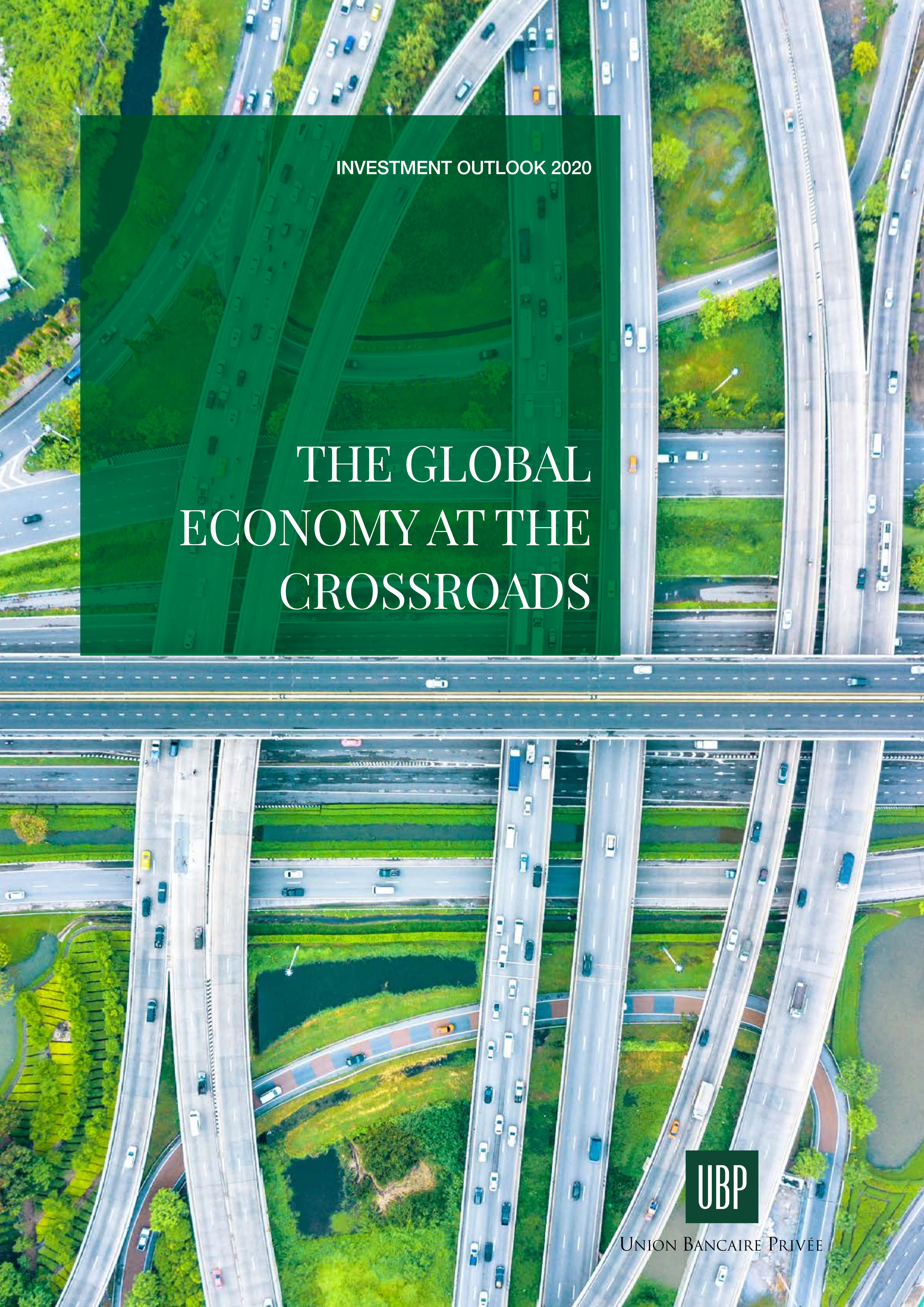


INVESTMENT OUTLOOK 2020

THE GLOBAL ECONOMY AT THE CROSSROADS

UBP

Union Bancaire Privée

THE GLOBAL ECONOMY AT THE CROSSROADS

Dear Reader,

Following the shock caused by near-20% declines during the fourth quarter of 2018, global equity markets rebounded strongly in early 2019 as the US Federal Reserve brought its rate hikes to an end in the first quarter before shifting to outright easing later in the year.

We expected the world's economies to move out of sync, and we were proved correct as the US remained resilient while other major economies suffered sustained slowdowns verging on recession by year-end. The increase in trade tensions that we predicted in 2018 came to pass, and the resulting uncertainty dragged down global growth expectations throughout the year. In response, the world's central banks adopted monetary easing measures, pushing bond yields to test, and in some cases fall below, their previous historical lows. Despite uncertainty about economic growth and persistent earnings downgrades throughout the year, equities outpaced bonds in 2019 as expected.

MICHAËL LOK
Group CIO and Co-CEO
Asset Management

Our risk-focused approach – via structured products and hedge funds – across portfolios served us well in 2019 as the rise in volatility in all asset classes was even greater than we had predicted in our cautious forecasts. Thematically, our focus on secular trends remained valuable, while our emphasis on the emerging field of impact investing proved timely.

Looking ahead to next year, central banks look poised to continue stabilising global credit markets at least until fiscal authorities around the world can begin increasing government spending, reducing the policy burden on their monetary counterparts. The time lags involved in enacting these new spending programs should continue to push volatility higher, especially in early 2020. As fiscal stimulus emerges, perhaps first in continental Europe, risks for bond investors are likely to increase. Within bond portfolios, investors should take a risk-focused capital-preservation approach rather than the quest for yield seen in recent years. Moreover, with government bond yields near historical lows, investors should look further afield and diversify more broadly among "risk-off" assets – including gold and safe-haven currencies – in the new year.

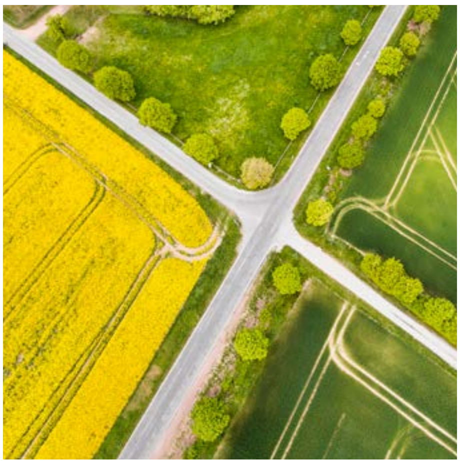
Central-bank easing and balance-sheet expansion should help contain equity market weakness until fiscal stimulus is applied more forcefully in late 2020. Until then, long–short hedge fund exposure should remain a key equity risk management tool in the year ahead.

2020 should continue to see socially-responsible investing catching on globally. Impact investing trends, which spread across developed markets in 2019, should take root just as firmly in emerging markets as the new decade begins. Moreover, broader ESG investing methods should gain in prominence, allowing investors to customise portfolios to match not only their investment objectives but also their personal values.

We examine all of these issues and more in the pages that follow. As ever, we look forward to working alongside you to develop an investment portfolio that meets your expectations and needs.

CONTENTS


FINE
GOLD



ECONOMIC OUTLOOK

GLOBAL ECONOMY IN TRANSITION: FROM MONETARY TO FISCAL POLICY

2020 is an opportunity for the two main levers of economic policy – monetary and fiscal – to be used jointly and in parallel, with governments and central banks working more closely together in managing the economic cycle.

Global economic growth peaked in mid-2018 and has been slowing ever since. This has been happening across economic regions, and governments are seeking to harness a wider range of economic policies to boost growth, or at least mitigate the worst effects of the US–China trade war.

The risks of trade and currency wars, along with a battle for technology leadership, have been dragging down business confidence and investment. Political risks remain high given next year's US presidential election, compounded by ongoing uncertainty about the terms of the UK's departure from the European Union and the prospect of further elections in Continental Europe. This has created a climate of malaise and a serious lack of visibility that could adversely affect companies' recruitment decisions and consumer confidence as we move into next year.

For 2020, it is vital that the late-2019 slowdown does not turn into a recession, but instead is replaced by a stabilisation period followed by a rebound like that seen in 2015–17. Financial markets and economic agents are looking to those responsible for economic policy, and above all central banks, to support the cycle and remove the threat of widespread recession.

2019 has brought a strategic shift by central banks, which have stopped raising interest rates and reverted to more accommodative monetary policies, including cuts to official interest rates and further liquidity injections.

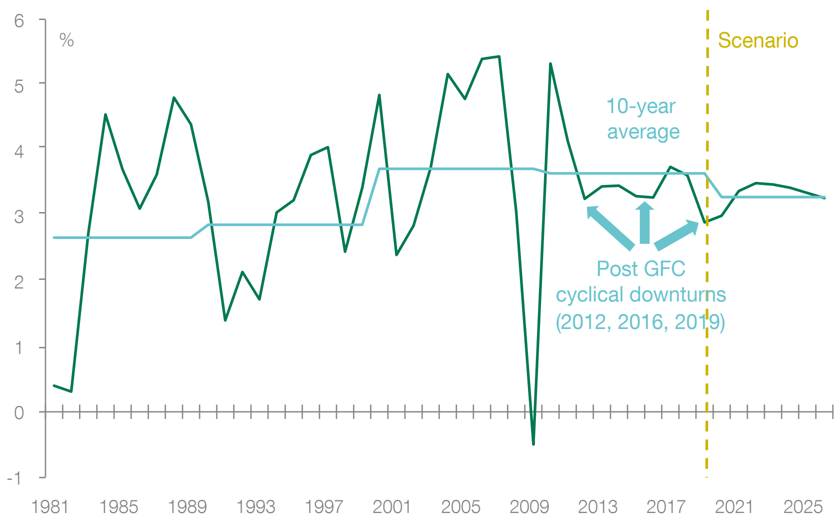
Governments are seeking to harness a wider range of economic policies to boost growth

This highly accommodative monetary environment is likely to last into 2020 with further rate cuts expected in the coming quarters. We should also see moves to ensure abundant liquidity, as occasional bouts of illiquidity have recently suggested that money is flowing less easily through economic and financial channels.

With wide swaths of the government bond market trading at negative yields, the situation is fundamentally different from that which existed at the time of the 2008 financial crisis. Back then, central-bank action was crucial in getting the money markets moving again and restoring the supply of credit. Today, the smooth running of the markets is less of a problem than ensuring that recent monetary adjustments are transmitted to the real economy.

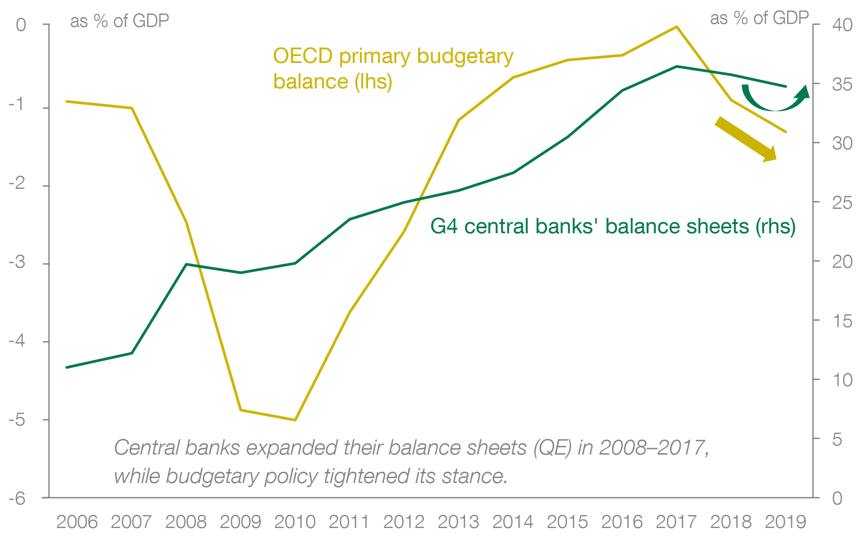
Indeed, the monetary stimulus model of the past decade is showing its limitations because, although it supports financial

WORLD GDP GROWTH



Sources: IMF, UBP Economic & Thematic Research

GLOBAL MONETARY AND BUDGETARY POLICY



Sources: OECD, Central banks, UBP

asset prices, transmission to the real economy remains limited except in the real-estate sector.

In addition, low interest rates – and indeed negative rates in some regions – have impaired banks' profitability, limiting the scope for large-scale rate cuts going forward. Even with some room to cut rates in the world's two largest economies, the same monetary policy measures are no longer producing the same effects as they did in 2008/9, and policy adjustments are now required to prolong the global cycle.

A window of opportunity is opening to introduce fiscal stimulus alongside ongoing loose monetary policy

Overall economic policy therefore needs to be adjusted, opening a new chapter in which fiscal policy will play a greater role while monetary policy remains loose. The need for a new approach is supported by several factors: interest rates are likely to remain low for a long time, fiscal policies have remained tight while economies have slowed, and lower interest rates are automatically reducing governments' debt servicing costs.

As a result, a window of opportunity is opening to introduce cyclical stimulus via fiscal policy, supported by ongoing loose monetary policy. Unlike the situation in 2009, when the G20 adopted a general, co-ordinated stimulus plan, fiscal policies are likely to be uncoordinated and dependent on local contexts. The amounts involved, the sectors targeted, as well as the timing of deployment will therefore differ between countries.

Thus, the financial markets, which are waiting for fiscal support to be announced, must realise that politicians work on a different timeframe to the markets, leaving the risk of occasional disappointment caused by this mismatch.

Indeed, upcoming elections and fragile coalitions in certain countries are not conducive to major decisions, implying that fiscal measures are likely to be introduced only gradually in 2020, at a pace specific to each country.

However, there is some room for manoeuvre, partly because low interest rates have reduced debt servicing costs by up to 1% of GDP in some countries. As a result, activity could receive a boost of between 0.5% and 1% of GDP depending on the country. Germany has the most leeway: it aims for a balanced budget but actually ends up with a surplus, which could be around 1.5% of GDP in 2019.

A secular shift in public spending is needed instead of short-term economic stimulus

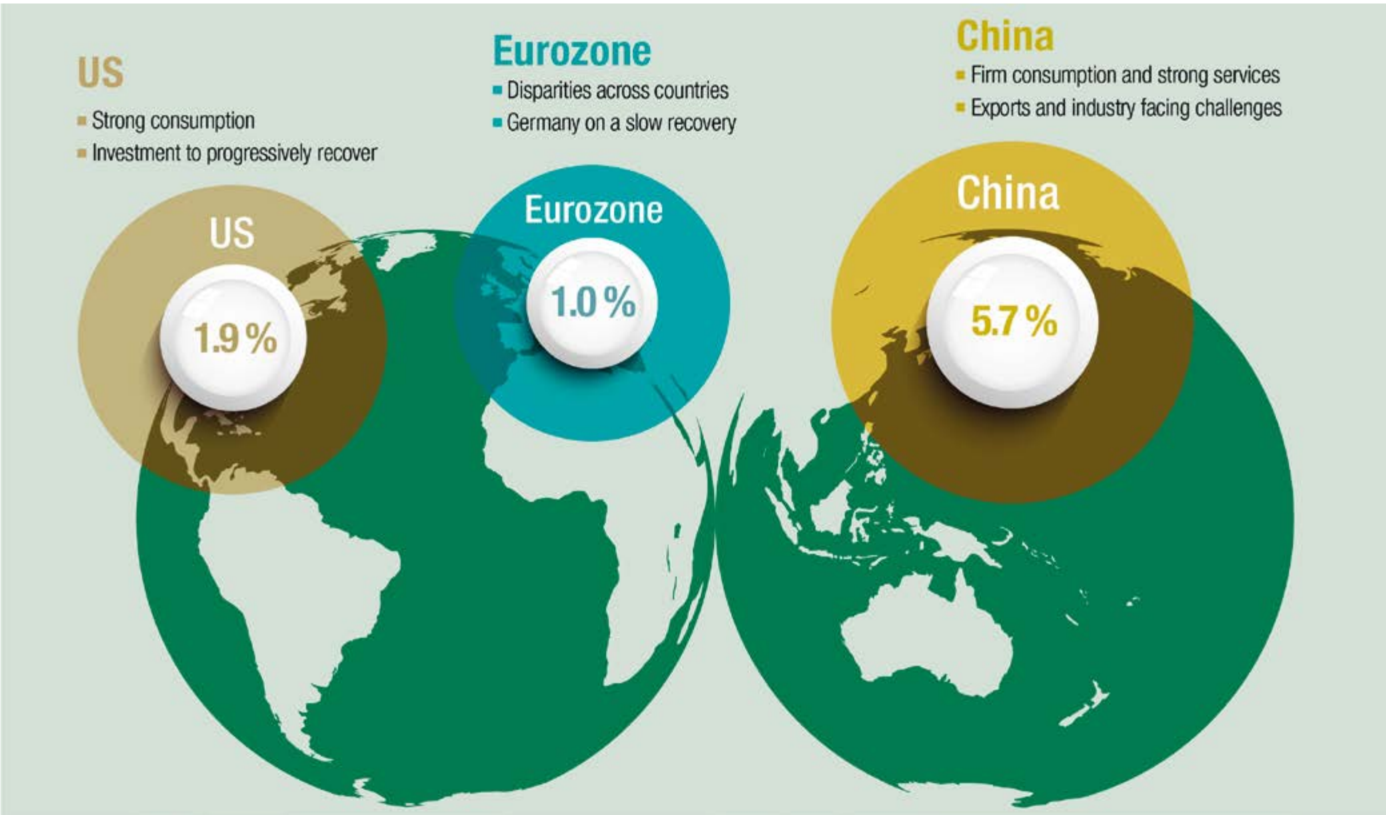
However, what is lacking is not so much room for manoeuvre, but the political will and the perceived urgency of the situation. In the US, bickering between the two main parties is preventing Congress from cutting taxes for the middle classes.

Countries could also experiment with specific stimulus measures outside of the government budget. The US has looked at a USD 2 trillion infrastructure plan, which is currently not progressing, while Germany has launched a climate plan, although it will only have a limited economic impact. In Europe, it is hoped that the new Commission will have a greater appetite for stimulus, making use of the eurozone's resources and financial capacity.

Accordingly, we should expect fiscal stimulus to happen over the long term, rather than through one-off efforts in individual countries. This would allow the US to keep growth at its trend rate of around 2%, and Japan and European countries to remain close to their potential growth rates of between 0.5% and 1.5%.

In that event, the manufacturing recession that has arisen in late 2019 would be replaced by an upturn, provided that trade tensions ease, and by a general rebound in investment. Services and consumer spending would also be strengthened in their role as growth drivers.

MODERATE GROWTH OUTLOOK IN 2020



Sources: UBP Economic & Thematic Research

Without such measures, the outlook for 2020 could be subdued, with growth of around 1.5% in the US and barely 1% in Europe.

In 2019, China and other Asian countries have announced a combination of loose monetary policy and fiscal stimulus to offset the drag resulting from the contraction in global trade. However, these measures are targeting specific sectors and it will take a long time for them to stabilise the economy. China is expected to post growth of between 5.5% and 5.9% in 2020.

But the biggest challenge for all countries, apart from protecting jobs and consumer spending in 2020, will be to address the decline in potential growth that is likely to occur by 2025 because of ageing workforces, which is a concern for many countries including China. Increased investment in infrastructure, R&D and workforce training are needed to prevent growth from falling into a rut of mediocrity in the medium term. Together with the fiscal stimulus expected in 2020, we need to see a secular shift in public spending instead of a very short-term boost to real incomes. If that were to happen, higher public spending would cause only a slight structural increase in public debt, because growth would be on a stronger upward path.

As a result, global growth could reverse the slowdown in place since late 2018 because of fiscal stimulus, which would conveniently benefit from the loose monetary policy likely still to be in place in 2020. Targeted public spending and public-sector projects would also ease the burden of weak productivity growth and shrinking labour forces, which are long-term negative factors for the potential growth of developed countries and now certain emerging countries as well.

WORLD SAVINGS & INVESTMENT

Sources: IMF, UBP

ASSET ALLOCATION

INVESTING AT THE CROSSROADS FOR THE GLOBAL ECONOMY

Equities should benefit while bond yields around the world are likely to remain very low as a transition from monetary to fiscal support for the global economy emerges in 2020. That shift should bring the US dollar's bull run to an end, leaving FX as an opportunity to manage risk and support total returns.

Policy makers around the world have begun to shift stances, though still tentatively, in an effort to soften the slowdown in economic activity that has characterised much of 2019. While monetary policy can help, fiscal stimulus is the catalyst for broader growth momentum. However, the global economy is in the early stages of this transition, which creates a risk because new spending programs may prove slow to arrive while additional monetary policy support will reach its limits, as highlighted in the previous section.

As a result, investors should seek to re-position in favour of equities while actively managing interest-rate risk in their global bond exposure in 2020. The economic boost from stimulus measures adopted around the world throughout 2019 should support this transition. Admittedly, however, managing the risk of this shift will be just as important for investors from a more tactical point of view.

For fixed-income investors, 2019 has been a good year because of sharply falling bond yields around the world, but risk management should be the focus for 2020 (see p. 16). Encouragingly, renewed monetary easing and balance-sheet expansion by both the US Federal Reserve and European Central Bank represent an effort to contain a sustained widening in credit spreads that might derail the nascent global economic recovery. At the very least, however, investors are likely to face increased volatility in bond markets, a process that began in 2019 (chart).

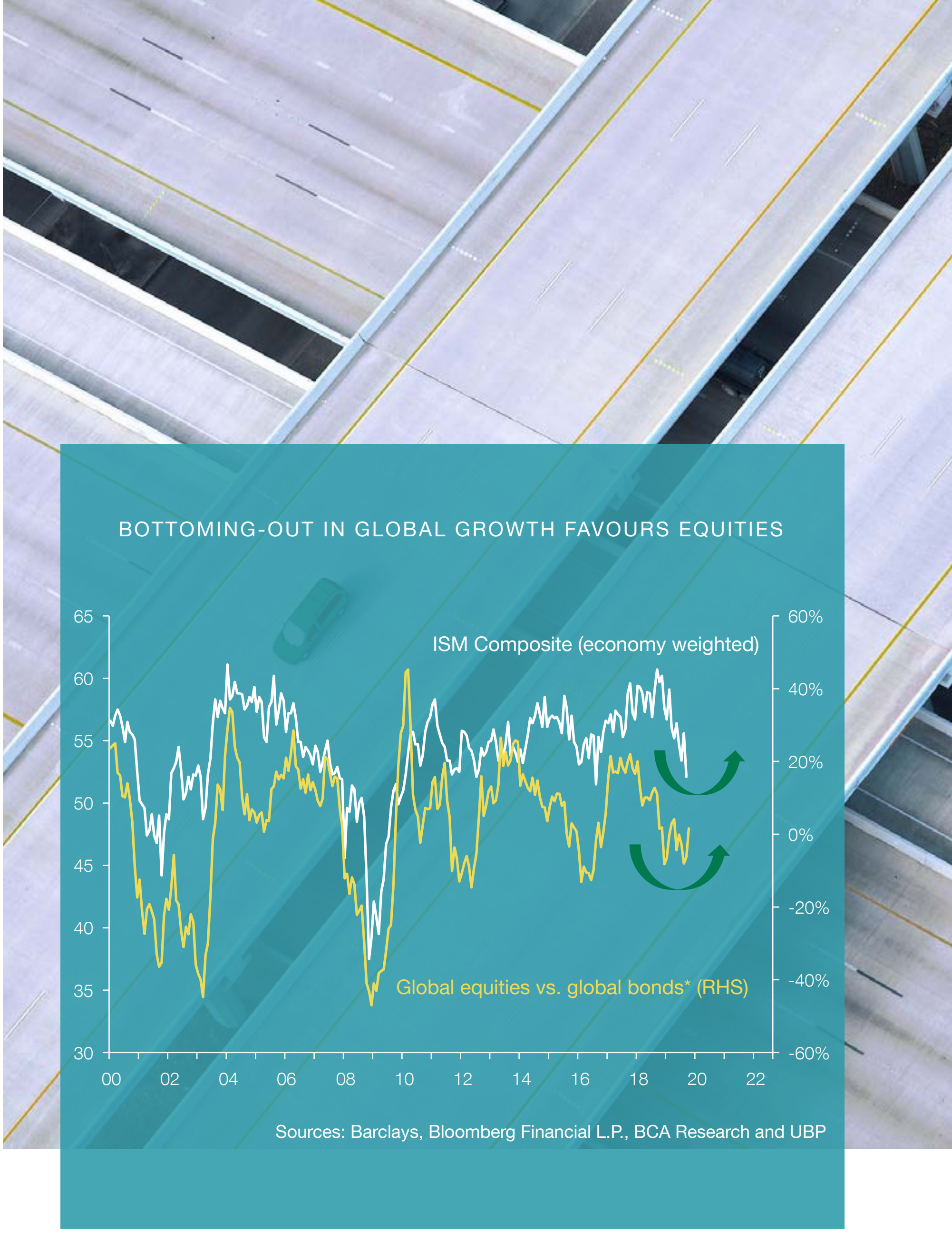
As we enter 2020, fixed-income investors should take comfort in the fact that the US and European central banks are committed to stabilising broader financial conditions and, more specifically, local credit markets. As a result, hold-to-maturity corporate credit exposure should prove valuable, even during this period of increased volatility. In exchange, investors will need to moderate their interest-rate exposure, especially anticipating an acceleration in fiscal spending as we move through 2020.

Emerging-market bond investors should benefit from a more helpful global backdrop as well. However, the near-term and idiosyncratic risks in this segment are more pronounced than in US or European credit markets. In particular, emerging-market bonds lack the same central bank backstop that the Federal Reserve and ECB are providing to their home bond markets.

Re-position in favour of equities while actively managing interest-rate risk in global bond exposure in 2020

THE DECADE-LONG DECLINE IN BOND VOLATILITY IS NEARING AN END

Sources: ICE Bank of America Merrill Lynch and Bloomberg Financial L.P.



BOTTOMING-OUT IN GLOBAL GROWTH FAVOURS EQUITIES

Sources: Barclays, Bloomberg Financial L.P., BCA Research and UBP

Moreover, as we have seen in 2019, the emerging-market bond universe is exposed to more China-specific risk. We expect China to continue focusing on domestic reform during the trade détente with the United States, and so emerging-market bonds may lack catalysts comparable to those of developed-market credit in 2020.

Global equities, in contrast, should benefit from a rebound in US and global growth and increased expectations as we enter 2020, just as we saw in 2011/12 and 2015/16 (chart).

Indeed, with central banks taking action in the second half of 2019 to reduce the likelihood of a downturn in the credit cycle, the headwinds buffeting investors through much of the past year are at last beginning to ease. A truce in the US–China trade war (see page 21) and a resolution to the UK–EU Brexit drama (see page 14) appeared on the horizon in late 2019, although tension remains high in the Middle East, posing a threat to this reduction in geopolitical risk.

With US equity valuations high, the key driver of returns in 2020 will be an improved outlook for earnings growth, which fell close to zero in late 2019. Though expectations for 2020 appear optimistic as we enter the new year, more moderate expectations combined with improving growth prospects in the coming year bode well for equities generally.

Moreover, as we highlighted in our 2019 Investment Outlook, while US equities have outpaced their global peers since the end of the global financial crisis, their outperformance is beginning to ease. Indeed, continental European equities – lacking the valuation obstacles of their American counterparts – have kept pace with US equities in 2019, aided by a weak currency. With the Brexit-related overhang set to ease, both UK and continental European equities stand to benefit from fiscal policy momentum moving into the new year. Although investors have sought refuge in global European/UK corporates over the past year, a pivot to more domestic companies is emerging as an opportunity as these headwinds fade.

While emerging equities historically benefit from improving global growth, we believe that an active stock-picking approach in the EM universe will add significant value. In China (see p. 12), we believe that key domestic consumption trends offer opportunities, especially in the onshore A-share segment in 2020.

With earnings expectations still modest, investors should also seek to use the predicted increase in volatility in global foreign-exchange markets to enhance portfolios' total return prospects. With the strong US-dollar trend of the past two years close to exhaustion (see p. 18), tactical opportunities in the currency market should present themselves in the new year.

Moreover, the transition from monetary to fiscal support for the global economy may not be a smooth one, and so the way this shift is handled will be an important risk-management focus. Longer-duration government bonds may provide tactical opportunities, and increasing exposure to "risk-off" assets will be an important diversification move in 2020. We believe that safe havens – i.e. the Japanese yen and Swiss franc as well as gold (see p. 20) – present attractive diversification opportunities.

CHINA

SPURRING CHINA'S TRANSFORMATION

Although the trade and strategy-related conflict with the US continues to hang over China, the struggle has merely accelerated China's ongoing economic transformation. Investors should align themselves with domestic Chinese policy-makers by focusing on technology, healthcare and insurance, along with onshore Chinese A-shares for domestic opportunities in 2020.

The past decade in China has seen it turn from a global industrial power into a rising consumer power as the country seeks to continue moving towards its goal of joining the world's high-income economies.

While it may appear that its momentum has been derailed by nearly two years of trade disputes with the US – which could develop into a broader conflict – the standoff between the two largest economies in the world has instead spurred China to speed up some of the more challenging aspects of its economic transformation.

Indeed, if anything, the trade war with the United States has exposed areas where China is vulnerable to external pressure, prompting it to pursue greater self-sufficiency where possible. Efforts to diversify supply chains and open up key segments of the Chinese economy have been an important, though largely overlooked, response to the Sino–American trade war that has captured headlines throughout 2019.

The US–China trade war has accelerated China's economic transformation

In dealing with this rapidly shifting landscape, investors should take an active approach, positioning themselves to invest alongside long-cycle Chinese policy initiatives. This approach has been beneficial for investors in China going as far back as the 1980s, as the country has evolved from being largely an exporter to being a nation focused on developing its domestic infrastructure and more recently empowering its consumers (see table).

Looking ahead, we expect China to continue pursuing development and leadership in key technologies while at the same time shifting its consumer focus to include "soft" trends such as education, online entertainment and insurance, providing opportunities for investors in these sectors.

Beyond this, recent developments have also revealed a new policy focus for China. With America having threatened to limit Chinese companies' access to US capital markets, China has begun to acknowledge the weakness of its domestic banking system and the fact that its reliance on US capital markets is a key vulnerability for its economy. This has led to both the early stages of a long-awaited restructuring of its domestic banking system and the opening up of its domestic equity and bond markets to foreign investors.

With banking sector reform giving rise to as many potential pitfalls as opportunities, two strategies can help investors navigate this transformation.

First, the domestic A-share market offers investors broader exposure to key domestic sectors, including retailing and healthcare, while lacking the old-economy focus on

5-year plan(s)	Policy objective	Company	Sector	Period	Total return (CAGR)	H-share index	Rel. perf. after 5 yrs
1986–90 & 1991–95	Increase export volumes by 35%	Li & Fung	Exports	1992–2000	55.0%	(10.2%)	(26.5%)
1996–00	More infrastructure	China Mobile	Telecom	1997–2005	55.0%	(19.9%)	(2.2%)
2001–20	Speed up technological progress	Tencent	Internet	2005–present	47.1%	8.8%	N/A
2006–10	Increase share of service industries	China Construction Bank	Banking	2005–2010	27.4%	22.2%	1.7%
2006–10	Increase share of service industries	China Life Ins	Insurance	2005–2010	40.8%	22.2%	(1.4%)
2011–15	Rebalance towards consumption	Brilliance China Auto	Autos	2011–2015	11.0%	(1.9%)	(5.7%)

telecoms, energy, and traditional banking seen in the offshore, H-share market. Efforts to develop and deepen this market should create more opportunities and align investor interests with China's broader policy objectives. This should allow A-shares' earnings growth – the key driver for total returns in China – to continue outpacing both that of China's offshore markets and that of broader emerging markets, as it has done consistently over the past 5, 10 and 20 years.

We also expect the accelerated transformation of the Chinese economy to bring bouts of volatility that may be better managed via select long–short hedge fund strategies focused on the Chinese market. Such exposure should also provide protection looking ahead to the second half of 2020 and early 2021, when the risk of renewed US–China tensions may increase as the outcome of the upcoming US presidential elections becomes clear *(see below)*.

WHAT NEXT IN THE US-CHINA TRADE WAR?

By the autumn of 2019, the US–China trade war had come to an important crossroads. Both countries had levied tariffs on substantially all of their bilateral trade and the two largest economies in the world were on the cusp of shifting their struggle onto a battlefield focused on "national security".

The Americans looked set to impose a technological iron curtain on the world by seeking to remove key US technologies from China's 5G and artificial intelligence supply chains. China, in response, began signalling its willingness to cause greater disruption to the American manufacturing supply chain, which has been critical to the just-in-time strategies of US companies since the 1990s.

With the détente agreed in October and expected to be signed at the APEC Summit in November 2019, the US in particular has stepped back from the brink, avoiding transforming this trade battle into an overt struggle for leadership of the global economy. Instead, US President Donald Trump appears to be shifting his focus from the global arena back towards domestic politics as he prepares for his re-election campaign in 2020.

As long as the outcome of the election remains in doubt and the US economic outlook remains in question (see p. 6), this fragile truce should hold, with only some minor skirmishes instead of the tit-for-tat escalation of 2018/19.

For China, recent developments should buy time for the mainland to step up reforms, especially in sectors with potential vulnerabilities that were exposed during the 2018–19 trade war. In particular, accelerating the global 5G roll-out and domestic network build-out will be crucial for making Huawei technology a fundamental part of the global telecommunications architecture, especially across emerging economies.

Domestically, in light of American threats to close Chinese companies' access to US capital markets, we can expect the development of Chinese capital markets – both equity and bond markets – and the reform of China's banking system to accelerate in 2020.

While many hope that a Republican defeat in the 2020 US presidential election could herald warmer US–China ties, US Senator Elizabeth Warren – the current front-runner for Democratic nomination – has already said that "… when President Trump says he's putting tariffs on the table, I think tariffs are one part of reworking our trade policy overall"[1]. It is therefore not clear that even a Democratic victory would bring an end to US–China tensions in 2021. If that is true, 2021 may instead bring renewed tension across the Pacific Ocean.

[1] in *State of the Union* on CNN, 11 March 2018

EQUITIES

SEARCHING FOR THE BREXIT DIVIDEND

Provided the Conservatives win the election, the UK outlook should stabilise. Sterling and domestically-focused equities stand to gain under such a scenario, and a stronger currency, rising consumer spending and increased domestic activity would support industries such as retail, real estate, financials, and airlines.

After years of political crisis, the UK appears finally to be on the way out of its Brexit chaos, reducing uncertainty for financial investors and the economy as a whole. A general election is likely to stabilise the political environment, provided it results in a Conservative-led government as the opinion polls currently suggest. That scenario would probably lead to wide-ranging tax reforms (affecting stamp duty, inheritance tax and VAT) and substantial fiscal stimulus in order to lessen the impact of Brexit on certain industries but also stimulate demand in others.

From a macro point of view, export growth has stabilised and real wage growth is now positive again, which is important for a consumer-driven economy. In addition, public sector net borrowing is returning to pre-crisis levels, leaving room for fiscal easing as government debt-to-GDP levels are relatively low compared with other developed countries.

For investors, two asset classes in the UK stand out as potential winners in a positive Brexit scenario: the British pound and domestically-focused equities. Sterling has been trading below pre-referendum levels for the last few years, despite the solid economy, and its fair value is likely in the 1.40–1.50 range against the US dollar.

The scenario of a strengthening currency and fiscal stimulus targeted at middle- to lower-income segments of the population favours domestic industries such as retail, real estate, financials and airlines. Their relative share price performance should be supported by a stronger domestic currency, along with rising consumer spending and increased domestic activity.

Two asset classes stand out: the British pound and domestically-focused equities

Homebuilders, for instance, are trading at cyclically low valuations, have robust balance sheets, are paying substantial dividends, and stand to benefit from a stamp-duty cut and initiatives to increase the housing supply. The retail sector should benefit from rising consumer confidence whilst airlines are expected to reverse some of their substantial valuation discounts, in absolute and relative terms, compared with European peers. Utilities also appear attractive, driven by low earnings multiples and high dividend yields that should draw attention in a yield-starved world, especially if the weak pound becomes a thing of the past in a post-Brexit world.

SECTOR FOCUS

CAPTURING THE BENEFITS OF THE FINTECH REVOLUTION

While adoption rates in Fintech remain relatively low, growth in the sector is rapid and the potential high. The payments segment holds the most promise in our view, with usage on a secular uptrend and margins improving, further bolstering the profitability of major players.

The financial technology (Fintech) segment offers a growing and diversified investment opportunity with companies specialising in Global Payments, Financial IT Infrastructure, Networks & Security, Data & Analytics, Insurtech and Regtech, as well as innovative platforms helping to reshape the global financial landscape.

Despite rapid growth in Fintech in recent years, adoption rates – including simple mobile banking penetration – are still only 33% worldwide. The sector provides exposure to otherwise non- or under-banked parts of the global economy, especially in emerging markets like China and India, where adoption rates are now well ahead of many developed markets. In addition, financial technology should facilitate and thus benefit from the rising global penetration rate of e-commerce, whose share of overall retail sales is expected to increase from 12% to 18% by 2021.

Within this burgeoning sector, payments is our preferred segment. It offers well-established investment opportunities in profitable companies with high growth rates, as card and automated payments continue to gain market share against cash. An estimated 85% of global transactions are still cash- and cheque-based, which means that there is plenty of room for penetration rates to rise. In addition, payments-related revenues have shown remarkable resilience in periods of weaker economic growth, with the secular uptrend in usage more than offsetting any cyclical headwinds that might emerge.

An estimated 85% of global transactions are still cash- or cheque-based, leaving an ample growth opportunity for Fintech

This underlying positive momentum behind revenues is also allowing leading companies in the payments space to benefit from economies of scale, achieving margin improvements that are further bolstering profitability. High-profile players in the industry are generating strong cash flow, 45–63% operating margins and expected revenue growth rates of over 10% on a medium-term horizon.

Other categories such as Financial IT Infrastructure and Networks & Security also present attractive investment opportunities, especially as services like Banking as a Platform (BaaP) and Banking as a Service (BaaS) gain ground. We expect services and software companies to deliver more than 10% revenue growth at 27% operating margins for investors, with low capital intensity and high cash flow return on investment.

More than **10%** revenue growth expected by services and software companies

27% operating margins expected for investors

FIXED INCOME

INVESTING IN A LOW- TO NO-INTEREST RATE WORLD

With nearly USD 13 trillion worth of debt trading at negative yields, bonds are no longer the low-risk investment they have been in the past. Encouragingly, there are still opportunities for bond investors, even in EUR and CHF, to both manage risk and generate modest returns against a backdrop of long-term threats in the fixed-income segment.

At a time when nearly USD 13 trillion worth of debt is trading at negative yields and 30-year US Treasury yields are flirting with the 2% mark for the first time since World War II, bonds are no longer the low-risk investment that investors have become accustomed to, especially euro- and Swiss franc-based investors.

This situation in the global bond markets has been created not only by the move to adopt negative deposit rates in much of Europe and Japan, but also the nearly USD 10 trillion of liquidity injected into bond markets via quantitative easing by the US Federal Reserve, the European Central Bank and the Bank of Japan alone since the global financial crisis.

Indeed, entering 2020, the drivers that have created this context of low or non-existent yields for bond investors look likely to continue in the near term. The US economy appears to be slowing, weighed down by a US–China trade war, Brexit-related uncertainties in Europe, rising wage pressure and broad dollar strength.

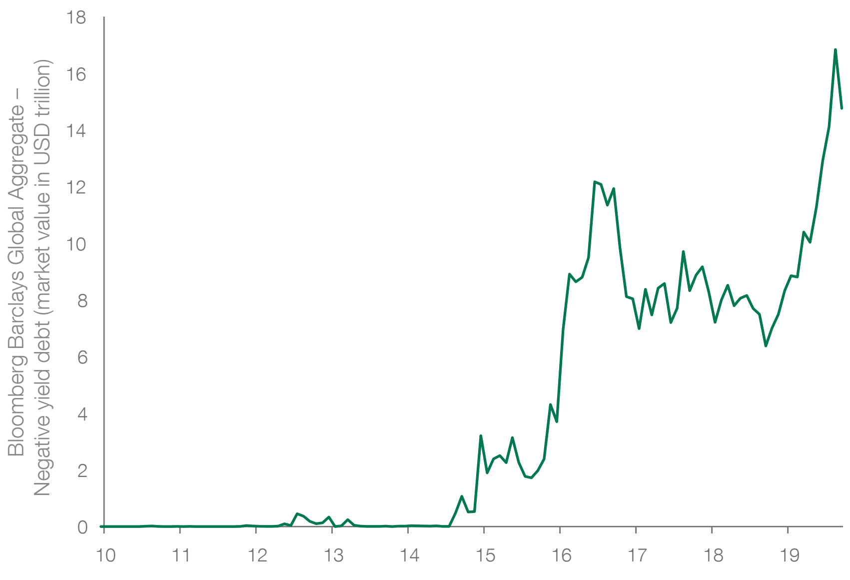
In response to this slowdown risk, the US Federal Reserve has once again started a new phase of interest rate cuts, reversing the hikes it carried out in 2017/18. Speculation is also building that the Fed may need to resume liquidity injections in earnest, given the instability of US money markets in autumn 2019. The European Central Bank and the Bank of Japan, facing similar domestic economic slowdowns, have more limited capabilities though we expect incremental liquidity injections that will help to contain any sustained increase in bond yields as we move into the new year.

Later in 2020, however, investors should be wary of the growing risk that increased government spending in Europe and, looking ahead to 2021, in the United States, effectively places a floor under bond yields and opens up the possibility of higher yields as a wave of fresh supply hits the global bond markets. Indeed, the -0.7% German Bund yield seen in 2019 may already represent that floor, should fiscal stimulus indeed accelerate in 2020 (see page 6).

For US dollar investors, the Fed's accommodative monetary policy and potential to cut rates further means that we are positive on credit risk in general, since Fed easing and liquidity injections should help contain any sustained widening in credit spreads. Volatility will undoubtedly increase. However, shorter-duration corporate bonds, in the 1–3-year segment, continue to offer above-inflation yields-to-maturity, with 2.2% on average in investment-grade debt and 6% in high yield. In the short-term emerging market debt market, a carefully selected and diverse portfolio of issuers allows for a yield-to-maturity of 4.5%.

Maintaining low duration in the credit segment is key, firstly to avoid any

NEGATIVE-YIELDING DEBT ON THE RISE



Sources: Barclays and Bloomberg Financial L.P.

potential impact from a liquidity squeeze in the new year, and secondly as the flat yield curve means that long-duration bonds do not provide much additional yield.

From a risk management perspective, allocating money to medium-term US government debt should allow investors to benefit from further additional rate cuts, but should also provide a buffer against credit exposure in portfolios if the economic slowdown proves more pronounced than anticipated.

A risk-focused approach is key for euro bond investors

For euro-based investors, putting together a similarly defensive portfolio is trickier, because they need to look at bonds with maturities of 30 years in Germany, 15 years in France and 4 years in Italy to find positive yields. Given the historically low level of European yields, a risk-focused approach appears more appropriate. Short-duration positions will allow investors to avoid significant declines in bond prices even if yields rise modestly, as they have in autumn 2019.

Though high-quality euro-denominated corporate debt is offering negative yields for maturities of less than 5 years, there are still exceptions that investors can access to build a portfolio. In particular, they include bonds that are not eligible for ECB purchases, i.e. debt issued by banks, by non-European companies and also by lower rated (BB) companies. A careful selection of bonds in these categories, with maturities of less than 3 years, offers investors a small but positive return in euro with limited volatility.

Complementing this, short-duration debt funds invested in the high-yield or emerging-market segments are expected to return between 2% and 4% in euro over a one-year horizon. For investors willing to extend their investment horizons, this mix may be supplemented by a selection of alternative investment funds with controlled volatility, convertible bonds or limited exposure to equity markets.

For Swiss franc investors, more deeply negative yields combined with the Swiss franc bond market's limited breadth and lack of liquidity make it challenging to build bond portfolios with attractive expected returns. However, CHF-based investors can opt for an approach similar to euro-based investors hedged back into CHF.

More broadly, however, investors must recognise the long-term consequences of the prolonged low-/no-interest environment. Pension systems are finding it increasingly difficult to achieve their return targets because they are unable to generate positive returns without taking significant risk. Consumers have seen income from their savings decline, increasing their need to put aside precautionary savings. Companies that might otherwise have struggled financially are being supported by artificially low financing costs, which is delaying badly needed retructuring. Thus, while there are still opportunities for bond investors to both manage risk and generate modest returns, threats will continue to build as the low-/no-interest rate environment extends further into the future.

FOREIGN EXCHANGE

DOLLAR'S STRENGTH RUNNING OUT

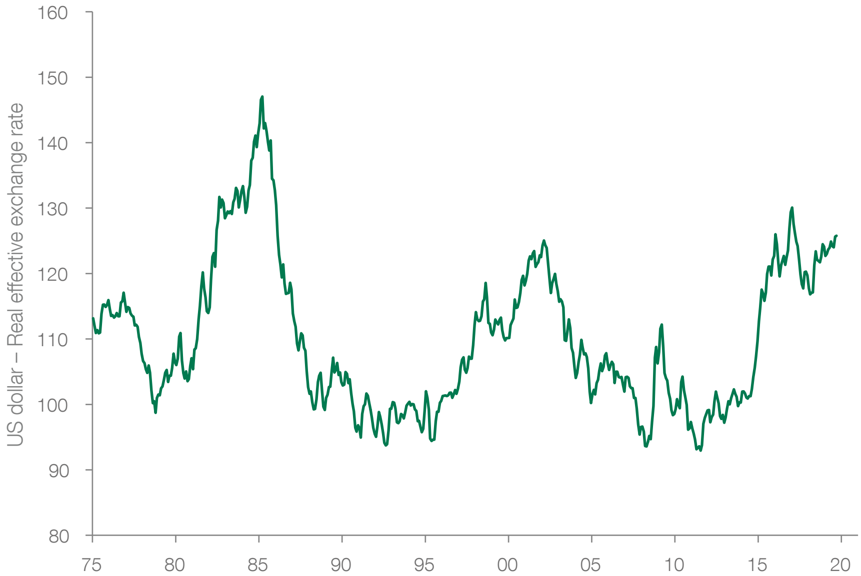
The uptrend in the USD has nearly run its course and the dollar will depreciate modestly in 2020. Traditional safe-haven currencies – JPY and CHF – will perform well. The EUR/USD rate should strengthen gradually in 2020 while Chinese yuan weakness will drag down Asian currencies.

The USD appreciated on a trade-weighted basis in 2019 against most G10 and high-beta emerging-market currencies, reflecting the severe deterioration in growth and inflation trends in many advanced economies. Expectations of rate hikes in several developed economies were scaled back and instead, a number of developed-country and emerging-market central banks eased monetary policy, in some cases aggressively. The USD appreciated because of the resulting yield pick-up. We believe that the uptrend has nearly run its course and that the dollar will depreciate modestly in 2020, reflecting slowing US growth and falling inflation, rate cuts by the US Federal Reserve, and an overvalued US currency.

US growth momentum has eased and is unlikely to improve meaningfully in 2020. The late-2019 contraction in manufacturing has begun to spread to other sectors of the economy. Although US core inflation currently remains above the Fed's 2% target, lower inflationary pressure at the global level should allow it to stabilise or even decline modestly in 2020, setting a low bar for rate cuts in 2020.

We expect the Fed to carry on cutting rates, as US growth and inflation continue to decline in 2020. The Fed may also resume its quantitative easing (QE) programme, since instability in US money markets in late 2019 indicates that the Fed has over-tightened monetary policy. Lower interest rates combined with renewed bond purchases appear necessary to stabilise money markets, and both factors are likely to weigh on the USD in 2020.

THE USD IS EXPENSIVE



Sources: Bank of International Settlements and Bloomberg Financial L.P.

Growth, inflation and monetary policy trends stand in stark contrast to the USD's valuation. The USD is currently trading at multi-year highs in trade-weighted and real effective exchange rate terms. It will be difficult for the currency to rise materially from its current elevated levels. US authorities are uneasy about the USD's current valuations and we expect the Trump administration to become more vocal about the dollar's strength if it continues to appreciate. Although we do not anticipate explicit intervention designed to weaken the USD, this is a risk.

USD weakness could manifest itself in a number of ways. If the Fed cuts interest rates against a background of robust global growth, higher-beta developed-market currencies such as GBP, SEK, NOK, AUD and NZD tend to outperform. Higher-yielding emerging-market currencies also generally outperform in this context, while safe-haven currencies like CHF and JPY tend to underperform.

The current economic environment is, however, defined by weakening global growth, falling inflation and muted inflation expectations. Trade war concerns add another layer of complexity to the picture. As a result, we believe that the USD will generally weaken on a trade-weighted basis, but traditional safe havens should outperform. This means that we expect good performance from the likes of JPY, CHF and gold (see page 20). We think USD/CHF can move close to 0.95, with risks skewed firmly on the downside. USD/JPY is likely to move to towards 100 with downside risks.

The EUR is not a safe-haven currency in the sense that it does not appreciate during periods of increasing risk-aversion. However, we expect that EUR/USD will gradually appreciate over the course of 2020, reflecting USD weakness rather than specific EUR strength. Eurozone assets show a comparatively poor risk/return profile. The eurozone current account surplus, although a strong source of underlying demand for EUR, and lower USD hedging costs (as US rate cuts emerge) will encourage corporates to increase EUR purchases.

Higher-beta developed-market currencies will continue to underperform as long as global growth and inflation remain subdued. Despite favourable valuations, we do not expect these currencies to appreciate greatly against the USD. Consequently, we do not see material upside for currencies like SEK, NOK, AUD or NZD.

We anticipate GBP/USD will trade to levels of around 1.35 and may even reach highs of around 1.40. The EU–UK withdrawal agreement means that worst-case 'no-deal' scenarios will not manifest themselves, and consequently deeply undervalued GBP exchange rates will appreciate now that uncertainty has been removed. Over the medium term, we think GBP/USD fair value is at levels of around 1.40.

Emerging-market currencies will not see major movement against the USD. Real yields are high for RUB and MXN, so those currencies will not fall sharply because the cost of holding short positions is high. Emerging-market currencies showing low real yields – BRL, TRY and ZAR – are most at risk of material depreciation.

In 2019, Asian currencies broadly fell in line with the weak CNH. We anticipate modest CNH weakness in 2020, reflecting China's slowing economy and the ongoing US–China trade war. Consequently, the risk to regional Asian currencies will be on the downside.

Tactically, currency investors may face similar risks entering 2020 as they did in early 2019. Enticed by the premium yields on offer in USD and anticipating further material rate cuts by the Fed, non-USD investors may be tempted to buy US Treasuries on an unhedged basis on a short-term view, expecting hedging costs to fall as rate cuts take place. Such an outcome would prevent near-term depreciation until non-USD investors seek to hedge their positions.

The uptrend in the USD has nearly run its course

Further out, currency risks centre on economic policy in the US, where Congress is currently debating the proposed "Competitive Dollar for Jobs and Prosperity Act". If passed, it would result in a "market access charge" being levied on incoming capital flows, in order to prevent "speculative" money from entering the US, and would supposedly push down USD exchange rates by more than the modest depreciation we expect for 2020.

Aside from that, we expect it would take a negative global growth shock like that seen in 2008/9, resulting in large-scale safe-haven flows into US Treasuries and the USD, for the USD to rise materially from its end-2019 levels.

COMMODITIES

RESERVING A PLACE IN PORTFOLIOS FOR GOLD

As western central banks lean heavily on bond-buying to stabilise the global economy, gold investors may benefit from both increasingly negative inflation-adjusted interest rates and ongoing geopolitical conflict across the globe.

Although the support for the gold price provided by trade and Brexit uncertainty began to ease in late 2019, this geopolitical respite should be viewed as temporary, perhaps until the outcome of the 2020 US presidential election becomes clearer. Even without this, various factors further support a rise in gold prices.

One of them is the decline in US inflation-adjusted interest rates, which are expected to fall in 2020, and so the opportunity cost for holding physical gold will be lower in real terms. The resumption of Federal Reserve bond-buying in 4Q2019 should also prevent yields rising much in 2020. A fall in US real interest rates close to -1% would equate to a gold price of up to USD 1,700 per ounce.

Another catalyst for gold is negative deposit rates in Europe. In 2019, the European Central Bank (ECB) cut its deposit rate by 10bp to -0.5%. The ECB also resumed its bond-buying programme and amended its forward guidance policy. Sweden's Riksbank and the Swiss National Bank have also maintained negative deposit rates, of -0.25% and -0.75% respectively. As retail banks begin to pass on the costs of negative deposit rates to their customers, physical gold will attract increasing attention from retail investors, providing strong support for gold prices over the course of 2020.

Meanwhile, central bank reserve diversification will also work in the metal's favour. In 2020, we anticipate that developed-country and emerging-market central banks will increase holdings of physical gold in order to diversify their reserves. Because central banks want to avoid buying negative-yielding bonds, gold reserves should become increasingly attractive. The ratio of central bank gold holdings to total reserves is also near multi-decade lows. Additional demand from central banks represents a multi-year trend which will further support the gold price.

As retail banks begin to pass on negative deposit rates, physical gold will gain appeal

Geopolitical risks and trade concerns also tend to send investors seeking safe havens. While tensions relating to the US–China trade war have eased and a way forward may be coming into view in the UK–EU Brexit negotiations, regional conflicts may emerge as a growing concern in 2020. Potential conflicts in the Arabian Gulf are a risk following the late-2019 strikes on Saudi oil facilities. Similarly, the withdrawal of American forces from Northern Syria raises the prospect of future conflict in that region.

Another key gold-supporting factor is volatility, and the number of risks facing financial markets in 2020 suggests that their volatility, particularly in FX, is unlikely to remain at today's low levels. Gold will benefit from increasing FX volatility and will outperform if any of the major central banks intervene in order to weaken their respective currencies.

US POLITICS

DAMNED IF YOU DO, DAMNED IF YOU DON'T

As presidential elections loom in the US, disruption in both domestic and foreign policy is on the cards whether Trump stays in or the Democrats take over. Even if the lull in the trade war with China holds, other issues like tax and competition law reforms will likely emerge, affecting US equity markets.

With US President Donald Trump entering the fourth and final year of his first term in office, the apparent truce struck with China in the autumn of 2019 signals a shift in attention towards his re-election campaign set to begin in 2020.

Though this will bring welcome respite for markets and the global economy, investors should be prepared for whoever is sitting in the White House in early 2021. Looking back at the last three years, many will point to an American president re-shaping the global order. Looking more closely, however, investors will recall that for the first two years of his presidency, Trump took a domestic focus, with immigration and tax cuts at the top of the agenda.

It was only in the second half of his four-year term, having seen Republicans lose control of the US House of Representatives and thus the ability to implement domestic policy, that President Trump turned his attention more clearly towards China and trade.

If the Republicans regain majority control of the House of Representatives, a re-elected President Trump might redirect his energy more permanently to domestic issues. More worryingly, however, with no re-election campaign to worry about, the already unconstrained Donald Trump may seek to reshape both US domestic and foreign policy, increasing the instability we have seen on the global stage in 2018/19.

If President Trump were denied a second term in office, the prospect of either Elizabeth Warren or Bernie Sanders as president might be similarly disruptive for the markets. Their campaign platforms of higher taxes for corporations and wealthy individuals as well as anti-trust enforcement actions against the largest American technology companies could at the very least affect the leadership that US equity markets have enjoyed over the past decade and potentially undermine a key driver to US economic growth.

If President Trump were denied a second term in office, the prospect of a Democrat as president might be similarly disruptive for the markets

As a result, while the outcome of the 2020 US presidential election remains uncertain, markets may focus on the relative calm in the battle between the world's two largest economies. However, as the next President of the United States comes into focus, whether Republican or Democrat, the prospect of instability driven by dramatic shifts in American domestic policy, and potentially foreign policy as well, is a key risk for later next year.

RESPONSIBLE INVESTMENT

GROWING MOMENTUM BEHIND ESG INVESTING

Companies employing sound ESG practices are not only better equipped to face future challenges, but are in fact also financial high achievers. Also, ESG investing offers a way to adopt an investment approach tailored to each individual's values.

Sustainably invested assets continue to grow around the world, not only because of increasing investor interest in corporate responsibility regarding environmental, social, and governance (ESG) issues, but also as investors recognise that companies employing sound ESG practices are better positioned to deal with future challenges in a rapidly changing global landscape.

Indeed, with governments across most major regions increasing their regulatory focus on sustainability issues, companies lagging behind in the ESG race will find that they are not only at odds with the concerns of investors and society in general across the globe, but increasingly non-compliant with a growing set of regulations.

Though some may view this as simply an increasing burden on companies, the *Journal of Sustainable Finance and Investment* highlights that, since the 1970s, companies that score high ESG ratings are also financial high achievers[1]. As such, an individual company proactively engaging with issues such as climate change, pollution and emissions, workplace safety and labour standards, and board independence, increases not only its regulatory compliance and contribution to society but, just as importantly for investors, its ability to create long-term economic value by comparison with its peers.

Responsible investing can also be used to identify new investment opportunities at a time of accelerating global change.

Electric vehicles, sustainable farming and financial services in developing countries are just a few examples of large industries that owe their success in part to businesses' efforts to contribute more to sustainability.

ESG allows investors to customise their investment approach to align it with their personal values

For investors, the benefits go beyond the economic value generated. With the quantity and quality of sustainability data growing exponentially, investors can increasingly customise their investment approach to align it with their personal values. For example, they may seek to focus on companies that are strong on green energy or human rights, or exclude weapons manufacturers or polluters from their investment portfolios.

ESG matters are likely to be of increasing interest to investors, and will pose growing issues for them, in the years ahead. Accordingly, by choosing a sustainable approach, investors can manage those challenges while tailoring their investments to their own values.

[1]Gunnar Friede, Timo Busch & Alexander Bassen (2015), 'ESG and financial performance: aggregated evidence from more than 2000 empirical studies'

RESPONSIBLE INVESTMENT

THE GLOBALISATION OF IMPACT INVESTING

Impact investing offers a way to tap into secular growth trends while also producing a non-financial, societal "dividend". Its spread into emerging markets gives investors a broader opportunity to make an impact.

The Global Impact Investing Network estimates that there are now over half a trillion dollars' worth of assets managed under impact mandates. This number has risen sharply over the last few years, and although listed equities are a tiny proportion of that total, they are a meaningful part of the growth and reflect growing demand across asset classes for investments that deliver value in a broader sense, not just financial.

Impact investing in listed equities offers investors a way to find companies with superior growth prospects by identifying businesses focused on addressing the world's most pressing challenges. Those companies tap into secular growth trends while, at the same time, producing a non-financial, societal "dividend".

The problems addressed by the UN's Sustainable Development Goals (SDGs) are far-reaching and complex, and require a considered and holistic response. Corporate disclosure continues to be a challenge, and an absence of disclosure is still conflated with an absence of positive action. For that reason, a successful impact investing approach requires an in-depth understanding of what individual companies do for their customers and society as a whole.

Beyond this, impact investors must acknowledge the complexity involved in assessing impact, as well as the differences between high- and low-income countries. For example, in developed markets, carbon neutrality can be established as a minimum threshold for investing in a project that does not directly target climate issues. In other words, in high-income countries, multiple impact objectives can be targeted simultaneously to achieve the social 'dividend' component for investors.

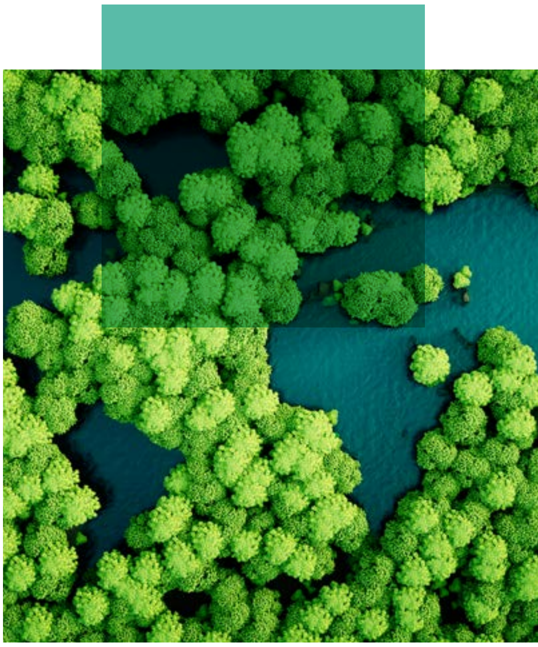
Look for the benefits of impact investing to spread into emerging markets

In contrast, when assessing impact in emerging markets, more flexibility is required. Companies aiming to reduce poverty and boost economic growth in some emerging markets (e.g. rural India, Indonesia or South Africa) may be less able to simultaneously target reduced carbon emissions, instead seeking to achieve a narrower development goal. Although this results in a lower social 'dividend' hurdle in emerging markets, the trade-off appears fair given that high-income countries represent only 16% of the world population but 46% of global CO_2 emissions.

Indeed, for investors wanting their investment portfolios to tackle global problems directly, emerging markets offer fertile ground. Compared with the rest of the world, they offer much greater potential for improvement in pursuit of many of the SDGs. Moreover, engagement with companies is a critical part of what impact investing is all about, and there are opportunities to build a constructive dialogue with companies in smaller emerging markets.

Governance standards vary and not every company will listen, of course. But impact investors have a greater chance of moving the needle in places where regulatory standards are generally lower but the appetite for change is quite often higher.

For those reasons, impact investors are expected to become increasingly active across emerging as well as developed markets in the years ahead.



MICHAËL LOK

Group CIO and Co-CEO Asset Management

Michaël Lok, who has over twenty years of experience in wealth and asset management, joined UBP in 2015 as Head of Investment Management. Previously, he was Global Head of Asset Management with Indosuez Wealth Management (Crédit Agricole Group), where he developed a range of UCITS funds for Private Banking and a set of UHNWI mandates and dedicated investment solutions with a focus on Asia and Latin America. This followed his roles as Head of Investment and Head of Risk and Quantitative Portfolio Management. Before that, he was Portfolio Manager at Banque Martin Maurel and HSBC France (ex-CCF). Michaël Lok holds two Master's degrees, one in Finance (DESS) and one in Banking and Finance (DEA), from the University of Aix-en-Provence.

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Chief Investment Officer (CIO) Wealth Management

Norman Villamin joined UBP in November 2015 as Head of Investment Services and Treasury & Trading of UBP Zurich. He was appointed Chief Investment Officer Wealth Management in 2016. With over twenty years of experience managing wealth both on an advisory and discretionary basis, Norman Villamin has been Chief Investment Officer for Coutts International, Head of Investment Analysis & Advice for Citi Private Bank in Asia-Pacific as well as the Head of Asia-Pacific Research for HSBC and the Head of Asia-Pacific Strategy for Morgan Stanley based in Hong Kong and Singapore. Norman Villamin holds a Bachelor's degree in Business Administration from the University of Michigan and a Master's in Business Administration from the University of Chicago.

PATRICE GAUTRY

Chief Economist

Patrice Gautry joined UBP in Geneva in February 2000 and heads the Bank's Economic and Thematic Research department. Prior to that, from 1991 to 1999, he worked in the Institutional Asset Management department of HSBC Group in Paris as head of economics and investment strategy. From 1988 to 1991, he was a manager of European diversified SICAV and mutual fund portfolios for the Ecofi-Finance Group. Patrice Gautry holds a Research Master's degree (Diplôme d'Etudes Approfondies) in economics from the HEC-CESA Paris and the University of Orléans, with specialisations in currency, finance and banking.

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