UOB Investment Insights

Market Outlook H2 2020

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Editorial

COVID-19 took the world by surprise in early 2020 with hard-hitting consequences. Governments had to implement lockdown measures which caused disruptions in ways we could not have imagined. Within two months, we had to adapt to changes in the way we live, commute, consume, shop, work, and even engage with people around us.

Charting the Way Forward: Recognising the New Norms

Many of us are working from home, engaging our colleagues through video conferencing tools such as Microsoft Teams, and our students have been going online to receive home-based learning from their teachers via Zoom. When the economy went into a lockdown, purchasing activities through e-commerce platforms skyrocketed. And while we face limitations on physical social gatherings and cannot go to the cinemas for entertainment, we were able to adapt through the use of social media or virtual entertainment platforms. Netflix added 16 million new subscribers in Q1 2020, twice its usual rate, while Zoom saw daily active participants jump from 10 million in December 2019 to 300 million in March 2020.

Unfortunately, there are companies that have been laggards in adapting their business to embrace technology. This pandemic has accelerated the challenges faced by such companies that have been totally unprepared for the digital world, and also those with high financial commitments or leverage. Some of these names sent shockwaves through the world due to their long history of existence, including Gold's Gym, Hertz, J. C. Penney and Virgin Australia.

Without the intervention of governments, more companies would have collapsed and unemployment levels may even rival those experienced during the Great Depression. Central banks across the world dropped their rates to near-zero levels and some continued to maintain negative rates. They also reactivated their asset purchase programmes and expanded their balance sheets to new record levels. The US Federal Reserve's balance sheet alone added another USD 3 trillion year-to-date[1]. Collectively, governments worldwide have also pledged more than USD 9 trillion[2] in fiscal support measures, which will increase total government debt by 18.7%[3] of global GDP this year, or an estimated USD 18 trillion, which is three times the size of the Japanese economy, or just below the GDP of the entire European Union (ex-UK).

The supply disruption and demand destruction suggest that an economic recovery back to pre-COVID levels will need time; alongside inflation that will stay muted in the near- to mid-term. With growing government debt levels and inflation unlikely to rise soon, we expect interest rates will stay at this low level for longer because of the health crisis.

Managing the Way Forward: Looking to New Winners

With risk-free rates so low, it will be prudent to invest in assets that can offer you a yield pick-up. US and Asian investment grade bonds currently deliver reasonable yields of 2.3% and 2.5% p.a. respectively. There are also winners who have distinguished themselves in this crisis. Their business models were already riding on megatrends such as Artificial Intelligence (AI) and technology applications that are shaping our future. And the win has been simply accelerated. Such companies will continue to win and thrive in the post-COVID world. Another winner is healthcare businesses that continue to innovate to meet the demands of changing demographics and defend against known and potential biological threats. Beyond traditional investible assets, such as bonds and equities, alternative assets such as precious metals can also hold up their investment value, underpinned by low or negative rates which are here to stay.

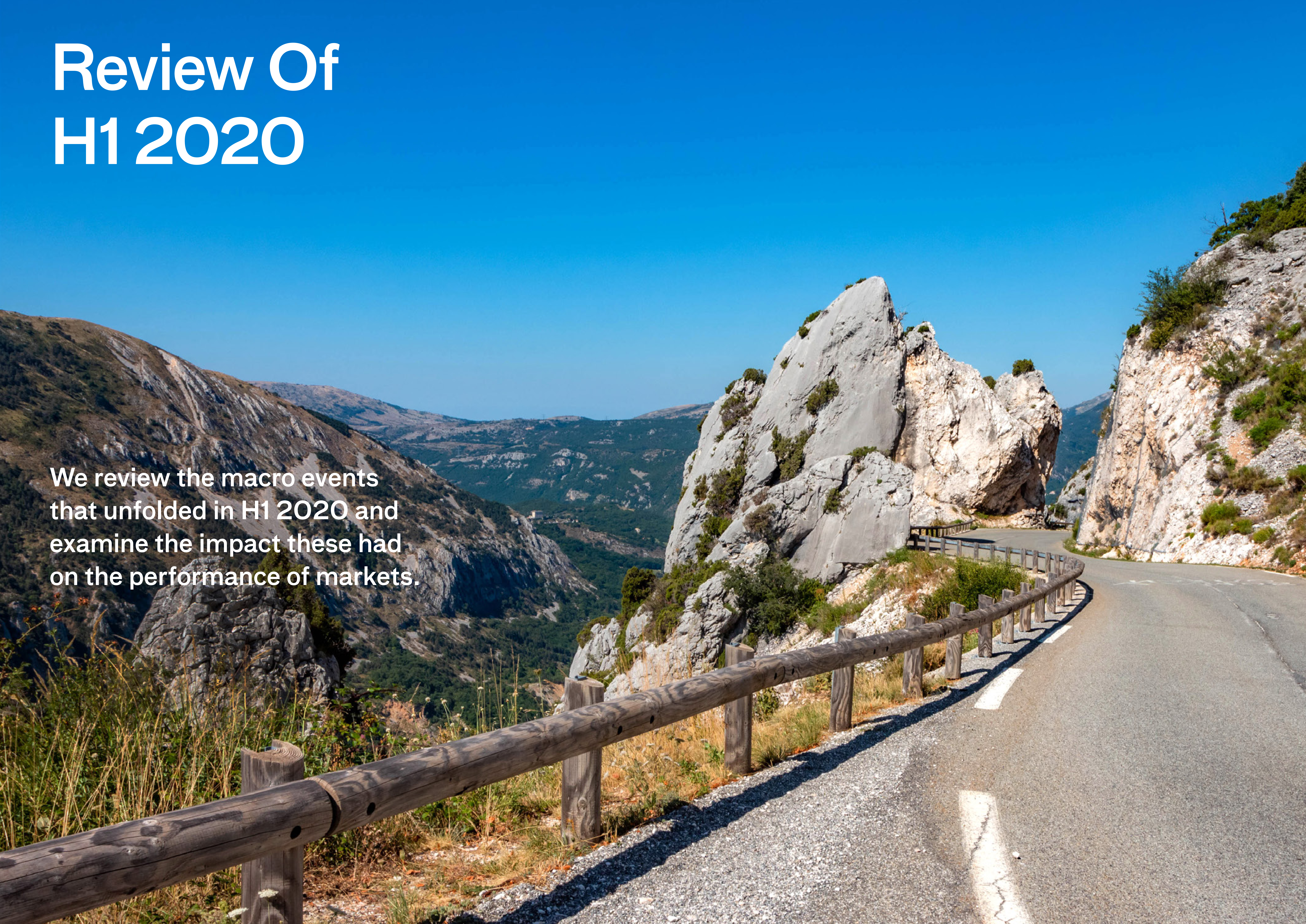
Financial market performance ahead is expected to be bumpy. The recent strong recovery has run ahead of market fundamentals. Assets are trading at valuations higher than pre-COVID levels when earnings and returns of most companies have been severely impacted by the pandemic. This confidence – shored up by central banks and government actions that suggest nothing will be allowed to fail – probably increases the vulnerability of a market correction if governments do not adequately deliver on their promises. There also remain unresolved market concerns including the risk of a resurgence in COVID-19 cases, disappointing earnings results, rising US-China tensions and a heated US presidential race this November. Against such a backdrop, how should one manage one's investments going forward? Adopting a longer investment horizon and investing in our top investment calls in tranches is what we would advise investors who are looking to ride through the potential volatility ahead.

The uncertain outlook of this pandemic can only be quelled by the development and widespread availability of a working vaccine. In the meantime, we need to adjust and adapt our lifestyle to cope with the very existence of this virus. We must learn to manage this living risk by taking precautionary measures, such as wearing a face mask, maintaining hygiene standards, avoiding crowds and practising social distancing. As we continue our journey ahead into the second half of 2020 and beyond, the economic and investment environment will be brighter, rewarding us well with the investment decisions we made earlier. Till then, I hope that you will continue to stay safe and maintain a healthy lifestyle.

Chung Shaw Bee
Singapore and Regional Head,
Deposits and Wealth Management,
Personal Financial Services

1 US Federal Reserve, June 2020.
2 International Monetary Fund, May 2020.
3 International Monetary Fund, June 2020.
Data source: Bloomberg. All percentages shown are expressed in their local currency terms where applicable and reflect total returns from 1 January till 15 June 2020 unless otherwise stated.

Review Of H1 2020



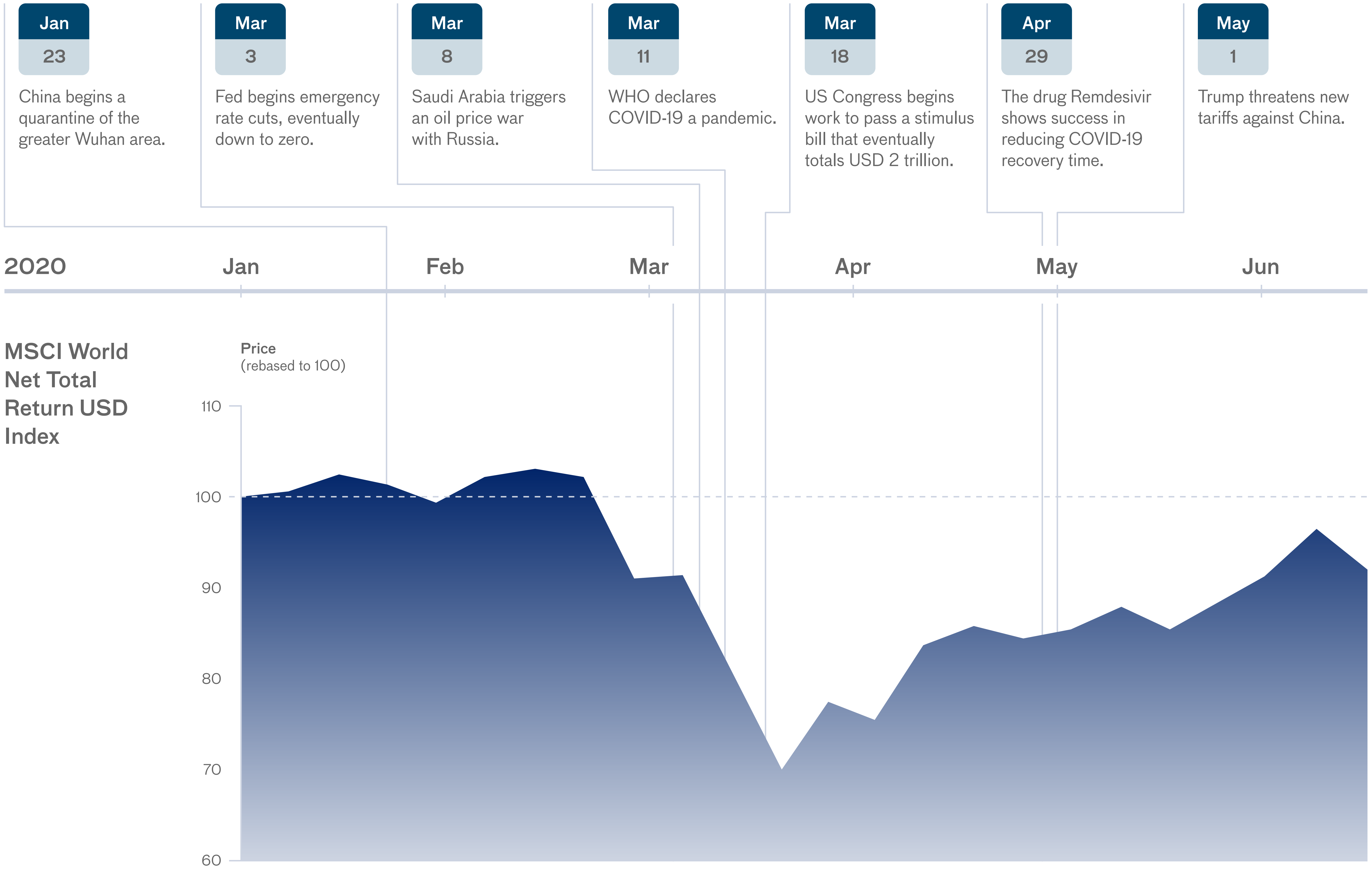
We review the macro events that unfolded in H1 2020 and examine the impact these had on the performance of markets.

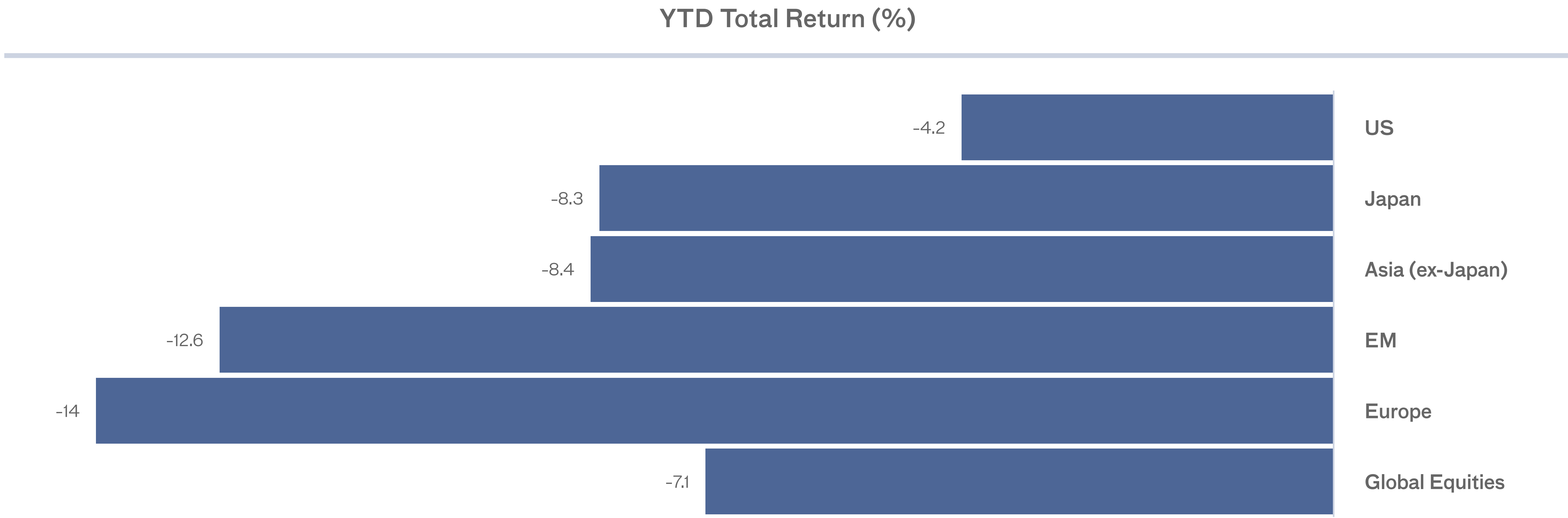
Asset Class Reviews

Equities

After a positive start to the year riding on investor expectations of a US-China reconciliation, equity markets around the world fell at an unprecedented speed as COVID-19 spread. Within five weeks, global equities fell 34% from a 12–February high to a 23–March low, and markets entered bear market territory. Efforts in all major developed and emerging countries to deploy both fiscal and monetary stimulus to support their economies have seen global equities and emerging market equities partially recovering from their lows to end with year-to-date returns of -7.1% and -12.6% respectively.

Among global sectors, only technology (+9.0%) was positive year-to-date as lockdowns prompted higher demand for digital platforms. Healthcare (-0.3%), communications (-0.7%) and consumer discretionary (-0.9%) were close behind as researchers race to find a vaccine while consumers engage in home entertainment and shopping on e-commerce platforms. The worst-performing sectors were energy (-33%), attributed to the sharp drop in oil prices, and finance (-21.6%), as a result of recession and liquidity fears.





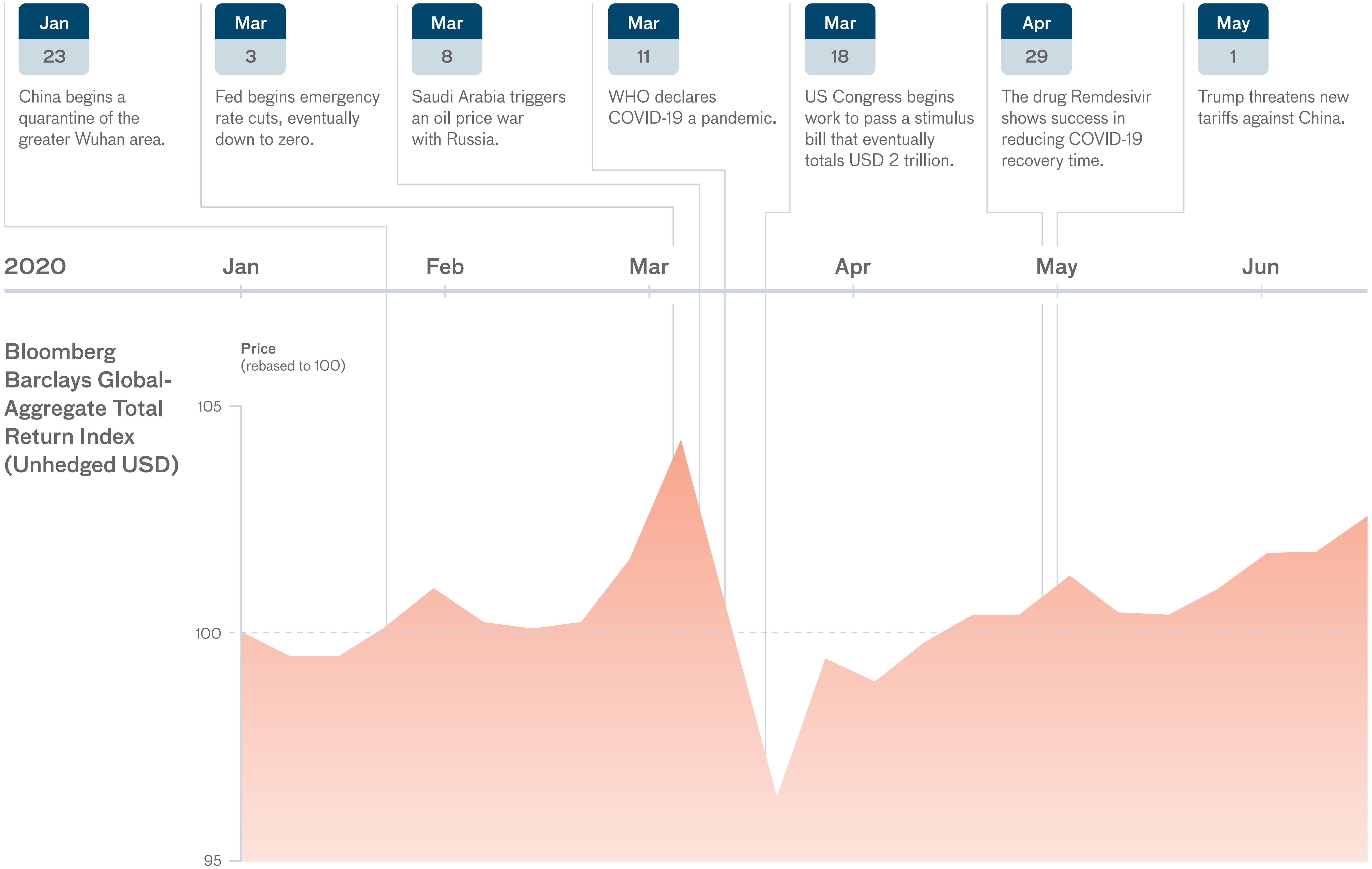
Source: Bloomberg. All percentages shown are expressed in their respective local currency terms, and reflect the total returns from 1 January till 15 June 2020.

Fixed Income

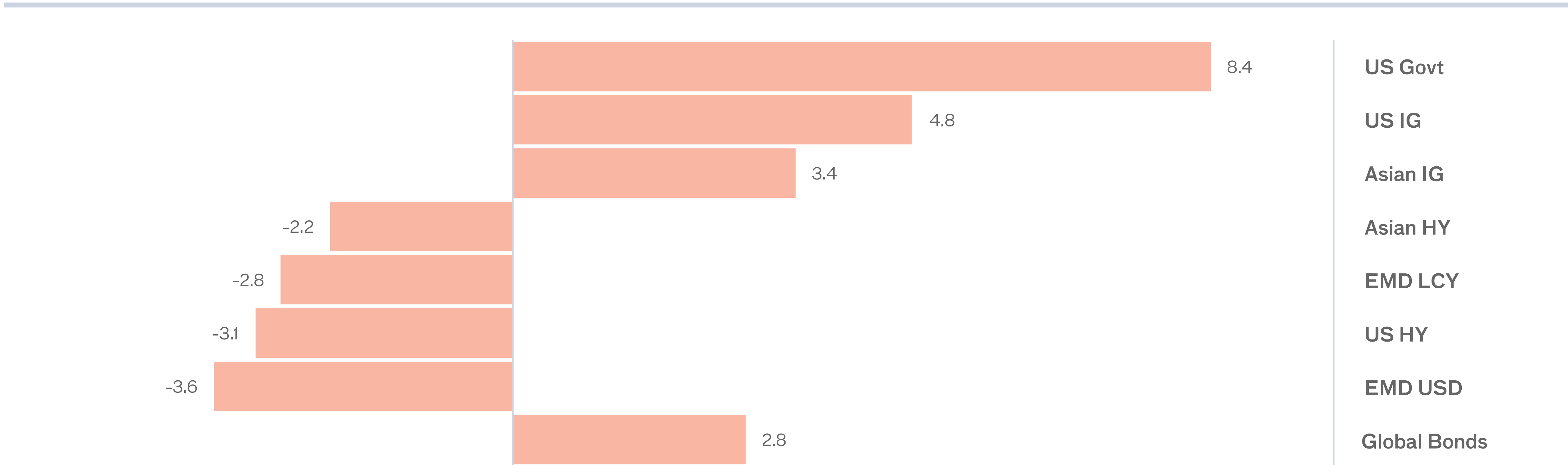
Global bonds have fared well (+2.8%) amid lower rates as central banks upped easing measures to tackle the economic fallout from the pandemic. Government bonds strongly outperformed credit markets in the first half of the year, as US Treasuries benefitted from risk aversion and rose 8.4%.

The major central banks' expansion of bond purchases further supported the credit markets after the initial liquidity panic in March:

- US investment grade (IG) bonds fell 19.8% and recovered after the Fed's injections to gain 4.8% year-to-date.
- The trend in the riskier high yield (HY) bonds and emerging market debt (EMD) was similar, falling to the 23-March low (US HY: -21%, Asia HY: -18%, EMD: -20.6%), and subsequently recovering partially to remain negative year-to-date (US HY: -3.1%, Asia HY: -2.2%, EMD: -3.6%).
- Finally, US dollar-denominated emerging market debt corrected 20.6%, and rose thereafter to be 3.6% down year-to-date.



YTD Total Return (%)



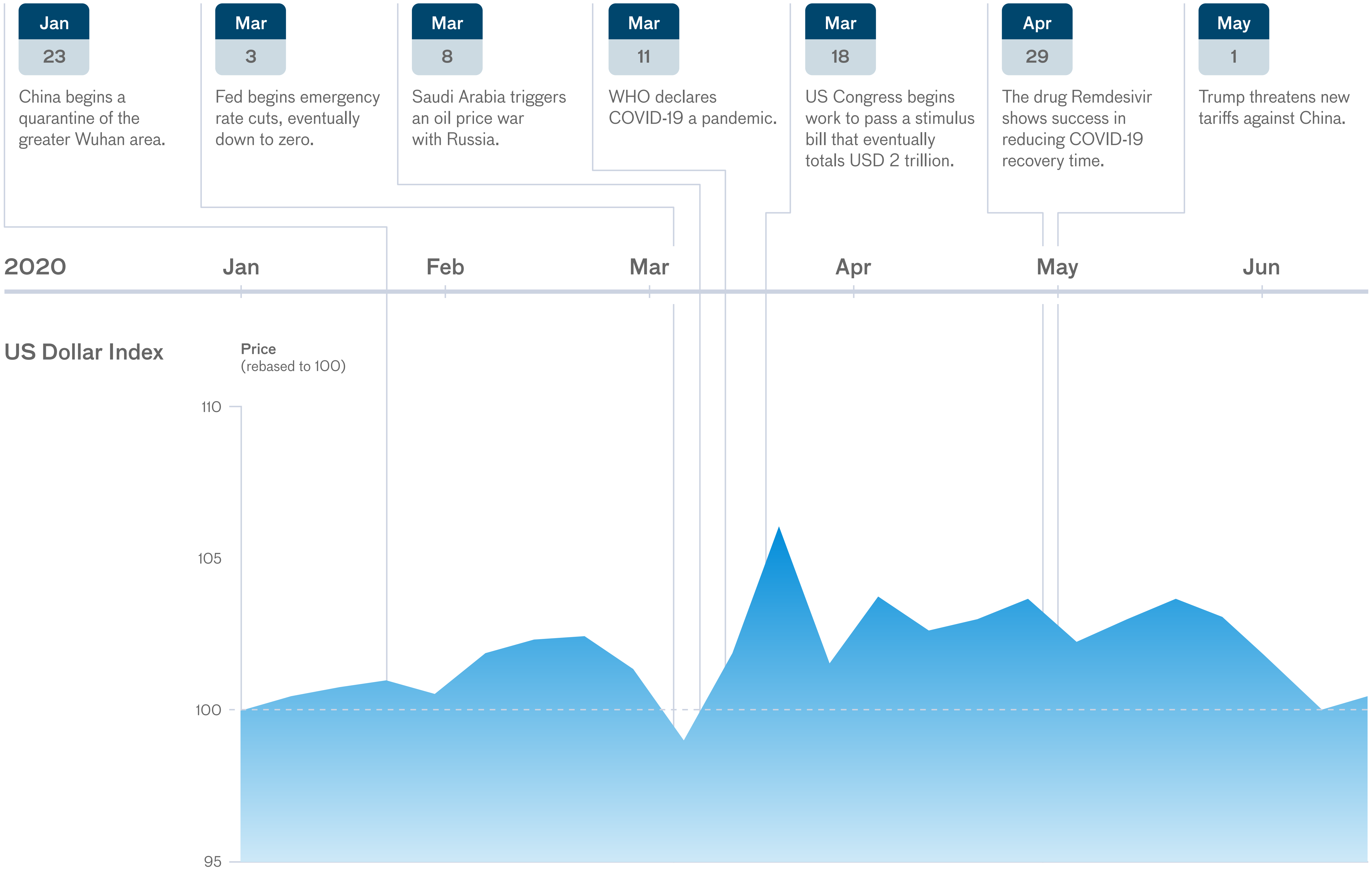
Source: Bloomberg. All percentages shown are expressed in their respective local currency terms, and reflect the total returns from 1 January till 15 June 2020.

Currencies and Commodities

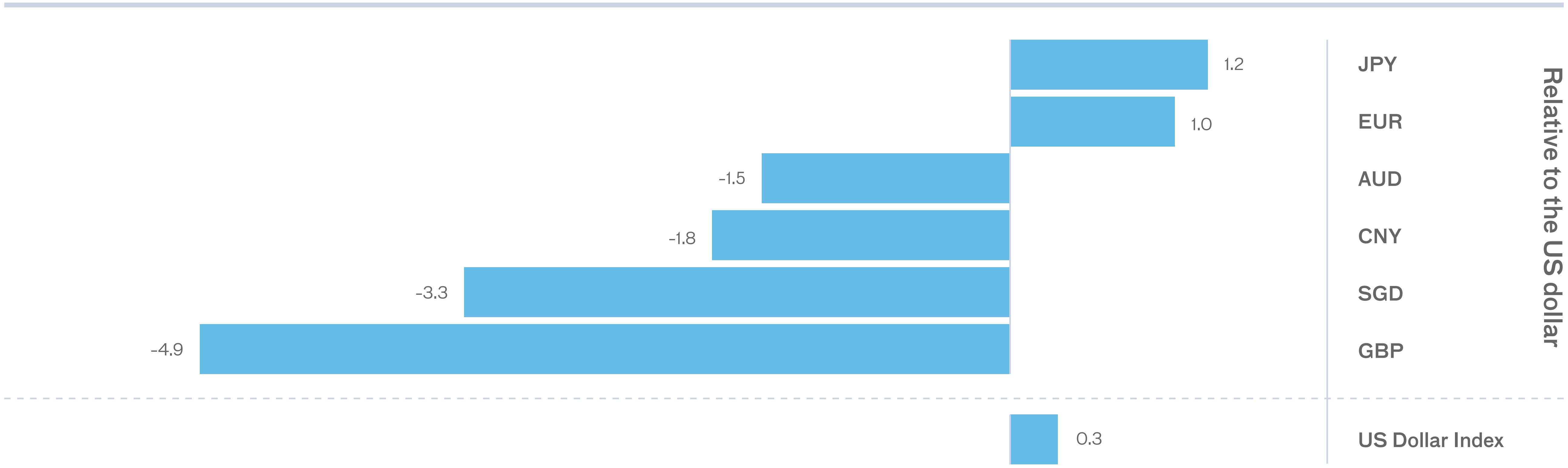
The US dollar rallied across the board as a result of risk aversion and a liquidity squeeze (the US Dollar Index was up 0.3% year-to-date). It remained strong relative to most G7 and emerging market currencies. Other safe-haven currencies were also resilient in these market conditions, like the Japanese yen and the Euro, which rose +1.2% and +1.0% respectively against the US dollar.

Crude oil prices collapsed below USD 20/bbl in April as drastically lower demand coupled with the supply shock from the price war between oil-producing countries took their toll. Curbs on output have resulted in the stabilisation of oil prices, which have recovered to USD 40/bbl. Year-to-date, Brent crude prices fell 39.8%.

Meanwhile, a combination of risk aversion, central bank easing and geopolitical tensions led to gold prices rising 13.7% year-to-date to USD 1,725/oz.



YTD Currency Movements



Source: Bloomberg. All percentages shown are expressed in their respective local currency terms, and reflect the total returns from 1 January till 15 June 2020.

Tactical Calls Review

Open Calls
Given the challenging market conditions, our market calls were resilient and most of them have fared better than the global equity benchmark, which fell 7.1% year-to-date.

Among our Megatrend ideas, Artificial Intelligence (AI) and Innovation equities fared the best, with a year-to-date gain of 18.8%. This reflected the surge in demand for AI-applications, digital solutions and technology services during the pandemic-driven lockdowns. Global Healthcare also responded relatively well given its defensive traits (-1.2%) and we continue to like the sector because of the global support for healthcare services.

Within the Emerging Market (EM) space, both Chinese onshore and offshore equities outperformed, at -2.8% and -1.4% respectively year-to-date, against -12.6% in broader EM equities. With China quick to restart its economy, markets are preparing for a domestic recovery, buoyed by Beijing's supportive fiscal and monetary measures. Global quality equities, i.e. companies with robust earnings growth and stronger balance sheets, responded better with -0.9% year-to-date return, given stronger fundamentals that helped them navigate better in environments of weaker growth and uncertainty.

US consumer staples, on the other hand, were down -6.2%, but have outperformed global equities by +0.9%. For investors who prefer to adopt a more cautious approach, this remains a call that can be considered as markets are expected to remain volatile for the rest of 2020.

Closed Calls
On EM equities, we have narrowed our focus to Asia ex-Japan equities. Several factors – including the region's better ability to manage the pandemic, its attractive valuations and further room for policy easing if necessary – leave Asia poised for outperformance when growth recovers. EM ex-Asia faces more headwinds as the major components are oil-exporting countries, particularly if commodity prices continue to stay depressed.

We have also initiated a High Conviction call on US high yield bonds, which should benefit from a compression in credit spreads as the economy gradually recovers from COVID-19.

Theme	Call	Start	End	Since Start^ (Total Return)	Year To Date+ (Total Return)
High Convictions	EM Equities	1–Jan–18	3–Jun–20	-9.7%	-10.7%
	Asia ex-Japan Equities	4–Jun–20	Ongoing	-1.5%	-1.5%
	US High Yield	1–Jun–20	Ongoing	1.7%	1.7%
	US Consumer Staples	31–Aug–19	Ongoing	-1.3%	-6.2%
Megatrends	Global Quality Equities	1–Apr–17	Ongoing	48.8%	-0.9%
	Global Healthcare	1–Jan–17	Ongoing	49.6%	-1.2%
	AI and Innovation*	1–Jan–19	Ongoing	53.1%	18.8%
	China Equities (H-Shares)	1–Jan–19	Ongoing	21.4%	-1.4%
	China Equities (A-Shares)	1–Oct–18	Ongoing	18.5%	-2.8%

* Performance of Allianz Global Artificial Intelligence Fund is used as the proxy for artificial intelligence and innovation equities due to the unavailability of a suitable benchmark index.
^ Source: Bloomberg. All percentages shown are expressed in their respective local currency terms, and reflect the total returns from call start date to 15 June 2020 or call end date, whichever is earlier.
\+ Source: Bloomberg. All percentages shown are expressed in their respective local currency terms, and reflect the total returns from 1 January or call start date, whichever is later, to 15 June 2020.

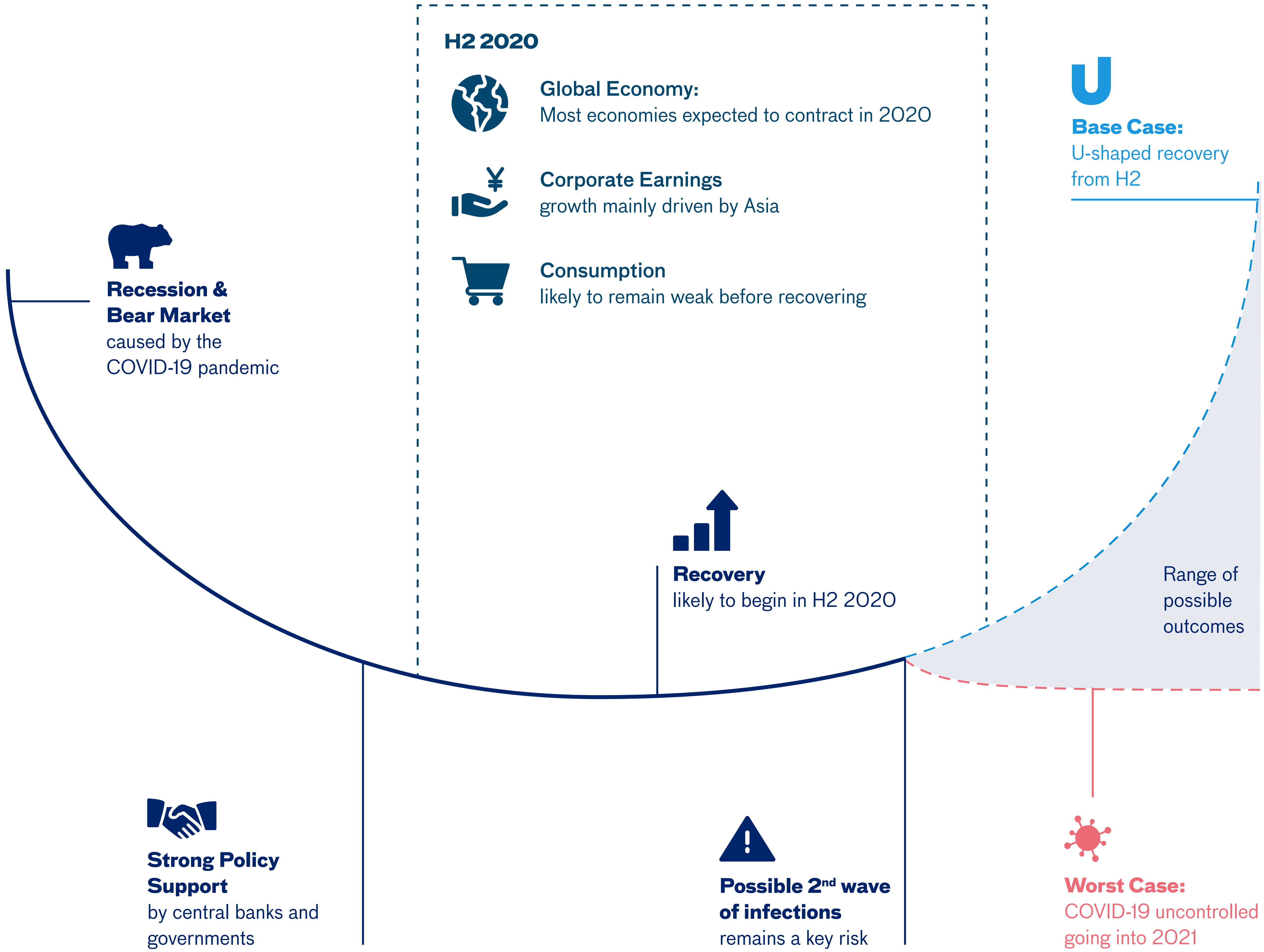
Macro Outlook for H2 2020

The macro environment forms the backdrop for our investment views. It is with an understanding of the driving forces shaping the investment landscape that we are able to formulate our strategies.

What Can Investors Consider?

- Markets will remain volatile in H2 due to the uncertainty of a second wave of infections and its severity.
- Investors should remain invested, and enter the markets prudently in tranches when opportunities present themselves.

Macro Outlook for H2 2020



Coming to Terms With a New Landscape

The global economy is set to gradually recover against a new market and macro backdrop, although fears of a prolonged pandemic and potential headwinds from escalating US-China tension weigh on confidence.

The global recession triggered by COVID-19 might linger given a possible second wave of infections if countries ease restrictions prematurely or without adequate safety measures to limit infections.

Companies hit hard by the lockdowns may lay off more workers and tighten cash outflows despite government programmes to keep jobs. Under such uncertainty, consumers may delay resuming a normal lifestyle and this can, in turn, impact consumption. Although economic activity will gradually resume, full recovery will likely require a COVID-19 vaccine and additional government stimulus.

The pandemic will also fuel longer-term behavioural shifts. Digitalisation and e-commerce will accelerate, affecting how consumers and businesses interact in this new normal of reduced physical engagements. Other changes will be more gradual, including some backtracking from globalisation as companies move some production back to their own shores.

In the meantime, a resurgence in US-China trade tensions is expected as we draw closer to the US elections in November. Threats and anti-China rhetoric will be a regular feature of Donald Trump's presidential election strategy, but he will likely resist action that might jeopardise economic recovery at home.

U-Shaped Recovery With Asia Leading the Way

Our base case is a U-shaped recovery, with economic activity gradually gathering momentum in the later part of 2020.

Amid these dynamics, the following three forces will dictate the pace and extent of economic recovery, both at global and local levels:

- The speed at which the pandemic subsides
- How quickly economic activity resumes as measures are lifted
- Whether any new waves of infections require a return to lockdowns

The GDP outlook reflects the scale of the challenges facing governments. The International Monetary Fund (IMF) forecasts the global economy to shrink by 4.9% in 2020 – the sharpest full-year contraction since the 1930s Great Depression. Developed countries are expecting an 8.0% contraction in economic growth (Figure M1), compared with a 3.0% contraction for emerging economies.

In the US, the unemployment rate skyrocketed from 4.4% in March to a post-Depression high of 14.7% in April, but is expected to fall to 9.5% by year-end. Support for businesses and households have come via fiscal and monetary stimulus such as corporate relief, cash handouts, interest rate cuts and government-backed loans. Yet in the pre-November election campaigning, competition between political parties is likely to impact the coordinated policymaking needed to prevent further economic damage.

In the Euro area, the European Central Bank has pledged monetary stimulus via more asset purchases and cheap funding. If the European Union can unify and successfully implement its EUR 750 billion Coronavirus Recovery Fund, it can boost the region's recovery prospects.

Japan's highly cyclical economy, meanwhile, is heavily dependent on China's recovery and demand from developed markets. The postponement of the 2020 Tokyo Olympics has certainly resulted in disappointment and excess supply. The Japanese government is likely to implement new stimulus measures to prop up the economy for now.

In Asia, export-reliant markets such as South Korea, Taiwan and Indonesia are at the mercy of demand in the developed world, with technology industries getting caught in the middle of the US-China dispute. However, the region's quick response to the initial outbreak might enable Asian countries to rebound relatively quickly. Policymakers are also committed to deploying fiscal policies to support growth.

Asian Earnings Continue to Grow due to Government Spending

Within the global context, Asia will lead in earnings growth for the rest of 2020, spurred by supportive fiscal policies.

Companies are facing the uphill task of determining the pandemic's impact on earnings. This has led to the move by 80% of S&P 500 companies withdrawing forward earnings guidance for 2020. Market consensus, however, forecasts earnings to contract across the S&P 500 (-13.9%) and EuroStoxx 600 (-14.7%) before rebounding in 2021 (Figure M1).

Japan's TOPIX is the only major developed market to forecast positive earnings growth for 2020, at 7.7%. Key factors driving the growth include an expected weaker Japanese yen amid a global recovery to fuel export-reliant automobile and electronics industries, and renewed consumer demand after the initial dampening effect of the 2019 sales tax hike.

In Asia, earnings will likely grow by 3.9% as companies increasingly look to capitalise on fiscal packages targeting domestic projects, such as China's "new infrastructure" of 5G networks, artificial intelligence development and digital transformation.

Consumption Through E-commerce

Consumers have embraced e-commerce out of necessity, and could adopt it permanently. High unemployment does not necessarily mean low consumption.

The pandemic has forced individual and family consumption to shift from brick-and-mortar shops to e-commerce platforms, resulting in a 209% increase in online sales for April compared to a year ago[1]. Being forced to embrace an online platform accelerates its adoption rate, as consumers discover the benefits of online shopping, eventually contributing to the growth of e-commerce platforms and bringing in higher revenues.

Despite significant government handouts globally, uncertain job markets has resulted in most people being more inclined to save rather than spend. The US personal savings rate, for example, rose four times from 8.2% in February 2020 to 33% in April 2020[2].

As the outlook of global economic recovery improves, it will in turn drive positive sentiment of job security and consumer confidence, thereby prompting increased consumer spending despite headline unemployment numbers remaining high. This was evidenced in the past six US recessions where consumption growth has typically led payroll growth by six months[3].

1 ACI Worldwide Research, 12 May 2020. ACI Worldwide is a NASDAQ-listed electronic payments company supporting 6,000 organisations globally.
2 US Bureau of Economic Analysis, Federal Reserve Bank of St. Louis, May 2020.
3 GaveKal Research, 8 June 2020.

Gradual Pickup in Economic Recovery

Caution will define how companies and investors approach the rest of 2020 as they await clear signs of progress – both in terms of how well COVID-19 is controlled as well as economic recovery.

Based on the progress in tackling the pandemic, a gradual economic recovery is expected in H2 2020.

However, many companies and individuals will likely remain cautious in spending due to:

- Fears of a second wave of COVID-19 infections
- Possible escalation of US-China tensions
- Potentially higher financial market volatility
- Effectiveness and efficiency of government policies

At the same time, COVID-19 is creating new opportunities for investors via changes in consumer behaviour, changes to globalisation trends and increased digitalisation. Significant selloffs in markets, when they occur, offer investors windows to access quality assets at more attractive levels. Explore our investment ideas in our strategy section and speak to a UOB Advisor on how to include them in your portfolio.

Figure M1
Economic and Financial Projections for 2020

Sources: UOB Global Economics and Markets Research, IMF World Economic Outlook (June 2020), Bloomberg Consensus.

Adapting to Long Term Shifts in the Wake of COVID-19

The Change to the Global Supply Chain

As companies review and potentially diversify production to mitigate future disruption to supply chains, the firms that can do so without significant efficiency losses will thrive.

Changes in attitude towards globalisation have gathered momentum over the past decade. Some lower- and middle-income jobs disappeared as firms continue to shift production to lower-cost developing countries. This led to the rise of populism, seen notably by Donald Trump's election as US president and British residents voting for Brexit.

As Trump had promised his voters, he withdrew the US from the proposed Trans-Pacific Partnership, renegotiated the North American Free Trade Agreement (now called the US-Mexico-Canada Agreement) and threatened China, Japan and Europe to widen access for US products. Trump also pushed for companies to relocate production to US shores.

COVID-19 has compounded this trend, showing how an unpredictable pandemic can affect global supply chains, especially the shutdown in Chinese production, for an extensive period.

Though fuelled by different drivers, companies will increasingly want to minimise disruptions, moving from "just-in-time" to "just-in-case" supply chain philosophy. They will likely diversify production bases to countries outside China, and re-house some capabilities in domestic markets (Figure M2).

Even though this process will likely be brought forward post COVID-19, it will still take time – factories need to be built, with more automation in the production process to manage labour costs. Workers with the right skillsets to utilise these new technologies must also be recruited or trained.

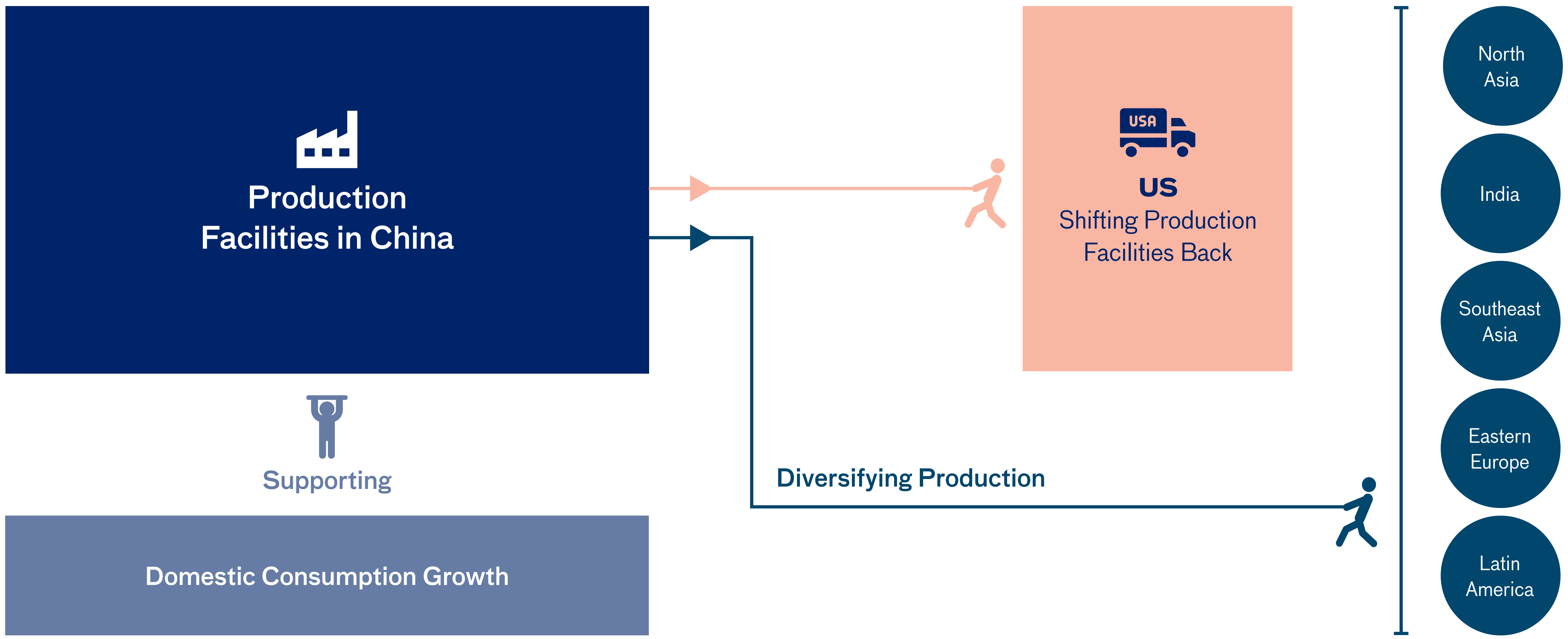
For low-value goods, Asian countries, especially across Southeast Asia and India, will more likely benefit as labour is plentiful and costs are generally lower. It could also result in greater connectivity to global trade outside China – assuming major economies do not set up new trade barriers against these countries too.

An unexpected side-effect for companies is higher costs from "re-shoring" and/or diversifying production centres. Together with lower discretionary spending brought about by slower wage growth, this can dampen corporate earnings growth over the next three years and will be a potential headwind for equity returns. This is a risk investors need to be aware of.

For China, it continues to mature economically with domestic consumption as the main driver of economic growth. Its factories are also moving up the value chain, offering higher income products and better paying jobs.

Figure M2

Production facilities could be shifted outside of China, but China's rising domestic consumption can fill the void.



Driving More Digitalisation

Ever-greater reliance on digital activities will breed new ways for businesses to interact with customers and for individuals to consume products and services.

While the world is clearly moving toward digitalisation, COVID-19 has forced much faster adoption among businesses and individuals (Figure M3). Companies that have invested in digitalisation, such as e-commerce platforms Amazon and Alibaba, would have reaped the benefits. With widespread adoption of digitalisation, key technologies such as high speed broadband and 5G have become critical to our everyday lives.

Businesses are also striving to engage customers digitally. Besides providing mobile apps to browse product and service offerings, companies are also offering virtual experiences to promote sales. This has resulted in increases in e-commerce sales of 209% year-on-year as at April 2020[1].

Companies across sectors are enhancing their operations by adopting technology and digital finance (Figure M3). Workplace interactions are going digital, with the increased use of video streaming and conferencing – for example, workplace communication and collaboration platform Microsoft Teams saw a 70% increase in worldwide daily active users to 75 million from March to April 2020, logging an average 4.1 billion meeting minutes daily in April[2]. Even college lectures, exercise classes and social activities such as birthday celebrations are being conducted virtually via applications such as Zoom, which saw more than 200 million daily users in March[3].

The pandemic also forced digitalisation within Healthcare, particularly in patient monitoring, telehealth (a 50% surge in the US in March[4]) and the use of health apps. Medical staff engaged patients through video consultations during lockdowns, enabling the remote monitoring of vulnerable patients in their homes.

Such trends will likely boost already-rising demand for cloud services. To facilitate everyday business activities such as employee collaboration, documentation and access to analytics, spending on Software-as-a-Service (SaaS) and Infrastructure-as-a Service (IaaS) (such as Microsoft Office 365 and Amazon Web Services, respectively) rose by 37% year-on-year in the first quarter of 2020[5].

The increasing implementation of 5G will also transform the transportation of people and goods, with self-driving vehicles becoming more common. As a result, annual data generation is expected to reach 44 zettabytes (44 trillion GB) by 2020[6], creating demand for Big Data services and applications as this information will require processing.

With the proliferation of data collection and consumption, data and cybersecurity are priorities for governments, corporations and individuals. Concerns over the robustness of national digital infrastructure, the increase in cyber theft and fraud, and personal data security will need to be addressed as this digital journey progresses.

1 ACI Worldwide, May 2020.
2 Wall Street Journal, June 2020.
3 The Verge, June 2020.
4 CNBC, April 2020.
5 Data Center Dynamics, May 2020.
6 International Data Corporation, Wellington Management, UOB Asset Management, May 2020.

Figure M3
Companies are incorporating digital strategies and business models

The New Pace That the COVID-19 Crisis Is Driving, Median Frequency.

Source: McKinsey & Co, Digital Strategy In A Time Of Crisis, 22 April 2020.

Key Drivers and Risks

Drivers

The key drivers for H2 2020 can be summarised below:

- **Sustained low inflation** – falling demand due to the slowdown in economic activity in the wake of COVID-19 has a deflationary effect.
- **Ongoing central bank support** – interest rates are expected to remain low for the foreseeable future.
- **Global government stimulus** – this will help to mitigate the negative impact of the pandemic on economic growth.

Risks

We see the following key risks for H2 2020:

- **Increasing US policy uncertainty** – as we get nearer to the November presidential elections, US-China tensions may escalate further as US politicians could seek to win votes by vilifying China.
- **A resurgence of COVID-19** – a second wave of infections could extend the global recession, further damaging the global economy and delaying recovery.
- **Fiscal policy missteps** – markets could be concerned that governments may not direct the stimulus efficiently, resulting in increased debt but a limited boost to the economy.

Strategy

As the global economy emerges from COVID-19, investors should remain cautiously optimistic. While unprecedented central bank and government support globally will likely prevent a 1930s-style Great Depression, financial markets are expected to stay volatile for the rest of 2020 amid fears of a second wave of infections and rising US-China trade tensions. Any significant selloffs in markets are therefore good opportunities for investors to buy into quality assets at cheaper valuations.

More specifically, given the changes to globalisation, companies with efficient cost structures and optimal supply chain strategies are attractive investment targets. Similarly, companies with access to onshore markets of countries with rising domestic consumption, such as China and India, will be less impacted from demand disruptions.

In the area of digitalisation, companies that harness, facilitate and enhance these activities will be winners in the post-pandemic world. By contrast, those companies that fail to adapt may lose out in the long run and potentially perish. In particular, greater deployment of Artificial Intelligence (AI) based applications and services bode well for companies adopting AI to optimise business models and understand the evolving demands of the marketplace.

Key Events Calendar

Political
Central Banks
Major Event

H2 2020

- **14—15 Jul** BoJ Meeting
- **16 Jul** ECB Meeting
- **28—29 Jul** US FOMC Meeting
- **17—20 Aug** US Democratic Presidential candidate announcement
- **24—27 Aug** US Republican Presidential candidate announcement
- **10 Sep** ECB Meeting
- **15—16 Sep** US FOMC Meeting^
- **16—17 Sep** BoJ Meeting
- **28—29 Oct** ECB & BoJ Meeting
- **3 Nov** US Elections (Presidential, Gubernatorial and Congressional)
- **4—5 Nov** US FOMC Meeting
- **21—22 Nov** 2020 G20 Summit in Riyadh, Saudi Arabia*
- **10 Dec** ECB Meeting
- **15—16 Dec** US FOMC Meeting^
- **16—17 Sep** BoJ Meeting
- **31 Dec** Brexit transition period due to expire unless renewed

^ Accompanied by Summary of Economic Projections.
* May be postponed/cancelled due to social distancing measures.

Asset Classes and Strategy

The interplay of various aspects of the investment climate influences the behaviour of different asset classes. Longer-term trends and development similarly shape the outlook for assets. It is by recognising these factors that we are able to identify high-conviction ideas and megatrends that underpin our investment strategies.

Using VTAR to Identify Ideas

Our award-winning framework focuses on analysing large volumes of financial data in the four components of Value, Trend, Activity and Risk (known as VTAR) to provide a holistic view of financial markets and identify investment opportunities across asset classes, sectors, geographical regions, and time periods. The UOB Personal Financial Services Investment Committee then examines these insights, in tandem with key risks, and comes to an eventual vote to determine the attractiveness of each potential investment idea.

VALUE

Purpose
Identifying investments with attractive valuations and earnings potential.

Common indicators
- Price-to-Earnings Ratio (P/E Ratio)
- Earnings Growth (EPS Growth)
- Option-Adjusted Spreads (OAS)

TREND

Purpose
Understanding the trend of the investment.

Common indicators
- Simple Moving Averages (MAs)
- Relative Strength Indicator (RSI)
- Fund flows

ACTIVITY

Purpose
Understanding the macro environment and business activities that may affect performance.

Common indicators
- Central bank policies
- Composite Purchasing Managers Index (PMI)
- Industrial Production (IP) and Retail Sales

RISK

Purpose
Identifying key markets risks and potential mitigating factors.

Common indicators
- Geopolitical events
- Industry- or region-specific events
- News flows

Asset Class Views

We maintain our neutral view on equities and slightly positive view on fixed income because of the ongoing uncertainties for the remainder of 2020. Equity markets currently appear to price in a quick recovery for economies, while understating the risk that the economic recovery may be hampered by a second wave of COVID-19 infections and/or escalation in US-China tensions. We would caution investors against being swept up by the current wave of euphoria.

Equities

Given COVID-19 uncertainties, the pace of global recovery is expected to be slow and gradual – hence our neutral stand on equities. There are some concerns over whether the announced governments' stimulus measures are adequate in providing timely support to businesses and households, as well as the ability of governments to successfully contain the outbreak. Given these concerns, volatility can be expected to remain elevated in the near term, which explains us recommending a 'cautiously optimistic' stance.

We are less favourable on developed markets for the following reasons: the rich valuations of US equities (21.5x price-to-equity, or P-E ratio), the difficulty in achieving a united European fiscal response and the tepid Japanese economy that warrants concern.

Asia ex-Japan markets, on the other hand, present more opportunities as Asian policymakers have room for more monetary stimulus when needed, which provides broad-based support for financial assets in general. Asia ex-Japan equity valuations are also more attractive (14.2x P-E ratio) compared against developed markets (20x P-E ratio), with more upside potential. In addition, China has reopened its economy earlier than others, thus allowing a revival of growth that should benefit the broader region.

Fixed Income

We remain overweight on fixed income as yields of various bond segments are now more attractive than before, and there is also the risk of a second wave of COVID-19 infections reintroducing market uncertainty. We are also encouraged by the support from central bank asset purchases which has been providing liquidity to bond markets.

Low interest rates make government bonds unattractive in the medium-term, with most of them offering yields of 1.0% or less, despite being good defensive assets during market selloffs. This makes investment grade corporate credits relatively more attractive, especially for Asian debt, which offers relatively higher yields (3.0%—3.5%) than its global peers (2.0%—2.5%). With Asian central banks remaining dovish given muted inflation, Asian investment grade bonds will remain supported as the demand for yield remains.

For investors willing to take on more risk for higher yields, we see an opportunity in the BB+ space of US high yield bonds, which offer reasonable yields and spreads, while being supported by the US Federal Reserve's bond purchase program. Emerging market bonds on the other hand are weighed down by poor investment sentiments – we remain neutral on these for now.

Currencies and Commodities

With global demand being weak, the US dollar will likely remain strong against Asian and emerging market currencies. As the global economy improves, the tide will then turn in the favour of Asian and emerging market currencies. During this time, oil prices are likely to stay within USD 30 to USD 40/bbl as demand is likely to recover gradually to pre-pandemic levels. Gold prices are likely to remain supported by central bank easing and its safe-haven appeal, rising to USD 1,750/oz by Q4 2020.

Asset Class	Subclass	VTAR	View
Equities	US	V: Neutral, T: Neutral, A: Neutral, R: Negative	Neutral
	Europe	V: Neutral, T: Negative, A: Negative, R: Negative	Slightly Negative
	Japan	V: Positive, T: Negative, A: Neutral, R: Negative	Slightly Negative
	Asia (ex-Japan)	V: Positive, T: Neutral, A: Positive, R: Negative	Slightly Positive
	Emerging markets (ex-Asia)	V: Positive, T: Positive, A: Negative, R: Negative	Neutral
Fixed Income	Developed market (DM) government bonds	V: Negative, T: Neutral, A: Neutral, R: Negative	Slightly Negative
	DM investment grade bonds	V: Positive, T: Positive, A: Neutral, R: Neutral	Slightly Positive
	Global high yield bonds	V: Positive, T: Positive, A: Negative, R: Negative	Neutral
	US-dollar emerging market (EM) debt	V: Positive, T: Neutral, A: Neutral, R: Neutral	Neutral
	Local-currency EM debt	V: Neutral, T: Neutral, A: Neutral, R: Negative	Neutral
Commodities	Gold		Slightly Positive
	Oil		Neutral
Currencies	US dollar		Neutral
	Singapore dollar		Slightly Negative

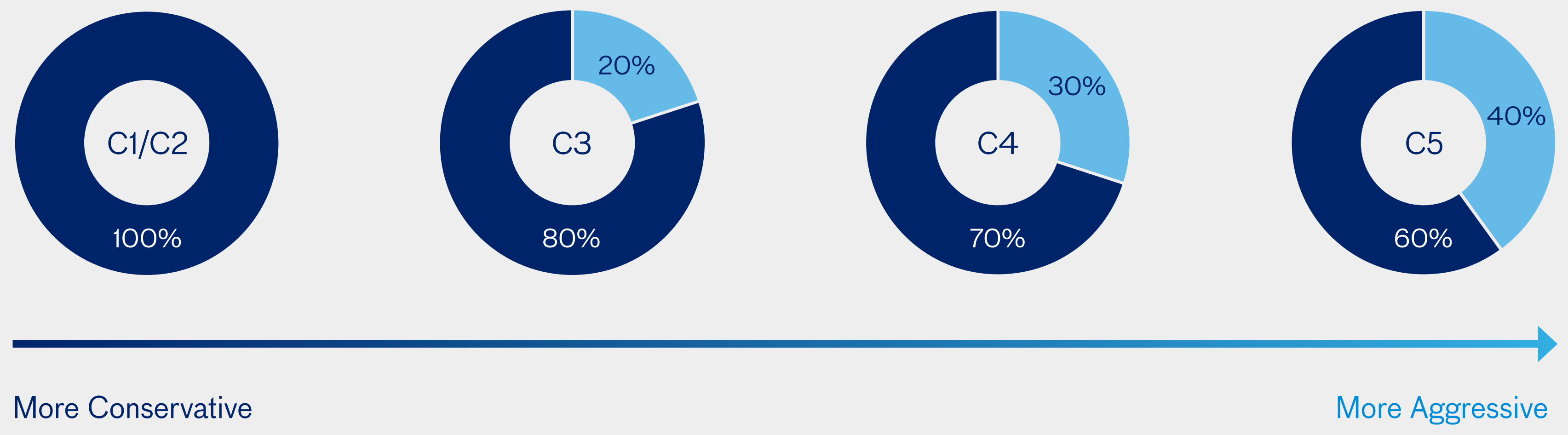
View scale: Negative · Slightly Negative · Neutral · Slightly Positive · Positive

Positive · Neutral · Negative · Not Applicable

Strategy Summary

UOB Risk-First Approach

Financial markets will likely stay volatile for the rest of 2020 as economies reopen in phases and at varying speeds, while investors adapt to a new normal post COVID-19. Our proprietary Risk-First approach can help smoothen the ride for our clients – depending on their risk profile, portfolios are constructed with a maximum of 20%, 30% or 40% allocated to Tactical investing (which has higher risk), and the remainder in Core investing.



■ Core Investing ■ Tactical Investing

Core Investing

Relatively lower risk in nature, yet able to generate reasonable returns that tend to be less volatile than the broader market in order to meet most clients' financial goals.

An allocation to core solutions helps to lower downside volatility – a much-needed outcome in such a challenging period.

Short- to medium-duration investment grade bonds

The defensive nature of these liquid bonds enables them to weather heightened volatility, giving investors greater portfolio stability. This asset will also experience lower drawdowns should central banks abruptly reverse their low rate stance due to an inflation spike.

Asian investment grade bonds

This asset class offers a good balance between defensiveness and yield. With relatively higher yields (3.0%—3.5%), compared with the broader global bond index (1.0%), and with spreads near their historical average (210 basis points), these bonds will benefit from the region's earlier resumption of economic activity from the COVID-19 pandemic.

Global multi-asset strategies

These strategies offer a flexible and diversified asset allocation to capture opportunities in a variety of market conditions and across various asset classes – including equities, bonds and alternatives. They can provide a mix of both income (historical 12-month yields of 4.5%—5.8%) and capital growth to meet an investor's financial goals.

Tactical Investing

Tactical strategies are identified using our award-winning VTAR framework, which focuses on analysing financial data in the four components of Value, Trend, Activity and Risk (VTAR). The framework aims to provide a holistic view of financial markets and identify investment opportunities across asset classes, sectors, geographical regions and time periods.

High Conviction Calls (6 to 12 months)

- Asia ex-Japan Equities
- Equities with High Quality Factors
- US High Yield Bonds

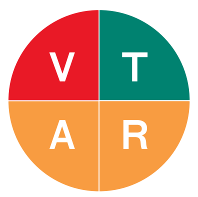
Megatrends (3 to 5 years)

- China
- AI & Innovation
- Global Healthcare

High Conviction Calls

Global Equities with High Quality Factors

Companies with high quality factors can create a competitive edge via their forward-thinking mindset in how they manage their business, stay nimble and plan for the future.



Companies are facing unprecedented challenges in the current economic climate, with overall earnings expected to fall by 10% in 2020. The impact of lockdowns on their supply chains might require them to diversify suppliers or introduce extra safety buffers which will offset some of their efficiency gains, thereby compromising on their financial discipline and sacrificing their competitive advantage. Yet, quality companies have shown resilience via stronger balance sheets, net cash positions and strong free cash flow, allowing them to tide through the recession. Having 30% less debt as a percentage of equity when compared to the global benchmark's average is an advantage, making them less burdened by interest costs and refinancing worries.

Greater prudence in how they spend and invest enables quality companies to put their capital to work via sound growth opportunities and/or give back to shareholders through dividends or share buybacks. The greater willingness to spend on research & development means these companies also have new or improved products and services in the development pipeline. Top-ranking quality companies have tended to outperform lower-rated companies over the past 30 years and generated additional returns of 1.7% to 6.3%[1].

Due to their stellar qualities, valuations of these companies are high, with a P-E ratio of 21.6x vs 17.4x (10-year average). Despite their higher valuations, they have demonstrated that they are able to withstand the recent market volatility better than their peers (Figure C1).

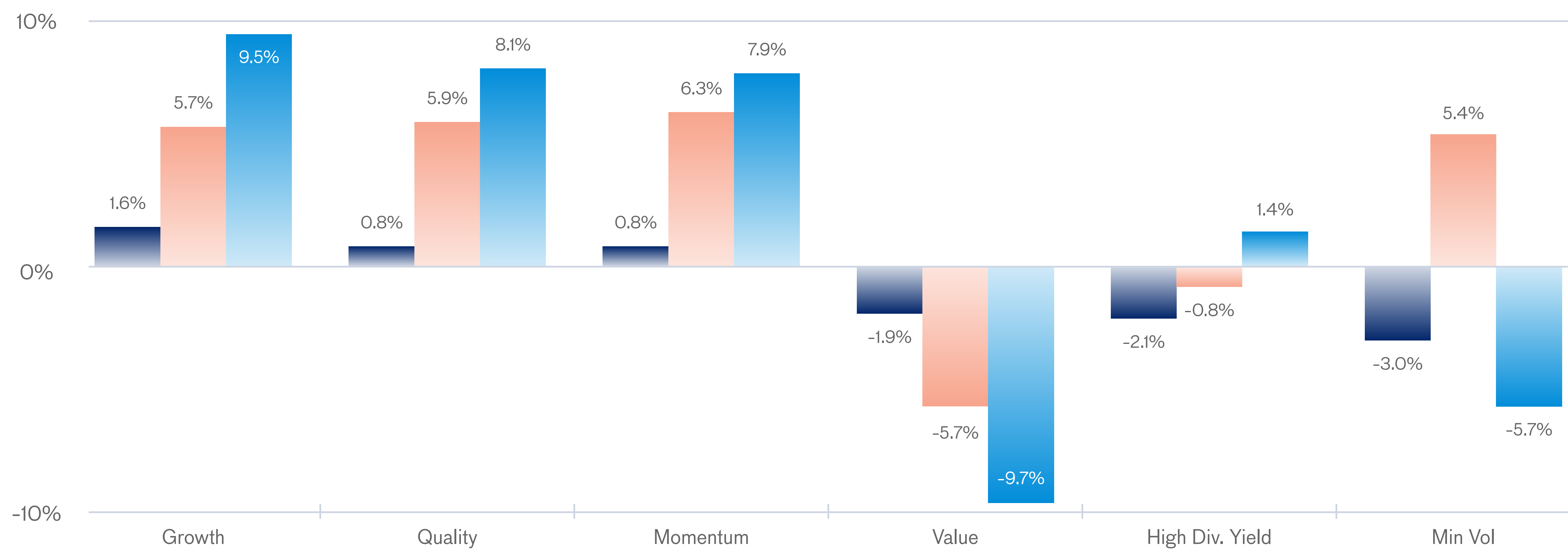
At the same time, quality companies are well-placed to grow with their emphasis on human capital development and the extensive use of technology. This allows them to manage costs better as well as adapt to changing economic environments. Ultimately, these elements enhance their competitive advantage, creating the economic moats that are common among quality companies. When the global economy recovers, they are likely to ride on the rising trend and emerge as winners.

1 Wellington Management, Empirical Research Partners analysis. Data period from 1987 to January 2020. Measured by free cash flow margin and incremental free cash flow margin.

Figure C1
Companies with higher growth and quality factors have outperformed in 2020 so far

May 2020
2020 Q1
2020 YTD

Relative Returns by Investment Style



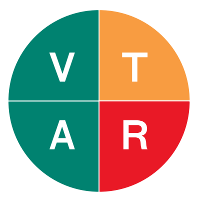
Source: Schroders, FactSet in USD as at 31 May 2020. Returns are relative to MSCI AC World Index. MSCI indices are shown Net Dividend Re invested (NDR). The sectors, securities, regions and countries shown above are for illustrative purposes only and are not to be considered a recommendation to buy or sell.

Positive Neutral Negative Not Applicable

High Conviction Calls

Asia ex-Japan Equities

Robust economic fundamentals across Asia provide the foundations for a faster recovery to fuel relatively strong corporate earnings growth, presenting more investment opportunities.



As with all regions, Asia faces several big challenges due to COVID-19. These include the risk of a second wave of infections and another subsequent lockdown, which will delay economic recovery. Rising US-China tensions may also negatively affect Asia given its reliance on China – although certain neighbouring countries may benefit as manufacturers diversify operations into their countries.

Overall, Asia seems better positioned than other regions to recover faster economically. Mainland China, Hong Kong and South Korea have gradually reopened their economies since March – a headstart expected to enable Asian companies to still deliver earnings growth of +4.0% in 2020 (versus -13.9% contraction for US companies)[1]. Despite slowing price momentum in Asian equity markets, fund flows have increased, especially in North Asia.

In addition, with six Asian economies ranking in the top 10 based on foreign currency reserves[2], these governments can fund COVID-19 fiscal stimulus packages without needing to raise taxes later.

The growing prominence of Asian companies continues, with 158 of the Fortune Global 500 now from Asia ex-Japan (Figure C2) – more than that from Europe (134) and the US (121). This increases the number of mature investible companies in a high-growth region. The size and expansion of domestic consumption in China complements this (refer to China Equities in “Megatrends” on pg 27), while partially insulating it from rising tensions with the US.

For now, valuations in Asia are cheaper, with a P-E ratio of 14.2x versus 20x for developed markets. This makes Asia an attractive investment proposition with more potential upside than developed markets.

These dynamics, coupled with impressive firepower in fiscal and monetary policies, greater macro stability, low inflation and positive yields, will likely boost consumption and corporate earnings in Asia, thus driving a faster recovery from the current pandemic.

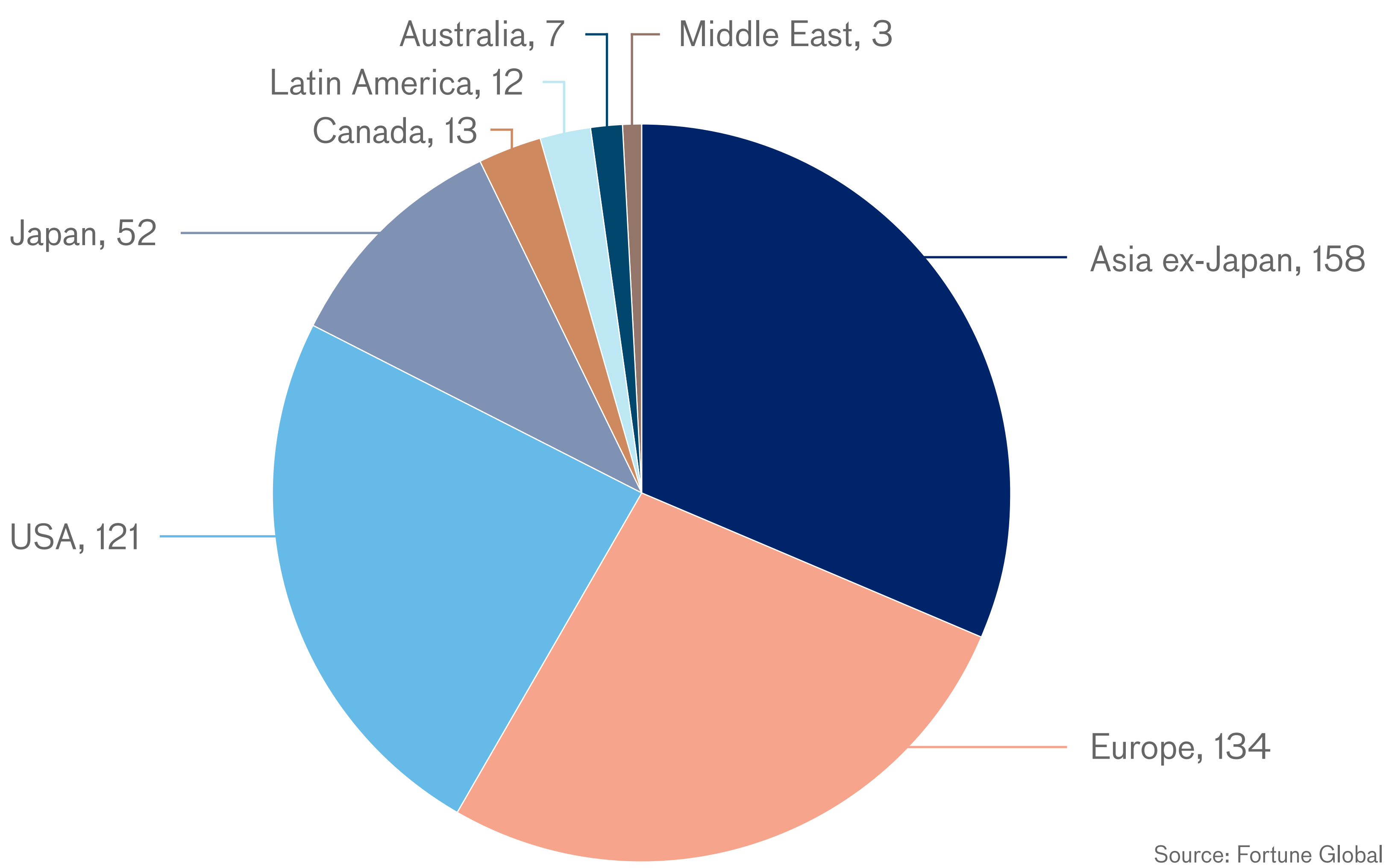
1 JP Morgan, Goldman Sachs, IBES. Asian companies are represented by the MSCI Asia Pacific ex-Japan Index. US companies are represented by the S&P 500 Index.

2 International Monetary Fund, January 2020. The six economies are (in order) Mainland China, Japan, Taiwan, Hong Kong, India and South Korea.

Figure C2

Asia ex-Japan comprises the largest region in Fortune’s list of the 500 largest global companies (by revenue)

Fortune Global 500 Companies (by Region)



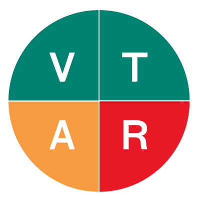
Source: Fortune Global 500, Fortune Magazine, July 2019.

■ Positive ■ Neutral ■ Negative ■ Not Applicable

High Conviction Calls

US High Yield Bonds

US high yield bonds are well-placed to benefit from policy measures aimed at shoring up the domestic economy, providing investors with a yield pick-up in a lower-for-longer rates environment.



Recessions inevitably increase the chance of rising default rates if companies face cash flow issues or if economic recovery is delayed. At the same time, deteriorating investor sentiment could see credit spreads widen as investors opt for 'safer' assets. However, when yields hit exceptionally high levels, opportunities arise for investors to pick the better quality issues and be rewarded as spreads narrow.

We like the higher-rated US high yield bonds as they are supported by US fiscal measures – for example, tax deferrals, loan provisions and household payments. These increase the resilience of most of these firms as they can continue to remain in business.

Investor confidence has also re-emerged; after a slowdown in corporate issuance in March, an increase of USD 36.7 billion in April[1] suggests more 'normal' liquidity conditions and the return of investor risk appetite.

The Fed has also helped to stabilise the market – witnessed by high yield credit spreads narrowing by 5.0% since the peak on 23 March 2020 – by including high yield bonds in asset purchases. Current credit spreads also offer a good risk-reward trade-off at around 600 basis points, which is the widest in four years.

Looking beyond the near-term, the knock-on effect of muted inflation expectations and low interest rates due to accommodative monetary policies by central banks will help companies keep up with debt repayments, in turn reducing default risk. In line with this, high yield markets will lure income-seeking investors given the potential yield pick-up of more than 5.0% over US Treasuries, which currently offer less than 1.0%.

The 12-month returns for US high yield bonds following a market selloff have historically been positive (Figure C3), supporting the tactical case for this asset.

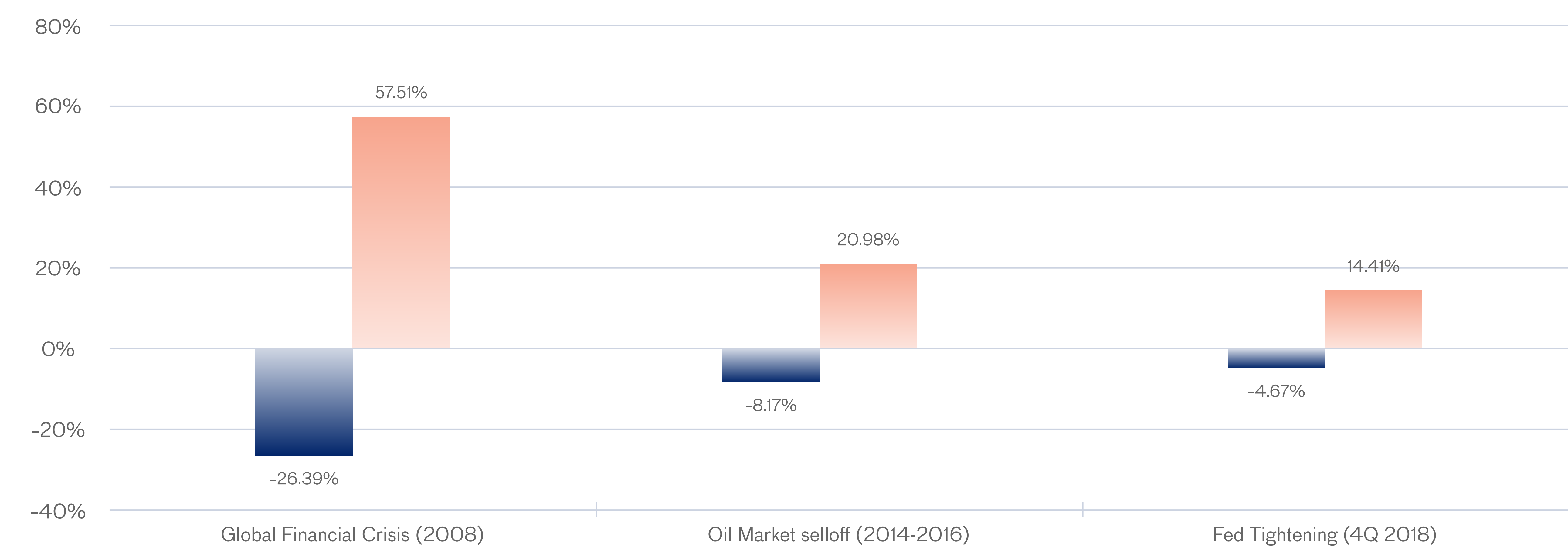
Given these drivers, along with improving liquidity and fund flows in recent months, as well as further new issuances in the pipeline, we expect the positive momentum in US high yield bonds to continue.

1 JP Morgan, 8 May 2020.

Figure C3

US high yield bonds typically outperform in the 12 months following a market selloff

Prior Selloffs vs 12-month Forward Return



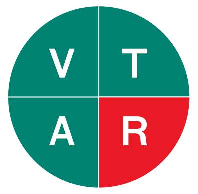
Source: Bloomberg. GFC (31 Dec 2007 – 31 Dec 2008), Oil selloff (31 May 2014 – 31 Jan 2016), 4Q 2018 selloff (30 Sep 2018 – 31 Dec 2018).

Positive Neutral Negative Not Applicable

Megatrends

China Equities

China is already kick-starting its economy with targeted investment, continued financial sector liberalisation and government stimulus.



Geopolitical tensions with the US have the potential to dent economic recovery in China, hindering production, exports and new investment flows. At the same time, any policy mishaps during the ongoing reforms of State-Owned Enterprises (SOEs) and the private sector might also hurt corporate and investor confidence. Nonetheless, the Chinese government continues committing to shore up growth in the event of any economic weakness in order to ensure social stability.

In the near term, China's relative success in curbing the impact of the COVID-19 pandemic quicker than its global counterparts has given businesses and consumers the confidence to start investing and spending again.

Valuations remain reasonable at 12.2x versus 11.5x (10-year historical average). In addition, earnings are still expected to grow by 2.0% in 2020, whereas many other countries are likely to see contractions.

Although it will take time for sentiment and activity in China to return to normal levels, the resumption of economic activity in March has kick-started the economy, preventing a prolonged erosion in economic growth. Beijing is also committed to fiscal and monetary stimulus, in the form of cheap loans for small-and medium-sized enterprises as well as cuts to banks' Reserve Requirement Ratios (RRRs). This is expected to continue during the recovery phase.

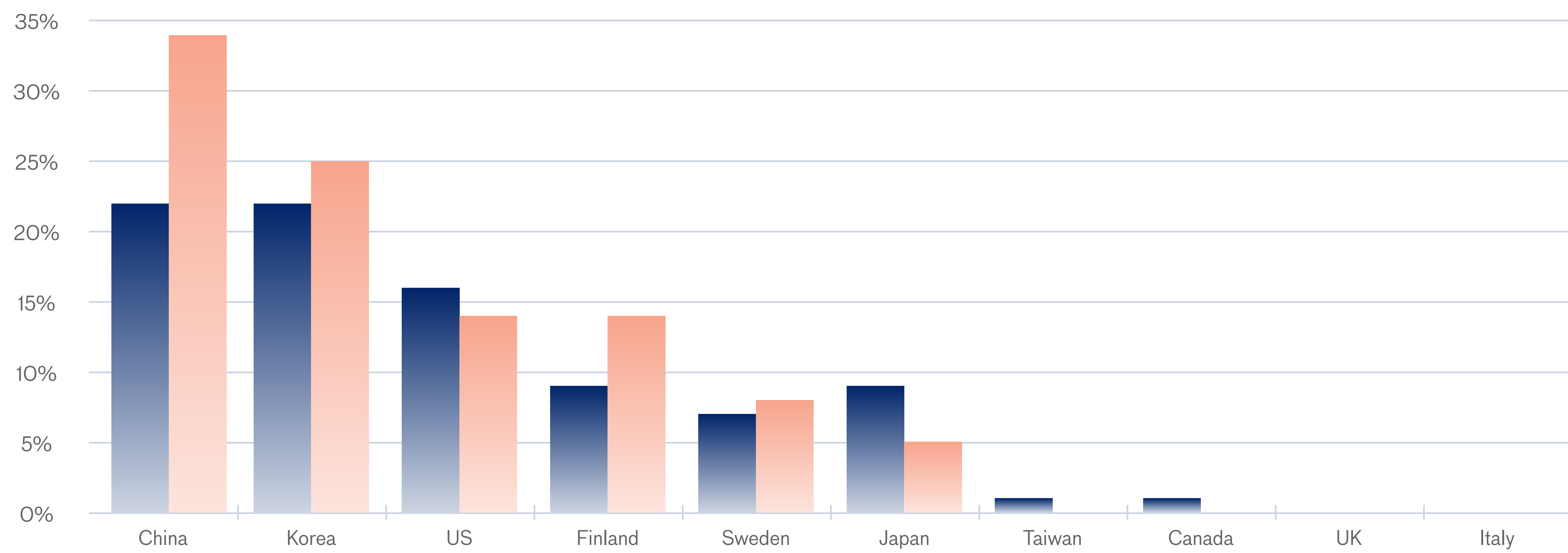
Simultaneous reforms to SOEs and the liberalisation of financial markets will also drive sustainable growth in the private sector. This will help spur China's technological progress via pioneering initiatives such as the roll-out of 5G networks (Figure C4) and the application of Artificial Intelligence in shaping the 'new economy' across areas such as entertainment, healthcare, automation and software. Broader inclusions of Chinese securities in global benchmarks will attract more capital flows onshore and raise foreign ownership.

All of these drivers support our positive outlook for Chinese equities but the biggest driver, in our view, is the growing population of middle-class Chinese consumers domestically, many of whom have rising disposable incomes. This will fuel new investment opportunities for those willing to look towards the longer term.

Figure C4
China is a leader in the 5G roll-out, which will empower various areas in the 'new economy'.

4G
5G

4G and 5G Patents by Country (% of Total)



Source: IPlytics, Goldman Sachs, as of 31 December 2019.

Positive Neutral Negative Not Applicable

Megatrends

Artificial Intelligence (AI) & Innovation

AI-enabled solutions are spurring innovation, growth and efficiency gains for many industry sectors and geographies in a rapidly changing world.

V T A R

Positive Neutral Negative Not Applicable

The resilient nature of innovative companies focused on AI solutions became clear during the Q1 market selloff. For example, the share prices of technology companies that facilitate virtual activity – such as video streaming, intelligent searches and optimised digital advertising – held up better due to strong demand and their relatively robust business models.

A growing number of businesses have leveraged innovation to meet new requirements under COVID-19, such as social distancing and working from home. Increased e-commerce usage during lockdowns has helped AI-enabled consumer applications to better understand real-time consumer demand. Meanwhile, the widespread adoption of AI in providing healthcare services, such as computed tomography (CT) scan analysis and virus research, has accelerated because of its usage during the COVID-19 pandemic.

The growing prevalence of AI has, however, brought with it closer scrutiny over AI-led technologies. This could limit growth opportunities, affecting margins and profitability for AI-related firms, and stunt plans of new disruptors or business models. Furthermore, any pushback on AI, stemming from claims of social manipulation and privacy concerns, could lead to greater government oversight.

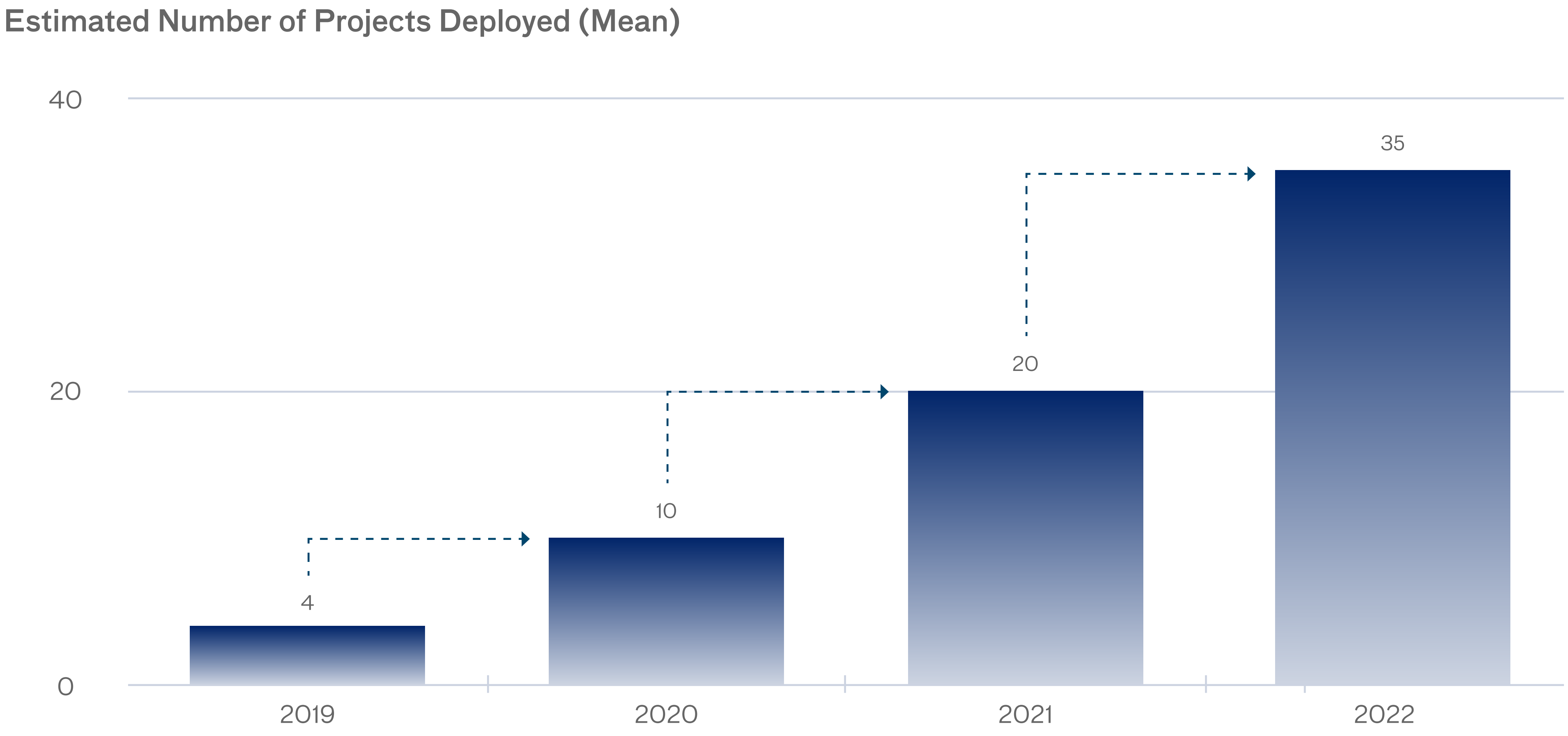
Yet, these concerns underestimate the extent of the structural shift towards using AI in multiple ways. Walmart's response to Amazon by introducing e-commerce is just one example of how embracing innovation offers incumbent organisations the potential to reinvent themselves to compete with AI-orientated disruptors.

In short, AI represents a diverse opportunity set across industries such as manufacturing, media and transportation – all of which are benefitting from AI 'augmentation' and driving a high take-up rate (Figure C5). AI is expected to contribute up to USD 15.7 trillion to the global economy by 2030[1].

Such positive forecasts, as well as the all-pervasive nature of AI – seen by companies leveraging tools such as big data analysis, the Internet of Things (IoT) and machine learning to enhance productivity – continue to warrant a positive outlook on this megatrend.

1 PwC, July 2017.

Figure C5
Average number of AI or ML projects deployed



Organisations foresee substantial acceleration in their adoption of artificial intelligence-powered applications.

Source: Gartner AI and ML Development Strategies Survey.

Megatrends

Healthcare

The combination of ageing populations and the greater affluence of the silver generation bodes well for spending on healthcare services as providers look to innovate in the solutions and treatments they offer.

Positive Neutral Negative Not Applicable

The COVID-19 pandemic has showed just how essential healthcare services are – there remains a core need for healthcare-led solutions to tackle infectious diseases at local, regional and global levels, such as the ongoing search for a COVID-19 vaccine.

On the flipside, two question-marks cloud the industry. First, the potential higher costs of creating new medicines might result in increasing government control over production or via drug price reforms, in turn stifling innovation. Second, a newly-elected Democrat president may consider overhauling the US healthcare system, which could hurt private firms.

Even so, there are many reasons for optimism that healthcare will thrive, fuelled by powerful and sustainable trends that are creating a strong and steady upward momentum for more healthcare services. A booming middle-class in emerging markets will create demand for healthcare, as will ageing populations globally, with persons aged 65 years or over projected to increase from 9.0% in 2019 to 16% by 2050[1].

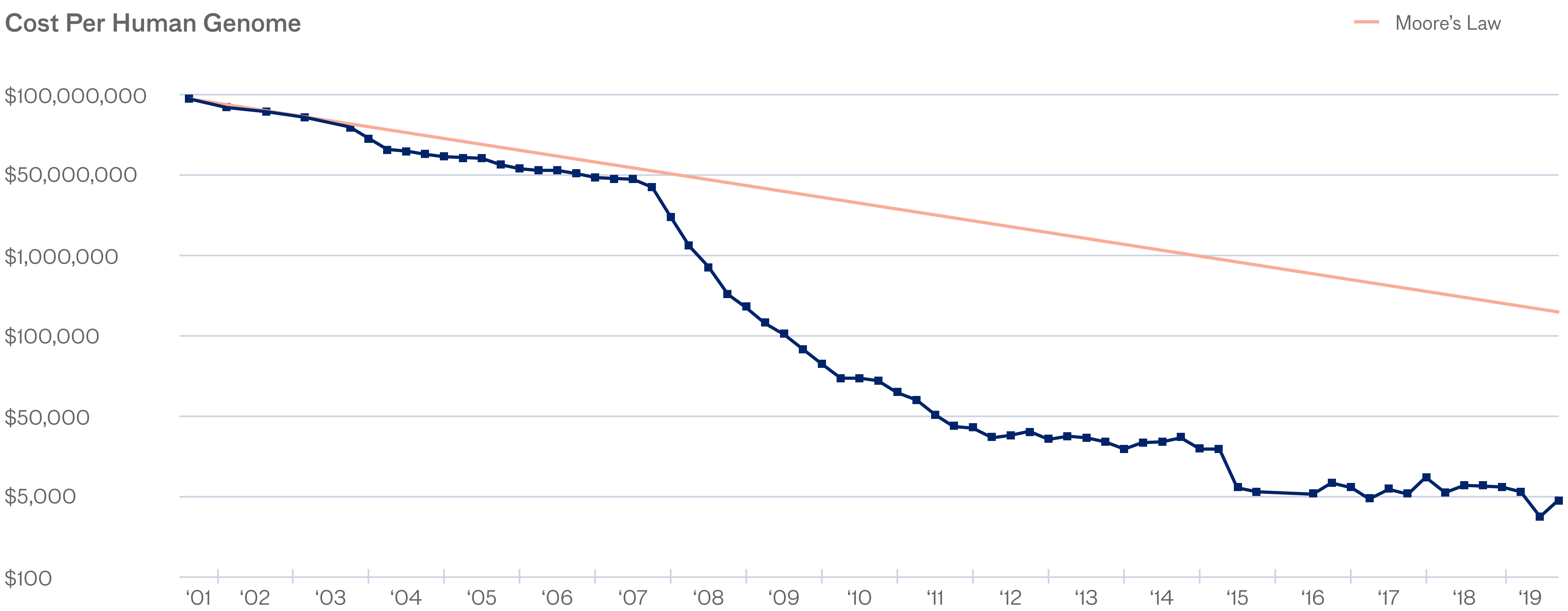
In terms of valuations, P-E ratios are slightly high at 17.3x versus 15.1x (10-year average), and earnings growth is expected to be flat. However, fund inflows have been strong in 2020 to date, at USD 6.5 billion.

COVID-19 has also re-emphasised the importance of preparedness and responsiveness, propelling a strong pipeline of innovation in the race to develop new treatments for critical illnesses, such as immune-oncology therapy for cancer. Furthermore, there is increasing investment in activities like genomic research (Figure C6), to enable earlier diagnosis of disease and facilitate preventive care or more suitable treatments. Gene-related therapy is another rapidly emerging area to correct significant inborn genetic errors.

Meanwhile, the healthcare sector is deploying technology to develop new service models – with a shift from 'fee for service' to 'fee for value' – leading to patients obtaining better health outcomes at similar costs. These innovations will enable healthcare companies to be more competitive and deliver greater value to customers and shareholders alike – this is why we remain positive on this call.

1 United Nations – World Population Ageing 2019.

Figure C6
Advancements in technology have reduced the cost of DNA sequencing over the past 20 years, making genome research more affordable.



Source: DNA Sequencing Costs: Data from the US National Human Genome Research Institute (NHGRI) Genome Sequencing Program (GSP).

Regional Macro Summaries

Equities:
Despite the current recession impacting businesses and consumers, the expected rebound in H2 2020 for most regional economies will present investors with selective opportunities in sectors that are more robust.

Fixed income:
Broadly supportive government and central bank policies will keep bond markets liquid and relatively stable across the region, with room for further rate cuts.

Currencies:
Most regional currencies should see some gains against the US dollar by the end of the year, on the back of a rebound in activity in local economies.

Singapore

-4.0%	-0.3%
2020 GDP (Forecasted, YoY)	2020 CPI (Forecasted, YoY)

Equities
The Straits Times Index is near its 10-year low. Banks, transportation, real estate developers and hospitality (including hospitality REITs) will benefit from a recovery.

Fixed income
Government bonds yields will remain low, with credit spreads expected to widen due to more companies raising cash through issuing new debt.

Currency
The Singapore dollar is expected to gradually recover against the US dollar as the pandemic eases throughout 2020, although it is unlikely to strengthen below 1.38.

Malaysia

-3.5%	-0.5%
2020 GDP (Forecasted, YoY)	2020 CPI (Forecasted, YoY)

Equities
Dividend yielding stocks continue to be attractive during recovery as valuations remain low. Avoid sectors related to tourism and oil & gas, due to possible extensions of post-pandemic restrictions and delays in global demand recovery.

Fixed income
Local institutions and pension funds are supporting the bond market, which faces a downgrade risk from FTSE's benchmark index. Rates should remain stable following the 100 basis points cut earlier in 2020.

Currency
Following the economic slump and oil price collapse weighing on the Malaysian ringgit, we forecast it strengthening to 4.25 against the US dollar by year end.

Source: UOB Global Economics and Markets Research, June 2020.

Thailand

-5.4%	-1.0%
2020 GDP (Forecasted, YoY)	2020 CPI (Forecasted, YoY)

Equities
The energy, banking, tourism and export sectors have all suffered due to COVID-19. Equities are expected to be range-bound between 1000 and 1350 for the rest of 2020, but will be supported by the government's stimulus package (worth 15% of GDP).

Fixed income
Foreign investors are still selling large amounts of government bonds. However, the Bank of Thailand will continue providing liquidity through bond purchases to keep interest rates low across the board.

Currency
Despite a slower economy, the Thai baht is expected to strengthen to 30.5 against the US dollar by year end because of the government's control over the COVID-19 pandemic.

Indonesia

2.0%	2.7%
2020 GDP (Forecasted, YoY)	2020 CPI (Forecasted, YoY)

Equities
A combination of supportive fiscal and monetary policy, plus cheap valuations in equities, signal room for a notable rebound. Likely beneficiaries are sectors such as agriculture, forestry & fishery, information technology & communication, and pharmaceuticals.

Fixed income
Bank Indonesia will likely remain supportive, including a potential further 25 basis points rate cut in Q3 to leave the benchmark rate at 4.0%. US dollar-denominated bonds should benefit from near-term US dollar strength.

Currency
The Indonesian rupiah is expected to weaken to 14,500 against the US dollar by year end due to uncertainty and loose monetary policy, despite a likely current account surplus.

China

1.8%	3.5%
2020 GDP (Forecasted, YoY)	2020 CPI (Forecasted, YoY)

Equities
Domestic equities remains attractive due to:
- further government and central bank-led stimulus if needed;
- the on-going resumption of production; and
- rising domestic investors' participation.

Sectors like new infrastructure, technology and consumption will benefit more from supportive government policies.

Fixed income
Although the scope for further monetary easing and lower rates will generally support the bond market, investors should be aware of possible default risks in sectors, such as exporters, tourism and entertainment.

Currency
The Chinese yuan is expected to hold steady against the US dollar at around 7.09, buoyed by an economic recovery and a relatively weak medium-term view for the US dollar.

Source: UOB Global Economics and Markets Research, June 2020.

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