IRISOS

Knowledge is power.

Q 04 / 2019

Quarterly Investment Review and Outlook

According to a major recent report by Bank of America Merrill Lynch Global Research, the next 10 years will be a “peak decade” with a number of trends reaching an inflection point.

The last 10 years have been eventful, mostly shaped by the fallout of the global financial crisis and an excellent economic recovery that followed. But as the global economy gets set to enter a new decade, don’t expect some sort of return to normality, whatever that might be. With interest rates at historic lows, a planet that is heating up, deflationary pressures everywhere, a rapidly aging population, and so on, we are set to enter into a new paradigm.

Quarterly Report – Q04/2019

At a glance

Review – 4th quarter of 2019

1. **Retail sales and CPI**
   - Around the globe, retail sales and consumer sentiment remain surprisingly robust, and this on the back of an excellent job market.
   - Core inflation eased to 2.3% YOY – the second highest rate since August of 2005.

2. **US Growth**
   - It is expected that 2020 earnings growth will continue at the same pace as during Q4/2019.
   - The consensus view for the US growth rate is 9.6% – rather on the high side given the late-cycle status of the economy. We would expect a growth figure of around 6% – still reasonably high.
   - We continue to assume that there is no recession in the US.
   - Given the above, US equities still merit an overweight when compared to other markets.

3. **Europe**
   - Europe remains the weakest link among DM; this gloomy outlook is based on the negative impact of trade war (European companies have higher commercial exposure in EM than the US has, and they are therefore more penalized than US companies).
   - During the Q3 reporting season, about 1/3 of European companies reported earnings above expectation, while in the US, nearly 80% of companies performed better than anticipated. We expect this disparity to continue.
   - Finally, ongoing social unrest (e.g., gilet *jaunes* and pension plan reform) is not supportive of general consumer sentiment in the long run.

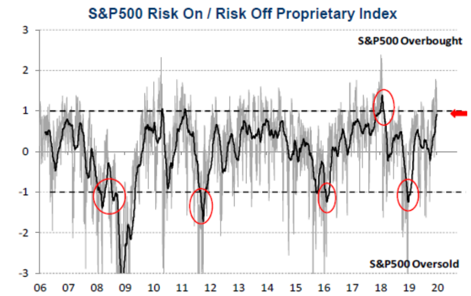
4. **Emerging Markets**
   - The global macro picture is expected to stay soft during the first half-year, followed by some pick-up supporting in the first instance DM.
   - We expect the trade war between the US and China to continue, though we expect that some agreements will be reached. Still, negotiations are unlikely to result in a substantial long-term agreement. The real concerns the US wants to address with trade sanctions lie elsewhere. Given this, roll-backs of newly implemented tariffs should not be expected.
   - Given trade tensions, Asian markets are expensive. EPS expansion is expected to reach double digits, but with a starting point about 1/3 below the top level.

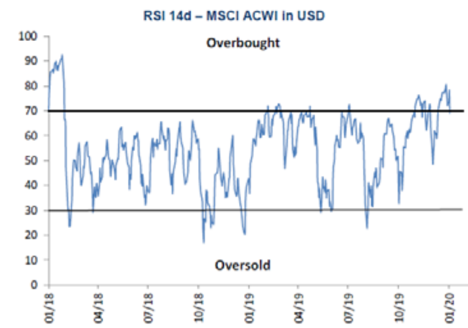
5. **US Elections – The Wild Card**
   - The lack of clarity regarding the trade war, along with the shift in spending, tax, and social policies make the 2020 elections a source of concern for the market. To gain edge, other subjects could be brought forward by the president at any time.

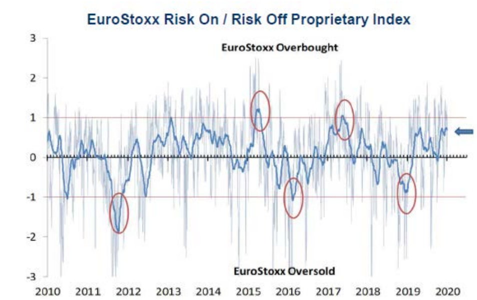
     In the past two years, investors were accommodated with above average volatility swings as a result of trade frictions. In the worst-case scenario, this was just about the hors d'oeuvres.

     While global economic activity is robust and well managed by companies throughout the entire economic cycle, the absence of a clear front-runner in the Democratic camp could result in a further polarization between the Republicans and Democrats, giving the market little time to adjust.

Risk factors suggest a slightly overbought market situation (charts 1 to 3)







Key concerns

The rules of the game are set by economic policies. Companies and investors have no control over levels of taxation, legal frameworks, borrowing costs, and trade agreements. However, based on historic events and the prevalent top-down conditions, one can still anticipate the state of the economy.

As highlighted in previous reports, the economy is relatively resilient and free of major issues. Even so, there is a rampant uncertainty as monetary policies have reached a kind of deadlock. The pre-requisite for new, real growth is inflation! This fact makes it almost impossible for any private or corporate investor to make long-term decisions, which in turn sustains the self-destructive process.

Breakdown in US industrial activity: PP-ratio[1]: <10%

Possible consequences:
- Renewed US stock market consolidation
- EUR appreciates strongly
- Yield curve steepening

DM-Recession to occur within the next 18 months: PP-ratio: <20%

Possible consequences:
- Save-haven currencies (USD, JPY, CHF) up
- General risk-off by investors
- Worsening of credit conditions, in particular for HY

Revival of the Philips curve (core inflation up): PP-ratio: <15%

Possible consequences:
- Term premiums up
- Yield curve steepening
- Debt (government, corporate, and private) sustainability issues

Increase in HY credit spread and increase of default rates: PP-ratio: <5%

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

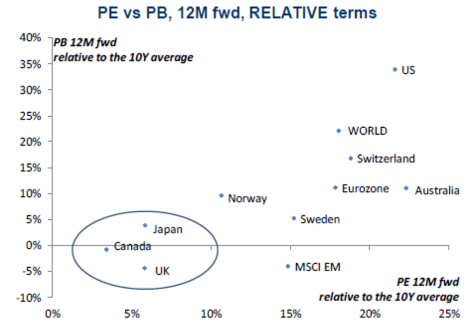
Downturn in Chinese economic activity: PP-ratio: <5%

Possible consequences:
- Emerging market downturn
- Commodity prices down
- Forced liquidation of US Treasury, accompanied by a weak USD

Unexpected increase in US public deficit, increase in twin deficit: PP-ratio: <15%

Possible consequences:
- Term premiums up
- US downgrade
- Weak USD

PE12FWD vs. Price to Book values – The US market is probably overpriced!



[1] PP-ratio: present probability ratio

Investment recommendations by type

1. Equities:

Short-term view: - Neutral/Positive

Medium-term view: - With recession risks still absent, we continue to prefer equities over fixed income. As valuations are stretched and long-term growth expectations are limited, the upside potential is limited.

Equity selections are expected to be even more key in 2020 than they were in 2019.

2. Bonds:

Short-term view: - Negative/Neutral

Medium-term view: - Be on the lookout for yield enhancement strategies! We continue to like this investment approach. On the back of fairly stable market conditions, we continue to expect these proxy strategies to produce considerable opportunities in 2020.

3. Credit:

Short-term view: - Neutral because of rich valuation

Medium-term view: - Strong overweight in corporate via short-dated investment grade bonds, coupled with a bonus strategy on defaults of x-over companies.

4. Metals:

Short-term view: - Neutral because of stronger USD

Medium-term view: - Neutral to negative: With political and monetary risks expected to dissipate over time, precious metals are expected to lose their status of refuge asset class.

4. Commodities:

Short-term view: - Neutral because of strong USD

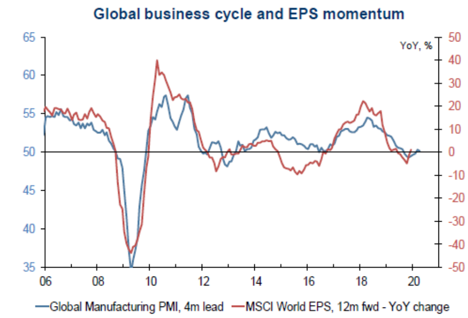
Medium-term view: - In the oil market, supply will outpace demand (because of lower economic activities). However, because the political landscape is unstable in major oil-production areas, this should keep up prices.

5. Structured solutions:

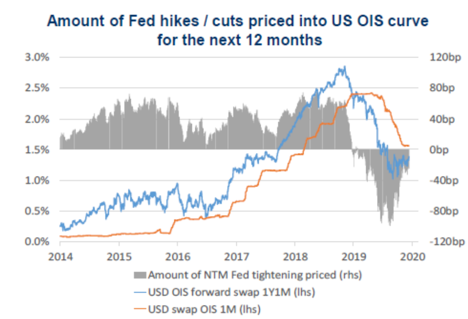
Short-term view: - In times of uncertainty, exploiting equity market volatility by means of conditional capital guaranteed structure appears to be an attractive opportunity, as compared to both fixed-income and equity markets. Recently launched structures include our "Premium Basket."

Medium-term view: - Longer-term investors might consider combined strategies including Credit "Main versus X-over." This strategy may be of particular interest in times of deteriorating credit and financial conditions.

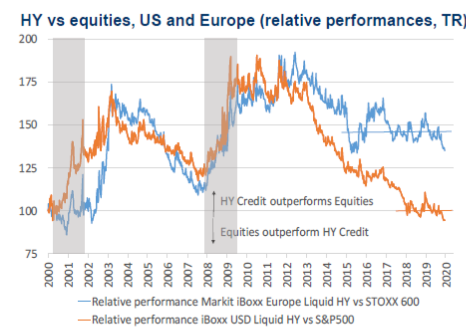
EPS Momentum again at average!



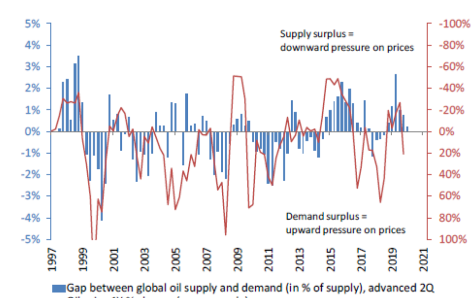
Fed hikes versus cuts: Expect the cycle to reverse



High Yield is performing extremely well – though for how long still?



Oil prices and the excess of supply vs. demand on the oil market – prices are rising while there is an oversupply!



Investment recommendations by theme

1. Globalization 2.0:

Short-term view: - Mixed

Medium-term view: - For years ahead, trade conditions between partners of different regions will be pivotal. In this context, the US-led trade war with China has abruptly halted Globalization 1.0. Near-term developments such as the upcoming US presidential election, the outcome of Brexit, and the reorganization of the European Union will affect the geopolitical backdrop.

In every process, there are two parties – a winner and a loser. The globalization 1.0 clearly demonstrated that there is no win-win situation. Globalization offered consumers goods at ever much cheaper prices, which was accompanied with huge job losses DM, particularly in the manufacturing sector.

The reversal of Globalization 1.0 will offer excellent investment opportunities.

2. From monetary policy to fiscal policy

Short-term view: - neutral

Medium-term view: - The next fiscal policy move is not expected to be accommodating (i.e., no tax cut is expected). Rather, one should expect specific measures to expand the fiscal burden on companies and private individuals. These initiatives should come along specific subjects and opportunities, such as green initiatives; following a textbook approach to analysis, this should lead to a degree of stimulus spending around infrastructure and environmental transitions.

3. Volatility

Short-term view: - neutral

Medium-term view: - In the past, event-driven sell-offs [e.g., EM debt crisis, collapse of LTCM (1998), TMT over-valuation (2001), retreat of energy prices (Q4/15), US-China trade war (Q4/2018)], have resulted in average market corrections of in excess of 10%.

At present, there are multiple triggers that could potentially disrupt the market. These events are unpredictable in terms of time. However, it is not overconfident to assert that any correction reveals new opportunities. In other words, market corrections in excess of 10% should enable investors to take a fresh look at available opportunities in a different context – a strategy we embrace.

4. Global order – a quick shift

Short-term view: - neutral

Medium-term view: - The rise of populism across DM and, to an extent, in EM is poised to enter into stage two. The populism occurs on the back of a more fragmented global disorder, which in turn fosters neither confidence nor long-term corporate engagements.

The lack of corporate engagements is highly unusual; such attitudes are typically only experienced after a period of recession. Therefore, we would expect this lack of engagement to fizzle rather quickly.

5. Transformation – ongoing paradigm

Medium-term view: - Transformation is by nature uncomfortable. More importantly, we are often reluctant to accept change because it implies an effort for which the expected payoff is in the unforeseeable future.

Yet, the upcoming transformation will open up a myriad of investment opportunities; however, taking advantage of them will require of investors a willingness to engage with the future rather than the past. Establishing a clear investment framework should help investors align valuable investment opportunities based on a given risk profile, while steering clear of common pitfalls. A simple comparison between the present and 2030 may crystallize a particular area of interest:

By numbers:

	2020	2030
# of people to move into suburbs/cities		790 million
# of workers in DM		-25 million
# of workers in EM		+470 million
# of 5G connections	5 million	6.5 billion
# of IIoT devices	10 billion	46 billion
# of Internet users	4.3 billion	7.5 billion
# of Megacities	33	43

By subjects:

	Ex-Ante 2020	Ex-Poste 2030
Population	Baby-boomers	Retires
Trade	Globalization	De-Globalization
Communication	Smartphones	Smart "X"
Wealth gathering	Concentrated	Redistributed
Monetary policy	QE	MP3
Environmental	A "concern"	Action
Geopolitical and economic center	US/Europe	EM
Wages >Prices for consumer goods	Declining	Low forever
Predominant currency	USD	?

Sources:
- Cybersecurity Ventures
- Ericsson
- UBS
- UN Population Division
- Vontobel
- World Bank

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5G – It's not just about speed

Every current economic player is subject to disruption by a new entrant, who will in turn be disrupted eventually by an even new model! The speed at which change is currently occurring is phenomenal, but this is just the beginning.

In absolute numbers, revenues derived from disruptive operations are still very low; in e-commerce they have just reached double-digits, and in finance and insurance, the very low single digits. For sectors offering the greatest opportunities, such as industrial production (automation) and healthcare, the trend is about to very modestly kick off.

Given the above, we see the digital transformation age as a theme expected to continue to deliver above-average prospects for the next two to three decades.

In 2019, performance development of technology related stocks was not exemplary. In fact, 2019 was a roller-coaster for most technology companies. Starting Q4/2018, stock prices came under pressure because of trade war concerns, new regulations and structural growth concerns. Consequently, because of the risk-off mode and fear, Investors dumped stocks instead of taking a more moderate thought-through process.

Because of short-term disruptive conditions, investors are advised to take a long-term view when it comes to technology investments, particularly in relation to disruptive technologies. While such investments are gaining traction, set-backs are common yet not prohibitive.

What are the major benefits of 5G applications?

The wireless industry is well known for its resilient ability to reinvent itself again and again. Starting in 1985, the industry sector introduced analog mobile voice service. This was followed by digital mobile voice services, texting, advanced signaling, and data transfers of up to 40 Kbps in 1990. Just prior to Y2K, 3G enabled internet access of up to 400 Kbps, limited streaming opportunities, and packet transfers. Some 10 years later, 4G facilitated internet access of up to 1Gbps, along with multi-media streaming and low latency.

Currently, 5G offers real-time streaming, network slicing, and data transfer 10 to 100 times faster than 4G. This enables for connected multi-tasking as latency (loading) times continue to shrink.

Major fields of application

Mobility
The availability of 5G is the missing puzzle piece for a truly hands-free experience. One can expect that driverless cars will enter into service between 2030 and 2040.

Entertainment
With 5G, downloading high-definition movies and related content will take only seconds. In addition, 5G will take center stage in the gaming industry. Cloud-based games will be the new norm, with multiple players around the globe sharing the same experience together.

Healthcare
5G will be the key enabler for healthcare to enter into the digital transformation phase. Different applications may be envisioned, from remote assisted surgeries and telemedicine to smart health. This sector is still in its very earliest stage; we would therefore expect the investment returns to be particularly high.

Manufacturing
Economy 4.0 is rethinking the entire manufacturing process, including supply management, transformation, inventory supervision, and delivery management. From an investment point of view, the manufacturing sector is the most interesting aspect of the process because the combination of digital, 5G, and robotics can eliminate inefficiencies.

Smart cities
Because computer power was lacking and slicing was not possible, attempting to manage highly complex infrastructures and operations was not possible until recently. The management of smart cities is typically an undertaking where slicing is required – customized software-based applications allow for the management of traffic safety, parking, power requirements, etc.

Agriculture
5G is truly disruptive for agriculture; simply put, the new technology will reframe traditional questions. Whereas farmers once asked “Can we grow corn?” the new question will be “What is required for corn to cultivated in a soft manner?” Massive computer power plus biological advances in exogens will allow for cutting-edge farms to improve performance, boosting productivity while making excellent use of agents.

Investment opportunities:

The range of 5G-beneficiaries is huge; it includes telecom sectors, 5G equipment makers, component makers (semis), and related service providers. Telecom operators may stand out as the likely winners (pricing power), but we believe the expected capex effort to be made by this sector will not be in line with the potential benefits. Beneficiaries are more likely to be found within indirect services, including internet platforms, 5G supply chain, semis, and consultancy groups.

Market-by-Market View

United States:

The American economy's resilience allows us to maintain a reasonably constructive view of the global economy. A near-term US recession still looks unlikely, although the growth forecast will slow from a steady 2.2% in 2019 to an uninspiring 1.6% in 2020. Even so, while growth is set to slow, healthy consumer spending and a robust labor market mean that a record period of economic expansion is unlikely to come to a dramatic halt.

The slowing global growth and uncertain political backdrop will continue to impact manufacturing and exports. Recent data suggests that management teams are more nervous, resulting in more subdued levels of business investment. In 2020, the US economy will also gain less of a boost from the aggressive fiscal stimulus measures which were put in place in the Trump administration's early years. Signs of distress in debt (personal and national) and deficit levels could also point to further weakness ahead.

Consumer strength
Although pressures have been building, consumers remain the driving force behind the domestic economy, accounting for around 70% of activity. Household demand continues to benefit from solid labor market fundamentals.

The unemployment rate recently fell to 3.5%, the lowest in half a century. We believe that the US economy is robust enough to generate jobs growth of around 125,000 per month in 2020, helping to maintain the multi-decade low in the unemployment rate. While pay growth has been less than economists might expect at this point in the economic cycle – slowing to 2.9% in September 2019 – it is still running comfortably ahead of inflation. The rise in real incomes has given consumers greater financial fire power, helping to generate robust retail sales.

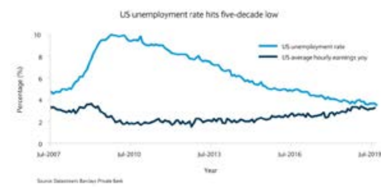
Trade hopes
Escalating trade tensions would most likely impede global growth further, thus reducing demand for US products and services. Additionally, rising producer and consumer prices would increase costs for businesses, resulting in the weakening of domestic consumption. Despite positive signs, the risk of a trade war hasn't disappeared overnight and any agreement remains vulnerable to an unpredictable President.

Presidential elections
The outcome of the 2020 presidential election will significantly impact the medium-term outlook for the US economy. While the Democratic candidate is unknown, there are likely to be significant policy differences with President Trump over taxation, climate change, regulation and international relations.

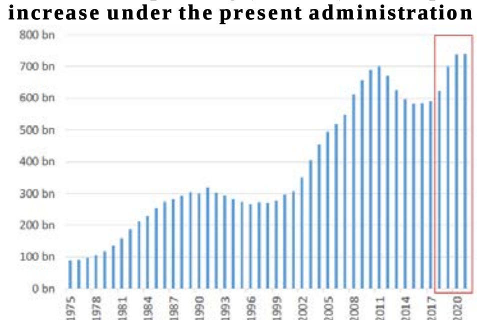
Measured rate cuts
The US Federal Reserve has embarked on "insurance cuts." These measured rate cuts reduce the risk of a policy mistake-induced recession and are expected to support growth prospects.

Lower rates cut the cost of financing, create a wealth effect (i.e., boost asset prices) and enhance business confidence. Future cuts are likely to be data dependent, but there's little evidence to suggest that the US central bank will need to rapidly slash rates in 2020. Thus, the US's relatively stronger growth profile and interest rate differential should continue to be a source of dollar strength. While dark clouds may continue to gather, the fundamentals of the US economy remain healthy. There is therefore little reason to believe this record period of economic expansion is about to end dramatically.

US Unemployment versus hourly earnings (YOY – 5y average)



US Defense spending (USD bn): a sharp increase under the present administration



Europe:

Will 2020 be the year when eurozone policymakers finally stop obsessing with balanced budgets and start focusing more on fiscal reforms to lift the region's lackluster growth prospects? Significant deterioration of Europe's growth profile over the past 18 months is sparking fears of a 2020 eurozone recession. The single market block is export-oriented; economies are therefore vulnerable to the slowdown in global growth, trade wars, Brexit uncertainty, and the manufacturing recession.

Accompanying the weaker external demand, Europe struggles with a broad range of internal disruptions. These include the "yellow-vest" protests in France and turmoil in the German auto sector. Meanwhile, Italy's budget battle with Brussels in 2019 resulted in subdued investment and restrained hiring.

Growth, not recession

While growth rates are expected to remain under pressure, we are not anticipating a contraction in 2020. Financial conditions are loose and consumer confidence remains resilient, buoyed by a falling unemployment rate. Recent data shows that eurozone unemployment fell from 12.1% to 7.4% in April of 2013 – the lowest unemployment rate since 2008. Additionally, pay growth is advancing at its fastest pace in a decade, supporting domestic consumption. While the US-China trade dispute has grabbed the headlines, President Trump has also been reviewing the US's relationship with the European Union (EU). And although a full-blown US-EU trade confrontation appears unlikely, we still expect some flare-ups (particularly US auto tariffs). While growth rates are expected to remain under pressure, we are not forecasting a contraction in 2020.

More dovish policy

The weaker growth backdrop has encouraged the European Central Bank (ECB) to ratchet up its policy response in another effort to stimulate growth, reflate the economy and generate jobs. The ECB cut the deposit rate to -0.5% in September (see chart). We anticipate further cuts, with the deposit rate at -0.7% by March. In addition, the ECB restarted its asset-purchase program and introduced measures to mitigate the impact of negative rates on the banking system in 2019. Along with these measures, the ECB has offered aggressive forward guidance and promised to keep rates low – or at least *lower* – until inflation persistently converges with its 2% target level – an objective unlikely to be met for the next few years.

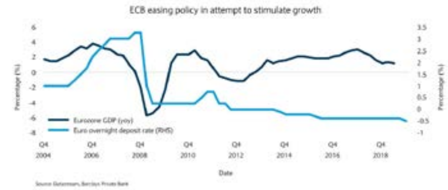
The ECB's measures, while supportive, are unlikely to be enough to radically change Europe's lackluster growth trajectory in 2020. Former ECB president Mario Draghi acknowledged this and encouraged Europe's political leaders to commit to the structural reform agenda and fiscal support.

Fiscal response

A wide-ranging package of structural reforms is required to promote growth and supplement monetary policy. These should include further integration of Europe's budget, fiscal and banking functions. Europe should also focus on increasing the flexibility of the labor market. Essentially, Europe needs to create a more competitive environment that drives up productivity. Early signs of possible fiscal support appear encouraging. Germany has announced plans to invest in a new climate change package and the Netherlands has announced tax cuts. However, the scope of the proposals and level of coordination are not currently enough to materially improve growth forecasts.

If European governments are determined to generate growth, they need to spend less time obsessing about balancing the books and devote greater efforts to the reform schedule.

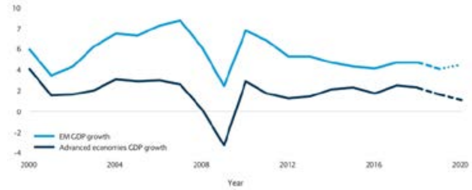
ECB easing policy in attempt to stimulate growth



Emerging Markets:

Will less restrictive policy from key central banks help set the scene for more buoyant growth in emerging markets (EM) next year? In 2020, EM will remain vulnerable to the vagrancies of the global economy. Moderated growth in the US, Europe and China will continue to result in reduced demand for EM products and services. The development of trade negotiations, sanctions, energy prices and domestic political conditions will also determine the fate of EM economies over the next year.

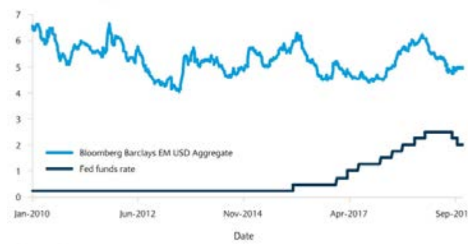
Emerging market (ex. China) growth rate se to pick up in 2020



Swings and roundabouts

While global growth has suffered from the trade wars, certain EM economies have profited by capturing US-China trade flows. Among those oft-cited beneficiaries of the trade diversion are Vietnam, Malaysia and Mexico. Rising tensions in the Middle East have led to concerns about the risk of a prolonged period of elevated oil prices. Spikes in energy prices may represent both a risk and an opportunity for EM. As a whole, EM Asian economies are importers of energy, while a higher oil price would benefit regions of Eastern Europe, the Middle East and Africa.

Emerging market debt (in USD) is attractive



EM have prospered from key central banks' 2019 pivot to policy easing, which has improved liquidity conditions. Inflation across most EM countries is low by historical standards, and is expected to decline further. This provides central banks with more room to ease policy and stimulate growth.

Encouraging prospects

After a specifically disruptive political backdrop for many EM during 2019, hopes of stability in certain key economies should help to provide a more stable backdrop in 2020. A re-acceleration in growth could be on the cards for economies whose fundamentals remain strong and will be supported by fiscal and monetary policy, such as India, Brazil and Russia.

India

The estimated 6% growth rate that India achieved in 2019 was the slowest in seven years. The weakness was driven by lower levels of private consumption, held back by lackluster income growth. However, the material reduction in policy rates, easier liquidity, reduced corporate taxes and improved weather conditions suggest that growth will recover to 7% in 2020. In order to stimulate long-term growth, the government must implement policy changes aimed at boosting investment, attracting capital and enacting financial reforms.

Russia

Russia benefits from a solid macro framework, with high levels of international reserves and low external debt. Its economic outlook benefits from a conservative fiscal policy and improved tax administration, which has generated a budget surplus. In addition, unemployment has improved and real wages are rising. Inflation has surprised to the downside and the central bank has aggressively cut rates, with more cuts expected in 2020. However, the possibility of US sanctions continues to pose a material risk to Russia's growth prospects.

Brazil

Confidence in Brazil's economic outlook has improved with pension reform and the release of funds held by employers in case of unfair dismissal. Recent data shows a positive contribution to growth from both supply and demand. We forecast that Brazilian growth will improve from an estimated 1% in 2019 to 2.1% in 2020.

Being selective

While growth forecasts for advanced economies have been falling, EM excluding China should provide a source of improvement in 2020. Investors, as always, will need to be very selective of regions and cognizant of risks.

China:

As Chinese growth is buffeted by the US trade war, will fiscal spending and an easier monetary policy be sufficient to support the economy in 2020? China is an essential driver of global growth. Its share of worldwide output has risen from 1.9% in 1992 to 16% in 2018, representing a dramatic shift in global dynamics. China is projected to surpass the US as the world's largest economy between 2030 and 2040. As a result, the country's future growth profile has widespread implications for the global economy (see chart).

Domestic consumption vital

China is an economy in transition. Previously, the Chinese economy was characterized as an arena for state investment – a manufacturing powerhouse – but increasingly, China should be considered a domestic consumption-led economy. The National Bureau of Statistics of China estimates that domestic consumption accounts for 42% of economic activity, up from 15% in 1991.

The country is already the largest market for cars, computers and smartphones. In fact, consultancy firm Bain estimates that in 2018, the Chinese consumers made 33% of luxury purchases; this figure is clearly demonstrates how quickly the local market leverage up in recent years. Domestic consumption will continue to be supported by a growing middle class, higher wages, and longer life expectancy.

Faster urbanization will also be a key driver of domestic consumption. The percent of China's population living in urban areas has more than tripled since the 1960s, rising from 18% in 1960 to 56% in 2015. This is relevant because urban households are estimated to spend twice as much as their rural counterparts, according to a paper published by the Federal Reserve Bank of Kansas City.

Growth drags

Trade wars have clearly infringed on China's growth prospects. It may be estimated that the imposition of tariffs on $360bn worth of exports to the US has reduced Chinese growth by the equivalent of 30-50 basis points per annum. The recent truce has provided some respite, but a re-escalation would further downgrade China's growth outlook. A debt deleveraging program also weighs on China's immediate growth potential. Domestic capital markets are relatively undeveloped, making companies reliant on indirect financing. In addition, credit growth has risen rapidly in recent years, pushing leverage to all-time highs and leading to concerns about the size of the shadow banking sector. Authorities have been aware of the issue and are therefore reining in borrowing at state-owned enterprises, tightening credit conditions for property developers and introducing financial market reform.

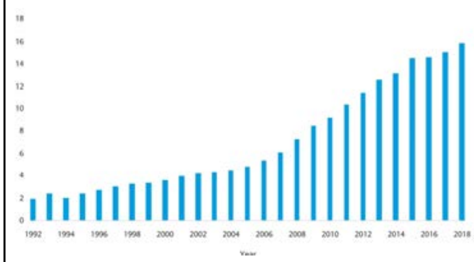
Balancing act

Chinese authorities will attempt to maintain a fine balancing act in 2020 as they look to mitigate the risks of the trade war and reduce leverage, while promoting a steady but slower growth profile. Policymakers are set to continue to use fiscal policy measures (tax cuts and infrastructure investment) to support the economy. Furthermore, monetary easing is anticipated in 2020, but is likely to be moderated by fears of exacerbating a housing bubble and aggravating leverage levels and inflation constraints. The anticipated policy response is likely to be restrained compared to previous bouts of economic weakness.

Outlook

Chinese growth is expected to be 5.5% in 2020, representing a significant reduction from 2019's estimated 6% and the 6.6% achieved in 2018. For the next five-year plan which is due to start in 2021, economists project growth of 5-5.5%. These forecasts represent a substantial slowdown from the 10% growth rate of just a few years ago. Still, China continues to grow into a much larger and a more mature economy, year after year.

China's contribution to global growth:



Tactical hedging and strategic diversification

With uncertainty set to remain elevated in 2020, adding value through hedging strategies and diversifying away from equities and fixed income seems to be a logical strategy.

Hedging exposure

Volatility may be used to generate a steady stream of returns through a systematic selling of volatility. However, in periods of uncertainty, there will also be times when volatility can be used to hedge opportunistically – that is, when the cost/benefit of doing so seems sensible. Because the timing of any sell-off or risk-off episode is uncertain, we see more value in staying invested and using cost-efficient hedging, rather than in staying on the sideline and losing value to inflation from holding cash.

Ramping up uncorrelated returns

We also see value in increasing exposure to asset classes or strategies that are less correlated with equities and fixed income. In this late-cycle environment and with the additional layer of geopolitical uncertainty, diversifying exposures or adding assets which have more fundamental drivers and are less sentiment driven are steps that should add value in portfolios.

We see several ways to add value. First, we continue to like low strike yield enhancement strategies as diversifiers in a portfolio. While we do not expect a recession in 2020, risks are increasing and uncertainty is high.

Second, private markets can be another potent diversifier. Adding private capital to a portfolio has historically decreased risks and improved returns (see chart). Private capital funds usually focus on particular fundamental drivers: the thorough due diligence advisable before making an investment implies that the value of this investment is primarily derived from a company strategy rather than top-down considerations. The illiquidity nature of the asset class also means that shifts in risk sentiment have less impact on private investments than on public markets.

Finally, we see opportunities to diversify in public markets using alternative strategies such as market neutral or merger arbitrage. Those strategies should only be partially correlated with markets, as they tend to focus on fundamental discrepancies arising from a particular situation, such as takeovers. Over time, there should be a pull to realize fundamentals, with little impact arising from top-down drivers.

Up to now, private equity has increased average returns and lower average volatility

Emerging Market Debt

In an era of depressed or negative returns, high leverage and thin liquidity levels, we believe that bond selection will be key in 2020, especially in the high yield sector. While performance is likely to be mixed in bond markets, we prefer investment grade and emerging market (EM) bonds.

Central bank accommodation puts a cap on yields in 2020

Yields on the equivalent of $17bn worth of outstanding bonds were negative in August of 2019 (see chart). The fear that liquidity may need to be re-invested at lower or negative yields is one of the main reasons why institutional investors fix coupons with longer maturities, even as bond yields reach sub-zero levels. As long as the threat of further policy rate cuts dominates, this trend is likely to persist in 2020.

Real yield should be the benchmark

The benchmark for wealth preservation should be the real yield (nominal yield adjusted for inflation), rather than the nominal yield. While a high nominal yield may look attractive on paper, it may be eroded by high inflation, as seen in 1980 when US 10-year nominal yields hit 13% while inflation was at similar levels, resulting in a real yield of close to zero. Since 1980, the real yield has gradually declined on the back of a higher savings rate in EM and a structural higher demand for safe bonds globally.

Global investor preference drives the market

We believe that the longer end of the rate curve will be capped for three reasons:

1. Investor preference to hold longer dated bonds in order to mitigate the risk of re-investing at even lower rates in the near future. This preference intensifies the closer yields are to zero (last-chance purchase).
2. Increased awareness of "tail risk" (since the credit crisis in 2008) and the subsequent desire to hedge against this risk.
3. Expectation that central banks will accommodate through quantitative easing when needed.

Rates volatility likely to increase

Although we believe that 2020 will not signal the end of the trend of lower yields for longer periods of time, we do see several factors which could potentially trigger temporary rate spikes in the near future. Among these, a constructive outcome from the US-China trade war negotiations, a positive Brexit result and positive economic or inflation surprise. We would see such spikes as an opportunity to enter increased duration.

Corporates leverage at elevated levels

Half of the US and European investment grade bond market is now rated BBB. Moreover, net debt in relation to operating earnings stands at 2.3 times, as compared with 1.5 times in 2001. At this point, higher leverage does not seem to be a concern, given low borrowing costs and stable earnings. Interest coverage (the amount available to serve interest rate costs) of 10% appears to be at a comfortable level

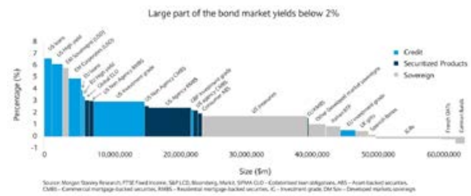
Fallen angel volume at historic lows

Historically, the risk of defaults has been contained in the investment grade segment – even in severe adverse scenarios such as during the 2008 credit crisis. But what about the downgrade risk? While larger companies such as GE or AB Inbev have been downgraded to BBB, most of the predominantly large issuers used levers like asset sales, scaling back dividend payments or optimizing working capital to maintain the investment grade rating.

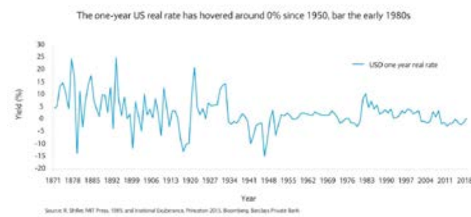
In the base case scenario, rating agency Moody's expects "fallen angel" volume (that from issuers downgraded to high yield status) to rise to $50bn in 2020, while the amount could rise to $164bn in a recessionary scenario. This is still a relatively low number, considering that BBB-rated bonds now amount to $2tn, more than double the $764bn seen in 2007.

The above reflects that fact that downgrade cycles are not highly correlated to economic cycles, but are more linked to company or sector-specific trends. As much as significant downgrades due to lower growth seem unlikely in our view, we think that the key to success in 2020 will be selection, while avoiding the most cyclical and leveraged companies within BBB space.

The 2 % return threshold splits the good from the riskier opportunities



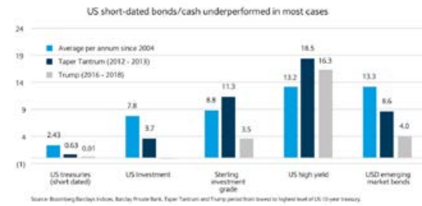
The 1-year US real return is around 0 % ever since 1950!



High yield bonds: Default rates at low levels, but cracks are appearing

Even if the European or US economies avoid recession, high yield issuers will be most exposed when growth starts to deteriorate. In Europe, for example, default rates are the lowest that have been observed since 2008 at 1.1%. Still, trends are deteriorating beneath the surface: leveraged loans trading at distressed levels have doubled from 2% to 4% as compared to 2018, while the low level of investor protection in bond documentation is another risk factor.

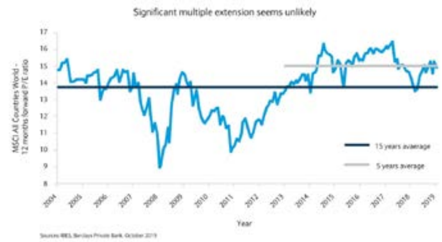
US short-dated bonds do worse than US cash



Defying the worries

While the specter of a US presidential election and recessionary fears cloud the outlook for many investors, prospects for a diversified global equity portfolio remain bright. Going into 2020, fundamentals point to some upside in equities, which justifies staying invested. Even so, uncertainty is high and market participants remain torn between fears of recession and hopes that the cycle will extend. In what is likely to be another volatile year, it makes sense to focus on ways to diversify and improve the risk/reward profile of portfolios.

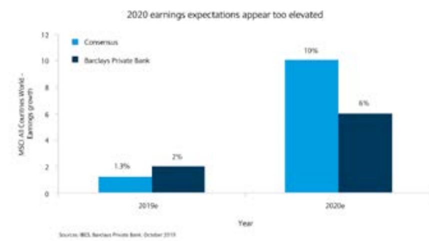
PE multiples are not expected to get much higher



Earnings likely to be lowered

After just 1% growth in 2019, bottom-up analysts expect global equities to deliver around 10% earnings growth in 2020 and 2021. However, most of the investor community believes that from a top-down perspective, 10% growth is unrealistic. Indeed, growth of 6% in 2020 looks more likely and realistic. This caution is based on the following factors. First, we believe that global economic growth will remain at or below trend. After a difficult 2019, growth could reaccelerate modestly, particularly in emerging markets. However, most of the developed world is likely to remain stuck with sub-par growth. This means that top-line growth should not surpass +4% in 2020, only slightly better than 2019's +3.5% growth. Second, from a margins perspective, we see limited scope for expansion, given the limited slack in labor markets, tougher raw materials equivalents and slow productivity growth (see chart).

2020 consensus view is very high



Limited room for valuations to expand

In terms of valuations using current consensus figures, global equities trade at a price to 2020 earnings multiple of around 15 times. This compares to 15- and 5-year averages of 13.8 and 15.2 times, respectively. Assuming earnings grow by only 6% in 2020, valuations appear even more stretched at 15.6 times. Easy monetary policy and low interest rates are likely to support valuations, but further multiple expansion would require investor sentiment to improve substantially. We don't see this happening unless there is a positive shock, such as a broad-based fiscal stimulus. While we will certainly see swings in valuations in the next twelve months, on a trend basis we expect multiples to remain unchanged.

What could go right?

It is difficult to imagine how earnings growth or multiples could go higher. For the former to occur, it would require either a pick-up in global growth or some one-off boosts, such as the tax break US companies received in 2018. While neither earnings growth nor valuations appear set to rise, pressure has been mounting on governments to take advantage of the low interest rate environment and increase spending. In particular, infrastructure spending, mostly geared toward energy efficiency, has been a popular topic. Should this occur in a meaningful way, we could expect earnings to pick up.

On the valuation side of the equation, we would need to see investors becoming euphoric once again in order for multiples to expand. This could be achieved if both economic and geopolitical risks were to shrink significantly. This is unlikely but possible, assuming that trade discussions move into "phase 2," allowing existing tariffs to be rolled back. In a blue-sky scenario, assuming that earnings grow by 10% and that multiples expand further, we believe that global equities could generate returns in the mid-teens.

What could go wrong?

After the last excellent twelve months, tensions are high and the list of problems that could affect sentiment is long. Among these, we see two main potential risks:

1. A worse-than-anticipated economic slowdown. While global growth has slowed, an outright recession seems unlikely. Still, even if the global economy avoids two consecutive quarters of negative growth, if investors believe a recession is near, equity markets could suffer. It happened in December of 2018, and we can't be sure it won't happen again.
2. Ultra-accommodative central banks, coupled with market expectations for further stimulus, could pose a dual risk to the markets. On one hand, investors could lose faith in central banks' ability to save the day as they run out of effective ammunition. On the other hand, markets could be wrong-footed if central banks start tightening monetary policy again, causing another "taper tantrum" episode. Even though downside risk would be significant, we would expect a quick recovery, as this scenario would only occur if economic activity was gaining momentum.

Equities still attractive

From a fundamental point of view, the risk/reward for investors appears challenging. However, in the context of a global economy that is slowing but still growing, with low interest rates and light investor positioning, we believe equities offer modest upside and significant relative value.

Volatility on the rise

As relevant as fundamentals may be, they are often overridden by sentiment in the short term. On that front, we expect 2020 to be another volatile year as investor perception swings between recession fears and recovery hopes. Over each of the past 40 years, global equities have experienced a median annual drawdown of -11.5% (see chart).

We believe 2020 will be more akin to the norm than to 2017, when markets never pulled back more than 2%. As such, investors should be able to take advantage of volatility spikes as the year progresses.

The US is our preferred region

From a regional perspective, the US still seems best positioned, owing to its growth-oriented profile. US equities have outperformed strongly over the past five years (+7% annualized excess return compared with non-US equities). We see little reason for this to change.

US valuations aren't particularly appealing, but we believe this can be justified by the market's added visibility. Even if the 2020 presidential election clouds the outlook, we doubt investors will be willing to switch out of US equities in periods of uncertainty to, for example, Europe or emerging markets. This was not the case in 2019 or, for that matter, in 2016, the year President Trump was elected and US equities outperformed by almost 10%.

Emerging markets require patience

Emerging markets (EM) have generated disappointing returns of late. Slowing growth, a stubbornly strong US dollar and idiosyncratic issues (such as protests in Hong Kong and political instability in Latin America) have not helped the situation.

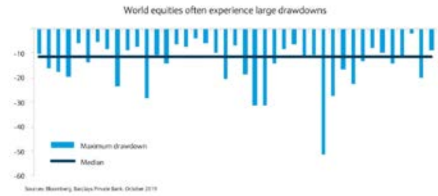
Going into 2020, the region's attractive medium-term growth prospects are still not properly reflected in valuations, in our opinion. However, we believe outperformance may not materialize until it is clear that growth in EM is stabilizing. Some green shoots of hope have started to appear, but another quarter or two may be necessary to reassure investors.

Eurozone as a value play

Eurozone equities have performed surprisingly well in the context of slowing global trade and challenged domestic economies. The European Central Bank has played its role in supporting the region. However, if eurozone equities are to move higher, we believe that more is needed.

The eurozone remains a value play that investors like to buy as a proxy for an improving macroeconomic backdrop. Next year is set to see large swings in investor sentiment, creating potential opportunities for eurozone equities to outperform. But without more profound reforms, fiscal stimulus and structural improvements in the banking sector, we believe the region overall remains a trading market. Instead, for long-term investors, we prefer to focus on specific opportunities at the sector and stock-specific levels.

Average drawdowns of world equities is above 10 %, but below 15 % in the majority of the cases.



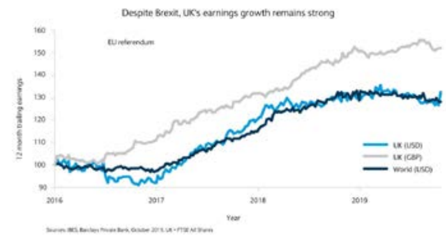
UK's time to shine

At over three years into the Brexit saga, most investors are significantly underweight on UK equities. Assuming that clarity finally emerges regarding how and when the UK will leave the European Union, significant inflows could follow, driving outperformance of the regional indices, which remain largely undervalued in light of strong earnings growth.

With "Brexit managed", we expect that UK companies, particularly those with large capitalization, will be able to adapt. As such, once the initial shocks – whether positive or negative – from both economic and exchange-rate fluctuations have passed, we believe that UK equities' attractiveness will shine again. Timing this opportunity will be difficult, but investors should put the UK market back on their radar.

Every year during the past decade, the moment came when "value" stocks were due to finally start outperforming again. The last twelve months were no exception, as the valuation spread between "cheap" and "growth" companies reached unprecedented levels. We see limited investment merits in chasing value. We do expect this investment style to be a hot topic in 2020. That said, the strategy will outperform periodically, but in relatively short bursts and in extremely hard to capture windows of opportunity. As such, we maintain our preference for "quality" stocks over the medium term.

The comeback of UK equities?



Maintain a barbell sector allocation

At the sector level, given our top-down view, we maintain a so-called barbell approach between cyclicals and defensives. Within that, we are reluctant to chase expensive bond-proxies such as utilities, and we believe that some of the early-cycle industries are unlikely to see a sustained rebound against a highly uncertain backdrop. As a result, consumer discretionaries, communication services, industrials and healthcare are our preferred sectors. At the sector level, given our top-down view, we maintain a so-called barbell approach between cyclicals and defensives.

Consumption to fare better

Although it would be wrong to assume that consumers can remain insulated from an economic slowdown indefinitely, we think consumption will remain resilient in the medium term. As such, we keep our positive stance on consumer discretionaries in all regions. Similarly, we remain constructive on communication services in the US, although we favor content producers versus large-cap internet names.

Industrials as a growth play

While industrials may struggle should economic momentum stall, we believe the sector is gradually becoming less sensitive to the economic cycle, offering attractive long-term growth prospects. Indeed, with the increased use of technology, most industrial companies are morphing into services providers. We believe this will reduce the volatility of earnings and allow for higher valuations as visibility improves.

Healthcare to remain volatile

Investing in the healthcare space ahead of a US election is always a challenge. We believe that 2020 won't be different, with healthcare likely to experience higher-than-usual volatility. Still, with its combination of attractive growth potential and undemanding valuations relative to defensive peers, the sector should not be overlooked. As such, we see any election-related weakness as a possible entry point into a sector that we think could generate outperformance over time.

Only a little "BBit" high yield, please

Buying BB-rated bonds, the highest quality within high-yield, was the favorite trade in 2019. This "tourism" flow led to the situation where the high-yield market performed well in a period during which the lowest rating bucket – CCC – performed poorly. Such performance differentials are historically uncommon. They demonstrate that inflows are not a result of increased investor confidence in risky assets, but rather a result of higher demand for yielding bonds in a world where yields are depressed. BB-rated bonds are expensive. The spread differential between BBB and BB-rated bonds reached a two-decade low of 66 basis points, while 15% of the overall high yield market trades inside the 80th percentile of BBB at this point. We feel that this vulnerability, combined with overcrowding, makes BB-rated bonds and the high yield market unattractive in general. We only see selective opportunities in 2020.

Emerging market (EM) bonds still offer an attractive carry

While EM bonds should receive more support from lower rates globally, we believe that the diversity, combined with still constructive growth prospects, makes EM hard currency bonds an attractive asset class. While lower growth will be a challenge for most EM countries in 2020, we believe some countries (Brazil, India, Russia) will cope with lower growth better than others (Turkey, Argentina). We also believe EM bonds will still offer an attractive carry for investors, who should focus on countries with stable governments that are willing and able to implement necessary reforms in order to navigate through an environment of lower growth.

IRISOS

Sector Analysis

Basic Materials

- This sector would be a major beneficiary of any improvement in trade frictions.
- We favor the chemical and industrial gases industries based on an expected bounce in demand.
- Oversupply is most likely to be a continuing challenge for growth and pricing across many industries.
- Chemical product demand should spur inventory restocking over the course of 2020.
- Agricultural seeds and chemicals should see improved demand with better weather and trade.
- The metals and mining outlook is very reliant on China's growth and trade outcomes.

Strategy: Concerns over increased trade protectionism and a potential slowdown in China have caused the materials sector index to lag the market this year. Year-to-date through 20 December, the materials sector posted a total return of 23.3% versus 31.0% for the S&P 500. Our Equity Strategy team has a neutral view that reflects a positive outlook for global growth and high corporate profitability, balanced by our continued concerns over slowing Chinese growth and global trade. It is currently difficult to be certain about the timing of the ultimate resolution of the trade issues.

Investment opportunities:
Given the new trade environment, we recommend that more dynamic investors focus on the cyclical economic recovery of Polymer and related companies through certificate XS2049532448, i.e., 8.04% 18 months RCB on BASF, Bouyges SA, and Peugeot SA. This product has a conditional capital guarantee of 65% (based on strike). The issuer of the product can call the product quarterly if all underlying are =>95% than the issue price. Call occurs at 100% plus coupon.

Consumer Staples

The sector's defensive merits are reflected in relatively stable cash flow generation, which should provide support amid slowing global growth. However, its premium rating is at the high end of its historical range, which should limit the upside potential barring the help of falling bond yields.

Europe: We prefer companies that are well positioned in faster-growing emerging markets. Those benefiting from efficiency improvements or M&A synergies feature better earnings growth. Also appealing are companies offering attractive and sustainable dividend yields owing to their ability to generate cash.

Americas: Our preference is to own companies with strong underlying top-line growth and margin momentum. We favor names with predictable organic growth apart from the need to accelerate top-line trends through acquisition, etc. In addition, we look for names that do not need to step up investment spend because they have maintained a high level over time, and margin expansion is therefore derived from sales growth rather than cost cutting.

Asia: Recent equity volatility caused by rhetoric regarding the progress of US-China trade talks demonstrate that no agreement is certain; even if there is a Phase 1 deal, we expect tensions to persist. In our risk scenario – to which we assign a 20% probability – consumer confidence could take a hit and threaten growth if trade talks break down and a further USD 160bn of more consumer-focused US tariffs on Chinese goods are implemented on 15 December. Still, we expect manufacturing would continue to bear the brunt of the negative impact. As a result, we continue to favor consumer-facing sectors over those exposed to business- and trade-related spending.

Investment opportunities:
Given the overall competitive outlook for the sector, investors should seek companies with strong balance sheets, low financing costs, and a strong focus on products and services. Because of the high absolute valuation and the limited upside potential, high yield dividend stocks are at risk; companies to consider include AD, ABI, BAT, NESN, EL, MO, and PM.

Key figures for Europe:

Target values:
Present fair value (DJStoxx600): 414
E12 months value (DJStoxx600): 448
Upside potential: +8%

Key economic ratios:

GDP Growth 20(E)	0.8
GDP Growth 21 (E)	1.2
CPI 20(E)	1.2
CPI 21 (E)	1.3
P/E 2018 (E):	15.7
P/E 2019 (E):	14.3
Div. Yield 2018:	3.1
Div. Yield 2019:	3.3

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

Technology

- The scope of our "Technology" section now includes both technology disruptors and enablers, as we believe growth-based investors should continue to maintain an exposure to technology disruption as a theme on a medium-long-term basis.
- We believe technology disruption is only in its early stages and should continue as tech and tech-enabled companies continue to gain market share against incumbent competitors across various industries.
- Among technology disruptors, we like platform companies with network effects and accelerating market share gain prospects. Among technology enablers, we like companies exposed to trends like cloud, Big Data, and artificial intelligence (AI).

We continue to recommend a focus on companies driven by corporate IT spending and capital investment by cloud service providers, as well as companies with idiosyncratic drivers. We remain cautious with respect to the semiconductor group (excluding Intel) and companies that are primarily driven by smartphones. From a style perspective, we believe technology holdings should be barbelled across select value stocks and reasonably priced growth stocks.

Investment opportunities:
Structural opportunities come from leaders in fast-growing industries such as the internet or the cloud (e.g., SPLK, SAP), while the cyclical upside is driven by companies with exposure to a sequential recovery or restructuring opportunities (e.g., MSFT, VISA, MA, ASML, CRM).

Communications Service

We continue to maintain an overweight allocation to the Communications Services sector. Its relatively low international revenue mix and exposure to three key drivers of content, connectivity, and advertising are exposed to strong secular trends, while offering shelter from trade war and tariff concerns. Additionally, we believe the sector offers an attractive combination of growth at a reasonable value and yield.

Within the Communication Services sector, we are attracted to companies that are prepared to capitalize on the ongoing shift to mobile and digital advertising. In telecommunications, our preference goes to companies that are poised to benefit from the continued growth in data traffic, and that have the potential to improve operating performance and maintain/increase dividends. In media, we prefer to own large-cap companies that possess "must-have" content and live sports programming.

Investment opportunities:
We currently believe many Communication Services companies face risks that outweigh their potential rewards, which is why we have a “hold” rating on most of the sector’s companies (GOOG, DI, NFLX, FB, AMZN).

Energy

The sector benefits from an attractive dividend yield and solid balance sheets. Free cash flows at major energy firms are sufficient to cover capex and dividend payments, provided that oil prices don’t drop significantly from current levels. However, below-average earnings momentum and the risk of weak oil demand amid a global slowdown are a drag on the sector’s performance.

Thanks to good investment discipline, European energy stocks continue to increase their profitability and cash flows. With lower capital (expenditure) intensiveness and well-supported dividends, more and more companies have share buyback programs in place. While oil prices remain volatile, free cash flows generally exceed capex and dividends as long as Brent stays above USD 50/bbl.

- We maintain our sector strategy focusing on high-quality names.
- The CIO global commodities team has rolled out the 12-month oil price outlook. We believe there is downside risk to oil prices in 1H 2020, reflecting an oversupplied

market. Prices should rebound in 2H 2020 as market equilibrium returns. CIO projects West Texas Intermediate at USD 55/bbl at year-end 2020.

Investment opportunities:
The overall economic conditions are good. The US economy is still growing, and developing nations will likely need more energy as they improve their infrastructures and modernize their economies. New supplies are slow to develop, and when combined with strong economic activity, this is price supportive. Although alternative energy sources are accelerating their market share (as compared to fossil energy), we do not see this as a threat but rather as an opportunity for the energy sector to become cleaner and more efficient. Attractive investment opportunities for the US include OXI, APA, and CLR; and for Europe, RDSA, TOTF, and FTI.

Financial Services

Our neutral allocation to US Financials reflects our outlook for a combination of solid fundamentals and a more mixed macro-economic backdrop in 2020. Financials' balance sheets continue to benefit from historically strong credit quality and excess capital. Although expense and capital allocation efficiencies should support solid EPS growth and profitability, lower interest rates and a flatter yield curve could dampen net interest margins; more muted economic growth could cause loan growth to slow and credit quality to deteriorate somewhat. Finally, although regulators are nearly done with post-crisis reforms, and compliance costs and capital/liquidity requirements should be less onerous, election year headlines and political risks could raise volatility/uncertainty.

We remain selective with our list, focusing on high quality executors, restructuring self-help stories and/or deeply discounted valuations. We also continue to prefer companies that are levered to the strong US consumer with below normal credit losses, despite the lateness of the economic cycle. We have a Neutral view of the Banks and Insurance subsectors, while remaining overweight on Diversified Financials.

Investment opportunities:
Despite having improved their pre-stress test capital ratios in recent years, banks remain vulnerable to adverse stresses. Many may face pressure from supervisors and market analysts to further bolster their capital positions.

It is therefore important to narrow down the potential investment universe to companies in which business activity is not clearly impacted by end-consumer behavior or exposed in a neutral manner to the above concerns.

E-Payments is one of the subsectors of interest. It will take a significant amount of time for new technologies to disrupt the existing business model, because current companies are deeply entrenched in their local merchants and clients.

Although broad changes do affect end-consumers, buyers will nevertheless continue to spend and pay by credit card, debit card, and the like. More importantly, because these companies operate worldwide, they are less impacted by regional developments. Our key picks: V, MA, PYPL, and ING.

Consumer Discretionaries

Europe: The two main subsectors in Europe (automobiles and luxury goods) show diverging trends. The auto sector's net profits are suffering from rising costs and stalling sales, while the luxury goods sector is benefiting from double-digit organic growth amid buoyant consumer confidence. However, the benign environment for luxury goods is reflected in elevated valuations, leaving limited scope for a sector rerating.

USA: We are attracted to strong brands/content with pricing power, as well as to companies that are aligned to the needs of Millennial consumers, a demographic that will have an outsized impact on consumption trends for years to come. In addition, we are attracted to

Key figures for USA:

Target values:

Present fair value S&P 500:	3'221
E12 months value S&P 500:	3'385
Upside potential:	+5.0%

Key economic ratios:

GDP Growth 20(E)	1.1
GDP Growth 21 (E)	2.1
CPI 20(E)	2.1
CPI 21 (E)	2.0
P/E 2020 (E):	20.1
P/E 2021 (E):	18.2
Div. Yield 2020:	1.9
Div. Yield 2021:	2.0

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
- Nvidia
- Apple
- IBM

Financials:
- VISA

companies with leading e-commerce and omni-channel capabilities and international exposure, particularly within emerging markets.

The overall macroeconomic backdrop for consumers is favorable, and financial conditions are supportive of consumer spending. Even so, political uncertainty – including ongoing trade tensions – could weigh on business and consumer sentiment.

Investment opportunities:
Understanding the changing consumer spending paradigm is key! There are strong indications – among these, the recent retail sales report – that consumers and especially Millennials have different spending habits now than they had prior to the Great Recession. Given this, we favor UUA, EL, NFLX, N, ADS, and ZAL, among others.

Industrials

Europe:

Following the strong performance of 2019, the sector's upside potential for 2020 is somewhat limited. Its premium rating offers limited upside given muted growth and the exposure of some of its constituents to the automobile sector. The high earnings visibility for the aerospace and defense subsector should provide support. From a bottom-up perspective, we see both pros and cons for the sector. We continue to see good investment opportunities in the aerospace and infrastructure subsectors. However, trade tensions create uncertainty for export names and limit customer investments for new equipment. In addition, the sector valuation offers no support.

USA:

- The global manufacturing downturn should abate as we move through 2020.
- We prefer the aerospace and railroad industries, along with self-help stories within capital goods.
- Defense companies should post superior growth, but the outlook is more guarded given elevated valuations and election risks.
- Future trade policy is likely to remain the major determinant of sector performance.
- Muted revenue growth should temper near-term capital spending.
- Focus on election risks is likely to increase.

Increased hopes for a US-China trade deal and economic stimulus have led the industrial index to post strong returns this year. Through 13 December year-to-date, the index has posted a total return of 29.0% versus 28.9% for the S&P 500.

Our equity strategy team has a neutral view on the industrials sector. While the US-China trade situation remains fluid, the recently agreed Phase 1 deal should help boost business sentiment and activity. Further clarity on trade should help reduce the level of inventory destocking that has weighed on sales and capital spending plans over the last year. Global manufacturing gauges are also showing signs of a bottoming. However, these positives are balanced by an industrial recovery that is likely to be more muted than usual.

Investment opportunities:
The absolute sector valuation looks rich, with the average market trading above the long-term average, based on strong EPS growth. This reflects investors' view that the sector is capable of positively engaging with ongoing transformations. Preferred companies are those with a combination of exposure to improving end-markets and favorable company-specific catalysts such as cost-efficiency programs, restructuring, acquisitions, and new products with high value add. Therefore, primary attention should be given to themes such as e-commerce, energy efficiency, automation, and robotics. Names to look at in the US include BA, CAT, DE, FED, and UT; and in Europe, Airbus, Rheinmetall, Sulzer, Rotork, and Fraport.

Key figures for Asia:

Target values:

Present fair value MXAPJ:	687
E12 months value MXAPJ:	770
Upside potential:	+12%

Key economic ratios:

GDP Growth 20(E)	3.8
GDP Growth 21 (E)	4.8
CPI 20(E)	3.9
CPI 21 (E)	3.3
P/E 2020 (E):	14.4
P/E 2021 (E):	12.8
Div. Yield 2020:	2.4
Div. Yield 2021:	2.5

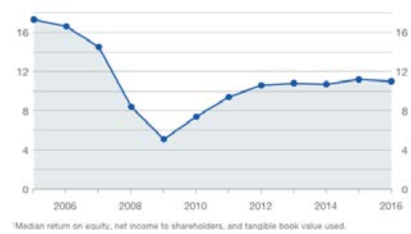
Most likely next short-term move:

MXAPJ	down

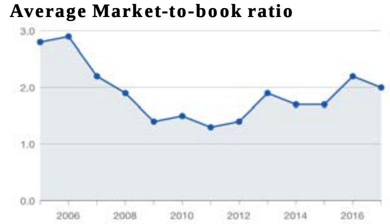
Key names to look at:

- Tencent
- Alibaba

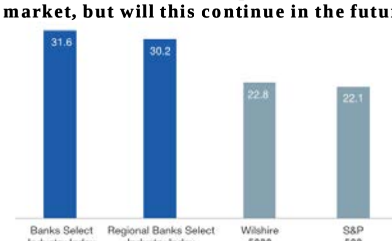
Average ROI of Banks recovered but remains stable!



Average Market-to-book ratio



The financial sectors outperformed the larger market, but will this continue in the future?



Healthcare

Europe: The sector is benefiting from improving and above-average earnings momentum, while valuations look attractive by historical comparison. Exposure to ongoing trade tensions is limited, but idiosyncratic risks at the stock level, as well as political uncertainty ahead of the US presidential election, are likely to remain a drag.

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, along with self-help stories in MedTech. Given the late stage of the cycle, we have a large-cap bias.

USA: Fundamentals are supportive (better drug pipelines, innovative new devices). However, leading up to the 2020 elections, political risks (drug pricing, potential healthcare insurance policy changes) may continue to loom.

Investment opportunities:
The healthcare market is fragmented, as its players are striving to increase their market share through such strategies as improvements to existing solutions and software platforms, development of new platforms, and strategic alliances with other market players. Therefore, several players account for significant individual shares in the market.

As orthodox as the idea may seem, it is not healthcare companies and MedTech in the earliest stage which will benefit from the transition to AI and MedTech in the earliest stage, but rather key players such as AT&T, Cisco Systems, Motorola Solutions, Samsung Group, Verizon Communication Inc., and Apple Inc. The list of niche providers includes the following: Philips Healthcare, Aerohive Networks Inc., and Allscripts Healthcare Solutions Inc.

Utilities

Europe: The sector offers an attractive dividend yield and is relatively insensitive to slowing growth and ongoing trade disputes. We are confident that high single-digit growth in 2020 is achievable among the sector's large caps, driven by ongoing investments in renewables and networks. Valuations have become less attractive after the sector's strong performance, which may limit the potential for further sector rerating. We expect earnings growth to be strong thanks to good fundamental trends, restructuring and the energy transition. Among our stock preferences are future-proof integrated companies that focus on renewables and regulated businesses.

USA: Fundamentals for US utilities remain stable with rising capital spending. Capital spending should remain focused on renewables, transmission, and distribution, driving 4-6% EPS growth annually on average. Capital spending is the primary driver of EPS growth in the sector. Dividend growth should roughly follow EPS growth. The longer-term trends of more electrification, increasing renewables investment, and a focus on reducing carbon emissions are generally positive for utilities, and support 4-6% annual earnings growth over the next 3-5 years.

Investing in utilities late in the economic cycle is often a balance of attractive defensive qualities and less appealing relative valuation. Utilities continue to look expensive versus the S&P 500, but more fairly valued versus the 10-year US Treasury. Given a 115-basis point dividend yield advantage over the S&P 500 and very mature business fundamentals, utilities are popular defensive portfolio investments. As such, we maintain a constructive and selective approach to the sector. Our equity strategy team has a neutral weighting of the sector relative to the S&P 500.

Investment opportunities:
The recent spike in volatility may have encouraged investors to seek the perceived safety of the utilities sector, but we continue to believe that this is not the right move. A growing economy and rising interest rates don't make for utilities performance, and we therefore believe underperformance will likely continue. For those who still wish to seek exposure to the sector, it may be opportune to consider the following names: in Europe, Centrica, Fortum, E.On, and RWE; in the US, American Water Works, DTE Energy, Excelon, and Nextera Energy.

Foreign exchange

Currencies

Several factors that may potentially pressure the USD next year

We continue to see a high risk that EUR/USD falls to 1.09 in the coming months, as the risk of the US and China not reaching a trade deal in December is still considerable. Such volatility usually benefits the USD, unless the Federal Reserve responds with a commitment to ease policy. Fed Chair Jerome Powell communicated clearly that the October FOMC policy rate cut was the end of the rate cut mini-cycle. If new trade tensions hit markets, we would expect some USD appreciation, and only later a communication by the Fed signalling more easing that could hurt the currency.

In our main scenario for 2020, we expect the US to contribute less to global demand growth. The European economy and European exporters in particular should benefit if trade tensions subside. In such an environment, the EUR/USD exchange rate has clear upside potential.

We think there are several reasons the greenback might come under pressure in 2020, apart from the growth dynamics. An easing of trade tensions weakens the USD, just as rising tariffs have strengthened it. The election campaign is likely to provoke a discussion on the sustainability of the US budget, which is a long-term burden for the USD. Finally, many long-term investors have built up USD positions over the last few years, and so the dollar's scope for further strengthening is shrinking.

Investment considerations:

We see a clear bias for EUR/USD to drop below 1.10 in the near term. But the tide should turn for the euro in 1H20, either due to easing trade tension and improving global growth or due to more pronounced Fed easing.

In the coming months, we recommend positioning for a 1.12 upside barrier and for a downside around 1.07.

One risk is a rebound in US inflation and growth that brings the possibility of Fed rate hikes coming back into the picture, which would lift the greenback. Another risk would be a US recession after escalating trade disputes, which could weaken the USD earlier and faster, since the Fed would likely cut rates aggressively.

Target values in 3 months:

EUR/USD:	1.1250 - 1.1750
GBP/USD:	1.2500 - 1.3500
USD/CHF:	0.9750 - 1.00

Target values in 12 months:

EUR/USD:	1.17 - 1.25
GBP/USD:	1.30 - 1.40
USD/CHF:	0.90 - 1.00

Purchase power parities:

EUR/USD:	1.28
GBP/USD:	1.56
USD/CHF:	0.93
EUR/CHF:	1.19

Most likely next move:

EUR/USD	down
GBP/USD	down
USD/CHF	down

Target values in 3 months:

Oil:	$75 - $80
Gold:	$1,500

Target values in 12 months:

Oil:	$75 - $80
Gold:	$1,600

Upside potentials:

S&P GSCI	up
Oil	up
Gold	up

Next most likely move:

S&P GSCI	up
Oil	up
Gold	up

Commodity related stocks:

Capital market assumptions

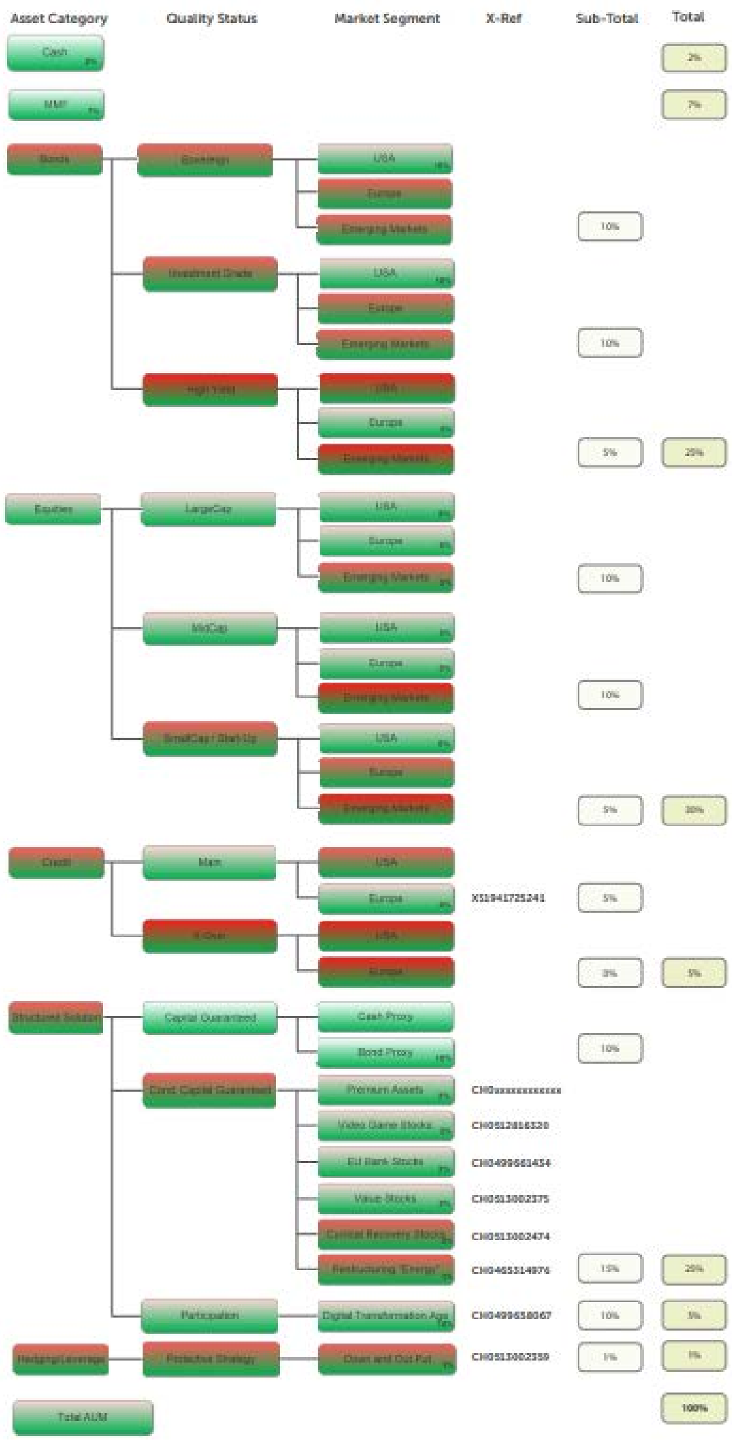
Return forecasts

Forecasts are in local currency (except EM equities), all figures are annualized

	Forecasts for the next 7Y			Average returns over the past 10Y	
	Return	Vol		Return	Vol
Cash USD	2.50%	0.00%		0.80%	0.40%
Cash EUR	0.30%	0.00%		0.10%	0.50%
Fixed income					
USD High grade bonds 5-10Y	2.60%	5.00%		5.00%	4.10%
EUR High grade bonds 5-10Y	-0.20%	4.20%		4.40%	3.90%
USD Inflation linked bonds	2.40%	4.70%		3.00%	3.30%
USD Corp bonds (IG)	3.30%	4.40%		4.80%	2.90%
USD High yield bonds	4.70%	9.70%		8.40%	6.10%
EUR High yield bonds	2.30%	8.70%		8.70%	7.30%
USD Senior loans	5.70%	6.90%		5.50%	3.50%
EUR Senior loans	3.50%	6.30%		6.00%	3.10%
EM Sovereign bonds (USD)	4.90%	8.60%		7.40%	6.30%
Equities					
US	5.70%	15.20%		13.50%	12.70%
EM (USD)	9.20%	20.70%		3.70%	17.00%
Eurozone	5.10%	17.30%		7.30%	14.40%
UK	6.00%	16.30%		7.30%	11.50%
Japan	4.60%	19.30%		7.80%	17.20%
Switzerland	4.50%	14.00%		8.40%	11.00%
Alternative Solutions					
HF (FOF, USD)	3.50%	5.20%		2.90%	3.90%
Alternative, other risks (USD)	7.20%	10.00%		7.80%	7.20%
Alternative, Private Estate (USD)	7.90%	9.20%		9.40%	5.10%
Alternative, Private Equity (USD)	10.20%	14.50%		13.90%	8.10%
Alternative, Private debt (USD)	8.20%	4.50%		10.20%	4.70%

Bloomberg, JPMorgan, MSCI, HFRL, BAML, UBS, IRISOS

Base-case Allocation USD Balanced



Disclaimer: Allocation may change as a result of the risk optimization - Past performance is no guarantee of future returns.

Asset Allocation Preferences – December, 2019

Sector	Region	Fundamental	Risk/Reward	Investment case
Basic Materials	Americas			Outlook increasingly reliant on trade policy and an improving China. Sector would be a major beneficiary from any improvement in trade frictions. Chemical and industrial gases industries are expected to bounce in demand. Agricultural seeds and chemicals should see improved demand with better weather and trade conditions. Metals and mining outlook very reliant on China growth and trade outcomes. Companies comfortable doing smaller acquisitions rather than large transformative deals.
	Europe			
	EM			
Consumer Staples	Americas			Preference is to own companies with strong underlying top-line growth and margin momentum. We favor names with predictable organic growth and without the need to accelerate top-line trends through acquisition. Concerns over health and wellness will continue to challenge packaged food companies. Pricing pressure increases, particularly within household products, creating top-line growth uncertainty.
	Europe			
	EM			
Consumer Disc.	Americas			Consumer spending trends are solid, with healthy labor markets, rising wages, a solid housing market, and consumer delinquencies at or near post-crisis lows. E-commerce trends should remain robust, driven by next-day – or in some cases, same-day – delivery. Differentiated retail concepts will continue to win the day as consumers will need a reason to shop off-line. Where will consumers actually spend? We think the best performing categories will be athletic apparel and footwear, home improvement and technology.
	Europe			
	EM			
Energy	Americas			Opportunities exist within a challenging macro backdrop. Key subjects for the sector include the following: a) Capital discipline – industry is professing all-in; b) M&A/Consolidation – the strong will get stronger; c) Offshore/international exploration and development ramp up capex, which is to turn into CF; and d) "Environmental mandate" is the new key phrase in industry.
	Europe			
	EM			
Healthcare	Americas			The sector is benefiting from improving and above-average earnings momentum, while valuations look attractive by historical comparison. Exposure to ongoing trade tensions is limited, but idiosyncratic risks at stock level, as well as the political uncertainty ahead of the US presidential election, are likely to remain a drag. In a late-cycle environment, healthcare acts as a portfolio stabilizer thanks to its defensive earnings profile.
	Europe			
	EM			
Financial Services	Americas			The combination of solid fundamentals and a mixed macro-economic backdrop for 2020 should be beneficial for quality executors and attractively valued consumer-focused firms. Lower interest rates and a flatter yield curve could weigh on stock price performance over the year. Regulators are nearly done with post-crisis reforms, and compliance costs and capital/liquidity requirements should be less onerous, but election year headlines and political/regulatory risks could raise volatility/uncertainty. Valuations are fair, in our view.
	Europe			
	EM			
Industrials	Americas			Fundamentals should gradually improve, but trade policy remains the major wild card. Future trade policy is likely to remain the major determinant of sector performance. The price/cost tailwind should moderate appreciably. Stock valuations are still not stretched, despite strong performance. Muted revenue growth should temper capex. Government stimulus would be positive, but its impact will take time.
	Europe			
	EM			
IT	Americas			The US Information Technology sector is underpinned by persistent trade-related risks, earnings estimates that leave little room for upside, and high relative valuations. Fundamentals and valuation risks: a) IT demand has been weakening at the margin; b) Valuations are near a 10-year high on an absolute and relative basis; c) Demand remains soft outside PCs/servers; and d) Excitement swirls around 5G, but smartphone demand is likely to be underwhelming.
	Europe			
	EM			
Com. Services	Americas			Communication Services offers attractive growth across three key drivers: a) Secular shift to direct-to-consumer/over-the-top video; b) Cable companies to benefit from high speed data upgrades, while wireless companies roll out 5G; c) Digital advertising still only 50% of total advertising, so plenty of room for continued growth.
	Europe			
	EM			
Utilities	Americas			Renewables and distribution grid investment drive growth. Rising capital spending focused on renewables and electricity distribution networks should drive 4-6% EPS growth, which should drive about 5% DPS growth. Renewable power investments to accelerate in 2020 before lower tax credits ensue in 2021 and beyond, though extension of renewable tax credits would be positive.
	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.