



SECOR Asset Management

Market and Macro Review – Macro Update

August 17, 2020

2020: Historic and Eventful Year

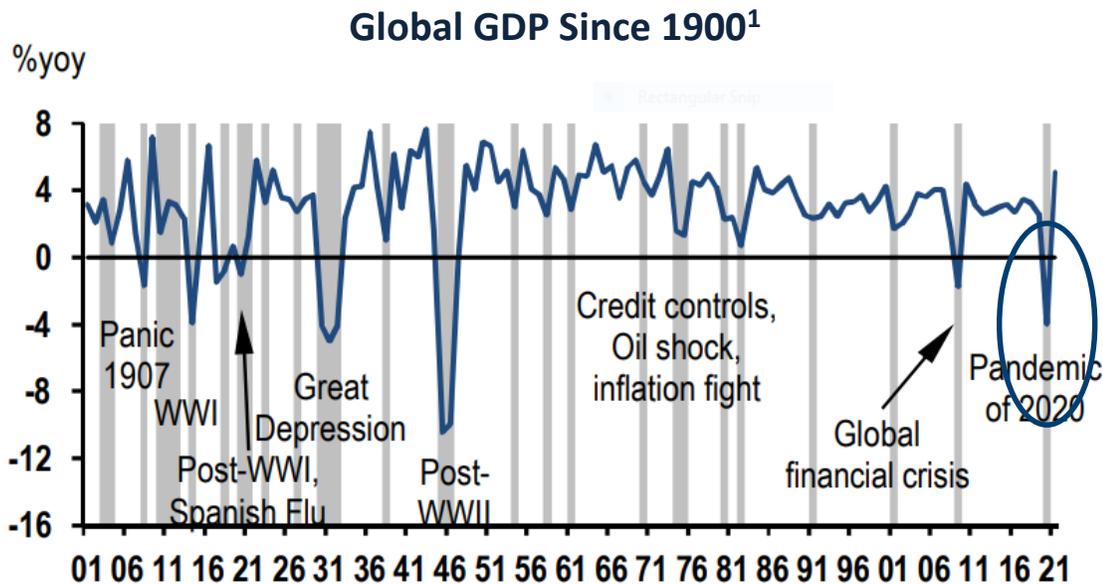
- **Entered Year on Positive Note in January**
 - Forecast called for global economy to expand 3+% in 2020
 - By end of Q1 evident Covid-19 pandemic game changer for outlook
- **Stringent Virus – Related Lockdowns/Simultaneous Supply-Demand Shock Near End of Q1**
 - Brought record 128-month expansion to end and global economy plunged into severest recession in 75+ years
 - Little, if any, hard data (ex China) in April to forecast recovery's timing
- **Forecast for Economic Recovery That We Presented in April Based on Following:**
 - Unprecedented and aggressive fiscal and monetary policies
 - Relatively short duration of prior “natural-disaster” recessions¹
 - Preliminary signs of Covid-19 new cases levelling-off
- **Our Forecast for Brief Recession Seemingly on Target But Covid-19 Headwinds More Persistent than Expected**
 - Mixed Covid-19 outcomes causing pause in easing of lockdowns suggesting slower than expected rebound but...
 - Economic data surprised on upside in May and June and global recession appears to be moving beyond trough
 - Our updated global GDP outlook for 2nd H 2020/ 2021 tweaked (lowered by ~0.5% point) but largely unchanged

1. Covid-19 recession is expected to follow relatively brief path of prior “natural-disaster” recessions rather than the protract recovery of the GFC due to the following: (1) Current recession not an endogenous shock triggered by large imbalances. (2) Deleveraging pressures likely to be more moderate – consumer balance sheets in relatively strong position.

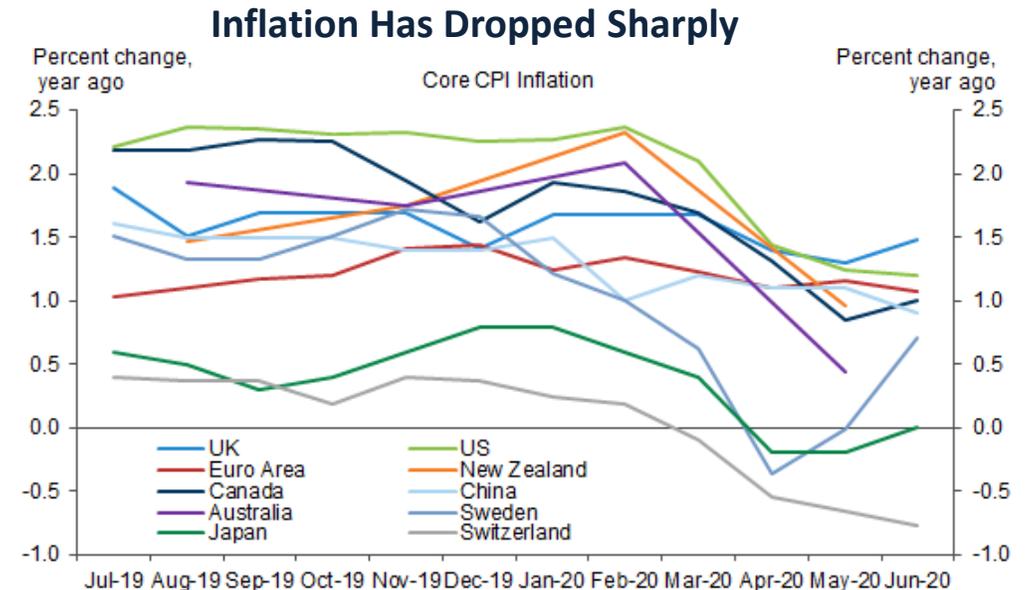
2020 GDP in Historical Perspective/ Pandemic's Effect on Inflation

- 2020 Covid-19 recession - Severest in past 75 years
- Much deeper than GFC - Only other period of negative global growth post WWII

- Covid-19 recession produced a large demand shock that has ...
- Pushed **core** inflation in major countries down from 2.25% to 0.5% range in January to 1.5% to -0.75% range in June



Source: Angus Maddison, JPM. As of August 2020



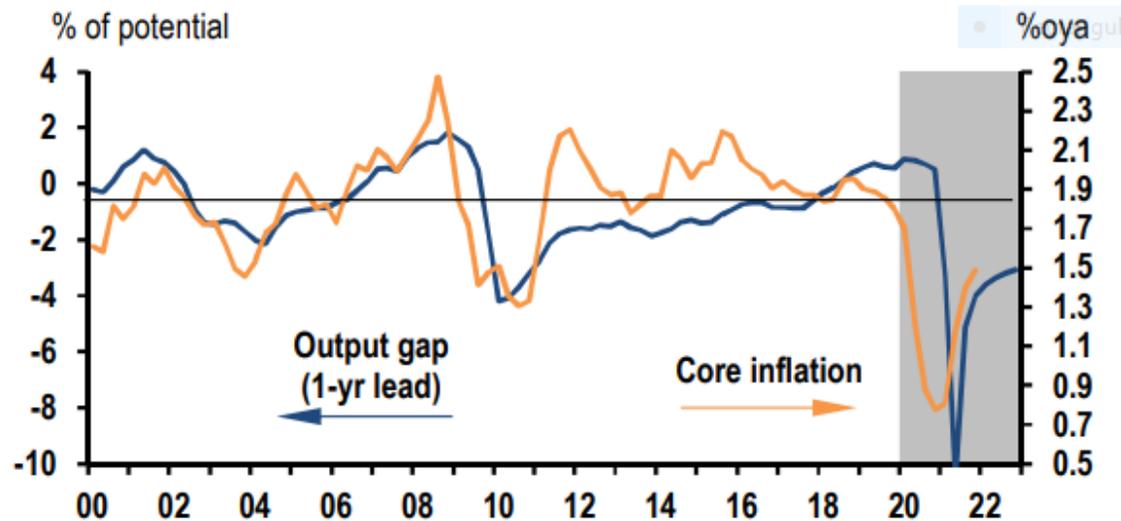
Source: Haver Analytics

1. Since 1900 there have been 8 global recessions – defined as period of negative GDP growth – 6 occurred pre-1945 and only 2 in post WW2 Keynesians period.

Inflation Expected to Remain Contained Over Cyclical Horizon

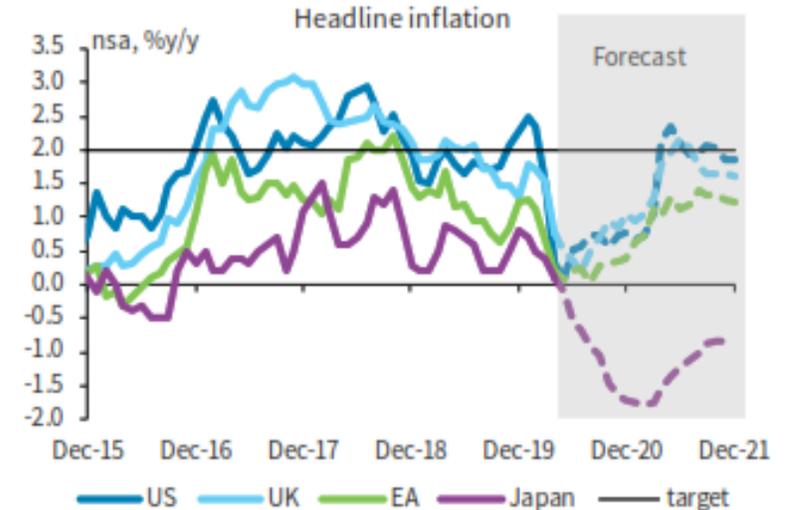
- Deep global recession precipitating large output gap
- Expected to hold global **core** inflation: to ~1.5% rate in 2021
- Rising commodity prices and improving economies expected to put some modest upward pressure on headline inflation in 2021
- Rates in major countries expected to reach 2% target at most

Output Gap and Core Inflation



Source: JP Morgan

Headline Inflation



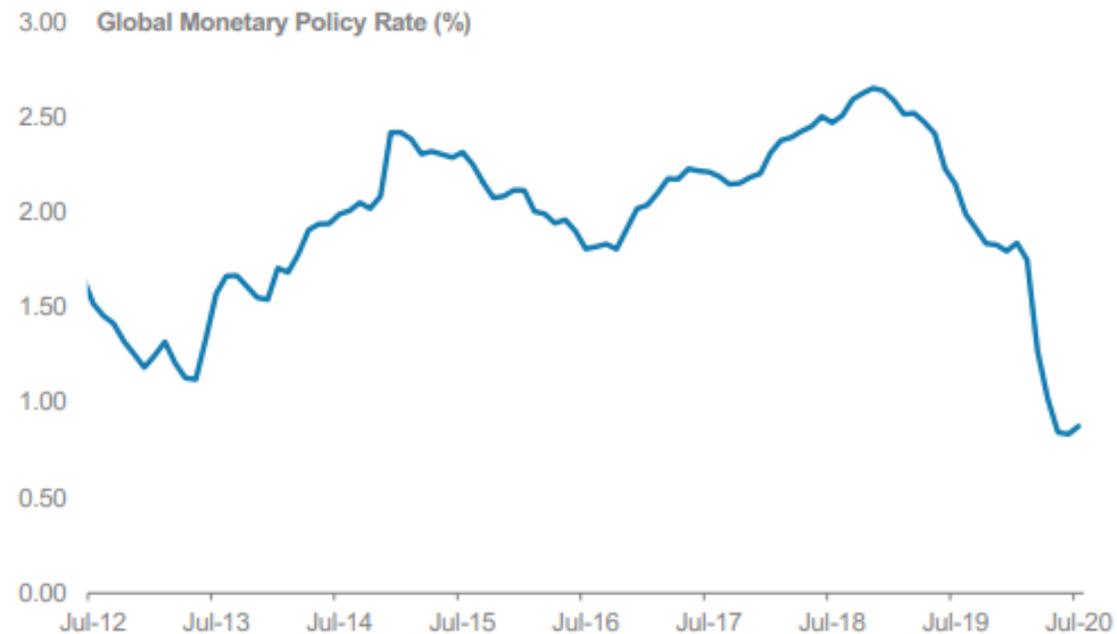
Source: Haver Analytics, GS

Policy Backdrop: Monetary Policy

- Global policy rate currently well below post-GFC lows
- Major central banks pledging to maintain low rates for foreseeable future

- Latest QE actions expected to increase most major central bank balance sheets by equivalent of more than 20%-points of GDP

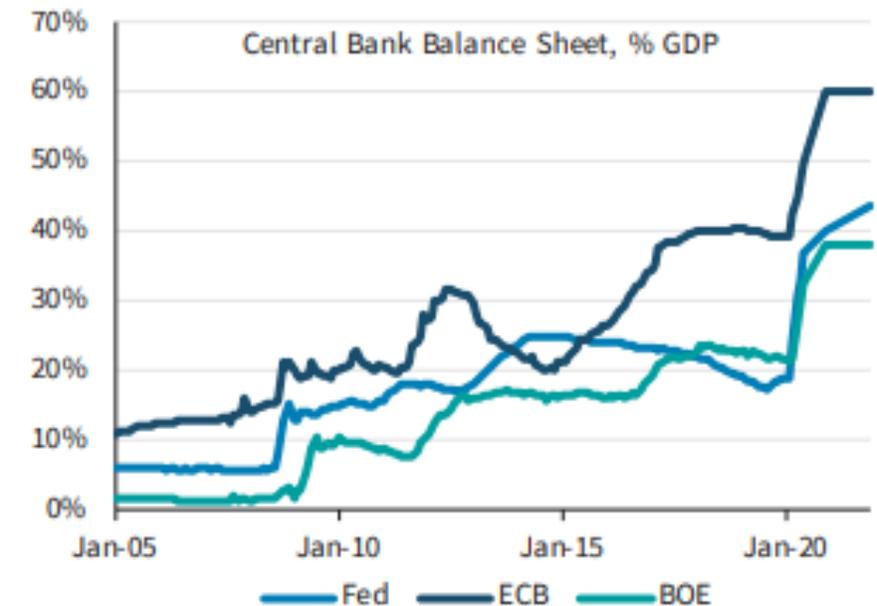
Global Policy Rate



Source: Haver Analytics, Barclays

Central Bank Balance Sheets¹

Central bank balance sheets to expand meaningfully



Source: Haver Analytics, Barclays

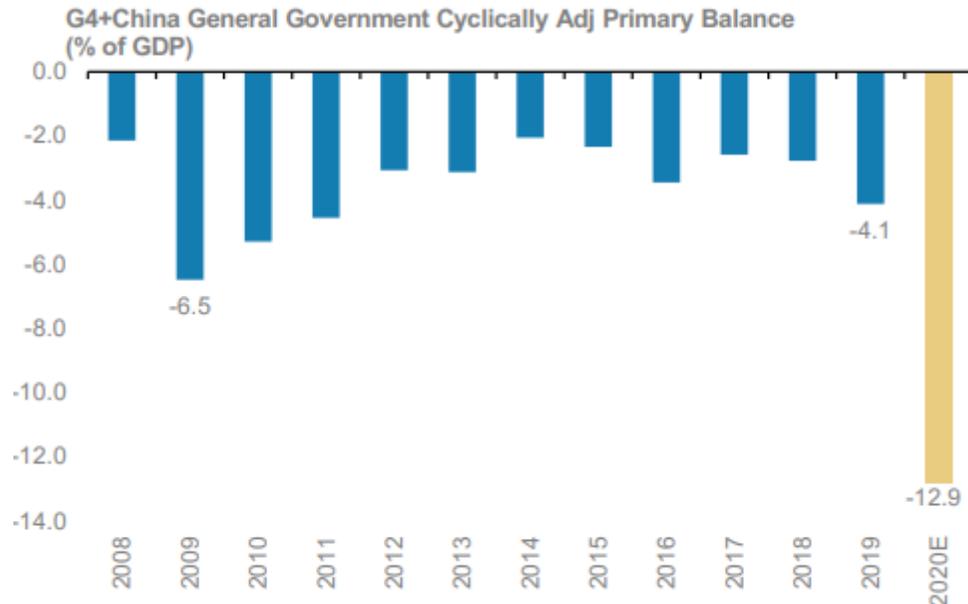
1. BoJ's debt to GDP ratio which is not included on the above chart is expected to rise to ~140 by YE '21 vs. ~100 at YE'19.

Policy Backdrop: Fiscal Policy

- Fiscal stimulus is expected to result in record peacetime budget deficits¹
- G4 & China 2020 estimated primary deficit ~13%, double 2009 shortfall

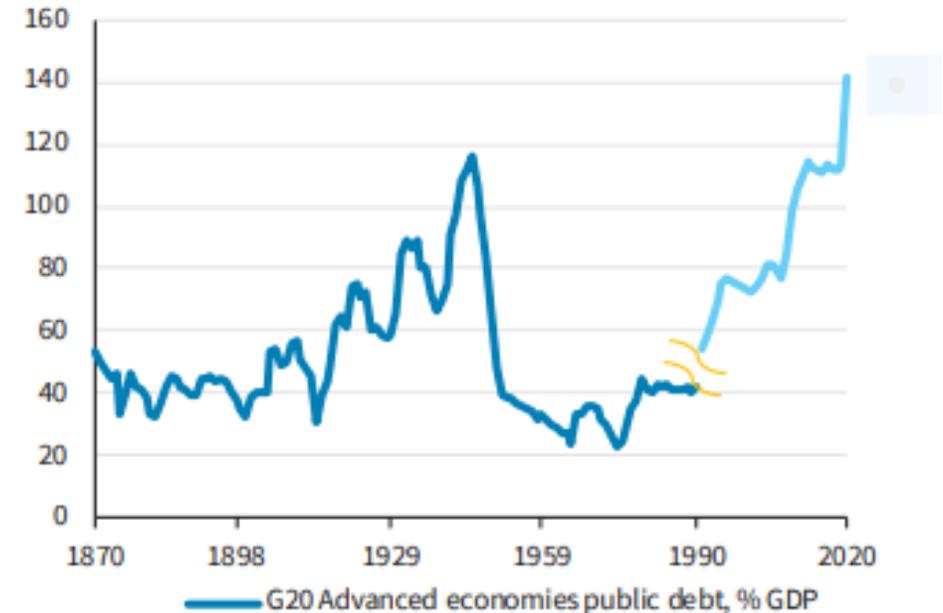
- G20 public debt ratios rising above historic WWII peak levels

G4 China Government Budget Deficits



Source: Haver Analytics, MS

G20 Public Debt (%GDP)²



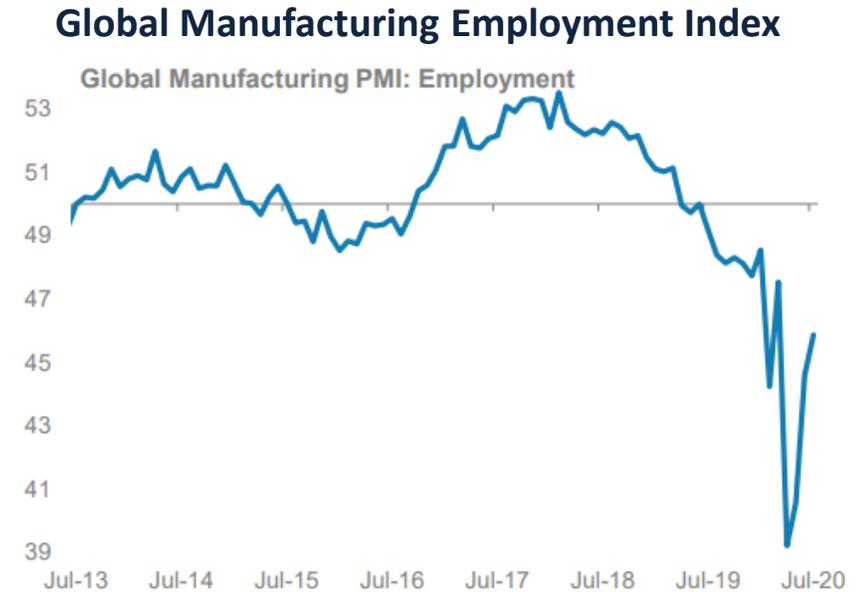
Source: IMF, Barclays

1. 2021 estimated G4 & China primary budget deficit expected to average ~9%.
 2. Government debt to to GDP ratios expected to rise virtually in every major country in 2020. Selected estimated DM primary budget to GDP 2020 ratios: US: 133, Japan 232, UK 97, Italy ~160, and Germany ~70. Selected EM ratios: China 64, India 81, and Russia 15, China's total debt to GDP ratio is outsized 293%

Recession Moving Beyond Trough

- Key global manufacturing & new orders PMIs:
 - Returned to expansionary mode in July
 - Manufacturing 50.6
 - New orders 52.6

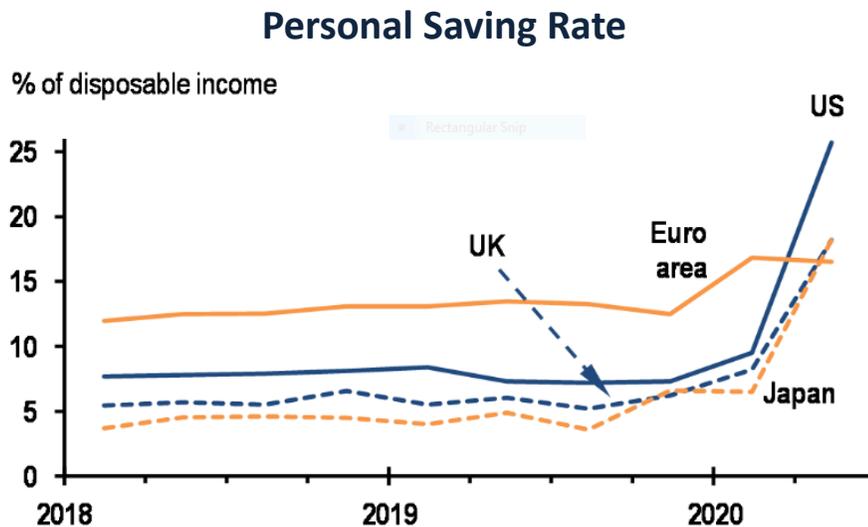
- Global manufacturing employment PMI
 - Up significantly from recessionary trough but not yet in expansionary mode



Recession Moving Beyond Trough

- Personal saving rates at record levels as:
 - Lockdowns curtailed spending, while fiscal stimulus supported incomes

- Retail sales jumped in May and June
 - Partially due to unleashing of pent-up demand as lockdowns eased
 - Auto sales still lagging improvement in total retail sales but production schedules point to subsequent improvement



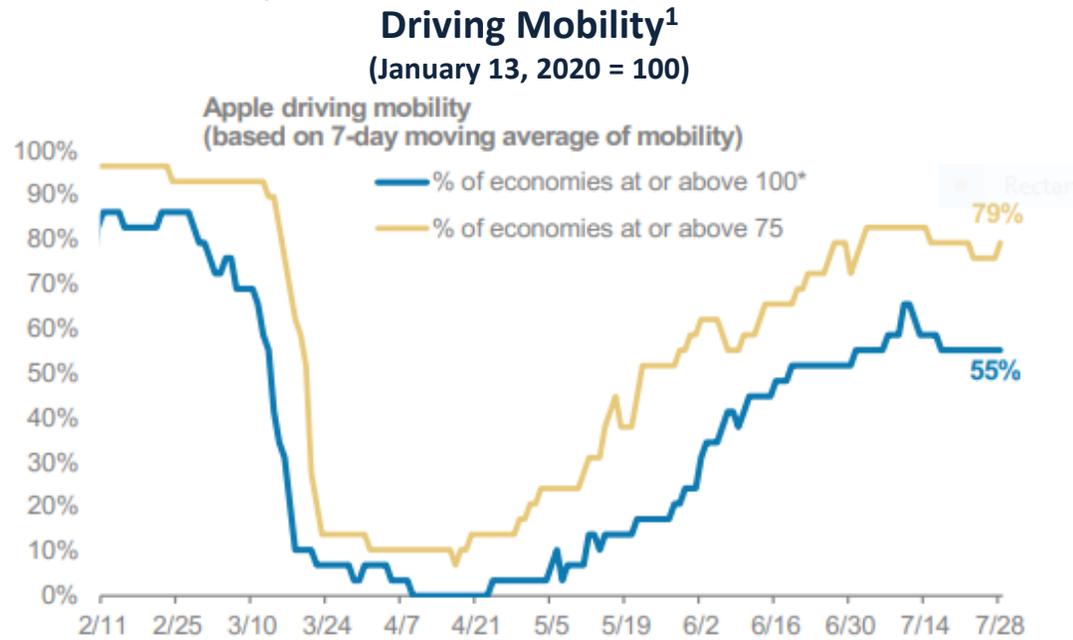
Source: Various governments, JPM



Source: JPM

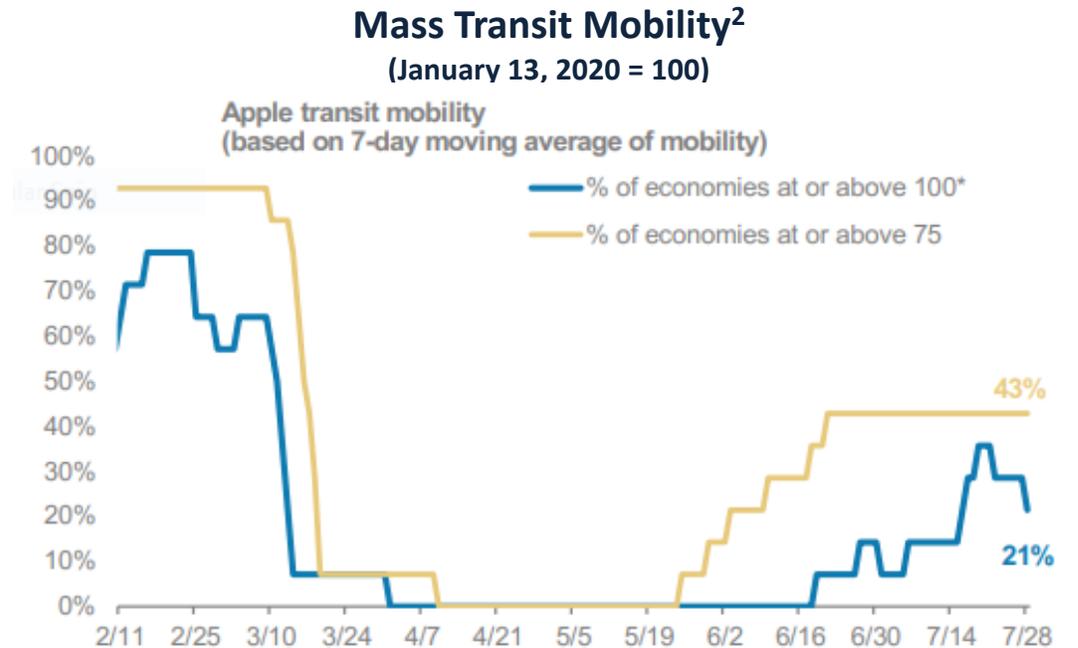
Recession Moving Beyond Trough

- 55% of major countries at or above pre-pandemic levels
- ~80% at or above 75% of pre-pandemic levels vs. ~10% in April



Source: Apple, MS

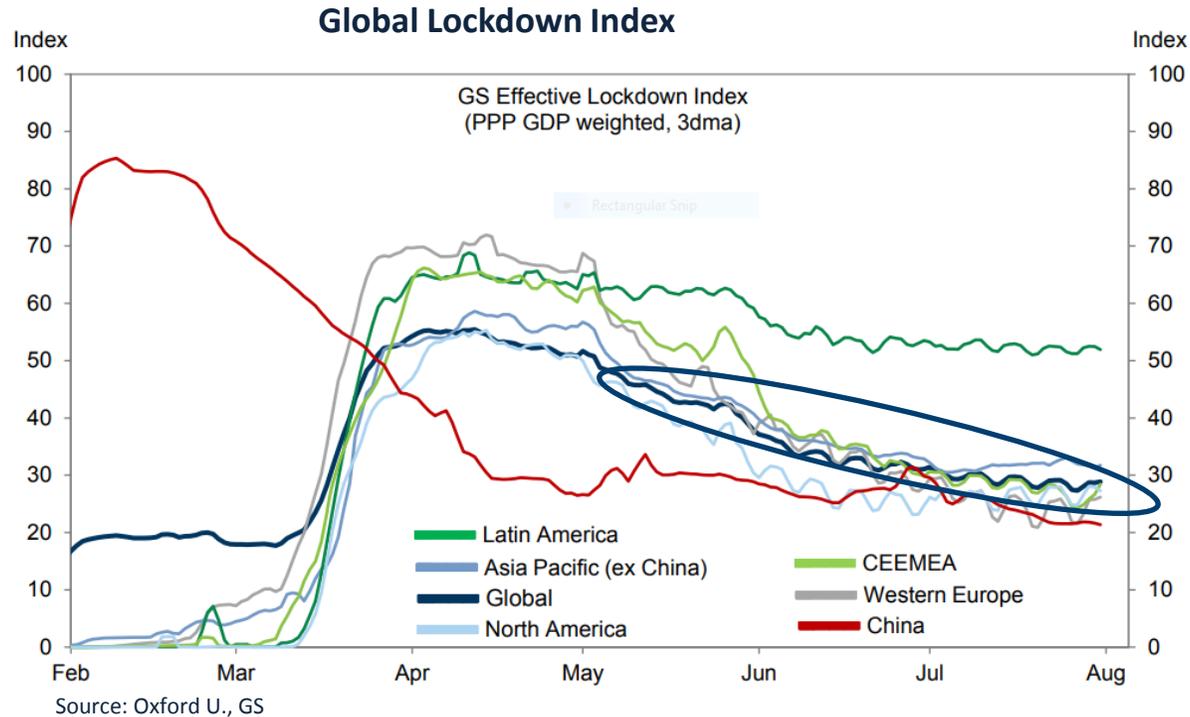
- After coming to virtual halt in April...
- Mass transit usage at or above pre-pandemic levels in ~20% of major countries



Source: Apple, MS

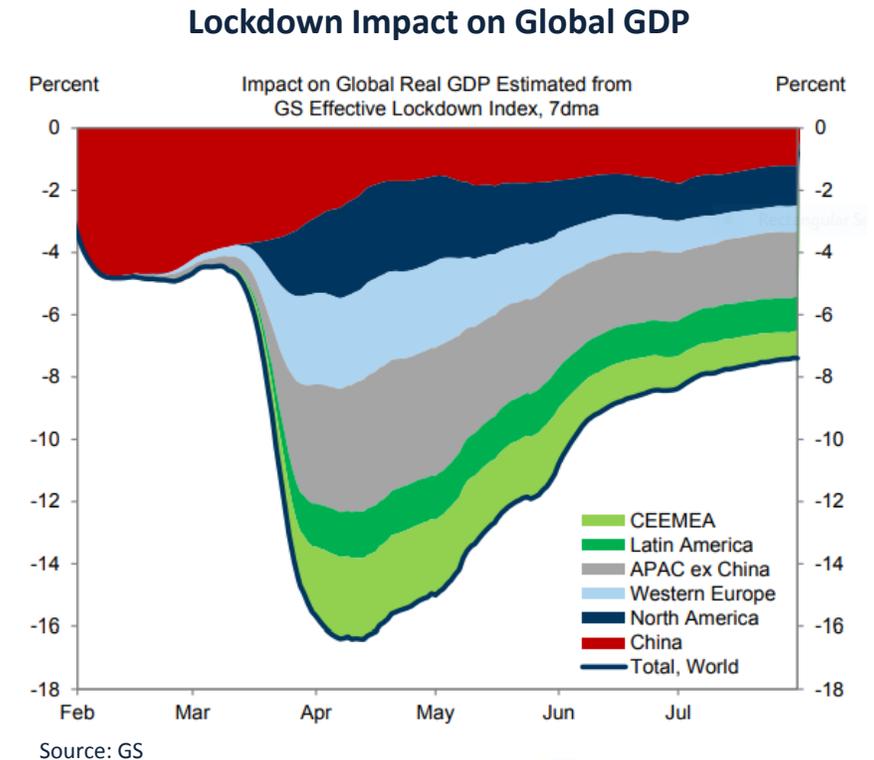
1. Driving mobility based on 29 countries including virtually all major DMs and Ems
 2. Mass transit mobility based on 14 countries

Lockdowns/Covid-19 Linchpins in Outlook



- Global composite lockdown index (dark blue line)
 - Significantly below April peak
 - Essentially unchanged in July
 - Easing in China offset tightening elsewhere

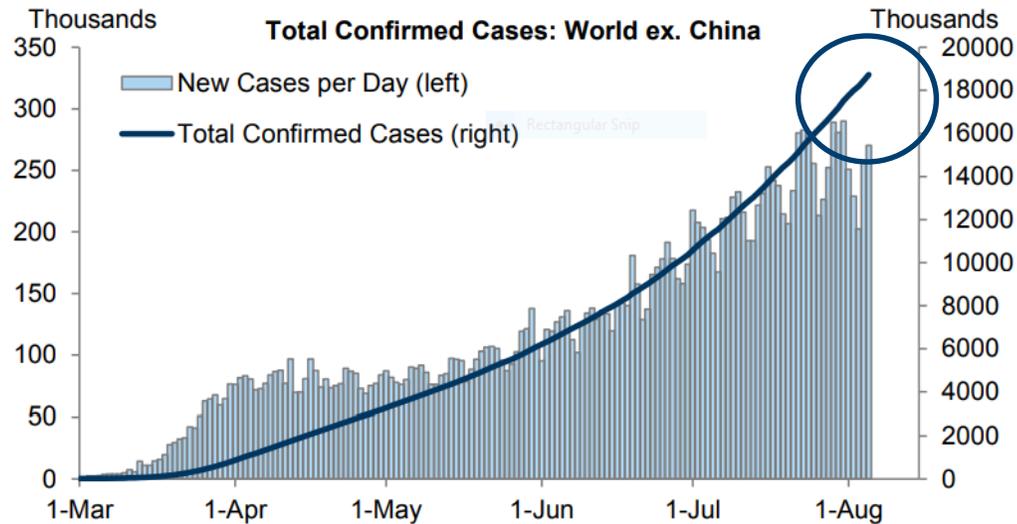
- Estimated impact of lockdowns on global GDP
 - Currently 7.5% hit vs. 17% at the April trough



Covid-19 Update

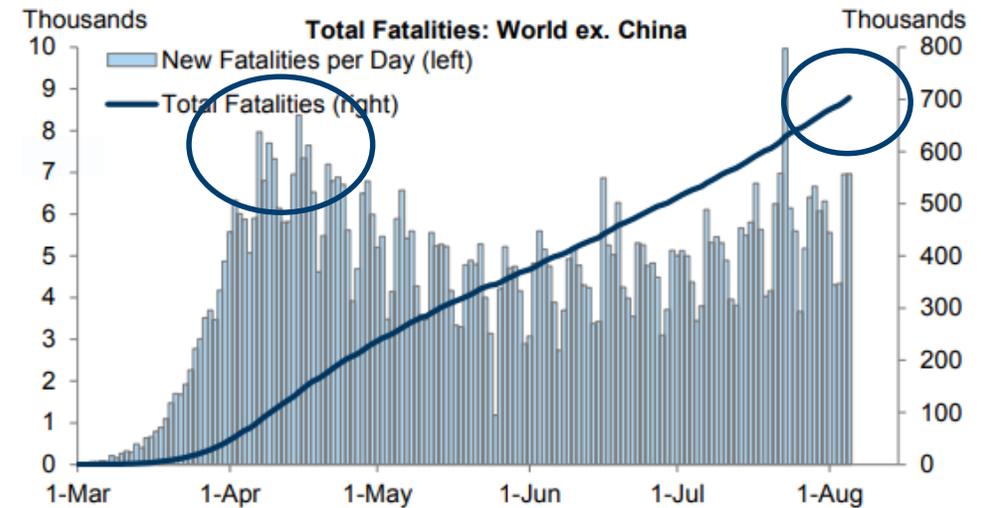
- Currently ~18 million Covid-19 cases worldwide (ex China) vs. ~2 million in April
- New cases ~270,000 per day currently
- Daily fatalities still rising but below April peak

Covid-19 Still Rising Globally¹



Source: JHU, CSSE

Fatalities Also Rising²



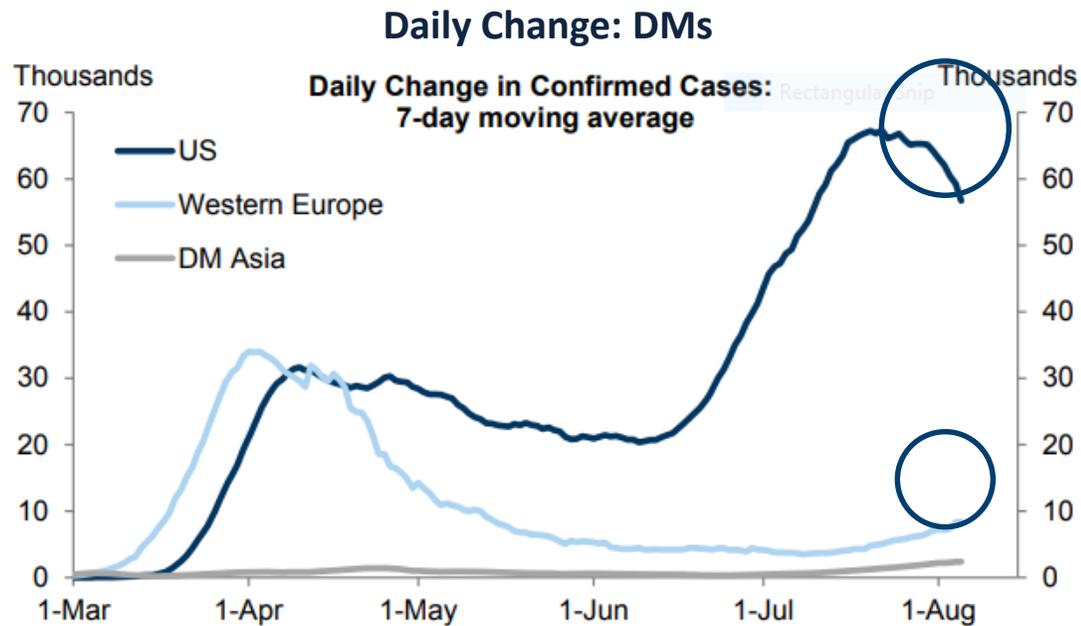
Source: JHU CSSE

1. Total cases (as of 8/5/20): Asia (3.5mm.), Mainland China (85K), Western Europe (1.8mm.), America (10.1mm.) US (4.8mm.).
2. Fatalities per million selected countries Belgium (~850k), UK (~700K), Italy (~600K), US and Brazil (~500K), Netherlands (~400K).

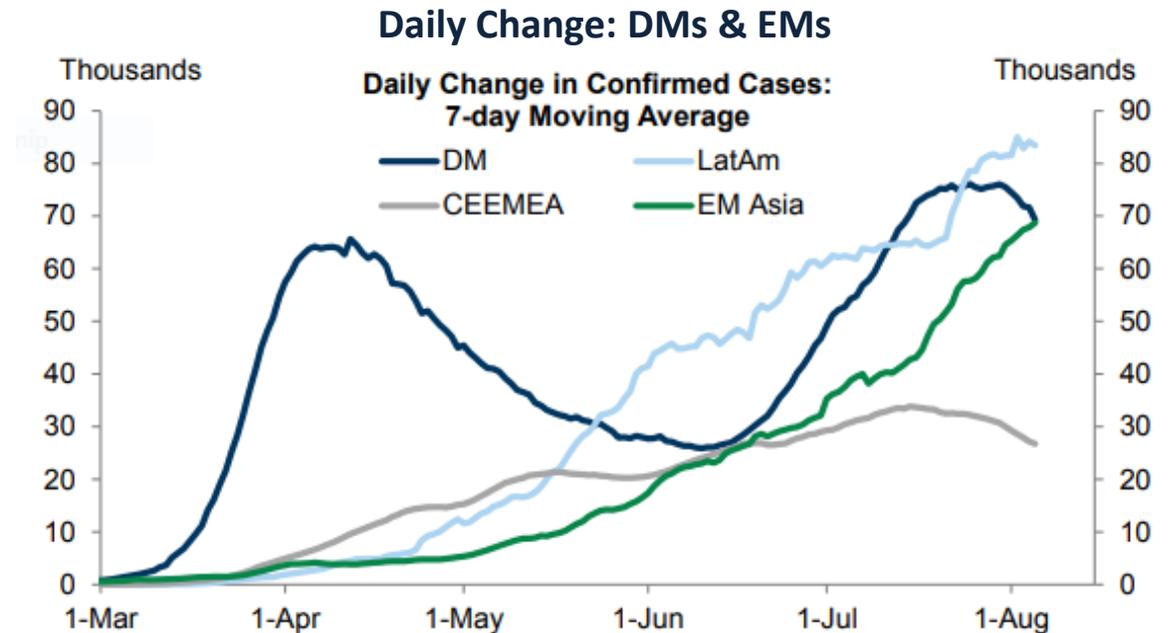
Covid-19 Update

- New US Covid-19 cases edging down but still at high level
- Europe and DM Asia at low levels, despite some renewed outbreaks

- Latin America and EM Asia (ex China) rising sharply
- Central and Eastern Europe¹... leveling off



Source: JHU, CSSE, JS

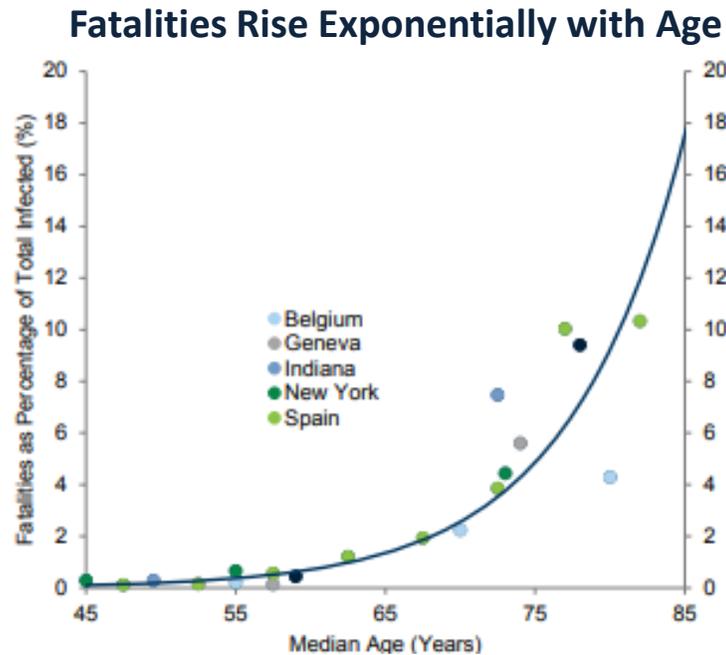


Source: JHU, CSSE, JS

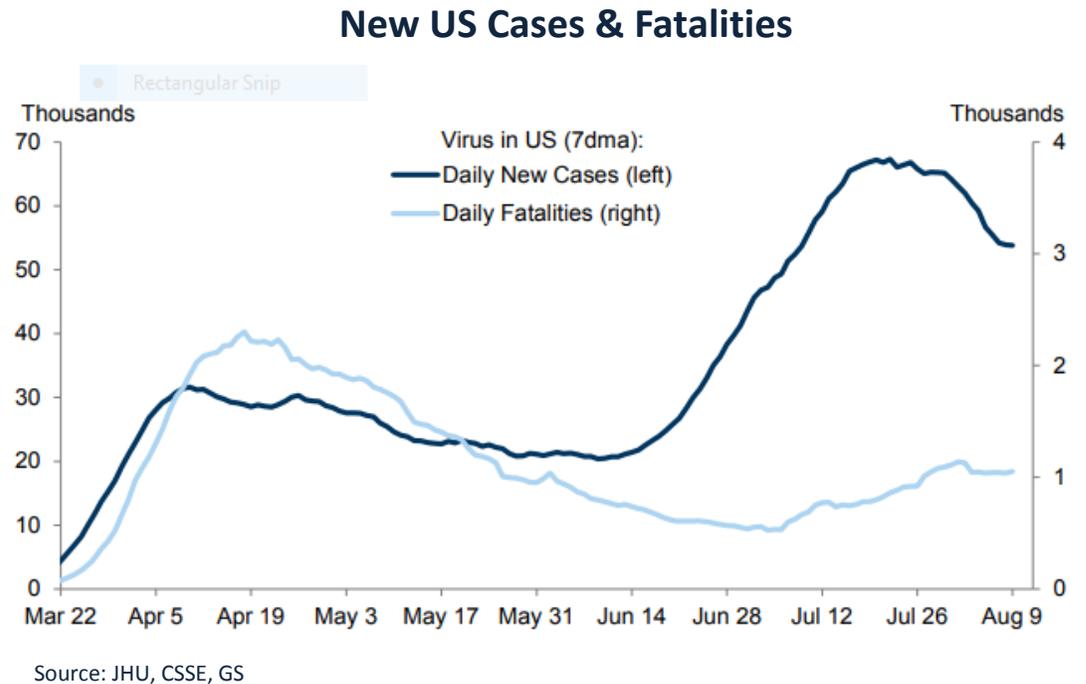
1. CEEMEA = Central and Eastern Europe Middle East and Africa

Covid-19 Update

- Fatalities Rise Sharply for Aged Cohorts
 - Recent study found¹...
 - Infection fatality rate close to zero for children and young adults but rises sharply between middle and old age



- Latest US Data Less Worrisome
 - New cases edging down in recent weeks
 - Fatality rates have edged up but remain significantly below April peak



1. Study by Andrew Levin et al referenced in recent (August 10) GS report

Covid-19 Ongoing Major Risk/Arguably Becoming More Manageable

- **Global Cases Still Rising/Composition Evolving**
 - Largely contained in Europe and China
 - Recent outbreaks limited but highlight need for continued vigilance
 - Still unsustainably high in US and rising in many EMs
- **Scientists and Policymakers Increasingly Adapt at Managing Virus**
 - Lockdowns, if imposed, likely to be limited in scope
 - Prudent and relatively simple protocols can mitigate risks¹
 - Treatment options continuing to improve²
 - Effective testing programs still “work in progress”³
- **Unprecedented Resources Marshalled to Launch Vaccine**
 - 167 candidate vaccines in various stages of development
 - Eight vaccines currently in Phase III large scale safety and effectiveness tests⁴
 - Many experts expect FDA to approve vaccine by YE or early ‘21⁵
 - No guarantee, however, that vaccine will be “silver bullet”⁶

1. Simple and prudent protocols include social distancing, face mask wearing and restrictions on indoor activities.

2. Improved treatment options include antibody drugs such as Remdisivir. Gilead Sciences is expanding its manufacturing network for Remdisivir and supply has grown 50-fold since January.

3. CDC reports 65 million Covid-19 tests have been performed thus far in US but long lags in reporting. Results compromise effectiveness. Need readily available test with quick reporting – e.g., one hour.

4. The FDA no vaccine 100% effective. FDA usually targets an efficacy rate of around 80%. For SAR-COV2 bar lower to 5%

5. Dr. Fauci has said that he expects the US to have millions of doses of vaccine by year end.

6. Some experts question the duration of potential protection from a vaccine, even if it is approved by FDA.

2020-2021 Global Cyclical Outlook

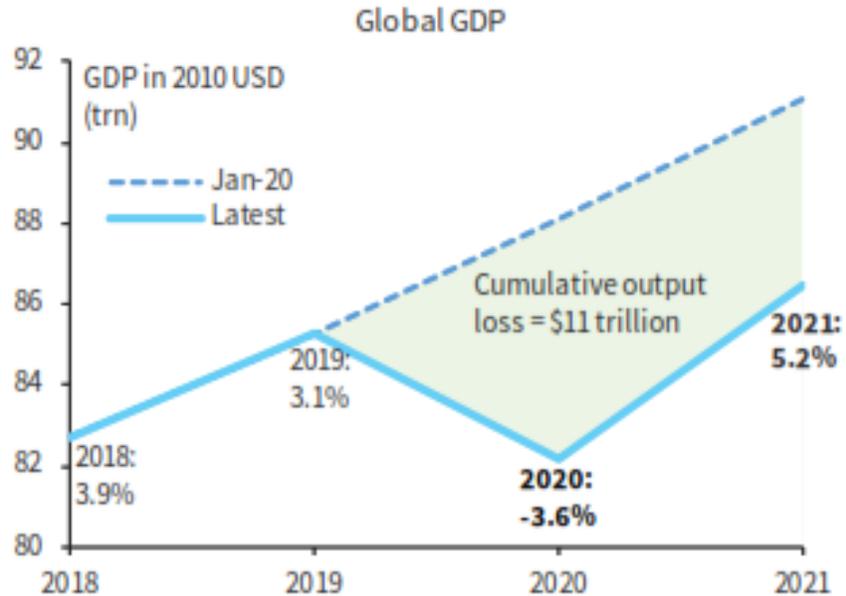
- **Historic 2020 Recession Outlook Imbeds Both:**
 - Covid-19 supply-demand shock that hit DMs & EMs earlier in year
 - And partial recovery from April trough supported by:
 - Gradual re-openings, unprecedented stimulus and pent-up demand
- **Outlook for Continuing Partial Recovery in 2021 Supported By:**
 - Continuing policy stimulus and “manageable” Covid-19 backdrop
- **Covid-19 Assumption Key Variable in Outlook¹**

	Expected Real GDP Growth %		
	Global	DMs	EMs
2020	-3.6	-6.0	-1.8
2021	5.5	4.5	6.0

1. For example, Goldman Sachs economists who assume an “early vaccine” forecast -3.3% global growth in ‘20 and 6.5% in ‘21. In contrast, IMF economists who are more concerned about the lingering effects of Covid-19 forecast -4.9% global growth this year and 5.4% in 2021.

Covid-19 Recession Huge Hit To Global Economy

Pandemic's Economic Crater¹



Source: World Bank, Haver Analytics, Barclays

- Confidence up significantly from recent lows
 - But herd immunity probably needed for full restoration

- Despite seemingly robust recovery
 - Global economy not expected to return to 2019 level until YE '21
 - Estimated 2-year loss in global output staggering \$11 trillion

Global Confidence

St dev from 2007-19 avg. Thru July



Source: JPM

1. Forecast shown about roughly in line with SECOR's – 2020 forecasts identical, 2021 slightly less optimistic than SECOR's

Key Country/Regional Briefs

■ **US Economy: Well Positioned for Cyclical Recovery**

- Policy backdrop/latest data/PMIs/consumer's financial position support expectation for modest recovery
- Fiscal cliff expected to be resolved but protracted impasse increasing tail risk¹
- Election results could have far-reaching implications for:
 - Specific sectors and long-term outlook but not expected to have material impact on cyclical outlook

■ **Euro Area: Growth Accelerating After Severe Lockdown-Induced 1st H Collapse**

- Re-openings/latest data/PMIs point to strong turnaround
 - North/South disparities wide in current year but all major EA countries expected to enjoy strong recoveries in '21²
 - Recent steps toward common EU bond/fiscal integration encouraging

■ **UK: Recovering From Exceptionally Weak 1st H**

- Retail sales returned to pre-virus level in June
- MPC left policy unchanged at August meeting
- Key questions remain to be addressed in Q4³
 - Expiry of furlough scheme/endgame for Brexit negotiations

1. Trump's executive orders – e.g., extra \$400/week unemployment benefit for next month and suspension of payroll taxes though yearend – may reduce urgency but ultimately compromise package expected. Democrats revised their package to ~\$2tr. and Republicans latest offer is for \$1tr. +.

2. Expected GDP growth rates in '20 and '21: Germany (-5.3%, 5.5%), France (-8.5%, 7%), Italy (-9%, 6%), Spain (-11%, 7%).

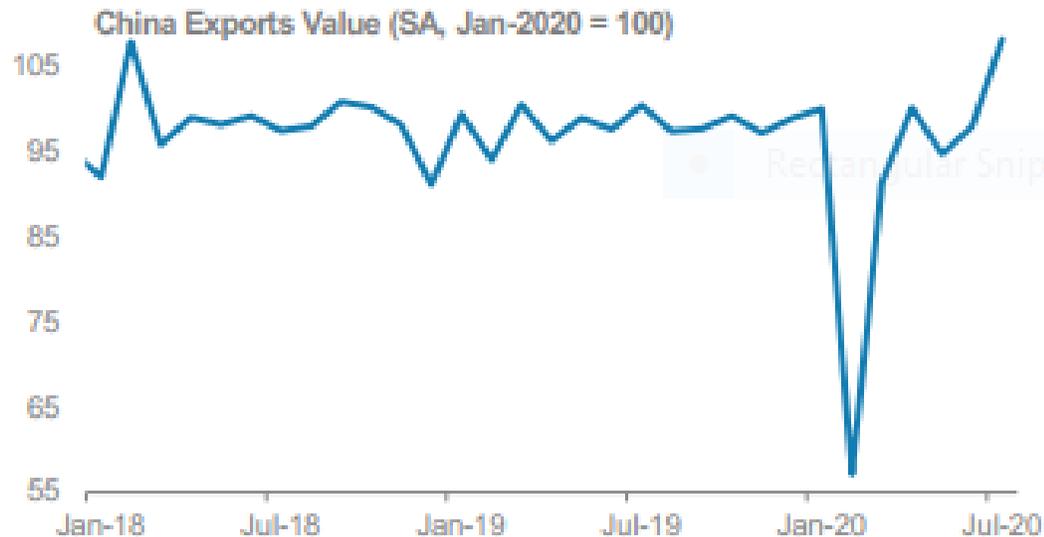
3. Assumption about Brexit outcomes key factor for 2021 outlook. For example, BoE's relatively optimistic Brexit outcome underpins their 9.5% GDP growth assumption for 2021 vs. 6.5% for SECOR.

Key Country/Regional Briefs

China: Returned to Positive Growth Trajectory After Weak Q1

- Early exit from 2020 recession attributed to:
 - Stimulative policies, albeit less aggressive than after GFC
 - Relative success in containing COVID
- Over the balance of '20 and in '21 China is expected to benefit from:
 - Strong export and infrastructure performance and ...
 - Continuing supportive policies¹

China's Exports



Source: Customs, Haver Analytics

China's Vehicle Sales



Source: CPCA, CEC, MS

1. 1. The PBC has indicated that accommodative credit policies will continue, with targeted support for SME

Selected Country/Regional Forecasts

	GDP Growth %		
<u>Major DMs</u>	<u>2019</u>	<u>2020</u>	<u>2021</u>
US	2.2	-5.2	2.7
Euro Area	1.3	-6.5	6.3
UK	1.5	-9.0	6.5
Japan	0.7	-6.0	2.5
<u>Major EMs</u>			
China	6.1	2.0	8.0
India	4.9	-4.0	8.0
Brazil	1.1	-6.5	3.5
Russia	1.3	-5.0	4.0

- 2020: Covid-19 recession severe hit to every major country/region
 - China's official data suggest subpar growth for full year following steep Q1 decline
- 2021: Robust growth rates forecast for most major countries...
 - But economic activity not expected to exceed 2019 levels in most countries.

Source: SECOR Forecasts

Identifiable Cyclical Risks (ex Covid-19)

Risk	Current Assessment
<ul style="list-style-type: none">▪ Inflation<ul style="list-style-type: none">– Output gaps at highest levels in 75+ years▪ Debt Levels<ul style="list-style-type: none">– Public debt – Raised to record peace-time levels to combat recession/potential long-term growth constraint– Household debt – Considerable deleveraging post-GFC– Business debt – Pre-pandemic business debt levels seemed manageable in low-rate environment. Post-pandemic sizeable share of US corporations have interest expense burdens that exceed cash flow¹▪ US-China Relations<ul style="list-style-type: none">– Rising US-China tensions expected to subside post-election but potential hit to business confidence	<ul style="list-style-type: none">– Inflation not a significant cyclical concern– Debt more nuanced issue<ul style="list-style-type: none">• Unprecedented public debt warranted to combat historic recession• Consumer debt limited concern• Increasing business debt defaults likely but limited systemic risk– US-China tensions bear watching

1. Recent NY Fed paper concluded a “sizable share” of US publicly listed corporations faces a potential credit crunch. Entertainment, hospitality and food businesses, hard hit by restrictions and decreased travel and dining services, particularly vulnerable.

Identifiable Cyclical Risks (ex Covid-19) – cont’d

Risk	Current ¹ Assessment
<ul style="list-style-type: none">▪ Upcoming US Elections<ul style="list-style-type: none">– Biden favored to win Presidential election – pledges significant tax, spending and regulatory changes²– Implementing tax and spending plans would probably require flipping 3 senate seats and eliminating filibuster rule for all legislation– But President has considerable control over regulatory policies– Potential mail-in ballot controversy	<ul style="list-style-type: none">– Proposed policy changes could have far-reaching effects on specific industries/companies with winners and losers– But effects of planned spending and tax increases should be largely offsetting in context of cyclical GDP forecasts
<ul style="list-style-type: none">▪ EM External Positions<ul style="list-style-type: none">– Recent IMF paper contends that given EMs more balanced external positions, required post-crisis adjustments likely to be smaller than in prior crises. Despite this relatively sanguine outlook, some countries at risk³	<ul style="list-style-type: none">– Possible surge in mail- in ballots tail-risk of contested election outcome– EM external debt in relatively sound position but some countries bear watching

1. Recent NY Fed paper concluded a “sizable share” of US publicly listed corporations faces a potential credit crunch. Entertainment, hospitality and food businesses, hard hit by restrictions and decreased travel and dining services, particularly vulnerable.

2. Biden’s spending proposals include \$2trillion plan to combat climate change to be spent over 4 years and a \$700bn “Buy American initiative”. His tax proposals include raising corporate tax rate from 21% to 28% (GS analysts estimate this would be a 12% hit to 2021 S&P 500 earnings) and increasing taxes on wealthy including returning top-personal rate to 39.6% and, increasing social security and capital gains taxes for high income earners. Proposed Medicare and drug payment plans could also affect hospital and pharmaceutical industries.

3. EMs with a higher share of commodity exports and high dependence on tourism and remittances are likely to see the largest deterioration in their external balances.

Pulling It All Together

- **Pandemic Initiated Extraordinary Chain of Events**

- Vertiginous, synchronous collapse in global economic activity¹
- Aggressive and prompt policy response/widespread lockdowns
- Far-reaching changes in social interactions including way we work, recreate, shop, educate over children, and worship
- Resources committed to developing vaccine and antibodies unprecedented

- **Global Recession Beyond Trough/Uneven Recovery Underway**

- Consumer spending lifted above recent peaks by policy support and pent-up demand
- Manufacturing expected to exceed pre-pandemic level in few months
- Covid-19 continuing headwind /expected to slow but not reverse the fledgling recovery
 - Lockdowns still in place but less stringent than few months ago
 - Recent outbreaks in Spain, France and US hotspots underscore need for continuing vigilance

- **Policy Backdrop/Economic Indicators/Halting Covid-19 Progress**

- Consistent with cyclical outlook that calls for:
- Global economic activity returning to its pre-pandemic level by YE '21
 - Latest vaccine news suggests vaccine risk skewed to upside
 - Other identifiable risks potential bumps along path to recovery

1. Global GDP dropped at ~15.5% in 1st H of '20, four times as large as GFC decline

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