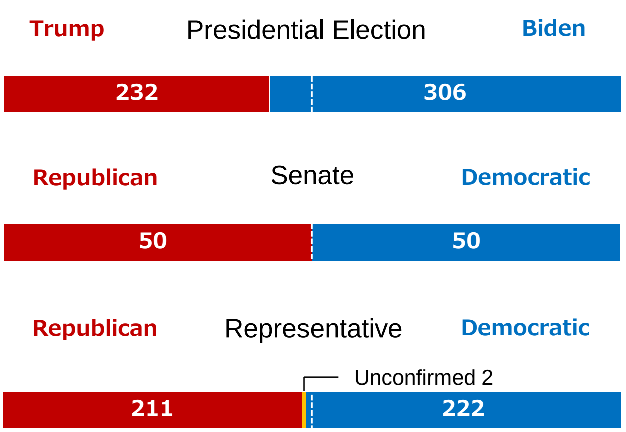
Source: Bloomberg, FactSet, Asset Management One

U.S. Economic Outlook

Political and Policy Outlook

Many of the economic policy promises made by President-elect Joe Biden during his presidential election campaign will be blocked by the Senate if the Republican maintains its majority. President Joe Biden will play the role of a balancer between the Democratic left and the Republican Party. Additional economic stimulus packages, which includes an extension of unemployment insurance benefits, will underpin the economy. Treasury Secretary Janet Yellen will lead a moderate, growth-oriented fiscal policy, but with a focus on overcoming the COVID-19 pandemic, limited cash distribution and improving the health care system. In terms of trade and foreign policy, the new administration will change the course from the Trump administration and focus on cooperation with allies. Hard-line foreign policy towards China will remain, but tariff hikes will no longer be a major policy tool, and the uncertainty surrounding trade policy which persisted until 2020 will be significantly reduced.

Election Results



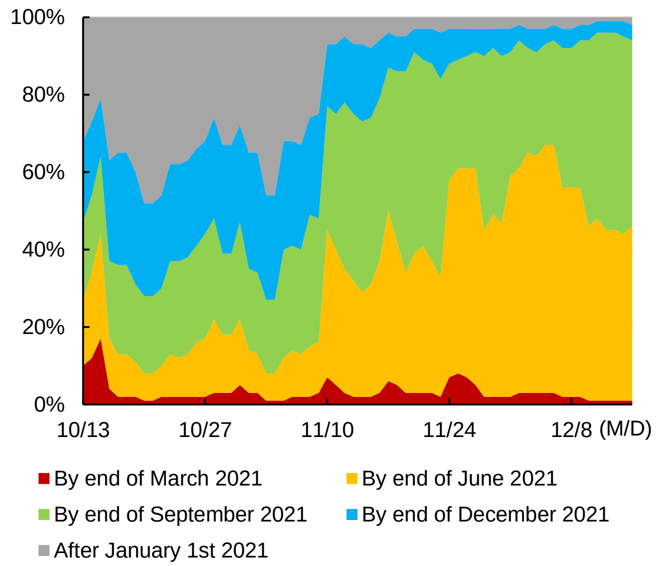
As of January 7, 2021.
Presidential Election shows electoral college votes.
Senate and Representative show the number of seats won.
Source: POLITICO

Two Major Risk Factors

In the Georgia Senate run-off, the Democrats won both seats, resulting in a "triple blue", which meant that the Democrats could use the "fiscal adjustment law" to pass fiscal legislation on their own. However, if the leadership of President Biden does not take hold and the wishes of the left-wing of the Democratic Party are strongly reflected within the administration, with priority given to policies of higher taxes through income redistribution and tighter regulation of the high-tech and financial industries, there is a risk that the economic recovery in 2021 will be hampered.

Another major risk is the delayed uptake of vaccines, which would hinder the assumed re-acceleration of the U.S. economy in 2021. This poses a great risk to the stock market, which has rallied on the back of the widespread use of vaccines, and may become a source of significant volatility.

Expected Probability of Timing of Vaccination Reaching 200 Million



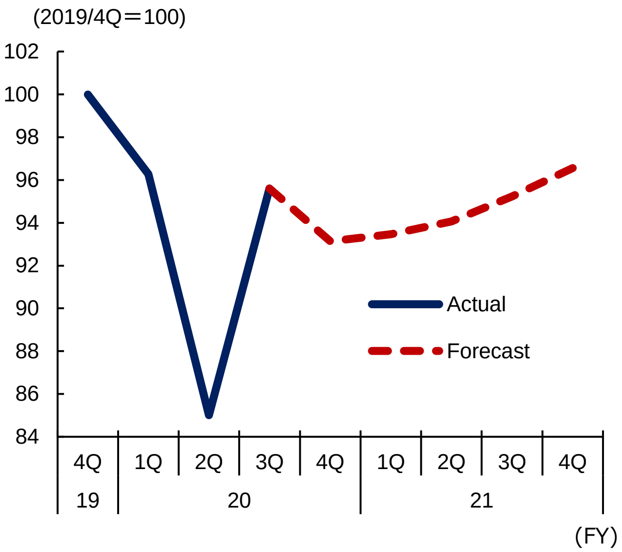
Source: Bloomberg

Eurozone Economic Outlook

Economic Outlook

The extent of the economic recovery in the euro area in 2021 will depend, as elsewhere, on the pace of containment of COVID-19: we assume that vaccination against the virus will start at the end of 2020, with widespread coverage in the April-June quarter of 2021 and achieving some degree of herd immunity in the second half of the year. Lockdowns and restrictions on movement in response to the second wave of outbreaks from October 2020 have been extended, notably in Germany, and are unlikely to be lifted until the January-March quarter in 2021.

Eurozone Real GDP

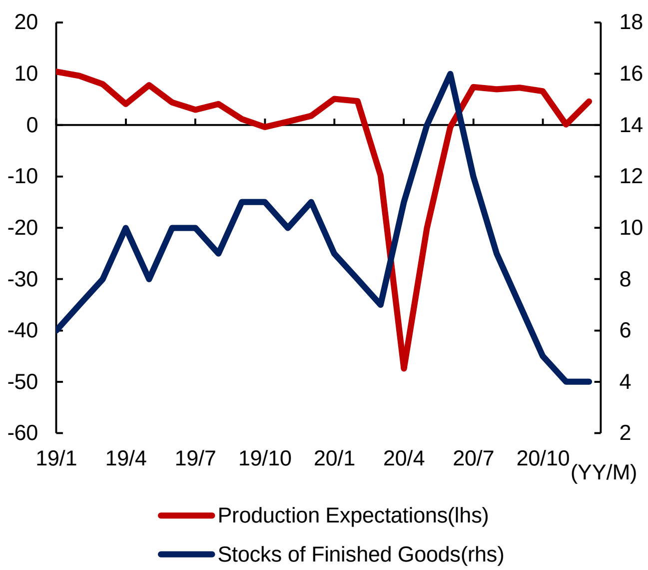


Data: 4Q, 2019 – 4Q, 2021
Source: Refinitiv, Asset Management One

We expect a limited recovery of the Eurozone economy in the January-March quarter, following negative growth in the October-December quarter in 2020.

However, we expect a recovery from the April-June quarter, driven by improved consumer confidence as a result of the expansion of vaccination programmes, and by exports as a result of economic recovery overseas, including in the U.S. In addition, from the second half of the year, the European Recovery Fund will begin substantial expenditure and boost the growth rate of the Eurozone economy.

Manufacturing Production Expectations and Stocks of Finished Goods by European Commission Survey



Data: January, 2019 – December, 2020
Source: Refinitiv

Eurozone Economic Outlook

Monetary Policy Outlook

The European Central Bank (ECB) at its Board of Governors meeting in December 2020, and based on the expectation that sufficient collective immunity will be achieved by the end of 2021, approved (i) an extension of the Pandemic Emergency Asset Purchase Programme (PEPP) until March 2022 and an increase of €500 billion, (ii) an additional conditional long-term money supply operation (TLTRO III) and an extension of the preferential interest rate until June 2022. Therefore, we expect the ECB to maintain the current accommodative monetary policy throughout 2021. In the ECB's price outlook, released at the same time, it suggested that inflation would remain low at 1.4% until 2023, short of its target of just under 2%. We expect the accommodative monetary environment to remain in place for an extended period of time after 2022.

Major Risk Factors

We believe there are two major risk factors to the recovery of the Eurozone economy. The first risk to the economic outlook for the Eurozone is the case of limited uptake of vaccines and failure to contain the pandemic. Some countries in the Eurozone, such as France, seem cautious about vaccination. Economic recovery will be limited If rollout and uptake of vaccination does not proceed swiftly and collective immunity is not established. The second is an early switch to fiscal austerity: the EU has announced a moratorium on fiscal rules until the end of 2021, so the likelihood of another economic downturn due to fiscal austerity, as in the case during the European debt crisis, seems small. However, in Germany, where the lockdown is about to begin again, VAT, which had been lowered in response to the pandemic, is expected to be raised from the beginning of 2021. While this may be justified from a fiscal discipline point of view, such a move may hinder the economic recovery.

Economic and CPI Outlook by ECB

	As of	2020	2021	2022	2023
Real GDP (YoY%)	Dec 2020	-7.3	3.9	4.2	2.1
	Sep 2020	-8.0	5.0	3.2	-
CPI (YoY%)	Dec 2020	0.2	1.0	1.1	1.4
	Sep 2020	0.3	1.0	1.3	-
Core CPI (YoY%)	Dec 2020	0.7	0.8	1.0	1.2
	Sep 2020	0.8	0.9	1.1	-

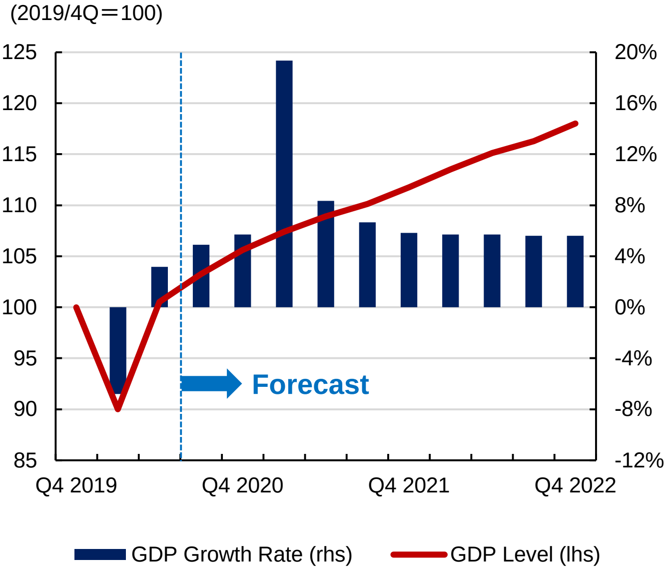
Source: ECB

Chinese Economic Outlook

Economic Outlook

Since the second quarter of 2020, the Chinese economy has maintained a positive year-on-year growth rate, and the growth rate for the full year has also turned positive. The Chinese economy has achieved a quick recovery thanks to economic policies giving highest priority to the resumption of production. However, recovery in consumption has been slow.

Chinese Real GDP Growth

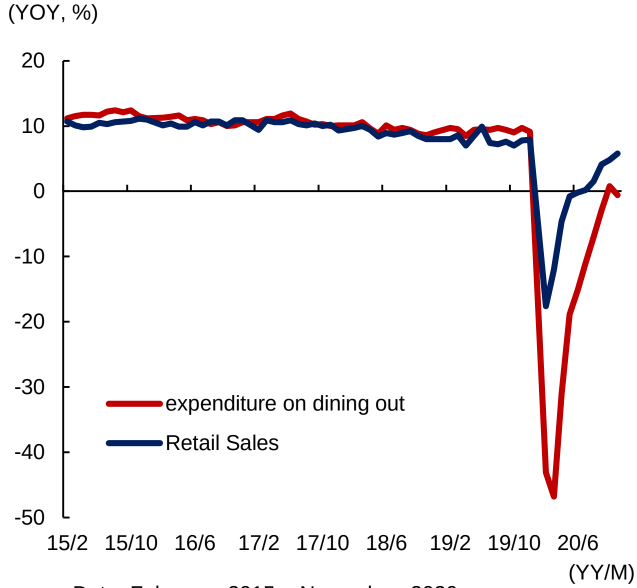


Data: 4Q, 2019 – 4Q, 2022
Source: National Bureau of Statistics of China, Asset Management One

In the first half of the year, we expect China's economy to continue growing in 2021, driven by the recovery of consumption, especially mass consumption and consumption of services, which still has room to recover. The recovery in economic activity in the major industrialised countries and the increase in exports due to the continuing special demands as a result of the ongoing COVID-19 pandemic will also boost the Chinese economy.

However, we expect growth to slow in the second half of the year as the slowdown in credit expansion following the normalisation of fiscal and monetary policy and the slowdown in infrastructure and property investment weigh on the Chinese economy. We expect below 6% GDP growth rate until the end of 2021, partly due to waning one-off demand as a result of the pandemic and subsequent rebound after the slowdown in exports.

Change of Retail Sales and Eating Out Consumption in China



Data: February, 2015 – November, 2020
Source: Refinitiv

Chinese Economic Outlook

The Next Five Year Plan and the Outlook for Fiscal Policy in 2021

The year 2021 marks the start of the plan to double GDP per capita, which has been set as a long-term goal until 2035. The 14th Five-Year Plan, which will run from 2021 to 2025, includes a policy of upgrading domestic manufacturing products, i.e. of producing high-tech products domestically.

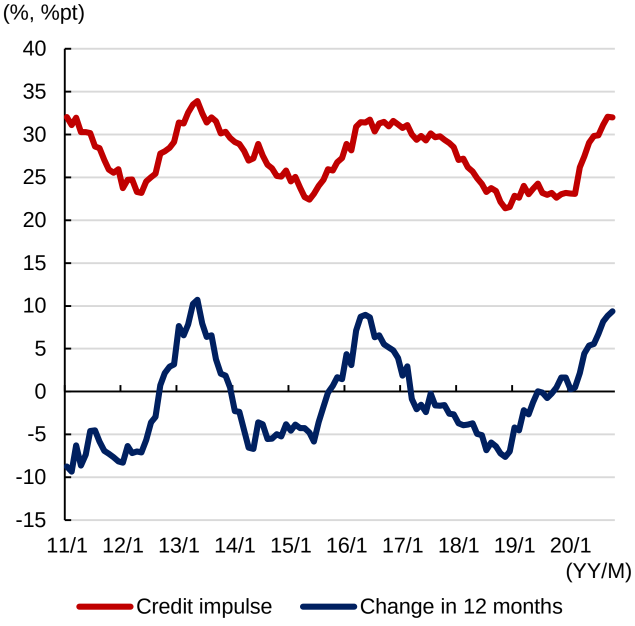
In this context, we expect fiscal policy from 2021 onwards to accelerate the shift in investment from traditional infrastructure investment to high-tech manufacturing, such as semiconductors, which should provide a tailwind for related industries.

Normalisation of Fiscal and Monetary Policy and Risk of Slowdown in Real Estate and Infrastructure Investment

In our view, the biggest risk to the Chinese economy in 2021 is a steep slowdown in real estate and infrastructure investment against the backdrop of the normalisation of fiscal and monetary policies.

As the economy recovers, we envisage a contraction in fiscal spending and peaking-out of credit expansion in 2021. Although the pace of credit expansion has already begun to slow in response to hints of monetary policy normalisation, this trend is likely to become more pronounced next year, exerting downward pressure on property investment.

Changes in China's Credit Impulse*



*Credit Impulse measures the impacts of new lending increments, or acceleration of credits, to GDP growth.
Data: January, 2011 – October, 2020
Source: Bloomberg

In addition to the normalisation of the pandemic response, changes in the eligibility for financial support will also invite concerns about a slowdown in traditional infrastructure investment. In our opinion, it is important to bear in mind that a decline in the large base of real estate and infrastructure-related industries could exert downward pressure on the Chinese economy in the second half of 2021 and beyond.

Topic: Supply Chain

Progress of supply chain shift

Rising labour costs in China, trade friction between the U.S. and China and the global outbreak of COVID-19 have prompted manufacturing companies to diversify their supply chains. In this context, ASEAN countries, with their competitive labour costs, are likely to be the most promising destinations for supply chain diversification. In addition, moves to secure domestic production bases in case of disruptions in cross border trade are spreading around the world. We believe this trend of diversification of supply chain across the world presents a new area of investment opportunity for many manufacturing companies.

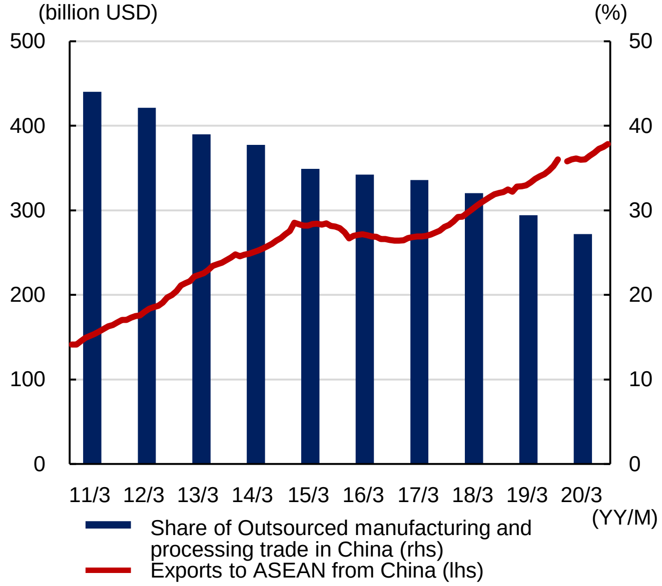
Outsourced manufacturing and processing trade in China is shrinking, signaling a shift of the downstream supply chain to ASEAN

The consignment processing trade format of importing raw materials, processing and assembling them using cheap domestic labour, and then re-exporting the final products has encouraged the concentration of industry and the transfer of technology to China, and has been one of the major driving forces behind China's economic growth.

However, as labour costs rose in line with China's economic growth, factories began to move to countries with lower labour costs, and China's consignment processing trade volume began to shrink. The U.S.-China trade frictions starting in 2018 accelerated this trend, and the imposition of restrictions against China in a wide range of sectors encouraged companies to shift their supply chains away from China. In addition, the global outbreak of COVID-19 in 2020 and the resulting temporary disruption of supply has prompted companies to further diversify their supply chains.

In this context, China's outsourced manufacturing and processing trade continues to shrink, suggesting an exodus of downstream supply chains from China. ASEAN countries, with their geographic proximity and relatively low labour costs, appear to be the destination of choice for companies to build a new supply chain away from China, as evidenced in rising ASEAN exports to the U.S., suggesting a shift in supply chains to the region. The export structure of the region has also transformed, shifting away from light industrial products towards higher value-added electric equipment. As was the case in China, these changes will encourage the concentration of industry and the transfer of technology in ASEAN, which will contribute to economic growth in the region.

Change in the share of Outsourced Manufacturing and Processing Trade in China and Exports to ASEAN



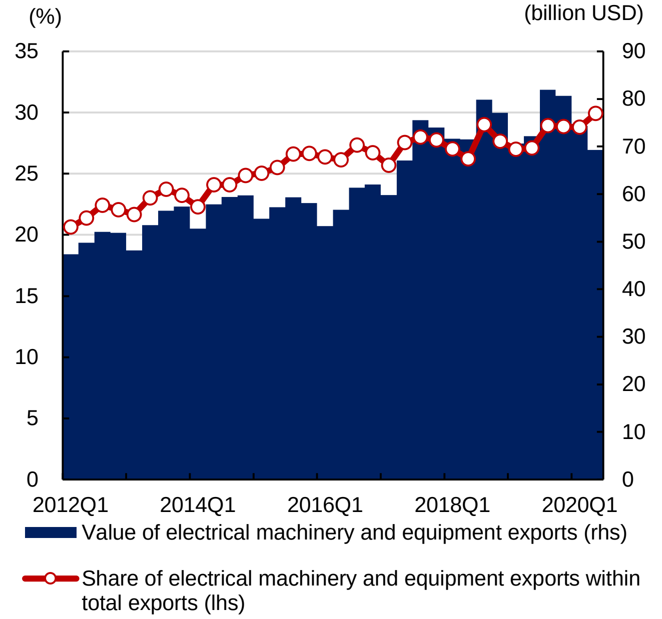
Data: (rhs) March, 2011 – March, 2020
(lhs) January, 2011 –November, 2020
Source: Refinitiv

Topic: Supply Chain

The impact of diversified supply chains will extend beyond ASEAN

Even after the fight against COVID-19 ends and the government transition in the U.S., the global trend of shifting supply chains away from China is likely to continue, and expectations will continue to grow for the ASEAN region as a promising destination for supply chains. In addition to these trends, countries around the world are also moving some of their production bases into their own countries in order to prevent excessive concentration of supply chain. For example, Japan has decided to spend more than 200 billion yen in subsidies to strengthen domestic production bases for manufacturers of items such as semiconductors, displays and medical supplies that are at high risk of supply chain disruption.

Change in the value of Electrical Machinery and Equipment Exports from ASEAN



Data: 1Q, 2012 – 2Q, 2020
Source: ASEAN

Thus, the impact of supply chain diversification is likely to be widespread, not only in ASEAN, which is the main destination, but also in other countries, triggering related investments. We are looking at new investment opportunities for manufacturing companies brought about by the movement of shifting and diversifying supply chains away from China, triggered by the U.S.-China trade friction and the COVID-19 pandemic.

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