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2021 Outlook Theme #1, 3/31/21 Update: Diverging then Converging Headlines

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Our first 2021 Theme was focused on the broadly predictable trends of the Covid-19 virus, and vaccines "*...a process we refer to as Diverging, then Converging Headlines. The vaccine and virus data first are on deviating paths, then both moving towards a favorable outcome in the second half of 2021.*

Q1'21 will see the vaccine timeline continue to progress in a positive direction, while the virus news remains negative. This will likely be the most challenging period, with the virus trend at its worst and the vaccine trend most likely to produce stories of delays and other start up mishaps. During Q2'21, the virus data should begin to turn and, hopefully, put both the vaccine and virus timelines on a converging course.

The markets will be locked onto this convergence, expected in late Q2'21, as opposed to the potential deceleration in economic data in late Q4'20 and into Q1'21. As long as neither trend shifts significantly enough to take the markets focus off that end of Q2'21 target, the Q1 headlines will be seen as merely noise. Since markets are forward looking, as 2021 progresses their focus will shift to the second half and where economic activity will go once the trends begin to converge.

The framework was broadly correct. The potential fault is one we should have anticipated better: the speed of this divergence, then convergence. The pattern of good vaccine data converging with improving virus trends went extremely fast, just as with most other features of this cycle. While headlines from the cresting second wave were prominent in January, by February it switched to the rising production of vaccines feeding the growing inoculated population, plus a sharp drop in Covid-19 cases, hospitalizations, and deaths. In short, what we laid out as a Q1 divergence of vaccine progress but poor virus trends, followed by a Q2 convergence as virus and vaccine trends both turned positive, instead ran through the full process just in Q1.

The only caveat is that this also accelerated the market trends. Rates rose quickly. Value significantly outperformed Growth. Industries that stand to recover traded higher on recovery optimism versus short term disruptions. Thus, the expected shift in the market's focus to the strong, post vaccination recovery, may start to take hold in Q2, as opposed to Q3 and Q4, under our slower timeline.

With this optimism, there is also room for disappointment to creep in. Even though Q2'21 will see the near full vaccinating

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of the US adult population, this could be tempered by the combination of more transmissible variants and re-opening economies spurring more cases in the yet to be vaccinated population. The likely feature will be stories of increased cases in younger patients, as this less vaccinated and more active group spurs circulation. The positive feature should be considerably lower severe outcomes (hospitalizations, mortality) due to the already high levels of vaccinations in vulnerable populations.

Globally, vaccine rollouts are not going as fast as in the US, but they should start to pick up pace. The EU, for example, is targeting 50% of its population in July. Overall, if it's the pandemic that has caused the recession, and the recovery from the pandemic seems to be accelerating towards normal, then we need to start thinking harder about how markets will price "normal".

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-The Barlcays Aggregate Index represents the total return performance (price change and income) of the US bond market, including Government, Agency, Mortgage and Corporate debt.

-The BofA Merrill Lynch Investment Grade and High Yield Indices are compiled by Bank of America / Merrill Lynch from the TRACE bond pricing service and intended to represent the total return performance (price change and income) of investment grade and high yield bonds.

-The S&P/LSTA U.S. Leveraged Loan 100 is designed to reflect the largest facilities in the leveraged loan market. It mirrors the market-weighted performance of the largest institutional leveraged loans based upon market weightings, spreads and interest payments.

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-The BofA Merrill Lynch US Emerging Markets External Sovereign Index tracks the performance of US dollar emerging markets sovereign debt publicly issued in the US and eurobond markets.

-The HFRI Fund of Funds index is compiled by the Hedge Funds Research Institute and is intended to represent the total return performance of the entire hedge fund universe.