



# Investment Outlook 2019

## Personal Financial Services



**UOB Investment Outlook 2019**

The theme for UOB's 2019 Start of Year Outlook revolves around "Uncovering Investment Gems". The search for gemstones involves a rigorous process that first requires an understanding of their properties and the identification of known areas where gem deposits can be found.

In the same way, identifying and harnessing investment opportunities takes an appreciation of the macro environment and the application of a discerning investment strategy.

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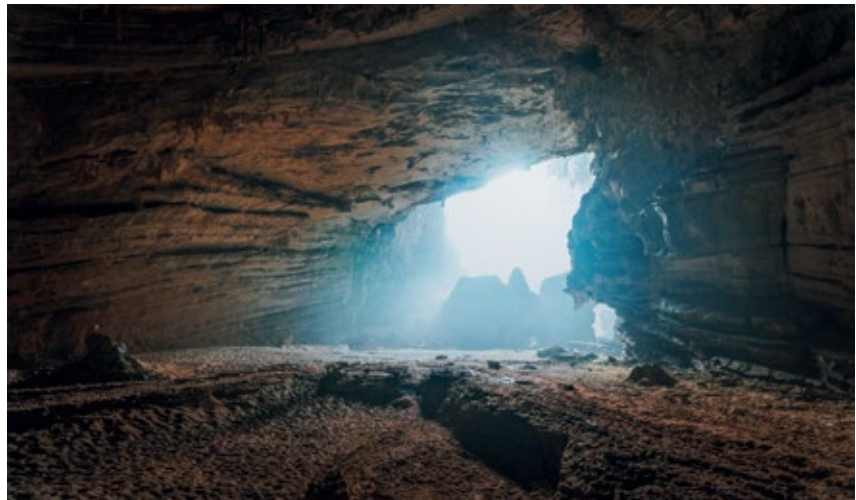
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Looking back, the financial markets had a buoyant 2017. This set a much more optimistic tone for 2018. When we started 2018, we held a more deliberative view given the lack of clarity in various macro concerns including the US-China trade situation back then, which was an overhang on sustained economic growth. Hence we embarked on a journey that was premised on managing investment risks of the investment opportunities we were convicted on. Taking the cue from nature, all elements are needed but in balanced proportions.

### **Review of 2018**

The key risks mapped out in our 2018 investment outlook materialised and injected uncertainties, raised volatility and gave many a bad case of the jitters. The tit-for-tat tariffs between the US and China raised concerns over rising prices and falling demand, fuelling fears of a global economic slowdown. This concern was exacerbated by the still pro-tightening of interest rates in the US on the back of strong economic data, including low unemployment.

Brexit continued to be stuck in political limbo with no clear deal in view. The mid-year sell-off in Emerging Market equities that was triggered by Turkey further dented investors' sentiments.

These risk events, together with weak investor sentiments, sent the performance of equity and fixed income assets south. Global equities fell by 8.19%\* with the Asia ex-Japan region – the worst performer – down by 14.33%\*; global bonds were not spared and also lost 1.20%\* as interest rates rose. Commodities such as Oil and Copper also came under pressure due to a strong USD and trade disputes that could potentially reduce demand from Chinese factories.

Declining sentiments over the end of cheap money and geopolitical tensions outweighed some of the bright spots in both economic data and corporate earnings expectations. Investors in Global Utilities and Global Healthcare equities saw positive returns of 3.12%\* and 2.22%\* respectively.

### **Exploring the investment landscape in 2019**

The equities bull cycle has run past 10 years, supported by global economic growth. The growth cycle is maturing and we are now in the late-cycle phase as evidenced by moderating growth, a tightening job market, rising inflation and higher interest rates. At this stage of the growth cycle, the inevitable

\* As at 31 December 2018.

question to ask is if there are increased signs of a possible recession. When we look across the investment landscape, we see continued strength in US consumer confidence which is still at its highest points over the last five years. US core inflation remains moderate at below 2%, US unemployment rate is robust at 3.7% – its lowest rate in the past 20 years – and the spread between the two-year and 10-year US Treasury yields is still positive. The global economy remains healthy: Global growth is still projected at 3.7% in 2019 with the US economy forecast to continue growing by 2.0% this year. The 10-year US Treasury yield is likely to hit 3.25% by year-end, with two more rate hikes expected this year. With moderated inflation expectations and healthy economic growth, the probability of recession remains low.

To add to the positives, corporate fundamentals remain sound with earnings projected to grow by a healthy 7.2%. The beaten-down markets also mean valuations of major asset classes are now less demanding.

### **Uncovering investment Gems**

2019 remains a year of being discerning when it comes to investing: Distinguish between market noises and investment fundamentals.

Focus on Quality and Value, which are even more important in late-cycle investing. Put money in good quality global companies that have demonstrated high return on equity, strong earnings growth and low financial leverage. These quality companies tend to ride out better in times of increased market volatility. In fixed income, with the spread widening in 2018, it is a good time to pick up quality names in the investment-grade space. These strategies offer sustainable cash flow or income. After being sold down in 2018, emerging market equities are attractive from a Value perspective. Improving corporate earnings and rising middle-class consumption are expected to be the key structural drivers of emerging economies, particularly China. Such structural improvements are expected to translate into longer-term earnings growth for the companies.

Over the last few years, we have witnessed fast changing demographics and consumer behaviour, driven by fast-ageing populations and technological innovations. Such shifts have given rise to new structural investment opportunities. We should also look out for such megatrends and participate in the evolution. Key areas will be Healthcare and innovation-driven companies that are the transformative forces in shaping the world's future.

### **Manage risk first in 2019**

While the landscape in 2019 offers selective investment opportunities, we must maintain our relentless focus on ensuring investment risks are managed so that we can enjoy successful financial planning. Remember to keep an eye on core financial goals such as preparing for retirement and our children's education. Achieving these goals requires time and planning. It is important to consistently allocate monies to such goals so that we can ensure that safeguarding our assets and building sustainable income are not neglected.

Looking forward to another exciting year and I would like to take this opportunity to wish you success in your investing journey!

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

# Macro Outlook







The macro environment forms the backdrop for our investment approach. To formulate our investment strategies, we have to develop a firm understanding of the driving forces shaping the investment landscape.



Treasured for their beauty, gemstones form when minerals crystallise deep beneath the earth's crust. They slowly take shape under high pressure and temperature. Diamonds crystallise under more extreme conditions, at intense temperatures deep in the earth's mantle before being pushed to the surface by violent volcanic eruptions.

2018 was a challenging year for major asset classes. We review the calls made in 2018, including the performances and drivers.

Investors experienced a rough ride in 2018 with major asset classes delivering a lacklustre performance. Global equities lost 1.2%\* while global bonds slipped 3.2%\*. We review how our calls have performed over the year.

Figure 01

## Calls Tracking

Source: Bloomberg returns expressed in local currency terms, 1 December 2018

Open Calls	Start	End	Total Return (%)
Global Healthcare	Dec 2016	Ongoing	33.6
Global Quality	Dec 2016	Ongoing	28.3
US Banks	Dec 2016	Ongoing	20.1
EM Equities	Dec 2017	Ongoing	-12.0
China A	Sep 2018	Ongoing	-7.7

Closed Calls	Start	End	Total Return (%)
Short Duration High-Yield	Dec 2016	Nov 2018	9.8
European Equities	Mar 2017	Oct 2018	5.2
Japanese Equities	Dec 2017	Nov 2018	-3.0
EMD LCY	Dec 2017	Oct 2018	-7.1

## Open calls

Our calls on global healthcare and global quality stocks outperformed, but calls on US banking stocks and EM equities underperformed.

Global healthcare was our top performing call, gaining 11.5%\* due to structural demand for innovative healthcare products. Since December 2016, global healthcare has delivered a 33.6% return and outperformed the broader MSCI World Index by 13.5%.

Global quality stocks gained 1.9%\* but still outperformed global equities which fell 1.2%\*. Driven by earnings growth, they are better able to weather rising interest rates. US banking stocks lost 2%\* on concerns of earnings peaking but we expect robust loan growth and higher interest margins to fuel earnings.

Emerging market (EM) equities fell 12%\* on lower multiples, trade war concerns and domestic risks, but the earnings outlook remains steady. Risks have been priced in after the valuations declined 20%.

We initiated a call on China A-shares in September 2018, given positive momentum indicators, cheap valuations and strong projected domestic growth. Although they have since fallen 7.7%, they underperformed the MSCI World Index by only 1.5%. We view China as a longer-term structural opportunity.

## Closed calls

We closed our calls on EM local currency bonds, US short duration high-yield bonds, as well as European and Japanese equities.

We closed our call on EM local currency bonds in July. We expect the US dollar to continue strengthening against EM currencies and this will reduce returns on EM local currency bonds.

Although a spike in yields in Q1 2018 affected the performance of US short duration high-yield bonds, the high coupon rate contributed positively to the return. Spreads tightened further in 2018 due to lower default rates as a result of the strong US economy. We closed our call in October 2018 as we expect limited upside heading into 2019 due to overly tight spreads.

European equities fell 5.1%\* in 2018 as growth momentum moderated. Fears of spiralling Italian debt, lingering uncertainty over Brexit and the upcoming leadership change in Germany have dimmed the outlook for European equities. From the start of our call in March 2017 to the close of our call in October 2018, European equities delivered a 5.2% return.

Japanese stocks lost 3% on concerns over the global economic outlook. We exited our call on Japanese equities in October 2018, as we believe that a planned consumption tax hike in October 2019 could negatively impact the domestic economy.

\* Denotes year-to-date figures as at 1 December 2018

# Road Map of 2019

## Summary

The global economy has demonstrated signs of moving into a late-cycle phase, which is usually marked by more volatile market conditions. Increasing protectionism in the US and political uncertainty in Europe could continue to drive volatility. Investors need to be diversified and more selective.

→ Add to

→ Detract from



### Fiscal Stimulus

The fiscal policy stance in the US is expected to turn neutral as a result of the divided Congress. The Chinese government is likely to introduce more fiscal stimulus.



### US Protectionism

Under the Trump administration, the US has adopted an increasingly protectionist stance.



### European Politics

Rising political uncertainty in Europe such as no-deal Brexit could lead to greater volatility in equity prices.

# Five Key Indicators of the Late Cycle in 2019

## 01 Moderating Growth

Global economic growth momentum has moderated amid heightened trade tensions, political uncertainty and rising interest rates.



## 02 Rising Inflation

Inflation is expected to rise modestly due to wage pressures and higher cost because of tariffs.



## 03 Tightening Central Banks

Global central banks are expected to be more data-centric and to gradually normalise monetary policies.



## 04 Higher Volatility

Financial markets tend to experience more swings during the late-cycle stage.



## 05 Diverging Performance

Divergences in the performances of the winners and losers can be expected in different asset classes, regions, and sectors.



## Themes for 2019



### Focus on Quality

Quality companies have stable earnings growth and strong balance sheets, and are better positioned in late-cycle investing.



### Look for Value

Opportunities have emerged due to overly pessimistic sentiments.



### Tap into Structural Ideas

Ideas based on megatrends are long-term plays that can yield benefits over a multi-year cycle.

The global economy has shown signs of moving into the late-cycle phase, but a recession is unlikely in 2019.

In 2018, macroeconomic uncertainty due to monetary policy tightening and trade war fears led to a bumpy ride in financial markets. Investors will need to navigate a more eventful year in 2019, as the late-cycle stage is usually the most volatile phase of the bull market.

## The global economy is approaching the late-cycle stage

After a decade-long expansion, the global economy has shown increasing signs of entering the late-cycle phase, where growth usually peaks and inflation accelerates.

Since 2018, the global economy has seen higher inflation, rising interest rates, a flattening yield curve, and moderating growth. Despite concerns that a potential slowdown could lead to more volatile asset prices, we see low probability of a recession in 2019. It is important to focus on fundamentals as selected opportunities are still available.

### Moderating growth

The global economy grew at an estimated pace of 3.7% in 2018, on par with GDP growth of 3.7% in 2017.

In developed markets (DMs), tax cuts fuelled US economic growth despite higher interest rates. However, Europe experienced slower growth as exports eased. Investor sentiment was also affected by Brexit fears and political uncertainty in certain countries. In particular, political turmoil in Italy led to widening yield spreads, triggering fears that increasing debt and rising default risk could hurt the Italian economy. Japan's growth also softened, hit by natural disasters and concerns over the US-China trade war.

Meanwhile, emerging markets (EMs) put in a mixed performance. Although China faced trade war fears, it has shifted to a more sustainable, consumption-based economic model. A recovery in domestic demand supported India's economy while higher oil prices propped up oil-exporting economies in the Middle East. Latin American markets experienced more tepid growth due to tighter financial conditions.

DMs and EMs will see uneven growth in 2019. DM growth will moderate given monetary policy normalisation while growth in EM markets should remain stable.

Heading into 2019, we expect global economic momentum to moderate due to softer trade flows, slowing manufacturing activity, a global electronic cycle downturn, and continued trade tensions between the US and China.

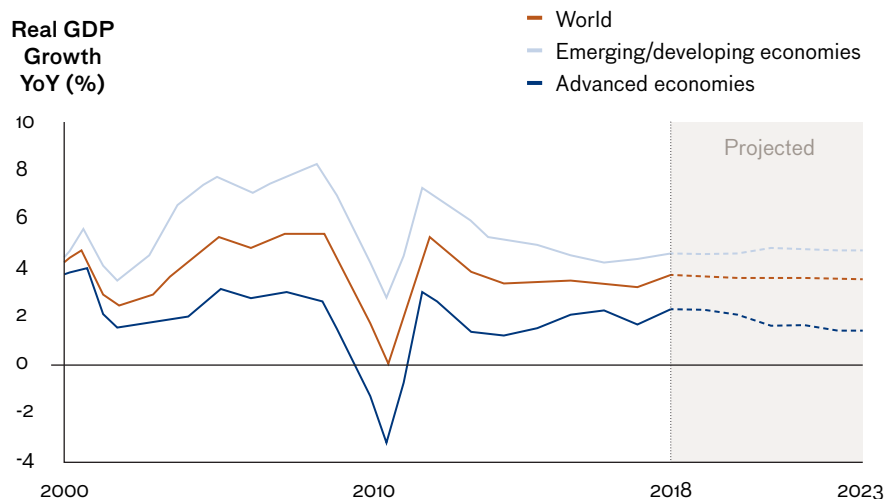
Still, the global GDP growth of 3.7% forecast by the International Monetary Fund (IMF) for 2019 is on par with 2018 figures and higher than the historical GDP growth average of 3.5% during the 2012-2016 period.

EM growth is expected to outpace DM growth in 2019. The IMF projects DMs to grow 2.1% in 2019 versus an expected 2.4% in 2018 while EM growth should remain stable at 4.7% for both years. DM growth momentum is expected to soften due to the effects of monetary policy normalisation and the fading impact from US fiscal stimulus, while EM growth should remain resilient given strengthening consumption.

Figure 02

### Global growth is expected to hold steady, led by EM

Source: IMF, World Economic Outlook, October 2018



Inflation is expected to rise modestly in 2019, particularly in the US, due to wage pressures and higher costs because of tariffs.

### Rising inflation

Since 2018, inflationary pressures have been gradually building amid solid growth and historically low unemployment. The labour market tightened in 2018, especially in the US, while the UK and Japan also witnessed lower unemployment levels. In October 2018, the US jobless rate fell to 3.7%, its lowest level since December 1969. Blistering growth in the healthcare, education, professional and business services, manufacturing and construction industries led to record job creation numbers, with the US economy posting job gains for eight straight years. The strong jobs market fuelled an increase in wages with average US hourly earnings growing 3.1% year-on-year in October 2018, its fastest pace of growth since 2009.

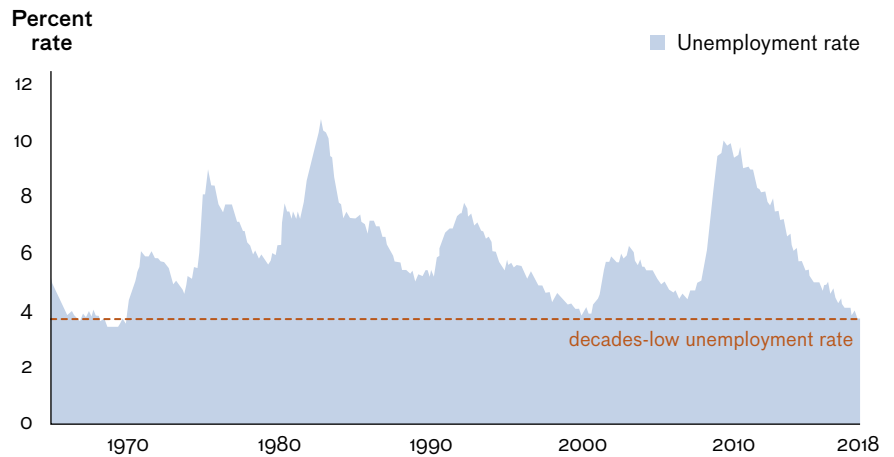
In 2019, the job market is likely to tighten further in DMs such as the US, Japan, the UK and parts of Europe. Low unemployment rates have raised fears that the labour shortage could drive up wages and stoke inflationary pressures.

In addition, rising costs as a result of the Trump administration's tariffs on imports from China could increase prices for manufacturers and consumers.

Figure 03

### US unemployment rate has reached decades low

Source: Bloomberg, 31 October 2018



Central banks are expected to become more data-dependent and hike rates gradually.

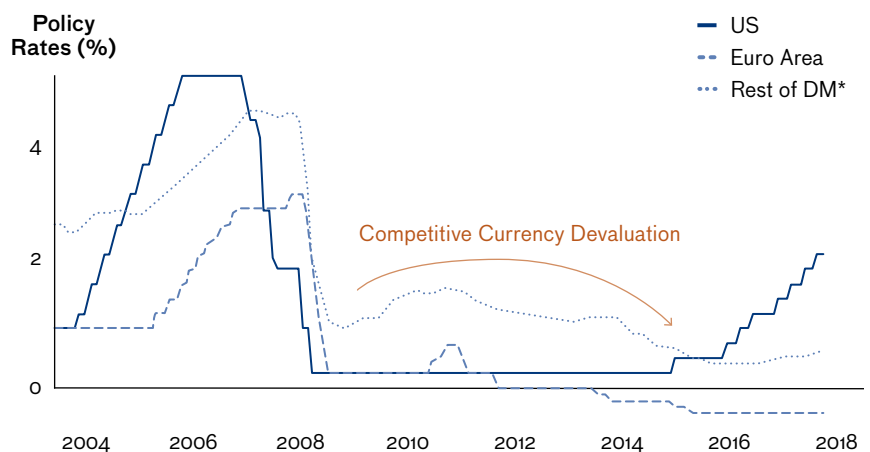
### Tightening central banks

With global growth moderating and inflation firming, global central banks are expected to be more data-centric and to gradually normalise monetary policies. The US Federal Reserve (Fed) has hiked rates four times in 2018 and is expected to raise rates another two times in 2019. However, should incoming economic data disappoint or trade tensions re-escalate, the Fed could turn more cautious and possibly hike less. Other DM central banks are likely to increase rates, with the European Central Bank (ECB) expected to do so in Q4 2019. The Bank of Japan is still the least likely to normalise its easy monetary policy in the near term, given slower growth momentum and low inflationary pressures.

Figure 04

### Global central banks followed the Fed and ECB to normalise policies

Source: MRB Partners, October 2018





## The late cycle is not indicative of a recession... yet

A recession is not yet imminent as corporate earnings remain healthy, leverage remains manageable and the spread between the two-year and 10-year is still positive.

Although the global economy is moving to the late-cycle stage, the risk of a recession happening over the next 12 months is low. Despite medium-term risks, indicators such as leverage, the spread between the two-year and 10-year Treasury yield and corporate earnings do not point to an imminent global recession.

### Leverage is still manageable

High leverage is usually seen as a catalyst for recession and rising US corporate and consumer borrowings have raised fears that the roots of an economic downturn are already in place.

While the US economy may have pockets of vulnerabilities, it is still less interest-rate sensitive than a decade ago. US corporates are now in a better position to service debt as earnings have more than doubled since the previous low in September 2009. Households and banks have also largely restored their balance sheets. The US household debt-to-GDP ratio has fallen from almost 100% during the Global Financial Crisis in 2008 to 77% in 2018, its lowest level since June 2002.

### Spread between the two-year and 10-year Treasury yield still positive

For the first time since the last financial crisis in 2008, the two-year and three-year Treasury yields surpassed their five-year counterpart in early December 2018. However, the more closely watched indicator – the spread between the two-year and 10-year Treasury yield – remains positive.

Historically, recessions happened after the spread between the two-year and 10-year Treasury yield dipped below zero. It is however important to keep in mind that a yield curve inversion does not imply that economic slowdown is imminent. For the last five economic recessions, the downturn happened only 11 to 23 months after the spread between the two-year and 10-year Treasury yield became negative.

Traditionally, equity markets tend to register strong gains during this period. Since the late 1970s, the MSCI World Index took an average of 14 months to reach its peak after the yield curve inversion and achieved an average return of 21%.

### Corporate earnings remain healthy

Global corporate earnings grew at a strong pace of 19.2% in 2018. In 2019, strong personal consumption supported by a healthy jobs market should continue to drive the positive trend in corporate profits. Global earnings growth is expected to rise around 8% in both 2019 and 2020.

## Key Risks in 2019

Increasing US protectionism, higher inflationary pressures and political uncertainty in Europe are the key risks in 2019.

### US protectionism on the rise

Increasing protectionism by the US continues to pressure China's exports even as China rebalances its economy to cushion itself from the trade war. We believe that a worst-case scenario would be the imposition of tariffs on a wider swathe of China goods.

Continued trade woes will hit Asian economies that are plugged into global value chains such as South Korea and Taiwan. Higher import prices in economies that levy tariffs or impose quotas could raise costs and lower profit margins.

### Central bank policy missteps

Inflation continues to rise amid a tight labour market. Wage pressures have shifted from a deflationary to inflationary scenario as employers raise wages to attract employees. The heightened risk of inflation overshoot could prompt central banks to tighten monetary policy more aggressively. Conversely, if central banks are overly aggressive in tightening monetary policy without high inflation, the excessive reduction in liquidity could suffocate economic growth.

### Political uncertainty in Europe

European politics could face another turbulent year. Italy has reached a deal with the European Union (EU) and agreed to reduce its deficit target for next year to 2.04% from the original target of 2.40%. However, Brexit is still in limbo and could continue to cloud investor sentiment.

After surviving the confidence vote, British Prime Minister Theresa May continues to be her party leader for a year. But she faces a tough job of convincing her party members and opponents to agree with the Brexit deal. As there is a wide and complicated range of Brexit outcomes, financial markets could see increasing volatility in the run up to the March 2019 Brexit deadline.

Meanwhile, key political events such as the European Parliament election in May, as well as the Portuguese and Greek elections in October could introduce additional uncertainty.

## Summary

Overly pessimistic sentiment exacerbated financial market drawdowns throughout 2018 and affected the performance of "good value" stocks. Given continued late-cycle risks, investors should adopt a more nimble investing approach. Selected opportunities can still be found in these areas:

- ◆ Quality plays with strong balance sheets and consistent earnings growth that can better weather moderating growth and higher interest rates.
- ◆ Value plays such as emerging market equities that are attractively valued due to market dislocation.
- ◆ Structural plays such as global healthcare equities that offer the potential for enhanced returns amid market volatility.

## Political Events

## Central Banks

## Economic Events

21 Jan

### Brexit no-deal statement

The British government has to make a statement within five days from this date in the scenario of a no-deal Brexit.

24 Jan

### ECB Meeting

Expect to stop bond purchasing programme starting from January.

24 Feb

### Thailand Parliamentary Election



19 & 20 Mar

### FOMC Meeting

Expect to hike rates by 25bps.

Mar

### China National People's Congress (NPC)

Fiscal budget and government work report.



29 Mar

### Brexit Deadline

UK will formally leave the EU.

17 Apr

### Indonesia Presidential Election

23–26 May

### European Parliamentary Election

May

### India Parliamentary Election



28 & 29 Jun

### G20 Summit in Osaka

Jul

### Japan Parliamentary (Upper) Election

17 & 18 Sep

### FOMC Meeting

Expect to hike rates by 25bps.

20 Oct (latest)

### Greece Parliamentary Election

24 Oct

### ECB Meeting

Expect to start the first rate hike.

Oct

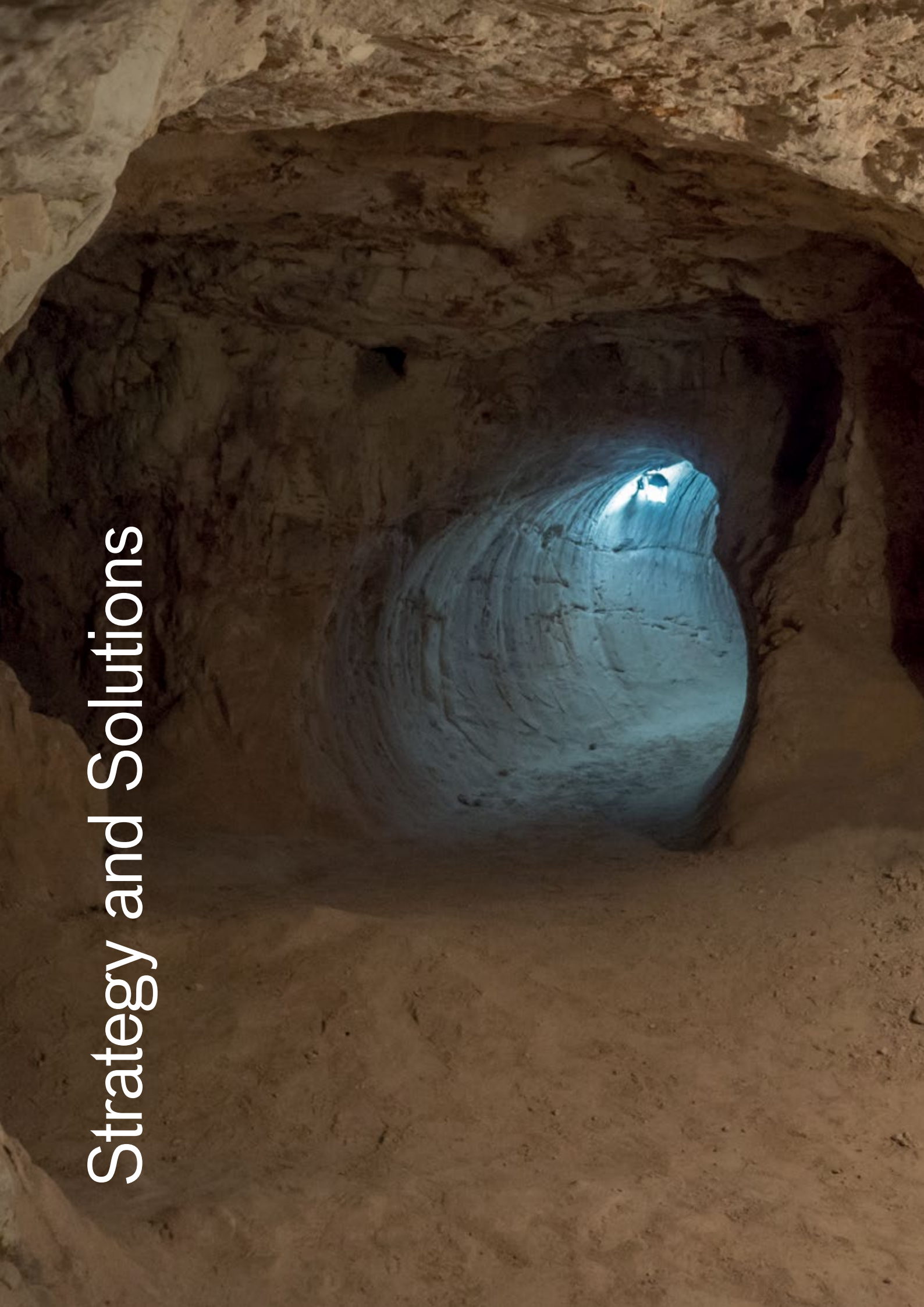
### Japan Consumption Tax Hike

Oct

### Portugal Parliamentary Election

# Key Events Calendar

# Strategy and Solutions





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



Depending on the geological conditions and the specific gem, there are different ways of mining gems, including surface and underground mining. The method employed for the extraction of gemstones needs to be a carefully-executed one as it is an intricate process. Opal for example, can be mined by sinking a shaft into the ground. Upon successful discovery of traces of the gem, the search is extended outwards by tunnelling along the same level in the ground.

# Asset Class Views

While we are neutral on major asset classes, there are still some worthy opportunities.

Even though we are neutral on equities and bonds, selected opportunities are still available in the respective asset classes.

		Asset Classes at a Glance			
		Negative	←	→	Positive
Equities	US				
	Europe				
	Japan				
	Asia (ex-Japan)				
	EM (ex-Asia)				
Fixed Income	DM Sovereigns				
	DM IG				
	HY				
	EMD USD				
	EMD LCY				
Commodities & Currencies	Gold				
	Oil				
	USD				

## Equities

Higher corporate earnings should support equities, with room for equities to rack up gains after the recent correction.

Equities tend to generate positive returns in the late-cycle phase, especially given attractive valuations after the correction. Nevertheless, investors still need to be cautious of drawdowns amid a volatile, sentiment-driven environment.

In developed markets (DMs), we are neutral on US and Japanese equities, and slightly negative on European equities. With the sell-down in late 2018, the absolute valuations of US equities look reasonable, but relative valuations to other regional equities stay elevated. Despite the strong US economy, fiscal stimulus concerns remain due to a divided Congress. Within US equities, we prefer US banking equities on attractive valuations and higher earnings due to rate hikes. Brexit and German Chancellor Angela Merkel's plan to step down, have raised political risk in Europe. Japanese equities are attractively valued, but the introduction of the consumption tax in October 2019, as well as the yen's safe-haven play, could weigh on sentiment. We are positive on emerging market (EM) equities. We favour Asia (ex Japan) given decent economic growth and compelling valuations. Within the region, China equities offer better return potential as valuations have fallen following the recent market sell-off.

## Fixed Income

Attractive carry should support total returns for bonds. Bonds of quality companies are preferred.

We have turned less bearish on bonds, as corporate spreads have already widened and yields are more attractive.

We remain slightly negative on DM sovereign bonds. Despite recent risk aversion and moderating US growth, it is premature to call for an end to the rate-hiking cycle. The Fed funds rate and 10-year Treasury yield are expected to reach 3.0% and 3.25% respectively by the end of 2019. We have upgraded DM investment-grade (IG) bonds from slightly negative to neutral. Recent spread widening offers decent yield pick-up versus sovereigns. Strong company balance sheets reduce the likelihood of further spread widening. Meanwhile, we continue to be neutral on DM high-yield (HY) bonds, EM debt (EMD) US dollar (USD) bonds and EMD local currency (LCY) bonds. While there is still some upside from yield pickup, gains could be capped due to rising volatility.

## Commodities and Currencies

Commodities are likely to see a mixed performance while the USD's strength could begin to wane.

Commodities can provide some diversification benefit, notably in gold. We are neutral on gold, but see emerging price supports, including more constructive investor positioning, higher safe-haven demands, and slower pace of rate hikes by the Fed. Meanwhile, we have upgraded the outlook for oil from slightly negative to neutral. Stable economic growth could continue to drive demand. However, the effectiveness of production cuts by the Organization of the Petroleum Exporting Countries (OPEC) and Russia could be compromised by rising production in the US. As such, Brent crude oil is expected to trade within a range of US\$55 to US\$65 per barrel.

In the currency market, the USD's strength could begin to wane given moderating US growth and the possibility that the US Federal Reserve could slow its pace of rate hikes. We expect the Euro and Aussie dollar to strengthen as the European Central Bank and the Reserve Bank of Australia are expected to hike rates in 2019. The USD could see the final stages of its rally against EM currencies in the first half of 2019.

## UOB Risk-First Approach

With an anticipated bumpy 2019, our proprietary approach can help smoothen the ride. Depending on clients' risk profiles, their portfolios are constructed with a maximum of 20%, 30% or 40% allocated to Tactical investing (which comes with higher risk) with the remainder in Core investing.

## Core Investing (Evergreen)

Focus on mitigating risks and include income-generating assets which are less market sensitive and display lower volatility.

### 01 Short- to Medium-duration High-grade Bonds

Highly liquid bonds that are defensively positioned to weather the heightened volatile environment. They offer greater stability to an overall investment portfolio. With credit spreads materially wider in 2018, there is value in short- and medium-duration papers.

### 02 Floating Rate Bonds

Benefit from rising interest rates because they pay coupons tied to the prevailing LIBOR rate plus a spread. The LIBOR rate should rise as the US hikes rates. Major banks with improving fundamentals are the major issuers of these bonds.

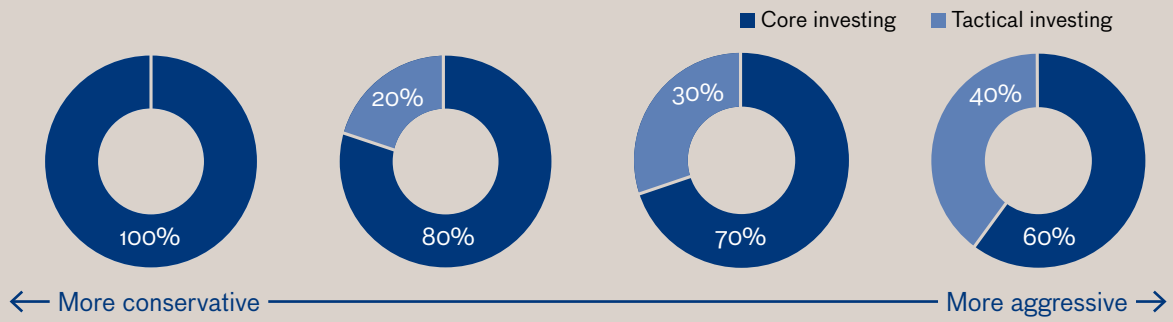
### 03 Multi-asset Income Funds

Offer flexible asset allocation, capturing market opportunities across various asset classes including equities, bonds and alternatives. They can deliver a regular income stream without compromising long-term capital growth, offering a more diversified solution for various market conditions.

### 04 100% Capital Return Structure

Offer guaranteed 100% return of the principal at maturity. They are better able to shield investors from market volatility.





## Tactical Investing

Capitalise on megatrends or other medium-term opportunities to grow capital.

### High Convictions (Medium-term)

Tactical opportunities that are identified using our VTAR (Value, Trend, Activity, and Risk) framework. They usually last for a 6–12-month horizon.



#### EM Equities

Benefit from a strong EM economy, higher earnings growth and attractive valuations.

#### US Banking Equities

Supported by rising interest rates, higher net interest rate margins and better credit quality.

#### Global Quality Stocks

Offer stable earnings growth and are supported by robust margins and low leverage.

### Megatrends (Long-term)

Offer investors the chance to ride on long-term trends to capture gains over a longer investment horizon.



#### Healthcare Companies

Rising demand for healthcare services due to a rapidly ageing population.

#### Innovation-driven Companies

Companies that can harness big data to develop artificial intelligence solutions will benefit from Industry 4.0.

#### China Equities

Supported by strong domestic consumption and institutional exposure from foreign funds.



Our high-conviction ideas have the potential to perform throughout the volatile late-cycle phase.

Historical trends have shown that equities can still stage a rally during the late cycle. Emerging market (EM) equities, US banking equities and global quality stocks are medium-term opportunities that can still potentially perform during this phase.

## **Emerging market equities: Supported by stronger fundamentals and attractive valuations**

### **EMs driving global growth**

EMs are expected to drive 72% of global GDP growth between 2015 and 2025. The rise of the middle class in EMs will fuel greater consumption, underpinning long-term growth.

In 2019, the growth gap between the EMs and developed markets (DMs) is expected to widen again as the effects of US fiscal stimulus start to fade. EM equities tend to outperform amid a widening growth gap.

### **EM equities are undervalued**

EM equities remain relatively cheap as markets have already priced in a hard-landing scenario in China. The current price-to-earnings ratio of 11x is comparable to September 2015 levels (at 10.6x) when the market had plunged on similar hard-landing fears. From then until the peak in January 2018, the MSCI Emerging Market Index had achieved a return of 79%.

External risks have been largely factored, given the current undemanding valuations. This offers good buying opportunities for the medium term.

### **Revised US trade deals could be a catalyst for an EM re-rating**

US President Donald Trump's attempts to rewrite the trade playbook have raised tensions with key US trade partners, notably China. EM equities have been oversold on trade war fears but the trade situation seems to be improving. Trade deals struck in 2018 with Mexico, Canada, South Korea, Japan and Europe demonstrate that the US is still open to trade negotiations and is not entirely anti-trade per se.

Middle-class consumption is expected to be the key driver of EM economies, and this is expected to translate into higher earnings growth for companies. Valuations are undemanding.

Trade tensions between the US and China remain a key risk in 2019. The trade truce announced at the G20 meeting could set the stage for more constructive talks. Any easing of trade tensions between these two economic giants could spark an EM re-rating.

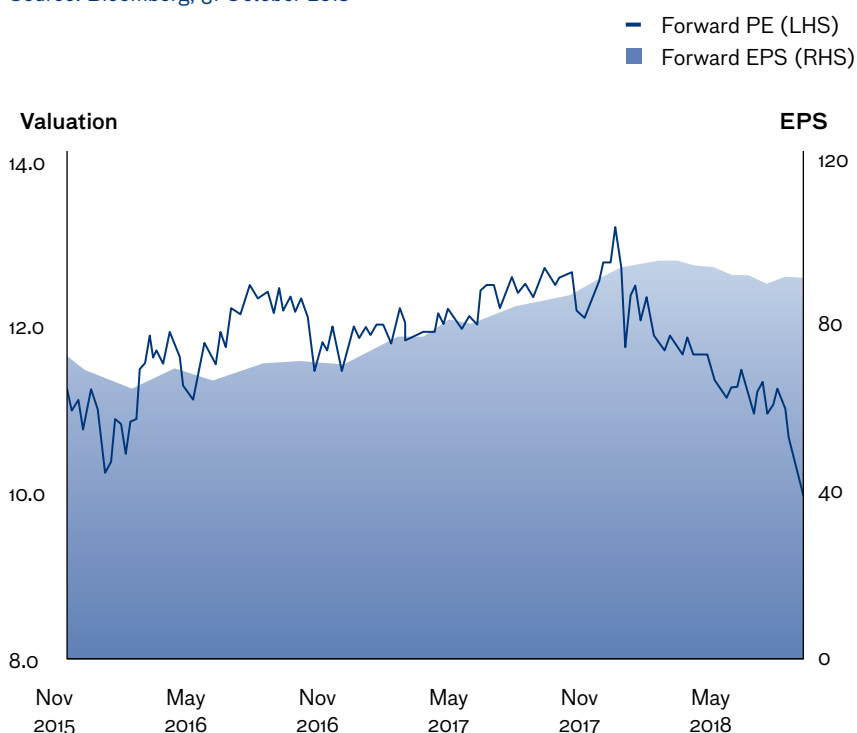
#### Need to be selective

Despite the upside for EM equities, a selective strategy should still be adopted as trade war fears have yet to subside. Investors should avoid countries that have run up large current account deficits such as Argentina, Mexico, Turkey and Indonesia. In comparison, China has more than five times the reserves to cover its US dollar-denominated debt.

We remain positive on China equities. While we cannot rule out an economic slowdown in China, better-than-expected industrial output figures and fixed asset investment data in October 2018 indicate that proactive measures from the government to support economic growth are yielding results. Therefore, a hard landing for China is unlikely.

Figure 05  
Earnings start to improve while valuation has hit three-year low

Source: Bloomberg, 31 October 2018



### US banking equities: Attractive valuations and higher earnings due to interest rate hikes

#### Healthy earnings outlook

Although earnings estimates for US banks rose more than 20% compared to 2017, share prices slipped 2% on recession fears. Despite the underperformance, we remain positive on the earnings outlook of banks, as growth drivers are still intact.

Net interest margins (NIMs) of US banks have expanded in a rising-rate environment, as loans are being repriced. Larger banks have better funding profiles because of their lower loan-to-deposit ratios. NIMs for large-cap

Rising interest rates, attractive valuations and a healthy earnings outlook for the banking sector will fuel gains in US banking equities.

banks improved from 3.0% in Q4 2015 to 3.3% in Q2 2018. Given the higher inflow of deposits and continued rate hikes by the US Federal Reserve (Fed), banks can afford to increase loan rates at a faster pace than deposit rates. This could boost the profitability of US banks.

The US banking industry is also benefitting from aggressive cost-cutting measures undertaken over the past decade. Investments in technology have improved efficiency, with the efficiency ratio (non-interest expenses as a proportion of net operating revenue) falling to its lowest levels in years.

The consensus earnings growth of 11% for 2019 is higher than the overall US market's projected growth of 8%.

### Better credit quality

US banks are in a stronger financial position than a decade ago, due to better-quality loan portfolios. Stricter lending standards have resulted in fewer bad loans and healthy corporate earnings. This, in addition to the low unemployment rate, has improved credit quality. Non-performing loans to total loans ratio for US banks has declined to 1% in 2018 from 5% in 2010.

### Low valuations

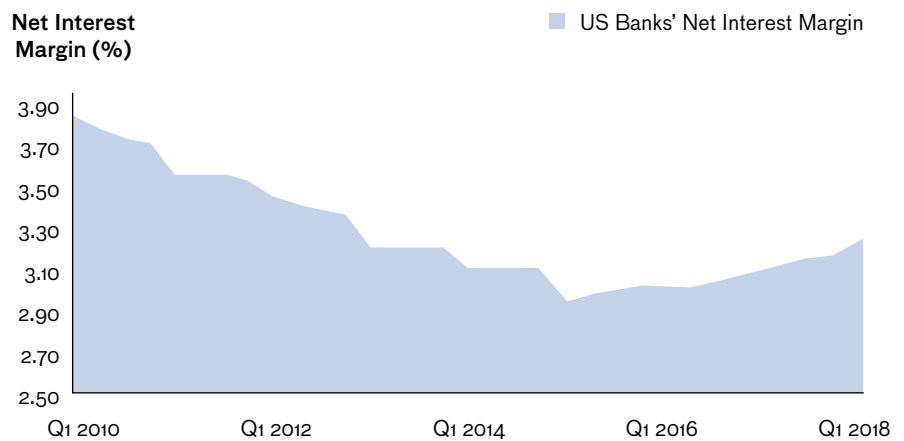
US banking equities are trading at relatively low valuations, with the price-to-book multiple at a 60% discount to the broader market as at December 2018. Valuations can still rise, given US banks' sound balance sheets and robust profitability.

The split Congress following the US mid-term elections has reduced the chances of financial deregulation. This should increase demand for traditional banking stocks, as larger banks are better able to comply with existing strict regulations.

Figure 06

### US Banks' interest rate margins have improved

Source: Federal Reserve Economic Data, 16 August 2018



## Global quality stocks: Focus on quality to ride out the late cycle

Global quality stocks offer stable earnings growth and are a better option to ride out any market volatility.

High-quality stocks are equities that have historically robust margins, stable earnings growth and lower debt levels. They tend to have lower downside risks and hence will be able to smoothen out the bumpy ride in this late-cycle market.

### Low leverage

At 0.2x, the net debt to earnings before interest, taxes, depreciation and amortisation (EBITDA) ratio of global quality stocks is significantly lower than the 2x ratio of the MSCI World Index. The low leverage allows quality companies to withstand the rate-rising cycle.

### Bright growth prospects

The earnings-per-share (EPS) of these stocks grew 18% in 2018. They are expected to clock EPS growth of 7% in 2019 and 11% in 2020.

### Lower drawdowns

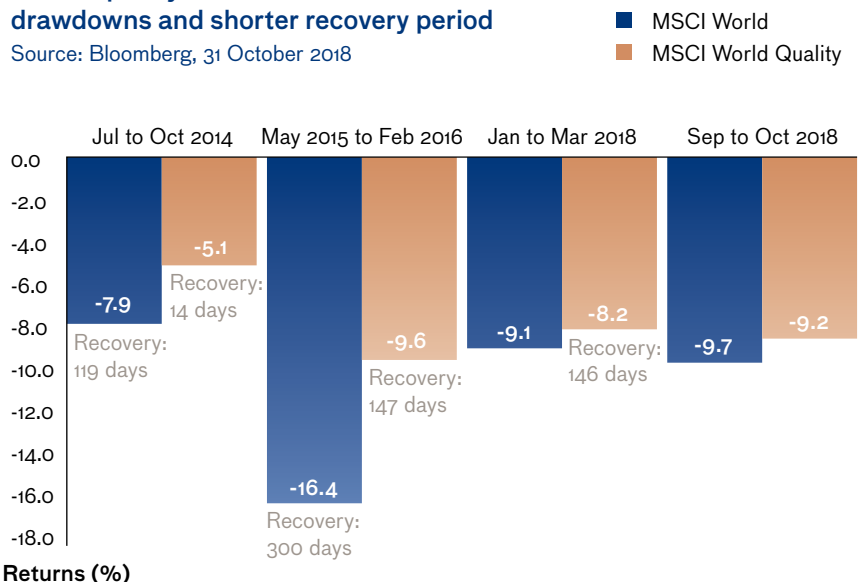
Global quality stocks tend to experience lower drawdowns during market sell-offs. For example, during the market's sharp fall between May 2015 and February 2016, quality stocks declined only 11% while global equities dropped 18%. Global quality stocks then staged a recovery in 150 days while global equities took double the time (300 days) to recoup losses. Quality stocks also tend to outperform the broader equity markets over longer investment cycles. They outperformed global equities by 19% (until 1 December 2018) over a 10-year horizon.

While valuations of global quality stocks can be richer than the overall market, there are still companies with stable businesses and steady cash flows that can offer meaningful returns over the long run.

Figure 07

### Global quality stocks have lower drawdowns and shorter recovery period

Source: Bloomberg, 31 October 2018



Healthcare companies, innovation-driven companies and China equities will benefit from long-term megatrends, including the ageing global population, rapid pace of innovation and a shift in the global balance of power.

Identifying megatrends that will redefine the global economy allows investors to tap on opportunities that can perform over the long term. Megatrends are deep-rooted, transformative forces that reshape the future of the global economy. These long-term structural shifts provide insights into future consumption drivers and investors can benefit from investing in such themes.

Here, we identify three key megatrends:

## **01 Structural demographic shifts: Rise of the silver economy**

Over the next few decades, a growing and increasingly ageing global population will transform the consumer market.

Despite declining fertility levels, the United Nations (UN) expects the global population to increase from 7.6 billion in 2017 to 9.8 billion in 2050, with emerging markets making up most of the growth.

Longer life expectancies and slowing birth rates will give rise to a rapidly ageing population. The UN predicts that the number of persons aged 60 and above globally will more than double in the next three decades, increasing from 962 million in 2017 to 2.1 billion in 2050. This means 13% of the world's population in 2017 was made up of people aged more than 60 and this percentage is expected to rise to 21% in 2050.

The inverse population pyramid, especially in developed countries, will place a heavier burden on the younger generation to care for ageing adults.

The rise of the "silver" demographic will transform consumption patterns and lead to more demand for healthcare services. Companies will need to come up with innovative, technological solutions to help the elderly manage their daily life, ease the strain on the healthcare sector and cope with the shrinking workforce.

# Megatrends are deep-rooted, transformative forces that reshape the future of the global economy

## Megatrend 01

### Structural Demographic Shifts: Rise of the Silver Economy

Population aged 60 and above is expected to double in 30 years



Silver demographic will transform consumption patterns



### How to ride on the megatrends?

Healthcare Companies



China Equities



AI and Innovation-driven Companies



## Megatrend 02

### Faster Pace of Technological Disruption

The world is now at the dawn of Industry 4.0



New opportunities will be opened up



## Megatrend 03

### Shift in Global Balance of Power

Rising middle class in Asia is becoming a key growth engine



China is central to the region's wealth



A rapidly ageing global population will change consumption patterns and lead to more demand for healthcare services.

Fuelled by technological breakthroughs such as big data analytics and artificial intelligence, Industry 4.0 will bring greater disruption.

Asia's fast-rising middle class is a key factor in the region's increasing economic prowess, with China central to the region's wealth.

## 02 Faster pace of technological disruption and innovation

The world is now at the dawn of the fourth industrial revolution. Also known as Industry 4.0, this era is fuelled by technological breakthroughs such as big data analytics, artificial intelligence (AI) and the Internet of Things. Advances in innovation will disrupt traditional business models, revolutionise industries and create new ones.

From website surfing and music streaming to social media and online shopping, consumers are leaving a large digital footprint. This has enabled the collection of multifaceted data on a huge scale. It is the key reason venture capitalists are investing large amounts of money into the rapidly growing big data ecosystem, even though such start-ups have yet to generate positive cash flow. The winners will be companies with the ability to access data and build intimate profiles of their consumers.

Sophisticated data models can now be used to generate AI where machine learning and predictive analytics can potentially transform industries and every facet of human life.

The acceleration of AI capabilities opens up endless possibilities in the field of behavioural analytics, predictive support and customer segmentation. Machine learning algorithms can now track and predict human behaviour. By harnessing these deep insights, businesses will be able to develop more intuitive solutions and better products for consumers.

## 03 Shift in global balance of power

The global balance of power is shifting as Asia's economic prowess increases. Home to the world's two most populous nations and with an emerging middle class, Asia has significant market potential. China and India make up more than a third of the world's population, with 1.42 billion and 1.35 billion people respectively.

Armed with greater disposable incomes, the fast-growing middle class is becoming an important engine of growth across Asia. More than half of the Asia-Pacific population (54%) will consist of the middle class in 2020 and this proportion is expected to rise to 65% in 2030<sup>1</sup>.

The tremendous spending power of Asian consumers will make the region more economically significant. Investments into the region are likely to rise as more global businesses look to increase their foothold in Asia.

China is key to the region's economic wealth. Driven by its economic might, China has been extending its sphere of political influence. Its ambitious Belt and Road initiative is expected to strengthen trade and economic ties across several continents.

The Chinese yuan (CNY) could increasingly be used as a reserve currency given its rising use in trade. While the CNY has yet to match the major reserve currency status of the US dollar, Euro and Japanese yen, it could steadily gain prominence as central banks gradually increase their CNY holdings as a share of global reserves.

<sup>1</sup> Source: Working paper by the Brookings Institution



# How to ride on the megatrends?

Megatrends are the big growth stories of the future. Investing in the beneficiaries of such megatrends can yield benefits over a multi-year cycle. Here are the key beneficiaries that stand to gain from those megatrends.

## 01 Healthcare companies

An ageing population will drive up healthcare spending while technological innovations will redefine medical diagnoses and patient care.

### Shifting demographics driving healthcare spending

Shifting demographics due to a rapidly ageing population will drive demand for healthcare services and pharmaceutical products. An increasingly wealthy middle class in emerging markets will boost demand for high-quality medical services.

Global spending on healthcare will increase to US\$24.5 trillion in 2040<sup>2</sup>, from US\$9.2 trillion in 2014. In particular, China and India will see the largest increase in healthcare spending. From 2014 to 2040, healthcare spending per person in China and India is projected to rise 7.2 and 3.5 times respectively.

### Technological innovations will shape the future of healthcare

Technological innovations continue to redefine the healthcare industry and transform how companies make drugs, conduct diagnoses and deliver patient care.

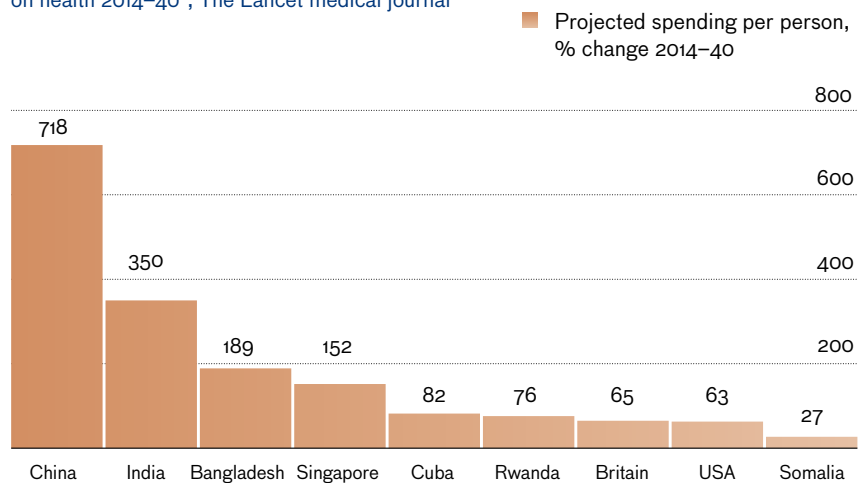
Big data analytics has enabled pharmaceutical companies to accelerate the process of introducing new drugs to market while sequencing the human genome can now take minutes instead of years as a result of technological advances.

AI has increasingly played an instrumental role in predicting patient responses to immunotherapy and smart chemotherapy. It has been used to develop diagnostic test kits for diseases such as dengue. Predictive AI tools have also improved the accuracy and timeliness of diagnoses, helping healthcare service providers to optimise patient care.

Figure 08

### Healthcare spendings are projected to increase significantly

Source: Economist, Joseph Dieleman, "Future and potential spending on health 2014–40", The Lancet medical journal



<sup>2</sup> Source: The Lancet medical journal

## 02 AI and innovation-driven companies

Companies that can harness the power of big data will benefit from the AI-driven fourth industrial revolution.

### Data is the “new coal”

The first industrial revolution marked the transition from the use of manual labour to manufacturing processes. In the manufacturing value chain, oil and coal formed the main energy sources while steel was a key raw material.

Then, the “innovators” were the machine designers while companies that brought business value were those that used machine-supported manufacturing to produce goods. Railroads formed the major infrastructure, performing as key enablers during that time to transport finished goods to other locations.

At the cusp of the fourth industrial revolution, we can use the same analogy in today’s world to observe how all the different elements of Industry 4.0 are taking shape.

Here, big data can be seen as the “new coal”. Companies with access to big data such as Facebook, Uber or Google wield immense power because they possess valuable information about the habits of consumers. Big data fuels the technological output developed by AI.

Semiconductors (such as Intel processor chips) are the basic materials that power AI-supported systems. The innovators of today are AI-application developers such as Oracle while AI-supported systems are developed by the likes of Amazon Prime. Today’s enablers are cloud providers such as Amazon Web Services.

### Investing in the AI value chain

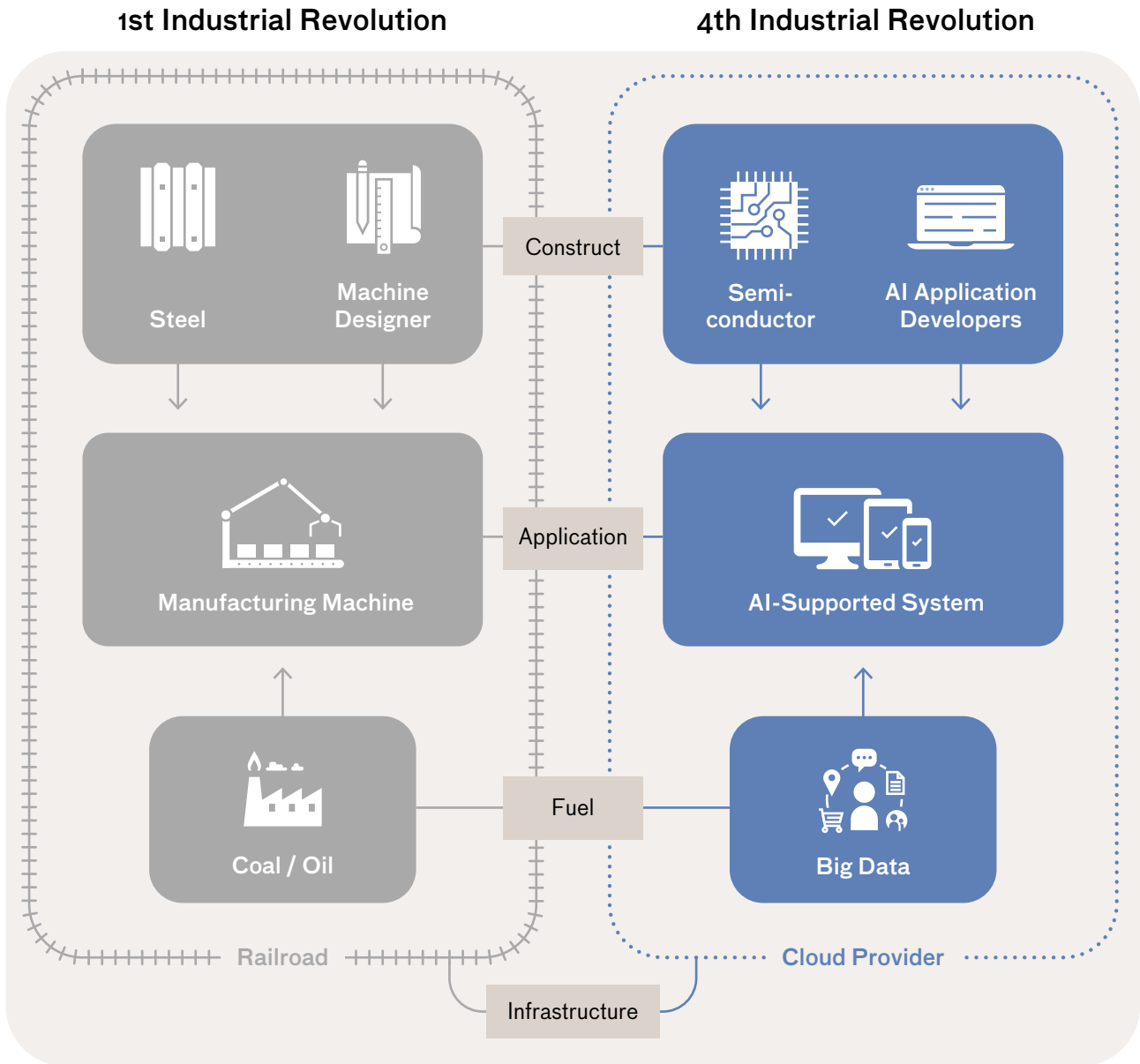
Companies that can harness the power of big data to develop innovative capabilities will become the biggest beneficiaries of the AI-driven fourth industrial revolution. This provides investors with opportunities to invest in the AI value chain.

Data analytics is shaking up industries and driving changes in product development, engineering, user experience and more. For example, search engine companies have used algorithm-based ads to much success while major e-commerce players have used AI to optimise supply chains and develop personalised recommendations for customers.

Meanwhile, cloud computing allows companies to save everything in the “cloud” and deploy services from the “cloud”. It can be thought of as the “silk road” of today because it is capable of connecting businesses with consumers, no matter where they are. The biggest cloud computing player globally currently holds a 50% market share. It generated US\$17.5 billion in revenue in 2017 and is forecast to more than double its revenue to US\$42 billion by 2020.

As new technologies converge, data analytics and cloud computing are just some of the opportunities that investors can look into. The fourth industrial revolution offers a world of possibility and many other opportunities await investors.

Figure 09  
**Industrial revolution value chain**  
 Source: UOB PFS Investment Strategy



### 03 China equities

China equities provide investors with an opportunity to participate in the country's growth story, which is powered by its strong domestic market.

#### Fast-rising domestic market

As China shifts to a consumption-driven economy to reduce its reliance on exports, its fast-growing middle class will be an important engine of growth. By 2022, over 550 million people in China who earn above US\$9,000 a year will be considered middle class<sup>3</sup>.

The affluent middle class will spend more on discretionary goods and services including electronics, fashion, education, travel, leisure activities and healthcare. China's strong growth prospects will shine the spotlight on China equities.

#### Banking on China's AI ambitions

China plans to become a global AI powerhouse by 2030. With a vast domestic market, it has access to huge amounts of data generated by its consumers as they conduct transactions online. This enables China to easily harness the power of big data to develop its AI capabilities.

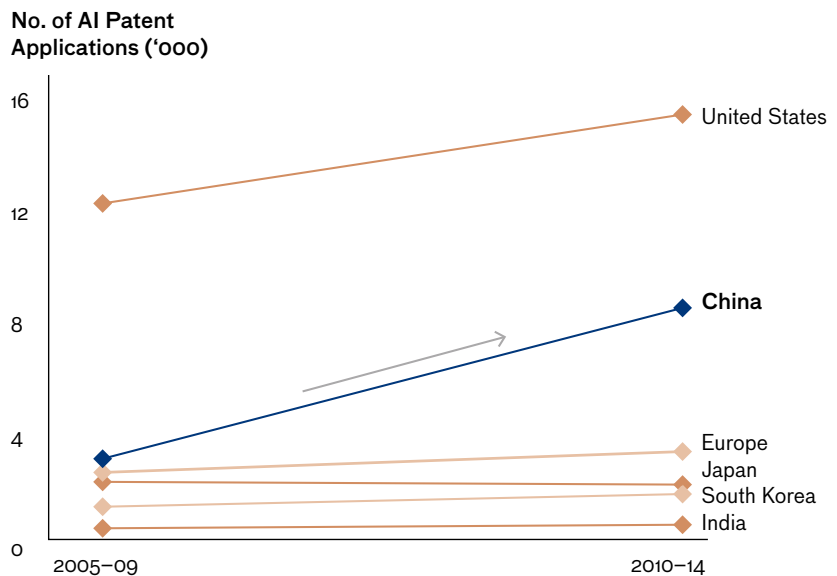
The market value of China's AI industry leaped 67% in 2017 and is worth US\$3.55 billion. It could soon leapfrog the US in terms of the number of AI patents filed.

Established tech players such as Alibaba, Tencent and Baidu are developing smart city solutions, autonomous driving and predictive healthcare, among others. With a supportive government and huge local market, it may not be long before China can commercialise its own AI technologies.

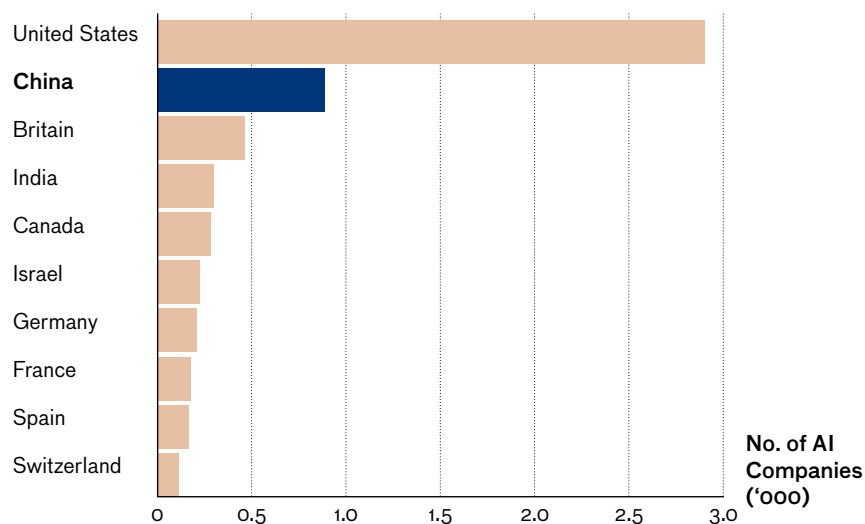
Figure 10

#### China is catching up in the AI race

Source: Economist, Press reports, Wuzhen Institute



<sup>3</sup> Source: McKinsey & Company



### Room to increase exposure to China equities

Financial liberalisation and index inclusion could make the Chinese equity market more appealing to foreign investors.

Historically, foreign investors had little access to A-shares. Over the past five years, however, the Chinese government has stepped up efforts to open up China's onshore financial markets to foreign investors, such as providing direct access via the Shanghai-Hong Kong and Shenzhen-Hong Kong Stock Connects in 2014 and 2016 respectively.

China A-shares currently make up only a small fraction – less than 5% – of the MSCI indices. But there is room for the weightage of China A-shares in the MSCI indices to increase to 28%.

With China equities currently under-allocated in global portfolios, institutional investors are expected to increase exposure to China A-shares when the MSCI weighting increases over time. This will continue to drive foreign fund inflows into China's equity market.

Local retail investors currently dominate China's sentiment-driven domestic equity market. To invest in China's equity market, foreign investors need to be more selective and pick out companies with solid fundamentals. They will need to be more patient to ride out any volatility in the equity market.

### Conclusion

Megatrends often take root over decades. Investors can take advantage of these megatrends by investing in their beneficiaries for a longer investment time frame as they can ride out short-term volatility.



Country Focus



With a well-established global presence today and particularly in Asia, UOB has a deep understanding of Asian markets, corporate culture and business mindsets. Our strong foothold in Singapore, Malaysia, Indonesia, Thailand and China positions us well to create greater access and growth in this region, for our customers.



Jade is highly prized for its exquisite beauty, and has a long history as a choice gem in Asia. More than 70% of the world's supply of high-quality jadeite comes from Myanmar and it is transported all across Asia to be crafted into jewellery and other products.

## Slowing growth amid an increasingly uncertain and volatile environment.



The Singapore economy faces a challenging season as growth momentum in external-oriented industries eases and the recovery in the domestic sector loses steam. We expect manufacturing activity to slow down due to the high base effect, with the important semiconductor sub-cluster likely to see sluggish growth. Spillover effects from lingering global trade tensions could put a drag on Singapore's open economy, denting exports and weighing on business sentiment.

We expect Singapore's economic growth to moderate to around 2.5% in 2019, lower than the projected 3.4% in 2018. This reflects the potential downside impact from global trade policy developments.

The Monetary Authority of Singapore (MAS) could further tighten monetary policy at its April 2019 meeting by increasing the slope of the Singapore dollar nominal effective exchange rate (SGD NEER) policy band. Although economic growth is projected to moderate in 2019, it is still above potential. Core inflation is likely to creep higher to 2.2% in 2019 from 1.8% in 2018. The US dollar (USD) is likely to strengthen on the back of higher interest rates as the US Federal Reserve continues its normalisation policy.



Singapore faces challenges on both the international and domestic front. The external, export-oriented sector faces a slower pace of growth, while the domestic sector recovery slows.

Given that Singapore's large external sector is highly connected to global supply chains, the increasingly risky

external trade outlook could threaten economic growth.

The MAS is likely to tighten its monetary policy stance slightly in April 2019 although the SGD could face further weakness in the face of a much stronger USD.

### Stocks

The rising interest rate environment should benefit banking stocks, as net interest margins improve. Intensifying trade tensions could cloud the outlook for Singapore equities given the economy's exposure to export-reliant sectors. However, Singapore's position as a key regional logistics hub is a silver lining as companies recalibrate their global supply chains to cushion the blow from ongoing trade woes. Investors will need to be more selective in their stock picking.

### Bonds

As short and long-term interest rates are expected to rise, investors need to be cautious over credit exposure and duration risk. High-profile bond defaults in 2018 from highly leveraged corporates serve as a reminder that investors need to be more discerning in terms of issuer quality. Therefore, we prefer short duration bonds by higher quality issuers in defensive sectors such as utilities and telecommunications.

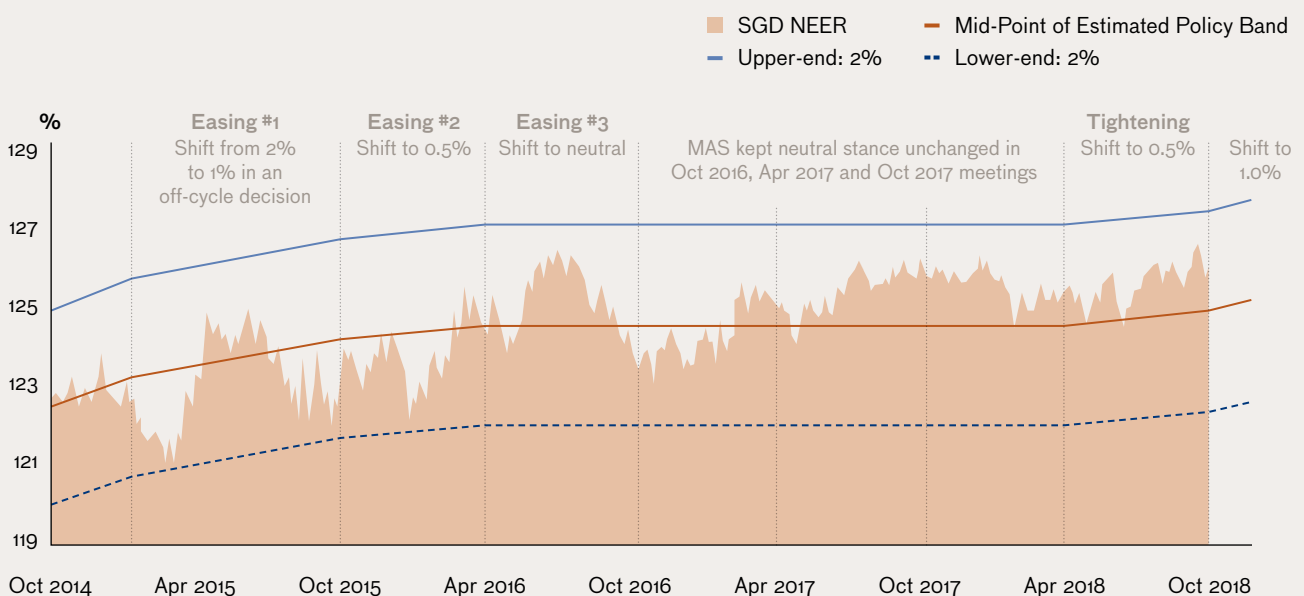
### Foreign exchange

Due to Singapore's open and trade-dependent economy, a US-China trade standoff is a negative driver for the Singapore dollar (SGD). Possible MAS tightening could limit excessive SGD weakness. We forecast USD/SGD to reach 1.40 in Q2 2019 and 1.41 in Q4 2019.

Figure 11

### MAS is expected to tighten gradually

Source: CEIC, Bloomberg, UOB Global Economics & Markets Research, 12 October 2018



## Balancing act between reforms, growth and fiscal measures.



Since coming into power in May 2018, the new Pakatan Harapan-led government has implemented a series of reforms to strengthen the economy, with transparency and accountability as key barometers of economic governance. Given cuts in government spending, we expect the country to achieve GDP growth of 4.8% on a higher fiscal deficit of -3.7% of GDP in 2018.

Entering 2019, the government will focus on ensuring sustainable and balanced growth, as well as on paring down the mounting debt level which includes contingent liabilities. It has also reaffirmed the development of the third national car project to revitalise the auto industry and boost economic growth. For 2019, we are projecting a GDP growth of 4.8% and a fiscal deficit of -3.4% of GDP.

We expect Bank Negara Malaysia (BNM) to maintain the Overnight Policy Rate (OPR) – the central bank's target interest rate – at 3.25% throughout 2019 as it focuses on managing growth, inflation and currency expectations amid tightening financial conditions.

Given the strengthening US dollar (USD) and escalating US-China trade conflict, we expect the Malaysian ringgit (MYR) to weaken slightly against the USD in 2019.

Malaysia's economic outlook remains strong under the reins of the new Pakatan Harapan government. Domestic demand will continue to be a key driver of growth, along with investments and net exports.

We project the OPR to remain unchanged at 3.25% throughout 2019. Though the MYR could soften against the USD, the MYR still has relatively stronger foreign exchange metrics compared to other Asian currencies.

### Stocks

Investors should remain selective on Malaysian equities as the economy undergoes a transitional phase under the new government. Stronger oil prices bode well for oil and gas stocks. Export-related counters (including rubber manufacturers and tech-related companies) as well as tourism-related equities could advance on the back of a weaker MYR. Automotive stocks could also receive a shot in the arm from the establishment of the third national car company.

### Bonds

Malaysian bond yields should increase in tandem with the rise in US Treasury yields. Higher US interest rates boost the attractiveness of US assets. This could lead to foreign fund outflows from Malaysia as investors seek better returns abroad. Despite this, demand from onshore real money is likely to keep the benchmark yield of around 3.25% well supported.

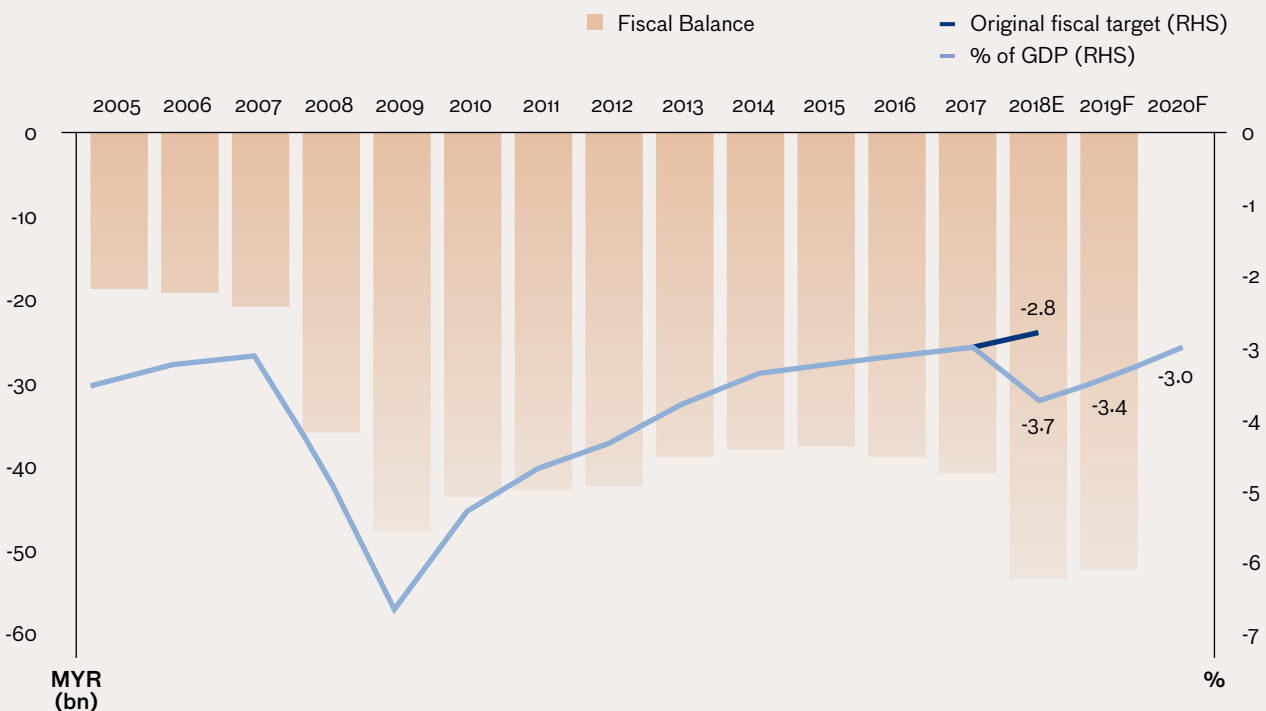
### Foreign exchange

The MYR is likely to continue its decline against the USD. However, a strong current account surplus should cushion the MYR's weakness. In the long run, the MYR will benefit from structural reforms and efforts to improve governance, transparency and accountability. USD/MYR is forecast to reach 4.23 by Q2 2019 and 4.25 by Q4 2019.

Figure 12

### Government sets a higher fiscal trajectory

Source: MOF, UOB Global Economics & Markets Research, 05 November 2018



Private and public investment as well as tourism to drive economic growth.



The economy is expected to expand 4.2% and 4% in 2018 and 2019 respectively. This is an achievable target if the Thai economy gains further traction from both domestic and external demand. Tourism is still a driving force for the economy. From a supply-side perspective, hotels, restaurants and transportation remain top performing sectors, growing at a faster pace than overall GDP.

Both consumers and businesses remain confident about the Thai economy, with the consumer confidence index continuing to rise after hitting a three-year high and the business sentiment index still improving.

Recent positive developments in the political arena also bode well for the economy. The approval of bills to install Members of Parliament and senators was published in the Royal Gazette in September 2018, paving the way for general elections to be held in 2019. Greater clarity on the political landscape should boost investor sentiment.

Given the slack in the economy, inflation remains manageable. We expect the Bank of Thailand (BoT) to raise the benchmark rate from 1.75% to 2%, possibly in H2 2019.

Thailand should be able to sustain a healthy economic growth that is supported by strong domestic factors including growing consumption, robust infrastructure spending and an expanding tourism sector.

The SET Index should see fair valuations in 2019. Rising short-term yields and stable long-term yields should lead to a flattening of the Thai government bond yield curve. We expect the THB to be range bound against a robust economic backdrop and strong external balance.

### Stocks

2019 consensus earnings estimates point to an earnings-per-share (EPS) growth of 10%. We expect the benchmark Stock Exchange of Thailand (SET) Index to trade between 1,600 and 1,900, translating to an attractive price-to-earnings (PE) ratio of 13.5x to 16.5x. Foreign fund outflows hit nearly US\$7 billion in 2018 but this should reverse in 2019, underpinned by a solid economy and greater certainty from the general elections. Commerce, property construction and banking are sectors to watch.

### Bonds

The Thai government bond yield curve has flattened due to rising short-term yields and stable long-term yields. We expect the BoT to slowly raise the benchmark rate from 1.75% to 2%, possibly in H2 2019. There is plenty of short-term supply as issuers aim to lock in low borrowing rates before further rate increases. Given the gradually rising yield environment, we favour bonds with short-term tenures.

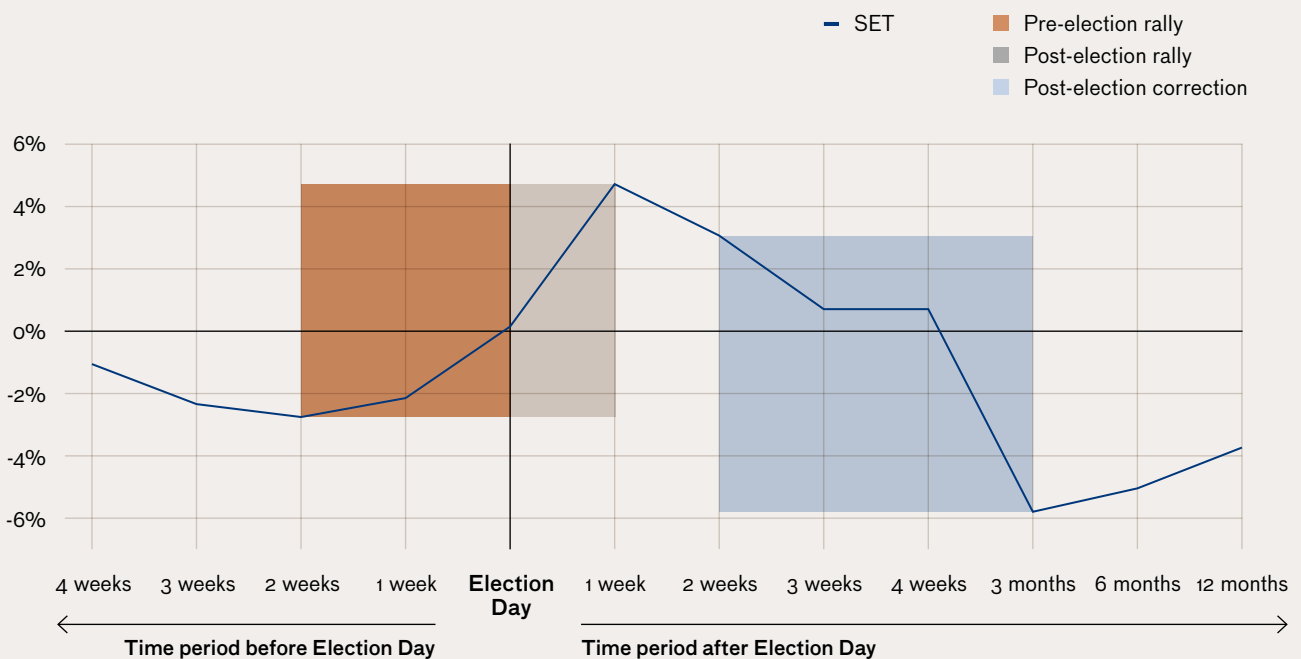
### Foreign exchange

Weakness in the Thai baht (THB) should be limited as the BoT follows the US Federal Reserve in hiking rates. An expected strong current account surplus should also put a floor on the THB. Overall, we reiterate mild weakness of THB against the USD, targeting 33.5 by the end of 2019.

Figure 13

### The average return of the Thai stock market in the past six elections

Source: Bloomberg, SCBS Investment Research, September 2018



Riding on the wave of  
progressive growth.



Indonesia's GDP growth in 2018 is expected to hit 5.3%, underpinned by lower unemployment, low and stable inflation and manageable debt levels. Structural reforms initiated under the leadership of Indonesian President Joko Widodo seem to be paying off.

As an emerging market, Indonesia is not immune to external pressures. In this case, ongoing trade war concerns and monetary tightening in the US could leave Indonesia vulnerable to capital outflows. However, Indonesia's economy has held up relatively well, compared to other emerging markets such as Turkey, Argentina and South Africa. The Indonesian government and the central Bank Indonesia (BI) have been more proactive in managing fiscal and monetary policies. It is therefore unlikely that we will see a return of the days of the 2008 Global Financial Crisis and the 2013 Fed Taper Tantrum where Indonesia saw capital flight due to rising US interest rates.

Progress on structural reforms and sound policy management should stem the flow of "hot money". This sets the stage for Indonesia to receive better quality capital inflows when external risks subside.

Indonesia's structural reforms and improved policy management to protect the economy against external risks seem to be paying off. The economy is not as vulnerable as during the 2008 Global Financial Crisis and the 2013 Fed Taper Tantrum.

As a result, Indonesia is poised to receive better quality capital inflows, when external risks wane. Nevertheless, the IDR could come under pressure given rising US interest rates, higher oil prices and ongoing trade tensions.

### Stocks

We favour financials, consumer goods, telecommunications and energy counters, as these sectors should continue receiving robust inflows. Relatively cheap equity valuations especially after the ratings upgrade should boost the allure of Indonesian equities. Prudent fiscal and monetary policies should cushion the impact of a weaker Indonesian rupiah (IDR). However, investors should remain vigilant to external risk factors such as trade war fears, Brexit and high oil prices.

### Bonds

Following six interest rate hikes in 2018, Indonesia's 10-year government bond yield climbed to more than 8% in Q4 2018, from 6.25% in Q1 2018. Short-duration Indonesian government bonds denominated in US dollars (USD) are still providing attractive yields of around 3.5% to 4%. Although the US Federal Reserve is still in the midst of its rate hike cycle, these bonds are insulated from local currency risk as they are denominated in USD.

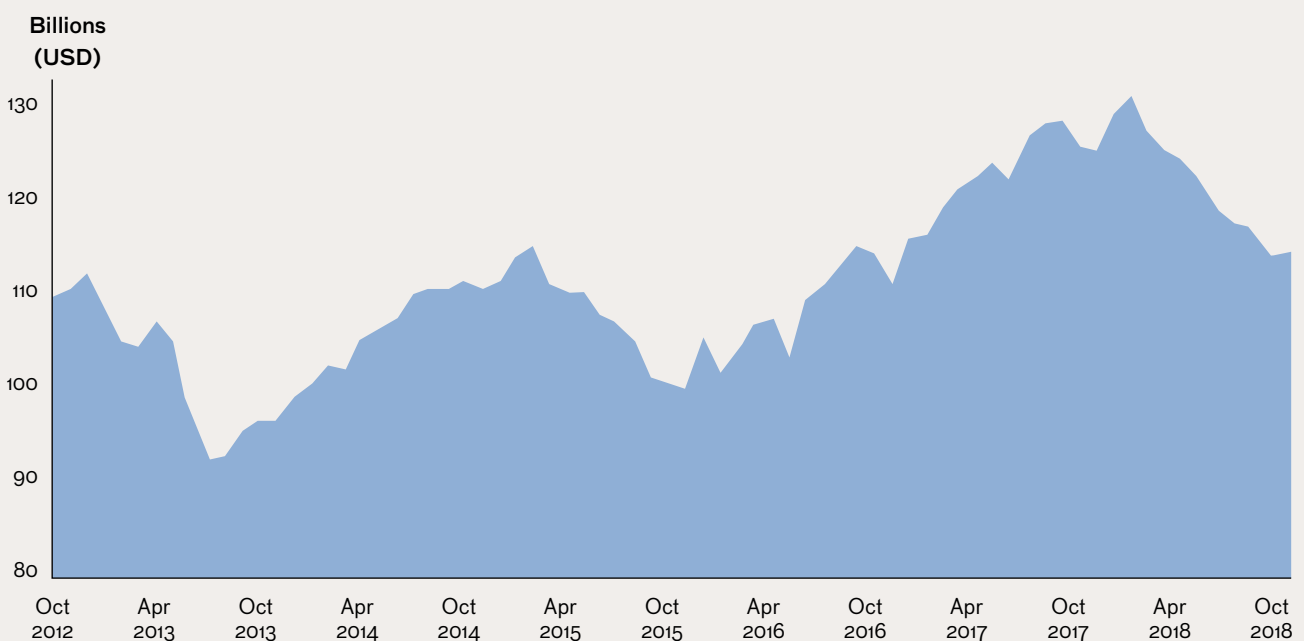
### Foreign exchange

External factors such as higher US interest rates, the ongoing US-China trade dispute, and potentially volatile oil prices, could weigh on the IDR. Indonesia also faces a widening current account deficit, continued trade deficits, rising interest rates and deteriorating foreign exchange (FX) reserves. BI is likely to retain the strategy of being ahead of the curve while intermittently dipping into the FX reserves to manage IDR volatility as the Fed continues to tighten gradually in 2019. USD/IDR is expected to hit 14,700 in Q2 2019 and 14,800 in Q4 2019.

Figure 14

### Indonesian forex reserve has improved since taper tantrum in 2013 but decreased YTD

Source: Bloomberg, 31 October 2018



## Economy to march on despite internal and external challenges.



China's economy continues to face headwinds from escalating trade war fears. Recently released economic data such as export orders have shown signs of moderation as a result of the trade frictions. Although both the manufacturing and services sectors have weakened in recent months, overall growth remains firm. Heading into 2019, GDP growth is expected to slow to 6.3% in 2019 from 6.6% in 2018. The long-drawn process of trade negotiations could negatively impact exports, investments and private consumption. However, proactive fiscal and monetary policies could soften any potential drag on growth.

The Chinese government has initiated a series of supporting measures – including tax cuts, fee reductions and lowering the reserve requirement ratios (RRR) – to support businesses, especially those in the private sector. We expect the government to pursue more proactive fiscal stimulus and monetary policies to shore up the economy.

The government has also pared back the pace of its financial deleveraging. The softer tone on debt cuts has relieved investor concerns that overly tight policies could crimp growth, especially since the country is in the midst of a trade row with the US. While we expect the authorities to continue with its policies to reduce leverage, the pace is expected to slow down in order not to dampen the economic growth.



China faces both internal and external headwinds. While the escalating trade conflict between China and the US could put a drag on exports and weigh on investor sentiment, the impact remains manageable.

The government is likely to introduce more fiscal stimulus and adopt accommodative monetary policies to sustain economic growth.

The CNY could depreciate further on policy moderation and continued trade uncertainty.

### Stocks

Weak investment sentiment drove Chinese equities to a two-year low in October 2018. However, attractive valuations, robust earnings growth and more proactive government support measures should increase the appeal of A-shares, particularly to institutional investors who are currently under-allocated in the equity market.

The inclusion of more China A-shares into the MSCI and Russell indices will further put them on investors' radars. As more institutional investors pour funds into China equities, they will account for a greater portion of turnover compared to retail investors. Greater fund inflows from institutional investors will enhance the liquidity of China equities in the long run.

### Bonds

Rising loan defaults among small and medium enterprises and some private companies weighed on investor sentiment, leading to a divergence in the performance of the interest rate and credit markets in 2018.

Entering 2019, investors should still favour the fixed income market as potential RRR cuts drive the benchmark yield lower. Continued deleveraging in China means investors will need to be more discerning about bond selection. Investors should target bond issuers with a stable outlook and a lower risk of default.

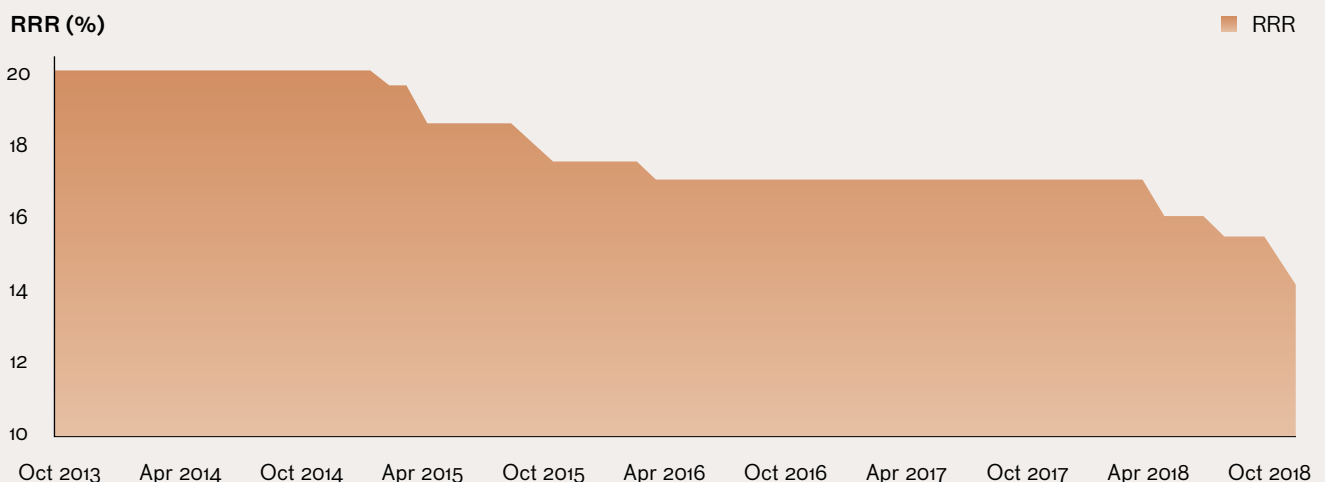
### Foreign exchange

The Chinese yuan (CNY) is likely to weaken, due to increased risks to trade and growth from the ongoing US-China trade conflict. The deteriorating yield differential between China and the US could also cast a pall on the CNY. We forecast USD/CNY to depreciate at a measured pace, targeting 7.00 in Q2 2019 and 7.10 in Q4 2019.

Figure 15

### People's Bank of China (PBOC) has been cutting RRR to support economic growth

Source: Bloomberg, 31 October 2018



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