



What Surprises Might 2021 Have for Us?

Key Private Bank Investment Center

“It’s tough to make predictions, especially about the future.” - Yogi Berra

We will soon publish our 2021 Outlook, which begins with a review of our 2020 Outlook. While we did not foresee the worst healthcare crisis in over a century, the worst economic decline in over ninety years, the fastest thirty-plus-percent market decline followed by the quickest recovery in stock market history, and the deepest racial divide in over fifty years, we did pose two “more extreme” scenarios that could unfold over the coming years. Paradoxically, we note, these scenarios have seemingly been hastened by COVID-19 and now command attention.

We labeled the first of these two scenarios “a new productivity paradigm” in which artificial intelligence, machine learning, cloud computing, and other innovative technologies could lift the economy to a higher plane of growth while simultaneously keeping a lid on inflation.

The second scenario we envisaged was “a new economic paradigm” — an era in which monetary policy reaches its limits. In this scenario, interest rates fall to zero while fiscal deficits and government spending surge similar to what transpired from the mid-1930s through the latter part of the 1940s. This would ultimately sow the seeds of inflation and heighten the need to incorporate new investment tools to enhance and protect one’s overall portfolio. These tools will be highlighted in our forthcoming Outlook.

For now, however, as we reflect on the unprecedented nature of 2020 and ponder the year ahead, our Investment Center has identified the following surprises that may surface in 2021. We hope you find these provocative, and we wish you good health and good fortune in the years ahead.

Possible Surprises in 2021

COVID/Pandemic Implications

Vaccine Development

- American ingenuity moves at breakneck speed to answer the call for a COVID vaccine as Moderna and Pfizer both use messenger RNA technology to win FDA approval. The fact that this technology has never successfully been used to develop a human vaccine in history is remarkable; especially surprising is that in less than a year, not one but two vaccines appear likely to succeed in eradicating this pandemic. - Curt Siegmeyer

Education & Households

- The post-pandemic shift in higher education accelerates. The value proposition of college has come under scrutiny with the forced virtual learning experience caused by COVID-19. Since 1985, the cost of a degree has more than doubled and the difficulty in paying back student loans is massive. Advances in technology allow for cheaper alternatives without the traditional campus experience, and we suspect that more alternative learning programs will emerge in this space, placing additional pressure on higher education. - Pat Grady
- Household formation accelerates triggering a baby boom. Birthrates in the US have been declining since 2008 when the Global Financial Crisis resulted in a major economic downturn. The ensuing high unemployment rate led to people postponing household formation, and the quarantine and work-from-home measures have led many to rethink their priorities. Since the lockdown began, many young professionals have abandoned downtown

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apartments and moved to the suburbs, resulting in a housing boom not seen since the mid-2000s. As the economy reopens and unemployment starts to normalize, household formation is likely to pick up further. As 2021 begins, it is very likely that flexible hours and remote working will become the norm and the catalyst behind a new baby boom. - Ather Bajwa

US Politics and Markets

Politics & Inflation

- President Biden enjoys a successful first year with bipartisanship not seen in decades. Congress passes a significant infrastructure bill that serves as a boost to employment and further strengthens the economy. The Fed contemplates raising interest rates. - Linda Kelly
- The Republicans win both runoff seats in Georgia leading the markets to expect gridlock until the next mid-term election. However, President Biden surprises the markets by quickly succeeding in building relationships with the Senate opposition in Congress and passes major legislation concerning infrastructure and energy. - Mike Sroda
- Five- and ten-year TIPS breakeven match the Fed's 2% inflation target. Inflation is currently below the Fed's target, but it edges higher as the economy recovers. - Rajeev Sharma

Climate Change & Energy

- Primarily due to decreased transportation as a result of COVID-19, US greenhouse emissions experience the biggest drop on record, falling to a level not seen since 1983. Momentum builds for significant policy changes, including a return to The Paris Agreement. - Claire Lofgren
- Crude oil exits 2021 above \$60 per barrel, and Energy is the best performing sector in the S&P 500 Index. With the global economy set to rebound sharply once vaccines become available, it becomes apparent to market participants just how much damage was done to US upstream production capabilities. Demand increases significantly, and the slow reaction function of producers causes prices to rise more than the consensus expects. Equity investors who have shunned the Energy sector for ESG and other reasons are forced to chase performance, further driving rotation into cyclicals. - Steve Hoedt

International Markets

China & Emerging Markets

- After years of slowly opening its economy and stock market to investors worldwide, China nationalizes Alibaba and Alipay. Such a takeover would roil markets on the level of the Russian takeovers in the late 90s. Volatility skyrockets and risk premiums spike but soon normalize due to positive developments regarding vaccines. Economic activity resumes, featuring trade and tourism, and emerging markets outperform given their cyclical nature and attractive relative valuations. - Don Saverno
- After skirting the issue for years, MSCI — the arbiter of universally accepted financial benchmarks — announces that China has graduated to developed market status after having been labeled an emerging market country since 1996. Because China represents nearly half of the current emerging market equity index, MSCI announces a phased out/phased in approach. At the same time, MSCI announces an expansion of Chinese equities for inclusion in its indexes. As a result, China's prominence within global equity market benchmarks grows substantially. A backlash ensues, and some question whether America's hegemony within the global financial system may be at risk. - George Mateyo
- President Trump's hostility toward China was the centerpiece of his foreign, economic, and trade policies. The new Biden administration will likely continue on this path. While we can expect the Biden White House to employ a more diplomatic tone during its negotiations, the probability that the new administration might pursue a more conciliatory policy is low. President Trump's plan of tackling China was largely based on a go-it-alone position, whereas a Biden government is expected to take a more strength-in-numbers attitude to challenging China. President Trump's tariffs remain in effect, and President Biden likely uses these as bargaining chips to extract concessions on trade, environment, intellectual property rights, and US access to Chinese markets. - Ather Bajwa

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The Middle East

- Growing out of the current Arab-Israeli peace process, a new united Arab Republic could be created. The United Arab Emirates and Bahrain will be added to the republic, and Oman, Kuwait, Egypt, India, and Sudan may also decide to join. There's a possibility Lebanon would feel pressured to join, but it is not likely that Iraq would unless it splits into pro-Israeli and anti-Israeli states. In that eventuality, the Sunni and Kurd portions of Iraq could potentially be included in the alliance. But all eyes will be on Saudi Arabia and whether it joins the new Arab Republic, which would be a potential game changer for the Middle East. - Cindy Honcharenko
- Saudi Arabia has three kings in one year. King Salman of Saudi Arabia dies or abdicates in favor of son Crown Prince Mohammed bin Salman. Saudi Arabia announces a historic peace deal with Israel, following similar peace deals announced between Israel and the UAE and Bahrain in 2020. Israel and Saudi Arabia lead a coalition and decisively attack military/nuclear targets in Iran. King Mohammed Bin Salman is assassinated in Saudi Arabia by Shia loyalists. - Justin Tantalio

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