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Equity Insights

2021 Investment Outlook: Equities

In the second installment of our 2021 Investment Outlook, Lord Abbett's equity investment professionals discuss how innovation and durability can potentially anchor growth, value, and dividend income strategies.

IN BRIEF

- The global pandemic reinforced the importance of innovation. We believe the sector will continue to create investment opportunities in 2021 and into the decade ahead.
- COVID-19 vaccine announcements triggered a rally in value stocks. While cyclical opportunities are likely in 2021, we believe companies with durable business models that adapt to the disruption of innovation are well-positioned for the future.
- Persistently low yields could provide a boost to dividend-paying stocks as investors search for yield. Dividend yields could also benefit from a return of capital to shareholders as a recovery unfolds.

Innovation and Adaptability

As the global pandemic forced the shut-down of economies around the world, a significant number of companies were able to maintain operations and adapt to the new remote environment through technological advancements that promote digital productivity and conquer distance through innovations in cloud technology, artificial intelligence, and virtual empowerment. These events highlight the power of the technology revolution, which has essentially kept the economy moving during the crisis. Biotechnology and the development of the vaccine also benefited from the tech revolution through advancements in genomic sciences, underscoring how innovation and adaptability can transform businesses and economies on a global scale.

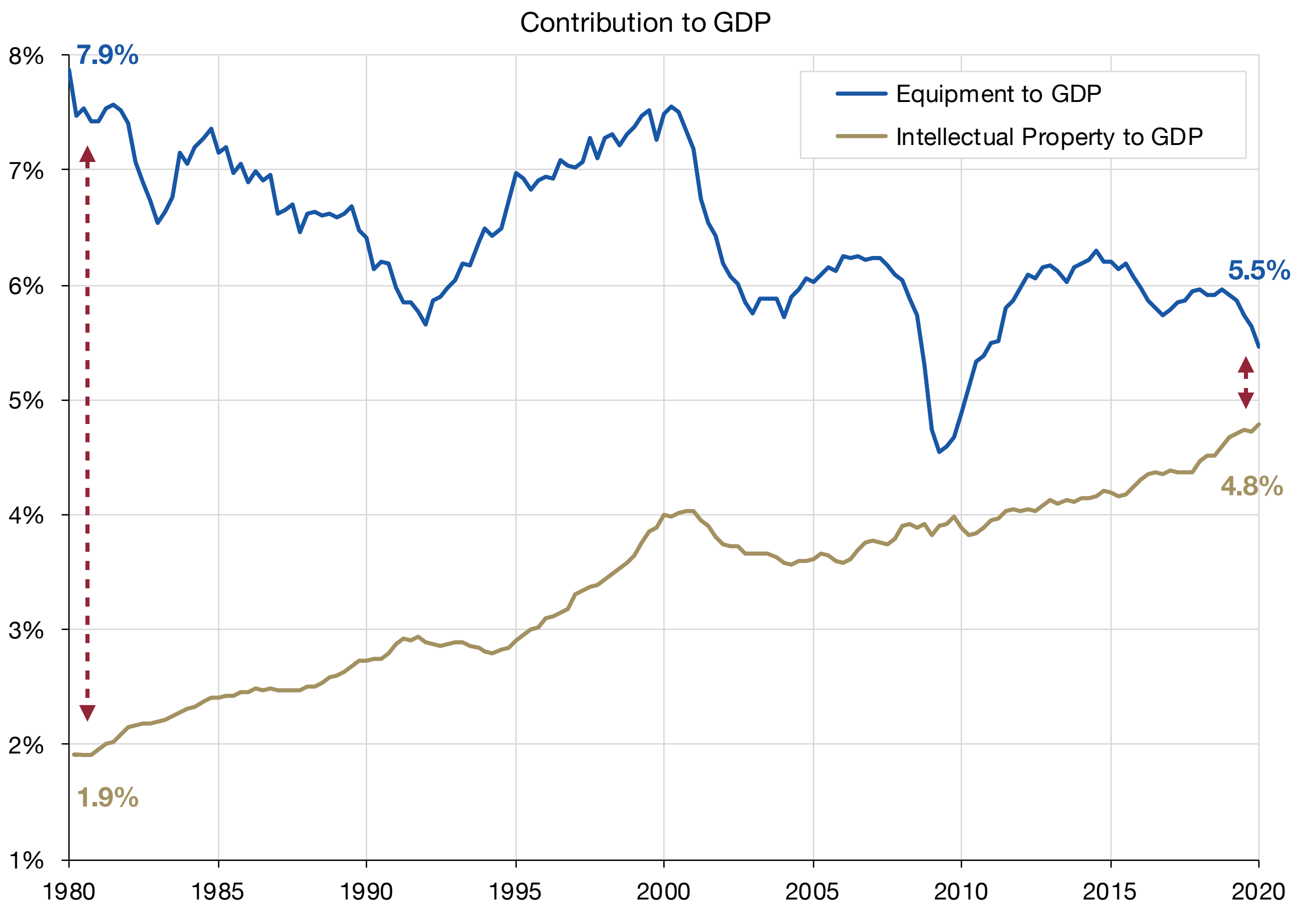
Positive Effects of Innovation for 2021 and Beyond

We believe the pandemic has proven that technology will remain an essential contributor to the activities that have adapted to the crisis environment. But a rotation into cyclical value and small cap companies picked up steam with the vaccine announcement, a development we have been watching carefully. We will continue to assess opportunities among the cyclical stocks that have durable business models and strong histories of revenue and earnings growth.

To sum up, our positive outlook for innovation extends not only into 2021 but through the decade to come. Advancements in technology contributed extensively to consumers' and businesses' ability to pivot towards activities and operations that sustained the economy during the crisis. Digital signatures, e-commerce, social networks, and video communication empowered individuals and companies, while the development of the vaccine was enhanced by innovations in biotechnology. This extraordinary adaptability benefited from the transformation of capital intensity over the last forty years from physical to intellectual, as shown in Figure 1.

> "Our positive outlook for innovation extends not only into 2021 but through the decade to come."

Figure 1. Shifting Shares of GDP for Equipment Versus Intellectual Property



Source: Bloomberg. Historical data as of 03/31/2020 (latest available). For illustrative purposes only. The data shown is based solely on the contribution to U.S. GDP.

Durability Within Value

The global pandemic severely affected economically sensitive stocks. Recent vaccine news subsequently produced a rally in these issues based on an expected economic recovery unfolding in 2021. Cyclical industries such as Financials, Industrials, and Energy could benefit from an easing in the pandemic crisis in 2021, and we believe these stocks may have more upside ahead. Indeed, these issues could potentially benefit from the broad recovery in corporate profits that analysts are expecting in 2021, based on earnings forecast revisions (see Figure 2).

Within the broader cyclical category, there are resilient companies that adjusted to the crisis through cost-cutting initiatives, inventory controls, and gains in efficiency. We have seen a significant improvement in corporate balance sheets during the year, which is also indicative of how certain companies quickly adapted their businesses in order to be better positioned for the future, beyond the cyclical upswing expected in 2021.

An important component of our investment process is determining the durability of a company's business model within the competitive landscape, as well as the ability to generate strong free cash flow. In our view, these durable, solidly performing companies that have successfully staved off the threat of disruption from innovation are well positioned to benefit from the end of the crisis not only for the coming year but for years ahead.

Dividends Play a Role

Amid a world awash in low interest rates, dividend-paying stocks could garner more attention in the year ahead. The COVID-19 crisis prompted an increase in the number of companies that reduced or ceased dividend payments. Looking ahead to next year, the stronger corporate balance sheets mentioned earlier could prompt companies to boost payouts to shareholders, resulting in better dividend yields in 2021. More importantly, within our approach we are focusing on those companies that remained income-producing during the crisis and have competitive business models, strong balance sheets, and management teams committed to providing for their shareholders.

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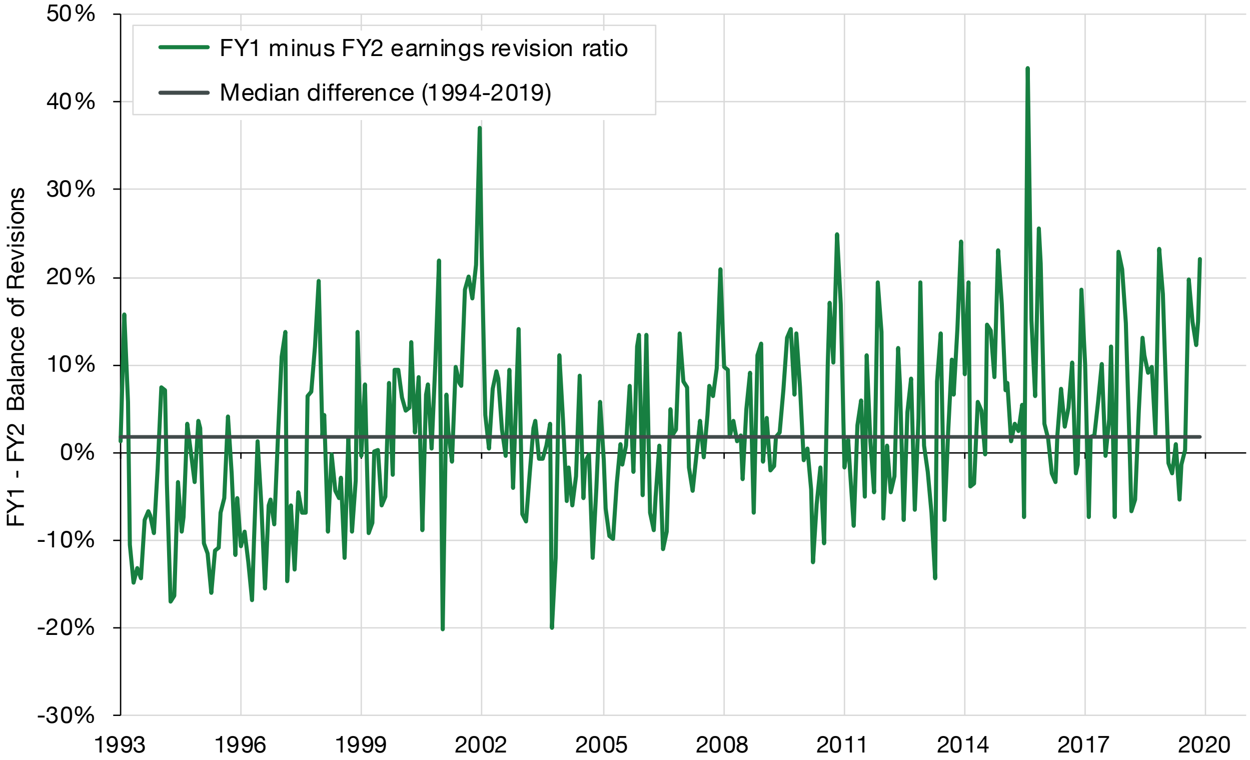
Figure 2. Analysts Expect Good News on U.S. Earnings Will Be Front-Loaded in Fiscal 2021

U.S. balance of fiscal 2021 less fiscal 2022 earnings revisions (based on the S&P 500 index), January 1, 1993—November 10, 2020



Source: J.P. Morgan "The Earnings Landscape", Nov. 10, 2020, and Lord Abbett.

For investors seeking income and total return, dividend-paying stocks historically have provided a relatively attractive risk versus reward profile, with lower volatility than the broad equity market. Those features may prove appealing to investors seeking a potentially lower-risk way to maintain equity exposure in 2021.

Global Equity

The unprecedented global fiscal and monetary response to the pandemic, followed by successful development of vaccines, supports our view that a fundamental global economic recovery should develop in 2021. We anticipate the cyclical boost to benefit the international equity segment.

Relatively attractive valuations versus U.S. equity could also provide additional support for international stocks after multi-year underperformance to U.S. stocks. Compelling dividend yields in a low to negative rate environment, greater leverage to a cyclical recovery, and the potential for more predictable foreign policy initiatives all point to a positive backdrop for international equity, in our view.

We believe certain regions that have been more severely impacted by the pandemic, such as Western Europe, and emerging markets outside of China, Korea, and Taiwan, could provide attractive relative value opportunities, and we are looking for key themes that could benefit from post-pandemic economic openings and recovery to perhaps provide added value.

Sectors that we believe stand to benefit from the anticipated recovery include technology, where we remain positive toward long-term secular names in e-commerce, fintech, and factory automation. Entering 2021, we have a constructive view on industrial and consumer-related semiconductors that are leveraged to a recovery in auto production, growth in electric vehicles, and 5G-driven recovery in smartphone units. In 2021, we believe we could see a rotation into COVID laggards, particularly airports and aerospace & defense, and also prefer names that could potentially benefit from structural growth drivers, such as renewable energy, electric vehicles, and industrial automation and robotics.

A Note about Risk: The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy. While growth stocks are subject to the daily ups and downs of the stock market, their long-term potential as well as their volatility can be substantial. Value investing involves the risk that the market may not recognize that securities are undervalued, and they may not appreciate as anticipated. Smaller companies tend to be more volatile and less liquid than larger companies. Small cap companies may also have more limited product lines, markets, or financial resources and typically experience a higher risk of failure than large cap companies.

No investing strategy can overcome all market volatility or guarantee future results.

Forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.

This article 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.

Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that markets will perform in a similar manner under similar conditions in the future.

Glossary and Index Definitions

Gross Domestic Product (GDP): The monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory.

Earnings per share (EPS) is a company's earnings divided by the number of shares outstanding. EPS can also be computed for an index such as the S&P 500.

Price-to-Earnings Ratio: Stock analysts calculate a price-to-earnings ratio by dividing a stock's current price by its earnings per share on a trailing 12-month basis. A forward price-to-earnings ratio is calculated by dividing a stock's current price by estimated future earnings per share.

The S&P 500® Index is widely regarded as the standard for measuring large cap U.S. stock market performance and includes a representative sample of leading companies in leading industries.

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

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

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