IRISOS
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Q 02 / 2019

Quarterly Investment Review and Outlook

Quarterly Report – Q02/2019

At a glance

Review – 2nd quarter of 2019

1. The interest rate story

- In our previous quarterly report, we mentioned that some Central Banks would consider a renewed QE action or might consider a preemptive interest rate reduction to kickstart the economy and avoid the risk of a recession.

  However, the consequences of such potential shock therapy are uncertain. On one hand, consumer confidence is on the rise, the rate of inflation is low, and interest rates are barely above 0%. On the other, the benefits of taking drastic action are not measurable, and an eventual failure would be difficult to explain. Yet, a comprise of "do what the market does not expect and act carefully" could generate the required impetus.

2. US Growth

Excellent US jobs data for June was released on July 4, 2019. Yet, May's report was weak, with employment rising just by 75,000 units and average hourly earnings growth slowing to 3.1%. We believe that for now the interest rate trajectory is clear—with precautionary moves to offset trade-induced slowdowns in growth, interest rates are most likely to be revised downwards. Conversely, future solid unemployment figures could cause investors to reduce the outlook for further cuts over the coming year.

3. Europe

- US writer Mark Twain once wrote, "You may forget where you buried the peace pipe, but not where the battle ax is." The same logic could apply to Europe; everybody knows what it will take to "make Europe great again," but no one is willing to begin the work, and each country is questioning whether or not its neighbor will benefit more most recent argument over who would become the next ECB Chairperson is a perfect example of what a great—and united—Europe is not supposed to do.

4. Global economic outlook

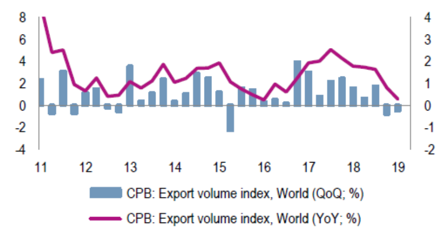
- All major asset classes delivered vibrant returns in the first half, thanks to shifts in the US-China trade dispute and Fed policy, which played out in three distinct phases. The meeting between Presidents Trump and Xi resulted in a truce in the US-China trade dispute, and while there is not yet a resolution, a plan for moving forward appears to be in place. Trade negotiations and forthcoming Fed meetings are pivotal policy events for the second half. We remain tactically overweight in equities with a regionally selective approach, and hold a number of countercyclical positions to protect against downside risks.

5. Consumption:

- **Are global consumers holding up?** Manufacturing has come under pressure in recent months. Many companies are delaying fixed investment spending amid uncertainty over trade. In contrast, consumers and services have been areas of relative strength. A range of service sector PMI readings—including from China, the Eurozone, and Japan—will indicate whether these sectors remain vibrant.

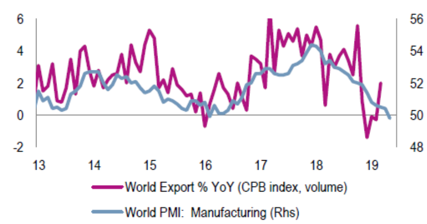
- We believe investors should stay invested and diversified to remain positioned for long-term market growth, particularly if recession risks decline and the cycle looks like it could extend. However, investors should also position themselves to protect against potential market risks.

Global exports are slowing down



Sources: Bloomberg, Natixis

... in this is truly reflected in the PMI



Sources: Bloomberg, Natixis

Key concerns

We have identified at least nine known potential sources of risk that could impact the market in the second half of 2019 and throughout 2020. These include the following:

Breakdown in US industrial activity

Possible causes:

- Renewed US stocks market consolidation
- EUR appreciates strongly
- Yield curve steepening

Sharp rise in commodity prices and in particular, energy

Possible causes:

- EUR GDP underperformance
- General risk-off by investors
- Yield curve flattening

Revival of the Philips curve (core inflation up)

Possible causes:

- Term premiums up
- Yield curve steepening
- Debt (Gov't, Corp., and Private) sustainability issues

Re-Introduction of custom tariff/trade war:

Possible causes:

- Disruption of industrial activities across the globe
- Higher prices for consumer staples
- Stock market corrections (based on lower EPS expectations)

Increase in HY credit spread and subsequent increase of default rates

Possible causes:

- US stocks down
- Wider credit spreads for HG issues
- Volatility up

Downturn in Chinese economic activity

Possible causes:

- Emerging market downturn
- Commodity prices up
- Forced liquidation of US Treasury, accompanied by a weak USD

Unexpected increase in US public deficit and sudden increase in twin deficit

Possible causes:

- Term premiums up
- US downgrade
- Weak USD

Outlook 2019/2020

Global

The first half of the year has been a positive one for investors, with strong returns across all major asset classes. Total returns for US and EMU equities were 17% and 15% respectively. US investment grade (IG) bonds returned 9% and their high yield (HY) counterparts 10%, while European IG and HY bonds delivered mid to high single digit percentage returns. In emerging markets, total returns for equities were 10% and 9% for USD-denominated sovereign bonds.

This performance was driven by shifts in Federal Reserve policy and investors' growing understanding of the context of the US-China trade dispute. Overall one has to look the trade dispute within the context of the broader trade system and its point of view. For example, in 2018, the total trade volume (merchandise and services) was about USD 25.28 trillion, whereas the US-China trade war only concerns about USD 300 billion—a fraction of total trade!

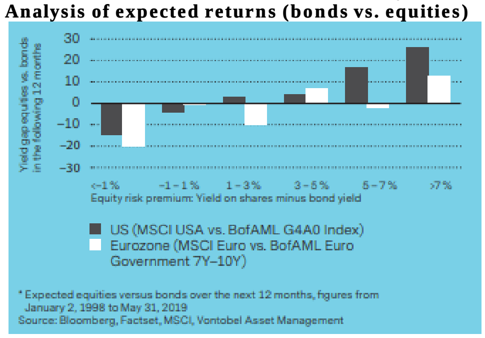
Equities remain attractive relative to bonds, with a global equity risk premium of 5.8% as compared to a long-term average of 3.5%. However, global equities have positively performed by 15% this year and absolute valuations based on the global price-to-earnings ratio are close to their 20-year average. In our base case, we expect markets to edge higher, but developments in trade negotiations and the outcome of the July Fed meeting are pivotal and may mean a less favorable end to the year.

We also would like draw investor's attention to the fact that in the trade war, time plays in favor of China. Regardless of Fed actions, the US president is unlikely to allow any worsening of trade tensions, as he will not wish to enter the re-election campaign with the smudge on his record of having obtained no concessions. In this environment we believe that investors should stay invested and diversified to remain positioned for long-term market growth. Not maintaining exposure to equities would mean betting against the Fed and the market. Since 2009 and the financial crisis, the Central Banks have generally succeeded at pivoting the right way.

Since the major economies are more or less synchronized, we would expect some coordinated actions to dissipate recession risks. Indeed, our baseline scenario considers an extension of favorable market conditions well towards 2025, naturally with some minor corrections along the way. Favorable market conditions mean, for instance, that corporate earnings are expected to rise despite headwinds on the back of increased efficiencies. Given this, companies related to IIoT should benefit above market average and are therefore particularly interesting.

We are positioned for this possibility by adopting a strategic overweight in equities and a regionally selective approach. In terms of currency movements, we consider that the USD will play a key role for investors; some 70% of global trade is settled in USD; it may therefore be opportune to consider a currency exposure along this line.

Risk-on still warranted, but visibility is low
Analysis of expected returns (bonds vs. equities)



1. Americas

Economic activity in the US is still robust; while there is risk of a recession, we strongly believe that the FED will navigate to avoid one. The length of the present business cycle is longer than average, and there are multiple reasons for this: a) a renewed supportive monetary policy, b) a business cycle that is in sync with the rest of the world, c) a tax deal that is still showing some support for ongoing spending and capex, and d) relocations (on-shoring), which are promoting US-based investments. Given the excellent consumer sentiment, an eventual rise of interest rates should be immaterial for the most exposed sectors, such as the consumer staples and discretionary sectors, utilities and ultimately, REITs (as a sub-sector).

We do maintain our positive stand on US equities, especially given the prospect of a suitable solution for both parties in a new Sino-American trade agreement. Corporate resilience remains strong (see Q1), but the potential disruptive effects of a US-China segmentation are largely unknown and pose an asymmetric risk (especially in the techno sector). After the rally at the beginning of the year, valuations are relatively high, yet the overall context is fragile A strong political statements may quickly shed light on the matter and provide the new direction for the market.

In a study conducted by Natixis, the question of sector re-allocation while the US is approaching a recession was examined. If their assumption is correct and a recession is coming, it may be opportune to perform the following arbitrages for equities:

(1) Long defensive (consumer staples, healthcare, telecom, utilities) vs. cyclicals (discretionary consumers, energy, industrials, basic resources)
(2) Large cap vs. small cap, since US small caps are now highly leveraged

Investment solution:

- Higher commodity prices: John Deere (agricultural equipment), Cummins (duty trucks and engines)
- Aerospace: Boeing and Honeywell (turn-around, specific industrial engineering and construction)
- Energy: Baker Hughes, Apache, and Schlumberger (higher energy prices result in higher capex, which should lead to higher future revenues)
- We are vigilant regarding Intel, Broadcom, Texas, and Qualcomm because each of these companies generates more than 50% of its revenues in Asia. These companies are therefore most impacted by the trade war in the short- and long-term, regardless of its resolution.

2. Europe

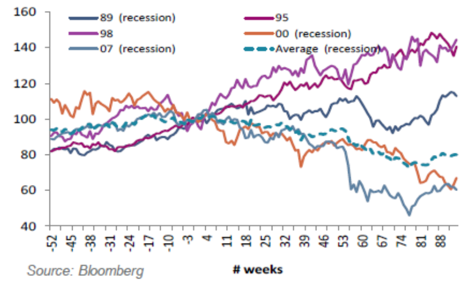
We are moving from a defensive tactical positioning to a more cautious strategic positioning by shifting back to negative on European equities. We thus acknowledge the growing asymmetry of macro and political risks.

We now assume a “No Deal – Managed” solution to be the most appropriate way forward for the new UK PM. Brexit has a direct impact on more than 1 million jobs across Europe. Still, although this is an important figure, one should not overestimate the eventual consequences for companies on both sides of the channel; after all, there has been ample time to plan and test BCP. In addition, we are not ignoring the recurrence of the Italian risk in the short run. With a new European Parliament only just taking shape, we do not believe major changes will take place rapidly. Even so, the healing process will take time and therefore it is appropriate to be on the lookout for companies that have a clear value proposition for their customers. Quality and high dividend stocks should perform better during periods of concern.

Investment solution:

- IIoT: ASML (Economy 4.0)
- Empowering Consumers: Adidas, Kering, Volkswagen
- Materials: Covestro AG and DSM
- M&A: E.On, AMSL, AB Inbev

S&P 500 performances in different economic situations:



Take-away:

- Equity index progressed significantly ahead of the first interest rate cut
- Monetary cycles preceding a recession have followed by a decline of the index over 2-year period
- Monetary easing cycles not followed by a recession (1998 and 1995) saw the S&P 500 go on to appreciate sharply. In this respect, there are analogies also with 2016, when the Federal Reserve announced at the start of the year its intention to mark a pause after its first interest rate hike end-2015.

3. Asia

More than ever, China has become the swing factor. The slowdown of global growth over the past year despite massive fiscal stimulus in the US, along with the still-supportive monetary policies in the advanced economies, illustrates that China is a key driver of the global cycle. The Chinese government's deleveraging campaign—which weighed down business and property investment—and the negative fallout of the trade conflict with the U.S. contributed to a slump in global trade growth. In turn, this slump dragged down business confidence and investment around the world, particularly in export-oriented economies in Europe, Asia and EM.

So far, there are few signs that the global trade cycle has bottomed out, and we see EM growth as still in sync with the rest of the world. However, with China upping the ante on stimulus, and a new trade deal between the US and China in the making, there is a good chance that global growth will stabilize and then pick up moderately later this year.

One reason for our cautious optimism on a recovery of global growth later this year is the easing of global financial conditions since the Fed's dovish pivot at the start of the year. Another factor is that China has recently stepped up the pace of fiscal and monetary easing.

As a result of the lingering US-China trade discussions, much of China's economic stimulus is directed at consumers and small businesses via tax cuts, because these are the two hardest hit groups. However, since the start of the year, China's policymakers appear to have shifted from carefully "irrigating" perceived future growth sectors of the economy to "flooding" the entire system in an effort to prevent a hard landing.

In this context we favor companies with high quality defensive growth, since they are expected to benefit most, whatever direction the economic environment should take.

Investment solution:

- While investing in EMA is still unpredictable, there are a few opportunities which benefit from a dual investment structure: DM and EM. While developed market companies offer better investor protection, emerging markets have a higher upside potential than DM. Product XS1677440361 reflects this in full.

- **Investment Idea** The credit linked note reflects the performance of the reference debt (senior) of Bombardier Inc., due January 2023. The equity part is linked to the performance of the South Korean, Taiwanese, and Australian stock markets (equal allocation). Performance participation is at 121%. During the lifetime of the product, there is no market reallocation.

The challenges of Ms. C. Lagarde

EU heads of state have come up with a list of nominees to head European institutions. Christine Lagarde, chairwoman of the IMF, has emerged as the (dovish) compromise candidate for the European Central Bank. If confirmed, she would be the first ever ECB president without any experience in monetary policy. Nevertheless, we think her management experience, including her time as chairwoman of the IMF, would help her to lead the ECB as an institution.

Ms. Lagarde will raise the profile of the ECB, making it a more politically-savvy institution that takes its message directly to the people. However, policy innovation, the trademark of her predecessor, may be relegated and Lagarde will likely face many challenges along the way.

- The ECB is aiming to counteract a prolonged period of economic weakness with relatively limited firepower. The key policy rate is already -0.4%, so the central bank has less leeway than does the Federal Reserve.
- The Eurozone economy is highly sensitive to global demand, which has been undermined by concerns over the global trade situation. This may improve following the recent truce. However, the new orders component of the composite global purchasing managers' index is currently at just 52—barely above the 50 level that separates business expansion from contraction—and has been trending lower. The ECB has also downgraded its Eurozone economic growth forecasts. It sees the rate of expansion as significantly lower than in the US.
- Eurozone inflation has been persistently weak and remains low, with core prices (excluding food and energy) rising just 1.3% in April.

The ECB nominations are still tentative, as there is a high risk that the European Parliament will reject the current nominees. But whatever the outcome, we continue to expect the ECB to remove the tightening bias from its interest rate forward guidance on July 25, and we expect no rate hike next year.

And while Mrs Lagarde is considered a qualified candidate, her success in gaining the job wouldn't necessarily make Europe a more attractive place to invest over a tactical horizon. Within international developed market stocks, we continue to recommend an underweight to Eurozone equities, where market gains have outpaced economic fundamentals. Eurozone stocks still aren't cheap, at 13.6x 12-month forward P/E, versus our fair value estimate of 12x.

Finally, it is worthwhile crediting Mr. Draghi, himself a PhD economist whose MIT (Massachusetts Institute of Technology) dissertation on economic theory and its application provided us with his famous 2012 commitment to "do whatever it takes." Ultimately, the philosophy saved the stability of the Euro during the debt crisis and made it possible for the union to hold together.

In contrast to Mr. Draghi's wide array of experience Ms. Lagarde has no real monetary and central bank management experience, and that could be an issue. Under Mr. Draghi's leadership, he provided a clear path forward, to the extent that only minor details had to be ironed out during policy and related meetings with economic and political leaders. We therefore expect that political pressure, especially from the French side, will dramatically increase moving forward.

Keep the change!

New research from Natixis' team that created the Equity Market Volatility (EMV) tracker and the Economic Policy Uncertainty Index confirms what many clients have been telling us for the past few years: Policy news, as compared to macroeconomic news, is increasingly driving market volatility.

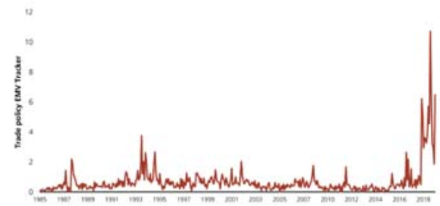
In particular, researchers find that trade policy concerns have massively increased as a source of volatility. According to the research paper since March 2018, trade policy has gone from "a virtual nonfactor in US stock market volatility to a leading source."

Market volatility has not been abnormally high during the Trump administration, and the relative shift to policy factors versus macroeconomic factors is part of a long-term multi-decade trend. Even so, the above research indicates that investment analysts cannot afford to simply "focus on the fundamentals."

The new reality in light of the above fact is that investors cannot afford to merely focus on the fundamentals. Policy uncertainty will continue to play a role in day-to-day market volatility, creating risks and opportunities for investors.

That brings us to models and flows. Most investment companies do run a fair value model for the pricing of assets classes. Based on macroeconomic news flow and in-house scenarios, price levels are projected. However, where is the value of these global models when global uncertainties play a broad-based role in the day-to-day volatility, reflecting the price building for a specific segment? Are we making a mistake by looking at data that was built on historic data analyses alone?

Trade policy related volatility measure



When politics muddies the waters!
There have been a total of six recessions since 1974; it may well be that the next one is not due to economic slow-down but rather political issues!

Here are our considerations: Around the globe and particularly in developing market countries, unemployment rates have been decreasing ever since the end of the FT. In some countries, such the USA, the unemployment rate is at the lowest level since 1970. In fact, the current US economic cycle is the longest ever—since 1854.

Still, that same blue-sky scenario does not exist everywhere. In Japan, Germany, Sweden, Italy, and even Switzerland, GDP growth in Q2/19 was less than in Q1/19. Ultimately, this is damaging, as consumer confidence is high and the same countries also benefit from declining unemployment rates.

The good news is that companies did relatively well on order flow and capacity management. This means that with modern technologies, companies begin correctly anticipating natural market fluctuations, and this is reflected through resilient consumption.

Unfortunately, more than ever, the economic cycle is disturbed by political agendas for the purpose of re-election. The US-initiated trade war, for example, was implemented on the back of national security and was not based on job concerns as had been done previously. In its aftermath, China, Russia, Turkey, Brazil, India, did initiate trade wars too. Will Europe follow suit? It appears a domino effect is underway.

Another example of a politically motivated disruption is the increased tension in the Middle East. The US has an interest in keeping the region in a constant state of unrest. After all, a barrel price of above USD 50 is required to keep most of the country's oil and gas exploring companies alive. Remember, the US economy's stake in this business sector is critical. During the past 10 years, US oil and gas companies have invested more than USD 100 billion into states such as North Dakota, Texas, New Mexico, all of which strongly vote Republican.

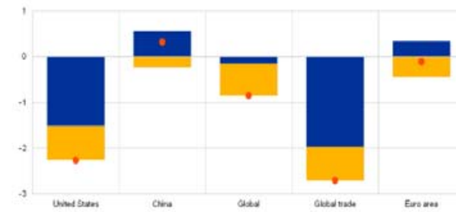
The same considerations may be developed for Saudi Arabia and Russia, both of which need a barrel price of around USD 70 to balance out their budgets. The embargo on Iran is a self-serving action for these governments, but it does not serve consumers.

The point is that governments which act with a populistic approach always interfere with the economy and the decisions of industry leaders, and now they are attempting to influence Central Bank matters!

An excessive politicization of economic matters could influence consumers behavior over the next few quarters, and even more than initially expected.

Consequently, it may well be that we will experience a recession that is not caused by the economy overheating and crashing, but rather by politicians taking irresponsible actions for which they will never be held accountable.

Trade war escalation:



Legend:
Blue: Trade
Yellow: Confidence
Red: Overall

What are our preferences?

Key takeaways for 2019/2020

General:

1. Bond prices are reflecting an interest rate cut
2. US-driven economic cycle to continue (on-shoring, hopes for a rapid solution to the trade war)
3. QE to be reduced to the lowest possible level in G-7 nations
4. Inflation likely to stay below expected levels
5. Energy prices on the rise as ME concerns could escalate.

Americas:

6. Interest rates on the decline for the first time since 2009
7. Tightening financial conditions and drag on the economy could lead the FED reversing the intended course of action
8. US Equities appear to be expensive; share buyback generate some kind of self-entertained value appreciation of around 10-12% per annum
9. Consensus view is that GDP growth is over-estimated (tax reform special effects are most likely trigger-based)
10. USD is expected to lose some of its present attractiveness, in favor of EM currencies
11. US companies' EPS expansion will soften in 2019, but will still be above 10%

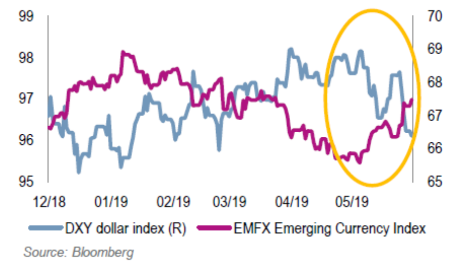
Asia:

12. China's industrial production to slow down despite renewed economic stimulus (QE)
13. Global investors have consistently underestimated the Chinese government's ability to control events through regulation. In this respect, we believe that financial leverage is well managed and that bad debtors will be cleaned out in a smooth manner
14. US Fed is expected to weaken the USD; this should help emerging markets in general, but in particular their currencies should perform better than expected.

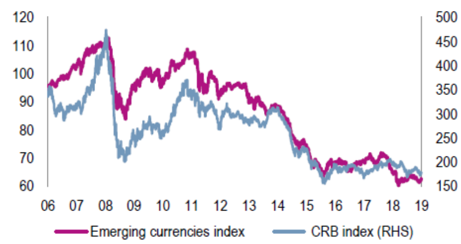
Europe:

15. New European Parliament is more fractured than ever
16. Industrial production growth is excellent, yet PMI should unfold much better during times of optimal conditions
17. Unemployment rates are decreasing further and soon to reach full employment, considering that structural unemployment is on average about 8% in Europe.
18. Wage growth is on a positive track and consumer sentiment is stable
19. The weakness of the EUR is not helping industries to accelerate
20. Macro indicators point to a stronger €/$ (targeting 1.25 in 12 to 18 months)

Emerging market currencies are anticipating a weaker USD:



... but weak commodity prices are a drag:



Secular Trends

For this edition, we have decided to forego the traditional sector reports and their respective investment opportunities. Instead, we have developed a number of key analyses covering strong secular developments. We do hope you enjoy the read.

Technology

How do tech giants deliver outsized return?

Networks and platforms reign within high tech, media, and telecom. Understanding the sector's dynamics is increasingly important for both investors and institutions.

The ability of technology, media, and telecommunications (TMT) companies to create value is extraordinary. Specifically, TMT companies generate more economic profit (net operating profit less the cost of capital) than any other sector of the global economy—that is more than the combined economic profit of companies in aerospace and defense, automotive components, and food products!

What makes TMT so profitable is a combination of unique factors, but most notably, continuing advances in digital technology that open new markets, stimulate growth, and provide opportunities for companies to seize leadership positions and gain enormous value.

A closer look at value creation across the TMT sector reveals a distinctive pattern—significant concentration of economic profits is created by a few companies in up to three sub-sectors. More importantly, because of a rapidly rising middle tier group, the top value-creating companies are continually challenged, and this is creates the necessary turnover to generate ever-increasing achievement.

The question is, are industries apart from retail (Amazon), transportation (Uber), and lodging (Airbnb) developing and implementing digitally enabled business models? We may yet be in the early stages of full digital enablement, but one fact is crystallizing: Digital technologies shape value pools. This is becoming increasingly relevant across the global economy.

Based on MCK[1] research of more than 2,400 publicly traded companies around the globe, it is estimated that the economic profit generated by TMT companies grew a hundredfold—$200 billion—from 2000 to 2014. Some 70% of the companies in our sample generated economic profits in the 2010–14 period, up from 45% in the 2000–04 period. Moreover, each of the five subsectors that make up TMT (software, consumer electronics, media, telecom and cable operators, and tech infrastructure and services providers) was among the most profitable of the 59 industries analyzed.

The fastest profit growth was among software companies and companies with software-enabled business models, such as Amazon, Tencent, and other "platform" enterprises. The economic profit of value-creating software companies grew nearly six fold from the 2000–04 period to the 2010–14 period (rising from $5.8 billion to $33.7 billion).

For the 2010–14 period, the top 20% of companies captured 85% of the economic profit in TMT industries. The top 5% of companies—including tech giants such as Apple, Microsoft, and Alphabet (Google's parent)—generated 60%.

Enter the challengers—the competing middle class!

Although the largest companies in TMT capture the majority of the economic profits, they also nurture a middle tier of companies that benefit from their networks. A growing group of middle-tier companies (in the 20^{th} to 80^{th} percentiles in terms of economic profit) is leading the sector in profit growth. Middle-tier companies' economic profits grew by a factor of 10 between the 2000–04 period and the 2010–14 period, or more than three times the growth rate of the technology giants.

[1] McKensey

Key figures for Europe:

GDP growth (%, change yoy)
2019: 1.3
2020: 1.3

CPI (%, change yoy)
2019: 1.2
2020: 1.4

Target values:
Present fair value (DJStoxx600): 386
E12 months value (DJStoxx600): 410
Upside potential: +6.2%

Key economic ratios:

P/E 2019 (E):	14.2
P/E 2020 (E):	12.8
Div. Yield 2019:	3.5
Div. Yield 2020:	3.8

Most likely next short-term move:

DJStoxx600	flat/down
DJStoxx50	flat/down
SMI	flat/down
DAX	flat/down

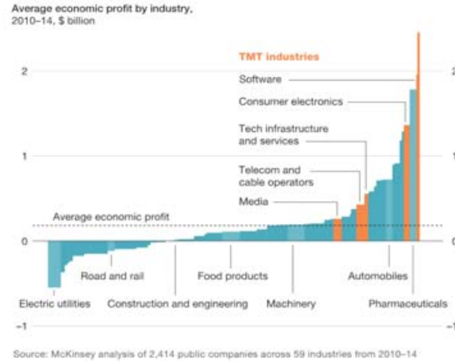
Key names to look at:

Strong intellectual property:
- Roche
- Novartis
- Amadeus

High competitiveness:
- Siemens
- Daimler
- Gemalto
- Richemont
- Swatch

Sustainable dividends:
- ABN-Amro
- Imperial Tobacco
- Altria
- Philip Morris

Which subsectors add most value?



This rising middle tier includes software and cloud services companies, as well as many players with software-enabled business models. Middle-tier players include Box, Baidu, Netflix, and WeChat. We see the growth of these and other middle-tier companies.

Against a background of rapid innovation in digital technologies, which range from artificial intelligence and automation to IIoT, we are convinced that the TMT sector will continue to outperform other sectors in the long run. The digitization of the global economy has only just begun.

Even so, research suggests that TMT leaders need to carefully monitor how profit pools are shifting. Furthermore, they must be willing to act decisively if they want to remain among those generating outstanding levels of economic profit.

In particular, tomorrow's leaders should build capabilities in four areas:

- Establishing a strong position in one or more software or services platforms and building ecosystems around platform offerings to ensure access to the fastest- growing profit pools.
- Continuously evolving business models to avoid being disrupted by well-funded start-ups or existing TMT leaders expanding to new markets.
- Replicating successful platforms in underpenetrated or ring-fenced areas (markets or white spaces), taking proven business models to markets with greater headroom.
- Using programmatic M&A to develop capabilities to quickly attack new, rapidly growing profit pools or cannibalize profit pools in other industries. Companies will need to continually reinforce and broaden their capabilities despite limited leeway to develop such talent organically, particularly in areas such as cloud and analytics, where competition for talent is intense.

Taking our data set as a whole across all industries, nearly 60% of companies that were in the top quintile in terms of economic profit in 2000 were still in the top quintile 15 years later. However, in TMT industries only 45% of the top players from 2000 remained in the top quintile in 2015. Over the same period, when compared to the average across all sectors, 25% more TMT companies that had started at the bottom of the pile ended up in the top quintile.

Today, some of the biggest value shifts are occurring in software, as well as in software- and Internet-enabled services. Traditional software players such as Adobe, Symantec, and SAP have high profits but low market cap growth. Compare this with the medium growth in market cap of software-as-a-service players such as Box, Salesforce, Slack, and Splunk, or with the more than 100% market cap growth from 2012 to 2015 of companies such as Alibaba and Amazon (which are providing digital services beyond TMT). Additionally, we see value shifting from the infrastructure layer to applications providers as software applications increasingly enable and monetize the unique functionality demanded by customers.

Companies mentioned in this section:

USA		**Asia**	**Europe**
Adobe	Netflix	Alibaba	SAP
Alibaba	Salesforce	Baidu	
Amazon	Slack	Tencent	
Apple	Splunk		
Box	Symantec		
Google/Alphabet	WeChat		
Microsoft	Box		

Implications for investors

There is a rule of thumb for tech, media, and telecommunications: Shares in leading companies are only expensive the day you buy them (with the obvious exception of when markets go through a prolonged global price consolidation phase).

Key figures for USA:

GDP growth (%, change yoy)
2019: 2.8
2020: 2.0

CPI (%, change yoy)
2019: 1.5
2020: 1.9

Target values:
Present fair value S&P 500: 2964
E12 months value S&P 500: 2964
Upside potential: - %

Key economic ratios:

P/E 2019 (E):	17.7
P/E 2020 (E):	15.9
Div. Yield 2019:	2.0
Div. Yield 2020:	2.1

Most likely next short-term move:

S&P 500	down
Nasdaq	down

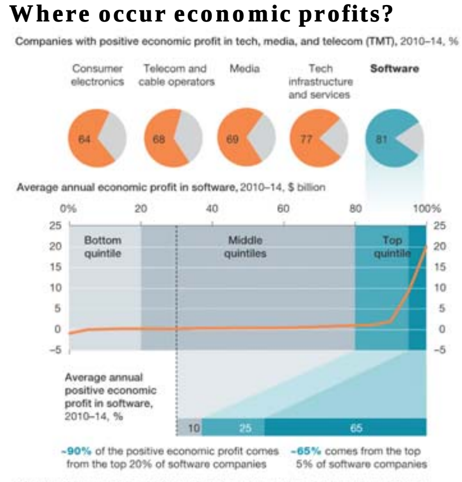
Key names to look at:

Strong intellectual property
- VISA
- Mastercard

Technology:
- Microsoft
- Micron Technology
- Salesforce
- CyberArc
- Apple
- IBM

Financials:
- VISA

Where occur economic profits?



Energy

The energy sector is in transition; these are the key opportunities and threats.

Renewable energy is the future—for industry, for the environment and for society as a whole. It is high on the global agenda and crucial to meeting the world's carbon-reduction goals. Moreover, renewable technologies are not just clean, they are also fast becoming the cheapest form of power generation in many markets.

Today's energy industry is in transition and is being shaped by a set of powerful global trends:

- Growth in global energy demand is slowing
- Demand for electricity will grow seven times faster than demand for other energy sources
- Renewables are becoming cheaper than fossil fuels
- Storage is increasingly being used to handle variability (demand and supply management)
- Coal and oil will peak in the next two decades, while gas will grow moderately

How can investors take advantage of these secular changes?

Europe has long been a hub for renewable energy. Modern wind energy was born in Denmark, home of Vestas, the world's largest wind-turbine manufacturer. Solar energy took off following Germany's Renewable Energy Sources Act in 2000. Renewables are central to the strategy of Europe's largest energy companies, including Denmark's Ørsted, Germany's RWE, Norway's Equinor, Portugal's EDP Energias de Portugal, Spain's Iberdrola, and Sweden's Vattenfall.

Yet despite the presence of so many powerful energy companies, strong financial business partners are relatively scarce. A few financial investors are financing large capital-infrastructure investments. Other investors—including asset managers such as Allianz Global Investors and Macquarie Infrastructure and Real Assets, as well as a number of pension funds—are offering funding for corporate bonds or equity stakes in pursuit of more regulated returns.

From 2018 to 2025, about 40% of annual global energy investments will go to renewable energy. This translates into an investment of almost €300 billion—almost three times the investment in fossil-fuel generation. Another 40% of investments will be used to develop transmission, distribution, and storage infrastructure, and only 6% will be spent on nuclear generation.

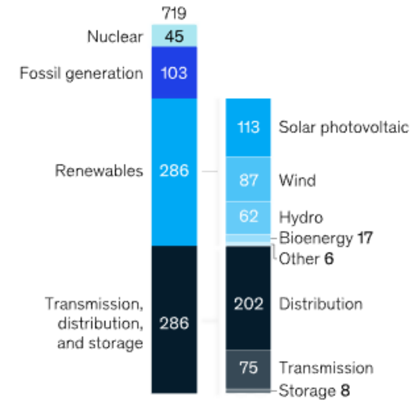
In Europe, most of the renewables investments will take place in France, Germany, Nordic countries, and the United Kingdom. The projects will be a mix of regulated and subsidy-free capacity in which generators are exposed to merchant price risk. To make a successful transition to an industry with high financing needs and routine exposure to wholesale markets, the renewables sector will require financial expertise to complement its deep knowledge of the energy industry.

Financial institutions seeking to provide this expertise should first define a business strategy that plays to their strengths, such as capitalizing on their competitive capital-cost advantage over traditional energy companies. They will also need to boost their capabilities—for instance, by building teams that include industry experts in power markets, renewables, and large capital-expenditure programs, as well as investment professionals, and by establishing connections in cross-border power markets. In addition, they will need to ensure they have state-of-the-art tools and resources in areas such as long-term merchant-risk management.

Several European utilities, including Alpiq, E.ON, RWE, and Vattenfall, have restructured their portfolios to separate their businesses into traditional and new energy. The March 2018 asset swap among RWE, E.ON, and Innogy is indicative of the changes underway. The deal enables RWE to intensify its focus on generation and become Europe's third-largest renewables company, with more than 60% of the region's capacity

Renewables will represent 40 percent of average annual global energy investments to 2025.

Estimated average annual power-sector investments globally,[1] € billion,[2] 2018–25



Note: Figures may not sum to listed totals, because of rounding.
[1]IEA new-policies scenario.
[2]Converted from original in 2017 dollars, using average exchange rate.
Source: Bank for International Settlements; *World energy outlook 2018*, IEA, November 2018, iea.org

for low-carbon generation. Meanwhile, E.ON is acquiring RWE's majority stake in its renewable-energy subsidiary Innogy and shifting its profile toward the grid and customer solutions, in order to meet the need for specialized downstream energy providers with the scale and efficiency to drive much-needed innovation.

After a dormant period, M&A activity in the energy sector has picked up considerably. The restructuring that is underway involves not only consolidation among European companies, but also strategic M&A deals by Chinese corporations and financial M&As by more aggressive financial-sector investors, such as Australia's Macquarie and Canada's OMERS Infrastructure Management.

Global Energy Perspective 2019

All this activity creates a need for financial advisers with knowledge of the energy sector. For example, when RWE carved out Innogy, financial institutions acted in an advisory role in what was the largest IPO in Germany in more than 15 years. The deal allowed RWE to separate its growth business from its legacy operations and create two entities with distinct portfolios and a clear strategic focus. RWE also gained more flexibility in dealing with funding needs, since it could use its shareholding in Innogy as a liquid asset. Further value was unlocked through the separation of Innogy from RWE's nuclear line of business, which carries unknown future liabilities because of the German government's requirement for the company to decommission nuclear power plants at its own cost.

As energy companies—especially renewables players such as EDP Energias de Portugal, Enel, Iberdrola, Ørsted, and RWE—expand their global footprints, they offer a range of opportunities for major partnerships. Financial sponsors are playing an increasingly important role as balance-sheet owners of renewables assets, holding ownership of half of the M&A deals in the energy industry between 2015 and 2017, and more than two thirds of the onshore wind projects in 2017.

Investors can provide capital at attractive returns; in fact, returns from energy projects are more attractive than those from traditional project and opportunities such as government bonds. But to capture these opportunities, investors must be willing to enter unknown territory and take time to understand the business. That involves building up knowledge, analytic skills and insight to identify opportunities as they emerge.

Investment opportunities

We are in process of setting up an investment theme with strong focus on social responsibility, capturing opportunities such as those in the field of energy transaction. Once the theme is made public, it may be accessed via our Fast-Track process and via our shop at shop.irisos.ch

Financial Services

The range of new FinTech companies is breathtaking! What are the emerging models and where are the investment opportunities?

1. Lending: These companies focus on fast digital decision-making processes. They may be the original fintech category, but they continue to expand and add new lending verticals. The now public personal loans provider LendingClub and business loans provider OnDeck paved the way. Bread and Affirm are focused on point-of-sale financing, Square Capital focuses on merchant cash advances, and Prosper and Avant offer personal loans, while SoFi has expanded from student loans to personal loans. Kabbage and Funding Circle seek to innovate in the business loan arena, Tradeshift is taking on supply-chain financing, and BlueVine and Fundbox have built digital-first factoring companies, while Petal and Figure are focused on credit cards and HELOCs, respectively.

2. Mobile-only lending: Tala and Branch both seek to offer microlending over mobile devices in developing countries. These US-based companies make real-time loan decisions dynamically by using every piece of information they can gather from the customer's mobile phone; public reports note that the companies use text messages, contacts, and hundreds of other data points to make underwriting decisions.

3. Demographic-focused products: A new set of companies are developing demographically-focused products. Some examples include True Link Financial's elder fraud protections, Finhabits' saving focus for Latinos, Camino Financial's lending for Latino-owned small and medium sized businesses, and Ellevest's product design for women. Each of these companies goes beyond branding to design products from scratch with unique uses and features in mind. Similarly, Brex offers cards tailored individually for startups and ecommerce companies.

4. Digital-first neo-banks or digital attackers: Neo-banks frequently start with a blank sheet and build a retail banking experience from there. Aspiration, Chime, and Varo all operate now in the US, and there are reports that UK-based Monzo and Revolut, as well as Germany's N26, are actively seeking to come to the US. Some are layering lending onto their platform, while others plan to continue to focus on debit accounts.

5. Trading: Robinhood provides free stock trading. To generate income, the company sells the retail order flow and seeks thicker margins through digital first-processes. Similarly, TransferWise offers its retail users the mid-market exchange rate and makes money through transparent fees, made possible by lower operating margins at scale. Many of the above-mentioned neo-banks also make money through debit exchange and deposit brokering—which would not normally be particularly lucrative, but which can make sense when built on greenfield digital infrastructure.

6. API platforms and ecosystems: API platforms are designed with software developers in mind as the target customer. Much of the financial services innovation in this space is concentrated in payments: Stripe, Braintree, Adyen, Credorax, and WePay are on the merchant-acquiring side, Marqeta is focused on card-issuing, and others like Ingo Money offer push payments. API platforms for lending are also emerging, most notably with the Kabbage Platform.

7. Bank-as-a-Service: BaaS is a type of developer platform that is designed to empower fintech companies. To access the payments system and store money, all fintechs need some form of banking partnership. Some banks are turning this idea into a product. Several US banks are enabling digital attackers and neo-banks, gaining access to inexpensive deposits and a rich source of fee income in the process. Treasury Prime sells BaaS enablement software to multiple banks, while SynapseFi (working with Evolve Bank & Trust) and Cambr (working with Lincoln Savings Bank) build API platforms for neo-banks through singular partnerships. At the same time, The Bancorp Bank, BBVA Open Platform, and Green Dot have all launched their own BaaS platforms.

8. SaaS for bank cost reduction: A new wave of fintech companies are building infrastructure for banks and selling their software-as-a-service to reduce the cost and improve the quality of certain critical functions. These fintechs include Numerated, Blend, Roostify, and Finvoice for lending, Droit and Alloy for compliance, and RiskSpan for data management, among others.

9. Blockchain for infrastructure cost reduction: A new generation of blockchain firms are focusing on specific use cases to improve the cost and functioning of core infrastructure. R3, Symbiont, and Blockstream are all working on general solutions, while The Interface Financial Group and ConsenSys are targeting supply chain finance, and Global Debt Registry and Securitize are focused on capital markets.

10. The Wildcards—tech companies in financial services: Banks are data and technology companies. Record-keeping and ledgering, transaction tracking, identity, and predictive modeling are all fundamental concepts in both banking and software engineering. It makes sense that many high-tech American digital-first companies are turning their eyes to banking, as their East Asian counterparts have done over the past decade. Apple's launch of a credit card may represent a new phase for branded fintech experiences. The launch of shopping on both Instagram and WhatsApp, testing payments in India, represent steps by Facebook into financial services. Google Pay's launching in India and conducting experiments in Southeast Asia show an increased focus in the space as well. All these products and more point to a more serious focus on fintech for those companies, which have the resources and partnership possibilities for scaled impact, not only in international markets but in the US as well.

Investment opportunities

Some major players such as Facebook and Google are entering aggressively into the payment and lending market. For the time being, all other banking sectors seem to be preserved because of the high threshold for aggressive disrupters. We believe that new competition will arise from inside the market by individuals with a strong view on the market behavior. Remember, finance and health are probably the exception wherein the traditional marketing and business approach cannot be easily replicated.

Key figures for Asia:

GDP growth (%, change yoy)
2019: 5.8
2020: 5.9

CPI (%, change yoy)
2019: 2.4
2020: 2.6

Target values:
Present fair value MXAPJ: 658
E12 months value MXAPJ: 720
Upside potential: +9.4 %

Key economic ratios:

P/E 2019 (E):	14.0
P/E 2020 (E):	12.3
Div. Yield 2019:	2.7
Div. Yield 2020:	2.9

Most likely next short term move:
MXAPJ down

Key names to look at:

- Tencent
- Alibaba

Industrials

Debunking the autonomous-vehicle paradigm

Imagine a future in which fleets of autonomous buses and shuttles effortlessly navigate through city streets to their designated stops. Ridesharing services dispatch shared autonomous vehicles (AVs) to pick up multiple passengers traveling along similar routes. Robo-taxis drop off passengers at subway stops for the next legs of their trips. Many traditional car owners decide they no longer need personal vehicles because shared-mobility AVs fulfill their needs. Road congestion drops because there are fewer vehicles.

Now imagine an alternative future in which everyone who once owned a traditional car instead has an AV. Many people without licenses also purchase AVs for their personal use, even though they either have not had a car for years or never owned one. Passenger-miles traveled could increase by up to 25 %. AVs circle while waiting for their owners to finish shopping or running errands if no parking spaces are available, or else they run a variety of unmanned errands, ranging from delivering groceries to picking up dry cleaning. City streets become even more gridlocked.

Which scenario will emerge worldwide? The answer will depend, in part, on whether public and private stakeholders invest in the infrastructure required to enable shared autonomous mobility (SAM). This issue is currently getting relatively little attention, since companies, investors, inventors, and policy makers are rightfully focusing on issues related to the AVs themselves, such as safety. However, stakeholders will soon begin discussing AV-infrastructure requirements in more detail as they undertake capital planning. Some of the decisions they make now could determine whether SAM gains traction.

Autonomous-vehicle infrastructure at a crossroads

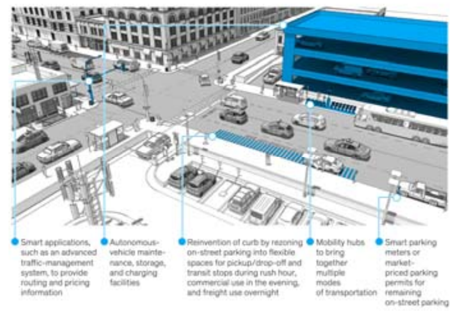
With the right infrastructure to enable shared mobility, multi-passenger robo-taxis could account for 500 billion miles traveled on US roads—about 9% of the total—by 2030. By 2040, robo-taxis could account for 50% of all miles traveled. In addition to reducing traffic congestion, vehicle emissions could plunge as a result. And since AVs make fewer errors than human drivers, transportation fatalities could decline. Real estate previously dedicated to parking could be repurposed into commercial or residential properties. These improvements combined could produce economic benefits totaling $850 billion annually.

Keeping infrastructure assets in good shape

Only 41% of US roads meet the requirements for a "good ride," as scored according to the International Roughness Index. Potholes, poor striping and other maintenance issues not only create safety problems, but also present challenges to AVs. If governments consider adopting faster, more efficient approaches to improving basic infrastructure, they could reduce these problems. In addition to improving safety and reducing costs related to vehicle wear and tear, their infrastructure investments would enable AV pilot testing. For example, maintenance teams could restripe poorly marked streets with six-inch-wide, highly retroreflective lines to help prevent cars from wandering off the road. These lines bounce light back to the original source, resulting in greater visibility than reflective lines.

Even after initial repairs are made, road maintenance will be a major and ongoing concern. Deteriorating roads are both a nuisance for human drivers and a major impediment for AVs. To promote higher levels of autonomy, mapping software must be highly accurate—for difficult intersections, for instance, it will need to record dimensions down to the inch. If roads are deteriorating and road markers are fading, the physical structure of the intersection will constantly change. Even minute alterations could thus impede the growth of AVs.

There are several infrastructure options transit leaders could consider to promote shared ridership.



McKinsey & Company

Shaping the future of global GDP

Share mobility may not be an immediate concern for all of us. However, planning ahead is required, because as much as 30% of the global GDP is related to the car industry. Here are some key take-aways:

- Support facilities: Autonomous fleets will need large support facilities to service and charge AVs. Even so, global maintenance costs will be about 35% lower than they are today.
- Staging areas: To avoid congestion, AV fleets and shared-ride services need locations where they can idle when picking up or discharging passengers. One solution might involve converting existing parking spots into staging areas accessible to multiple fleet operators.
- Transfer of technology: For a traditionally built car, the dominant technology and up to 40% of vehicle's value is either located on US soil or in Europe. In contrast, the technology for autonomous cars (up to 30% of a vehicle's value) is located in Asia!

Possible developments to come

The ramifications of the shift to autonomous cars are important, in terms of the activities/jobs to be affected, the infrastructure/technology required to enable the shift, or the financing of the project.

New business models will most likely emerge with the following developments:

- Collecting charges: This will be done via smart meters and IIoT enabled applications connected to 6G.
- Infrastructure maintenance: To enable a smooth process across a broad geographical region, the infrastructure must be a 100% reliable. This will require new technologies of building and maintaining the infrastructure, resulting in the creation of new jobs and activities.
- Operating the fleet: AV fleets could be managed based on the models implemented for bike-share programs.

Foreign exchange

Currencies

The turnaround in Central Bank Policies.

There are only a few indicators regarding the longer-term direction of exchange rates. If one can be mentioned, then it is the purchase power parity. Yet, apart from indicating whether that currency pair is overvalued or undervalued, analysis does not tell us much else.

At present, the market seems to be waiting for more clarity on a number of subjects, such as consumer confidence, wage growth, global economic activity, Brexit, trade war, EU politics, and others. In general, global economic concerns normally result in an USD appreciation, followed in turn by a decline of USD interest rates (to bring things back into balance).

Where do we stand at present?
Business climate surveys in the US, Europe and China still paint a picture of increased uncertainty. The US-China trade dispute is experiencing repercussions and reducing willingness to invest. Increasingly, growth and inflation both appear to be declining. Against this backdrop, the major central banks, the Federal Reserve in Washington and the European Central Bank (ECB) in Frankfurt, have put monetary policy normalization on hold for the time being. Market speculation about interest rate cuts has been increasing.

Energy/Commodities

Crude oil: Volatility will remain high due to the following factors:

- Uncertainties regarding global demand, associated with the trade war and the slowdown in manufacturing activity
- Supply that is expected to remain tight; supply from Iran and Venezuela fell sharply in May
- Most strategists consider that the recent sell-off increases the probability that OPEC+ will extend its production quotas

Gold: The market maintains a positive strategic bias, as global risks increase and real rates should remain low. Gold exposure will be a good hedge against the continuation of the risk-off mode and heightened uncertainty (trade war, Italy, Brexit). But we are not following any black-swan hedge strategies, because they are not warranted from a fundamental point of view.

Industrial metals: The market is subject to a structurally tight supply. There is a negative bias due to the weaker economic activities in China. Also, DM manufacturing PMIs are projecting lower factory activities going forward. It remains to be seen whether this decline is due to a structural adjustment or a reversal of the trend experienced since 2009.

Target values in 3 months:

EUR/USD:	1.1000 - 1.1500
GBP/USD:	1.2500 - 1.3000
USD/CHF:	0.9750 - 1.00

Target values in 12 months:

EUR/USD:	1.20 - 1.25
GBP/USD:	1.25 - 1.35
USD/CHF:	1.00 - 1.05

Purchase power parities:

EUR/USD:	1.30
GBP/USD:	1.59
USD/CHF:	0.92
EUR/CHF:	1.20

Most likely next move:

EUR/USD	up
GBP/USD	down
USD/CHF	flat

Target values in 3 months:

Oil (brent):	\$60 - \$70
Gold:	\$1,350

Target values in 12 months:

Oil (brent):	\$65- \$75
Gold:	\$1,400

Upside potentials:

S&P GSCI	flat
Oil	up
Gold	up

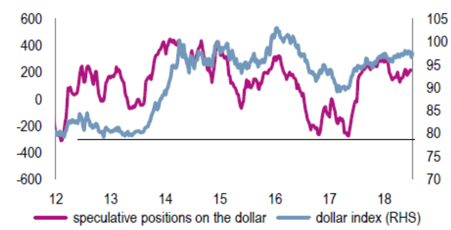
Next most likely move:

S&P GSCI	flat
Oil	up
Gold	up

Commodity related stocks:

-

The market is long USD



Source: Bloomberg

Asset Allocation Preferences – July, 2019

Sector	Region	Fundamental	Risk/Reward	Investment case
Basic Materials	Americas			Trade war: We believe that the subject was much overheated as less than 15% of the global trade volume is concerned. Until full clarity is shed on the matter, and with China as the boiler room for the world's economy, the basic material sector is clearly exposed to volatility. Observations now suggest that companies start de-engaging from Asian production facilities, which in turn reduces the burden for the Chinese government to act.
	Europe			
	EM			
Consumer Staples	Americas			Organic top-line growth is accelerating more than expected, while companies are passing on raw material inflation. Also, the combination of low interest rates and strong balance sheets provides a platform to engage in M&A. In personal care, M&A remains a powerful trigger, while sales momentum is strong.
	Europe			
	EM			
Consumer Disc.	Americas			The two main subsectors—automobiles and luxury goods—show sharply diverging trends. The car sector's net profits are suffering from rising costs and slowing sales growth, while the luxury goods sector has benefitted from double-digit organic growth and high profit margins. But the benign environment for luxury goods is as good as it gets, in our view, and elevated valuations leave ample scope for a sector rerating.
	Europe			
	EM			
Energy	Americas			The key takeaway from this sector is as follows: a) Operators now prioritize disciplined capital spending, with 2019's budget lower than 2018's budget. b) For a number of operators, growth was deemphasized in favor of returns and cash flow generation. c) Free cash flow yield (cash flow from operations less capex) is a metric that investors are looking to in order to gauge the investment merits of the operators within the energy sector, as well as versus other sectors within the broader market.
	Europe			
	EM			
Healthcare	Americas			Healthcare companies typically offer consistent earnings growth, high returns on capital, and growing dividends for income-seeking investors. We prefer companies with improving growth prospects, as well as self-help stories in med-tech. We have a large-cap bias, given the late stage of the cycle. On the biotechnology side, some late phase 3 projects were cancelled; we are expecting some more mean reversion to come.
	Europe			
	EM			
Financial Services	Americas			Improving economic growth across the globe, driven largely by still-healthy US consumers, is set to provide a good backdrop for financial services stocks overall. The main beneficiaries can be found within the segment of diversified financials, as they benefit from the secular shift (online payments framework, which enables capital optimization potential). European operators suffer from over-regulation.
	Europe			
	EM			
Industrials	Americas			In the 2018 downturn, industrial sector-related stocks suffered most. Yet consumer sentiment is still strong around the globe; surprisingly, it even held up well in Europe, where consumers tend to react rapidly to changing conditions. With China entering into a new stimulus program, Germany, Italy, and the USA are expected to rebound most.
	Europe			
	EM			
IT	Americas			This sector's companies recently experienced significant volatility; although the sector's key areas (e.g., IIOT, connectivity, etc.) remain fully intact, we nevertheless expect volatility to remain high. The sector is currently trading with a Fwd PE of close to 18. This is in line with average premiums over the past two decades. Software and service companies are our preferred play, as they take advantage of recurring revenues.
	Europe			
	EM			
Telecom.	Americas			Telecommunications is a capital-intensive business; therefore, the most recent underperformance can be attributed to rising interest rates and still stiff competition for new customers. Given that a new infrastructure deployment is in the works (the upgrade to 5G), we would not expect the sector to suddenly start outperforming in a market-neutral environment.
	Europe			
	EM			
Utilities	Americas			Near-term attractiveness of the sector has changed. After two years of constant improvement of fundamentals, power producers benefited from rising wholesale power prices, a trend that is now expected to continue.
	Europe			
	EM			

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Sources:
Analysis and comments: Bloomberg, Reuters, Natixis, UBS, BNP-Parisbas.
Data and graphical items: Bloomberg, Reuters.

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Knowledge is power.