2021 Investment Outlook: Economies, Rates, and Fixed Income

Lord Abbett investment leaders assess the factors that could influence global economies and fixed-income markets in the New Year.

This has been an unprecedented year, and most global citizens likely will be pleased to have 2020 in the rearview mirror. As the COVID-19 virus ravaged every corner of the world and turned the economic downturn seen in the United States into an American tragedy, the investment markets have, on the other hand, rallied to record highs.

While that may seem counterintuitive—and based on the overly negative investment outlooks that prevailed back in mid-2020, it certainly should—our midyear 2020 outlook focused on assessing valuations in the context of an uncertain world rather than making forecasts. With 2020 winding down, we asked the experts from our midyear presentation for their thoughts on the coming year. Our panelists represent a wide range of Lord Abbett investment capabilities: Partners Giulio Martini, Director of Strategic Asset Allocation; Andrew O'Brien, Portfolio Manager for Taxable Fixed Income; Thomas O'Halloran, Portfolio Manager for Innovation Growth Strategies; Daniel Solender, Director of Tax-Free Fixed Income; Leah Traub, currency expert and Portfolio Manager for Taxable Fixed Income; and Kewjin Yuoh, Portfolio Manager for Taxable Fixed Income, Liquid Securitized Products.

In this, the first of three parts, our experts address macroeconomic and monetary policy conditions in the New Year and their potential effect on fixed-income investments. The second part will cover the prospects for U.S. equities, while the third and final part will examine key themes for the municipal bond market in 2021.

The team struck a decidedly bullish tone this past summer, highlighting, on the one hand, attractive valuations with very poor economic boost priced in and a very accommodative U.S. Federal Reserve (Fed) and Central Bank system, on the other hand.

The Shot Heard Around the World

Then, on November 9, 2020, Pfizer and BioNTech announced a vaccine candidate against COVID-19 that proved a highly successful efficacy rate of over 90% in their Phase 3 data. Subsequent and equally positive news from Moderna followed a week later. The impact to the equity markets was immediately felt and, along with the relief from 2020 election uncertainty, the Dow Jones Industrial Average temporarily broke through the 30,000 mark. As we turn our outlook towards 2021, near record high equity price levels and narrower credit spreads raise the question of whether markets have moved too much ahead of anticipated economic and corporate earnings growth expected to be achieved through the recovery.

Four Factors Forming the Road Ahead

Giulio Martini closely follows economic and policy developments in his role as the head of the firm's multi-asset strategies. He says there are four key factors that enabled the upward trajectory of the markets coming out of the lows reached in late March of this year. The positive impact of each could potentially support a sustained bullish environment into 2021.

Most important, of course, has been the announcement of multiple COVID-19 vaccines and the unexpected efficacy that has been achieved. We believe the vaccines provide a clearly visible path towards normal economic activity and social behavior by the end of 2021. The second factor is the resolution of the 2020 U.S. election cycle and the strong prospect of a divided government, with extreme factions of either party most likely neutralized. Third is the two straight quarters of unexpectedly strong earnings announcements from U.S. listed companies as well as the highest level of positive earnings surprises we have ever seen historically. Strong earnings growth is evidence that underlying earnings power for U.S. companies has not been severely damaged by the COVID-19 crisis, and a full restoration to operations and earnings can be expected with the end of the crisis. Lastly, the robust recovery in China, the second largest economy in the world, has provided the key through which most global supply chains pass and has been a support mechanism for other global economies.

COVID-19 Spread and Stimulus Delay Make for a Bumpy Ride

While these positive forces have helped to support current market valuations and should continue to contribute to a constructive view in the near term, what remains less clear is the road leading to the second half of 2021, when we expect the COVID-19 vaccines to be widely available. The first half of 2021 could be more difficult if the number of infections and hospitalizations continue to climb at an alarming rate. Aside from the human toll, which has been tragic, continued COVID-19 spread could further damage the U.S. economy. The extent of the damage depends on Congress agreeing on a fiscal package that preserves purchasing power for unemployed workers, delivers aid to state and local governments with budget constraints, and sustains companies in industries where consumption is inherently social. If Congress falls short, economic growth could more likely hit a pothole.

Positive Outlook for Second Half of 2021

Regardless, the investment markets will still be reassured by the prospect of a full recovery by the end of 2021 due to the COVID-19 vaccines that are on the horizon. As the healthcare crisis peaks, and more uncertainty is sure to come, 2020 is still ending with a large portion of uncertainty in retreat and a return to normal social and economic behavior visible down the road.

A Global Recovery from a Global Outbreak

Leah Traub's role in taxable fixed income requires a sharp focus on currencies and global rates. When looking at emerging and developing economies, she says the road to recovery in those regions may not simultaneously benefit from the COVID-19 vaccine along with developed economies.

Implications for Developing and Emerging Markets

The global pandemic affected nations and regions at different speeds and magnitudes. Likewise, the breadth, strength, and timing of economic recoveries among developing and emerging markets have been diverse. China's economy, for example, is operating at nearly pre-COVID-19 levels and, in fact, sentiment measures in manufacturing and industrials have exceeded pre-crisis levels. The outlook for China's economic strength in 2021 is also reflected in the substantial rise seen in their commodity prices. The spread of the virus has also been contained based on reported figures that show zero new contractions. This indicates that China has been able to resume close to normal operating levels while dealing with the disease. Other Asian economies, such as Korea and Taiwan, have been exhibiting similar trends and for those reasons in common, their currency valuations have not appreciated significantly with the vaccine announcement.

Our view, based on this evidence, is that the effect of the COVID-19 vaccine will play a more crucial role in reviving economies in countries where containment has been more difficult, such as the United States and western Europe where a resurgence in virus cases has been more pronounced.

"The outlook for China's economic strength in 2021 is also reflected in the substantial rise seen in their commodity prices."

Differentiated Impact and Recovery in Vulnerable Emerging Markets

The virus has taken a greater toll on emerging economies, such as South America, Southeast Asia, Indonesia, India, and Thailand, which have not displayed resilience similar to north Asian economies. The differentiated effects from the virus and in the lesser capacity to adapt economic activity during the pandemic aligns the importance of the COVID-19 vaccine more firmly to the recovery in these regions; indeed, their currencies appreciated sharply after the vaccine announcement. Going forward, we believe that the vaccine will continue to have a more significant impact on these countries, and we expect the same in terms of potentially more upward momentum in currency valuations.

Broadening the Cyclical Recovery Among Emerging Markets

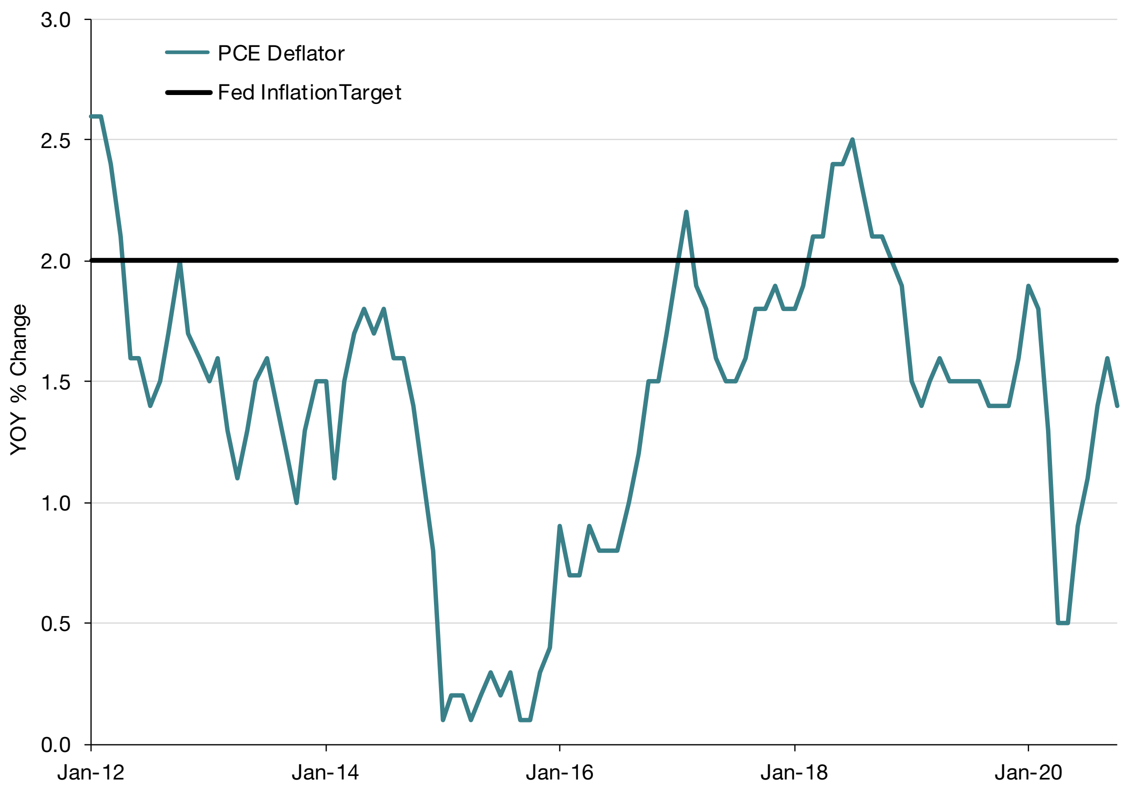
Looking deeper into 2021, we are anticipating a more broad-based, as opposed to differentiated, cyclical recovery as more stressed emerging economies benefit from COVID-19 vaccine penetration, which in turn should also provide support to the laggard currencies in those markets.

Global Rates

At the onset of the COVID-19 vaccine announcement, initial sentiment regarding global interest rates was less constructive, based on the belief that central banks would perhaps take a step back from their stimulative policy since a resolution to the virus was near. That overly optimistic view on vaccine deployment has since abated. More directly, the U.S. Federal Reserve, members of the European Central Bank and members of the Bank of England have reiterated that monetary policy will remain stimulative for the foreseeable future. Policymakers may actually raise the level of quantitative easing until tangible evidence of a recovery in economic growth and inflation is apparent. Inflation has been falling consistently short of the Fed's 2% target (see Figure 1). Our view on global interest rates going into 2021 echoes these policies and we expect global interest rates to remain lower through most of the year.

Figure 1. Inflation Has Remained Consistently Short of U.S. Federal Reserve's 2% Target

Actual Inflation and Fed Target



Source: Bloomberg. Data as of October 31, 2020. The **PCE price index**, also referred to as the **PCE deflator**, is a United States-wide indicator of the average increase in prices for all domestic personal consumption.

Fixed Income: Transitioning to a Post-Pandemic World

The economic shutdown caused by the COVID-19 virus resulted in an immediate and steep downward spike in activity that many believed to be a collapse in business operations and social behavior as we once knew them. The reality turned out to be quite different. By mid-2020, the "pandemic pivot" was the term used to describe the effective innovations implemented by companies and institutions to rapidly transform processes and adapt to the crisis. Andrew O'Brien, Partner and Portfolio Manager specializing in corporate credit, gives his expert view on the era of transformation during the pandemic and discusses the outlook for corporate debt in 2021.

Persistent Versus Temporary Change

We have been closely following transformation within corporate operations during the COVID-19 crisis in order to ascertain the difference between structural changes that will persist in the post-pandemic environment as opposed to temporary adjustments. Looking forward to 2021, we believe a significant portion of the changes will remain as permanent tools used to increase efficiency and reduce costs. Video conferencing is one example. Another, more noteworthy lasting effect is the recognition that uncertainty is ongoing, and strategic adaptability remains a part of forward planning.

One of the challenges to investing in 2021 will be the ability to anticipate how the transition to a post-pandemic world will influence adaptations to the crisis. To a large degree, the sustainability of those changes will depend on the consumer. During the crisis, e-commerce sustained retailers but entertainment and leisure suffered significantly. As society emerges from the crisis, we could see a substantial shift in consumer activity away from staples and into the activities that came to a halt this past year.

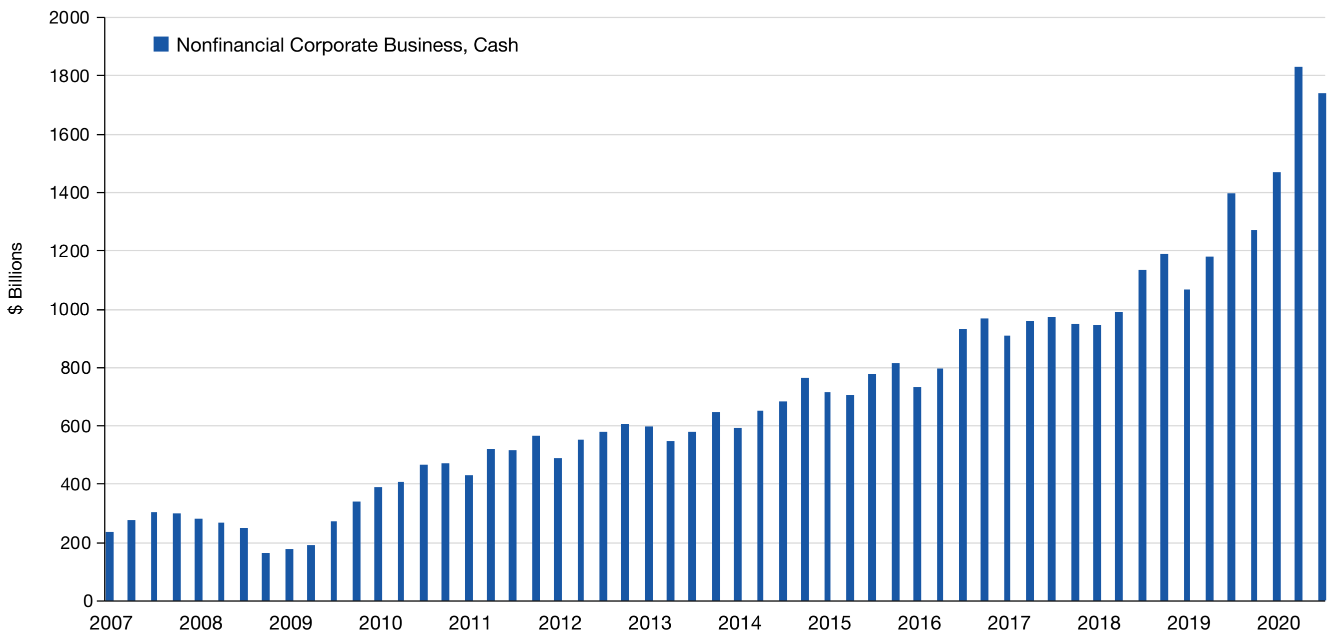
Bolstered Corporate Balance Sheets Contribute to a Positive Outlook

Corporations have also been adjusting their balance sheets by taking advantage of historically low interest rates to refinance shorter-term debt and lock in low longer-term coupons. Record levels of corporate bond issuance in 2020 contributed to the purpose of improving capital structures, interest coverage, as well as available cash on corporate balance sheets (see figure 2). Our positive stance on corporate credit takes these factors into account.

Looking out to 2021, one of the key questions, however, will be how that capital is deployed—either in additional capital expenditures where tax incentives reside, or in the form of share

Figure 2. Cash on U.S. Corporate Balance Sheets

Cash on corporate balance sheets is near multi-year highs.



Source: Board of Governors of the Federal Reserve System. Data as of 09/30/2020.
Based on Nonfinancial Corporate Business; Checkable Deposits and Currency; Asset, Level.

repurchase programs or increased dividends to shareholders. Recent attractive equity returns may limit the latter but if the equity markets languish in the coming year, pressure from shareholders to return a portion of that capital is possible. We remain positive on the sector, but also vigilant about the risk-taking posture of corporate management and how they will manage capital structures going forward.

Credit Risk Versus Valuation Risk

Remaining vigilant about potential risks is a substantial part of our investment insight. Within this low yield environment, credit spreads have largely retraced to pre-COVID 19 levels, and strong asset performance contrasts with declining long-term GDP expectations.

Kewjin Yuoh, lead Portfolio Manager for the firm's taxable-fixed income strategies with a focus on liquid and securitized credit, lends his expert views on assessing credit risk and valuations following the strength seen in 2020.

Low Yields and Low Volatility Support Credit

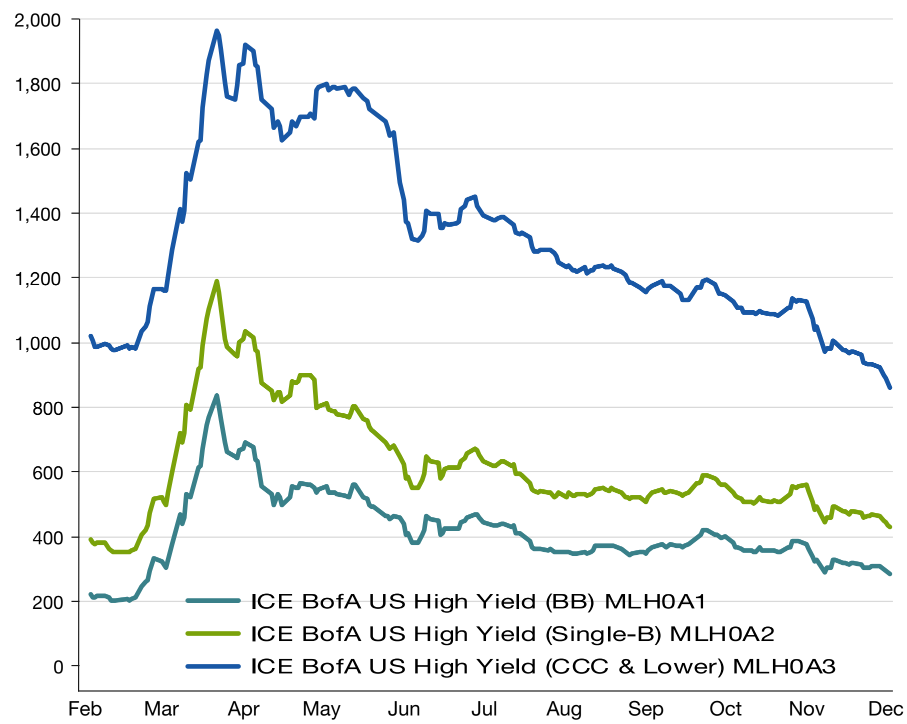
The low to nearly negative real-yield environment within the Treasury sector has created an appetite for risk as investors reach for positive real yields in credit and support valuations. An additional backstop has been the transparency from the Fed with its intent on maintaining its policy of low short-term interest rates, providing relative stability to the yield curve and low interest-rate volatility which has enhanced risk appetites further.

On a fundamental level, the importance of the COVID-19 vaccine can't be understated, especially considering the number of jobs that were displaced during the crisis. Taking the view that potential full employment may be reached by the end of 2021, given successful implementation of the vaccine, we anticipate the economic recovery and return to strong employment levels could be powerful contributors to credit fundamentals in the year to come.

Aside from any unexpected policy shift by the Fed, the environment for credit as we look out to 2021 could support additional spread tightening, within the framework of an economic recovery, lifting credit fundamentals. Credit segments that may offer relative value in that environment include sectors where yields have not compressed to pre-COVID 19 levels, such as High Yield (see Figure 3).

Figure 3. Spread Opportunity in U.S. High Yield by Credit Rating

ICE BofA U.S. High Yield Index: Spreads by Credit Quality



Spreads by Credit Quality	2/28/20	2020 High	12/4/20
ICE BofA US High Yield (BB)	332	**837**	286
ICE BofA US High Yield (Single-B)	517	**1189**	429
ICE BofA US High Yield (CCC & Lower)	1166	**1962**	863

Source: Bloomberg. Data as of December 4, 2020. Spreads referred to in basis points (one basis point is one-one hundredth of a percentage point). The historical data are for illustrative purposes only, do not represent the performance of any specific portfolio managed by Lord Abbett or any particular investment, and are not intended to predict or depict future results. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment. **Past performance is not a reliable indicator or guarantee of future results**.

Mortgage Credit – A Tale of Two Sectors

Low yields and low volatility are normally positive influences on the housing and commercial real estate markets. But in order to assess the securities backed by mortgages for these types of properties, you need to examine how the real estate will be purposed in the future.

Office space has been the focus of much attention recently due to the impact of the pandemic shifting a massive portion of the workforce out of commercial real estate. Not widely known, however, is that office space in terms of square footage dedicated per individual has been reduced by nearly half over the last ten years. Imbalance in supply is not an issue. Regionally, in the Northeast for example, the effects have been more significant as the cash flow to more sensitive properties—retail and hotels for example—was greatly reduced, and clarity on the valuation of these properties disappeared.

The COVID-19 vaccine changes our longer-term outlook over the next year and into 2022. We believe commercial real estate was given a recovery path by the vaccine going forward and could resume to show signs of upward valuation, but we do expect a lag in the response to improving economic activity. The commercial mortgage-backed securities affected by the severe downward pressure on cash flows have priced in the negative effects caused by the pandemic. We anticipate those securities to perform in line with the recovery in the properties just mentioned.

The pandemic affected the residential housing market differently. Household formation in the suburbs has increased with the migration outside of city centers. Activity in housing supports economic recoveries and is also a leading indicator of economic growth, and we expect that trend to continue into 2021.

Where we may see less compelling relative value is in the residential mortgaged-backed security sector. The pandemic nudged buyers who may normally have waited a few more years into the mortgage market, although at low rates, which is a positive for home owners. Historically low rates on mortgage loans have certainly contributed to mortgage activity either in the form of buying a new home or refinancing to renovate an existing home. But as a recovery unfolds, as we expect it should, residential mortgage rates may move higher, potentially putting downward pressure on valuations of residential mortgage-linked securities.

Next: How the burst of innovation fueled in part by the pandemic may influence equities in 2021.

LORD ABBETT®

A Note about Risk: The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. Fixed-income investments are subject to various other risks including changes in credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors. Lower-rated securities are subject to greater credit risk, default risk, and liquidity risk. Credit risk is the risk that debt issuers will become unable to make timely interest payments, and at worst will fail to repay the principal amount. Treasuries are debt securities issued by the U.S. government and secured by its full faith and credit. Income from Treasury securities is exempt from state and local taxes. Although U.S. government securities are guaranteed as to payments of interest and principal, their market prices are not guaranteed and will fluctuate in response to market movements. The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of companies and/or sectors in the economy. There is no guarantee that these investment strategies will work under all market conditions or are suitable for all investors and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market.

Statements concerning financial market trends are based on current market conditions, which will fluctuate. All investments involve risks, including the loss of principal invested.

This material is provided for general and educational purposes only. The examples provided are for illustra¬tive purposes only and are not indicative of any investor situation.

This commentary may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize or that actual returns or results will not be materially different from those described here.

A **basis point (bp)** is one one-hundredth of a percentage point.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus Treasury bonds or another benchmark bond measure. Spread-to-worst measures the dispersion of returns between the best and worst performing security and is often linked to bond markets.

The **ICE BofA U.S. High Yield Index** is a capitalization-weighted index of all U.S. dollar-denominated below investment grade corporate debt publicly issued in the U.S. domestic market.

ICE BofA Index Information:
Source: ICE Data Indices, LLC ("ICE"), used with permission. ICE PERMITS USE OF THE ICE BofAML INDICES AND RELATED DATA ON AN "AS IS" BASIS, MAKES NO WARRANTIES REGARDING SAME, DOES NOT GUARANTEE THE SUITABILITY, QUALITY, ACCURACY, TIMELINESS, AND/OR COMPLETENESS OF THE ICE BofAML INDICES OR ANY DATA INCLUDED IN, RELATED TO, OR DERIVED THEREFROM, ASSUMES NO LIABILITY IN CONNECTION WITH THE USE OF THE FOREGOING, AND DOES NOT SPONSOR, ENDORSE, OR RECOMMEND LORD, ABBETT & CO. LLC., OR ANY OF ITS PRODUCTS OR SERVICES.

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

The information provided herein is not directed at any investor or category of investors and is provided solely as general information about our products and services and to otherwise provide general investment education. No information contained herein should be regarded as a suggestion to engage in or refrain from any investment-related course of action as Lord, Abbett & Co LLC (and its affiliates, "Lord Abbett") is not undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity with respect to the materials presented herein. If you are an individual retirement investor, contact your financial advisor or other non-Lord Abbett fiduciary about whether any given investment idea, strategy, product, or service described herein may be appropriate for your circumstances.

*The opinions in this commentary are as of the date of publication, are subject to change based on subsequent developments, and may not reflect the views of the firm as a whole. The material is not intended to be relied upon as a forecast, research, or investment advice, is not a recommendation or offer to buy or sell any securities or to adopt any investment strategy and is not intended to predict or depict the performance of any investment. Readers should not assume that investments in companies, securities, sectors, and/or markets described were or will be profitable. Investing involves risk, including possible loss of principal. This document is prepared based on the information Lord Abbett deems reliable; however, Lord Abbett does not warrant the accuracy and completeness of the information. Investors should consult with a financial advisor prior to making an investment decisio*n.

Lord, Abbett & Co. LLC | 90 Hudson Street | Jersey City, NJ 07302-3973 | T 1.888.522.2388 | lordabbett.com

2021INVOUTLOOK
12-20