GLOBAL OUTLOOK 2020

MARKETS, INVESTMENT & STRUCTURING – H1 2020

MARKETING MATERIAL

EMERGING MARKETS: A SECULAR STORY

FOCUS
THE RISE OF THE MIDDLE CLASS

MARKETS
BULLISH ON CHINA

SUMMARY

EDITORIAL

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REVISITING THE EMERGING MARKETS OPPORTUNITY

Emerging markets (EM) are a long-lasting investment story that obviously predates the BRIC (Brazil, Russia, India, and China) concept popularised in 2003. The secular story of emerging countries' convergence to the level of mature markets' productivity and income per capita gained traction some 15 years ago with China's growing role in global manufacturing and supply chains around the world.

This story became popular again after the 2008-2009 crisis and the vigour of emerging markets contrasted sharply with the Euro Zone in crisis in 2011. The nature of the story changed: China started to become synonymous with the largest middle class in the world and a highly innovative ecosystem, rather than simply being considered the factory of the world thanks to its cost advantage. 2012 was a symbolic year when the Greek crisis reached its climax and the emerging markets' contribution to world GDP began to exceed 50%.

Since 2014, however, the secular narrative has been somewhat weakened by several factors, ranging from the excesses of shadow banking and corporate leverage in China to the adverse consequences for emerging markets of US interest rate hikes in 2018, and on to the implementation of protectionist measures initiated by the President of the United States Donald Trump.

What is still true among the structural arguments in favour of the emerging markets case today? Does the promise of strong growth still hold in 2019-2020? What are the potential weaknesses that can be witnessed in terms of policy-mix, reform pace, or industrial strategy that could erode the leadership potential of these countries?

Ahead of the US election, it makes sense to revisit the investment case for emerging markets that has long been a structural conviction of ours.

- The reversal of US monetary policy in favour of renewed accommodation should be a positive catalyst for emerging markets.
- Any weakening of the US dollar could attract flows into cheap emerging currencies offering higher carry and attractive exchange rates.
- A potential resolution of the trade war should be a strong catalyst for financial flows into emerging markets, and could eliminate one source of the global economic slowdown.
- Looking at 2020 and beyond, the foreign policy agenda of the various candidates vying for the Democratic Party's nomination in the race for the White House suggests this election could be a turning point in the US-China relationship, even if we do not expect that the US will again fully embrace globalisation.

It is important to take a step back from the headlines and revisit the fundamentals of the emerging markets, including delving into the specific situations found in several key countries. This reveals much heterogeneity among the countries concerned and implies that investment strategies need to be tailored to the specific environment. It also reflects the powerful secular trends that underpin the emerging markets' growth.

We wish you happy reading and much success in 2020.

Indian Ocean

TRADE, PROTECTIONISM, AND EMERGING MARKETS

Few threats to the global business cycle expansion are as imminently menacing as protectionism. Global trade volume growth started to decline in January 2018, well before any measures had been implemented. Simply talking about imposing tariffs was sufficient to dampen world trade.

Chart 1 shows the relationship between trade volumes and gross domestic product (GDP). When trade volume growth dips below its average, global GDP growth tends to do the same. In the fourth quarter of 2001, trade volume growth contracted by 6.5% year-on-year, while world GDP slowed to 1.3% year-on-year (YoY), avoiding recession.

In January 2009, trade volumes shrank by 19% while world GDP fell by 2.4% YoY in the first quarter of that year. Trade volume growth recorded a drop of 1.2% YoY in August 2019, and world GDP growth dipped below its average for the first time since 1993 – looking more like 2001 than 2009. As long as protectionist measures do not increase materially from what has already been implemented, a recession is unlikely to be brought about by such measures alone.

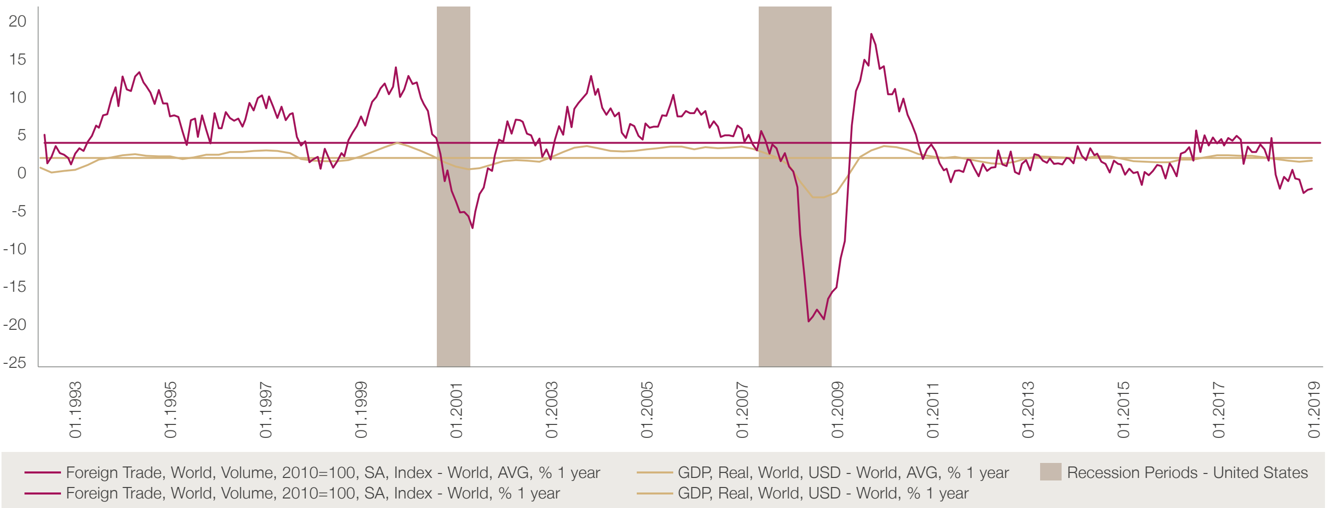
While protectionism probably poses the greatest contemporaneous risk to the global business cycle, the good news is that the increase in tariffs comes from a historic low. In the US average tariffs had fallen below 2%[1]. In September 2018 they had risen to around 3%. With all tariffs under consideration, the average could climb higher still to around 7%.

While this is the most negative scenario, it pales in comparison with the 14% or so average tariff that prevailed in the 1940s, or the 40% in the 1930s. Also, the share of imports affected by new tariffs remains relatively modest. In the US it is about 13%, in China around 7%, and globally below 3%. These facts are among the reasons why we do not forecast a recession at this stage.

It is also important to realise that as the world is turning more protectionist, it is simultaneously taking steps in favour of freer trade. The World Trade Organisation (WTO) monitors the actions taken by its members either in favour or against free trade. From October 2018 to May 2019, 20 protectionist measures were implemented versus 29 trade-liberalisation actions. As the protectionist measures are 3.5 times above the average observed since 2012, the balance could yet tip. For now, free trade still has the upper hand.

In 2019, 302 regional trade agreements saw the light of day. The Trans-Pacific Partnership has gone ahead without the US. The EU has concluded deals with Mercosur, Japan, and Canada. Africa has created a free-trade area encompassing 22 countries, the greatest trade liberalisation seen since the WTO was formed in 1994. These are all positive developments.

CHART 1: GLOBAL TRADE VOLUMES AND GLOBAL GDP, % YOY AND AVERAGE % YOY SINCE 1993



Source: Factset, Indosuez Wealth Management.

1 - *Traders' Dilemma*, World Bank, Policy Research Working Paper 8640, November 2018.


Sentosa Island, Singapour

THE EFFECTS OF TARIFFS

Now that we have put today's protectionism in some perspective, we turn to the effects of tariffs. The direct effect is that the price of imports subject to the new and/or higher tariffs increases. This either hurts corporate profit margins or consumers, or both. Indirect effects are that producers affected by tariffs might sell fewer products, buy fewer intermediate goods, and so on, all along the local and international supply chains, thus having a dampening effect on global trade.

Tariffs can also cause trade redirection, for example, when a supplier affected by tariffs can be replaced by a supplier who is exempt. To the extent that this kind of substitution is possible, it can benefit companies and countries not directly involved in the trade conflict. If substitution is not possible, the importing countries' current account balances are likely to worsen, unless the sensitivity of domestic demand to the price increases is such that import volumes drop by more than the tariff increase.

Analyses of the impact of trade restrictions on GDP depend critically on assumptions regarding trade substitutability and the price-sensitivity of demand. Moreover, these assumptions are generally fixed while in the real world the relationships are dynamic and evolve over time. Any conclusions are indicative and should not be taken as certifiable magnitudes. "It is more what you'd call guidelines than actual rules", as Barbossa said in the *Pirates of the Caribbean*.

CHINA MOST IMPACTED

Nevertheless, on the basis of such static analysis[2], China is the most heavily impacted country by current and threatened tariffs that may subtract between 0.5 and 1.0 percentage points from GDP over 2-3 years. The impact on US GDP is potentially about half that of China, and smaller still (some 0.2 percentage points) if trade redirection is taken into account. Developing Asia could actually benefit by nearly 0.2 percentage points, and the effect on world GDP could be a reduction of around 0.2 percentage points.

The sector the hardest hit is China's electronics industry where output could shrink by 0.15% of GDP. South Korea is exempt from US tariffs on steel and likely to benefit in this sector. The rest of Asia could see gains at the expense of China in trade in textiles, agriculture, and wholesale trade as well as in electronics.

If protectionism spread to autos, Europe and Japan would be at most risk. Latin America could benefit from redirected trade in soybeans, but this could come at the expense of other crops. Most emerging countries could see an increase in the production of iron, steel, and soybeans.

WELFARE GAINS

The impact on current accounts will likely be somewhat smaller surpluses in China, and a marginally larger deficit in India and the US. Mexico and Canada are particularly vulnerable to the ratification of the North American Free Trade Agreement's (NAFTA's) replacement, the US-Mexico-Canada Agreement (USMCA). Overall, emerging markets are actually likely to see welfare gains from higher US and Chinese demand for their products, as long as the protectionism does not provoke a sharper deceleration in the global business cycle.

2 - *The Impact of Trade Conflict on Developing Asia*, ADB Economics, Working Paper No. 566, December 2018.

THE RISE OF THE MIDDLE CLASS

Demographic projections indicate that the world population could increase by an additional 2 billion people until 2050. Out of this increase, more than 1 billion people could be joining the world middle class, seeking access to consumption, financial services, urban housing, transport, telecommunications, education, and healthcare, generating significant growth prospects and investment opportunities in the process. At the same time, this is set to increase the pressure on resources and the climate, in turn requiring yet more investments in a more climate-friendly energy production, transport, agriculture, and consumption.

DEMOGRAPHIC PROSPECTS

The world population could reach approximately 10 billion people by 2050, according to a United Nations report. Although this number immediately generates anxiety regarding overpopulation in low income countries as well as its impact in terms of stress on natural resources and migration trends, it is also likely to be accompanied by a swelling of the ranks of the world's middle class. Only focusing on the next decade shows the world's middle class rising from 3.2 billion to 4.9 billion, according to Organisation for Economic Cooperation and Development (OECD) forecasts.

Most of this growth will take place in Asia, which will capture 85% of the expected expansion of the middle class population. A decade from now, Asia will represent 66% of the total middle class population in the world compared with less than 30% 10 years ago. Within this additional middle class population in Asia, it is estimated that 40% to 45% of this growth will come from India, 35% to 40% from China and 15-20% from the rest of Asia (Chart 2).

This trend was accurately anticipated several decades ago by two economists, Wolfgang Stolper and Paul Samuelson who proposed a theorem in 1941 revisiting the Ricardian model of foreign trade and competitive advantage but adding its revenue distribution effects. In the Stolper-Samuelson theorem, the opening of trade between mature and emerging economies not only creates international specialisation as anticipated by David Ricardo, but leads to higher inequality in the mature economy while the lower-income country would see the emergence of a middle class.

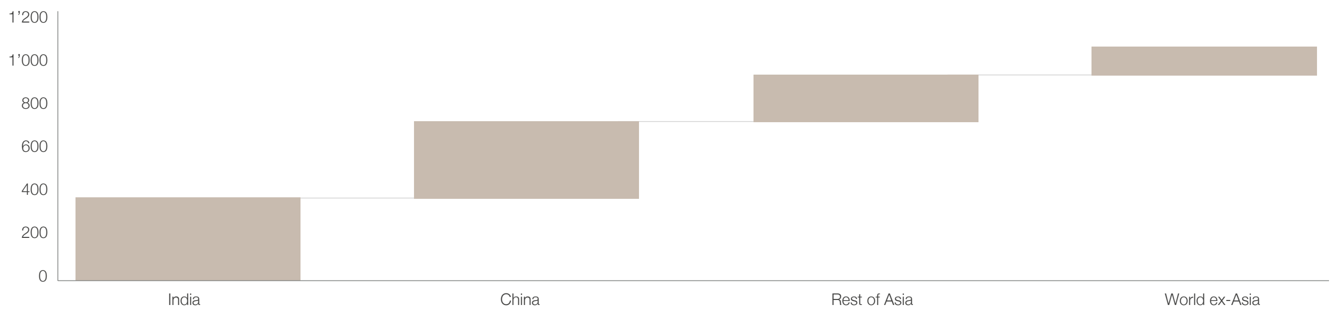
It is striking how prescient this article was in light of the consequences of globalisation on revenue dispersion over the past two decades only.

MACRO-ECONOMIC IMPACT AND INVESTMENT OPPORTUNITIES

This transformation brings a radical change in the way investors picture the emerging market story.

First, from a macro-economic standpoint, this means that emerging markets will have a significant domestic market on consumers and will become less dependent on developed markets, both from an international trade perspective and from a capital/financing standpoint. This trend by itself means that global trade as a percentage of global GDP could decelerate without taking into account the increasing tensions around trade and tariffs. It also means that emerging countries will be able to rely on a broader tax base which, in turn, would likely increase their debt sustainability and their capacity to finance the development of infrastructure and public services.

CHART 2: EXPECTED GROWTH IN THE GLOBAL MIDDLE CLASS 2017-2030, MILLION PERSONS



Source: Brookings Institute, Indosuez Wealth Management.

Second, from an investment standpoint, an additional 1.7 billion of people will aspire to adopt a consumption-based urban lifestyle, bringing significant growth opportunities across industries and services in its wake. This population will not only seek access to consumption of everyday goods and services, but will also wish to access financial services and mortgages in particular. The growing middle class will also contribute to financing domestic growth through their savings which are also likely to boost the development of domestic financial markets, including pensions. Middle class values in a growing economy catching up with Western countries in terms of income per capita will furthermore generate greater fundamental needs such as education and healthcare which areas thus can be expected to benefit from enhanced growth prospects in the so-called emerging markets.

We expect the following sectors and themes to benefit the most:

- Discretionary consumer goods and premium brands.
- Consumer services: tourism, banking, insurance, home services, telecommunications, e-commerce.
- Fundamental needs: housing, transport, education, health, elderly people dependency.
- Smart city/urban life: water, electricity, waste management, air treatment.

In Asia, the revenue pool related to this additional 1.5 billion middle class population represents USD 18.5 trillion additional spending, Chart 3 (with the concept of middle class defined as people spending around or above USD 12'000 per head). This will be a stabilisation factor for these economies, less dependent of international flow and trade.

This opportunity can be captured as much by domestic entities as by global leaders that have the brand, the reach, the competitive advantage, and the flexibility to address these needs.

From the political and social standpoint, the effects are far from negligible.

SOCIAL IMPLICATIONS AND CHALLENGES

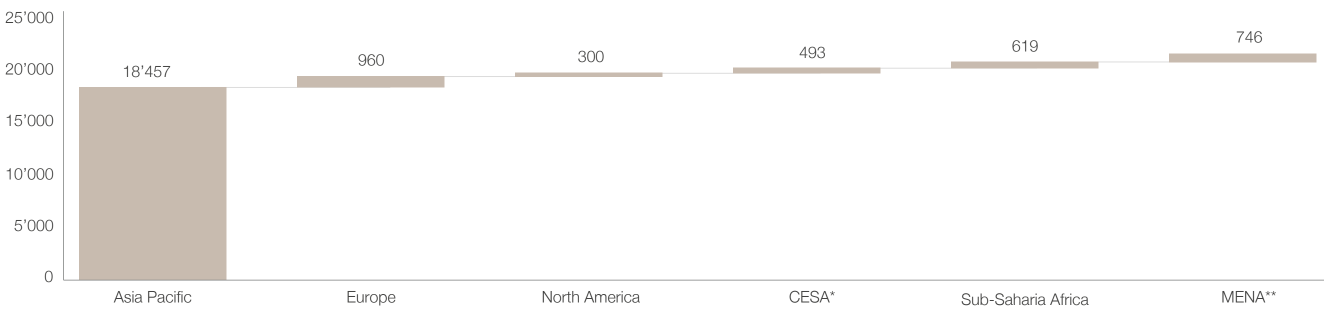
On the one hand, a growing middle class could be seen as a factor of social and political stability, as it has already happened in Asian countries embracing that trend since the 1960s. On the other hand, a well-educated middle class population has a greater capacity to be critical vis à vis their institutions, political governance, and public services. Their usage of technology and social media can create social unrest, putting pressure on governments to implement reforms and better governance. The risk is that this middle class could lose hope of a better future for the next generation if the cost of living (education, real estate, healthcare) grows faster than revenues.

This trend can be challenged. The pressure on the climate and natural resources will be significant. Projections show that the countries with the highest increase in their middle class often experience simultaneous jumps in carbon emissions, such as India, Pakistan, or Nigeria. A study quoted by the Brookings Institute indicates that a middle class household generally has a carbon footprint 50% higher than a poor household. This will depend mainly on where the population is located, with the idea that urban populations have a lower carbon footprints than rural populations.

The paradox is that this trend will increase pressure on governments from these populations to tackle global warming. More investments will have to be made in clean energy, carbon neutral housing, collective transport, water distribution and sanitation, waste management and recycling infrastructures.

Ignoring this secular trend means simultaneously misrepresenting the economic drivers of emerging economies, missing a significant opportunity, and ignoring a major challenge for the future of our planet.

CHART 3: ADDITIONAL SPENDING BY THE MIDDLE CLASS, 2017-2022, USD BILLION



* Central, Eastern and Southeastern Europe and Central Asia
** Middle East and North Africa
Source: Brookings Institute, Indosuez Wealth Management.

TECHNOLOGICAL LEADERSHIP IS MOVING TO ASIA

The trade war between the US and China over the past 12 months has shown China's growing influence in world trade. Beyond the tax increases between the two countries is a battle all the more important – world technological leadership.

Technological leadership is important as it may define not only the global economic powerhouse but could reshape the geopolitical order given the rising importance of technology in areas such a national security and defence.

Just over a decade ago, only a few Asian countries – namely Taiwan and South Korea – could compete in terms of technology with western nations as some of these nation's companies managed to evolve from just assembly lines into innovators and world leaders in their respected fields.

DIGITAL WORLD

The past decade has also experienced a second phase with a progressive shift in technological innovation from the US and Japan to China with the birth of technology giants in mainland China. While Chinese companies have historically been dubbed copycat for their capacity to replicate western products at a lower price, they are now at the forefront of innovation in many area. A number of Chinese start-ups have developed into major global players in technology, from mobile to e-commerce, to social networks to emerging industries such as financial technology.

Alibaba Group, for example, has 860 million global active users, including 730 million in China alone. Tencent Holding's WeChat counts 1.1 billion users. According to Forbes, 4 out of the 7 largest internet services and retailers in 2019 by revenue all reported high double digit sales growth (Table 1).

In some specific areas Chinese companies are well ahead of their western peers. The integrated mobile user platform on WeChat helps Tencent combine mobile advertising, gaming, and payment.

TABLE 1: THE WORLD'S LARGEST INTERNET SERVICES AND RETAILING COMPANIES

Company	Revenue (USD million)	Revenue percent change	Country
Amazon.com	USD 232'887	30.90%	United States
Alphabet	USD 136'819	23.40%	United States
JD.com	USD 69'847	29.40%	China
Alibaba Group Holding	USD 56'147	48.70%	China
Facebook	USD 55'838	37.40%	United States
Tencent Holding	USD 47'272	34.40%	China
Xiaomi	USD 26'443	55.90%	China

Source: Forbes, Indosuez Wealth Management.

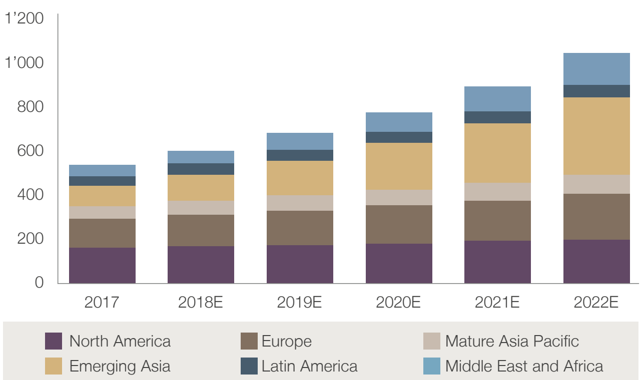
The Chinese giant's technological leap is not without risk. For example, the US banned its telecom carriers from using Huawei's 5G technology as security concerns were raised over the potential influence the Chinese government could exercise over Huawei to give it access to US communications and so pose a national security risk for the US. Given the lack of strong competitors in 5G technology – apart from Samsung, Nokia and Ericsson to some extent – the US has so far failed to put pressure on its allies. Only Australia, Japan, and New Zealand have banned Huawei to provide 5G in their countries while most European countries have allowed it.

HOW DID THIS TECHNOLOGICAL SHIFT HAPPEN?

First, China has a competitive advantage with a very large and relatively protected domestic market and a population totalling more than 1.4 billion. China has benefited from a demographic shift with a growing young middle class whose consumption habits are different from their parents. This younger generation has been quick to adopt new technology and in particular mobile phones in order to communicate, play games, and pay online or offline.

The rise in digital payment in Asia is striking. The number of non-cash transactions (Chart 4) is expected to grow at a much faster pace in emerging Asia at around a 29% compound annual growth rate (CAGR) over the next few years, quickly overtaking US or Europe where the same growth is expected to rise around only 5% according to Capgemini.

CHART 4: NUMBER OF WORLDWIDE NON-CASH TRANSACTIONS, BN, 2017–2022 E*



Source: Capgemini, Indosuez Wealth Management.
* Estimates

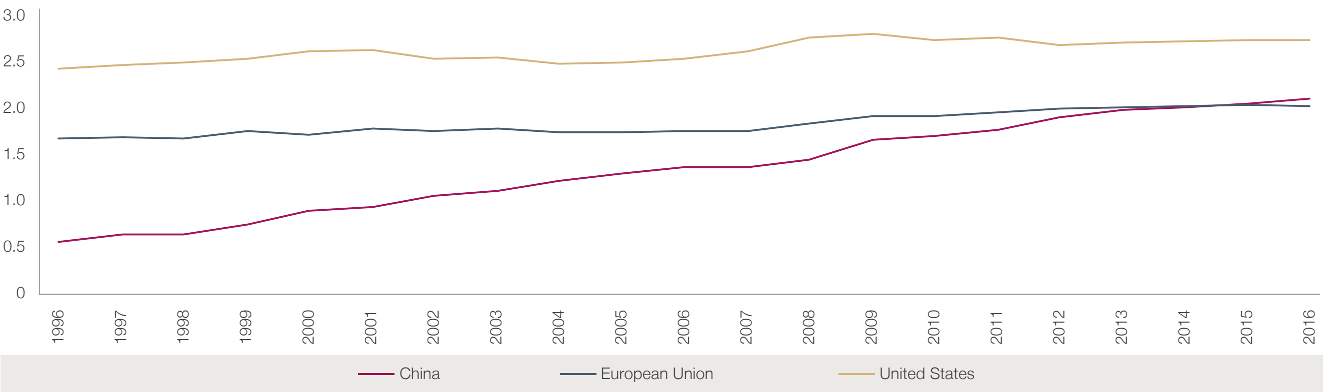
Second, China has massively invested and changed its economy from a pure manufacturing powerhouse to a leader in tertiary industries. Services now account for the majority of China's GDP. In 2018, the primary, secondary and tertiary industries accounted for 7%, 41% and 52% of GDP, respectively. The Chinese government aims to generate "innovation-driven development", a vision notably developed in its "Made in China 2025" strategic plan that focuses on key industries such as robotics, advanced information technology, aviation, and new energy vehicles. This plan, and the strong commitment in general of Chinese authorities to achieve leadership in high value-added industries, has spurred criticisms from other countries fearing forced technology transfers.

To reach that goal, China has set a national research and development (R&D) objective of 2.4%, above the OECD average of 2.4%. According to World Bank data, China outpaced the European Union in 2016, with R&D spending at 2.1% of GDP compared to 2.0% in Europe, shrinking the leading position of the US at 2.7% of GDP (Chart 5).

The ratio of R&D expense to sales of the CSI 300 Index (Chart 6), an index of 300 A-share stocks listed on the Shanghai or Shenzhen stock exchanges, also increased from 0.5% in 2009 to 2.2% in 2018. It is now closer to that of the S&P 500 index at 3.3%. What is interesting is that the increase does not come from the larger weight of the technology sector, but rather from an increase in spending in the information technology sector. Over the past decade, the ratio rose from 0.7% to 8% for companies in this sector, fast approaching that of US tech companies (9.2% for the S&P 500 Information Technology Index).

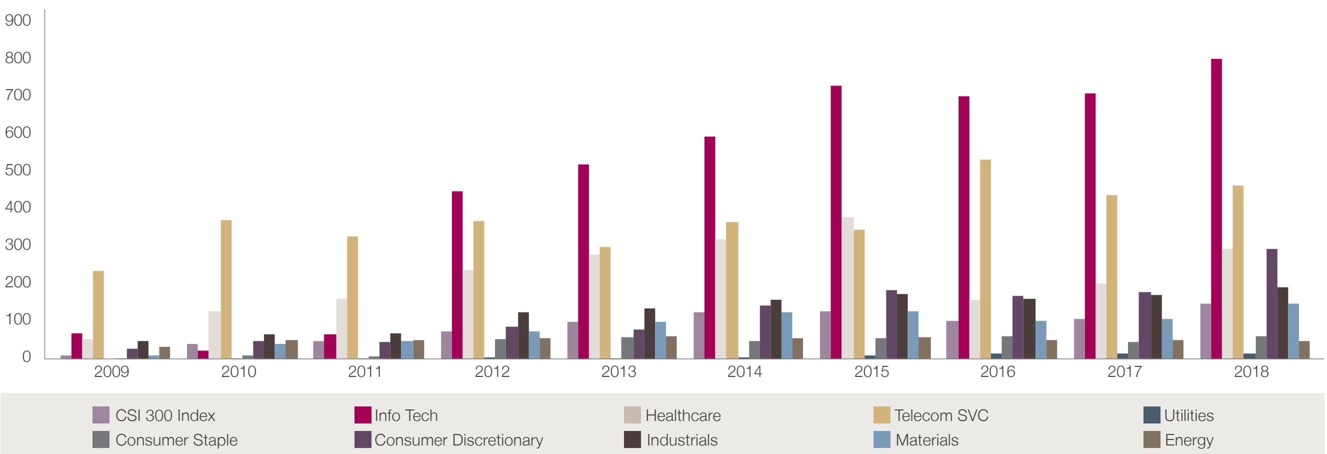
Given the importance of technology, the race for leadership in this area is not just about economic dominance but the reshaping of world geopolitics. Notwithstanding the lag in Europe, even the US may lose its technological crown to China. Do not call Asia emerging; it is a growth market becoming the global technological leader.

CHART 5: RESEARCH AND DEVELOPMENT EXPENDITURE, % OF GDP



Source: World Bank, Indosuez Wealth Management.

CHART 6: RESEARCH AND DEVELOPMENT EXPENDITURE,% OF SALES, CSI 300 INDEX



Source: Bloomberg, Indosuez Wealth Management.

POTENTIAL GROWTH AND DEMOGRAPHIC CHALLENGES

The world's total population is likely to rise to 9 billion between now and 2040[3]. While that is a large number, the global trend in population growth is down. Global demographic trends, however, mask some important differences between countries.

Mature countries are mostly concerned with declining population growth rates (Chart 7), while certain emerging markets are still experiencing strong growth in their populations, particularly in Africa and the Middle East. A crucial question is what these diverging demographic trends might mean for GDP growth.

THE WORKING POPULATION AND ECONOMIC GROWTH

Regardless of fertility rates in today's population, new-born babies will not be part of the working-age population until the age of 20[4]. Hence, it is not currently possible to ascertain a repeat of the demographic dividends (or in other words, the additional GDP per capita) realised over the period 1950-2010. On the contrary, given the continued relative decrease in the size of the working population between now and 2050, all other things being equal, a growth trajectory below the previous standard is to be expected.

The issue of the size of the working population is also influenced by the aging of the population If this arises from a longer life expectancy, all one needs to do is push back the retirement age and thereby extend the working life in order to prevent a too great decline in the dependency rate (the ratio of working population to total population). If the aging of the population is the result of low birth rates, the working population shrinks, and fewer active members will be available to support the needs of the entire population.

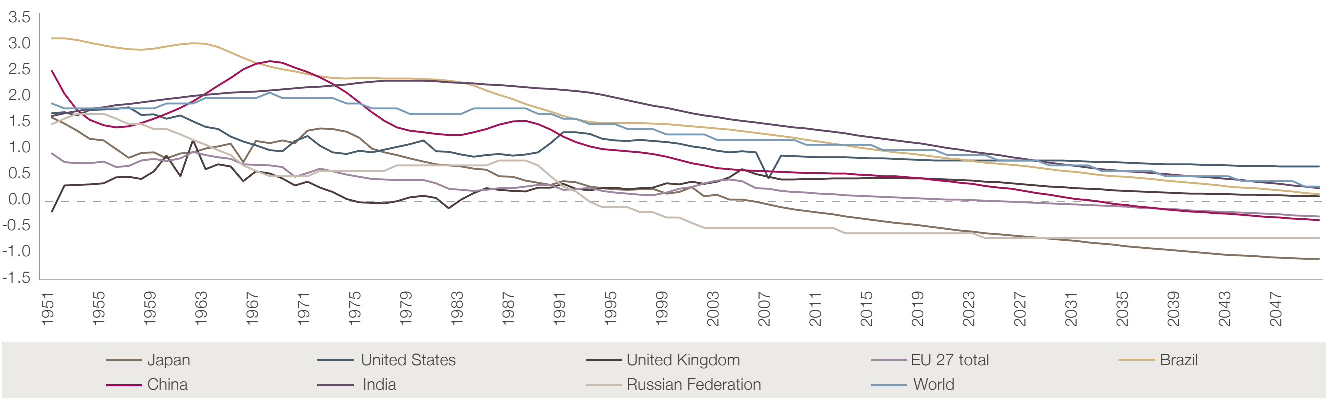
Not only countries with contracting working-age populations will face the problem of the dependency ratio – those with high demographic growth will likely also have to tackle this issue. By 2050 we will see an explosion in the population aged over 65 that will worsen the dependency ratio even further. For example, the ratio of those aged over 65 to those aged between 15 and 64 was 2.6 in 2015 in Kuwait, but will be close to 20 in 35 years' time[5].

That being said, over the recent years, the contribution to economic growth coming from an increase in the population was significant in various mature countries. For example, over the years 2010-2015 the population increased by 0.7% per year (compared with an average annual GDP growth of 2.3%) in the US, by 1.2% per year in Switzerland (versus 1.9% GDP annual growth), and by 0.5% per year in France (compared to 1.1% GDP annual growth). Germany is in a class of its own as the population growth was a mere 0.2% per year, but the economic growth reached an annual average of 1.9%.

As for emerging countries, the relative contribution to growth stemming from demographics is lesser. In China the population increased by 0.5% a year over 2010-2015 and the economy grew by an annual rate of 8.1%. In Indonesia the annual population growth was 1.3% while the yearly average GDP growth rate stood at 5.7%. In Brazil the population expanded at a pace of 0.9% per year while the GDP grew annually by 1.3%.

The bottom line is that the global slowdown in population growth which arguably points to lower GDP growth rates (ceteris paribus) is less worrying for emerging countries because the phenomenon is less acute there.

CHART 7: POPULATION GROWTH RATE, %



Source: OECD, Indosuez Wealth Management.

3 - Source: OECD.Stat – Historical population data and projections
4 - *A new "New Normal" in demography and economic growth*, Robert Arnott and Denis Chaves, Journal of Indexes Europe, December 2013.
5 - *The Demographics of Frontier Economies*, A Roy et al, CS Global Demographics and Pensions Research, April 2016.

Easter Island, Chile

At the country level, immigration can slow down population shrinking and aging. Emigration would obviously have the reverse effect. The increase in the size of the working-age population is among the many positive impacts linked to immigration identified by the OECD[6]. Offsetting a possible outflow of local workers (job seekers, young people out of work) via immigration seems to be an easy option when the figures are calculated, but this disregards the effects on social relationships that are necessarily associated with the arrival of immigrants. Consequently, it is not realistic to envisage that immigration can occur on such a scale that it stabilises the dependency ratio.The outflow of a surplus of existing working-age population in a country via emigration can also prove to be problematic (although remittances and returning workers are associated benefits). Even if such solutions were established within a given country, these would not resolve the issue of low birth rates at a global level.

POPULATION STRUCTURE AND POTENTIAL GROWTH

Total production in an economy is equal to the total number of hours worked multiplied by hourly production. The total number of hours worked is a function of total employment, which is itself dependent on the employment rate turnout (the ratio of the actual workforce to the population of working age), population of working age, and total population. Demographic characteristics are not simply a question of the size of each group. The average age of the working-age population, for example, influences the number of hours worked per person while the second figure will be lower if the first is higher.

In 2014 the OECD established a projection for the period 2030-2060 in an effort to determine potential growth at that point in time[7]. The OECD assumes that technological progress will enable the return in the long term of GDP growth *per*

6 - *Is Migration good for the Economy?*, Migration Policy Debates, OECD, May 2014.
7 - OECD – Growth Prospects and Fiscal Requirements over the Long Term

capita to the level observed over the period that preceded the 2008 crisis – around 1.5% a year[8]. The negative effect of an aging population is further assumed to be offset by an increase in the turnout via a drop in the retirement age, improvements in education and an increase in the number of women in the job market. Total potential growth, however, is nevertheless found to likely decline due to the lower rate of population growth.

The most remarkable finding in the OECD's analysis, though, is the still rising weight of the emerging markets and Asia in the OECD-wide economy. While the total GDP of China and India represented 33% of OECD GDP in 2010 (in purchasing power parity terms), by 2060 it is likely to represent 73%. The share for all of Asia, which was 25% of world GDP at the beginning of the century, is likely to reach 45% over the same horizon[9].

A LACK OF REFORMS?

Certain structural reforms (the job market, encouraging innovation to boost productivity, improvements in the efficiency of governance, and other factors) could in theory improve growth.

Is a lack of reforms the origin of social unrest observed in the second half of 2019 in some countries?

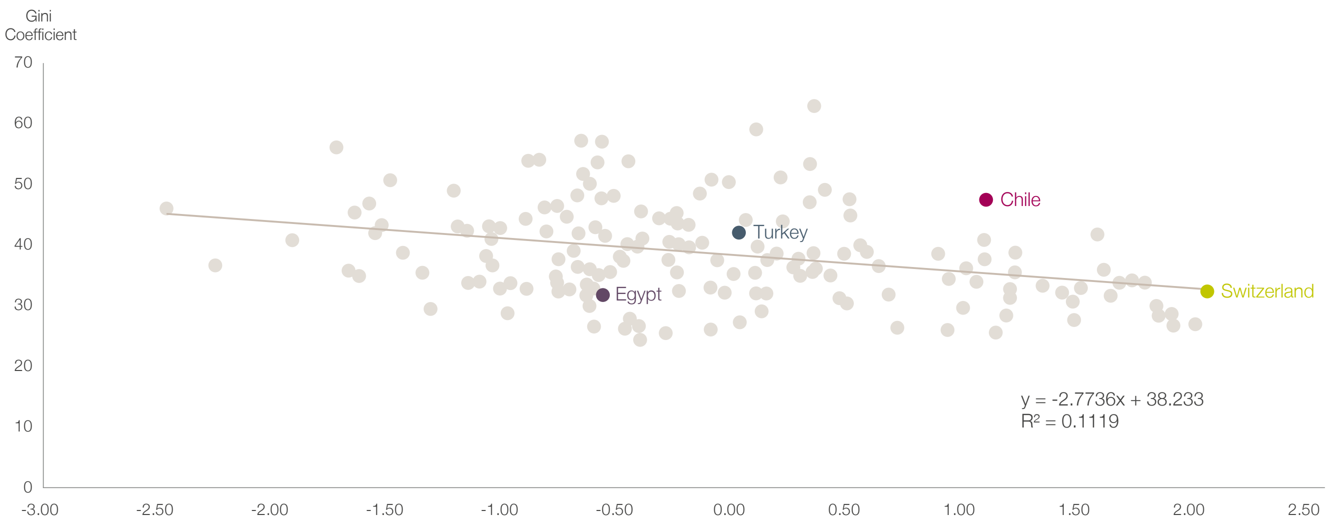
In Chart 8, we position each country (163 in total) according to the efficiency of its government and the degree of inequality in terms of income within its population (Gini coefficient). The link between these two factors is low. The purple dot represents Egypt, the blue Turkey and for comparison the green is Switzerland. The government seems less efficient in Egypt than in Turkey, but the degree of inequality appears to be lower there. Nevertheless, we might expect the north-west quadrant (inefficient government plus high inequality) to be occupied by the countries that are more likely to suffer from social unrest. This is not always the case as illustrated by Chile's cherry dot not appearing in this quadrant.

SPECIFIC FEATURES OF EMERGING MARKETS

It remains the case that generalisations often fail to capture the diversity of the emerging world, and it is necessary to analyse the specifics for each country before drawing definite conclusions.

This is also valid in terms of demographics, and the needed reforms linked to it. Fast-ageing countries have to rethink their retirement systems. Countries dealing with a growing number of students and adults of working age, the focus should be on labour market reforms and the improvement of the education system.

CHART 8: GOVERNMENT EFFECTIVENESS INDEX



Source: World Bank, Indosuez Wealth Management.

8 - The question of long-term growth prospects is the subject of open debate among economists. See, for example, *Is US Economic Growth Over? Faltering Innovation Confronts the Six Headwinds*, Robert J Gordon, NBER, Working Paper Number 18315, August 2012; *A Great Leap Forward: 1930s Depression and US Economic Growth*, Alexander Field, Yale University Press, New Haven and London; *Technological Breakthroughs and Productivity Growth*, H Edquist and M Henrekson, IFN Working Paper Number 665, 2006; *General Purpose Technologies*, Boyan Jovanovic and Peter L Rousseau, NBER, Working Paper Number11093, January 2005; *From Shafts to Wires: Historical Perspective on Electrification*, Warren D Devine, Journal of Economic History 43(2), 1983.

9 - "OECD Economic Outlook 95 long-term database". Here, the world corresponds to the OECD countries plus the BRICS countries, Indonesia, and Saudi Arabia.

Shanghai, China

REGIONAL OUTLOOK

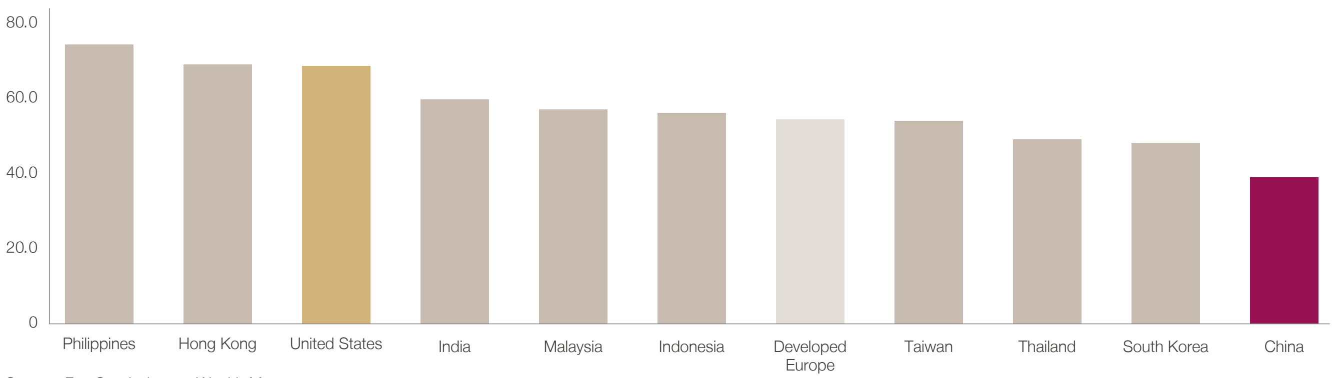
CHINA: BEYOND TRADE WAR

As the US-China trade conflict weighs on global growth and disrupts global manufacturing supply chains and business sentiment, it is imperative to understand that the fundamental issues extend beyond trade. The rising technology leadership and competitiveness of China is the main reason, and remains its key focus as set out in China's long-term strategic policy agenda. As fundamental investors, we stay focused on China's structural economic re-balancing and long-term growth perspectives beyond short-term geopolitical risks. Over the past decade, China has made significant changes on its economic structure, switching from an export driven economy to a more balanced economy (Charts 9 and 10). Middle-class consumption upgrades driven by powerful e-commence ecosystems and new retail will continue to be the growth driver for China into the next decade.

China has been shoring up support for its domestic economy, aiming at fuelling the other two important engines of the economic growth: consumption and fixed asset investment.

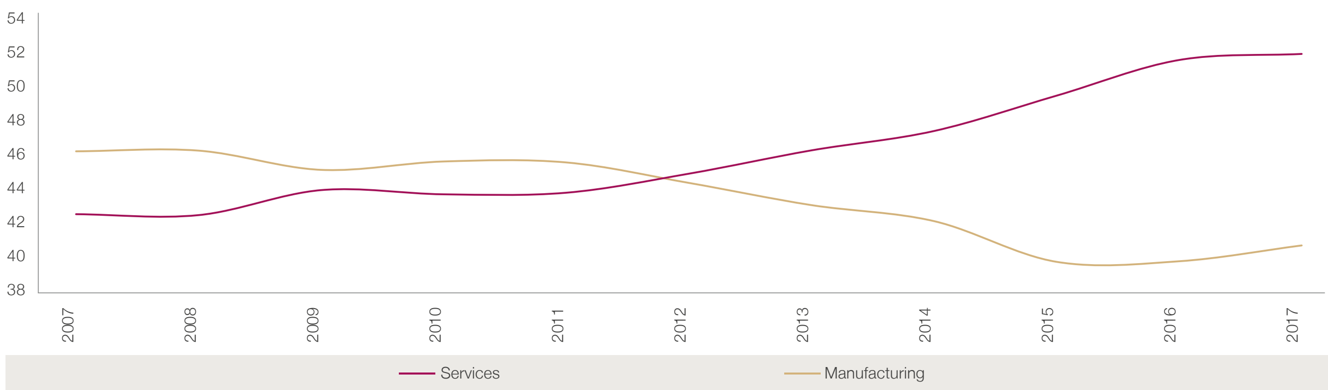
Fiscal policy took the front seat in 2019, including value-added tax (VAT) reforms as part of the RMB 2 trillion tax cut package[10], adding further cuts to individual income taxes and social security premium to stimulate domestic consumption. The finance ministry announced a large increase in special local government bond quota (from RMB 1.35 trillion in 2018 to RMB 2.15 trillion in 2019)[11] to support major infrastructure projects (urban railways, highways and utilities). The People's Bank of China (PBoC) bolstered monetary easing mainly through reserve requirement ratio (RRR) cuts, open market operation (OMO) rate cuts, and medium-term lending facility (MLF) rate cuts. The loan prime rate (LPR) reform is a milestone in China's long-awaited interest rate liberalisation.

CHART 9: PRIVATE CONSUMPTION AS % GDP, 2018



Source: FactSet, Indosuez Wealth Management.

CHART 10: CHINA GDP PER SECTOR, % OF TOTAL



Source: FactSet, Indosuez Wealth Management.

10 - The State Council, Ministry of Finance, China.
11 - China Government Work Report announcement during "Two session" on 5 March 2019.

Tea plantation, India

The recent 19th National People's Congress 4th plenum stressed China's focus on "improving the mechanism for scientific and technological innovation", which we view as China's best offence and defence amid long-term bilateral tensions with the US. Over the past decade China invested heavily in technology and a transformation of the country. Both are starting to bear fruit: China now has the most extensive high-speed railway network in the world (29'000 km)[12] and accounts for two-thirds of the world's total high-speed railway networks; China is the world market leader in electric vehicles (EV) industry, representing more than 50% of global EV sales, about three times the size of the European and US markets each[13]. This also points to China's commitment to sustainable and environmental-friendly development.

China has also been ramping up massive R&D investment into a new wave of technology innovation, along with talent development and regulatory supervision, leading in artificial intelligence (AI), big data, financial technology (FinTech), cloud computing, autonomous driving, high-end manufacturing, automation and robotics among other initiatives. Since 2014, China has led the world in the number of first patent filings in AI, ahead of the US. China's R&D investment has exceeded the EU's in 2014 and is catching up with the US[14]. The faster rollout and commercialisation of 5G in China will be a key positive for the Internet of Things (IoT) and AI technology across industries.

In its social reform, China is speeding up healthcare reforms and deepening its social pension reforms, as innovation and R&D become the focus in the pharmaceutical industry in order to achieve sustainable growth in response to an ageing population.

With regards to financial markets, China is opening up, and this remains a key focus on the policy agenda. The launch of the bond connect and stock connect programmes are facilitating global investor access to China's markets. The inclusion of China A-shares in the MSCI China index could make China stand at 42%[15] of MSCI Emerging Markets Index if 100% of China A-shares are included. The inclusion of China bonds in global bond indices[16] will be equally ground breaking, representing a major milestone given China's debt market is worth USD 13 trillion and is the world's third largest after the US and Japan's[17]. China's entry into major indices confirms emerging market Asia's rise in the EM asset class that will likely lead to increased inflows into China and EM more broadly.

Looking beyond the trade-war and uncertainties, China has powerful secular growth engines to pave the way for innovation and tech-driven growth into the next decades. Policymakers will need to keep a firm agenda to achieve this long-term goal.

12 - The World Bank, 2019 data.
13 - McKinsey & Company, 2019 August report.
14 - OECD Main Science and technology indicators, World Intellectual Property Organisation.
15 - *China and the future of equity allocations*, Zhen Wei, MSCI, June 2019.
16 - Global bond indices mentioned includes JPMorgan Bovernment Bond Index - Emerging Market, Bloomberg-Barclays Global Aggregate, World Government Bond index.
17 - *A new Chapter in China Bonds market*, Bing Li, head of China, Blomberg, 1 April 2019.

INDIA: POLICY, GROWTH, AND STRUCTURAL REFORMS

In a low growth environment, India was until recently outpacing most countries, recording real GDP growth above 7% a year on average in 2014-2018. India was also a positive story in terms of structural reforms initiated by Prime Minister Narendra Modi. The story now looks less compelling as other challenges have come to the surface.

GDP growth has softened on the back of corporate and environmental regulatory uncertainty, and concerns about the health of the financial sector are adding further stress. In spite of some questionable data handling, the official numbers nevertheless showed the economy growing at merely 5.3% YoY in the second quarter of 2019, down from 11.4% in 2010 and below the average of 7.5% since 2005. Industrial production contracted by 1.4% YoY in August and by a further 4.3% YoY in September 2019, with a 20.7% drop in capital goods production which was the worst performance in 7 years.

New car sales data paints a similar picture, falling by 23% in the second quarter of 2019, the biggest contraction since 2004. This all suggests that GDP growth in the second half of 2019 could continue to decelerate.

India is facing a number of challenges, both economic and political. On the economic front the country runs a virtually perpetual current account deficit (-1.3% of GDP on average since 1991 and -2% in the second quarter of 2019, having hit -5% in 2012). Oil dependency remains a significant contributor to the current account deficit, which is well understood by financials markets: when the oil price goes up significantly as in 2017-2018, the rupee tends to depreciate, and the contrary held true in 2013-2015.

There is a stubborn government budget deficit, which nevertheless has recovered from the -6% of GDP in 2012 reduced to -3.3% in the second quarter of 2019. This deficit is expected to grow again to closer to 4% in 2020.

Not only are there twin deficits but triple deficits since at the root of these imbalances is a structural shortfall of savings. This is problematic for a number of reasons – one is that a savings deficit tends to lead to a lack of investments. It would be helpful to boost productivity to raise living standards (resulting in higher savings), curtail the informal sector (increasing the share of the officially employed active population and bringing savings into the system), and deepen the capital markets. All of this necessitates profound reform.

NEED FOR REFORM

Enter the political situation. Since Narendra Modi became prime minister in 2014, the India story for investors relied on the promise of structural reforms – from infrastructure and the land act to the job market and the tax system, as well as deregulation of the private sector and restructuring of the banking sector. The pace of reforms has slowed and disappointed recently. One can wonder why Mr Modi is not pushing through more economic reforms given his strong position in parliament. Perhaps the pace will pick up in 2020 if some small regional parties join Mr Modi's bloc, potentially allowing it to obtain an absolute majority also in the upper house. If so, India would sorely need fiscal consolidation, subsidy rationalisation, and tax-base enhancing measures along with land and labour reforms.

Moreover, the public sector's role in the private sector needs to be reduced while rationalisation of the banking sector needs to accelerate. This is why the reform passed on the insolvency bankruptcy code is an important step, helping to accelerate the resolution of insolvencies, something that has been stressed by the Reserve Bank of India (RBI) which is pushing for non-performing assets to be recognised and for changes in banks' corporate governance.

In this weaker GDP growth environment with fewer structural reforms, more is being done regarding the cyclical policy-mix. Recently, the government announced a surprise cut in the official domestic corporate tax rate from 30% to 20%. This boosted the domestic equity market in October 2019. The move represents an additional fiscal burden, but should improve the competitiveness of India compared to its Middle Eastern or Asian neighbours.

Monetary policy is in motion, too: interest rates have been cut 5 times in recent quarters, helped by lower than expected inflation. After a period of frictions between the government and the RBI, which led to the departure of its governor in 2018 there is a feeling of smoother coordination since Shaktikanta Das took over the role, but one that reflects the government's dominant role in the policy-mix in India.

Monetary easing is a positive, but political interference with the central bank can be costly in terms of its credibility in the longer run. Evidence of the sustainability of fiscal policy will have to be demonstrated beyond short-term effects expected on growth. This can only come from structural reforms.

BRAZIL: REFORMS AND RECOVERY

After a disappointing performance in 2019, there are signs the Brazilian economic recovery is gaining traction. Credit is expanding again, housing activity is rebounding and the labour market is gradually improving. The economy will continue to face some significant headwinds in the short to medium-term. Within an international context, the slowdown of the global economy does not help while the situation in Argentina remains a source of downside risk. Locally, sluggishness in many sectors will continue to hinder investments and the need to conclude the fiscal consolidation will subtract from aggregate demand.

The counterpart of weaker growth has been low inflation, paving the way for an expansionist monetary policy. We think the current monetary policy easing cycle will continue into 2020, leading the Selic Rate 4.25% in the beginning of 2020, (a target interest rate set by the central bank, Chart 11) and remaining at that level throughout the year. That, in turn, is likely to support and accelerate the cyclical recovery of the economy.

The fact the Brazilian economy looks poised to have a stronger cyclical recovery in 2020 is good news. The real upside risks for investors, however, comes from the opportunities created by the bold agenda of economic reforms proposed by the government. After recently approving a stronger than expected pension reform, congress will now debate a set of constitutional amendments proposed by Economy Minister Paulo Guedes aimed at creating the institutional conditions for completing the fiscal consolidation process, and overhauling the role of the state and the Brazilian federative system.

From a fiscal point of view, which is likely to be the focus of investor attention, the bills try to put an end to the secular trend of growing non-discretionary spending that threatens debt sustainability and hinders public investments. In order to do this, the bills aim to reducing the public sector wage bill subsidies, tax exemptions and earmarking budgetary resources.

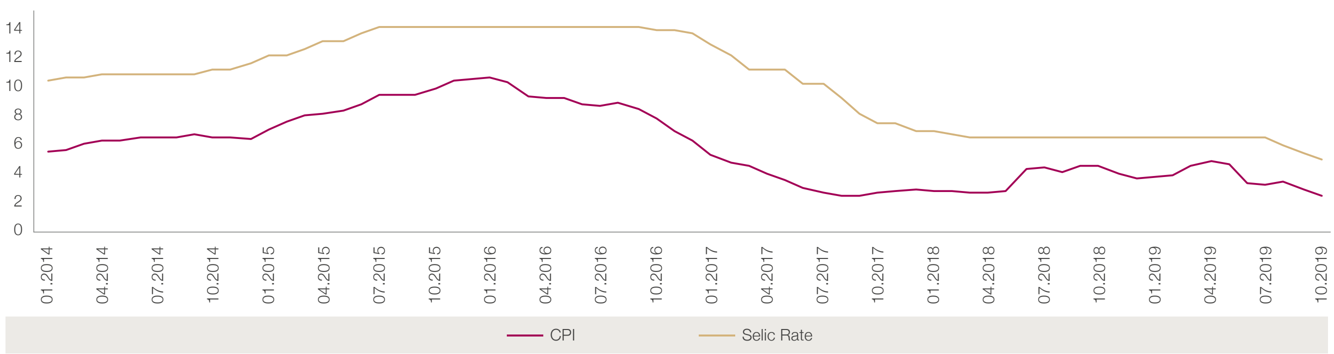
Approving these bills it is not going to be easy. In October 2020 there will be elections for municipalities and this may strengthen the hand of powerful interest groups that oppose the reforms. It also means the government will have to race against the clock to approve them: by mid-year the focus will be the elections and it is unlikely that major reforms will move forward in congress in the second half of the year.

The fate of the structural reform agenda is also under constant threat by the current unusual political arrangement. Unlike other "reformists" presidents that Brazil has had, President Jair Bolsonaro lacks a broad support-base in congress – he can reliably count on not much more than 100 votes out of 513 in the lower house. The good news is that congress has been surprisingly willing to cooperate. Paulo Guedes has established a productive relationship with some of the main leaders in congress, especially with Speaker Rodrigo Maia. That relationship has helped the reform process despite the perceived lack of the engagement of President Bolsonaro.

Alongside the structural reforms to improve fiscal and economic institutions, the government has some plans regarding privatisations and concessions. The government has already announced there are no plans to privatise the main state-owned companies like Petrobras, Banco do Brasil, and Caixa Econômica Federal, so privatisation is unlikely to be a game changer for the country. So far, the pace of privatisations and concessions has been somewhat disappointing. Despite that, the push towards increasing private investments through privatisations and concessions is positive and remains an upside risk for the country.

We believe, political risks aside, Brazil has the boldest agenda of structural reforms in the region. We encourage investors to try to look beyond the controversies created by the unusual politics of Jair Bolsonaro. The potential for investment opportunities is real, if uncertain.

CHART 11: CPI AND SELIC RATE, %



Source: Banco Central do Brasil, Indosuez Wealth Management.

MIDDLE EAST: BETWEEN RESILIENCE AND UNCERTAINTIES

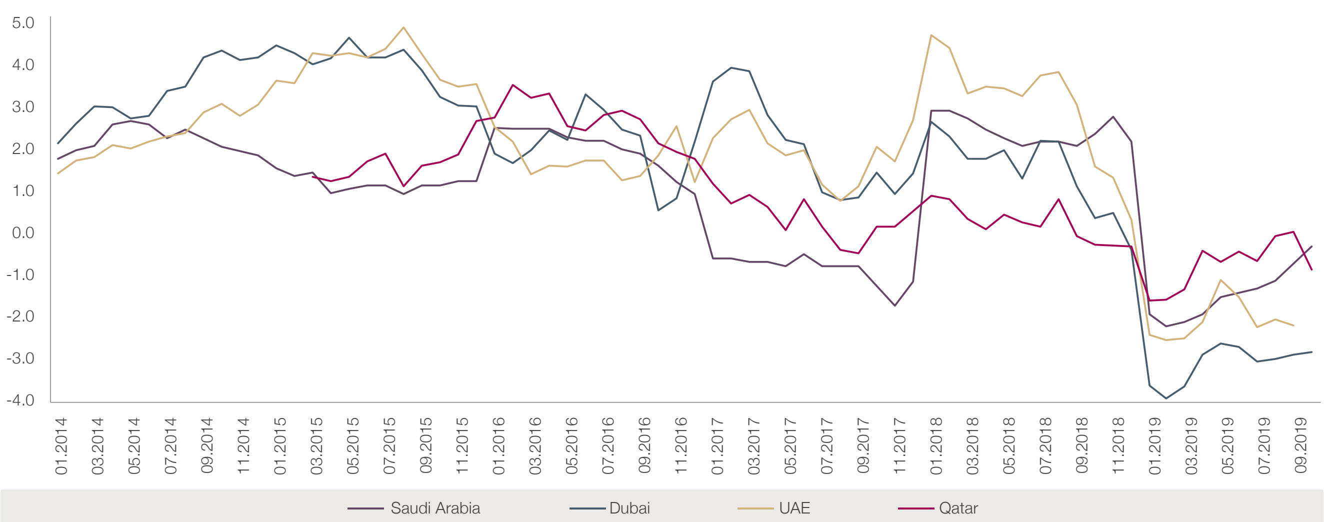
In terms of the business cycle in the Middle East, low or even negative inflation rates are a striking feature. Once the base effect linked to VAT hikes dissipated, one would have expected to see higher inflation rates in Saudi Arabia and the Unites Arab Emirates (UAE). Instead, the changes in consumer prices has remained subdued, a likely reflection of muted GDP growth (Chart 12). In the short term, while some rebound can be expected, we do not see the Middle East and North Africa (MENA) countries being able to return to the pace of real GDP growth experienced over the 2000-2015 period (4.6% a year).

On the positive side, the US Federal Reserve's accommodative mood will allow the central banks of the countries whose currency is pegged to the US dollar to keep interest rates low. These include the UAE, Qatar, and Saudi Arabia. Given this and the amount of external reserves held by the countries in question, the foreign exchange peg is not at jeopardy in the area.

Low interest rates in Saudi Arabia will help to contain the surging debt-to-GDP ratio. The current oil price is not high enough to balance the Saudi budget. According to the International Monetary Fund (IMF, Fiscal Monitor, April 2019), the general government deficit could be as high as 7.9% of GDP in 2019, which translates into a deteriorating net debt-to-GDP ratio. With low inflation and only moderate real GDP growth, the debt-to-GDP ratio could reach 50% by 2024, and this despite the Aramco initial public offering (IPO).

The high geopolitical risk does not mean investors cannot find attractive investment opportunities in this region. Valuation multiples in Middle East stock indices are sometimes more attractive than in other parts of the world. Interesting and diversifying stories can be found in the banking industry, infrastructure, real estate, telecoms, or even in the digital field. Investors just need to be mindful of the importance of these interconnected energy, macro-economic, and geopolitical dimensions when taking their investment decisions in the region.

CHART 12: INFLATION RATES IN SELECTED COUNTRIES, %, YOY



Source: Bloomberg, Indosuez Wealth Management.

Amur River, Russia

RUSSIA: BEYOND SANCTIONS

There is a strange thing happening Russia. It is as if Russia had recovered its investment-grade profile partly thanks to international sanctions.

These sanctions have put downward pressure on growth but at the same time have led to a number of positive developments. Accumulation of international reserves has gathered pace equating to approximately 14 months of imports and have also benefitted from active diversification in to other currencies in order to be less dependent on the US dollar (30% are now in euros). Deleveraging of the economy has also continued and import diversification have caused productivity improvements in agriculture which has never been seen before. Adding to this is the flexibility of the Russian ruble, low inflation (3.9% in September 2019) and a contained unemployment rate. All of this has helped improve the sovereign profile of the country.

GROWTH TO REMAIN LOW

Russian growth is low and will stay low. The country's growth profile has been the same for years, relying heavily on consumption and not enough on investment. The first quarter of 2019 (with 0.7% GDP growth) failed to demonstrate any pick up in investment. This means the potential growth rate will remain low, hovering around 1%. For 2019 as a whole, the Central Bank of Russia has downgraded its growth forecast to 1%. Without the 2.2% growth in private consumption during the first semester, mostly based on retail loan increases, the actual GDP growth will be closer to 0% (Chart 13).

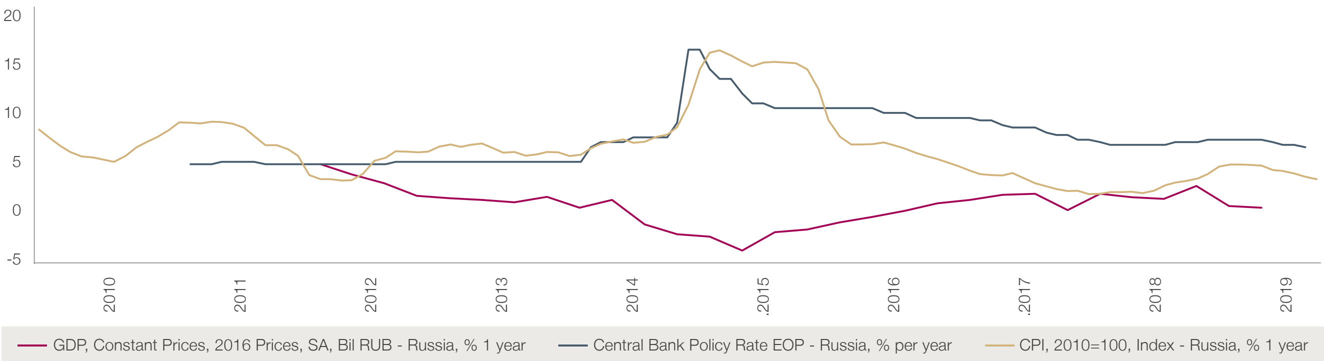
This stagnation is not only an economic problem but also a political one as demonstrations have continued to erupt regularly over the past two years. Initially, demonstrations were focused against the retirement reforms but have spilled over, turning more political and in particular against the way some local elections were organised. Whilst the demonstrations do not threaten the political stability of the country, they do highlight the social climate, notably among the lower middle class, who have been impoverished by the weak growth cycle.

The issue with the investment component of growth (except in commodity sectors) is an old pattern of a rental economy based on natural resources. It also may be explained by several structural impediments which include bad corporate governance, lack of public regional infrastructures, inefficiency of public investment, low levels of entrepreneurship and small and medium-sized enterprises, reduced regional labour mobility, and a global trend towards short-termism.

The government has been aware of these difficulties for years, and has been trying (also for years) to stimulate investment into the Russian economy, an objective of the national projects programme. Despite the concentration of executive power, the economy is suffering from administrative inertia. As a result, the delay in the implementation of national projects is significant; in the first half of 2019 just 32% of the annual target had been funded.

That said, in this low growth and low inflation environment, monetary policy is central to the Russian investment story. With a credible central bank and a flexible currency, allowing for an easing policy designed to achieve domestic economic goals, Russian debt has managed to attract inflows from foreign investors who are sensitive to the better financial sustainability metrics than in other emerging markets, and to the somewhat better political visibility. Finally, the Russian equity market remains attractive in terms of valuation which has been held back by two of its largest sectors, energy and finance, in turn undoubtedly hurt by the sanctions aimed at them.

CHART 13: RUSSIA: GDP AND CPI, % YOY, AND CENTRAL BANK POLICY RATE, %



Source: Factset, Indosuez Wealth Management.

Hinczowy, Slovak Republic

INVESTMENT CONVICTIONS

GLOBAL MACRO-ECONOMIC OUTLOOK

WHERE WE STAND IN A HISTORICAL CONTEXT

In our world today, the salient perception is that things are not going very well, therefore, we begin by examining where we stand at this moment. The world economy has just had its most amazing 25 years in all of human history. Two billion people have moved out of low human development levels during this time. In 2018, the majority of the global population entered the middle class for the first time ever. Global income distribution has never been so equal. The world used to be 90% poor. Things started to change in the 1800s, and now the ratio has been completely reversed as 90% of the world's population has at least two dollars per day to live on. Of course, the global population used to be one billion, meaning that 900 million people were poor. Today, with a world population of close to 8 billion, there are still some 800 million people living in poverty.

This economic progress was based on unprecedented freedom of movement of capital, labour, goods, and services. As the world is moving increasingly to restrict those freedoms, it seems unlikely that the coming 25 years will be able to repeat the stunning performance seen since the latter part of the 20th century.

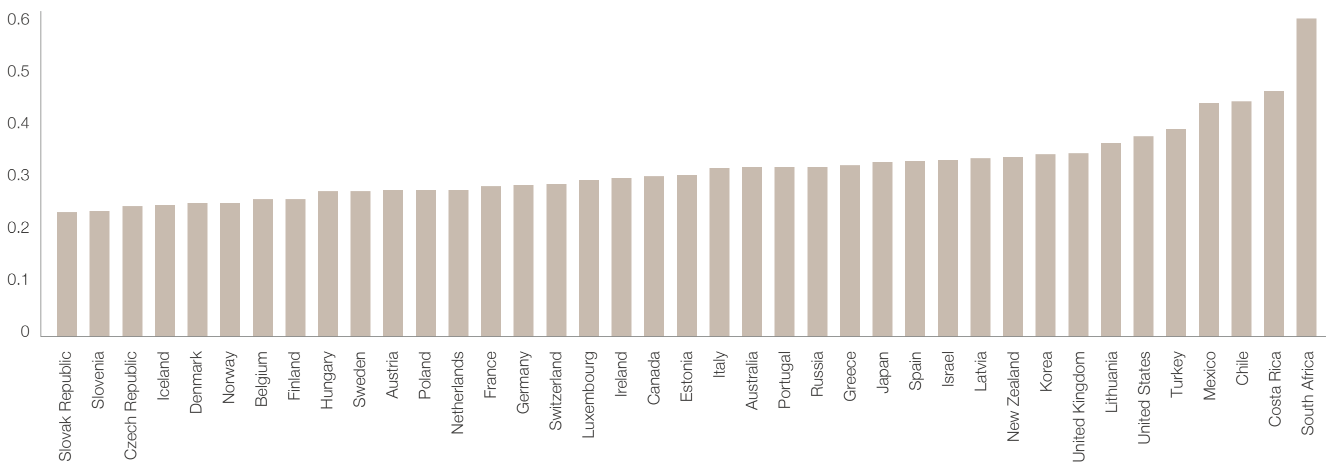
One reason for that is the high and rising inequality within certain countries. Looking at Gini coefficients, the common measure of income inequality (where 0 is perfectly equal and 1 is perfectly unequal), it is particularly noteworthy that the US is ranked next to Turkey and Mexico with a Gini coefficient of 0.39, according to the OECD, compared to the lowest in the sample, which is the Slovak Republic at 0.24, and the highest which is that of South Africa at 0.62 (Chart 14). Only four countries in the sample are closer to the inequality seen in South Africa than the US, while 33 countries outperform the US.

INEQUALITY AND GROWTH

Inequality affects economies and politics in multiple ways. Economically, a certain degree of inequality can be good for growth if, for example, it raises the absolute incomes of the poorest. Inequality of opportunity and intergenerational inequality tend to have a negative impact on growth.

Politically it is a generally accepted fact that the political influence of the wealthy is disproportionately high. If that wealth is held among an ever-decreasing number, the implication is a potentially an anti-democratic concentration of power.

CHART 14: INCOME INEQUALITY: GINI COEFFICIENT, 2018 OR LATEST AVAILABLE



0 = perfectly equal, 1 = perfecty unequal.
Source: OECD, Indosuez Wealth Management.

The connection between economics and politics is evident: when the current economic context is bad, more people are dissatisfied with the politics in a country. In Pew's 27 country survey, most people said they believe elections bring about little change, that politicians are corrupt and out of touch, and that courts do not treat people fairly. Every country has its own specificities, but factors such as these go a long way to explain protests by disaffected populations seen around the globe as well as growing polarisation, and frustration with "elites" in many countries.

PROTECTIONISM

In such a climate, protectionism has been the political response in the past as it seems to be today. Tariffs and non-tariff barriers to trade act as a tax and tend to depress activity. The relationship between trade volumes and GDP is not static. Many variables go into the determination of GDP growth. However, when global trade volumes fall below average, global GDP growth is likely to suffer a similar fate. See page 5 for a more detailed discussion.

POTENTIAL GROWTH

Nevertheless, in spite of today's trade war, world GDP growth is holding up, and this is the case in most major economies. "Excess" growth – that above potential – has been eliminated compared to when GDP growth accelerated in 2017 and 2018. When in line with potential, however, it is hard to characterise current GDP growth as particularly sub-par. The challenge in this case is to lift the potential growth rate which may be seen as too low in many economies.

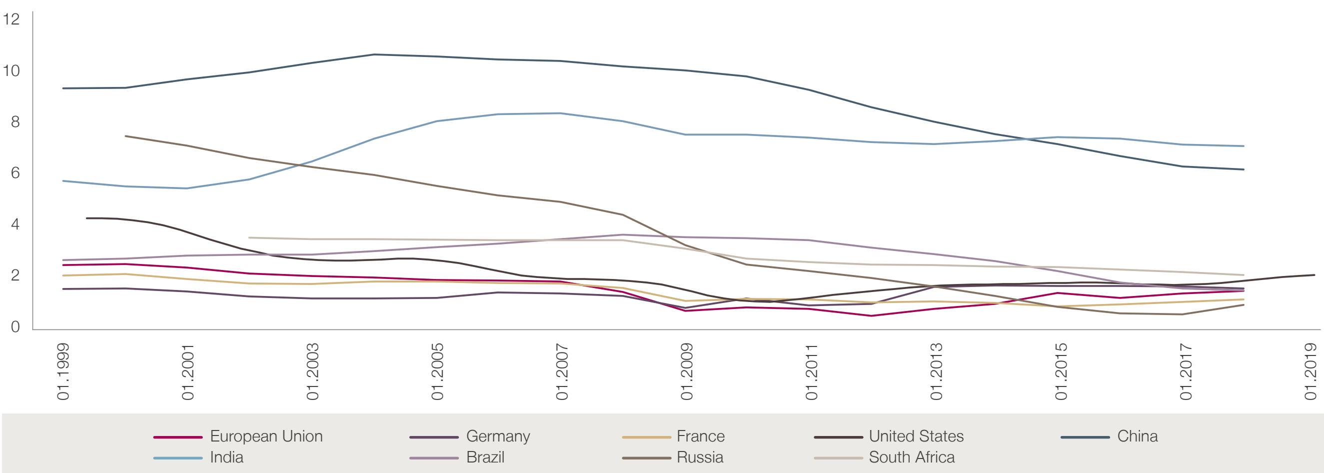
Lifting the potential growth rate is about increasing the size of the economic engine. That can only be done by adding resources, eliminating bottle necks, and becoming more efficient. The present focus on monetary policy is ignoring the fact that the role it plays is more like the fuel we put in the tank rather than affecting the size of the engine. Without fuel we will go nowhere, but how fast we advance is more in the hands of the elected politicians than in those of the appointed central bankers.

The pace of reform as monitored by the OECD has slowed since the peak reached around 2012 in mature countries and in 2014 in emerging economies. While the overall speed of reform has slowed, mature countries have increased the number of reforms aimed at increasing productivity while emerging markets have made much progress in boosting employment. However, with reforms slowing, it is unlikely that potential or actual growth will rise markedly from current levels.

Potential GDP growth has slowed the most notably in Russia, which has fallen to the bottom of our sample (Chart 15) with a potential growth rate of 0.9%. China has seen its "natural" capacity to grow drop to 6.2% but remains second only to India at 7.1%. US potential GDP has risen from the 2010 low of 1% to 2.1% currently, and the Euro Zone's has picked up from 0.5% in 2012 to 1.5% at the end of 2018. Generally speaking, mature markets have improved since the 2008 crisis. In emerging economies, the potential is often much higher than in mature countries, but it has declined since the global financial crisis.

This leaves us with an outlook for GDP growth remaining in the vicinity of potential unless greater trade tensions or other unexpected events push it lower. Barring such surprises, the global business cycle continues to be supported by historically low inflation – allowing interest rates to stay low as well – a significant drop in unemployment globally, benign oil prices, and, although the US dollar could helpfully be weaker, its strength is not choking growth at this stage. These supports are likely to limit the degree of deceleration we can expect in the world economy.

CHART 15: POTENTIAL GDP GROWTH RATE, % YOY



Source: FactSet, Indosuez Wealth Management.

INFLATION

Importantly, low inflation, or outright drops in prices (deflation), is particularly growth promoting, as long as GDP growth is positive. At present most countries are showing positive GDP growth, and deflation or disinflation can therefore not be cyclical. In this case, low price increases mean higher real wages and increased consumption. This is what the global business cycle has benefitted from in the post-2008 crisis period when private consumption has been the main source of GDP growth.

If low inflation is structural, where does it come from? We argue that it is brought about mainly by the technological revolution. Such revolutions in the past have taken around 100 years from the first innovation to full deployment in the economy. As the first computer sae the light in 1947, we think inflation will most likely be modest until 2047. This is fortunate in today's global economy because it would be complicated for central banks to raise interest rates in response to hypothetically higher inflation given the record debt burdens many countries carry. This does not make the debt levels sustainable, but it does make them affordable.

By extension, when the US cuts its policy interest rate, it is helpful to all who borrow at variable rates in US dollars, and it allows all the countries with their currency tied to the US dollar greater flexibility in terms of stimulating their own economies. Were the US dollar to depreciate in response to the rate cuts, it would reduce the foreign currency price of all trade denominated in US dollars. Emerging markets could reap the greatest benefits in this situation.

UPSIDE GROWTH SURPRISES REMAIN LIMITED

The chance that GDP growth surprises on the upside appears limited, primarily given the complicated situation politically and the associated slowdown in the pace of economic reforms. A weaker US dollar could generate a faster pace of growth in most places, with the exception of Europe, as would a pick-up in investment activity, and increased employment. These could occur if risk appetite were to rise and uncertainty fade. Such an outcome looks unlikely as long as the trade conflict remains ongoing.

GROWTH CONTRIBUTORS

Taking a closer look at the sectors that contribute to growth, net exports (exports of goods and services minus imports of the same) makes a slim contribution on average in many economies. In the US the average contribution since 2000 was a negative 0.13 percentage points a year.

For the Euro Zone the average over the same period is at least positive, at a modest 0.05 percentage points.

In more mature economies, it testifies to the international supply chains that tend to render exports import-intensive. Drops in trade volumes could aggravate this situation, but there is some comfort in knowing that net trade is generally not the main contributor to GDP growth.

That privilege tends to belong to private consumption. In the US, private consumption has made an average contribution of 1.6 percentage points since 2000 while in the Euro Zone it is 0.7 percentage points.

Investment, or gross fixed private capital formation, is the likely wild card over the coming years. In China it represented 44% of GDP in 2017 (World Bank) compared to 21% in the US and the Euro Zone. In terms of investment's contributions, the average since 2000 in the US is a positive 0.4 percentage points, although the latest number (third quarter 2019) was a negative 0.3 percentage points.

The Euro Zone is in almost the opposite situation with an average contribution of fixed investments of merely 0.1 percentage points since the start of the century, but a 1.2 percentage point contribution in the second quarter of 2019.

US investments are thus story is declining from a higher level, while the Euro Zone's are accelerating from a lower level. This makes for a certain momentum advantage in the camp of the Europeans.

Government consumption makes negative contributions to GDP in times of austerity and positive contributions in times of fiscal expansion. Over a cycle it should stay close to zero in a fiscally prudent country. In the US, the average contribution since 2000 is 0.2 percentage points and the latest (third quarter 2019) was 0.35 percentage points. It is unlikely to pick up from here.

In the Euro Zone the average is 0.1 percentage points which is also contribution in the second quarter 2019. This is up from a negative 0.05 percentage points in 2011. The Euro Zone's fiscal policy has become a bit more expansionary. Additional fiscal stimulus would be welcome, but is not expected to add more than around 0.2 percentage points to GDP growth in the area.

INDOSUEZ GROWTH FORECASTS

Our key macro-economic forecasts expect of a soft landing in the global business cycle (Tables 2 and 3). Of the forecast 3.1% world GDP growth rate for 2019, 1.1 percentage points come from China and 0.5 percentage points from India. Over 50% of global growth is generated by these two countries. The US makes a 0.3 percentage point contribution and the Euro Zone adds 0.1 percentage points.

From an investment point of view, the message is difficult to ignore. Seeking some form of exposure to emerging markets in general and to China in particular should be the goal of almost every investor. These are our core convictions regarding the global macro-economic outlook:

- A soft landing in the global business cycle at around 3% GDP growth with most countries growing in line with their potential.
- The risks to the outlook are mostly on the downside and the obvious swing variable is the degree of trade restrictions in place in future.
- Inflation is structurally low thanks to the technological revolution and is already a global phenomenon that could last into the middle of the century.
- As a consequence, interest rates are likely to remain low for much longer, further mitigating the risk of recession.
- The policy-mix could be improved in many countries where loose monetary policies, tight fiscal policies, and insufficient structural reforms fail to lift either current or potential GDP.
- This outlook should benefit emerging markets in particular because there is greater room for additional monetary, fiscal, and reform stimulus among these countries than in mature markets – as long as the US abstains from tightening its monetary policy, that room is free to be exploited.

TABLE 3: CENTRAL BANK POLICY RATES, 2019-2020 FORECASTS, %

	2017	2018	2019	2020
Argentina	28.75	65.00	70.00	65.00
Australia	1.50	1.50	0.70	0.45
Brazil	7.00	6.50	4.50	4.50
Chile	2.50	2.75	1.55	1.50
China	4.35	4.35	4.30	4.20
Euro Zone	0.00	0.00	0.00	0.00
India	6.00	6.50	5.15	4.75
Indonesia	4.25	6.00	4.90	4.90
Japan	-0.10	-0.10	0.00	0.00
Malaysia	3.00	4.10	4.20	4.20
Mexico	7.25	7.75	7.75	6.00
Philippines	3.00	4.75	3.95	3.60
Russia	7.75	7.75	6.30	5.95
Saudi Arabia	2.00	3.00	2.25	2.00
South Africa	6.75	6.75	6.45	6.35
South Korea	1.50	1.75	1.25	1.15
Switzerland	-0.75	-0.75	-0.75	-0.75
Thailand	1.50	1.75	1.25	1.15
Turkey	8.00	24.00	13.25	11.70
United Arab Emirates	1.75	2.75	2.00	1.75
United Kingdom	0.50	0.75	1.00	1.25
United States	1.50	2.50	1.75	1.75

Source: Bloomberg, Indosuez Wealth Management

TABLE 2: KEY MACRO-ECONOMIC FORECASTS, % AND PERCENTAGE POINTS

	2017		2018		2019		2020			2017	2018	2019	2020
	GDP	CPI	GDP	CPI	GDP	CPI	GDP	CPI	PPP weights (2018)	Contributions	Contributions	Contributions	Contributions
World	3.8	-	3.6	-	3.0	-	3.2	-	100	Pct points	Pct points	Pct points	Pct points
United States	2.5	2.1	3.0	2.2	2.0	2.0	1.8	1.9	15.2	0.38	0.46	0.30	0.27
Japan	2.0	1.0	0.3	0.7	0.5	1.2	0.9	0.4	4.1	0.08	0.01	0.02	0.04
United Kingdom	1.4	3.0	1.4	2.5	1.0	1.5	1.1	2.0	2.2	0.03	0.03	0.02	0.02
Euro Zone	2.7	1.4	1.1	1.9	1.0	1.0	1.2	1.2	11.4	0.31	0.13	0.11	0.14
Germany	2.8	1.7	0.6	2.2	0.5	1.1	1.2	1.3	3.2	0.09	0.02	0.02	0.04
France	2.8	1.2	1.0	2.2	1.0	1.2	1.1	1.2	2.2	0.06	0.02	0.02	0.02
Italy	1.6	0.0	0.0	1.5	0.2	0.4	0.8	1.0	1.8	0.03	0.00	0.00	0.01
Spain	3.1	1.2	2.3	1.7	2.0	0.5	1.5	1.0	1.4	0.04	0.03	0.03	0.02
Switzerland	2.5	1.1	1.5	0.9	1.2	-0.1	1.2	0.6	0.4	0.01	0.01	0.00	0.00
Brazil	2.2	2.9	1.1	3.8	1.1	3.6	2.4	3.7	2.5	0.06	0.03	0.03	0.06
Mexico	1.6	6.8	1.6	4.4	0.2	3.5	1.4	3.4	1.9	0.03	0.03	0.00	0.03
Argentina	3.9	24.8	-6.4	47.1	-1.8	65.0	0.3	50.0	0.7	0.03	-0.04	-0.01	0.00
Russia	0.9	2.5	2.7	3.9	1.4	3.3	1.5	3.7	3.1	0.03	0.08	0.04	0.05
India	7.0	5.2	6.6	2.6	4.8	4.0	5.9	3.5	7.7	0.54	0.51	0.37	0.45
China	6.8	1.8	6.4	2.2	6.0	3.8	5.7	2.4	18.7	1.27	1.20	1.12	1.07
Asia ex China, India, Japan*	4.3	-	4.5	-	4.5	-	4.5	-	7.9	0.34	0.36	0.36	0.36

*Hong Kong, Indonesia, Malaysia, the Philippines, Singapore, South Korea, Taiwan, Thailand, and Vietnam.

Nota Bene : World GDP is PPP (Purchasing Power Parity). All numbers in % are Q4 YoY. Contributions are growth rates multiplied by the weight of the country/region in world GDP, expressed in percentage points.

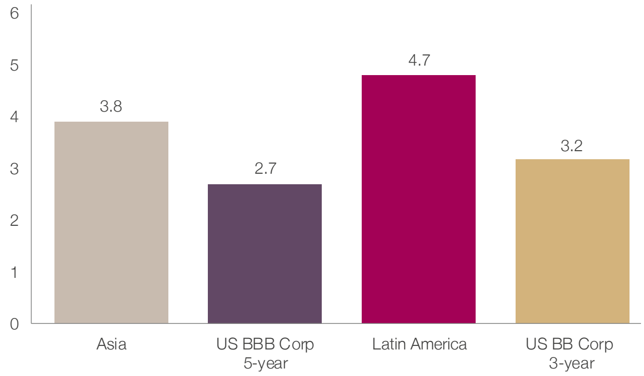
Source: Bloomberg, Indosuez Wealth Management.

THE CASE FOR EMERGING MARKET DEBT

The sharp decline in global bond yields has most recently triggered a renewed search for yield. In this context global investors have taken greater interest in emerging market debt, which provides yield pick-up versus their counterparts in the developed world. The US Federal Reserve's rate cuts are expected to ease the pressure on emerging market's funding costs.

At this point, Asia offers about 1% yield pick-up versus its equivalent in the US while the yield advantage for Latin America is even more pronounced, at 2% (Chart 16). Although the risk level in emerging debt is higher than in US debt, fundamentals across emerging markets have improved significantly.

CHART 16: EM DEBT OFFERS YIELD PICK-UP, %



Source: Bloomberg, Indosuez Wealth Management.

Serra da Beleza, Brazil

Jakarta, Indonesia

IMPROVED FUNDAMENTALS

Although past decades saw financial and debt crisis in Asia and Latin America these regions are today significantly different from the past. There is a greater variety of funding sources including local currency, and the size of the market has increased. Both market depth and liquidity have improved from 20 years ago. More importantly, both regions now include a number of investment-grade and higher quality sovereign markets (Chart 17).

Over half of Asia's USD bond market is accounted for by countries whose sovereign ratings are in the investment-grade category. In Latin America, slightly less than half of the index is comprised of credits issued by companies operating in investment-grade rated countries such as Chile, Mexico, Peru, and Colombia. Brazil, which makes up 44% of the Latin America index, is in the BB- category (Standard & Poor's rating).

Taken together, there is an investable universe containing a good level of investment-grade quality issues coupled with selective good opportunities in the high yield bucket.

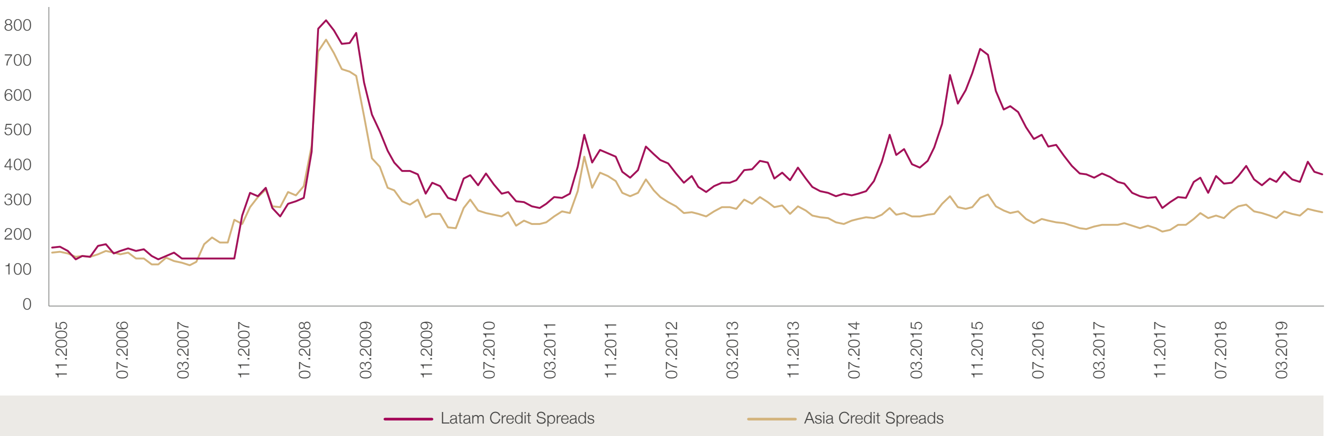
The market for corporate debt has also deepened. In Asia, the local currency bond market is now a sizeable asset-class. There is a fair amount of flows in the local rates market of Singapore, South Korea, Hong Kong, and Indonesia. This is a trend that should continue in the future.

TABLE 4: RATINGS EVOLUTION

EM Asia	1990-2000	2000-2010	2010-Present
Singapore	Aa2	Aa1	Aaa1
Hong Kong	A3	Aa1	Aa2
China	A3	A1	A1
South Korea	Baa2	A2	Aa2
Malaysia	Baa3	A3	A3
Thailand	Ba1	Baa1	Baa1
India	Ba2	Ba1	Baa2
Indonesia	B3	Ba2	Baa2
Philippines	Ba1	Ba3	Baa2
Latin America	**1990-2000**	**2000-2010**	**2010-Present**
Chile	Baa1	A2	A1
Mexico	Ba2	Ba2	A3
Peru	Baa2	Ba2	A3
Colombia	Baa3	Ba2	Baa2
Brazil	B1	Ba2	Baa3/Ba2

Source: Moody's, Indosuez Wealth Management.

CHART 17: EM CREDIT SPREADS HAVE TIGHTENED FROM THE WIDES OF 2016, BASIS POINTS



Source: Bloomberg, Indosuez Wealth Management.

INVESTMENT FLOWS INTO EMERGING MARKET BONDS

Emerging market bonds are sensitive to the US interest rate policy. The good news is that the US Fed rate cuts in 2019 provided some breathing space as well as inflows into the asset class. For example, emerging market bond ETFs have received significant inflows in 2019 (Table 5). This can be seen as a proxy for overall asset-class flows. If we have a benign macro backdrop along with accommodative monetary policy, the search for stable carry could continue and bring more inflows into emerging market debt. This is evident given the experience in 2019.

The forces at play argue for hard currency over local currency debt at this point, especially given the less appealing relative risk/volatility mix of the latter, in a context where monetary easing in emerging markets puts those currencies under pressure (Table 6).

WHAT TO EXPECT IN THE FUTURE

EMERGING ASIA

In 2020, we expect the market to remain broadly stable with credit spreads trading in a range-bound fashion. China accounts for nearly half of the universe (Table 7), and the Chinese government has rolled out various stimuli to support the economy. These include cutting reserve requirement ratios (RRRs), and encouraging banks to lend to small-and medium-sized enterprises.

We believe these measures will help support investor sentiment in the China credit market, and could have a positive spill-over effect on the rest of Asia. For example, South Korea is highly dependent on the Chinese economy's health as China is a critical part of the global manufacturing supply chain and a consumer of technology products. Stability in China should also lift sentiment in the South Korea USD credit market.

TABLE 5: ETF FUND FLOWS, USD MILLION

EM Fixed Income	1 Month	3 Months	YTD	1 Year	3 Years
Total	3'172	5'437	14'751	15'657	29'452
Not Declared	296	482	2'201	2'533	2'621
IG BBB or higher	1'109	1'011	1'406	1'167	9'187
High yield	15	10	85	-62	337

Source: Bloomberg, Indosuez Wealth Management.

TABLE 6: MONETARY POLICY EXPECTED STANCE

Asia-8 Monetary Policy	Expected Stance
China	Easing
Korea	Easing
Indonesia	Easing
Thailand	Neutral
Malaysia	Easing
Philippines	Easing
Singapore	Easing
India	Easing

Latam Monetary Policy	Expected Stance
Chile	Easing
Mexico	Easing
Peru	Easing
Colombia	Neutral
Brazil	Easing

Source: Bloomberg, Indosuez Wealth Management.

TABLE 7: EMERGING MARKETS BENCHMARK COMPOSITION AND CREDIT RATINGS, %

Emerging Asia*	Sovereign Credit Ratings (Moody's/S&P/Fitch)	Index Weight
China	A1/A+/A+	48.71
India	Baa2/BBB-/BBB-	7.03
Indonesia	Baa2/BBB/BBB	12.32
Philippines	Baa2/BBB+/BBB	4.13
Korea	Aa2/AA/AA-	9.07
Emerging Latam*		
Chile	A1/A+A	8.70
Mexico	A3/BBB+/BBB	24.00
Peru	A3/BBB+/BBB+	5.70
Colombia	Baa2/BBB-/BBB	8.80
Brazil	Ba3/BB-/BB-	44.00

*Asia index is BofAML Asian Dollar Index and Latam Index is CEMBI Broad Latam.
Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

In Indonesia, we expect further reforms from the administration of Present Joko Widodo (also known as Jokowi), and a particular emphasis on infrastructure investment and education. We see this as positive development that could raise the potential growth of the Indonesian economy. In the medium-term, however, the headline risk coming from US-China trade tensions will likely be a key driver of the Indonesian credit spreads along with global commodity prices.

Indian growth is widely expected to slow further. This could weigh on the credit spreads of the domestic and cyclical issuers, such as steel companies, while reform of insolvency rules may trigger accelerated loss recognition on the balance sheets of banks.

As a result of this we have cut our allocation to commodities, metals, and mining positions in India.

LATIN AMERICA

Latin America is often seen as one homogenous region, one single bet. The region represents a group of countries that share some common characteristics, but also have their own set of strengths and challenges. Differentiation is key to identifying their possible paths while taking advantage of the diversification opportunities found in the region (Tables 8 and 9).

Unlike past sovereign debt crises, there was no real contagion from the Argentinean debacle following the presidential primaries in August 2019. Efforts pursued by other countries in the region to diminish external vulnerabilities seem to have left them better equipped to face volatility. For the most part, after the crises of the late 1990s, Chile, Colombia, Peru, and Mexico pursued more liberal agendas. Reforms included privately financed retirement systems, opening the economies to international trade, and the privatisation of state-owned companies. In addition these countries aimed for healthier mixes of local and external debt, stronger international reserves, and current account deficits better financed by foreign direct investment.

Brazil's economy remained relatively more closed, and the government has kept a larger role. The current administration is pursuing ambitious reforms. The pension reform, aimed at stabilising the trend of the public debt, was approved in October 2019. Expected further measures include a tax reform, initiatives to privatise many government owned companies, reduction of bureaucracy for doing business, and modernisation of the public sector. Reforms will likely face challenges as part of the complicated political process, but they are an important step in the right direction.

Understanding the dynamics of current credit ratings has proved an opportunity for the creation of excess returns in this market. Brazil's sovereign credit ratings were hit with multi-notch downgrades during the 2015/2016 crisis. As a result, the ratings of some companies with investment-grade-like credit metrics are limited by the soverign's ceiling. Many of these companies emerged out of the crisis as survivors – leaner and more efficient.

Lower interest rates also have the potential to benefit the debt-payment abilities of companies. The region benefits from the global trend of subdued inflation and low interest rates. The main economies in the region have undergone, or are in the middle of, easing monetary cycles. In many cases interest rates are at historic lows, enabled by the historically low levels of inflation. This is also the result of sluggish growth.

Some of the countries in the region, such as Peru and Colombia, have moved from a low-income to middle-income economy. Such a transition can result in lower YoY economic growth and we see low growth as the key challenge for the region at this point. In the face of high inequality, discontent and instability are set to continue.

TABLE 8: DEBT FUNDAMENTALS

	Current Account Deficit % of GDP*	Primary Budget Deficit % of GDP*	External debt % GNI**	Total reserves % Total external debt**	Short-term Debt % Total Reserves**
Brazil	-2.0	-1.3	30.3	67.2	17.8
Chile	-3.6	-1.8	-	-	-
Colombia	-4.3	1.6	42.3	35.5	31.5
Mexico	-1.2	-1.7	38.0	38.9	34.6
Peru	-2.0	-1.5	31.3	90.5	16.6
Argentina	-3.1	-1.1	56.1	23.6	102.1

*June or September 2019, latest available.
** December 2018.
Source: World Bank Data, Bloomberg, Indosuez Wealth Management.

TABLE 9: KEY MACRO FIGURES, NOVEMBER 2019

	Inflation YoY (%)	Reference Interest Rate (%)	Rate at Current Cycle High (%)	Change (%)
Brazil	2.5	5.00	14.25	-9.25
Chile	2.1	1.75	5.25	-3.50
Colombia	3.9	4.25	7.75	-3.50
Mexico	3.0	7.75	8.25	-0.50
Peru	1.9	2.25	4.25	-2.00
Argentina	53.5	64.00	85.00	-21.00

Source: Bloomberg, Indosuez Wealth Management.

Guanajuato, Mexico

Hard currency debt prices have recently shown remarkable resilience to political turmoil in a number of countries. In October 2019, tensions between President Sebastián Piñera and congress reached a new high. In a showdown of popular discontent, Chile was battered by demonstrations and riots. Credit default swaps for the country continued to trade in the low range of historical levels. So far bond prices have shown limited corrections. Even in Mexico, where the first year of the current administration has been marked by a decrease in investment confidence and economic growth, markets have focused on the administration's inclination towards fiscal austerity and the potential for the approval of the US, Mexico, and Canada (USMCA) trade deal.

At current levels we continue to like the risk/reward in the asset-class, favouring quality in terms of credit ratings with special consideration for the limitations of the sovereign ceiling.

We think the spread compression is mostly behind us in Asia so any price gain is likely to be muted. This leaves emerging market debt as mostly a carry story for 2020.

We have relatively higher conviction on Latin America over Asia credits from a regional allocation perspective. Within Asian high yield, we prefer low beta China high yield property names over the other sectors (Table 10).

TABLE 10: EMERGING MARKETS DEBT KEY VIEWS

Asia Fixed Income Call	Overweight	Neutral	Underweight
Investment grade			●
High yield	●		
Corps	●		
Sovereigns			●
Hard Currency	●		
Local Currency			●

Latam Fixed Income Call	Overweight	Neutral	Underweight
Investment grade	●		
High yield		●	
Corps	●		
Sovereigns			●
Hard Currency	●		
Local Currency			●

Source: Indosuez Wealth Management.

EARNINGS GROWTH AND VALUATIONS IN ASIA

The year 2019 has been a volatile one for equity markets. This has been even more remarkable in emerging Asia. Looking at the MSCI All Country Asia excluding Japan index, the first quarter saw a positive return of 11.2% while the second quarter reported a 1.6% loss, followed by a third quarter loss of 5.5%[18], and the last quarter showing a rebound.

The year was marked by an ever-present and overhanging uncertainty regarding an elusive trade deal between the US and China. This negatively affected global investor sentiment toward China. Nevertheless, the Chinese government stepped up proactive countercyclical policy measures to support growth and stability in the domestic economy. As fundamental equity investors, we remain overweight China in our Asia equity strategy.

Digging through the constant news flow from and toward China or the US and separating facts from sheer noise and fiction is an important, if not vital, task that fundamental equity investors need to accomplish in order to make informed investment decisions. Within that context, we think Chinese equities, at this time, offer an attractive risk/reward profile for long-term investors.

Chinese equities have proved resilient in 2019 (as per November) unlike other Asian equity markets such as India or Thailand (Chart 18). As of early November 2019, Chinese equities (MSCI China index) showed virtually no negative 6-month revisions for their full year 2019[19] earnings expectations. The current consensus among analysts forecasts 16.1% EPS growth for the full year 2019 (MSCI China index), 0.1 percentage point higher than the forecast in May of 2019. The situation is different in India, where there was a 7.7 percentage point negative revision for the same period, or Thailand, suffering a 10.9 percentage point negative revision[20].

In Asia the main positive contributor remains China given the resilience in growth among e-commerce and consumer-related companies. China offers the highest and most resilient earnings growth in the region thanks to an increasingly domestic consumption-driven growth. This shift in China's economic drivers away from exports and into domestic consumption is a major long-term trend offering many investment opportunities into new economy sectors, spanning from e-commerce to 5G communications, online gaming, or even education and healthcare. Over the third quarter of 2019, Chinese corporate earnings have been only fractionally revised down thanks to resilient consumer spending.

SECTORS

In terms of sectors, China's consumer discretionary, consumer staples, and healthcare have experienced the strongest earnings growth with positive EPS revisions in 2019 unlike some of the old economy sectors such as financials or utilities[21]. This bodes well for our current preference for companies in the new economy/new consumer trend area in China. The consumer-related sectors' continuing robust sales and earnings growth demonstrated that business transformation, going increasingly premium, and innovation remain the key earnings drivers helping Chinese consumer companies to shine amid macro uncertainties. In the healthcare sector, nationwide industry reforms are essential to accelerate market consolidation and should be most rewarding for industry leaders enjoying top notch innovation and high-quality services.

We believe equity valuations remain supportive in China: the MSCI China index is currently trading at 11.3 times price/earnings (P/E) ratio (on a 12-month forward basis), some 15% below its long-term average (13 times)[22]. As a comparison, the Asia excluding Japan region currently trades at 13 times P/E ratio (on a 12-month forward basis)[23], making Chinese shares currently more attractive than most of the other Asian equity markets, in our assessment (Chart 19). This is the case for both China's H- and A -shares. H-shares are Chinese equities trading on Hong Kong's exchange while A-shares are domestic equities trading on mainland China's stock exchanges (Shanghai and Shenzhen).

Structural changes in China's financial markets and low foreign ownership should support the attractiveness of Chinese equities over the medium to long term. Domestic fiscal and monetary policy support, financial markets opening up, positive flows on the back of MSCI A-share inclusion, combined with attractive valuations, continue to support our positive view on the China/Hong Kong equity market.

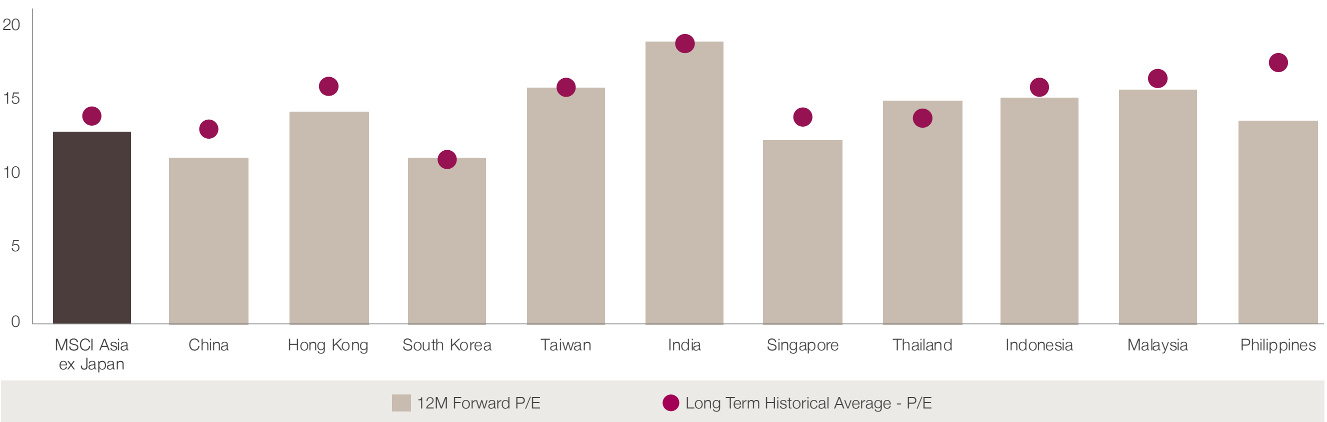
In 2020, earnings revisions and visibility should be the key drivers to watch. We believe high earnings growth sectors in China will include consumer discretionary, consumer staples, healthcare, and information technology.

18 - Bloomberg, (data in USD).
19 - Factset, November 2019.
20 - *EPS growth and 6-month EPS estimate change revisions for the year 2019*, Factset, 6 November 2019.
21, 22, 23 - Factset, November 2019.

Consumer discretionary (e-commerce in particular) should remain the key growth driver given a robust industry growth in terms of both top- and bottom-line, resilient gross merchandise volume (GMV) growth while better capital management and cost control should continue to boost return on equity (ROE). Healthcare and consumer staples are also preferred on strong domestic policy support and industry reforms. We remain selective in the IT sector while favouring market leaders and technology advancement such as secular demand-driven growth in optical components and cloud/ data centre-related investments. Information technology earnings have already started to show positive signs since September 2019, and this should bode well for a recovery in 2020. Despite US/China trade tension-related disruptions to manufacturing and exports, China's consumption-driven economic re-balancing and structural reforms are still moving ahead, and infrastructure investment should accelerate as part of counter-cyclical measures by China's leadership.

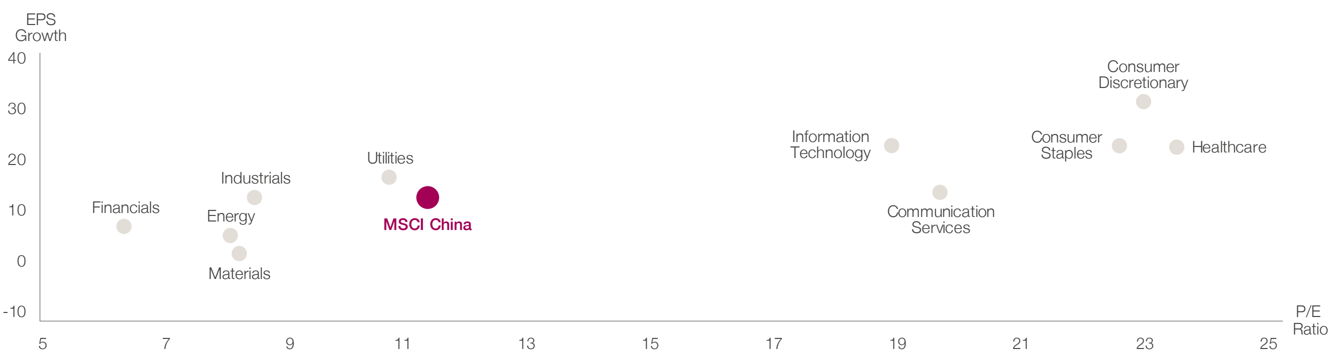
We are more cautious on Indian equities due to high valuations, no discount to long-term average valuations and potentially few catalysts in the near term. We are underweight Association of Southeast Asian Nations (ASEAN) overall while maintaining a neutral to overweight stance on Singapore equities mainly due to their rather attractive resilience and dividend yields (in the financial sector in particular). Overall, selectivity remains key within an Asia equity portfolio.

CHART 18: EQUITY VALUATIONS IN ASIA, AVERAGE AND 12-MONTH FORWARD P/E



Source: Factset, November 2019, Indosuez Wealth Management.
Past performance does not guarantee future performance.

CHART 19: MSCI CHINA 12M FORWARD EPS GROWTH AND P/E BY SECTOR



Source: Factset, November 2019, Indosuez Wealth Management.
Past performance does not guarantee future performance.

Atlanta, Georgia, United States

CAUTION ON EMERGING MARKET CURRENCIES

The US Federal Reserve's decision in 2019 to renew the expansion of its balance sheet (for liquidity management purposes) might prove to represent the entry trigger for which emerging markets were waiting. Combined with the third Fed rate cut, higher beta currencies look more attractive on a relative value basis. We may be on the cusp of an outright US dollar peaking phase given the uncertain US political backdrop. If so, it would favour certain higher yielding emerging market foreign currencies (EMFX) pairs. In such past cycles, when countries in Latin America and Asia largely dependent on US dollar debt were able to refinance at manageable levels, their GDP growth remained sustainable and their currencies outperformed the USD on a net yield carry basis. This time around it could occur again but not in a blanket fashion equally benefitting all.

For a while the dollar has been supported by solid growth, foreign direct investment inflows to record-setting equity markets, and attractive real yields to boot. These attributes largely shielded against the underlying fundamentals that could come home to roost.

Now we note the unsustainable fiscal policy in the US, the ongoing impeachment process, and the more dovish Fed on the one hand, while risks elsewhere seems to be receding – notably perhaps those surrounding Brexit. In this light, it might be time to consider greener and relatively cheaper pastures elsewhere.

RUBLE SURPRISE

Since the start of 2019, the strongest fiat currency, immediately trailing the stellar performance of precious metals, has surprisingly been the high-yielding Russian ruble despite the ongoing sanctions imposed. Russia has been able to forge strong alliances in the Middle East and with neighbouring China by positively disrupting the traditional supply chain dynamics in its favour. Massive joint infrastructure investments are now bearing fruit as they more effectively deliver energy resources enabling Russia to by-pass the US dollar altogether. This contributed to Russia's 2.3% GDP growth in 2018, exceeding expectations, although 2019 will not come close to matching this. Highly adequate central bank currency reserves, a high deposit rate coupled with a healthy 7% current account surplus in per cent of GDP in 2018 will maintain the ruble as a currency diversification alternative to consider.

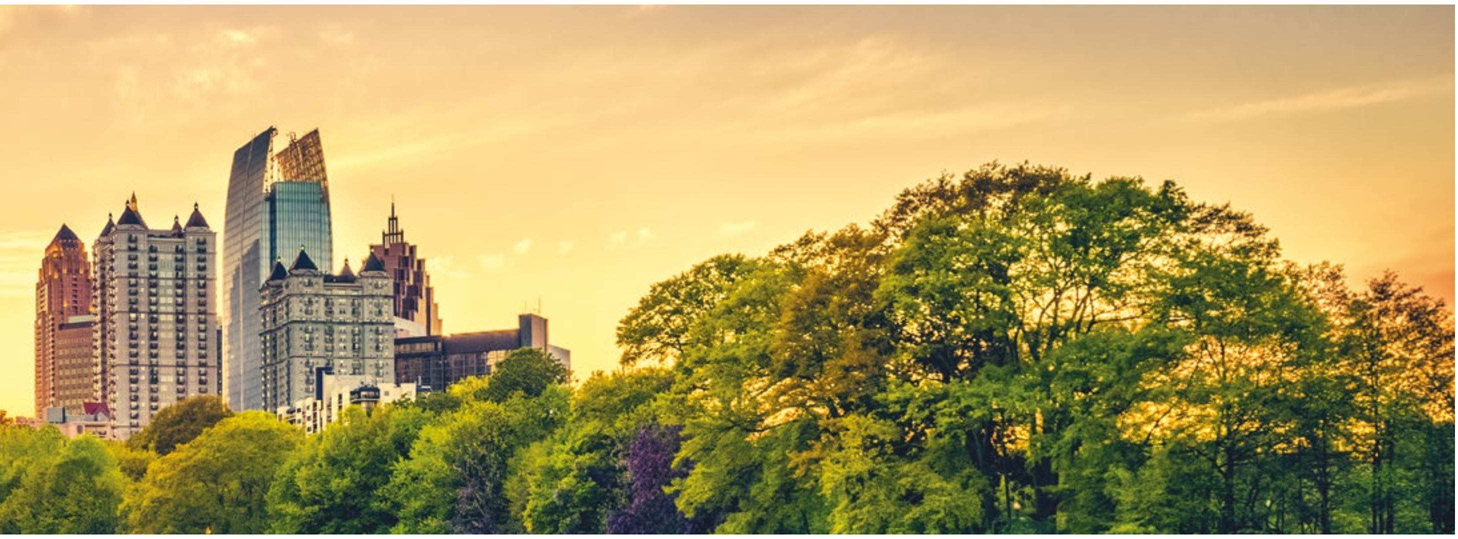
CURRENT ACCOUNTS

As a currency bloc, Asia should in theory be perfectly poised to benefit from an impending topping out of the US dollar, especially the current-account-surplus countries. It all hinges on some easing of trade tensions. Constructive talks with no action will not be enough to ignite bottom-picking interest in local Asia currencies that have followed the Chinese renminbi lower over 2019.

The People's Bank of China (PBoC), although leaning heavily against natural domestic outflows of the Chinese yuan (CNY), still allowed a breach of the psychological 7.00 resistance level versus the US dollar, dragging all other Asians pairs with it.

The jury is still out on the timing for a general Asian currency bloc recovery phase. Interest rates have been heavily reduced in order to help exports and any recessionary effects from dwindling trade flows. AAA Singapore, for example, is grappling with zero growth given its 70% of GDP dependence on exports.

We fear that a recovery of this bloc will be slow and at best uneven until a more comprehensive, tariff-free recovery in global trade returns beyond a mere face-saving trumpeted phase 1 deal. The high-yielding Indonesian rupiah could prove to be a surprise winner against regional pairs.

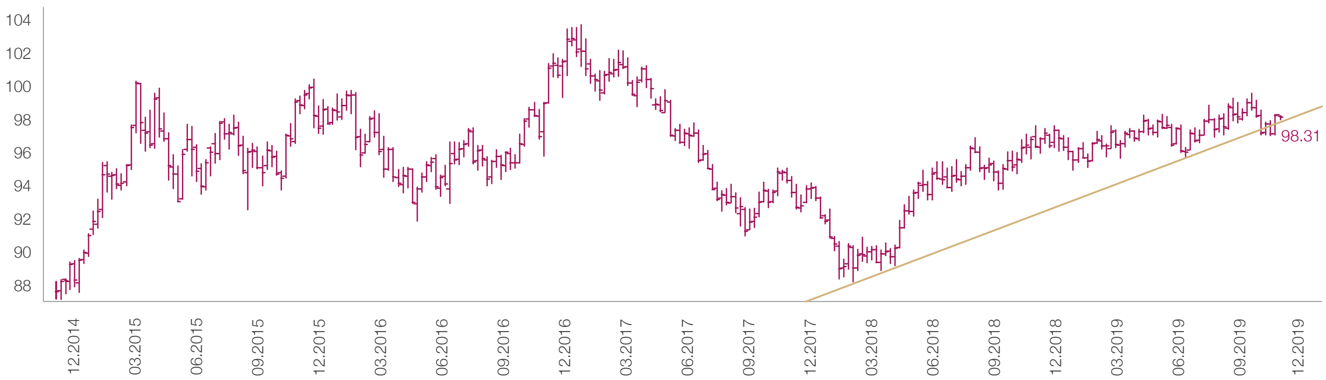


We are cautious on the deficit-laden, high-yielding Turkish lira and South African rand as their fiscal situations are still expected to deteriorate and as interest rates contract further. This leaves us to consider Latin America where our crystal ball does not see the outlooks equally distributed across the continent. Both Venezuela and Argentina fail to tick any boxes. Size really does matter in Latin America and limits our interest to Mexico and Brazil. The Mexican peso has gradually shed its high carry appeal with investors who remain concerned that reforms are too slow in being implemented just as President Andrés Manuel Obrador remains stubbornly committed to austere deficit-reduction over growth stimulus.

Brazil on the other hand, is currently cheap versus the US dollar. We remain cautiously bullish the brazilian real on bouts of weakness, such as the current slip due to the disappointing foreign interest during the oil drilling-rights auction. Our constructive view is based on the underlying long-term view that Brazil's government is competent enough to develop an ambitious reform programme, the congress and senate are stacked in favour of implementing these reforms, and the Brazilian electorate recognises the need for them and are buying in. The Brazilian central bank has amassed plentiful reserves that will enable them to defend bouts of weakness near the attractive 4.25 level versus USD.

Given that in 2019 the US Fed has clearly transitioned from reducing its balance sheet and raising interest rates to exactly the opposite, the sun may soon set on its currency's outperformance in 2020. This phase is not expected to be sudden as it appears the FOMC is now on hold. Even a gradual topping formation will favour certain emerging-market high-yielders with superior fiscal and current account backdrops. We favour US dollar investors diversifying to the Russian ruble and Brazilian real and potentially the Chinese yuan and Indonesian rupiah, if and when the trade impasse is addressed with more certainty.

CHART 20: USD INDEX (1973=100)



Source: Bloomberg, Indosuez Wealth Management.

OUR GLOBAL VIEW

After a 2018 characterised by trade-war escalation, tightening US monetary policy, and a spectacular market drop in the last quarter, 2019 did not start with a very favourable environment for emerging markets. Despite this backdrop and generally slower growth, several emerging country asset classes performed remarkably, illustrating once again that macro-economics are not the only guide to asset allocation.

Some funds invested in domestic Chinese equities outperformed most equity markets around mid-2019 while emerging-market bonds have posted close to double-digit performance on the back of the drop in long-term interest rates and spread tightening. Several other specific factors contributed positively to market performance, such as pension reform in Brazil, and corporate tax reform in India. Dispersion increased on the back of asymmetric chocks and imbalances, affecting primarily countries such as Argentina, Venezuela, and Turkey.

We think emerging markets GDP growth should stabilise around or above 4.5% in 2020, significantly higher than developed markets. Growth in Asia will continue to be higher than in Latin America, Eastern Europe, or the Middle East, although with some deceleration in China and India. Beyond the structural factors highlighted in this outlook, 2020 growth in emerging markets could be fuelled by a number of positive catalysts: a globally supportive monetary environment, a potential easing in trade tensions, a trend towards greater fiscal stimulus, and additional structural reforms.

The dominant trend in monetary policy should continue to be accommodative, justified by lower inflation numbers. In particular, an accommodative US Fed puts less pressure on capital flows. This also reflects the key risk factors to monitor in 2020.

The long-term sustainability of a policy-mix in emerging economies will continue to be scrutinised, with a greater fiscal deficit and rising debt in China, for example. The growth in total leverage that occurred in the past decade is not sustainable in the long term. The situation seems manageable at this stage given strong savings, a healthy foreign exchange reserve base, and a good track record of macro-prudential coordination between the government and the central bank.

This is unfortunately not true everywhere. In the short term, countries in South-East Asia and Latin America could well experience some stress that have lower GDP growth, weaker current accounts, more dependence on foreign capital, and limited foreign exchange reserves. Therefore, selectivity will continue to be key.

In this context of moderate growth but low probability of recession, we continue to be globally constructive while selective on emerging-market asset classes. Higher expected medium-term equity returns in these countries, coupled with lower valuations than in developed markets, should be helpful. There are, however, some structural risks to monitor. In a long-term low interest rate environment in mature markets, we think the yield premium on emerging debt in USD should continue to attract flows. The benefits from spread compression and monetary easing are mostly behind us though, notably in Asia where investment grade spreads are becoming thin.

Emerging currencies trade low relatively to the past 5 years, and a peaking and potentially weaker dollar should theoretically be favourable to emerging currencies. Given the monetary easing path in emerging markets and the remaining uncertainties and imbalances, we find it early to be long emerging currencies for USD or EUR based investors with the exception of the Brazilian and Chinese currencies. Despite the yield differential we continue to prefer hard currency over local currency debt.

Emerging equities are expected to post close to 10% earnings growth and generate healthy dividend yield in 2020, and trade at a discount to mature markets.

A rotation from emerging debt to equities would seem logical in this context. Within that universe we continue to find more opportunities in domestic Chinese equities, in particular in companies benefiting from secular trends such as an emerging middle class, acceleration of innovation or infrastructures connected to the Belt and Road Initiative (BRI). Chinese domestic equities currently offer the most appealing mix in terms of earnings growth and valuation.

The risk factors to monitor regarding emerging markets in 2020 are relatively similar to those in 2019 with momentum improving in US monetary policy, dollar momentum, the outlook regarding trade, stabilisation of growth in China, and geopolitical risks. Positive catalysts affecting these elements could drive a rebalancing into emerging equities by global investors in 2020.

Istanbul, Turkey


Frankfurt, Germany

PERFORMANCE TABLES

TABLE 11: ANNUAL COMMODITY PERFORMANCE, LOCAL CURRENCY

COMMODITIES	2015	2016	2017	2018	2019
Steel Rebar (CNY/Mt)	-29.38%	60.46%	42.69%	-8.19%	-1.91%
Gold (USD/Oz)	-10.41%	8.14%	13.53%	-1.56%	18.31%
Crude Oil WTI (USD/Bbl)	-30.47%	45.03%	12.47%	-24.84%	34.46%
Silver (USD/Oz)	-11.51%	15.84%	7.23%	-9.36%	15.32%
Copper (USD/Mt)	-25.32%	17.65%	30.92%	-17.69%	3.50%
Natural Gas (USD/MMBtu)	-19.11%	59.35%	-20.70%	-0.44%	-25.54%

TABLE 12: ANNUAL FIXED INCOME PERFORMANCE, LOCAL CURRENCY

CORPORATE BONDS	2015	2016	2017	2018	2019
Governments Bonds Emerging Markets	-12.62%	6.29%	12.49%	-10.62%	1.88%
US Government Bonds	1.31%	1.11%	1.10%	1.41%	5.22%
Euro Government Bonds	1.76%	1.86%	0.39%	0.40%	3.16%
Corporate EUR High yield	-0.25%	8.14%	4.82%	-3.37%	9.55%
Corporate USD High yield	-5.03%	15.31%	6.32%	-1.48%	14.65%
Corporate Emerging Markets	-6.08%	7.61%	2.84%	-6.89%	9.11%

TABLE 13: ANNUAL FOREIGN EXCHANGE RATES PERFORMANCE, SPOT

CURRENCIES	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
EUR/CHF	-0.62%	-15.70%	-2.71%	-0.74%	1.63%	-1.99%	-9.54%	-1.48%	9.16%	-3.82%	-3.55%
GBP/USD	10.81%	-3.45%	-0.44%	4.58%	1.86%	-5.92%	-5.40%	-16.26%	9.51%	-5.62%	3.94%
USD/CHF	-3.13%	-9.66%	0.31%	-2.42%	-2.46%	11.36%	0.78%	1.69%	-4.39%	0.80%	-1.58%
EUR/USD	2.51%	-6.54%	-3.16%	1.79%	4.17%	-11.97%	-10.22%	-3.18%	14.15%	-4.48%	-2.22%
USD/JPY	2.64%	-12.80%	-5.19%	12.79%	21.39%	13.74%	0.37%	-2.71%	-3.65%	-2.66%	-0.98%

TABLE 14: ANNUAL EQUITY INDEX PERFORMANCE, PRICE INDEX, LOCAL CURRENCY

2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
98.14%	20.89%	0.00%	19.42%	51.46%	51.66%	9.93%	27.92%	38.71%	-6.24%	33.95%
96.71%	16.99%	-5.55%	18.01%	29.60%	11.39%	6.79%	16.44%	34.35%	-9.27%	27.30%
74.14%	16.36%	-7.62%	17.71%	24.09%	8.08%	5.58%	14.43%	21.78%	-10.44%	23.85%
67.89%	12.78%	-11.34%	15.15%	17.37%	4.35%	-0.73%	9.54%	20.96%	-12.48%	22.72%
63.29%	12.07%	-18.94%	14.37%	14.43%	2.92%	-2.74%	8.57%	20.83%	-13.24%	16.35%
27.99%	9.55%	-19.16%	13.40%	0.61%	2.23%	-4.93%	5.32%	20.11%	-16.31%	14.85%
26.98%	9.00%	-20.41%	13.18%	-5.03%	-2.71%	-11.31%	2.87%	19.69%	-16.57%	14.85%
23.45%	8.63%	-21.92%	7.55%	-7.65%	-4.62%	-16.96%	-1.20%	19.42%	-17.80%	13.31%
22.07%	-0.97%	-22.57%	5.84%	-8.05%	-14.78%	-22.37%	-1.85%	7.68%	-18.71%	12.08%
5.63%	-12.51%	-25.01%	5.43%	-15.72%	-17.55%	-32.92%	-11.28%	7.63%	-25.31%	9.95%

BEST PERFORMING

WORST PERFORMING

FTSE 100 | Japan Topix | MSCI World | MSCI EMEA | MSCI Emerging Markets
Stoxx Europe 600 | S&P 500 | China Shanghai Index | MSCI Latam | MSCI Ex Japan

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

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The Indosuez Wealth Management Group is following all of these reforms very closely and has a specific framework to cover all related legal, commercial, and operational impacts. For now, you are not required to do anything in relation to your financing operations or investments indexed to the benchmark rates concerned by these changes. You will receive further information once a better picture surrounding the details of the replacements are known. Please feel free to contact your account manager if you have any questions.

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GLOSSARY

Backwardation: Refers to a situation where a futures contract's price is below the spot price of the underlying. The opposite situation is referred to as Contango.

Barbell: An investment strategy that exploits two opposing ends of a spectrum, such as going long both the short- and long-end of a bond market.

Basis point (bp): 1 basis point = 0.01%.

Below par bond: A bond trading at a price inferior to the bond's face value, i.e. below 100.

Bottom-up: Analyses, or investment strategies, which focus on individual corporate accounts and specifics, as opposed to top-down analysis which focuses on macro-economic aggregates.

Brent: A type of sweet crude oil, often used as a benchmark for the price of crude oil in Europe.

Bund: German sovereign 10-year bond.

Call: Refers to a call option on a financial instrument, i.e. the right to buy at a given price.

CFTC (Commodity Futures Trading Commission): An independent US federal agency with regulatory oversight over the US commodity futures and options markets.

COMEX (Commodity Exchange): COMEX merged with NYMEX in the US in 1994 and became the division responsible for futures and options trading in metals.

Contango: Refers to a situation where the price of a futures contract is higher than the spot price of the underlying asset. The opposite situation is referred to as Backwardation.

CPI (Consumer Price Index): The CPI estimates the general price level faced by a typical household based on an average consumption basket of goods and services. The CPI tends to be the most commonly used measure of price inflation.

Duration: Reflects the sensitivity of a bond or bond fund to changes in interest rates, expressed in years. The longer the duration of a bond, the more its price is sensitive to any changes in interest rates.

EBIT (Earnings Before Interest and Taxes): Refers to earnings generated before any financial interest and taxes are taken into account. It takes earnings and subtracts operating expenses and thus also corresponds to “operating earnings”.

EBITDA (Earnings Before Interests, Taxes, Depreciation and Amortisation): EBITDA takes net income and adds interest, taxes, depreciation and amortisation expenses back to it. It is used to measure a company's operating profitability before non-operating expenses and non-cash charges.

ECB: The European Central Bank, which governs the euro and euro-member countries' monetary policy.

Economic Surprises Index: Measures the degree of variation in macro-economic data published versus forecasters' expectations.

EPS: Earnings per Share.

ESG: Environmental, Social and Governance.

ESMA: European Securities and Markets Authority.

Fed: The US Federal Reserve, i.e. the central bank of the United States.

FOMC (Federal Open Market Committee): The US Federal Reserve's monetary policy body.

Futures: Exchange-traded financial instruments allowing to trade the future price of an underlying asset.

G10 (Group of Ten): One of five groups, including also the Groups of 7, 8, 20 and 24, which seek to promote debate and cooperation among countries with similar (economic) interests. G10 members are: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the UK and the US with Switzerland being the 11th member.

GDP (Gross Domestic Product): GDP measures a country's yearly production of goods and services by operators residing within the national territory.

GHG: Greenhouse gases.

Gulf Cooperation Council (GCC): A grouping designed to favour regional cooperation between Oman, Saudi Arabia, Kuwait, Bahrain, United Arab Emirates and Qatar.

High yield: A category of bonds, also called “junk” which ratings are lower than “investment grade” rated bonds (hence all ratings below BBB- in Standard & Poor's parlance). The lower the rating, the higher the yield, normally, as repayment risk is higher.

Hybrid securities: Securities that combine both bond (payment of a coupon) and share (no or very long maturity date) characteristics. A coupon might not be paid, as with a dividend.

iBoxx investment grade/high yield indices: Benchmarks measuring the yield of investment grade/high yield corporate bonds, based on multi-source and real-time prices.

IMF: The International Monetary Fund.

Investment grade: A “high quality” bond category rated between AAA and BBB- according to rating agency Standard & Poor's.

LIBOR (London Interbank Offered Rate): The average interbank interest rate at which a selection of banks agree to lend on the London financial market. LIBOR will cease to exist in 2020.

LME (London Metal Exchange): The UK exchange for commodities such as copper, lead, and zinc.

Loonie: A popular name for the Canadian dollar which comes from the word “loon”, the bird represented on the Canadian one dollar coin.

LVT: Loan-to-Value ratio; a ratio that expresses the size of a loan with respect to the asset purchased. This ratio is commonly used regarding mortgages, and financial regulators often cap this ratio in order to protect both lenders and borrowers against sudden and sharp drops in house prices.

Mark-to-market: Assessing assets at the prevailing market price.

OECD: Organisation for Economic Co-operation and Development.

OPEC: Organisation of Petroleum Exporting Countries; 14 members.

OPEC+: OPEC plus 10 additional countries, notably Russia, Mexico, and Kazakhstan.

Policy-mix: The economic strategy adopted by a state depending on the economic environment and its objectives, mainly consisting of a combination of monetary and fiscal policy.

PMI: Purchasing Managers' Index.

Put: An options contract that gives the owner the right, but not the obligation, to sell a certain amount of the underlying asset at a set price within a specific time period. The buyer of a put option believes that the underlying stock price will fall below the option price before expiration date. The value of a put option increases as that of the underlying asset falls, and vice versa.

Quantitative Easing (QE): A monetary policy tool by which the central bank acquires assets such as bonds, in order to inject liquidity into the economy.

Renminbi: Translating literally from Chinese as “currency of the people”, this is the official name of China's currency (except in Hong Kong and Macao). It is also frequently referred to as the yuan.

Russell 2000 Index: A benchmark measuring the performance of the US small cap segment. It includes the 2000 smallest companies in the Russell 3000 Index.

SEC (Securities and Exchange Commission): The SEC is an independent federal agency with responsibility for the orderly functioning of US securities markets.

Spread (or credit spread): A spread is the difference between two assets, typically between interest rates, such as those of corporate bonds over a government bond.

SRI: Sustainable and Responsible Investments.

Subordinated debt: Debt is said to be subordinated when its repayment is conditional upon unsubordinated debt being repaid first. In return for the additional risk accepted, subordinated debt tends to provide higher yields.

Swap: A swap is a financial instrument, often over the counter, that enables two financial flows to be exchanged. The main underlyings used to define swaps are interest rates, currencies, equities, credit risk and commodities. For example, it enables an amount depending on a variable rate to be exchanged against a fixed rate on a set date. Swaps may be used to take speculative positions or hedge against financial risks.

USMCA: The United States-Mexico-Canada Agreement, signed by the political leaders of the three countries on 30 September, 2018, replacing NAFTA (created in 1994).

VIX: The index of implied volatility in the S&P 500 Index. It measures market operators' expectations of 30-day volatility, based on index options.

Wedge: A wedge occurs in trading technical analysis when trend lines drawn above and below a price chart converge into a arrow shape.

WTI (West Texas Intermediate): Along with Brent crude, the WTI is a benchmark for crude oil prices. WTI crude is produced in America and is a blend of several sweet crude oils.

WTO: The World Trade Organisation.

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