INVESTMENT INSIGHT January 2020

Investment Services Department

Altruist®

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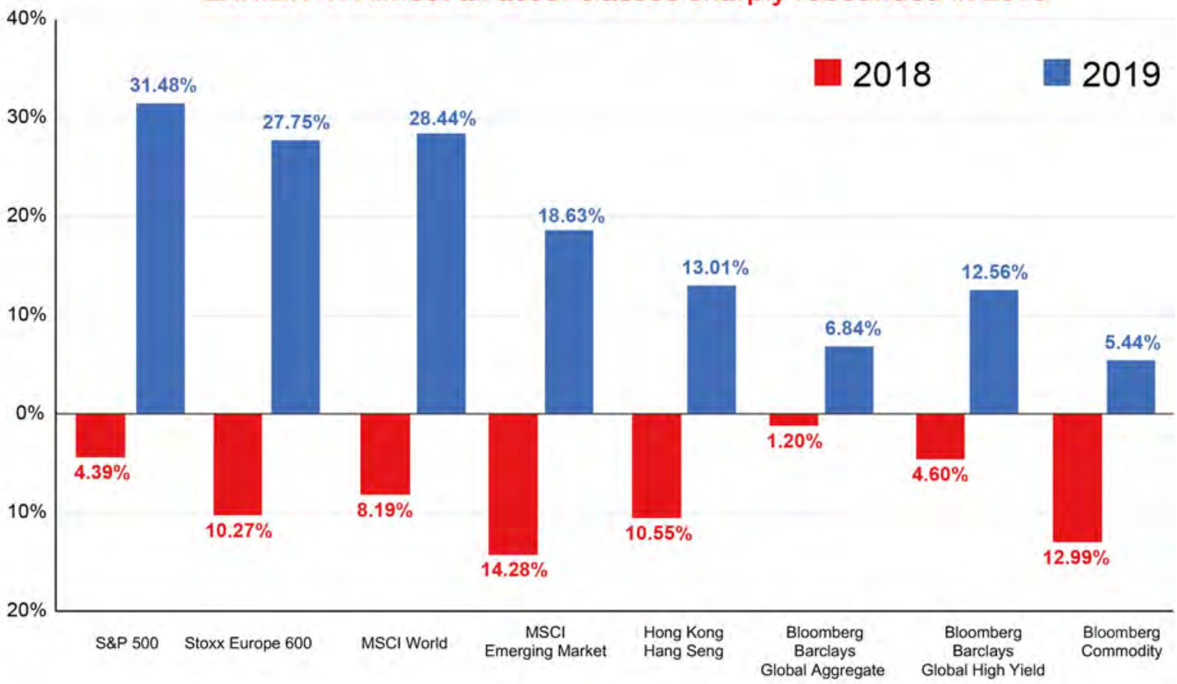
Will market rally continue in 2020?

2019 market highlights

- Amid the risk of China-U.S. trade war and "No-deal Brexit", global economy experienced a weak growth.
- To avoid further economic slowdown, central banks around the world shifted to accommodative monetary policies simultaneously.
- Almost all asset class advanced in 2019 and the U.S. and European stock markets even hit its historical high level at the year end.

To most of the investors, year 2019 was extraordinary since almost all asset classes rebounded sharply from 2018 low and delivered remarkable return. The China-U.S. trade war and Brexit were still the main sources of market uncertainties. However, as China and the U.S. reached the "Phase One" trade deal and the Conservative Party won the majority in the U.K. General Election in December, global stock markets surged further at the year end and the European and U.S. stock markets even hit new record highs simultaneously.

EXHIBIT 1: Almost all asset classes sharply rebounded in 2019



Source: Bloomberg (as at 31/12/2019)

It seems that there is a divergence between the stock market performance and economic fundamental. While those major global stock markets are at historical high levels, the global economy is in the period of "synchronized stagnation". Rising trade and geopolitical tensions have increased uncertainty about the future of the global trading system and international cooperation, taking a toll on business confidence and investment decisions. Momentum in manufacturing activity has weakened substantially, to the lowest level since the global financial crisis.

EXHIBIT 2: A divergence between the performance global stock markets and manufacturing activities

Source: Bloomberg (as at 31/12/2019)

On the other hand, the stock market performance now is highly correlated with the direction of central banks' monetary policies and liquidity injection. During 2019, the U.S. Federal Reserve cut the interest rate 3 times by 0.75%. In Europe, the European Central Bank restarted its quantitative easing program at a monthly pace of €20 billion bond purchase in November. At the same time, the People's Bank of China ("PBOC") has also cut its reserve requirement ratios ("RRR") several times since early 2018. The market was full of liquidity and stimulate different risk assets to rally last year.

2019 was a year with good harvest for investors! Looking ahead, investors are worth considering the following factors which could have significant influence on the investment markets.

China-U.S. trade war

China and the U.S. reached the "Phase 1" trade deal which has improved the overall sentiment, but it did not mean the end of the trade war. It is believed that there may be some blocks on the issues of government subsidies, intellectual property protection, etc. in the upcoming "Phase 2" negotiations.

Increasing global geopolitical risk

One of the biggest political uncertainties in 2020 is the coming U.S. presidential election in November. Historically, the volatility of U.S. stocks has typically been higher in election years, as markets frequently reprice the probability of the future administration's policies. Besides, the tension in Middle East is heightening while North Korea threatens to resume its nuclear and missile test program. All those geopolitical uncertainties may bring shocks to the global financial markets.

Stance of monetary policy of global central banks

To avoid economic slowdown, it is believed that global central banks will keep dovish stance in 2020. The loose monetary policies could bring market liquidity and boost economic activities in the near term, however, it may create a global debt problem in the long run. According to the special report published by the World Bank in 2018, global debt levels have reached an all-time high of 230% of GDP and debt growth is particularly alarming in emerging markets.

Market valuation

The recent stock market bullish momentum is mainly driven by market liquidity and without the concrete support of economic condition. After the rally, the valuation of several global major equity markets has been above the historical average and at recent years high. If any risk factors worsen, the possibility of market correction may increase.

TABLE 1: The P/E ratio of global major equity benchmark indexes

Index	Year end of 2018	Year end of 2019	10-year monthly average
MSCI World	15.66	20.61	17.91
MSCI Emerging Markets	11.72	15.43	13.40

Source: Bloomberg (as at 31/12/2019)

5G era

We are now entering the new decade of the 21st century and also the 5G era. The new 5G mobile communications will be significantly faster than the previous generation and it can carry more data and be more reliable. It is believed the 5G will bring changes to our livings in the coming 10 years and the road to 5G may also create many new investment opportunities as well.

Unlike last year, 2020 will not be another easy year for investors. Global economic growth will still be sluggish and most of the good news may have been digested by the market. While uncertainties remain and are increasing, it is expected that investment market volatility is likely to heighten. We believe that investors need to prepare for the challenge ahead by focusing on risk management and asset allocation with true diversification.

TABLE 2: Global Stock Markets Performance

	2019 Q4 Return		2019 Return	
Indexes	Local Currency	USD	Local Currency	USD
S&P 500	9.06%	9.06%	31.48%	31.47%
Nasdaq Composite	12.49%	12.49%	36.74%	36.74%
Euro STOXX 600	6.17%	9.35%	27.75%	25.26%
DAX	6.61%	9.62%	25.48%	22.95%
CAC 40	5.46%	8.61%	30.45%	27.91%
Nikkei 225	8.88%	8.14%	20.69%	22.37%
Hong Kong Hang Seng	8.35%	9.05%	13.01%	13.64%
Hang Seng China Enterprises	9.51%	10.21%	14.50%	15.13%
Shanghai Stock Exchange Composite	5.01%	7.80%	25.30%	23.76%
Shanghai Shenzhen CSI 300	7.43%	10.28%	39.19%	37.48%
Singapore Straits Times	3.88%	6.84%	9.38%	10.88%
Korea KOSPI	6.55%	10.41%	8.38%	4.46%
Taiwan TWSE	11.01%	15.24%	28.79%	31.50%
India SENSEX	6.81%	5.98%	15.66%	13.17%
Indonesia JCI	2.33%	4.26%	4.17%	8.71%
Thailand SET	-3.04%	-0.99%	4.26%	13.26%
Russia RTS	18.11%	18.11%	56.46%	56.46%
Brazil IBOV	10.41%	14.48%	31.58%	26.91%
S&P Pan Arab Composite	4.50%	4.50%	12.42%	12.42%
MSCI World	8.68%	8.68%	28.44%	28.44%

Source: Bloomberg (as at 31/12/2019)

TABLE 3: Major Currencies Performance (In terms of USD)

	Change in 2019 Q4	Change in 2019
Currencies	In terms of USD	
Euro	2.88%	-2.22%
British Pound	7.88%	3.94%
Japanese Yen	-0.49%	0.99%
Hong Kong Dollar	0.61%	0.52%
Chinese Renminbi (CNY)	2.66%	-1.22%
Australian Dollar	4.01%	-0.40%
New Zealand Dollar	7.62%	0.31%
Singapore Dollar	2.67%	1.26%
South Korean Won	3.46%	-3.49%
Taiwanese Dollar	3.31%	2.25%
Indian Rupee	-0.72%	-2.25%
Indonesian Rupiah	2.37%	3.78%
Thai Baht	2.06%	8.61%
Russian Ruble	4.63%	12.46%
Brazilian Real	3.12%	-3.87%

Source: Bloomberg (as at 31/12/2019)

Review highlights and outlook around the globe

United States

- The US economy grew by an annualized 2.1% in the third quarter, which was unchanged from the previous estimate but better than the 2% expansion in the previous quarter. Personal consumption expenditures made the biggest contribution to growth and it increased an annualized 3.2% but less than the 4.6% growth in the last quarter. While some moderations are expected in the coming quarters, income growth remains relatively solid and should continue to fuel the outlays that make up the biggest part of the economy.
- The U.S. job market remained robust in 2019. According to the data from the Labor Department, nonfarm payrolls increased by 266,000 in November which was the largest advance since January 2019 and marked the 110th consecutive month of job gain. The unemployment rate was at 3.5%, 50-year low. Besides, average hourly wage rose mildly by 3.1% year-on-year.
- With healthy job market, steady wage growth and low interest rate environment, the U.S. housing market was generally on upward trend in 2019. The November new home sales increased 19.4% on annual basis to a seasonally-adjusted annual rate of 719,000 and this was the 4th consecutive month that sales topped 700,000. On the other hand, as there was a shortage in supply, the existing home sale only rose 2.7% from a year ago to a seasonally-adjusted annual rate of 5.35 million in November.

EXHIBIT 3: Rising trend of U.S. home sales in recent years

Source: Bloomberg (as at 31/12/2019)

- The trade war between China and the U.S. enters to the third year in 2020, the U.S. economy is still in the good shape but signs of downshifting are becoming more evident. The average annual growth of industrial production dropped to 1% in 2019 which was lower than 4% in 2018 and 2.3% in 2017. The ISM Manufacturing PMI even fell into the contraction territory in recent months while the service sector was also slowing down. The ISM non-manufacturing PMI averaged 55.5 in 2019 while the figure in 2018 and 2017 were 58.9 and 56.9 respectively. In addition, exports to China slumped 32.5% in the first 10 months of 2019 and total exports went down 17% while imports from China shrank 29% and total imports declined 17% as well.

EXHIBIT 4: Both manufacturing and non-manufacturing activities in the U.S. slowed down

Source: Bloomberg (as at 31/12/2019)

- The U.S. stocks delivered the best return since 2013 last year, the S&P 500 and Nasdaq Composite gained 31.47% and 36.74% respectively. Although the risk of recession is still not big in the near term, the economic activities in the U.S. have already slowed down and many companies have been revising their earnings forecast to a lower level at the same time. We believe that there are a lot of market-leading companies in the U.S. and still have confidence on the long-term investment outlook of U.S. equity, however, we are doubtful whether the current earnings growth can support the market valuation. Moreover, 2020 is the U.S. presidential election year and stock market volatility is typically higher. For the above reasons, we would prefer to take a "wait and see" view on U.S. stocks right now.

Europe

- The Euro zone economy grew at a modest pace at 0.2% in the 3rd quarter of 2019. Consumer spending was the main source of growth in the quarter, while net trade acted as a slight drag. Among the bloc's largest economies, Germany narrowly avoided a recession in the third quarter, but the economy has essentially stagnated.
- It is expected the Euro zone will have sluggish economic growth in the coming quarters. Having reached a three-month high in November, the IHS Markit Eurozone Manufacturing PMI in December dropped from 46.9 to 46.3 and it was the 11th consecutive month that the Manufacturing PMI fell below the crucial 50 no-change mark. Germany was again the weakest-performing country, whilst the deteriorations found in Italy and the Netherlands were the sharpest in over six-and-a-half years. Conversely, growth was sustained to a solid degree in Greece, whilst a marginal gain was seen in France.
- The inflationary pressure remained weak in Eurozone although the consumer price rose to 1.3% in December, the highest level since June 2019. It was still far below the European Central Bank's 2% inflation target.

EXHIBIT 5: The inflationary pressure remained weak in Eurozone

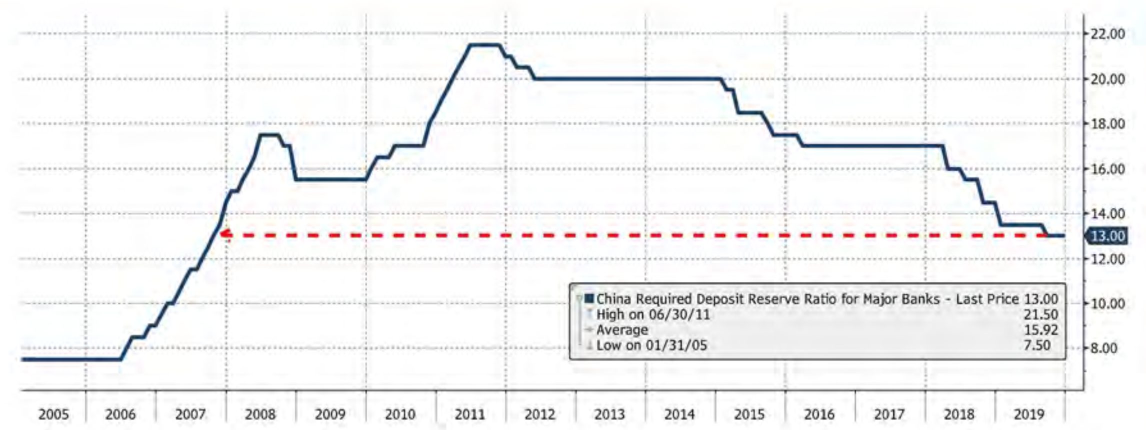
Source: Bloomberg (as at 31/12/2019)

- In UK, the Conservative Party not only obtained the majority seats in the December General Election, it was also the Party's biggest victory since 1987. The election result helped to reduce the uncertainty of Brexit on 31st January 2020 and the British Pound soared 7.8% against the USD in the last quarter.
- European stocks rallied in 2019 and the Europe Stoxx 600 even hit all-time high in the year end. Even though the ECB has restarted the quantitative easing program, the slow economic growth, low inflation and government bond yield environments are hard to change, and we tend to be cautious towards the long-term investment outlook of the region.

Asia

- The Chinese economy has been slowing down since the first round of tariffs was imposed by the U.S. in February 2018. The GDP grew by 6% year-on-year in third quarter of 2019 which was the least since the first quarter of 1992. Exports to the US, the biggest sales market, fell 28% in the first 10 months of 2019. Manufacturing production has been slowing. The yuan also weakened near 11% against U.S. dollar during the period.
- To boost growth and reduce borrow cost, the PBOC lowered its RRR by 50 basis points, effective on 6th January 2020. The RRR for big banks will then be cut to 12.5% from 13% and it was the lowest level since 2007 and the move would release about 800 billion yuan into the economy by freeing up banks to lend more money.

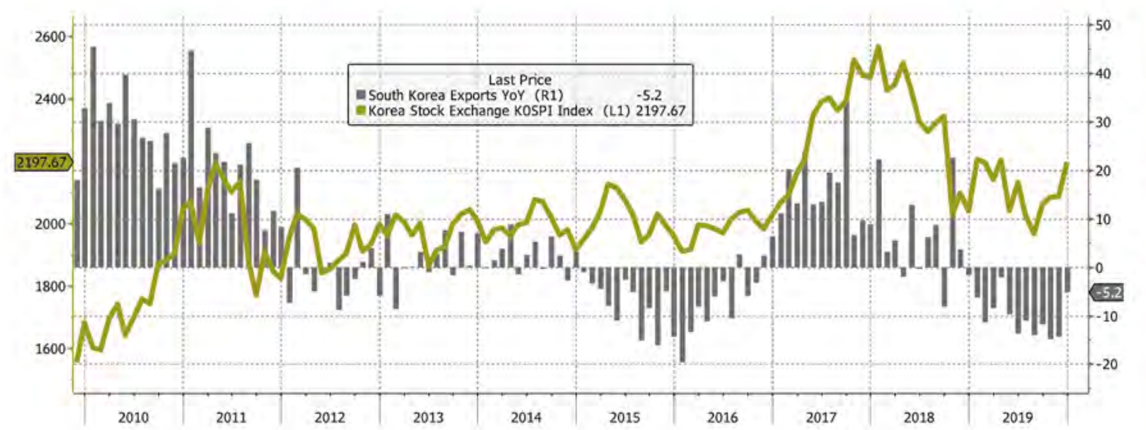
EXHIBIT 6: The Chinese Required Deposit Reserve Ratio for major banks was the lowest since 2007



Source: Bloomberg (as at 31/12/2019)

- The South Korean economy currently is also experiencing the slowest growth in 10 years. The trade war between China and the U.S. and the sluggish semiconductor market have severely affected the country's exports. In addition, the trade conflict between South Korea and Japan have also been heightened since July. Japan even restricted the exports of vital raw material of semiconductors and digital flat screens to South Korea and hit the production of the country's electronic products. According to the latest data, South Korea 's exports fell 5.2% in December from a year earlier, and it has been the 13th consecutive month of negative growth. Not surprisingly, the Ministry of Planning and Finance cut the country's 2019 economic growth forecast to 2% from the previous 2.4% to 2.5%; and the 2020 economic growth forecast was also lowered to 2.4% from the forecast of 2.6% in July this year.

EXHIBIT 7: South Korean exports declined for the 13th consecutive month



Source: Bloomberg (as at 31/12/2019)

- Japan raised the sales tax from 8% to 10% on 1st October and the negative impact of the tax hike was prompt. The retail sales plummeted 7.1% and 2.1% year-on-year in October and November respectively. At the same time, the Jibun Bank Japan Manufacturing Purchasing Managers' Index fell to 48.4 in December, indicating the 8th consecutive deterioration in business conditions across the Japanese manufacturing sector. To support the fragile economy and avoid the risk of further slowdown after next summer's Tokyo Olympics, Prime Minister Shinzo Abe has announced to launch a ¥13.2 trillion fiscal stimulus package in early December to repair recent typhoon damage, upgrade infrastructure and invest in new technologies.

- While the U.S. and the European stock markets achieved impressive return in 2019, there was a huge difference in the stock market performance among different countries in Asia. In China, the CSI 300 Index rose more than 30% in 2019 as the MSCI decided to increase the weight of mainland Chinese A-shares in its benchmark index. The Indian stock market was also stimulated by the government's tax reform announced in mid-September, the Sensex Index hit record highs again and again. On the other hand, those exports-dependent countries in the Asian region suffered and their stock markets performed poorly. Looking ahead in 2020, it is expected that the trade relation between the U.S. and China will have certain improvement. Besides, entering the 5G era, global demand on new telecommunication related products is expected to rise. Regions like South Korea, Taiwan and Singapore, etc. that are strong on the production of those products may be benefited and exports may recover from the bottom. In that case, their stock markets may bring investors a pleasant surprise in 2020.

Fixed Income

- To avoid further economic slowdown, most of the major central banks in the world loosened their monetary policies in 2019. In U.S., the Federal Reserve cut the Federal Funds Rate 3 times by 0.75% while the European Central Bank even restarted quantitative easing and set to buy €20 billion worth of bonds since in 1st November. In China, the PBOC also lowered banks' RRR for 2 times from 14.5% to 13%. The yield of most government and corporate bonds continued to fall and the amount of negative-yield bonds in the world even rose to more than $17 trillion USD in the summer of 2019. Besides, the yield between the 2-year and 10-year U.S. treasury has also inverted in late August as well.

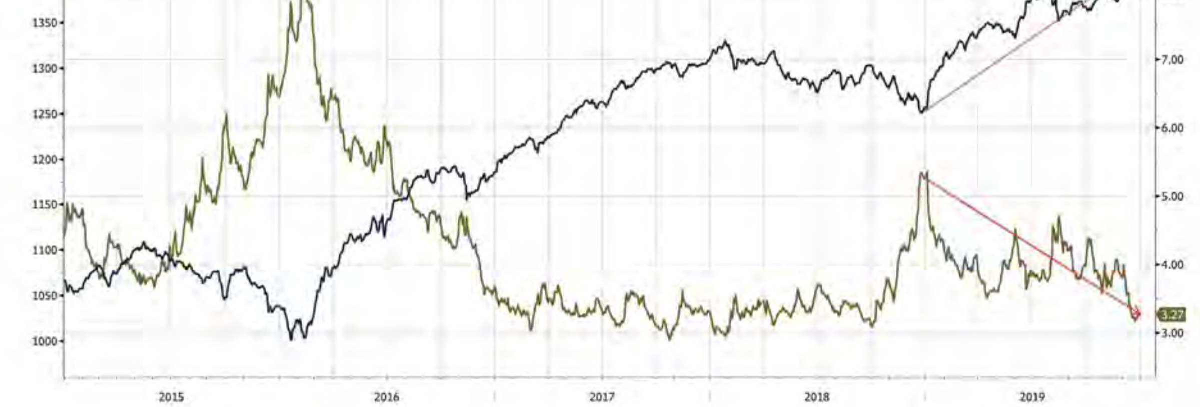
TABLE 4: Changes of U.S., Germany and Japan 10-year government bond yield in 2019

	Year end of 2018	Lowest in 2019	Year end of 2019
U.S.	2.684%	1.457% (3/9/2019)	1.917%
Germany	0.235%	-0.718% (28/8/2019)	-0.190%
Japan	-0.012%	-0.297% (29/8/2019)	-0.030%

Source: Bloomberg (as at 31/12/2019)

- However, as the Fed Reserve indicated that there were no plans to cut rate in 2020 and considering that the current stance of monetary policy was appropriate to support economic growth during its meeting in December, the short-dated treasury yield fell while the long-dated rose. As a result, the U.S. yield curve steepened and returned to its "normal" shape from inversion.
- As the central banks around the world re-entered easing mode in 2019, both investment grade and non-investment grade fixed income investment rallied. Since the hunt for high yield continued in such low-yield environment, the yield spread between the U.S. high yield bond and U.S. treasury narrowed significantly from 5.27% to 3.27% in 2019 and the Blomberg Barclays Global High Yield Index even rose more than 12%.
- In 2020, it is expected the global low interest rate environment may continue, However, since the yield spread between the U.S. treasury and high yield bond has already dropped near the lowest level in recent years, investor should be mindful that the downside risk of high yield fixed income may be higher right now. It is believed that holding a more diverse and high credit quality fixed income portfolio seems to be a more appropriate stance.

EXHIBIT 8: As the yield spread between the U.S. treasury and high yield bond narrowed, high yield bond rose significantly in 2019

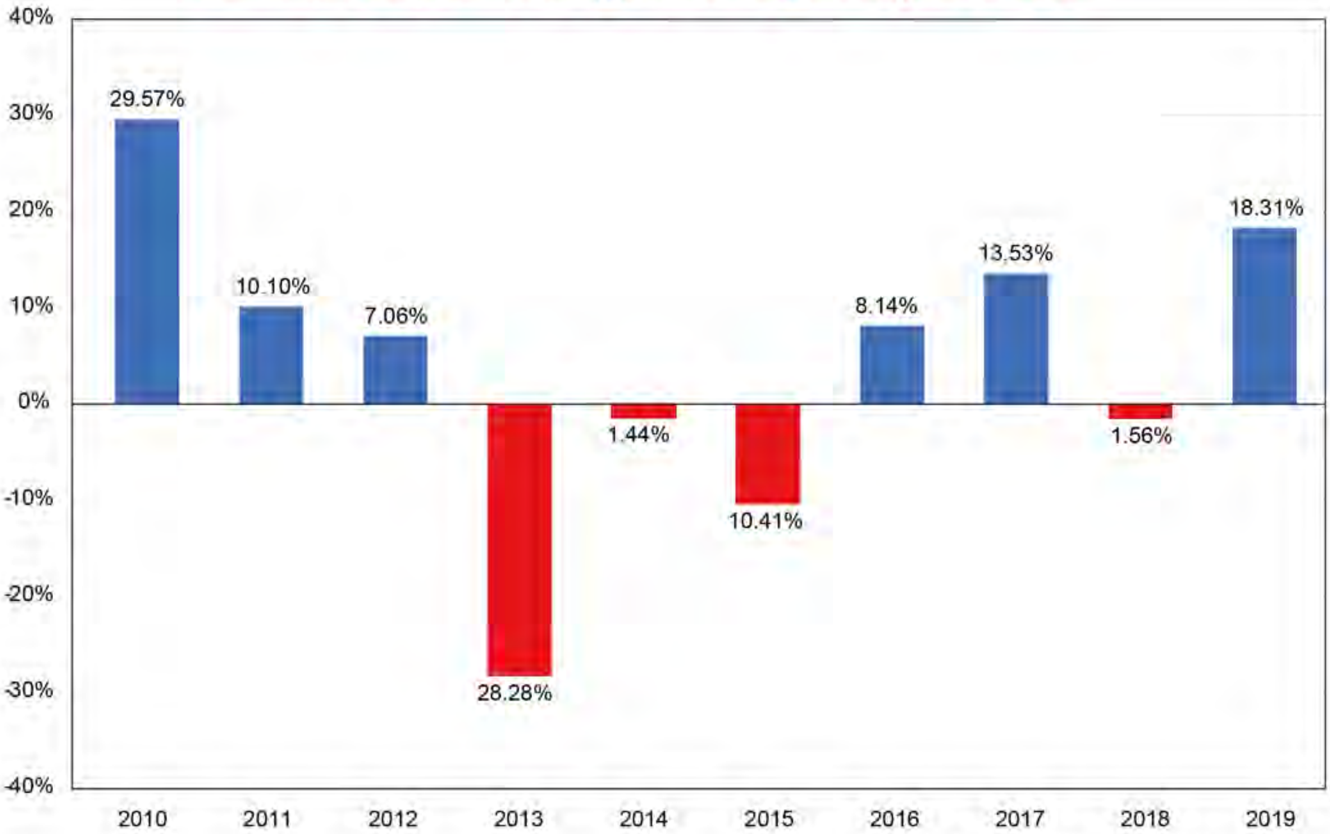


Source: Bloomberg (as at 31/12/2019)

Commodities

- In order to boost the oil price, the OPEC and its allies agreed to cut oil production by an additional 500,000 barrels per day from January 1, bringing total output reductions to 1.7 million barrels daily during the meeting held in Vienna, Austria on 6th December.
- Oil price rallied over 10% in the last quarter of 2019. It is unclear whether energy prices will continue to rise. Even as the members of the cartel cut production, there is more oil coming to market from non-OPEC nations. US oil production has more than doubled over the past decade, driven by the boom in shale production. The United States was a net oil exporter for the first time in decades in September.
- Gold is always viewed as a kind of "safe haven" asset; investor would like to hold more gold when they tend to have lower risk appetites. Worries of global economic slowdown, escalating trade war between China and U.S. have stimulated the gold price to rally in 2019 and posted the biggest annual gain since 2010. Gold also offers no yield or interest. Under the current low interest rate and low bond yield environment, the opportunity cost of holding gold is largely reduced.

EXHIBIT 9: Gold posted the biggest annual gain in 9 years in 2019



Source: Bloomberg (as at 31/12/2019)

- Looking ahead in 2020, it is believed that geopolitical and economic risks are likely to feature just as they did in 2019 and the central banks across the world will maintain their loose monetary policies. For the above reasons, it is expected that the bullish momentum of gold will continue.