UOB Investment Insights

Investment Outlook 2020

The theme for UOB's 2020 Start of Year Outlook revolves around "Maintaining balance in an uncertain environment". In ballet, developing good balance takes discipline and is essential to keeping posture and executing smooth, complete moves. Urban ballet, a contemporary interpretation of the classical dance, goes a step further by transposing the art form away from the stage to an urban setting, which presents unexpected variables that the dancer will have to take into consideration.

In the same way, the landscape in 2020 is expected to continue to be marked by market-moving, polar forces that will contribute to economic and geopolitical uncertainty. The investment themes we have identified in this publication take these into account. Investors can remain sure-footed by maintaining investment discipline and staying vigilant and focused.

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Editorial

Looking back at 2019

2019 set market records though the year started with a great deal of caution and worry. Trade tensions, rising recession fears, and geopolitical events weighed on the minds of investors. Central banks had to reverse their earlier hawkish stances to pre-empt the impact of a slowing global economy. The later part of the year brought some sort of resolution, with the US and China finally reaching a Phase One deal, while the Conservatives' election victory in December 2019 paved the way for Brexit to occur by the end of January 2020, leading to a slight diminishing in uncertainties.

Against the backdrop of central banks' accommodative monetary policies, both equities and fixed income had a stellar 2019, with the former gaining 25.5%[1] and the latter 6.7%[2]. Safe-haven assets such as the USD and gold benefited amid growth and trade uncertainties, while the SGD held up despite the weaker trade environment as the political stability associated with the currency was sought after, resulting in it advancing 0.6% against the USD.

Some of our investment calls such as China A-shares, companies with sustainable earnings growth and resilient balance sheets, and innovation-themed equities outperformed global equities with gains of 34.8%, 33.2% and 26.1% respectively. Global healthcare stocks and EM equities also delivered strong double-digit gains.

What to expect in 2020

2019 surprised many on the upside despite the many twists and turns of events. Will this upward trajectory continue? How will China manage its economic transition amid its deliberate market reforms? There remain many unresolved macro issues: Although a Phase One deal is widely expected to be signed, the next phase of US-China negotiations is likely to remain drawn out given the differences between the two countries. The US presidential election, the outcome of Brexit, as well as China's domestic and debt challenges could turn into risk scenarios that investors should be mindful of.

While understanding the risks out there, it is equally important to be aware of the drivers of investment returns. Recession fears have subsided and the outlook has brightened as US-China trade relations improved. Robust US consumer spending arising from strong labour markets at record-low unemployment, the low double-digit corporate earnings growth projections which may be further supported by easing of trade tensions, and policymakers' readiness to ease monetary and fiscal policies to support economic growth are factors that should provide further strength to financial assets. In fact, global growth is expected to be 3.4% in 2020 as compared to 2019's 3.0%, with emerging markets taking the lead at 4.6%, ahead of their developed peers' 1.7%. The interest rate environment is expected to stay low for longer, which will send investors hunting for better returns.

There are three key investment themes for 2020 which we believe are important when planning one's investment portfolio:

[1]Source: Developed Market equities are represented by the MSCI World Index.
[2]Source: Global bonds are represented by the Bloomberg Barclays Global Aggregate Index.

1. **Resilience** – Asset valuations are no longer considered cheap. Expect emergence of adverse news or uncertainty to introduce volatility. It is important to build resilience in one's portfolio. Own assets that will continue to do well in a down-cycle, such as US consumer staples, and invest in assets underpinned by megatrends such as healthcare, which is supported by the changing demographic of ageing populations.

2. **Growth** – Companies with sustainable earnings expansion and those able to incorporate new technologies and processes to reinvent themselves to drive better bottom-lines are likely winners. These companies are desirable investments in an uncertain environment as they could provide higher-quality long-term growth for one's investment portfolio.

3. **Rising EM affluence** – The economic growth of emerging markets have been stellar compared to developed markets. This year, we expect the trend to continue. Domestic consumption has supported economic growth well despite the slowing external trade environment. Moving forward, an easing of US-China trade tensions following a Phase One deal is likely to improve business confidence, which could support investment growth. Additionally, a recovery in semiconductor earnings could support broader Asian growth.

Looking out to the next 12 months, 2020 should see a transition to moderate economic growth. While economic and geopolitical uncertainties are unlikely to go away, we need to separate noise from fact and fundamentals so that we do not let volatilities derail our investment goals.

It is on this premise that the theme for our publication this year is "Maintaining balance in an uncertain environment", brought to life through the depictions of "Urban Ballet". Ballet is a form of performance dance that uses movements as expressions. These movements exude precision, strength and require a keen focus on maintaining balance while executing poses. Taken to an urban setting, dancers have to be nimble and possess an awareness and appreciation of the landscape, including any features that may pose obstacles and hindrances to movements.

In the same vein, investing in 2020 will require one to exercise discipline in understanding the risks before investing; as well as not losing sight of one's investment goals due to unexpected noise and news. Above all, one must stay agile and be mindful of the possible and unfolding risks so that the investment decision making process is a considered one.

In summary, focus on the objective of why you invest, adopt a risk-aware and balanced approach when making your investment decisions; and we should expect a successful investment journey in 2020.

Chung Shaw Bee

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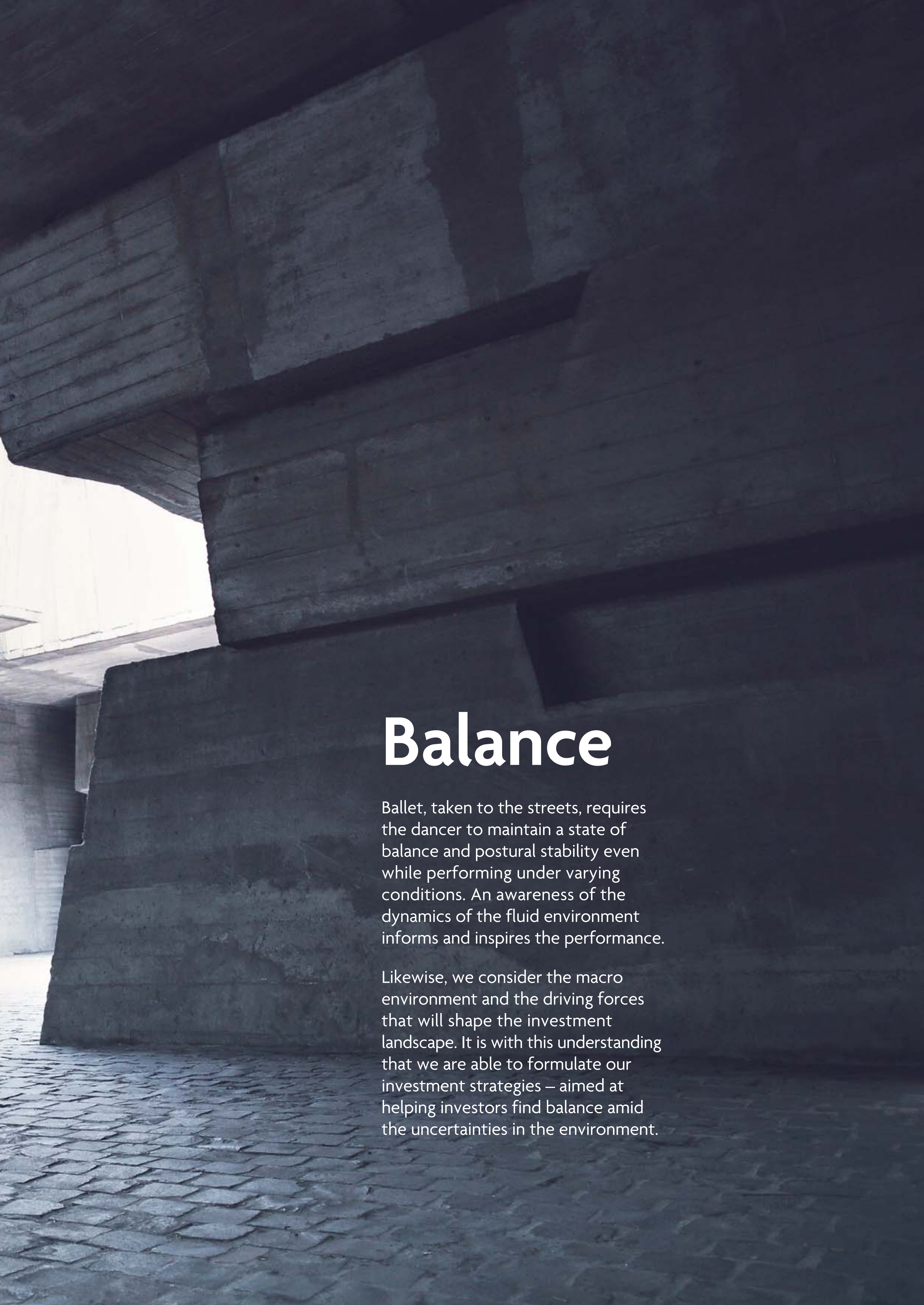
Source: Bloomberg. All percentages shown are expressed in their respective local currency terms and reflect total returns from 1 January till 15 December 2019.

Macro Outlook



Balance

Ballet, taken to the streets, requires the dancer to maintain a state of balance and postural stability even while performing under varying conditions. An awareness of the dynamics of the fluid environment informs and inspires the performance.

Likewise, we consider the macro environment and the driving forces that will shape the investment landscape. It is with this understanding that we are able to formulate our investment strategies – aimed at helping investors find balance amid the uncertainties in the environment.

Asset Class Review

Most asset classes did well in 2019 amid high market uncertainty throughout the year. Equities outperformed fixed income despite increased volatility caused by US-China trade tensions.

2019 saw equities and fixed income markets focusing on different sides of US-China trade talks: Equity investors priced in a trade deal, while fixed income investors priced in a higher probability of an economic recession in case talks broke down. This resulted in both equity and fixed income markets posting strong gains, along with gold, oil and the USD.

Equities

Throughout 2019, the ebb-and-flow of the US-China trade dispute drove global equities, generally positively. Markets rebounded whenever trade talks showed progress, yet pulled back when negotiations stalled. Such pauses were temporary, as positive earnings surprises lured investors back.

US-EU trade tensions and several geopolitical flare-ups brought additional complications to markets. Emerging markets (EM) saw USD 20 billion of net capital outflows as investors sought the relative safety of developed markets (DM) like the US. Asia ex-Japan, in particular, accounted for 82% of total EM outflows[1]. DM equities also benefited from the easing by major central banks, including the mid-year reversal in the US Federal Reserve's (Fed) tightening; they returned 25.5% in 2019, while EM equities delivered 15.2%.

Fixed income

Strong fixed income performance in 2019 reflected widespread negativity and recession fears. An inverted yield curve in March and August reflected concern over the Fed's aggressive rate hikes amid weakening economic growth. The Fed changed stance in July, cutting rates in three consecutive meetings, aligning monetary policy with Europe and Japan.

The flight to safety benefited investment grade (IG) debt: US IG and US Treasuries performed strongly (+17.7% and +13.2% respectively), as did US high yield (+13.3%) and Asian high yield (+12.5%), with lower rates urging investors to seek higher yields.

Currencies and commodities

Uncertainty kept safe-haven currencies like the USD and JPY in favour. The GBP strengthened 4.7% against the USD as Brexit uncertainty subsided. By contrast, China allowed the CNY to weaken past 7.00 against the USD (-1.8%) to relieve exporters amid trade tensions.

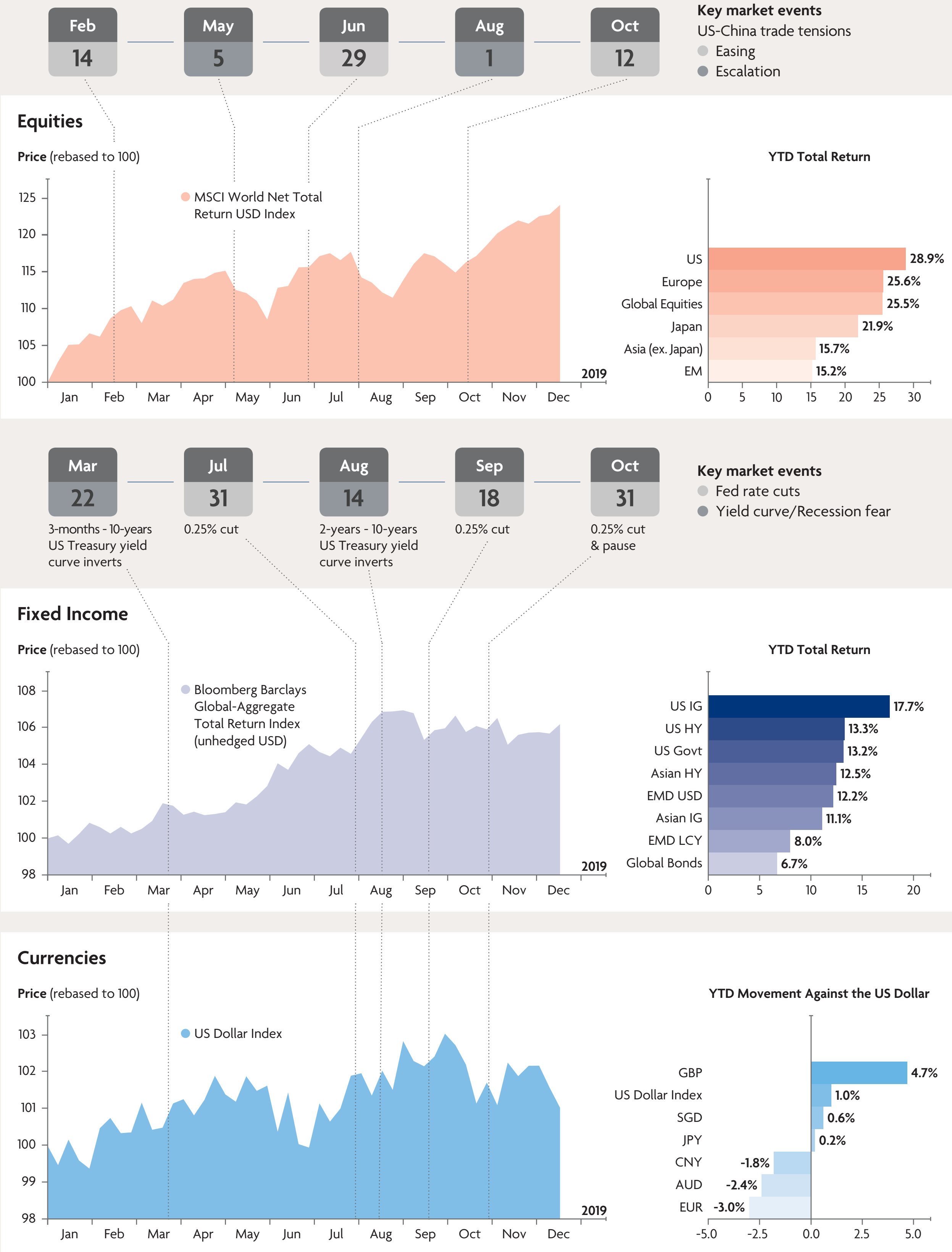
Gold rose over 14.9% to USD 1,476 per ounce during 2019 on recession fears and central bank easing. Oil rebounded from Q4 2018 lows of USD 50 to USD 65 per barrel but prices were capped given slower growth expectations.

[1]Source: EPFR Global, MSCI, J.P. Morgan Global Emerging Markets Research, 6 December 2019

Source: Bloomberg. All percentages shown are expressed in their respective local currency terms, and reflect the total returns from 1 January to 15 December 2019.

Figure V1

YTD Market Performance



Source: Bloomberg. All percentages shown are expressed in their respective local currency terms, and reflect the total returns from 1 January to 15 December 2019.

Tactical Calls Review

Most of our tactical equity calls have outperformed the main equity benchmark and the following is a review of our calls in 2019.

Figure V2

Theme	Call	Call Start Date	Call End Date	Total Return From Call Start Date^	Total Return Year to Date+
High-convictions	US banks	31 December 2016	29 May 2019	+14.9%	+12.2%
	EM equities	31 December 2017	Ongoing	-1.6%	+15.2%
	US consumer staples	1 September 2019	Ongoing	+4.1%	+4.1%
	Global quality equities	31 March 2017	Ongoing	+46.9%	+33.2%
Megatrends	Global healthcare equities	31 December 2016	Ongoing	+48.1%	+20.6%
	Artificial intelligence and innovation equities*	31 December 2018	Ongoing	+26.1%	+26.1%
	Chinese equities	31 December 2018	Ongoing	MSCI China +19.2%	MSCI China +19.2%
		30 September 2018	Ongoing	China A +18.1%	China A +34.8%

*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 December 2019 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 December 2019.

Our calls on China A-shares, quality equities and AI & innovation equities outperformed global equities. Our calls on global healthcare and EM equities underperformed, but still delivered double-digit returns.

Open calls

Despite geopolitical uncertainties and recession fears, China A-shares was our best-performing call for 2019, delivering 34.8% returns and outperforming its H-share counterparts, which gained 19.2%. The domestic focus of A-shares helped them weather external trade headwinds, with government stimulus helping to sustain economic growth. Exporters were supported after the CNY weakened past 7.00 against the USD.

Global equities with a quality tilt were another strong performer. These stocks rose 33.2%, outperforming the broader MSCI World Index by 7.7%. Equities linked to artificial intelligence (AI) and innovation jumped 26.1% after the communications and entertainment sectors broadly reported earnings above expectations, and investors began pricing in a possible trade deal.

More broadly, emerging markets (EM) equity returns oscillated between gains of +14.0% and a low of +1.6% before coming in at +15.2%. This is on the back of the ups and downs in US-China trade talks, political turmoil across Latin America and volatile oil prices weighing on sentiment.

Global healthcare equities climbed 20.6% although investors were rattled by radical proposals to limit drug prices, suggestions of costlier healthcare schemes from various US (Democratic) presidential candidates, and China boosting production of generic drugs.

We initiated a call on US consumer staples in September 2019 given a clear upward technical trend and the sector's historical resilience. It is a suitable investment to build portfolio resilience amid a slowing earnings growth environment. To date, the call has gained 4.1%.

We closed our call on US banks before the Fed began cutting rates.

Closed calls

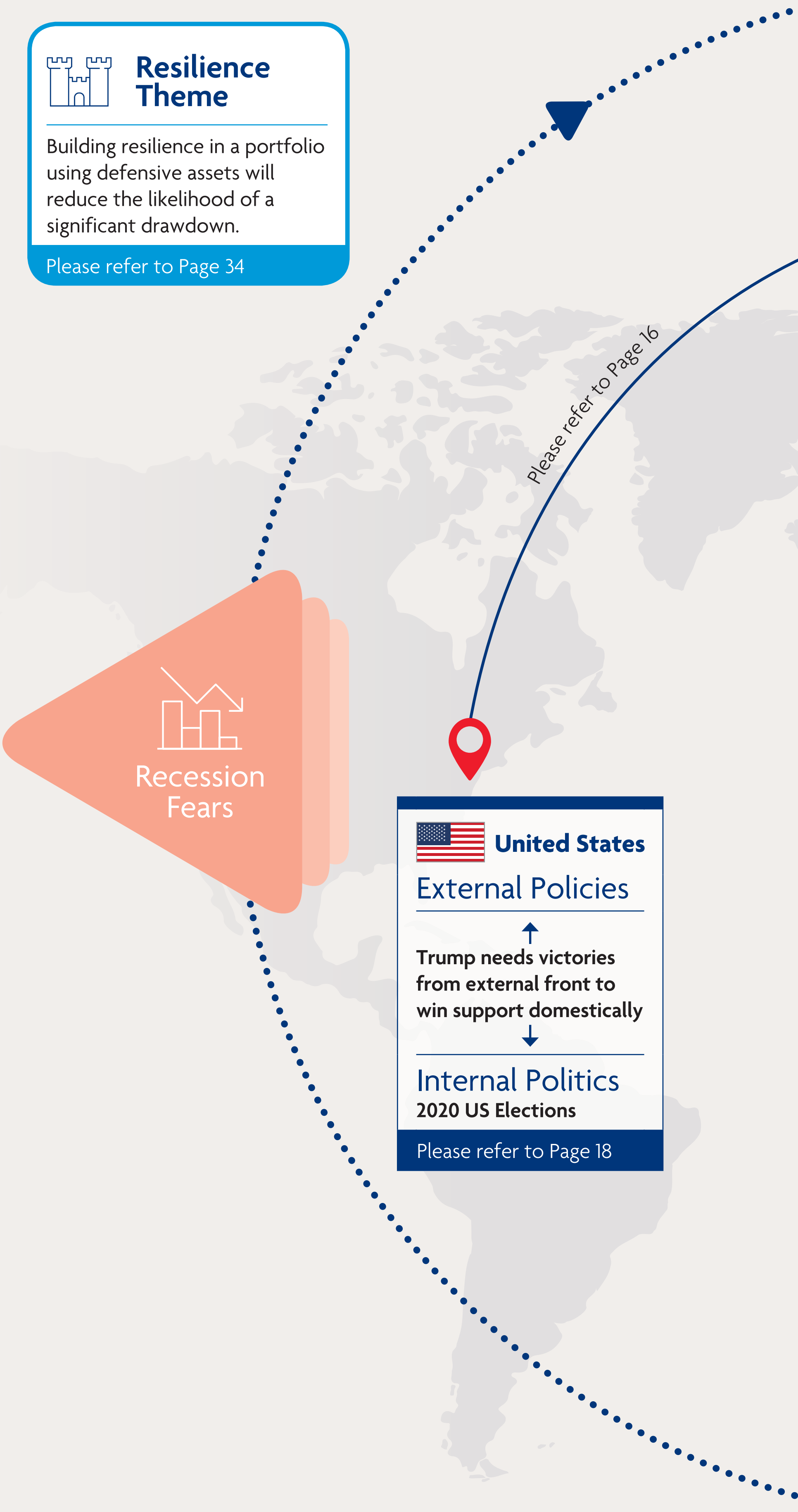
We closed our US banks call in June 2019 due to a lack of near-term catalysts after the Fed hinted it will cut rates, threatening banks' net interest margins. The call was up by 14.9% since we started it in January 2017. The anticipation of the negative impact of trade tensions on cyclical sectors such as banks, coupled with technical indicators showing declining momentum despite cheap valuations, led to the closure of the call.

Source: Bloomberg. All percentages shown are expressed in their respective local currency terms, and reflect the total returns from 1 January to 15 December 2019.

Macro Landscape for 2020

Global economic growth in 2020 is likely to improve from 2019, but the presence of many market-moving forces raises the (low) possibility of a recession: Tensions between the US and China will likely continue but each will face different internal challenges, such as Trump's likely use of US foreign and trade policies to advance in the 2020 elections, while China has to balance supporting economic growth without significantly increasing debt; the longer-term EU-UK relationship also needs to be redefined in a post-Brexit world.

These market-moving forces can create volatility for markets and shape the direction of the global economy in 2020. To address this macro environment, governments and central banks across the globe are responding with monetary and fiscal measures to support global growth. We have identified three specific investment themes to help investors find balance and navigate this new decade.



Emerging Markets Theme

Ongoing US-China tensions have pushed valuations of emerging market assets lower, making them attractive. Structural shifts in the emerging economies are also expected to support faster growth compared to developed economies.

Please refer to Page 38

Monetary Stimulus

Growth Theme

Companies that are able to deliver sustainable and superior earnings growth will outperform given the uncertain economic backdrop.

Please refer to Page 36

Trade Tensions

Uncertain Future Relationship

Please refer to Page 22

United Kingdom

Europe

China

Economic Growth

↑

Managing growth without debt spiralling out of control

↓

Debt

Please refer to Page 20

Sustaining Global Growth

Fiscal Stimulus

2020 Growth Outlook

Better growth but macro concerns remain

A positive turn of events indicates better global growth in 2020 than in 2019. However, uncertainties remain that can introduce new risks as well as new opportunities. Monetary policy continues to be the key stimulus measure, as fiscal stimulus faces political roadblocks.

Delicate balance needed in 2020

Concerns that plagued investors in 2019 are likely to continue in 2020. The macro landscape is filled with competing forces that will shape headlines, events and future outlook in various ways, such as global growth versus recession, US-China dynamics and the future EU-UK relationship. When seeking investment opportunities, the priority will be finding a balance between these forces.

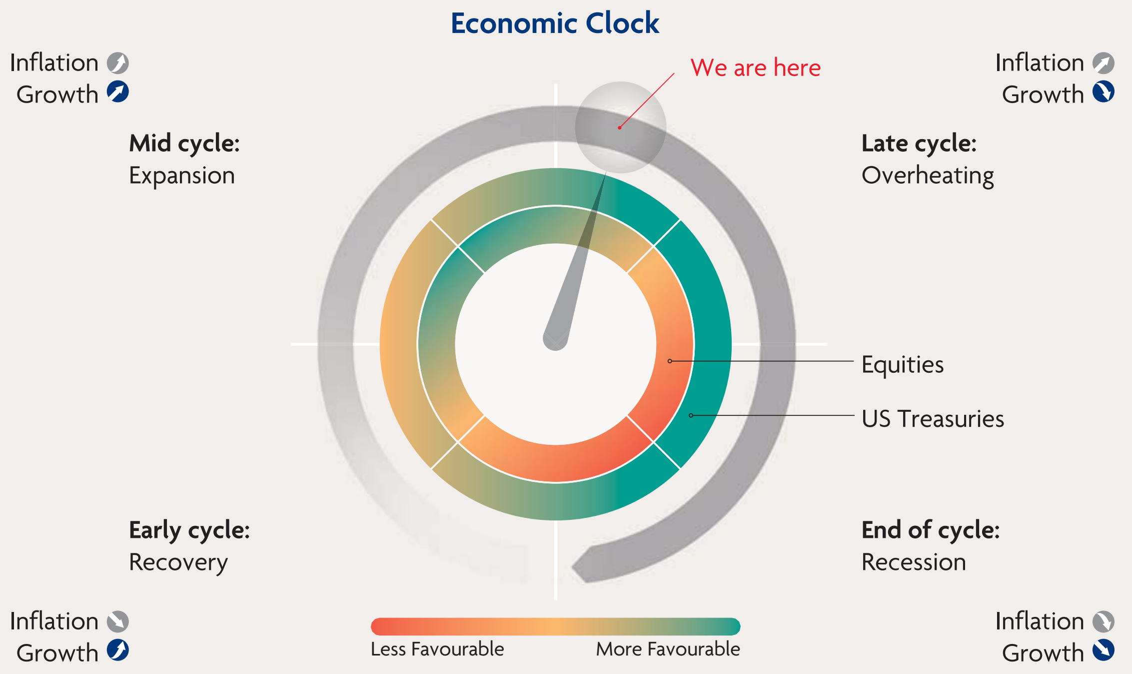
The International Monetary Fund forecasts suggest global growth will improve in 2020 – at 3.4% versus 3.0% in 2019 – mainly reflecting a projected improvement in economic performance across emerging markets (EM) under macroeconomic strain. As a result, EM growth at 4.6% is expected to outpace the 1.7% figure for developed markets (DM), led by Asia as the fastest-growing region globally at 6.0%.

Although the key downside risk of a protracted US-China trade dispute continues to weigh on global growth expectations, the Phase One deal lifted overall sentiment. The challenge would be the next phase of negotiation.

Both the US and China have their own motivations, albeit different, to show results in 2020: Trump wants support ahead of the November elections, and China wants to avoid using too much debt to stimulate its economy.

Figure M1

We are in the earlier part of the late-cycle economy



Although we are in late-cycle, a recession in 2020 is unlikely

Media headlines will likely continue to worry markets. The inversion of yield curves in March and August 2019 proved this, although alarm bells quietened when the curve sloped upwards again after the 31 October Fed rate cut; the bond market no longer anticipated a recession.

Even though we are in the late phase of the economic cycle with slowing growth, we do not expect to see a recession in 2020. Inflation remains persistently low and is likely to stay muted globally, suggesting we are hovering at the earlier part of this late phase (Figure M1).

Measures to stretch this long global expansion to mitigate or avoid a possible recession include:

- Diffusing trade tensions
- Reviving multilateral cooperation
- Providing timely central bank support

Low inflation allows continued monetary easing

There is increasing willingness among central banks to respond quicker to weak data, as seen by the Fed's pre-emptive rate cuts in mid-2019. With low expected inflation, central banks in major developed markets will likely continue to use monetary stimulus to support the economy, yet this is likely to have limited impact with rates already low. Without pressure from the major central banks, emerging markets will have more leeway to loosen to support domestic growth.

In addition, the Fed faces internal pressure from members who prefer to raise rates, thus limiting further rate cuts. In the UK, the Bank of England will likely cut rates post-Brexit to prop up the economy. The European Central Bank, meanwhile, has signalled that fiscal stimulus is further required to revive growth. In Japan, the Bank of Japan is expected to maintain its loose monetary policy, or possibly ease further.

Fiscal stimulus needed but faces possible roadblocks

Fiscal policy offers a much-needed boost but the political will is generally lacking. Any fiscal-led stimulus in 2020 is therefore likely to differ globally:

- China has the surplus of reserves and political flexibility to take action, with the scale likely supportive for Asia overall.
- In the US, a divided Congress will likely come to agreement only if the economy deteriorates into an actual recession.
- The EU sits in-between – recognising the necessity but lacking the political will to do so.

The US-China Dynamic
Opportunities from uncertainties

The expected progress in US-China trade talks will ease global growth concerns but tensions will likely shift towards technology or other areas of competition. Investors can expect new opportunities to emerge amid stiff competition.

We expect continued jostling throughout 2020 by the world's two economic superpowers – the US as the incumbent global economic leader on the one hand, and China as the nation on the rise, on the other. Their respective ambitions and various policy actions, both externally and internally, will have a strong influence on global market trends, as well as broad business and investment sentiment.

Will history rhyme?

The current economic power struggle is reminiscent of the Cold War and the associated Space Race between the US and the Soviet Union in the 1960s and 70s, where the two countries competed for global influence via technological prowess.

Positive outcomes can happen as countries vie for leadership, particularly in technology and innovation. Notably, the US-Soviet Space Race led to numerous military technological advances that transformed consumer goods, enhancing our daily lives. Examples are the digital camera (1969), the Internet (1969) and the global positioning system (GPS, 1978).

Trade negotiations will take time as challenging issues remain

Our base case is for the US and China to sign the Phase One deal in early 2020, while negotiations for Phase Two are likely to continue throughout and possibly beyond 2020.

Phase Two talks are expected to be more challenging as both sides are less willing to compromise on the possible issues to be covered, such as intellectual property rights, forced technological transfers, state subsidies to industries and further loosening of capital controls. There is also a possibility that President Trump may re-escalate tensions if China's concessions are deemed to be insufficient.

Future uncertainties also bring future opportunities

Within this scenario, however, significant uncertainties remain given the potential for delayed additional tariffs to be imposed and, if so, further retaliations.

We are mindful of the following as we look ahead in 2020:

- Future uncertainty – How the US and China respond to each other will cascade down to global growth expectations and geopolitics.
- Future opportunities – Both sides will invest more into research and development in pursuit of technological supremacy and innovation. This competition will also fuel the much-needed reform in China.

5G technology has already emerged as another competitive arena between the two countries. Points of future tension that may arise are linked to various emerging technology themes – from artificial intelligence to self-driving vehicles – as well as financial and professional services, where the US and China continue to compete aggressively as part of this modern-day Cold War-style stand-off. Such competition provides opportunities for investors to benefit from companies that are able to secure a competitive advantage.

US
Balancing external policies to win domestically

US pre-election posturing will increasingly dominate domestic and foreign policies. Strong consumption will continue to keep the economy going.

The US faces a contrast politically: internal factors like the presidential impeachment and pre-election campaigning on the one hand, and external policies relating to trade and geopolitical conflict on the other.

At the same time, strong US consumer demand, a low unemployment rate and healthy corporate balance sheets are positive drivers for the economy.

If trade tensions begin to ease and with the Fed likely to keep rates low, politics will likely dominate the landscape in 2020, culminating in the November election.

Waging multiple battles abroad...

Looking outwards, President Donald Trump seems to view tariffs as a political weapon to protect US economic interests. This can be seen by his approaches to China and the European Union (EU) in his bid to “make America great again” and raise his popularity at home, yet pulling back sufficiently to encourage a deal.

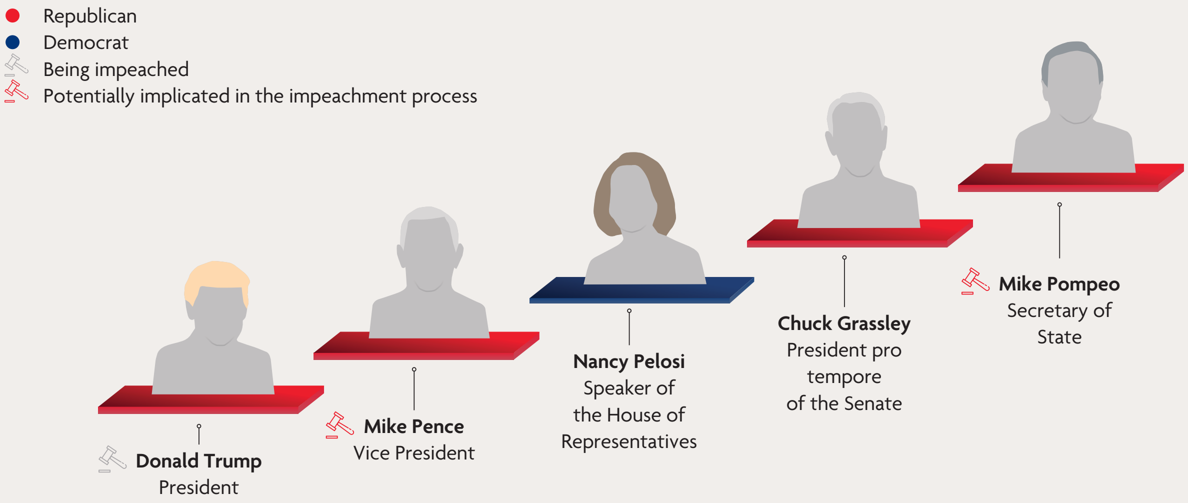
Concurrently, the administration must also address ever-rising geopolitical tensions, including with Iran and North Korea over nuclear weapons.

...While fighting multiple battles at home

Yet it is closer to the US mainland that investors must pay attention to. Having lost control of the House of Representatives to the Democrats in the 2018 mid-term elections, Trump will likely use foreign and trade policy successes (or those he perceives as such) to bolster his re-election bid; this will therefore drive the short- and medium-term economic outlook both in the US and abroad.

Figure M2

US presidential line of succession: House Speaker Nancy Pelosi (Democrat) in line for office if both the President and Vice President are removed



Trump's impeachment could introduce noise to financial markets, but is unlikely to pass the Senate, given a Republican majority and the potential implication of Vice President Mike Pence, whose removal might result in a Democrat (Nancy Pelosi) becoming President (Figure M2).

Regardless, the US faces partisanship within Congress. This will likely delay any fiscal stimulus until the economy falls into recession, leaving monetary policy, via the Fed, as the sole tool to support economic growth.

Potential for stronger earnings growth; US consumers remain a bright spot

Even with downside risks due to the US-China trade drag, we expect to see trends that could lead to stronger earnings growth due to Trump's focus on winning re-election and the buying power of US consumers.

More specifically for the corporate outlook:

- Earnings for companies in the S&P 500 are expected to grow by 10% to 12% in 2020. Earnings expectations might even rise if further progress is made in trade talks.
- However, political and policy uncertainty will keep companies on edge in 2020. This will sway corporate earnings expectations, which typically perform well in a divided government (the current consensus) but would likely be revised lower in a unified government across the Presidency, Senate and House, given the higher chance of interference via regulation.
- Healthcare, technology and energy are sectors most susceptible to such potential regulatory risks.
- In addition, Democrat frontrunners are calling for a repeal of Trump's 2017 corporate tax cuts. This could reduce corporate earnings by approximately 11% in 2021.

In terms of consumers:

- Consumption has remained strong, with retail sales and personal expenditures in the US heading higher amid low inflation. We see these trends as driving the service sector, which is relatively more shielded from trade tensions, than the manufacturing space.
- Consumption will likely grow by 2.5% in 2020 due to a tight labour market, which results in lower unemployment rate and higher disposable income.
- A rollback of tariffs as part of the Phase One trade deal would be positive. However, any further escalation in trade tensions could pose a threat to the US consumption story if it begins to impact consumer goods.

China

Balancing growth with debt

China needs to take a measured approach to how it boosts economic growth, applying the right mix of monetary and fiscal measures without misallocating capital and creating a debt burden.

In a similar way to the US juggling internal and external factors, China faces its own delicate balancing act: The central government in Beijing must weigh its desire to support economic growth with the urge to drive it via increasing amounts of debt.

Prudent policies to support growth

There is little doubt the uncertainty and impact from the prolonged trade dispute with the US has negatively affected China's manufacturing sector; fixed asset investment growth has fallen from +7.9% in January 2018 to +5.4% in September 2019, while export growth has fallen from +10.7% to -3.2% over the same period.

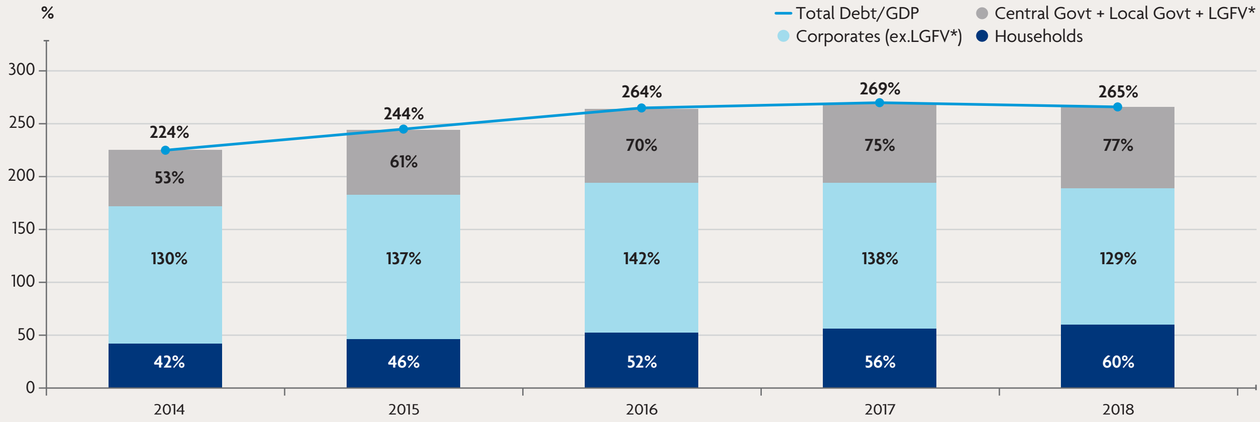
However, the domestic service sector remains stable. The contribution of consumption to GDP growth has increased steadily from below 40% in 2003 to above 60% since 2015[1], overtaking that of investment since 2014. This is due to increasingly-powerful Chinese consumers, coupled with their growing appetite for financial assets to add required diversification. In line with this, corporate earnings from companies in the CSI 300 Index are expected to grow by 14% in 2020.

Inevitably, export-oriented companies face downside risks from a slump in trade if tensions with the US persist, although a weaker CNY partially supports them. As a result, we expect domestic-oriented companies to be more resilient.

[1]Source: Wind Financial Database, Haitong Securities Research

Figure M3

China's total debt-to-GDP has stabilised since Beijing started taking active steps to limit debt growth



*Local Government Financing Vehicles

Source: People's Bank of China, Wind, Bloomberg, China Trustee Association, Asset Management Association of China, Bank of International Settlement, China Insurance Regulatory Commission, Chinabond, China Central Depository & Clearing, China Securities Finance Corporation, Company Data, Goldman Sachs Global Investment Research

The government also has various tools at its disposal. China has already embraced targeted monetary easing to be nimble as it focuses on providing the required support in areas that need it. For example, the central authorities in Beijing have allowed the CNY to weaken past 7.0 against the USD to ease the impact of trade tensions. Another tool available for China is a cut in the reserve requirement ratio (RRR). Furthermore, the country's central bank, the People's Bank of China continues to adopt market-oriented reform measures, such as the introduction of the loan prime rate (LPR) function, to reduce real interest rates and ease financing difficulties.

From a fiscal standpoint, China is unique among its global peers as the only major economy that can afford stimulus measures at will. This gives the government an opportunity to inject various economic boosters into the system when it deems necessary, such as to infrastructure projects and property. There is also the knock-on effect of such stimulus efforts helping to shore up Asian economic growth more broadly.

What China does need to be mindful of, however, is risk of policy missteps in the government's desire to support the economy.

Keeping an eye on debt in the meantime

Along these lines, the government must be wary of unintended consequences from its own stimulus measures. The risks include directing resources towards propping up companies in industries that are not aligned with the broader economic effort. Such a misallocation of capital has other damaging side effects too; for instance, increasing the overall loan supply can take a negative toll on banks' non-performing loans.

More broadly, managing the balance between growth and debt will remain tricky for China. Although it should remain optimistic about its ability to manage any debt burden, given its track record from using deleveraging initiatives effectively to bring debt under control when needed in 2018 (Figure M3), the need to keep economic momentum going is central to the government's goal of social and political stability.

Europe and the UK
Redefining relations amid weak growth

The EU-UK relationship will take many years to be defined after Brexit. Political differences will be a roadblock to a much-needed, broader fiscal stimulus.

Brexit does not mean the end of uncertainty

The UK was defined largely in 2019 by Brexit-related uncertainty and failures to deliver on political promises. With the landslide win by the Conservatives, the UK appears on-track to leave the European Union (EU) by January 2020, but its economic future with the EU will take several years to negotiate given this is such a complex and significant relationship.

A likely scenario is the UK being pulled in different directions, by conflicting US and EU regulations, following efforts by the US to open trade talks with the UK to open a new market previously inaccessible due to regulatory differences.

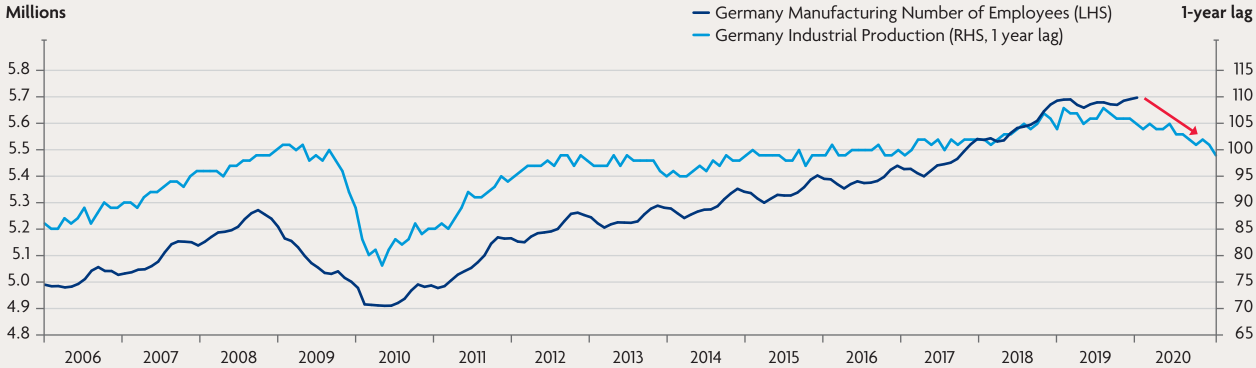
The outlook for the UK economy remains murky.
We see three main elements to this journey:

- The Bank of England will likely cut rates to support the economy, post Brexit.
- The UK will look to the EU or US for a trading partner able to grant quicker access to essential imports to minimise economic impact.
- Post-Brexit, markets will find some clarity and, eventually, begin to attract corporate investment again.

Overall, we expect the impact of Brexit to be largely confined to UK-listed equities and the GBP. However, with pending trade negotiations and related uncertainty, UK investments ought to be minimised in the interim.

Figure M4

German economic weakness could lead to a higher unemployment rate, which can then be a catalyst for Germany to begin fiscal stimulus



Source: Bloomberg

Stimulus to stay given weak growth

European Central Bank (ECB) President Christine Lagarde, known to be dovish, will likely initiate a strategy review within the ECB that will support loose monetary policy for a prolonged period amid muted inflation, although its stimulus effects are likely to be subdued.

The continent is relatively exposed to global trade tensions – exports account for 28% of the Eurozone's GDP, compared with 12% for the US and 19% for China. Around 16% of all EU exports in 2017 and 2018 went to the UK[1]; post-Brexit uncertainty can pose an additional risk to EU exports. We expect the EU economy to slow further. Any fiscal stimulus would help to improve the growth outlook.

At the same time, Germany remains the EU's key economic engine, but manufacturing PMI there has fallen and export growth shrank from +7.0% in Q4 2017 to +0.1% in Q2 2019. Such a slowdown could lead to a rise in German unemployment (Figure M4), a possible catalyst for the country's politicians to approve fiscal stimulus.

France and Italy, meanwhile, began fiscal expansion in 2019. This is expected to continue into 2020. More specifically, Italy was permitted a budget deficit slightly above the EU's fiscal deficit limits, which should help to support growth, and France is expected to see higher consumption gains based on higher employment stemming from prior labour market reforms. However, the Yellow Vests movement continues to pressure the French government against removing expensive fuel subsidies, thus limiting France's ability to redirect resources towards other forms of fiscal stimulus.

Mixed earnings prospects for European corporations

At a corporate level, earnings of companies in the STOXX Europe 600 Index are expected to grow by 9% to 10% in 2020. The upside, however, could be limited due to slow economic growth rates and impact of US tariffs on industries such as aircraft and auto manufacturers. Defensive sectors like healthcare and consumer staples are more likely to outperform and particularly luxury stocks where consumption from the rising emerging market middle class is driving the earnings growth.

This pessimism about growth in 2020, coupled with elevated geopolitical risks within Europe – in comparison with the US – has resulted in our negative outlook for the EU.

[1]Source: European Commission Trade Helpdesk

Summary

In conclusion

While these market-moving forces are beyond our ability to influence, we, as investors, can seek opportunities by identifying the winners and losers in an environment where outcomes are harder to predict.

Drivers

The key drivers for 2020 can be summarised as:

- Global inflation is likely to stay muted due to slowing but positive global growth, thereby providing room for stimulus to continue.
- Major central banks are expected to keep rates low to support the global economy, as political roadblocks in developed markets prevent fiscal support.
- China's ongoing fiscal stimulus is likely to provide support for broader Asian economic growth.

Risks

The key risks in 2020 are likely to be:

- US policy uncertainties in a contentious election year, as Trump uses trade and foreign policies to sway domestic voters, while many Democratic candidates are calling for more extreme-left policies, such as raising corporate taxes on healthcare, technology and energy companies.
- In anticipating the impact from trade tension, there is the risk that Chinese government stimulus may be misallocated or misdirected, resulting in negligible or negative economic impact from higher debt.
- An unexpected spike in geopolitical tensions, resulting in a sudden slowdown in the global economy, thus limiting corporate earnings growth and capital expenditures.

Strategy – Tapping on opportunities by maintaining the right balance

The global economy remains in the late-phase of the cycle. In response, investors can find opportunities by striking a balance amid the many market-moving forces, staying nimble and yet maintaining a view towards taking opportunities to selectively build resilience, seeking late-cycle earnings growth and capitalising on the higher economic growth potential for emerging markets in 2020.

Key Events Calendar

11 Jan
Taiwanese General Elections

20–24 Jan
World Economic Forum in Davos, Switzerland

21 Jan
BoJ

23 Jan
ECB

28–29 Jan
US FOMC

19 Feb
ECB

27 Feb
The Economist's Asia Trade Summit in Hong Kong, China

12 Mar
ECB

17–18 Mar
US FOMC*

15 Apr
South Korea Legislative Elections

28 Apr
BoJ

30 Apr
US FOMC ECB

4 Jun
ECB

11 Jun
US FOMC*

13 Jul
US Democratic Presidential Primary announced

22 Jul
BoJ

24 Jul–9 Aug
2020 Summer Olympics in Tokyo, Japan

30 Jul
US FOMC ECB

28 Aug
US Republican Presidential Primary announced

4 Sep
ECB

11 Sep
US FOMC*

20 Oct
2020 World Expo in Dubai, UAE

29 Oct
BoJ

3 Nov
US Elections (Presidential, Gubernatorial and Congressional)

6 Nov
US FOMC

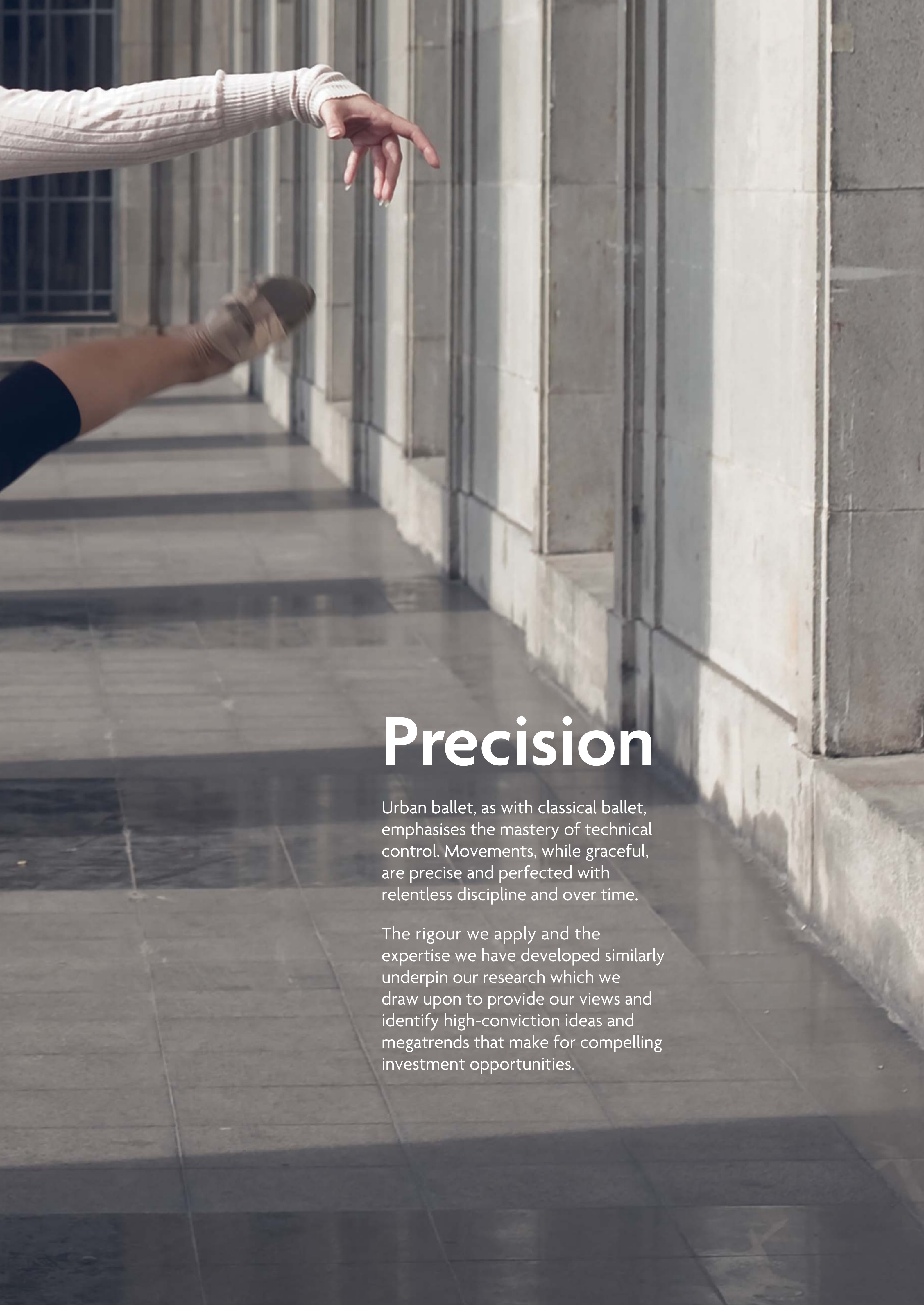
10 Dec
ECB

17 Dec
US FOMC*

- Political Events
- Major Events
- Central Bank Policy Announcements

*Summary of Economic Projections

Strategy and Solutions



Precision

Urban ballet, as with classical ballet, emphasises the mastery of technical control. Movements, while graceful, are precise and perfected with relentless discipline and over time.

The rigour we apply and the expertise we have developed similarly underpin our research which we draw upon to provide our views and identify high-conviction ideas and megatrends that make for compelling investment opportunities.

Asset Class Views

We upgraded our Equities view from slightly negative to neutral, while maintaining the Fixed Income view as slightly positive. This overview is based on reduced risk factors from trade conflicts and Brexit, and a lower likelihood of a severe global economic recession.

Asset Class	Subclass	VTAR Framework	Views				
			Negative	Slightly Negative	Neutral	Slightly Positive	Positive
Equities	US	V T A R			●		
	Europe	V T A R		●			
	Japan	V T A R			●		
	Asia (ex-Japan)	V T A R				●	
	EM (ex-Asia)	V T A R				●	
Fixed income	DM government bonds	V T A R			●		
	DM investment-grade bonds	V T A R			●		
	DM high-yield bonds	V T A R		●			
	EM US dollar debt	V T A R			●		
	EMD local-currency debt	V T A R			●		
Commodities	Gold					●	
	Oil				●		
Currencies	USD				●		
	SGD			●			

● Positive ● Neutral ● Negative ● Not Applicable

A positive turn of geopolitical events point to a more optimistic equity outlook. Domestic growth will be a key driver of Asian equity returns.

Equities

We upgraded our Equities view from slightly negative to neutral as certain geopolitical uncertainties such as US-China trade tensions and Brexit show signs of progress, thus reducing the likelihood of a global economic recession. However, investors should not throw caution to the wind as new uncertainties could emerge from Phase Two trade negotiations and US political posturing ahead of the 2020 elections.

Within equities, we maintain a neutral view on US equities, given the rich valuations. However, we identify opportunities in the US consumer staples sector due to its defensive nature, as well as companies that can tap into innovative growth opportunities to drive long-term growth. We remain neutral on Japanese equities, given its dependence on global trade, persistently low inflation and regional uncertainty from its mini-trade dispute with South Korea, even though valuations are not demanding. Similarly, valuations are attractive in Europe but we continue to be slightly negative on European equities given slowing growth and risks from politics, populism and the uncertainty of future EU-UK relations.

Equities across emerging markets (EM), especially Asia are the bright spots. Valuations are attractive, particularly for China A-shares, where a partial US-China trade agreement is likely to give a further boost. Furthermore, rising domestic consumption is driving growth in key markets, including China, India and parts of Southeast Asia, reducing their reliance on exports for economic growth and allowing companies that focus on domestic markets to benefit from the higher growth.

Fixed income will be supported by loose monetary policies. Investment-grade bonds provide more buffer against sudden policy reversal.

Fixed income

We remain overweight on fixed income as central banks in the US, Europe and Japan are expected to maintain loose monetary policies, with a possibility of reintroducing quantitative easing (QE), to tackle weaker economic growth. The slowing global economy and geopolitical uncertainty have led to a preference for safety in higher quality bonds.

We prefer Asian investment grade (IG) bonds as they offer a reasonable balance of quality and attractive yields over developed market government bonds. While high yield debt offers a better yield pick-up, the risk-reward trade-off is inferior due to continued market volatility. We are cautious about EM debt in general, particularly the local currency bonds since EM currencies, led by the CNY, could weaken further against the USD if trade tensions persist. Be selective in USD-denominated EM debt, especially from countries that continue to run a current-account deficit.

Stronger EUR and AUD against USD. Gold could outperform Oil.

Currencies and commodities

The EUR and the AUD are likely to appreciate against the USD as the interest rate difference narrows. In turn, the USD will appreciate against broad Asian currencies and the SGD, which for their part, are likely to weaken alongside the CNY as China tries to sustain exports to offset its structural economic slowdown.

With the upside for Brent Oil capped by slower global economic growth, it will likely remain range-bound, between USD 60 and USD 70 per barrel. Gold, by contrast, will benefit from low rates and higher demand from central banks to diversify from holding the USD – we expect Gold to hit USD 1,550 per ounce by Q3 2020.

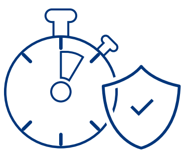
2020 Strategy Summary

UOB Risk-First approach

Ongoing tensions between the polar forces highlighted in our Macro Outlook suggest bouts of volatility in 2020. 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 (evergreen)

Prioritise a sufficient allocation to Core holdings to generate a stable income stream and, potentially, to preserve assets. This is key to weathering downside volatility before considering a Tactical position.



Short- to medium-duration high-grade bonds

Investors can seek greater stability in their overall investment portfolio via highly liquid bonds, whose defensive nature means they can weather an environment of heightened volatility. This asset will also have lower drawdowns against any sudden central bank reversal in the low rate environment due to an inflation spike.

Asian investment grade bonds

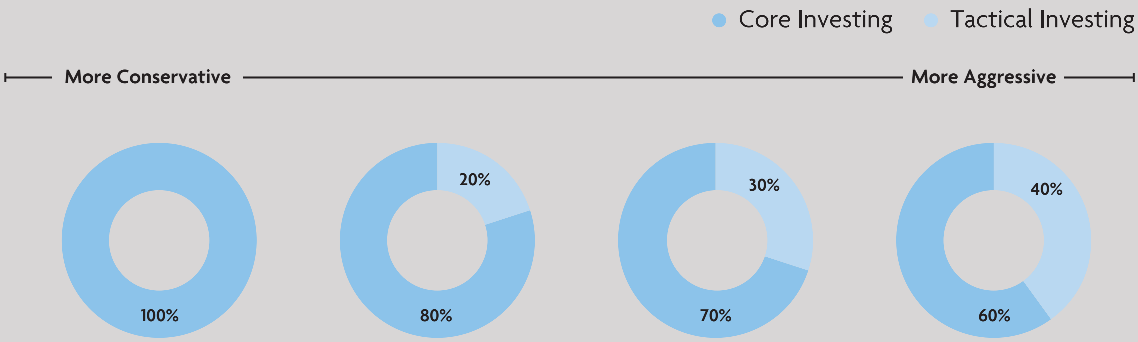
With reasonable yields and spreads near their historical average, these bonds work well against the backdrop of a more dovish Fed combined with relatively soft economic data leading to a cap on rates. This offers a good balance between defensiveness and yield.

Global multi-asset strategies

These strategies offer flexible asset allocation to capture market opportunities across various asset classes, including equities, bonds and alternatives. It is a more diversified solution amid a variety of market conditions, and it offers a mix of income and capital growth to meet an investor's financial goals.

100% Minimum redemption at maturity structures

These structures offer 100% minimum redemption if the note is held to maturity, subject to the issuer's credit risk. They can shield investors from market volatility by providing downside protection while offering yield enhancement through exposure to different asset classes.



Tactical investing

To better navigate and identify the opportunities in today's market environment, we classify our high-conviction (medium-term investing) and megatrend (long-term investing) ideas into three themes:

Resilience theme

Investments in sectors such as US Consumer Staples and Healthcare offer a more defensive approach by focusing on non-cyclical growth with lower drawdowns should markets turn south.

Growth theme

In the short term, global companies with higher returns on equity (ROEs), stable earnings growth and lower financial leverage can offer sustainable growth opportunities amid uncertainty. Over the longer term, the positive impacts of artificial intelligence (AI) and innovation on productivity can boost global economic growth.

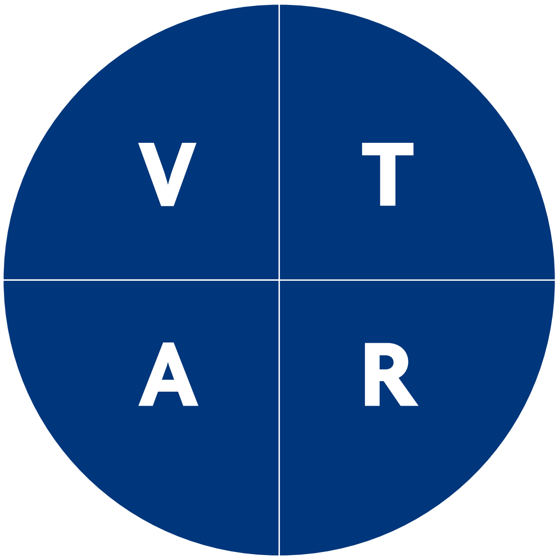
Emerging markets theme

Investing in emerging market equities and China's consumer story are potentially lucrative ways to access opportunities that have been sold-off due to ongoing trade tensions. These also represent regions with higher domestic consumption and middle-class growth potential over the longer term.

2020 Tactical Summary

Using VTAR to identify ideas

Our award winning framework focuses on analysing large volumes of financial data in the four components of Value, Trends, 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.



High-conviction ideas

What are high-conviction ideas?

These are themes that we identify as having the potential to deliver positive returns over the medium term.

Time horizon

6 to 12 months

Strategy execution

Invest over the medium term of 6 to 12 months, with a review of positions every 3 to 6 months to determine the relevance of the strategy in the portfolio.

RESILIENCE THEME		US consumer staples
GROWTH THEME		Global equities with high quality factors
EMERGING MARKETS THEME		Emerging market equities

Positive Neutral
Negative Not Applicable

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.

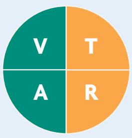
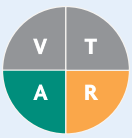
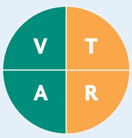
Common indicators
- Geopolitical events
- Industry- or region-specific events
- News flows

Megatrend ideas

What are megatrend ideas?
These ideas capture the transformative forces that are expected to impact the economy, business and personal lives on a global scale over the long term.

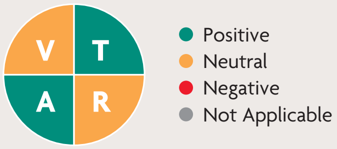
Time horizon
3 to 5 years

Strategy execution
Gradually build up holdings using dollar-cost averaging over a longer-term period of 3 to 5 years (and beyond) as these investments tend to be volatile in nature.

RESILIENCE THEME		Global healthcare
GROWTH THEME		Artificial intelligence and innovation
EMERGING MARKETS THEME		China's growing domestic economy

Positive Neutral
Negative Not Applicable

Resilience Theme



US consumer staples should outperform the broader US equity market in a low interest rate environment and amid slower economic growth.

High-conviction idea – US consumer staples

US consumption remains strong

Our positive outlook for US consumer staples along with robust historical earnings and the current price uptrend make this a sound defensive play. In fact, US consumers alone account for 17% of the world's GDP – higher than China's total contribution of 16% – while US consumption via retail sales has remained strong amid low inflation (Figure C1), which should support the sector's earnings potential. We also believe the sector will benefit from our expectations that the Fed will continue to keep rates low for now.

Potential to outperform amid low rates

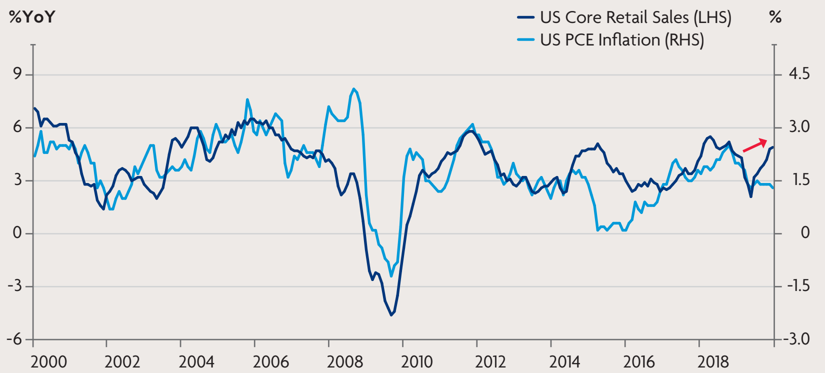
Historical trends are helpful when assessing the sector's response to previous periods of easing. Given their defensive nature and dividend yields, US consumer staples share characteristics with US government bonds, rising in price when rates fall. For example, US consumer staples outperformed the S&P 500 when the Fed started cutting rates after the tech bubble burst around the turn of the century. We see upside in the near term as stock price movements have yet to follow recent rate cuts, while we expect the Fed to keep rates low.

A reasonable premium for stable uptrend

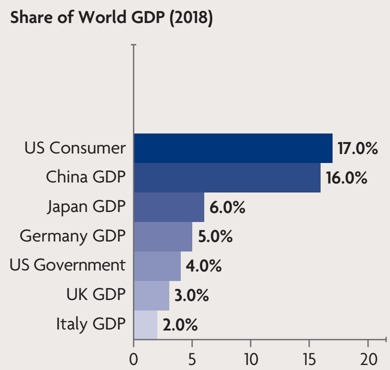
Due to their defensive nature and lower drawdowns, US consumer staples have generally traded at a higher valuation than the broader S&P 500 index, with the sector's 10-year average price-to-earnings ratios at 17.3x versus the S&P 500's 15.0x. Although US consumer staples command a premium, the sector continues to show a stable growth uptrend against cyclical sectors such as technology, financials and industrial. This justifies paying the premium to participate in the upside with lesser potential drawdowns than the broad market.

Figure C1

The US consumer is the largest contributor to the world's economy and is still going strong



Source: MRB Partners, US Census Bureau, US Bureau of Economic Analysis



Source: Strategas, C.J. Lawrence, SunTrust IAG

- Positive
- Neutral
- Negative
- Not Applicable

Pressures from a growing silver population on the back of higher life expectancy will ensure demand for global healthcare gets stronger, coupled with new technologies expanding this sector's potential.

Megatrend idea – Global healthcare

The world will spend more on healthcare

Several factors will drive healthcare spending: ageing and growing populations, greater affluence in developing markets, advances in treatments and health technologies, more prescribed drugs and rising healthcare labour costs. Globally, healthcare spending is projected to increase at an annual rate of 5.4%[1] from 2018 to 2022. Life expectancy is forecasted to rise from 73.5 years in 2018 to 74.4 in 2022[1], resulting in roughly 668 million people globally aged over 65 years old by then (11% of the world's population); in 1950, there were 202 million older persons (8%).

Innovation drives better healthcare

Technologies such as artificial intelligence (AI) and quantum computing will herald important evolutions within healthcare. These include better and more personalised care from AI integration and the ability to process DNA data more effectively via breakthroughs in quantum computing; one recent initiative showed a decline in re-admission rates equivalent to a cost saving of over USD 13,000 per patient.

Medicare-for-All's risk to healthcare profitability may be mitigated

The US offers promise for the sector over the medium to long term; spending is projected to reach nearly USD 6 trillion by 2027. The future of Medicare-for-All – a government-led insurance programme to cover every resident, inspired by the election campaign – may affect the outlook for healthcare stocks negatively. The risk comes from the potential dent to profitability for many drug manufacturers and healthcare providers from government-controlled costs. On the flipside, US citizens may reject the scheme given it will be funded by higher taxes (Figure C2).

[1]Source: 2019 Global health care outlook, Deloitte, 9 January 2019

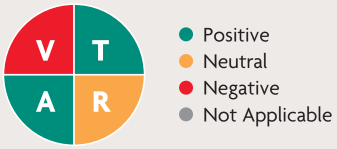
Figure C2

The public's view of Medicare-for-All can shift significantly after learning more about its implications

	Favour	Oppose	Net favourability
Do you favour or oppose having a national health plan, sometimes called Medicare-for-All?	56%	42%	+14
Would you favour or oppose a national Medicare-for-All plan if you heard that it would do the following?			
Guarantee health insurance as a right for all Americans	71%	27%	+45
Eliminate all health insurance premiums and reduce out-of-pocket healthcare costs for most Americans	67%	30%	+37
Eliminate private health insurance companies	37%	58%	-21
Require most Americans to pay more in taxes	37%	60%	-23
Threaten the current Medicare program	32%	60%	-28
Lead to delays in people getting some medical tests and treatments	26%	70%	-44

Source: Kaiser Family Foundation Health Tracking Poll conducted 9-14 January, 2019

Growth Theme



Companies with sound balance sheets and superior financial strength are better able to withstand uncertainty and continue to deliver positive earnings growth.

High-conviction idea – Global equities with high quality factors

Higher quality leads to higher earnings certainty

Companies with a high return on equity (ROE), sustainable earnings growth and low financial leverage typically deliver superior earnings growth with more certainty in an uncertain or slower growth environment. There are three reasons for this: strong balance sheets without high debt help companies withstand adverse conditions or unexpected challenges; earnings stability makes forecasting more predictable and therefore reduces the risk of disappointing investors; and a high ROE shows efficient allocation of resources.

Higher quality earnings more likely to lead to better returns

Particularly in a volatile market environment, stocks with these characteristics tend to outperform their peers that only focus on delivering high earnings growth. The longer-term evidence also indicate that companies with high quality factors in general returned 2,100% over the last 30 years compared to 650% for the broader index.

Keeping valuations in mind

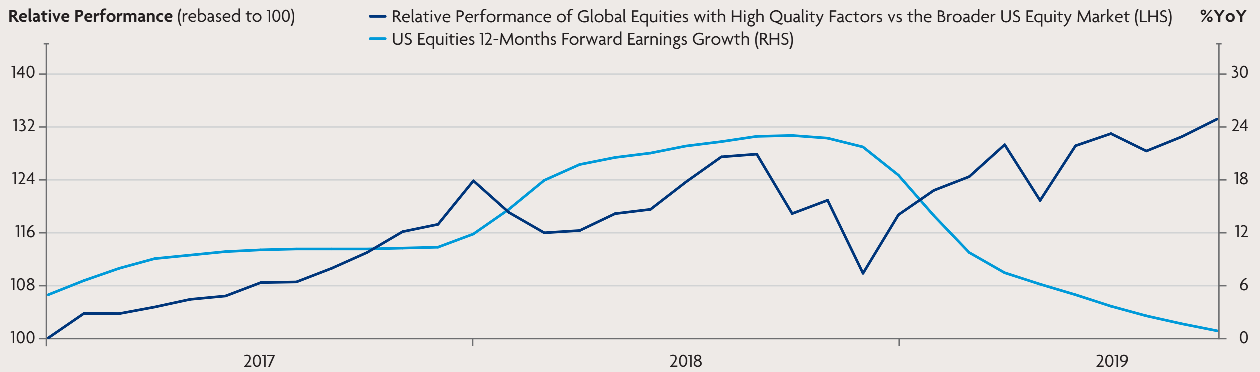
At the same time, investors eyeing such stocks should watch valuations closely. They are fairly high as investors have been willing to bid for them amid the threat of US protectionism until the growth outlook improves. The resilience in retail consumption, coupled with concerted global central banks easing, should sustain the global economy and justify the high valuations.

Superior profit growth amid slower earnings growth

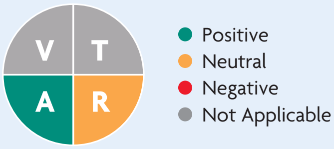
The recent weaker earnings backdrop provides a strong case for equities with high quality factors. This is because slower earnings raise the appeal of those companies with the ability to consistently produce superior and stable profit growth (Figure C3), thus making them an attractive opportunity in 2020.

Figure C3

Companies with high quality factors tend to outperform the broader US equity market when earnings growth slows



Source: MRB Partners, MSCI



AI has the potential to drive growth in every industry worldwide. AI adopters with a proactive strategy are likely to drive higher margins – and some sooner than what many expect.

Megatrend idea – Artificial intelligence (AI) and innovation

AI brings significant gains

The application of AI is expected to drive growth across all sectors and geographies globally. AI-enabled technologies could double the economic growth rates of many advanced countries by 2035[1], with AI forecasted to generate global GDP gains of USD 15.7 trillion by 2030[2].

High growth potential attracts interest

Growing interest among organisations to implement AI in some way, along with investment in AI research globally, will propel future innovation across many sectors (Figure C4). AI is also a priority area for venture capital funding given its high growth potential. Many AI companies are also increasingly aware of regulatory concerns, such as data privacy and masking, and have started working with authorities to develop best practices.

Increasing deployment provides new opportunities

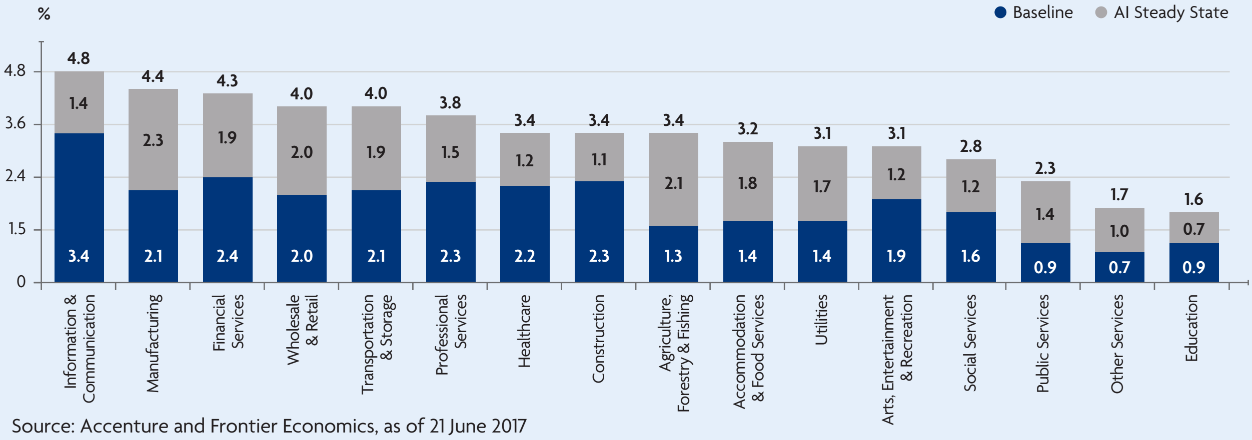
AI is spearheading innovations to help address demographic, economic, environmental, infrastructure and social challenges: from "intelligent cities"; to voice assistants handling an estimated 40%[3] – and rising – of all Internet searches; to real-time facial recognition. Research firm Gartner estimates 'AI augmentation' will create 2.3 million jobs in education, healthcare and the public sector in 2020 alone.

The AI super-race – US vs China

Both the US and China place a lot of emphasis on AI as a critical pillar of competitiveness. Many reports point to China's dominance in start-ups and AI-related patents. In the US, government organisations relating to intelligence, technology, defence and science continue to fund new research in universities and the private sector. Such competition will fuel new opportunities, which longer-term investors can tap into.

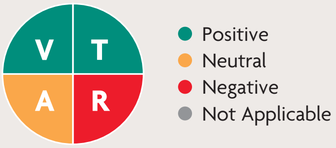
[1]Source: Accenture and Frontier Economics, May 2017
[2]Source: PricewaterhouseCoopers, June 2017
[3]Source: 6 AI Developments to Follow in 2019, Springboard, March 2019

Figure C4
The potential of AI is far reaching – and might come sooner than we think



Source: Accenture and Frontier Economics, as of 21 June 2017

Emerging Markets Theme



EM are more appealing relative to developed markets (DM), given cheaper EM valuations and higher economic growth momentum, even though trade-related tensions remain a risk factor.

High-conviction idea – Emerging market (EM) equities

EM offers good value with potential upside

Although the current price-to-earnings (P/E) ratio of 11.8x is above the 10-year average of 11.2x, investors in emerging market equities are still getting a reasonable discount over global equities' P/E ratio of 16.4x. The likelihood of further monetary easing by the major central banks adds to the appeal of EM equities. Asia, in particular, is set to benefit from the semiconductor recovery (Figure C5); especially for major chipmakers in South Korea and Taiwan, which together comprise roughly 28% of the MSCI Asia ex-Japan Index. Progress in US-China trade talks will help soothe broader concerns over outlook.

EM economic growth and earnings are turning for the better

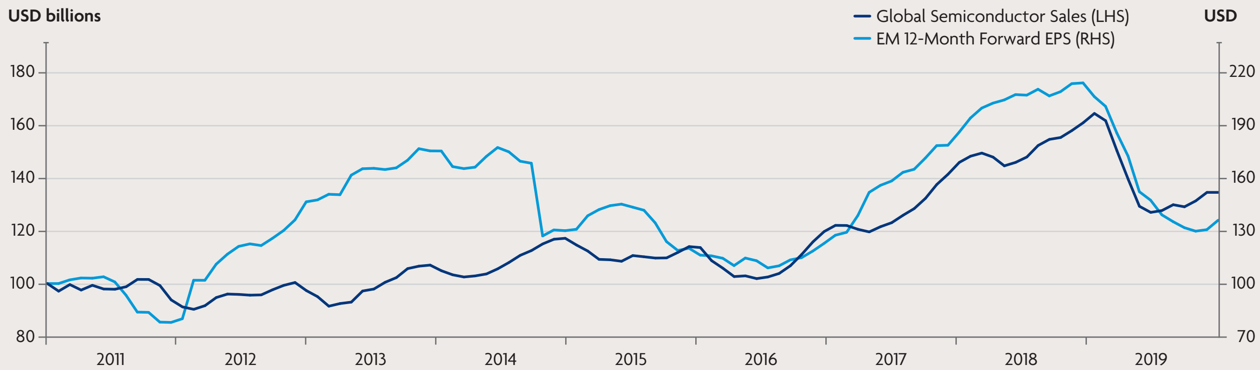
A modest recovery in economic growth can be expected from mid-2020 as the effects of global monetary policies and China's fiscal stimulus kick in. Although China is expected to grow at a slower pace than 2019 given policymakers' emphasis on quality growth, growth is expected to accelerate in India and Brazil, providing some tailwinds for EM equities. In addition, the uptrend of global semiconductor sales promises to help drive EM equity returns – the pressure from the US-China and Japan-South Korea trade disputes are easing, and the sector has historically been closely linked with EM earnings.

Be mindful of EM risks

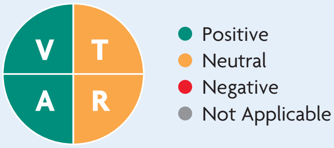
Prolonged fund outflows was a risk in 2019 until the Phase One deal was announced, and can possibly resurface in 2020 if US protectionist trade tensions escalate. This scenario can result in a significant drop in EM growth expectations, pushing investors to seek refuge in developed market equities instead, as in 2019. Slower global growth expectations can also adversely impact energy prices, in turn affecting growth prospects of emerging economies that rely heavily on energy exports, such as Russia and Brazil.

Figure C5

A rebound in global semiconductor sales can lead a recovery in EM equity earnings



Source: Semiconductor Industry Association, MSCI



Four key long-term drivers for this economic superpower include the growing purchasing power of its consumers, technological advances, inclusion in global indices and a shift in retail investor focus from property to equities.

Megatrend idea – China's growing domestic economy

Four key long-term drivers

Consumption growth has become the main driver for China's domestic economy, contributing 60% of GDP growth. This is based on and supported by several trends, including a commitment to technology via the bid for global e-commerce and artificial intelligence (AI) dominance. Also notable is the inclusion of China A-shares in flagship MSCI and FTSE benchmarks, with an estimated USD 116 billion in additional foreign investment inflows in Q3 2019 alone. Another exciting trend – and likely long-term driver – has been the shift in allocations away from real property in favour of domestic equities (Figure C6). With financial assets increasing over the last 30 years from 20% to 30% of Chinese wealth, there is scope for this to continue its upward growth trajectory over time.

Cheaper valuations but inflows increasing

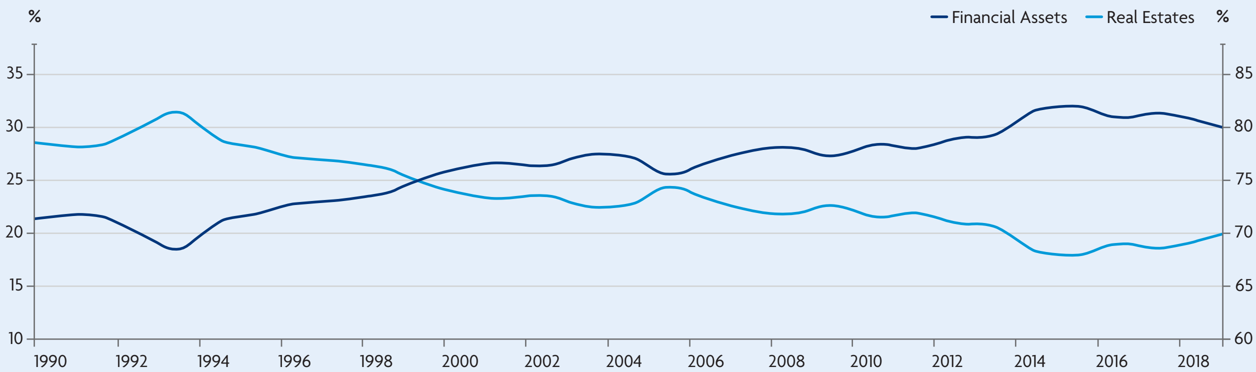
Despite progress, Chinese onshore equities' valuations, at 11.2x earnings, remain slightly lower than the 10-year historical average of 11.7x, and lower than the broader Asia ex-Japan equities' 13.0x, suggesting room for potential gains once value is recognised. With positive inflows for Shanghai Stock Connect and Shenzhen Stock Connect, plus recovery in northbound flows from Hong Kong since mid-2019, increasing overseas interest gives equity prices potential to break out of their consolidated range.

Government support to suppress short-term woes

Although key economic indicators have shown signs of weakening, the possibility exists for further cuts in the reserve requirement ratio (RRR), plus room for targeted structural reforms to reduce corporate financing costs, improve monetary policy transmission effectiveness and advance consumption tax reforms. Furthermore, the expansion in services can counter weaker manufacturing and exports momentum, thus supporting equity prices in the near-term.

Figure C6

The decrease in real estate holdings corresponds to an increase in financial assets



Source: Wind, Haitong Securities Research

Shades of Asia

With a global footprint and a well-established presence in Asia, UOB has a deep understanding of Asian markets, corporate culture and business attitudes.

Our strong foothold in Singapore, Malaysia, Indonesia, Thailand and China positions us well to create access and facilitate growth for our customers in this region.

Singapore

Uncertainty and volatility will lead to slower growth.

Singapore's growth outlook remains vulnerable if US-China trade tensions re-escalate due to the nature of its export-oriented economy. The Phase One deal involving some tariff rollbacks in January 2020 will be a source of optimism.

Singapore's vulnerability is reflected in its output gap – the difference between actual GDP growth and potential GDP growth – which has been in negative territory since Q4 2018 (Figure R1). As a result, the Monetary Authority of Singapore (MAS) has projected that the domestic pace of economic growth will be below potential in 2019 despite the central bank easing monetary policy at times to address the shortfall.

Investors should watch for possible moves by the MAS to further ease monetary policy to protect economic growth, in line with its policy objectives. In 2020, the MAS may flatten the slope of the Singapore Dollar Nominal Effective Exchange Rate (S$NEER) and ease policy all the way to neutral to cushion both inflation and growth risks in 2020.

Manufacturing and trade momentum in Singapore remain lacklustre amid soft economic fundamentals. As Singapore is an export-oriented economy and a price-taker, the MAS may allow the SGD to weaken further if global trade tensions remain high – as it did during the early 2000s and in 2008/09.

Equities

High-yielding stocks in the Financial and Real Estate sectors should perform well in 2020 as we expect investors to continue to look for dividend yields in a low interest rate environment. Singapore banks reported healthy profits despite falling interest rates in 2019, with strong deposit growth suggesting an incremental build up in liquidity, a positive sign for banks. The Singapore REITS index is likely to continue its outperformance over the Straits Times Index in 2020 as the increase in residential prices and the redevelopment of older properties highlight resilient demand trends, which will support prices and yield.

Fixed income

Singapore rates are expected to inch lower against the backdrop of the broad, synchronised global monetary policy easing led by the US Federal Reserve (Fed). The 10-year Singapore Government Securities (SGS) is expected to reach 1.8% in Q1 2020 and hold at this level for the rest of the year.

Currency

MAS' objective is to maintain price stability conducive to sustained growth and it has eased monetary policy to try to address the persistent negative output gap in H2 2019. We expect the Singapore dollar to weaken to 1.39 against the USD by Q3 2020 to cushion both inflation and growth risks into 2020.

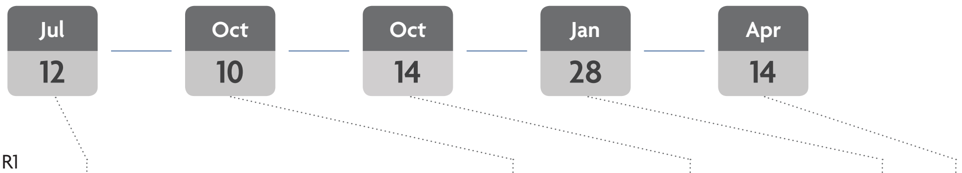
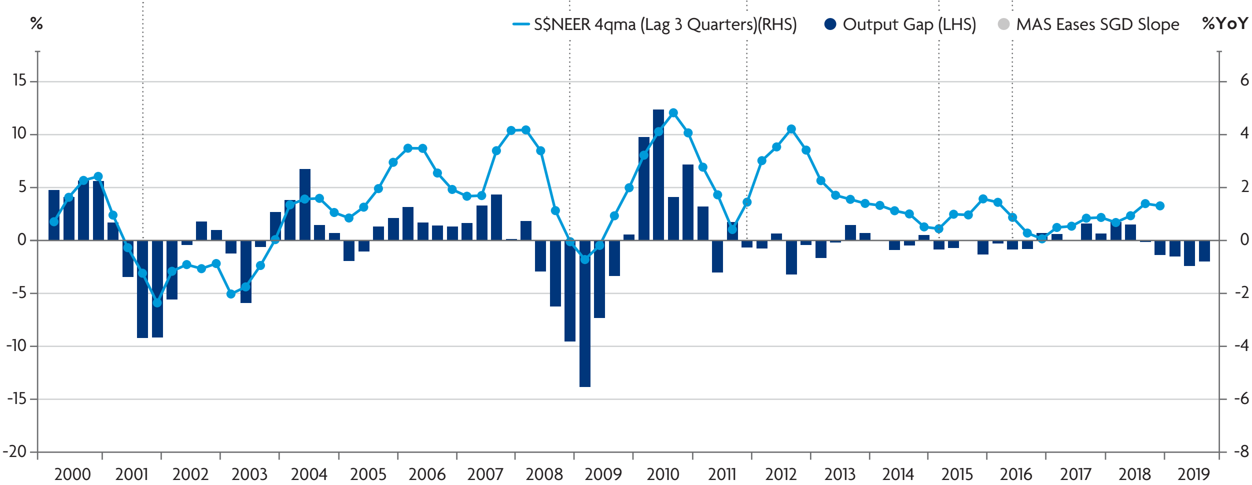


Figure R1
Singapore's output gap has worsened in 2019



Source: Macrobond, UOB Global Economics & Markets Research

Malaysia

Private consumption and public expenditure are drivers of the economy.

We expect Malaysia to feel the effects of weak business sentiment and softening global growth, with GDP likely to moderate slightly to 4.4% in 2020 from 4.6% in 2019. Yet, an expansionary budget this year will offer some support to growth, as will the recovery in the price of palm oil. Further buoying the Malaysian economy will be the expected support for Brent crude oil prices – which will likely be in the range of USD 60 to USD 70 per barrel due to ongoing Middle East tensions.

A potential risk will come from the anticipated prime ministerial change in 2020. This change in leadership has the potential to change the political landscape substantially, with any resulting uncertainty contributing to market volatility.

Domestic demand is likely to remain resilient in 2020 amid robust private consumption (Figure R2). At the same time, the government is expected to prop-up fiscal spending, especially on infrastructure, as a way to insulate Malaysia from any knock-on effects of trade tensions and geopolitical risks.

We project that Bank Negara Malaysia (BNM) will cut the Overnight Policy Rate (OPR) – the central bank's target interest rate – by 25 basis points to 2.75% in Q1 2020.

Malaysia's growth outlook remains muted, in sync with global economic trends. A combination of private consumption and public sector expenditure will continue to drive the domestic economy. BNM is expected to follow the US Federal Reserve's recent rate-cutting example with its own easing.

Equities

Tourism, technology and construction are all sectors to watch in Malaysia. This is based on a range of factors, including: the government's efforts to drive an Industrial Revolution 4.0; trade diversification in the wake of US-China tensions; and the revival of mega projects, such as the East Coast Rail Link (ECRL), and the Pan Borneo Highway in East Malaysia. We also expect a lower interest rate environment to support dividend-yielding stocks.

Fixed income

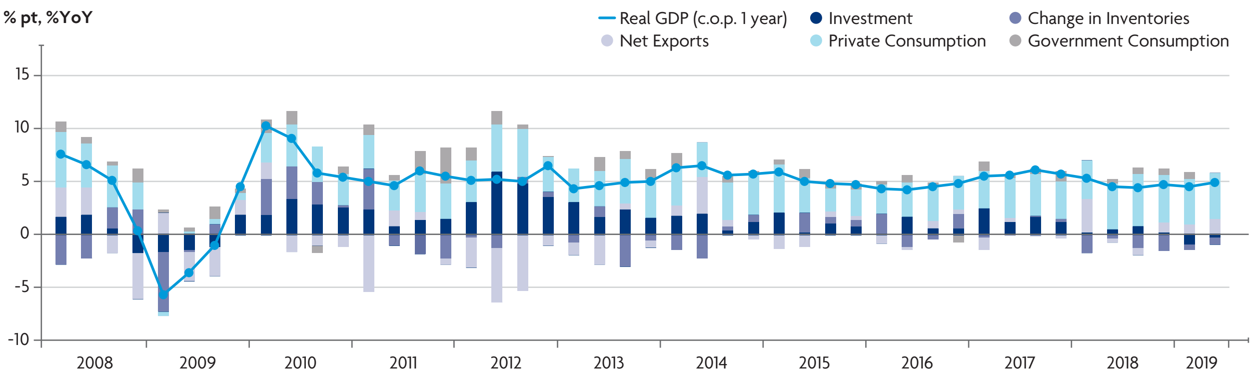
The Malaysian bond market continues to face headwinds. FTSE Russell has kept the country on its watchlist for potential exclusion from the World Government Bond Index (WGBI), with the next review in March 2020. We would expect the positive engagement between BNM and FTSE leads to Malaysia remaining in the WGBI but with a lower weighting to pave the way for China's inclusion.

Currency

The Malaysian ringgit (MYR) will move in-step with the outcome of progressive trade deal negotiations that the US-China agree throughout 2020. We forecast the MYR to reach 4.19 against the USD by Q1 2020 and then 4.25 by Q3 2020.

Figure R2

Private consumption is likely to remain resilient in 2020



Source: Macrobond, UOB Global Economics & Markets Research

Thailand

Domestic growth faces headwinds from external uncertainty.

The Bank of Thailand (BoT) is offering further support for the country to live up to its economic potential by lowering its growth forecast for 2019 and 2020. The economy is now projected to grow by 2.8% (previously 3.3%) and 3.3% (previously 3.7%) respectively.

Signs of slower growth can be seen from the contraction in merchandise exports from the previous assessment, owing to the slowdown in trading with partner economies. At the same time, tourism, another key contributor to the economy, is likely to see stalled growth and expectations of a slowdown in private consumption will dampen domestic demand – regardless of support from fiscal stimulus measures – driven by falling household income and employment, in turn resulting in elevated debt levels.

For inflation, we anticipate it will rise towards the BoT's target of 1.0% in 2020.

Thailand's manufacturing, exports and tourism face external headwinds, but a brighter outlook will follow the expected positive developments in trade talks between the US and China. The government could use policy intervention and its budget announcements to provide a much-awaited – and needed – boost.

Equities

The consensus for 2020 earnings growth estimates is between 8% and 10%. We project that the benchmark SET Index will trade between 1,500 and 1,800. The positives, in our opinion, include factors such as upcoming government measures to jolt the economy into action, the continued low interest rate environment, and potential sovereign credit rating upgrades based on positive adjustments of the country's credit outlook by Fitch Ratings and Moody's Investors Service (Figure R3). Although valuations are on the higher side, these market drivers can also dampen downside risk by helping to sustain the valuations through rerating.

Fixed income

Thai government bond yields have not moved significantly in 2019 due to its strong currency. With a positive rating outlook for 2020, the estimated outflow of approximately THB 75 billion[1], or USD 2.5 billion, is likely to reverse if the BoT signals further monetary policy easing. Consequently, short-term rates should fall, but long-term rates will remain anchored near current levels.

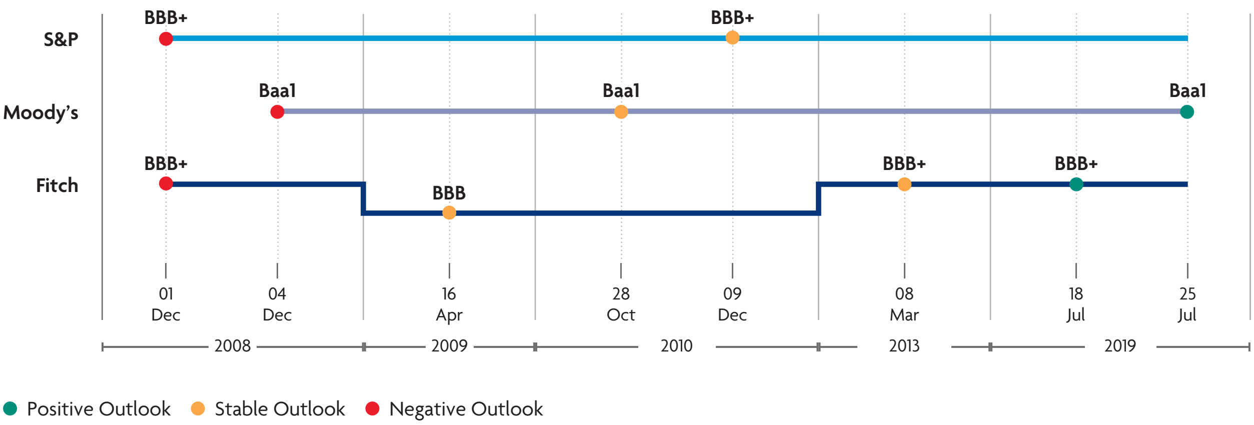
Currency

After the Thai baht (THB) outperformed regional peers for the majority of 2019, we expect the THB to trade sideways against the USD as its upside is capped by USD strength, while Thailand's 6% current account surplus will likely prevent a significant weakening. In anticipation of the BoT shifting into easing mode to support economic growth, we forecast the THB to reach 30.8 against the USD in Q3 2020. However, the likely trading range for the year overall will be between 30 and 31.5.

[1]Source: Thai Bond Market Association, October 2019

Figure R3

A credit rating upgrade will attract foreign inflows for Thai bonds and support the equity market



Source: Bloomberg

Indonesia

Political stability will be conducive for growth.

The peaceful inauguration of the new president and vice-president in October 2019 should boost foreign investors' confidence towards future policymaking. Lesser policy uncertainty, together with labour reforms as part of a widespread structural overhaul, should benefit the Indonesian economy, which we project to grow by 5.2% in 2020.

The government faces a heavy workload – focusing on corporate tax cuts at one end of the spectrum, and increasing taxes on items such as cigarettes, plastic and electricity on the other end. Investors also need to carefully assess how the government manages its current account deficit in 2020.

Indonesia's economic growth outlook in 2020 is likely to be lower and slower. The new cabinet has a clear and ambitious agenda that will shape fiscal policy and help to determine foreign capital flows. Current account deficit management will be key to domestic stability.

Equities

We favour the financial, consumer goods, infrastructure and telecoms sectors in Indonesia in 2020. The defensive nature of the consumer goods sector gives it resilience amid uncertainty from trade tensions. Financials and infrastructure, meanwhile, should benefit from the shifting of the capital, Jakarta, to East Kalimantan, which will require extensive construction over the next five years and is estimated to require a total investment of IDR 466 trillion, or USD 33 billion. Telecom companies are set to gain as the growing digital economy leads consumers across the country to increase mobile data usage. Investors should avoid the mining sector, however, based on the government's plan to ban nickel exports as of January 2020.

Fixed income

We expect the outlook for Indonesian bonds to stay positive in 2020. Negative yields in some developed markets, coupled with low inflation and interest rate cuts globally, support this view. Bank Indonesia (BI) is also projected to reduce rates further to offset the 175 basis points hike since 2018. Investors ought to be cautious of rising inflation risks as parliament readies to hike taxes and reduce subsidies for cigarettes, plastic, online transportation, parking fees, electricity and BPJS (Badan Penjamin Jaminan Sosial, or mandatory insurance). Figure R4 shows a government study done in 2017 on the projected increase in electricity prices after subsidies. The government kept the subsidies until the 2019 presidential elections.

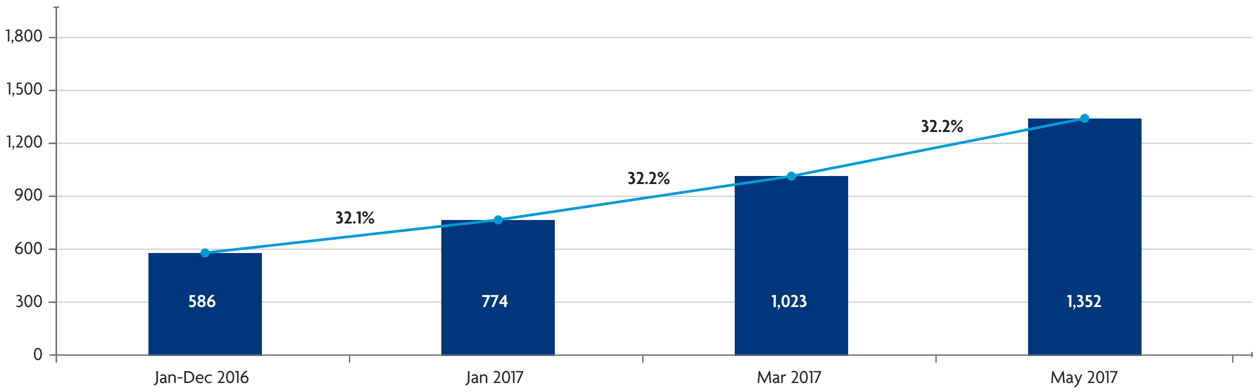
Currency

We expect the Indonesian rupiah (IDR) to weaken against the USD to 14,500 by H2 2020. This is in line with projections for the year that the current account and trade balances are expected to widen.

Figure R4

The reduction in subsidies, such as electricity, following the 2019 presidential elections will likely contribute to higher inflation in Indonesia

Cost per unit of electricity (IDR per kWh)



Source: Departemen Kebijakan Ekonomi dan Moneter, Bank Indonesia

China

Consumption will be the main economic driver.

The headwinds from trade-related uncertainty plus continued deleveraging in recent years have depressed China's economic growth, especially for the manufacturing sector. Fixed asset investments and exports have also slowed since 2018 as a result of this.

Yet, with consumption as the bright spot for the domestic economy (Figure R5) – both today and likely going forward – the service sector remained stable in 2019. Its contribution ratio of consumption to GDP growth has remained strong and is expected to rise further.

The government is likely to add its support with various measures. In terms of monetary policy, a focus on structural reforms to lower financing costs for enterprises is preferable since large-scale monetary easing may lead to higher inflation and overheating in the property market, further increasing debt ratios. As for fiscal stimulus, the recent tax cuts and special debts for construction projects are expected to continue in 2020. Furthermore, trade diversification and CNY depreciation would help to ease the negative impacts on exports due to trade disputes.

China's relatively strong service sector continues to support economic growth amid uncertainty in US-China relations. Government stimulus measures are expected to underpin the domestic economy, although the approach to monetary and fiscal policies will determine the sustainability of these efforts.

Equities

More top-down policies and regulatory changes will support investor sentiment as well as bolster earnings. Relatively reasonable valuations enhance the attractiveness of A-shares, which will also increasingly attract inflows from foreign investors given their inclusion into the MSCI and FTSE-Russell indices. This will boost liquidity for China equities over the longer term.

Fixed income

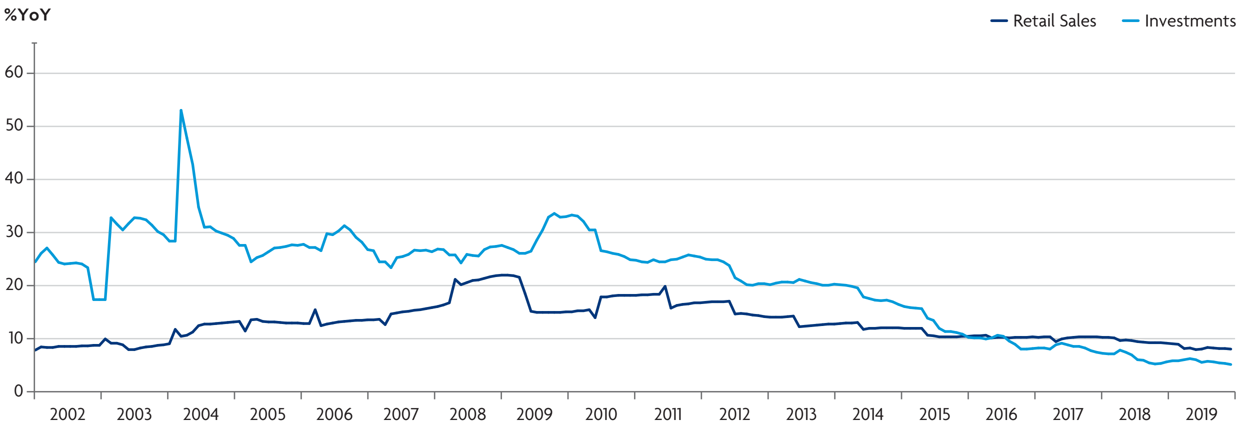
Chinese fixed income performed well in 2019 on the back of the continued decline in the benchmark yield and concerns over the slowdown in growth. However, interest rates are likely to stay near current levels, thus limiting further upside potential. For 2020, we favour high-quality bonds and see some structural opportunities in credit, such as short duration urban construction investment bonds.

Currency

The future of the CNY will depend on the nature of ongoing US-China trade negotiations throughout 2020, as well as the extent of any slowdown in domestic growth. We expect the CNY to stay below 7.00 against the USD in the near term, with a target of 7.20 by Q3 2020.

Figure R5

China relies more on retail sales than investments to grow its economy



Source: Bloomberg

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