Uncertainty Is the Only Certainty for 2021, Say Natixis Investment Managers Affiliated Asset Managers

- Portfolio Managers and Executives from AlphaSimplex, AEW Capital Management, Gateway Investment Advisers, Loomis Sayles, Managed Portfolio Advisors, Mirova, Natixis Investment Managers, and Vaughan Nelson Investment Management Provide 2021 Outlooks

- Managers Anticipate Elevated Volatility, Global Reflation, Higher Taxes and Growing Demand for ESG

BOSTON, Jan. 13, 2021 – In a new year already marked by political turmoil and a worsening global pandemic, uncertainty rules. Amid vaccine rollouts and economic stimulus measures in many developed nations, high hopes for 2021 are counterbalanced by continued virus spread, lockdowns and elevated unemployment in affected industries. Despite this, the US stock market powered through to end 2020 at a record high.

Natixis Investment Managers today announced insights from portfolio managers and executives from its affiliated investment firms and ETF group:

Commercial Real Estate to Rebound as Economic Activity Resumes
by Russ Devlin, director of North America research, AEW Capital Management

Commercial real estate in general and REITs in particular had a difficult 2020, particularly in sectors like malls, hotels and offices which depend on people moving about and filling buildings. As Covid-19 vaccines are rolled out, we expect people to return to cities and move about more freely as we get deeper into 2021. This should help drive a rebound in usage and stronger fundamentals at these harder-hit property sectors.

It is important to note that 80% of the US REIT sector is outside of the mall, office and hotel sectors that get most of the attention. Sectors less dependent upon foot traffic like industrial warehouses and data centers have been much more resilient and even benefited from economic activity’s shift online. Secular trends that support these sectors will not go away even with the normalization of that activity as the pandemic subsides. Indeed, between e-commerce’s salutary effect on warehouse and data center demand, the Millennial generation’s first steps into suburban living via renting single-family properties, and even the burgeoning demand for lab space, senior housing, and medical office space that reflects an aging population, a much larger share of the REIT market has strong growth drivers than headlines about struggling malls would have one believe.

Valuations are not stretched. Yields for REITs continue to be at much more attractive spreads than usual relative to bonds, and both current yields and the potential for a rebound in incomes as the pandemic subsides could be return drivers over the next several years. REITs are also more attractively valued versus stocks on an earnings multiple basis than they have been for some time. With characteristics of both liquid equity and fixed income assets and fundamentals that are tied to the broader real estate market, the REIT sector is an interesting hybrid that deserves a look as investors assemble their portfolios.
Uncertainty Overshadows Investors’ Risk Appetite  
*by Katy Kaminski, chief research strategist and portfolio manager, AlphaSimplex Group LLC*

Although 2020 ended on a strong economic note, the start of 2021 shows increased uncertainty. Despite the positive direction in markets and hope for recovery, rising numbers of Covid-19 cases, a slow start to the vaccine rollout, concerns around the U.S. presidential transition, and other geopolitical questions loom. After the run-up in risk assets in 2020, it remains to be seen if investors’ strong risk appetite will continue this year.

Fiscal and monetary policy will remain at the forefront of investors’ minds. Coordinated easing and market intervention of central banks around the world abated the freefall in assets in the beginning of 2020, but the long-term implications of these interventions are yet to be seen.

A change in leadership in the U.S. may lead to a more globalist approach, including less friction on trade and more investment flow into emerging markets, particularly China. However, looser fiscal policy and the possibility of tax increases could increase the risk for inflation. Another important question looms: Will expansionary fiscal and monetary policy be able to sustain a continued rally in risk assets?

Elevated Implied Volatility Expected in 2021  
*by David Jilek, chief investment strategist, Gateway Investment Advisers*

As 2020 came to a close, market conditions reflected an unusual mix of resilience and anxiety. The US stock market advanced despite worsening pandemic statistics, political tension over election results and partisan bickering over the economic relief bill. Meanwhile, the CBOE® Volatility Index® (the VIX®)
remained solidly above its long-term average, even as the market ascended to new highs.

At year-end, the VIX® futures curve suggested above-average implied volatility may continue in 2021. If it does, Volatility Risk Premium, which measures the spread in price between implied and realized stock market volatility, has the potential to remain attractive in 2021. Surface measures of realized volatility may be kept low in the new year due to a continuation of low correlation across individual stocks, which has been fueled by a dynamic relationship between the prices of “stay at home” vs. “reopening” stocks. This apparent calm may be interspersed with periodic volatility spikes driven by sharp market pullbacks and advances as investors digest new developments.

In the options markets, 2020 saw a change in the typical mix of buyers and sellers; an explosion of activity in individual stock options spurred purchases of volatility-linked index options by market makers, putting upward pressure on implied volatility levels. Meanwhile, a Q1 volatility spike caused catastrophic losses for volatility-selling strategies and drove several out of the market, thus removing a source of downward pressure on implied volatility that has persisted in recent years. If the 2020 mix of option buyers and sellers continues, this could further promote elevated implied volatility in the new year.

Global Reflation to Buoy Credit Markets Across the Risk Spectrum  
*by Tom Fahey, co-director of macro strategies at Loomis Sayles*

Key ingredients are in place for global financial markets to continue discounting the recovery phase of the
credit cycle. Covid-19 vaccine distribution is underway, the US will deliver additional fiscal support as Democrats control Congress and monetary policy is likely to remain highly accommodative for several years. A weak dollar would also add to global reflation efforts.

Investment grade credit spreads have rebounded to pre-pandemic levels so while there is not much room for spread tightening, we think it remains a very supportive environment to earn the extra yield in credit markets. Investors should feel comfortable overweighting spread sectors relative to government bonds in the US, Europe and emerging markets. Near-record low interest rates, sizable liquidity and strong demand for yield should help keep credit market volatility at bay.

Higher yielding, lower quality credit spread sectors should see further spread tightening as the default risk premium continues to decline. Credit cycle recovery phases usually see a big surge in profits and a powerful rebound in economic activity, allowing debt relative to income levels to decline and companies to achieve easy deleveraging that lowers the default risk premium. Combined with low government yields, this dynamic also drives investors out the risk spectrum.

US-dollar-denominated emerging market (EM) corporate credit looks relatively attractive because spreads have only retraced 75% of the Covid-induced spike. Plus, the EM credit sector has been trying to deleverage since the commodity and energy bust of 2015. EM corporates have been dealing with stresses pre-pandemic, including sizable depreciations of their currencies, and have done a remarkable job. The sector should see positive momentum as long as the global economy, Asian economies in particular, continues to improve.

Local emerging market yields have fallen in many markets but still offer a significant pick up compared to developed markets. EM currencies have also been depreciating for years and look cheap compared to the dollar. If the dollar is peaking, as we think it might be, then local EM bond markets should do well.

Global developed market yield curves should remain anchored at the front end but longer-term yields could drift higher as the recovery takes hold. At this point, a rise in yields is a good sign that global reflation efforts are working. We should welcome and not fear a rise in yields; a steep yield curve is good for the banking sector, which is a huge weight in both global credit benchmarks and equity indices.

Uncertain Outlook for Tax Policy
by Curt Overway, president and portfolio manager, Managed Portfolio Advisors

President-Elect Biden laid out an aggressive policy agenda on the campaign trail in a number of areas, including tax policy. The primary thrusts of his proposed changes to the tax code were increases in tax rates for households with incomes in excess of $400,000 and corporate tax rates. The impact of these would be especially significant on investment portfolios for very high-income households, specifically those earning more than $1 million, as capital gains would be taxed at the ordinary income rate, which would also be increased.

We had expected more clarity on the outlook for taxes by now, but uncertainty remains. Passage of Biden’s stated policy goals was dependent on retaining a majority in the House and winning a majority in the Senate; even with Democrats winning both of the Georgia Senate seats, they now have the slimmest of majorities with a 50/50 split and the vice president holding the tie-breaking vote. That will make it
challenging for Biden to get his more aggressive policy initiatives, including sweeping changes to the tax code, through Congress.

At some point, however, it seems tax rates are likely to increase and Democrats’ technical Senate majority would in theory allow them to pass certain legislation through the reconciliation process with a simple majority. Taxes and an infrastructure bill are the two most likely areas they would look to tackle via this process. Given the razor-thin margin, however, the legislation would likely need to be less ambitious than policies Biden articulated during the campaign. Without a blue wave, the outlook for proposed increases in tax rates for wealthier households and corporations in 2021 is a bit murkier. If tax rates are increased, it may be difficult to limit that to only households earning $400,000 or more as Biden promised during his campaign. That level is more than five times the median household income in 2019.4

What we know with certainty is that, even at current levels, taxes take a significant bite out of investment returns. A systematic approach to mitigating the tax liability generated in investment portfolios can lead to a meaningful improvement in after-tax returns. The magnitude of this tax drag on investment returns may go up or down with tax rates, but it is always important to consider tax issues when managing taxable assets.

**Sustainable Investing Continues to Gain Importance**

*by Amber Fairbanks, global equity portfolio manager, Mirova US*

While we expect an economic recovery in 2021 and expect the world to look more ‘normal’ than it has since the start of the pandemic, trends have emerged during this crisis that we think will persist for many years to come and affect growth opportunities over the long term.

The digitalization of the economy accelerated as people worked from home and increasingly shopped online, two trends likely to continue after Covid. Healthcare is likely to see increased spending and political support as governments acknowledge their shortcomings in addressing the pandemic. Government spending has been significantly stretched around the world, limiting states’ capacities to further support their economies in the event of another crisis.

There has been tremendous growth in ESG in the last several years, and asset managers are increasingly looking to brand strategies this way to capture a portion of the fund flows. While there have been some managers that have done this in a thoughtful, value-adding way, several more have done so in ways that add little if any value to investment outcomes because it is in no way a meaningful or intentional part of the process. The proliferation of so-called ESG strategies, a trend we think will continue given increased investor interest, has made it increasingly important for investors to understand how a manager is integrating ESG in their investment process to ensure it is deployed in a way that is both material and intentional.

**ETFs: Expect Optimism for US Stocks, High Quality Bonds and ESG**

*by Nick Elward, head of institutional product and ETFs, Natixis Investment Managers*

As we enter 2021 amid significant uncertainty, we expect US ETF investors will put most of their equity dollars to work in US ETFs rather than international ETFs. We believe investors may have more confidence in the US economy coming out of the pandemic more quickly than Europe and emerging
markets. Going into the Covid-19 crisis, investors had more enthusiasm for US markets over international. The vast monetary policy support and fiscal aid undertaken by the US government is another reason for near-term optimism about US companies and consumers.

A similar theme carries from equities into the fixed income market. As health officials, policymakers, and financial professionals work to understand the near and long-term ramifications of the Covid-19 pandemic, we anticipate investors will remain cautious. With continued concerns about companies’ ability to ride out several difficult quarters, we expect investors may gravitate toward investment grade fixed income over high yield. To avoid defaults, credit research may matter more in 2021 than it has in recent years. In this scenario, investors tend to prefer owning active fixed income products, of which there are a range available.

Finally, ESG ETFs may have their biggest sales year ever in 2021. Sales momentum for Environmental, Social and Governance (ESG) ETFs has been increasing over the last few years. It began in Europe, with both investors and governments driving flows, then became popular with US institutional investors. Now we are seeing an increase in retail investor interest. US demand has translated into increased flows into existing ESG ETFs and the launch of new ESG ETFs. We expect this trend to continue in the year ahead. There seems to be increasing agreement among policymakers and business leaders that the world needs to do more to address climate change – and there is evidence that younger generations of investors prefer owning more sustainably mindful portfolios.

International Small Cap Is Well Positioned for Growth

by Marco Priani, senior portfolio manager for international equities, Vaughan Nelson Investment Management

Fiscal stimulus throughout the relevant geographies, accommodative monetary policy, an earnings recovery off a low base and attractive valuations in absolute and relative terms make the international small cap space attractive in 2021. To these short-term tailwinds, we should add several positive longer-term qualities such as a large and growing opportunity set, a balanced structure sector-wise and a more attractive profile compared to the large cap asset class in terms to exposure to positive secular growth trends.

The risks for 2021 are not asset-class specific but involve a delayed vaccination or stimulus rollout process, and in financial terms the uncertain limits to monetary tools: Financial risks, if crystallized, are likely to emerge first in fixed income asset classes and then influence equities.

All investing involves risk including the risk of loss.

This material is provided for informational purposes only and should not be construed as investment advice. The views and opinions expressed are as of January 8, 2021 and may change based on market and other conditions. There can be no assurance that developments will transpire as forecasted, and actual results may vary.

Equity securities are volatile and can decline significantly in response to broad market and economic conditions.
Fixed income securities may carry one or more of the following risks: credit, interest rate (as interest rates rise bond prices usually fall), inflation and liquidity.

Sustainable investing focuses on investments in companies that relate to certain sustainable development themes and demonstrate adherence to environmental, social and governance (ESG) practices; therefore the universe of investments may be limited and investors may not be able to take advantage of the same opportunities or market trends as investors that do not use such criteria. This could have a negative impact on an investor’s overall performance depending on whether such investments are in or out of favor.

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¹ The CBOE Volatility Index® (VIX®) is a key measure of market expectations of near-term volatility conveyed by S&P 500® stock index option prices. The CBOE Volatility Index® (VIX®) reflects a market estimate of future volatility, based on the weighted average of the implied volatilities for a wide range of strikes, first and second month expirations are used until eight days from expiration, then the second and third are used.
A curve that shows the relationship among bond yields across the maturity spectrum.

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Source: US Census Bureau, “Income and Poverty in the United States: 2019”. Median household income in 2019 was $68,703. [https://www.census.gov/library/publications/2020/demo/p60-270.html#:~:text=Median%20household%20income%20was%20%2468%20%2C703%20and%20Table%20A%20D1](https://www.census.gov/library/publications/2020/demo/p60-270.html#:~:text=Median%20household%20income%20was%20%2468%20%2C703%20and%20Table%20A%20D1).

Mirova is operated in the US through Mirova US LLC (Mirova US). Prior to April 1, 2019, Mirova operated through Ostrum US.

Cerulli Quantitative Update: Global Markets 2020 ranked Natixis Investment Managers as the 17th largest asset manager in the world based on assets under management as of December 31, 2019.

Assets under management (“AUM”) as of September 30, 2020 is $1,067.3 billion. AUM, as reported, may include notional assets, assets serviced, gross assets, assets of minority-owned affiliated entities and other types of non-regulatory AUM managed or serviced by firms affiliated with Natixis Investment Managers.

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Press Contacts:

**NATIXIS INVESTMENT MANAGERS**

Maggie McCuen
Tel: 617-449-2543
Maggie.McCuen@natixis.com

**ARENA COMMUNICATIONS FOR NATIXIS INVESTMENT MANAGERS**

Denise Robbi
Tel: 508-523-4067
drobbiarena@gmail.com

**LOOMIS SAYLES**

Orla O’Brien
Tel: 617-478-7480
OOBrien@loomissayles.com