GIC

THINKSPACE

PERSPECTIVES ON

The Year Ahead

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This article provides a deeper look into an interview conducted by the Nikkei Shimbun with GIC's Group Chief Investment Officer Dr Jeffrey Jaensubhakij, on GIC's outlook for the world in 2021. The interview was published in late December 2020 in the Nikkei Shimbun's "Economic Outlook" column. You can read the original interview here, and an English adaption here.

WHAT IS THE OUTLOOK FOR THE GLOBAL ECONOMY IN 2021?

Since the onset of COVID-19, many countries and governments have provided substantial fiscal packages to mitigate the negative economic impacts of the pandemic and support incomes. Hence, consumer spending in 2020 remained relatively high, with the exception of travel-related areas and services.

Going into 2021, we expect a recovery given continued policy and monetary support, even if not to the extent we saw in 2020. Savings are also quite high as not all of the income support from 2020 has been spent.

One key factor will be how quickly the vaccines are fully distributed. In countries where distribution is well-executed, we can expect faster recoveries, particularly in the services sector. But for tourism-dependent countries and industries, the recovery will likely be delayed as it will take more time for borders to open and international travel to resume.

At the same time, we expect a continued divergence of outcomes, or a "K-shaped" recovery.

The first dimension is divergence among industries. In areas such as e-commerce and food delivery, we have seen demand strengthen and even accelerate due to COVID-19. On the other hand, industries involving travel and in-person interactions have experienced a significant decline in demand, and will still recover slowly.

The second is divergence relating to income levels. Industries involving generally higher wages, such as financial services, have seen incomes and employment recover very quickly. But industries that have been hit the worst by the pandemic, such as the small-business service sectors, tend to involve lower wages, and recovery will unfortunately be slow and require continued fiscal support. This also has implications on consumption patterns, and potentially for the longer term.

The third is divergence among countries. Countries that have established healthcare systems and good adherence to COVID-related restrictions, as well as those with the fiscal and monetary capacity to stimulate their economies, have fared better. While this divergence is expected to continue, a broader recovery over 2021 is likely.

WHAT ARE YOUR VIEWS ON THE STATE OF THE STOCK MARKET, WHICH HAS REACHED RECORD HIGHS IN RECENT TIMES?

Valuations in the stock markets have already factored in a strong economic and earnings recovery for 2021. So if all goes well, the recovery is already priced in. But if the recovery halts or is impeded, the stock market will have to digest this and may slow down for a period.

At the same time, there is also divergence in the stock markets, where some parts – such as "old economy" stocks, more COVID-impacted sectors and even some Asian markets – still have room to come back, especially if the next year or so sees more of a normal cyclical recovery.

There are also many uncertainties. For example, risks related to the vaccine roll-out, potential for subsequent waves of the virus and follow-on economic impacts. Should the pandemic or downturn be prolonged, there could be other risks associated with high corporate indebtedness, and structural changes in business and consumption trends.

At GIC, we maintain a cautious stance overall, and are guided by our key investment principles of taking a long-term approach; preparing, not predicting; and investing based on fundamentals.

WITH INTEREST RATES CLOSE TO ZERO OR NEGATIVE IN MANY MARKETS, WHAT ARE THE KEY IMPLICATIONS AND CHALLENGES FOR INVESTORS?

Investors face a difficult dilemma. Fixed income assets traditionally provide stable income and serve to mitigate risk in the face of equity market downturns. However, as central banks in many countries have little or no room to cut rates, the income and protection effects of bonds have diminished. This has significant implications for how we think about portfolio construction, and what we need to do to ensure our portfolio continues to be well-balanced with stable income streams and hedges for risk assets.

Low interest rates, combined with high asset valuations and protracted uncertainty, present significant challenges to investors including GIC, with no easy solutions. We expect future returns will be harder to come by.

Our teams are thus focused on finding bottom-up opportunities with good risk-reward. This requires us to leverage our on-the-ground, cross-asset capabilities and actively look into more niche categories of assets and sectors. We also emphasise working closely with our global network of established partners.

One example is the logistics sector. It has been an area of focus for GIC in recent years as we see this benefitting from longer-term trends such as accelerating e-commerce adoption and changing supply chain management strategies. In 2020, we made several investments in this sector, working with skilled partners to scale our exposure in this space globally.

ASIA HAS BEEN A SIGNIFICANT GROWTH ENGINE FOR THE GLOBAL ECONOMY PRE-COVID. HAS COVID-19 CHANGED THIS?

As we have previously outlined[1], GIC has been committed to Asia's growth story for over three decades. We remain confident in Asia's potential for out-performance over the longer term[2], as the region should benefit significantly from the recovery in global travel and exports, as well as continued growth in intraregional trade and interconnectivity. At the same time, we are conscious of important differences across Asian economies in terms of the level of development, economic structures, and institutional capabilities. The varying capacities to deal with the pandemic will also shape a less synchronous recovery for the region.

One key trend to note is that COVID-19 has accelerated the diversification of global supply chains to avoid heavy concentration of production in China. Other Asian economies like Indonesia and Vietnam are benefitting from this readjustment, as companies seek to leverage their large and young populations, relatively low labour costs, and potential for productivity growth. These markets also offer opportunities to benefit from technology leapfrogging and innovation.

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[1] GIC ThinkSpace, *Asia's Growing Importance in the Global Economy and Financial Markets*
[2] GIC ThinkSpace, *A Changing Global Investment Environment*

AS A LONG-TERM INVESTOR IN JAPAN, WHAT IS GIC'S VIEW ON THIS MARKET?

Having been invested in Japan for more than 30 years, we have seen many ups and downs. Since 2012, there have been important, positive developments in Japan in many aspects – a key example is the improvements in corporate governance. We see good potential for these positive changes to persist, and for continued opportunities in this market.

Given Japan's ageing population and limited domestic market growth prospects, the ability to remain competitive and grow their overseas presence is especially important for Japanese corporates. Importantly, there are many domestic companies with strong technologies and manufacturing capabilities that have the potential to be exported overseas. Hence, Japan remains a key investment destination for GIC.