# 2019 Investment Outlook

## Going back to first principles


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# Agenda

# Poll question 1:
# What is wrong with the markets?

1. **US Fed –** interest rate hikes too rapid, quantitative tightening too aggressive, “don’t know how to putt”.

2. **Trade tensions –** Starting to impact growth and profitability.

3. **Late cycle worries –** Ageing cycle triggers investor jitters at first hint of a correction.

4. **The Trump slump –** Weaker policy leadership compared with 2008 implies that even moderate problems could become a crisis.

5. **Brexit** – Uncertainties and concerns around a hard Brexit scenario.

6. **Fundamental issues –** GDP, leverage, earnings, valuations.

Source: UOBAM, 29 Dec 2018

# Poll question 2:
# How many times in history has global growth been above trend, global earnings growth been double-digit, inflation under control and yet it was a year of both equity and bond losses?

1. Four
2. Three
3. Two
4. One
5. Never

# Poll question 3:
## What is the expected US core inflation rate in 2019?
## (2018 year-end core PCE* inflation was 1.9%)

1. < 2%
2. 2% to 2.5%
3. 2.5% to 3%
4. > 3%

** PCE: personal consumption expenditure*

Source: UOBAM, 29 Nov 2018

# Poll question 4:
# How many US Fed rate hikes do you expect in 2019?

1. Three or more
2. Two
3. One
4. Zero

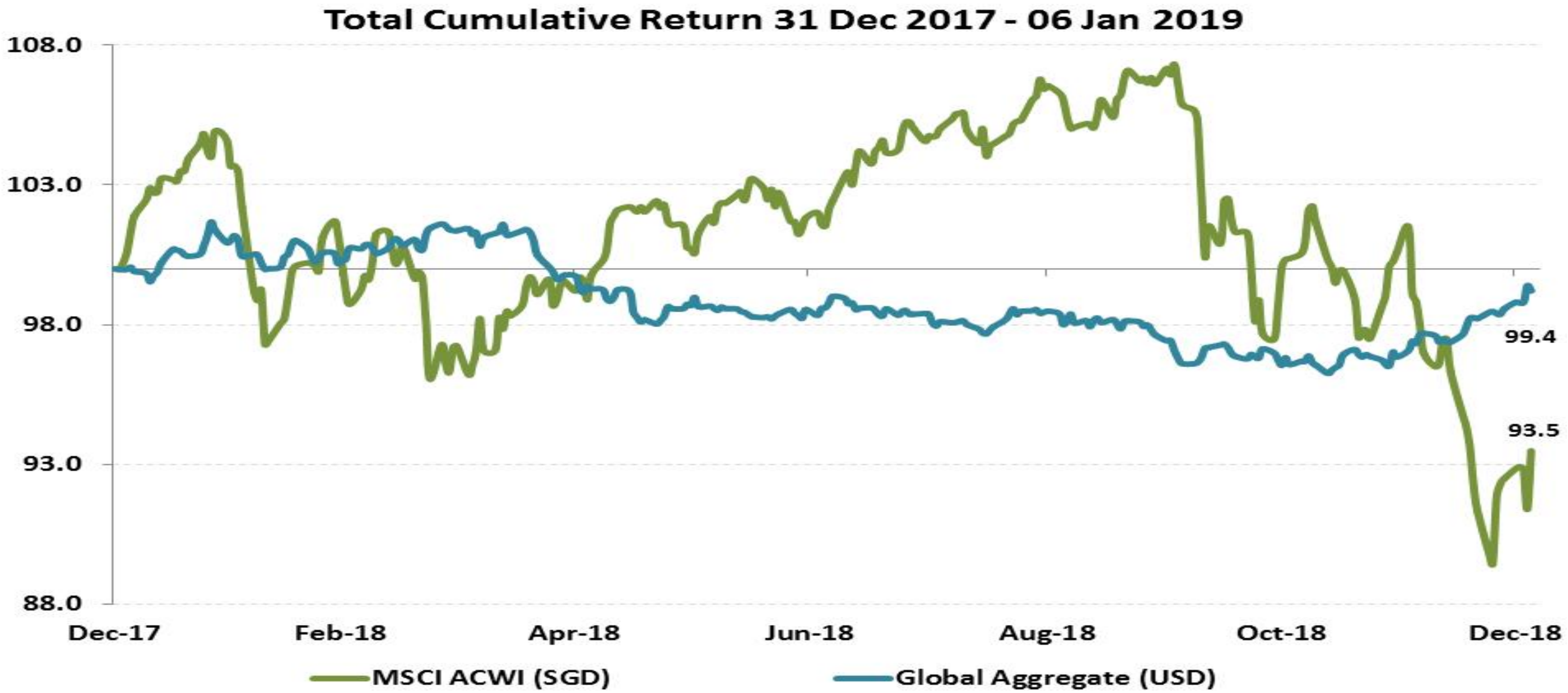
# Poll question 5:
# When do you expect the next global recession to happen?

1. 2019
2. 2020
3. 2021 or after

# Agenda

# 2018 review – Global equities and fixed income

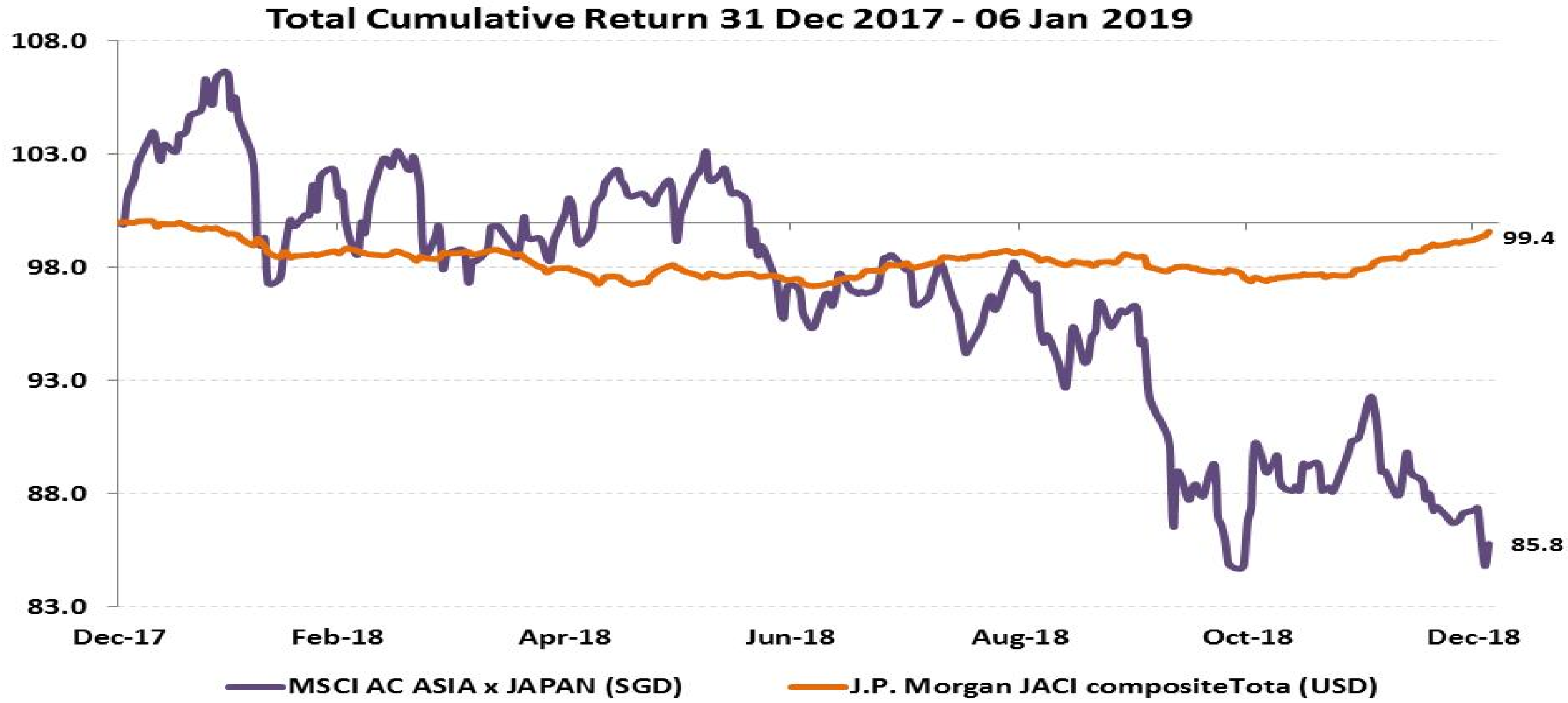
Global equities were performing adequately up to the fourth quarter, but the correction was severe.




Note:
GDP - Gross Domestic Product; USD – US Dollar
Source: UOBAM, 28 Dec 2018

# 2018 review – Asian equities and fixed income

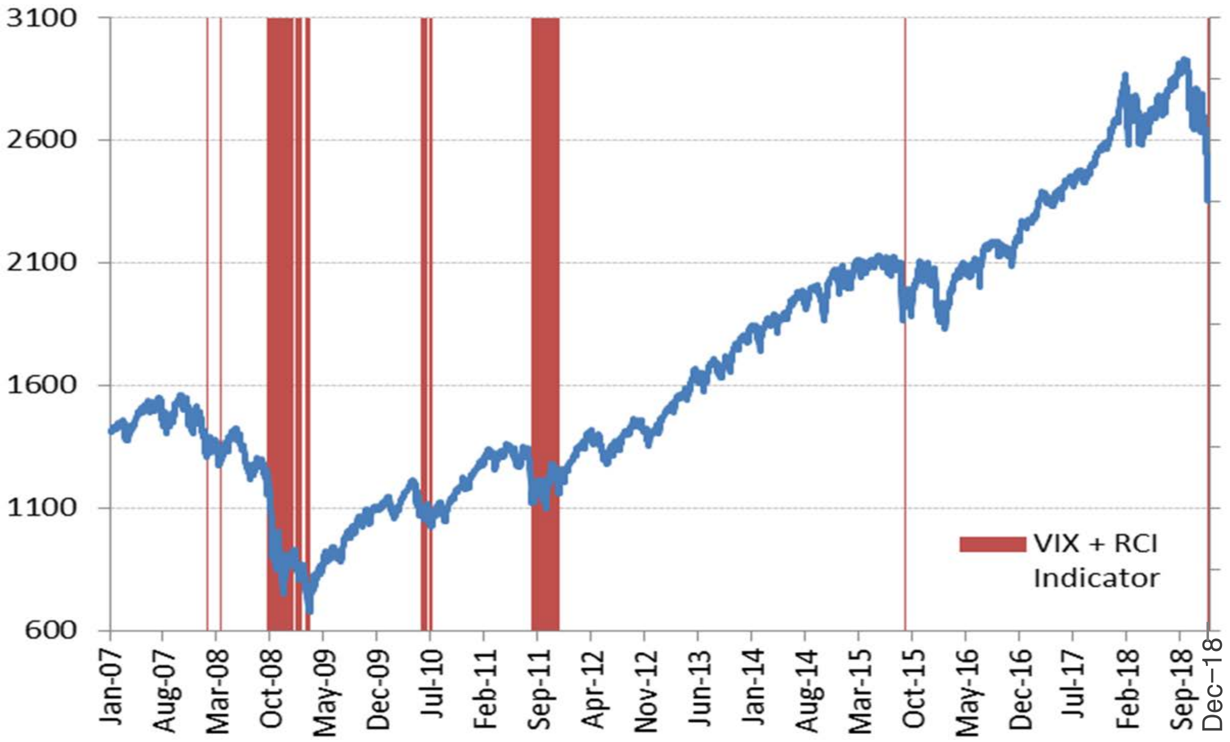
Asia struggled most of the year and especially around periods of heightened trade tensions.




Note:
GDP - Gross Domestic Product; USD – US Dollar
Source: UOBAM, 28 Dec 2018

# 2018 review – Dec 2018 correction triggered crisis signals

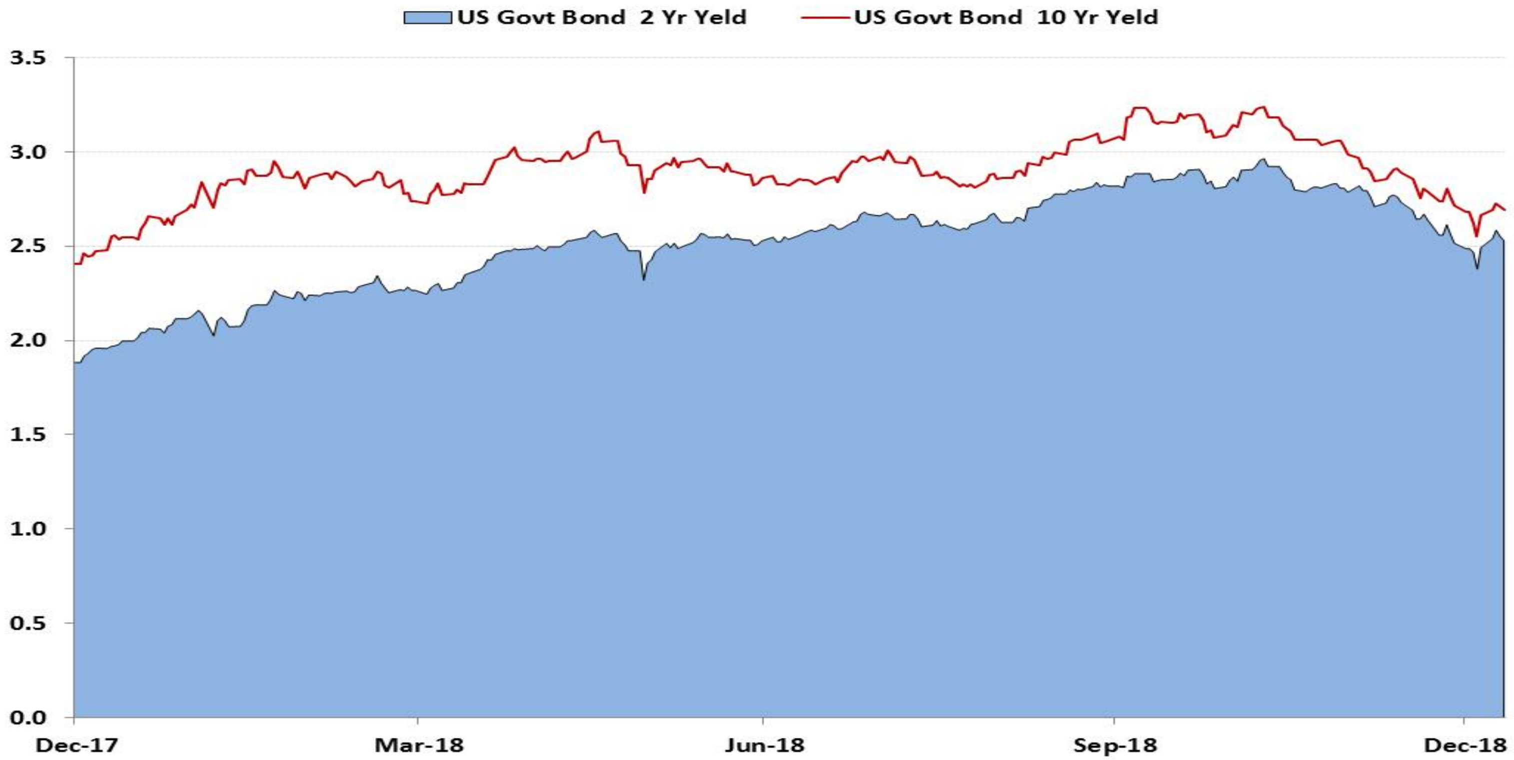
Volatility and Correlation signals hit threshold levels that signal "disorderly markets".
This indicates that markets are not operating on fundamentals and more caution is warranted.




Note:
GDP - Gross Domestic Product; USD – US Dollar
Source: UOBAM, 28 Dec 2018

# 2018 review – Government bond yields

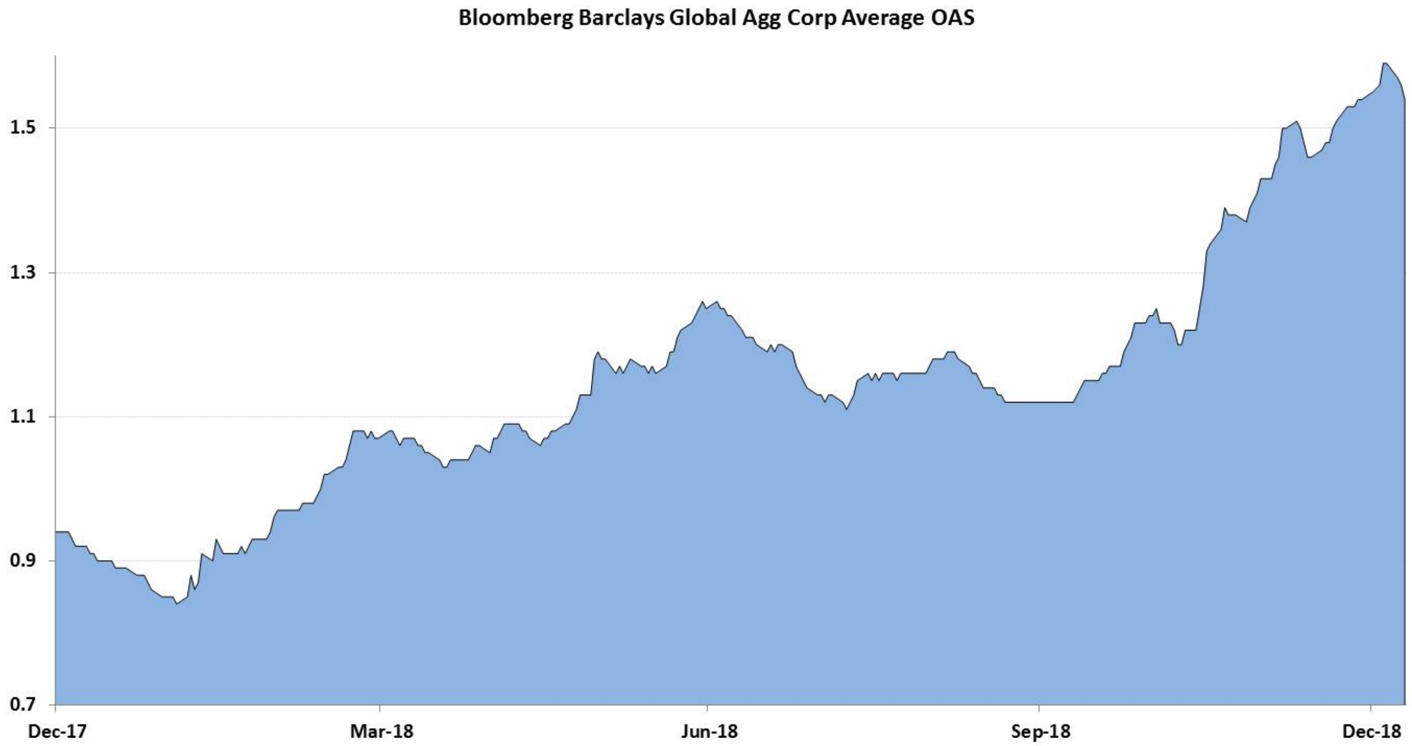
Rising bond yields is a steady headwind for fixed income performance.




Note:
GDP - Gross Domestic Product; USD – US Dollar
Source: UOBAM, 28 Dec 2018

# 2018 review – Global credit spreads

Fixed income investors were primarily focused on rising rates but credit spread widening was more severe.




Note:
GDP - Gross Domestic Product; USD – US Dollar
Source: UOBAM, 28 Dec 2018

# Agenda

# Going back to first investment principles

In markets, go back to **first principles**:

1. How healthy is global growth?
2. How strong are earnings?
3. What represents value at current prices?
4. What is the chance of a recession?

**A fundamentals scorecard-driven process such as ours still points to a strong outlook.**

# 2019 global growth outlook

Global growth in 2019 is expected to be slower than 2018, but still at a reasonable level of trending growth.

| Real GDP | Actual | | FORECASTS | |
|---|---|---|---|---|
| | 2016 | 2017 | 2018 | 2019 |
| World | 3.3 | 3.7 | 3.7 (3.7) | 3.5 (3.5) |
| United States | 1.6 | 2.2 | 2.9 (2.9) | 2.5 (2.6) |
| Eurozone | 2.0 | 2.4 | 1.9 (1.9) | 1.5 (1.6) |
| Japan | 0.6 | 1.9 | 0.8 (0.9) | 0.9 (0.9) |
| UK | 1.8 | 1.8 | 1.3 (1.3) | 1.5 (1.5) |
| China | 6.7 | 6.9 | 6.6 (6.6) | 6.2 (6.2) |
| India* | 8.2 | 7.1 | 7.2 (7.5) | 7.3 (7.3) |
| Brazil | -3.3 | 1.1 | 1.3 (1.3) | 2.5 (2.5) |
| Russia | 0.3 | 1.6 | 1.7 (1.7) | 1.5 (1.5) |

Figures in brackets are as of 31 December 2018

* India GDP from 2013 based on Fiscal Year ended March.

Note: All data are sourced from Bloomberg, Datastream and UOB Asset Management Ltd (UOBAM) unless otherwise stated, as at 16 Jan 2019

Source: UOBAM, Bloomberg, Dec 2018

# 2019 Asia growth outlook

Asia growth adequate but moderating from 2018 levels.

| COUNTRY FORECAST | Real GDP (YoY %) | | | CPI (YoY %) | |
|---|---|---|---|---|---|
| | FY2017 (ACTUAL) | FY2018 (FORECAST) | FY2019 (FORECAST) | FY2019 (FORECAST) | FY2020 (FORECAST) |
| ASIA x JAPAN | 6.2 | 6.0 | 5.7 | 2.4 | 2.5 |
| CHINA | 6.9 | 6.6 | 6.2 | 2.2 | 2.3 |
| HONG KONG | 3.8 | 3.4 | 2.5 | 2.4 | 2.3 |
| * INDIA | 7.1 | 7.2 | 7.3 | 3.8 | 4.5 |
| INDONESIA | 5.1 | 5.2 | 5.1 | 3.2 | 3.8 |
| KOREA | 3.1 | 2.6 | 2.5 | 1.6 | 1.8 |
| MALAYSIA | 5.9 | 4.7 | 4.6 | 1.0 | 2.0 |
| PHILIPPINES | 6.7 | 6.3 | 6.4 | 5.2 | 4.0 |
| SINGAPORE | 3.6 | 3.3 | 2.7 | 0.5 | 1.3 |
| TAIWAN | 3.1 | 2.7 | 2.3 | 1.5 | 1.2 |
| THAILAND | 3.9 | 4.2 | 3.9 | 1.1 | 1.3 |

* India GDP from 2013 based on Fiscal Year ended March. Old series from 2008-2012 based on Calender Year.

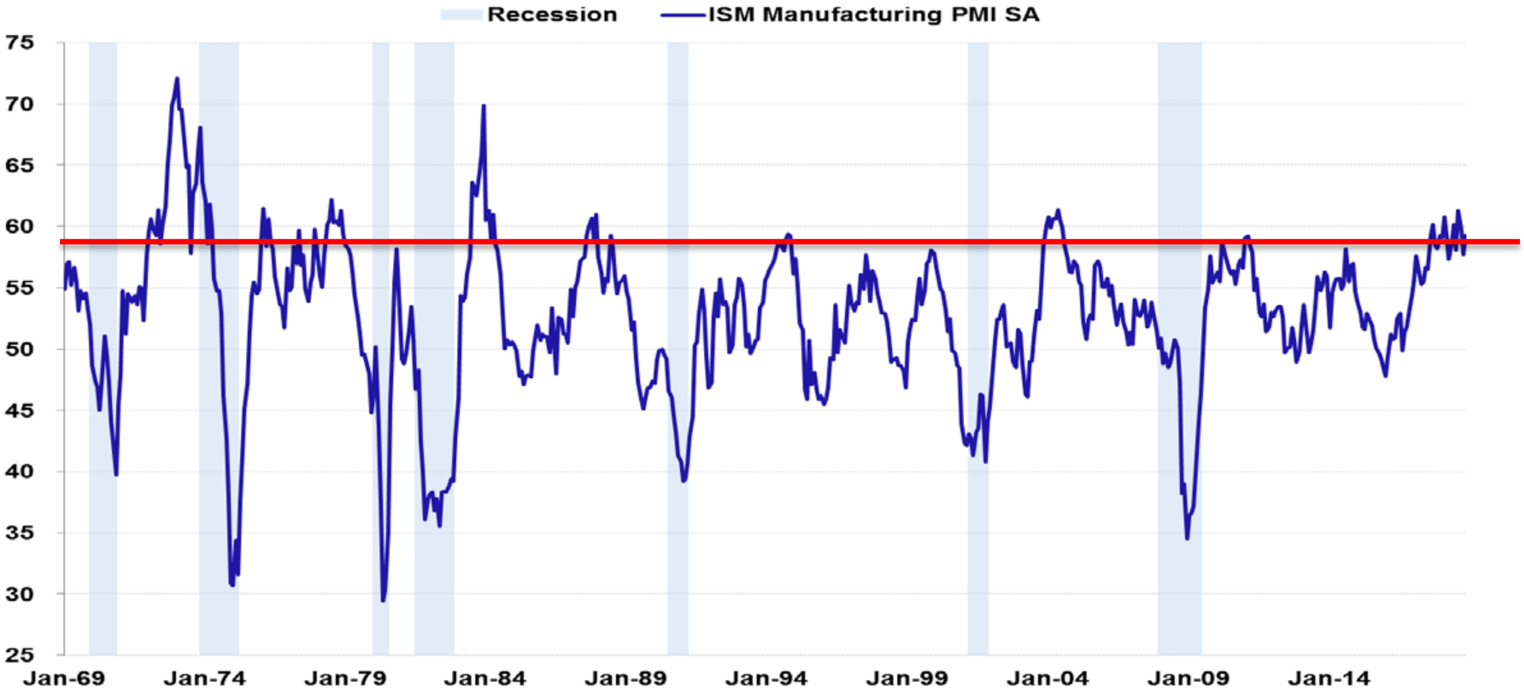
* India CPI from 2013 based on Fiscal Year ended March.

Source: Bloomberg, Updated as at 16 Jan 2019

Source: UOBAM, Bloomberg, Dec 2018

# US manufacturing surveys are in the top 2% of its readings

This level of non-inflationary growth has never led to a recession within a year.




Note:
GDP - Gross Domestic Product; USD – US Dollar
Source: UOBAM, 28 Dec 2018

# Global corporate earnings – Still supportive

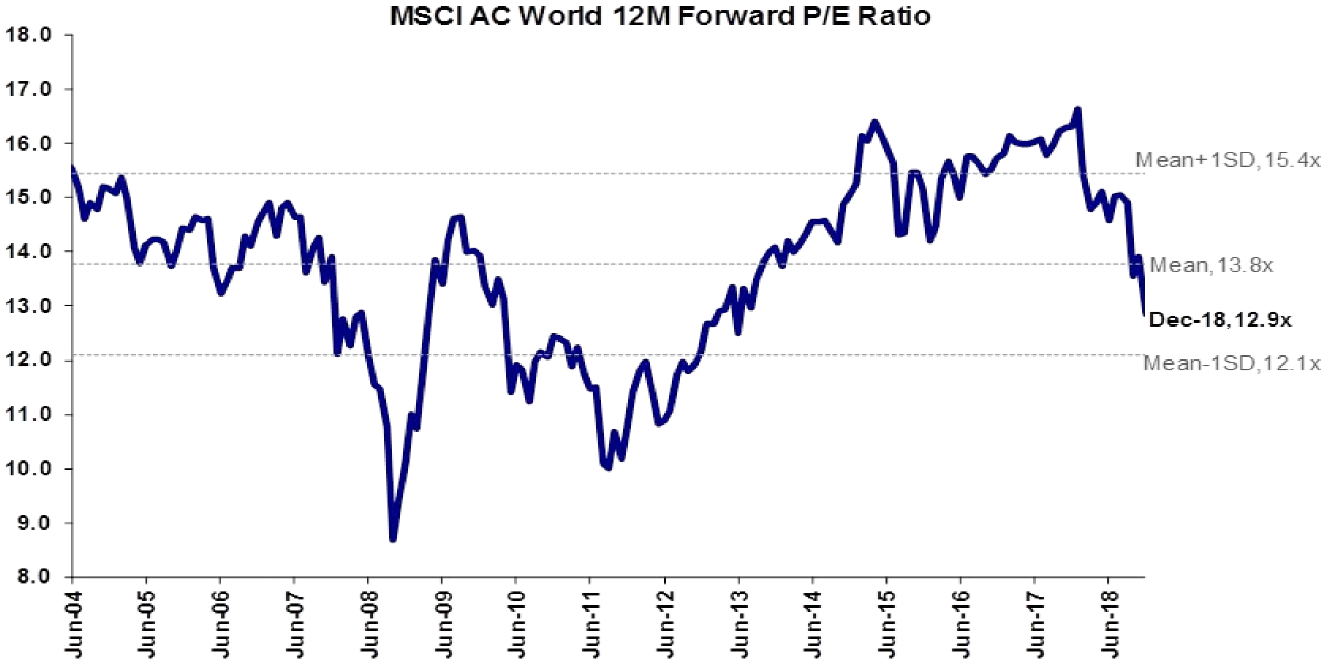
2019 earnings forecasts are still supportive of healthy equity market performance, though there are fears of downgrades.

| | PER | | DVD YLD | EPS Growth (YoY%) | | PBR | | ROE | |
|---|---|---|---|---|---|---|---|---|---|
| Regions | 2018E | 2019E | 2018E | 2018 | 2019E | 2018E | 2019E | 2018E | 2019E |
| AC World | 14.9 | 13.7 | 2.9 | 15.7 | 8.7 | 2.1 | 2.0 | 14.2 | 14.4 |
| World | 15.5 | 14.3 | 2.9 | 16.1 | 8.5 | 2.2 | 2.1 | 14.5 | 14.7 |
| US | 17.0 | 15.6 | 2.5 | 24.2 | 9.1 | 3.1 | 2.9 | 18.5 | 18.7 |
| Europe | 13.8 | 12.6 | 3.7 | 7.3 | 9.3 | 1.7 | 1.6 | 12.1 | 12.6 |
| Japan | 12.3 | 11.9 | 2.3 | 3.7 | 3.5 | 1.2 | 1.1 | 9.8 | 9.5 |
| Australia | 14.6 | 14.0 | 4.7 | 7.3 | 4.8 | 1.8 | 1.7 | 12.4 | 12.5 |
| Canada | 13.9 | 12.5 | 3.0 | 14.1 | 11.1 | 1.7 | 1.6 | 12.1 | 12.6 |
| Asia Ex Japan | 11.9 | 10.9 | 3.0 | 9.9 | 9.2 | 1.4 | 1.3 | 11.7 | 11.8 |
| Latam | 13.4 | 11.3 | 2.9 | 16.3 | 18.4 | 1.8 | 1.7 | 13.7 | 14.9 |
| EMEA | 9.1 | 8.4 | 4.1 | 20.5 | 8.1 | 1.2 | 1.1 | 13.5 | 13.0 |

Source: UOBAM, MSCI Datastream, 21 Nov 2018

# MSCI AC World PE valuations have turned attractive over the past year

Strong earnings and weak prices have made markets attractive.

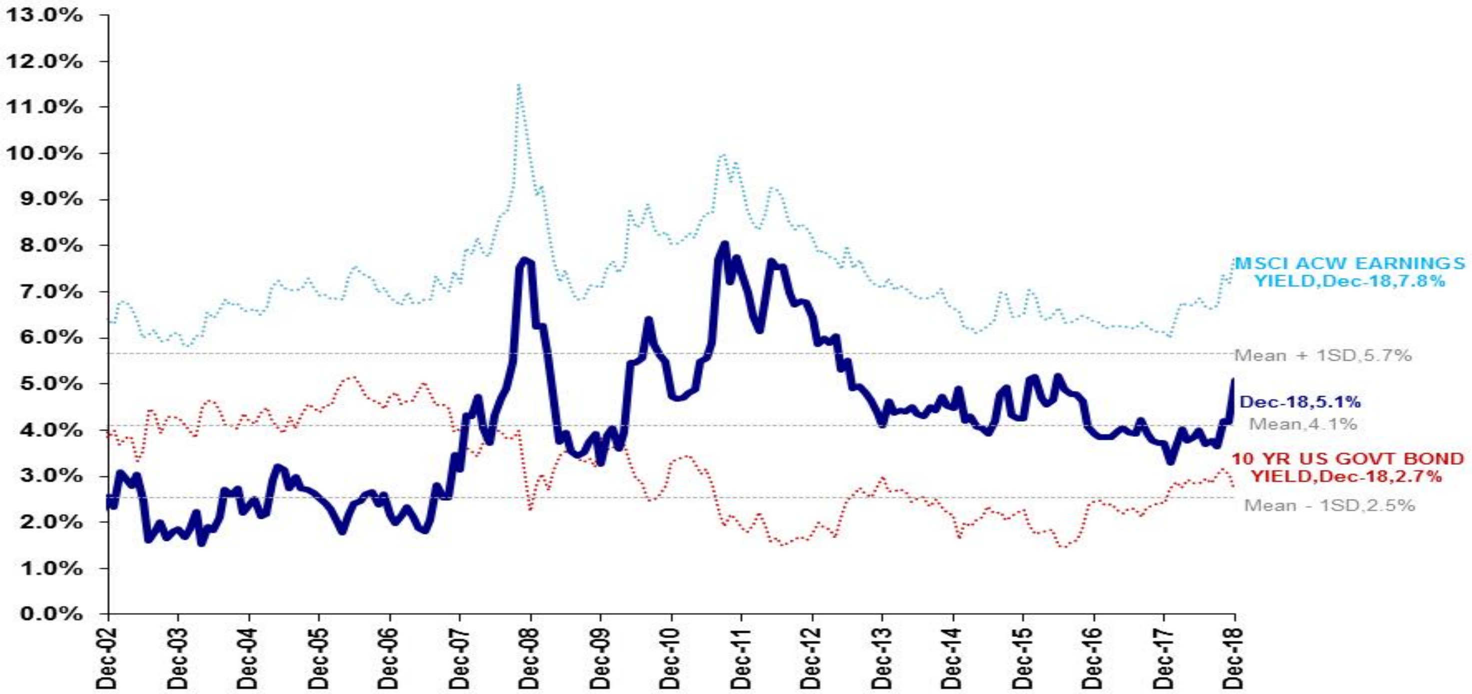



Source: MSCI IBest, Datastream, 30 December 2018

Note:
GDP - Gross Domestic Product; USD – US Dollar
Source: UOBAM, 28 Dec 2018

# MSCI AC World earnings yield spread highlights how equities are relatively very attractive

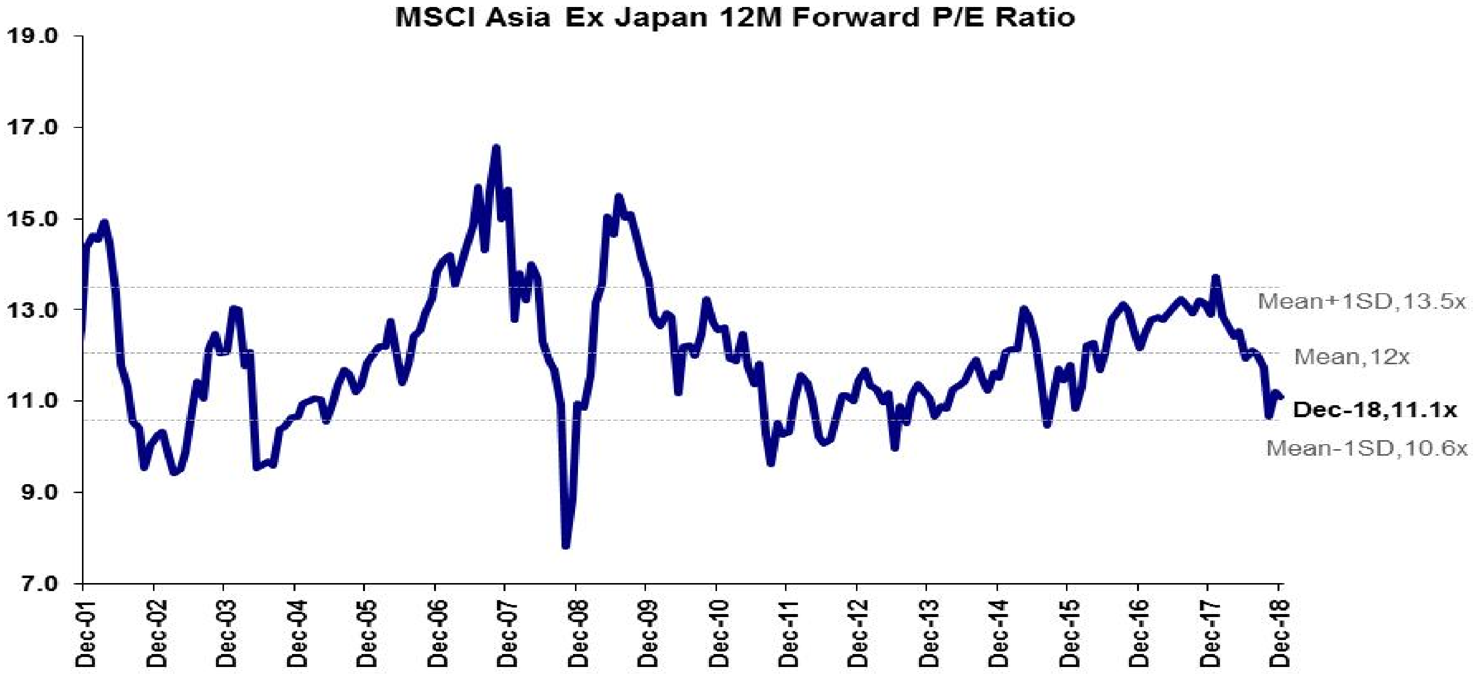
Earnings yield – remaining as one of our preferred equity valuation criteria – has also turned attractive.




Note:
GDP - Gross Domestic Product; USD – US Dollar
Source: UOBAM, 28 Dec 2018

# MSCI Asia ex Japan PE valuations

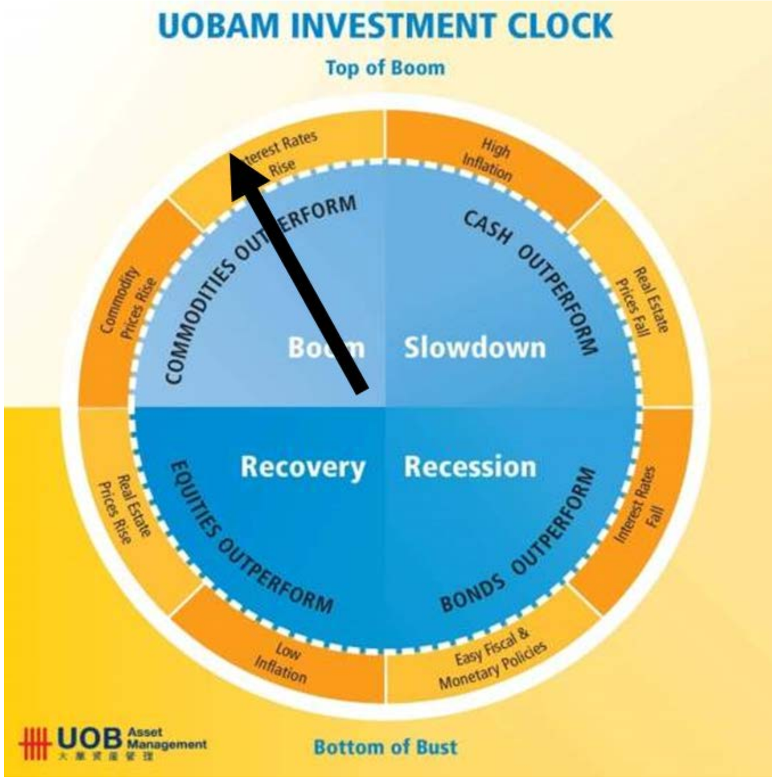
Asia valuations are low.




Source: MSCI IBest, Datastream, 30 December 2018

Note:
GDP - Gross Domestic Product; USD – US Dollar
Source: UOBAM, 28 Dec 2018

# Investing in a maturing cycle



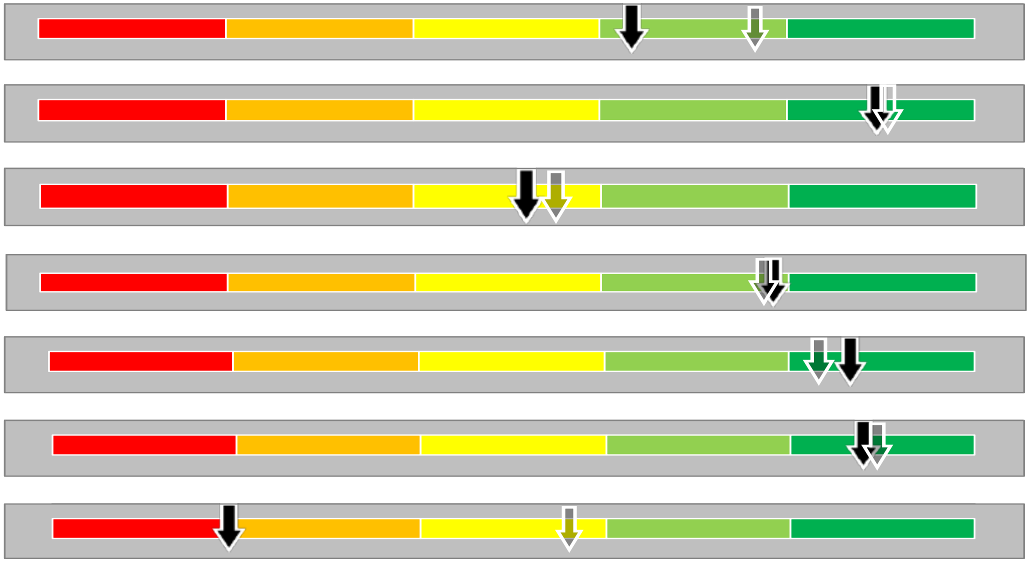

- US Fed normalisation means the clock is ticking.
- Inflation and rising rates are now the key risks to the cycle.
- Until the cycle fully matures, the stock/bond ratio will increase and assets such as property and commodities should be well-supported.

Source: UOBAM, 31 Dec 2018

# Recession checklist – Current status

The models and indicators we monitor for the potential end of the cycle are not giving warning signals yet.

| Recession Indicators | | Warning Signal |
|---|---|---|
| 1 | Yield Curve Inversion | |
| 3 | Leading Indicators Fading | |
| 3 | Leverage concerns | |
| 4 | FED probability models | |
| 5 | Financial Stress (Vol and OIS Spreads) | |
| 6 | High Yield vs IG spreads | |
| 7 | Market correlation spikes | |

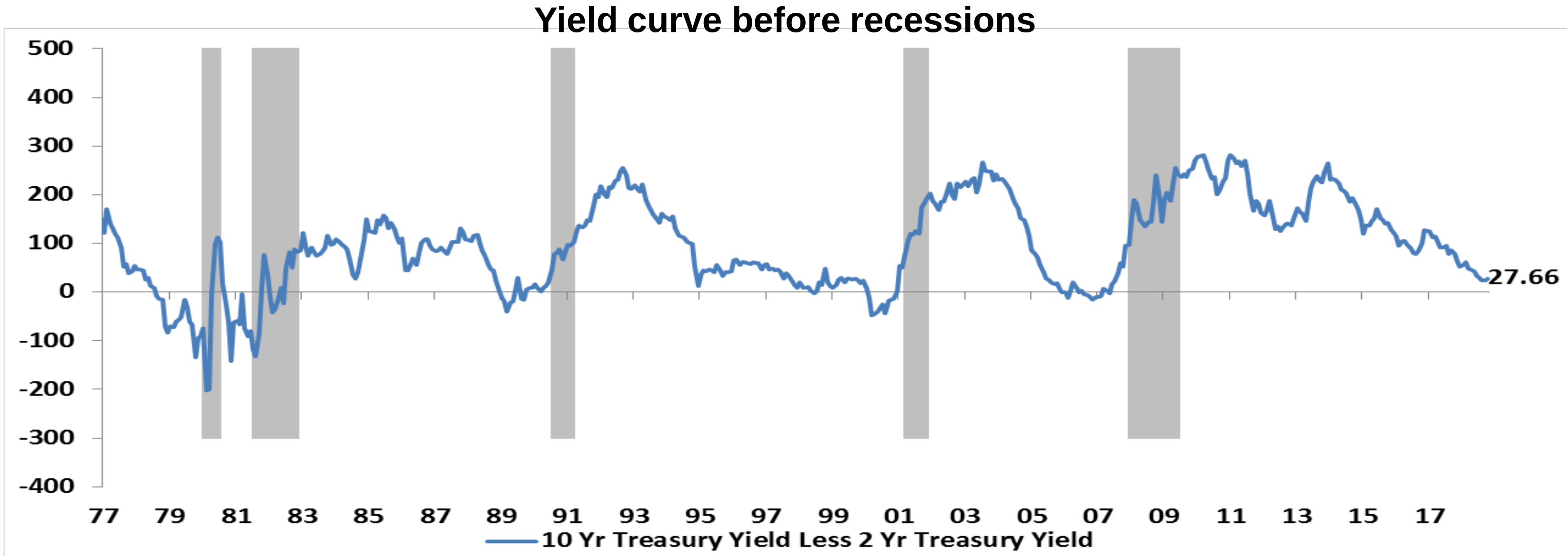


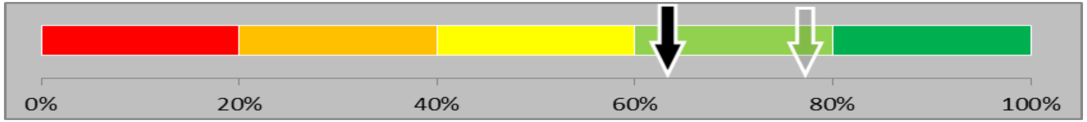
= No Trigger Signal
= Warning
= Trigger Indicates Recession

Source: UOBAM, 31 Dec 2018

# Recession checklist – Yield curve

The yield curve inverted an average of 17 months prior to the last five recessions.
We estimate we are six to 12 months before the yield curve inverts.




| Yield Curve Inverts | Recession Begins | Months Between |
|---|---|---|
| Sep-78 | Feb-80 | 17 |
| Aug-80 | Aug-81 | 11 |
| Jan-89 | Aug-90 | 19 |
| Feb-00 | Apr-01 | 14 |
| Feb-06 | Jan-08 | 23 |
| | **Average:** | **17** |

Source: UOBAM, 29 Dec 2018

# History of inversions

**Late 1980s Cycle**
- The 2-10 yield curve inverted in Jan 1989.
- Global equity market performance in the next 12 months was 12%.
- The next recession started 1991.

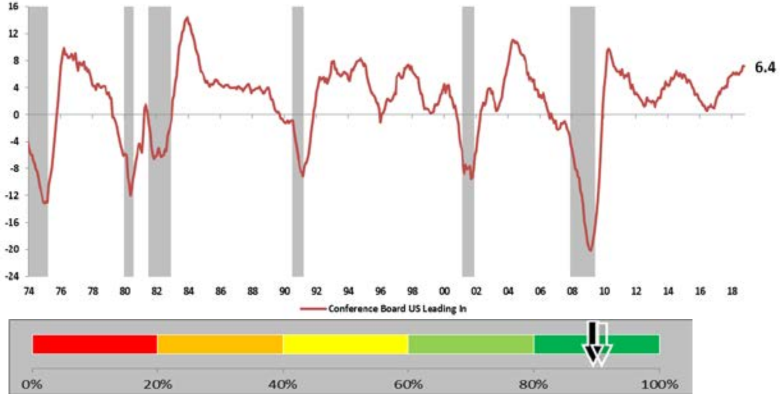
**Late 1990s Cycle**
- The 2-10 yield curve inverted in Jun 1998.
- The global equity market performance over the next 12 months was 18%.
- The next recession started in Mar 2001.

**The 2000s Cycle**
- The 2-10 yield curve inverted in Jan 2006.
- The global equity market performance over the next 12 months was 12%.
- The next recession started Dec 2007.

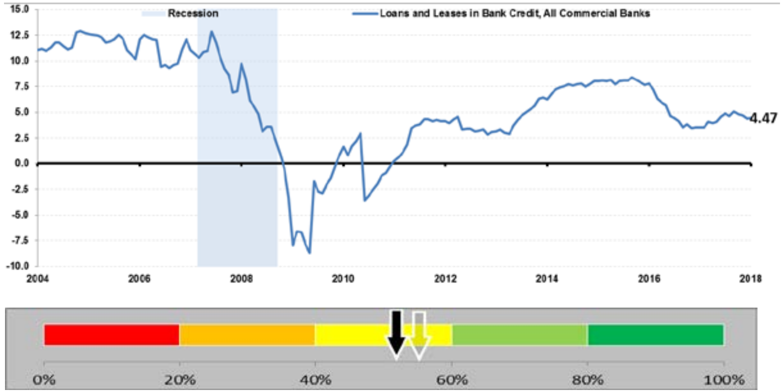
Source: UOBAM, 29 Dec 2018

# Recession checklist – Indicators

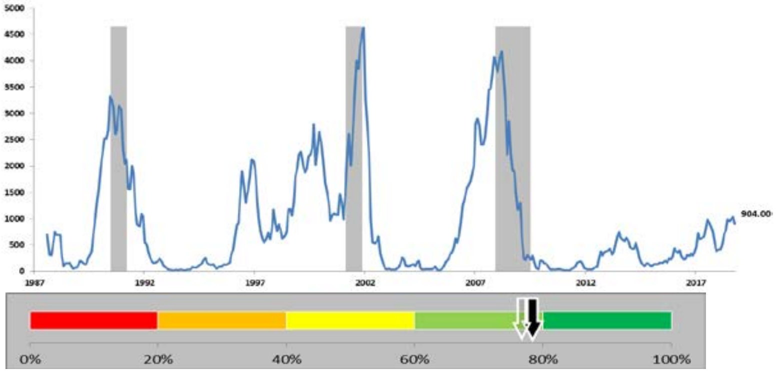
## Leading indicators before recessions



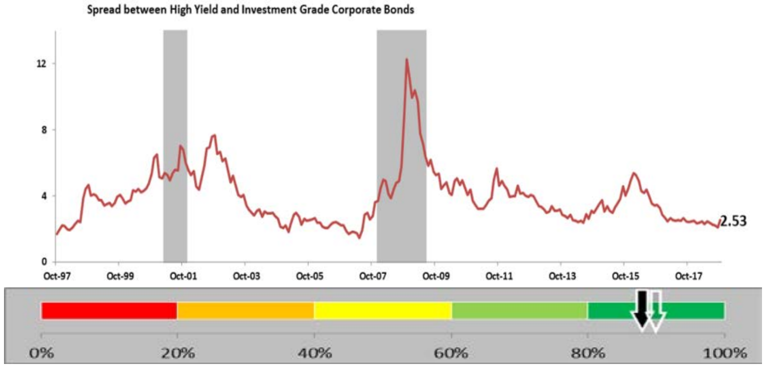

## Leverage and lending




## Recession Probability Models




## High yield vs IG credit spreads

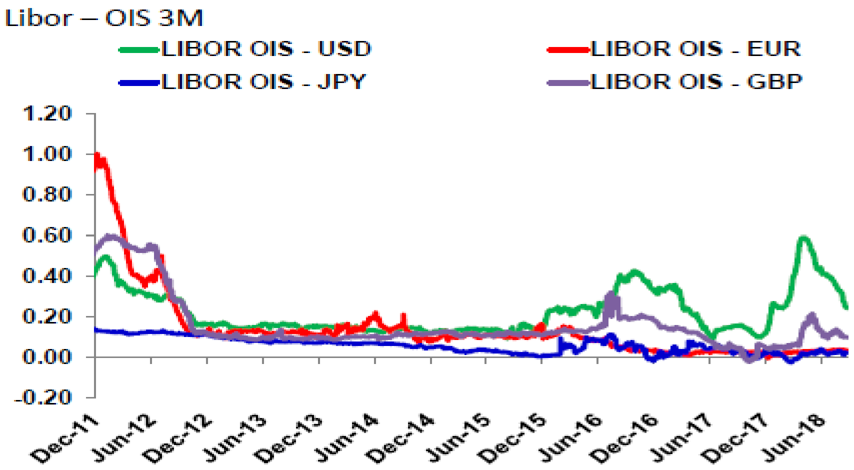


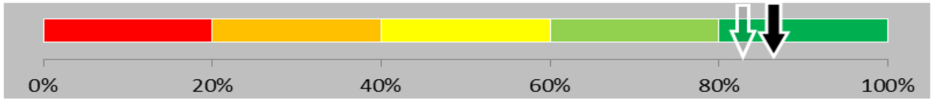

Source: UOBAM, 31 Dec 2018

# Recession checklist – Market signals

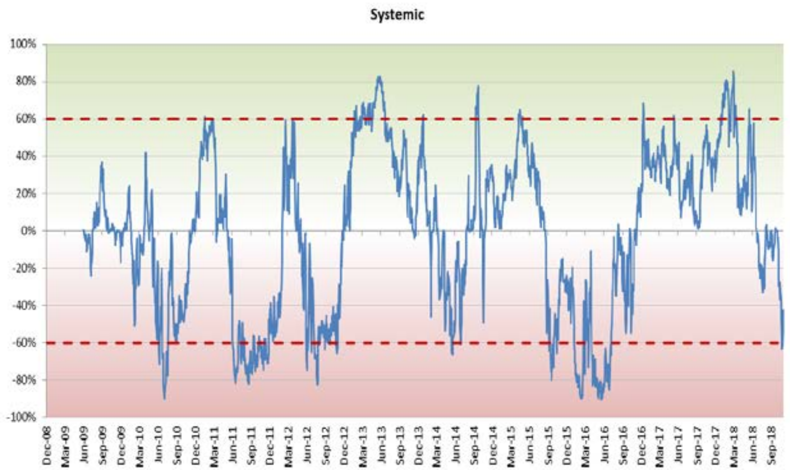
Market behaviour in bank liquidity spreads and market correlations are not indicating any signs of distress.

## Bank Liquidity Spreads




## Asset Correlations




Safe

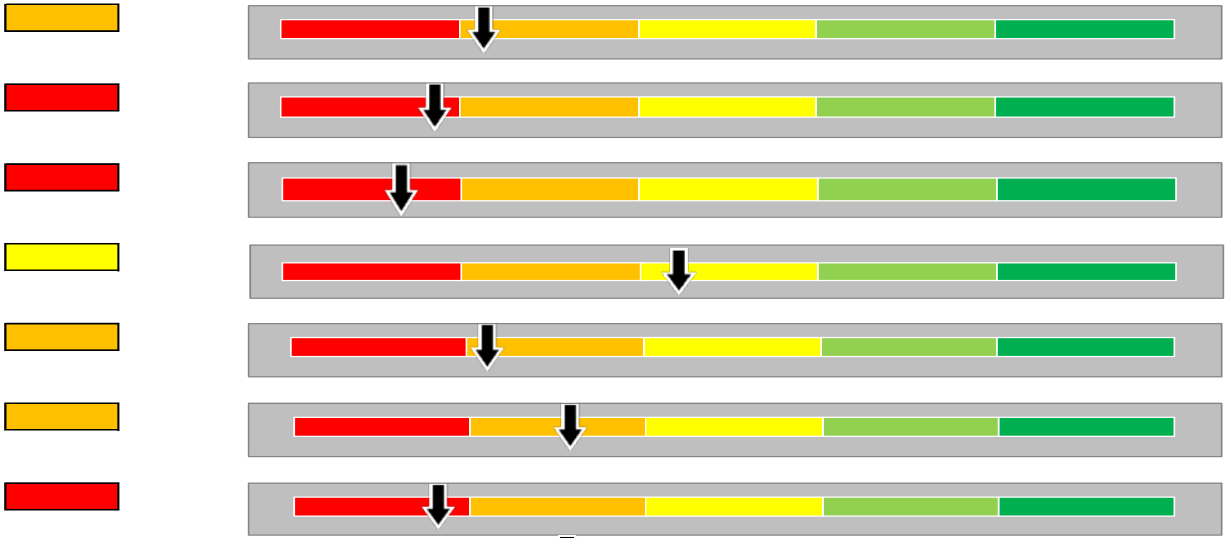
Danger


Source: Bloomberg, US Fed, UOBAM, 22 Nov 2018

# Recession checklist – Status in mid-2007

We are often asked – how did the recession checklist look prior to the last recession?

| Recession Indicators | | Warning Signal |
|---|---|---|
| 1 | Yield Curve Inversion | |
| 3 | Leading Indicators Fading | |
| 3 | Leverage concerns | |
| 4 | FED probability models | |
| 5 | Financial Stress (Vol and OIS Spreads) | |
| 6 | High Yield vs IG spreads | |
| 7 | Market correlation spikes | |



Denote current levels in the respective checklist

= Intermediate levels

= No Trigger Signal

= Warning

= Trigger Indicates Recession

Source: UOBAM, 28 Sep 2018

# Agenda

# Will the market "issues" persist in 2019?

1. **US Fed –** interest rate hikes too rapid, quantitative tightening too aggressive.

2. **Trade tensions –** Starting to impact growth and profitability.

3. **Late cycle worries –** Ageing cycle triggers investor jitters at first hint of a problem.

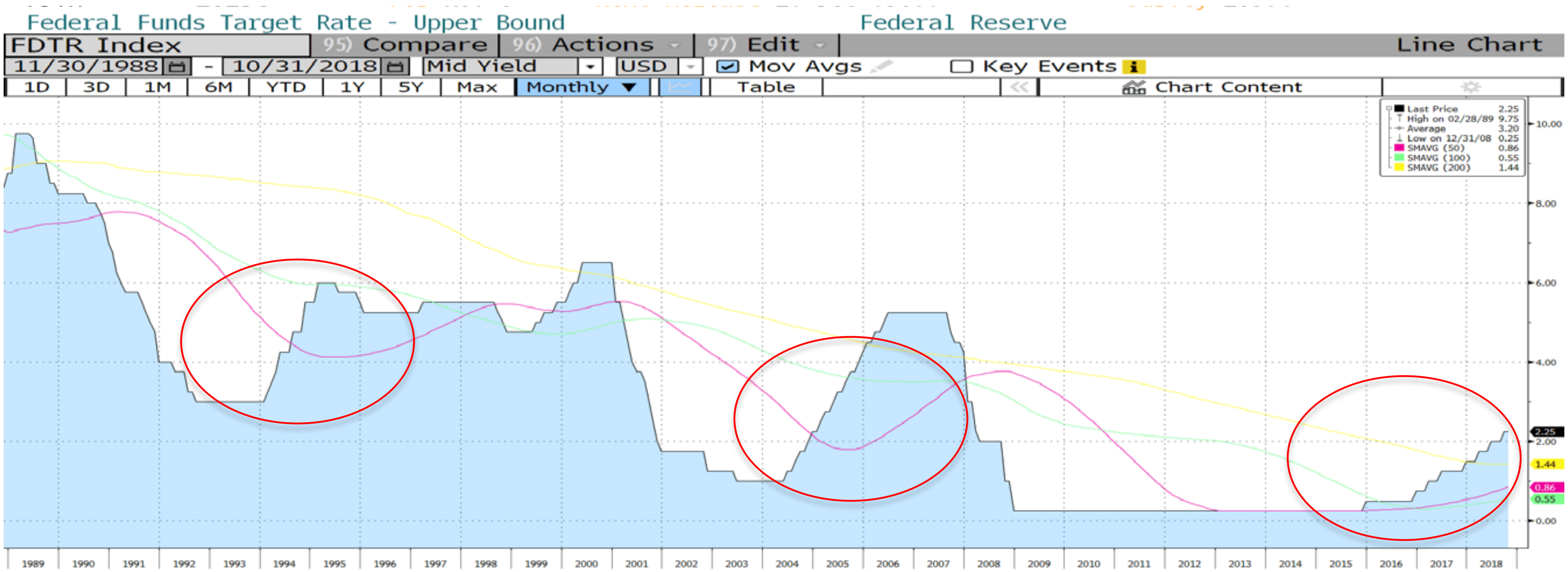
4. **The Trump Slump–** Weaker policy leadership compared with 2008 implies that even moderate problems could become a crisis.

5. **Brexit** – Uncertainties and concerns around a hard Brexit scenario.

Source: UOBAM, 29 Dec 2018

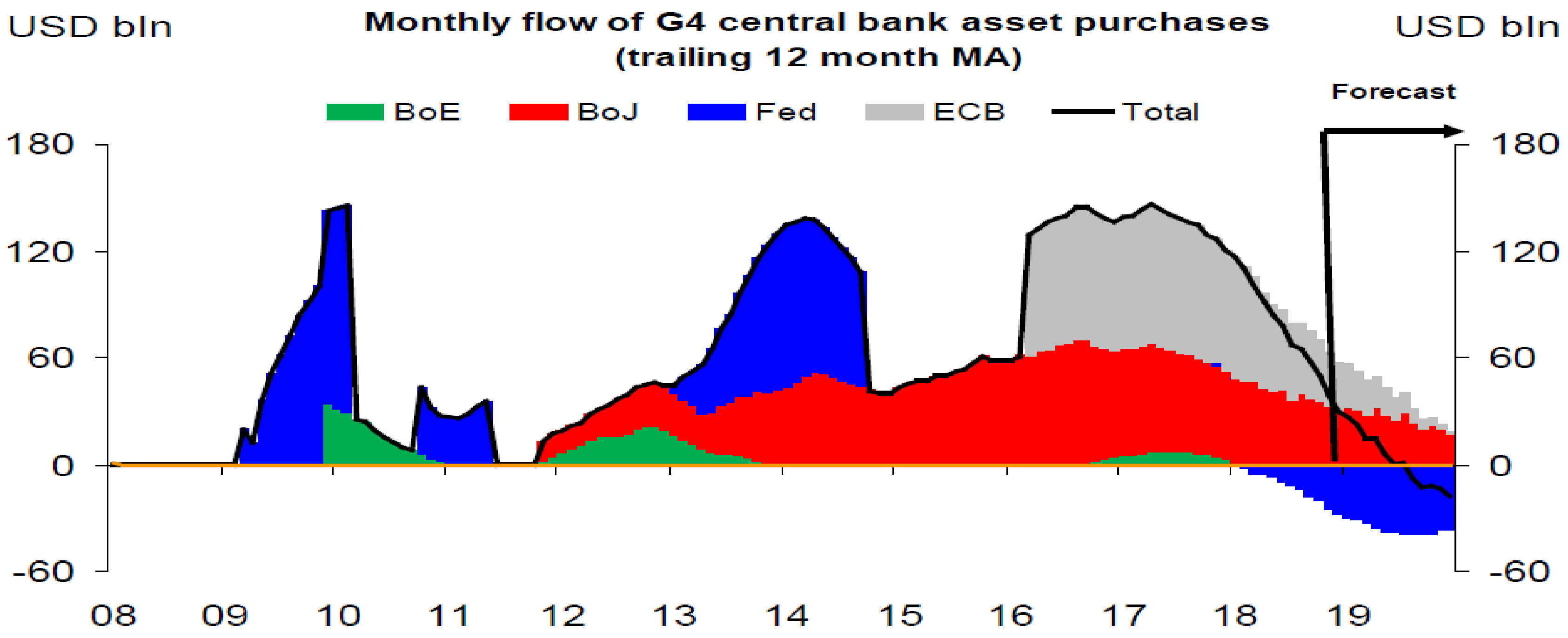
# US Fed Funds rate cycles – We argue that 2018 hiking looked more like 2004/2005 than 1994

In hindsight, market performance of stocks and bonds behaved much more like 2004 than 1994.
*(1994: Global equities were down 6%, FI down 4%; 2004: Global equities up 11%, FI up 4%)*




Source: Bloomberg, UOBAM, 29 Dec 2018

# QT and QE reductions are affecting global liquidity, turning 2018 into a 1994

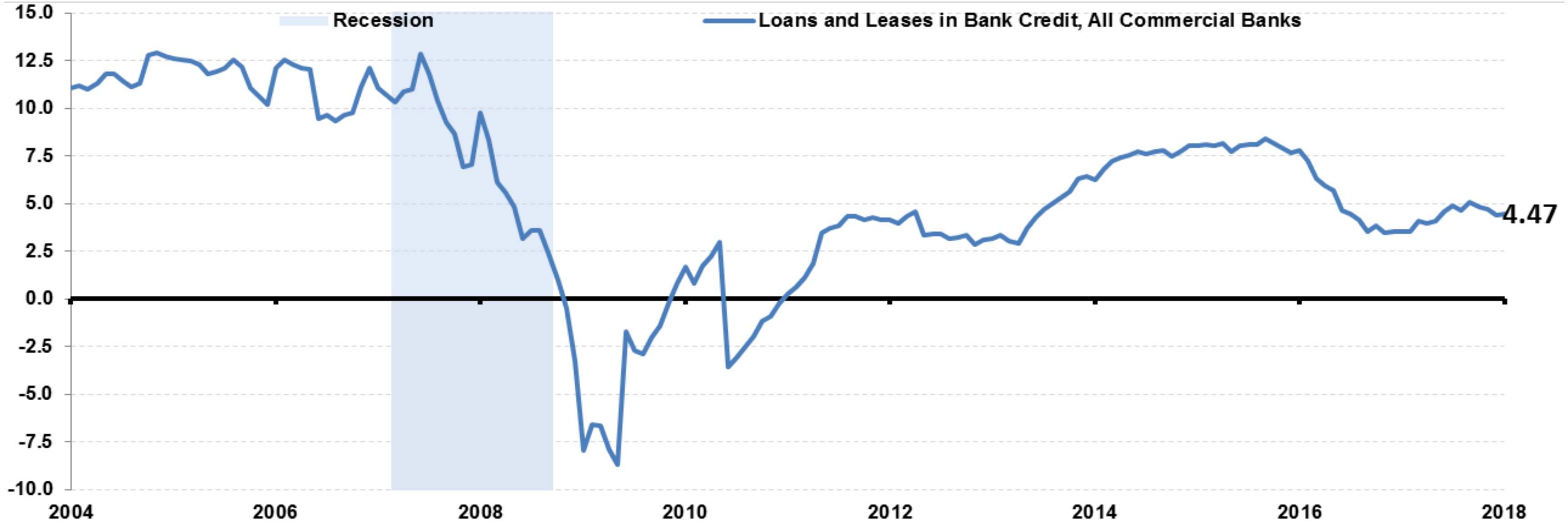



Assumptions: Fed will redeem assets to the terminal cap of $ 50 bn consistent with the FOMC's Sep 2017 decision and the June 2017 addendum. ECB will buy EUR 15 bn worth assets in Oct, Nov and Dec 18 and then stop buying. BoJ to buy the average of 2018 so far in Oct, Nov and Dec 2018 and then stealth taper from Jan 2019 to bring monthly purchases to zero by Dec 2019. FX in the forecast assumed to be the same as Sep 2018.

Source: Fed, ECB, BoJ, BoE, Haver Analytics, DB Global Research

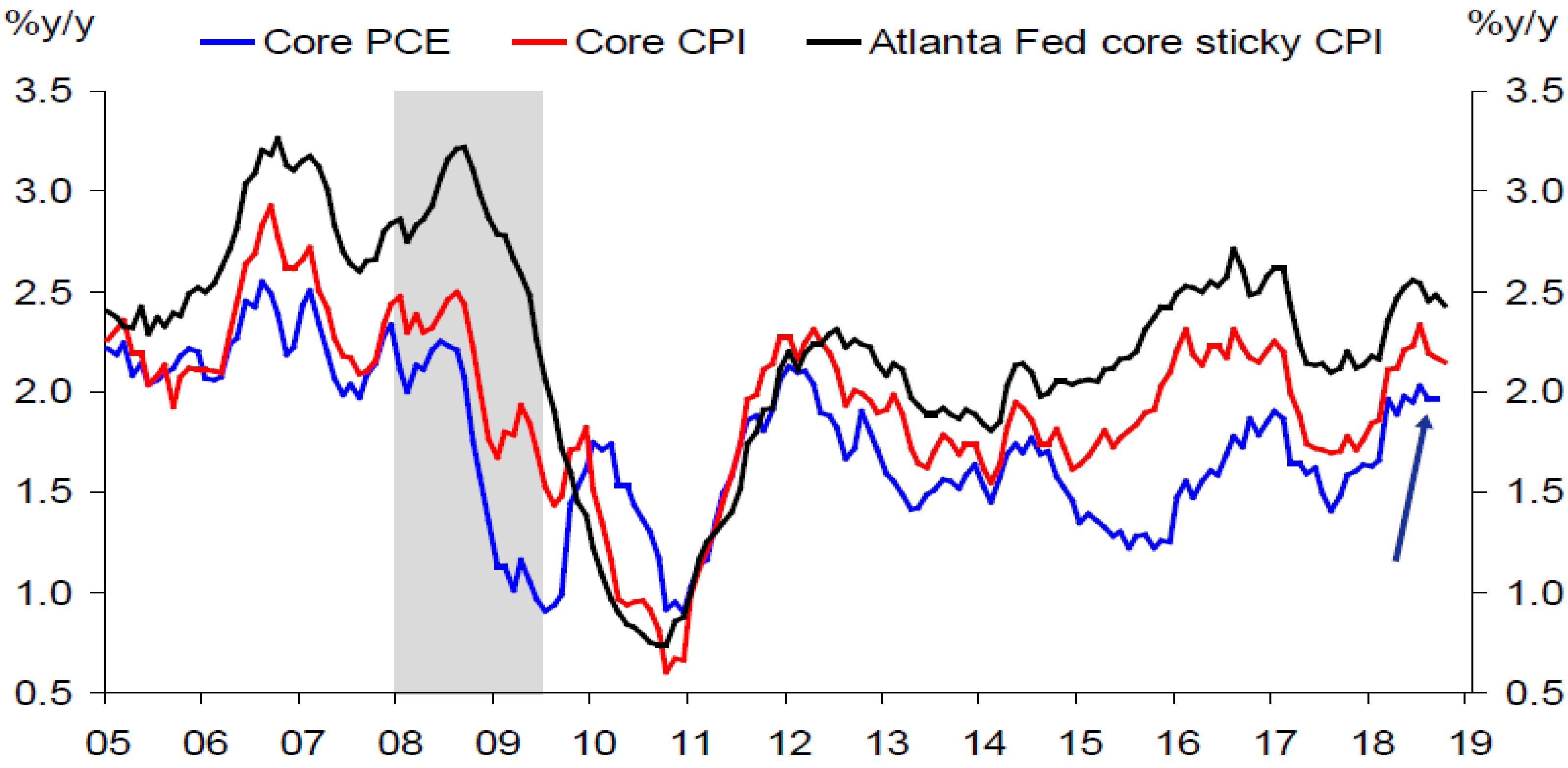
# Below the radar contribution to tight liquidity – low private sector loan growth

Usually, the US Fed raises interest rates because it is concerned about the overheating of lending. Higher interest rates should cool it off. But in this cycle, loan growth was not high.



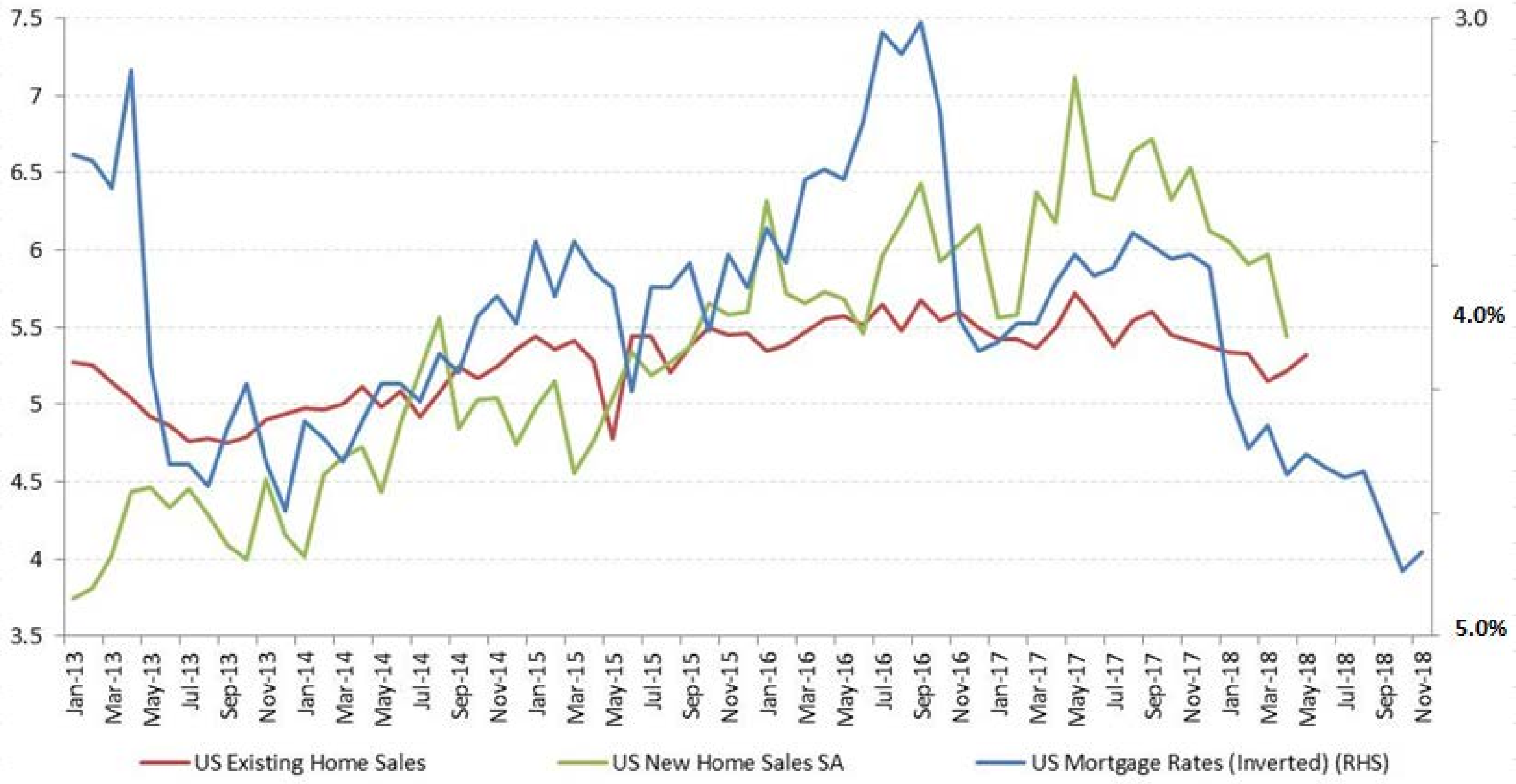

Source: UOBAM, 29 Dec 2018

# Inflation was rising for most of 2018, but peaked in the 4th quarter and has been stable




Source: UOBAM, 24 Dec 2018

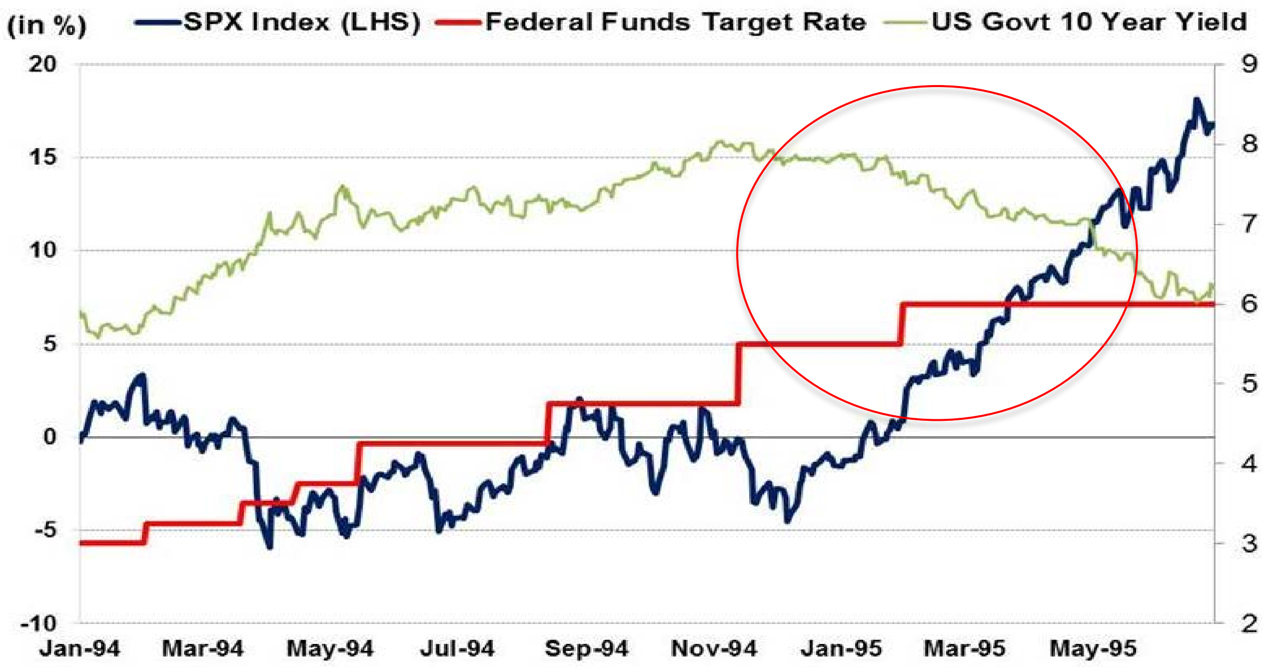
# US Fed risks – Rising rates may be affecting housing




Source : UOBAM, 29 Nov 2018

# So, if 2018 is looking like 1994, will 2019 look like 1995?

When the inflation scare in 1994 eased, the US Fed paused rate hikes in early 1995. Recession fears proved unfounded and equities rallied in 1995.

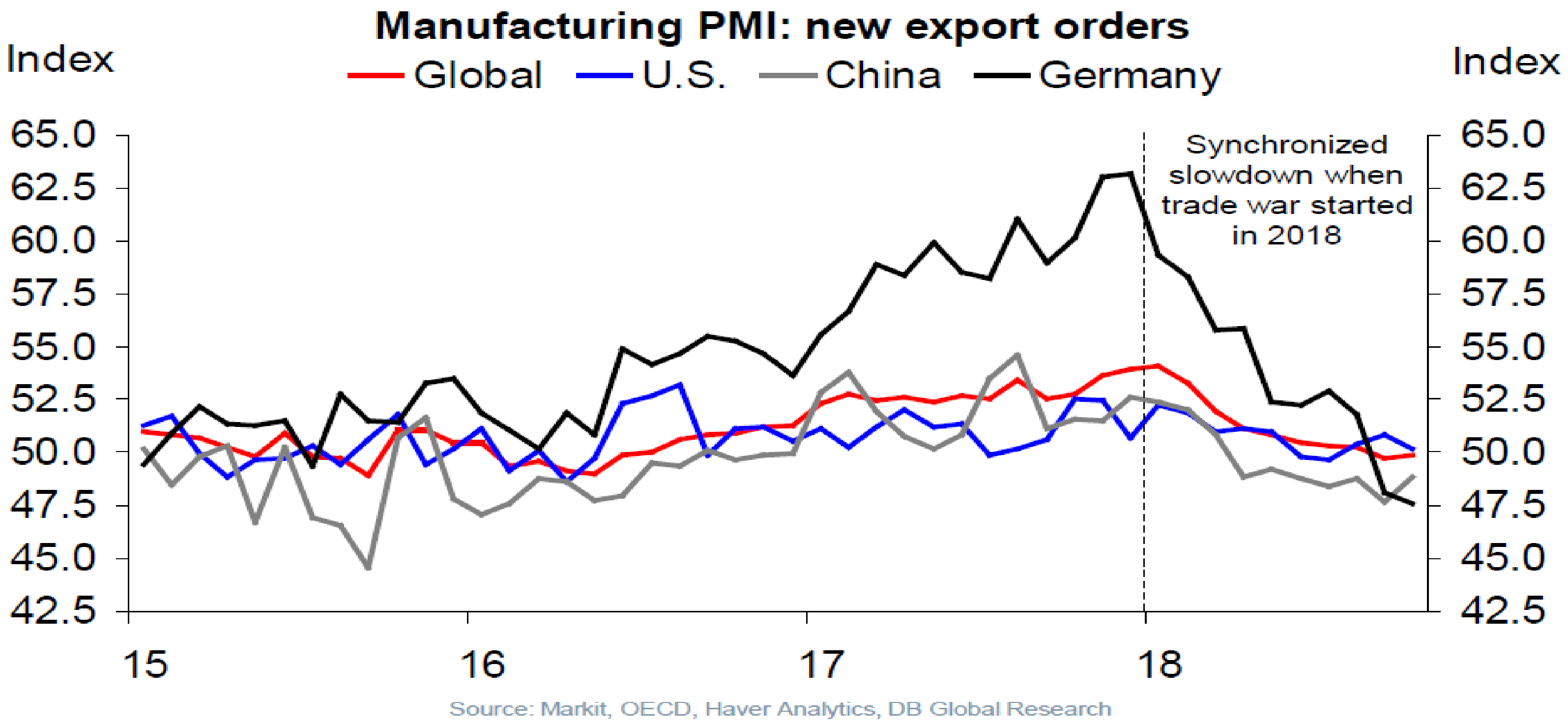



Source: MSCI, Bloomberg, 30 June 1995

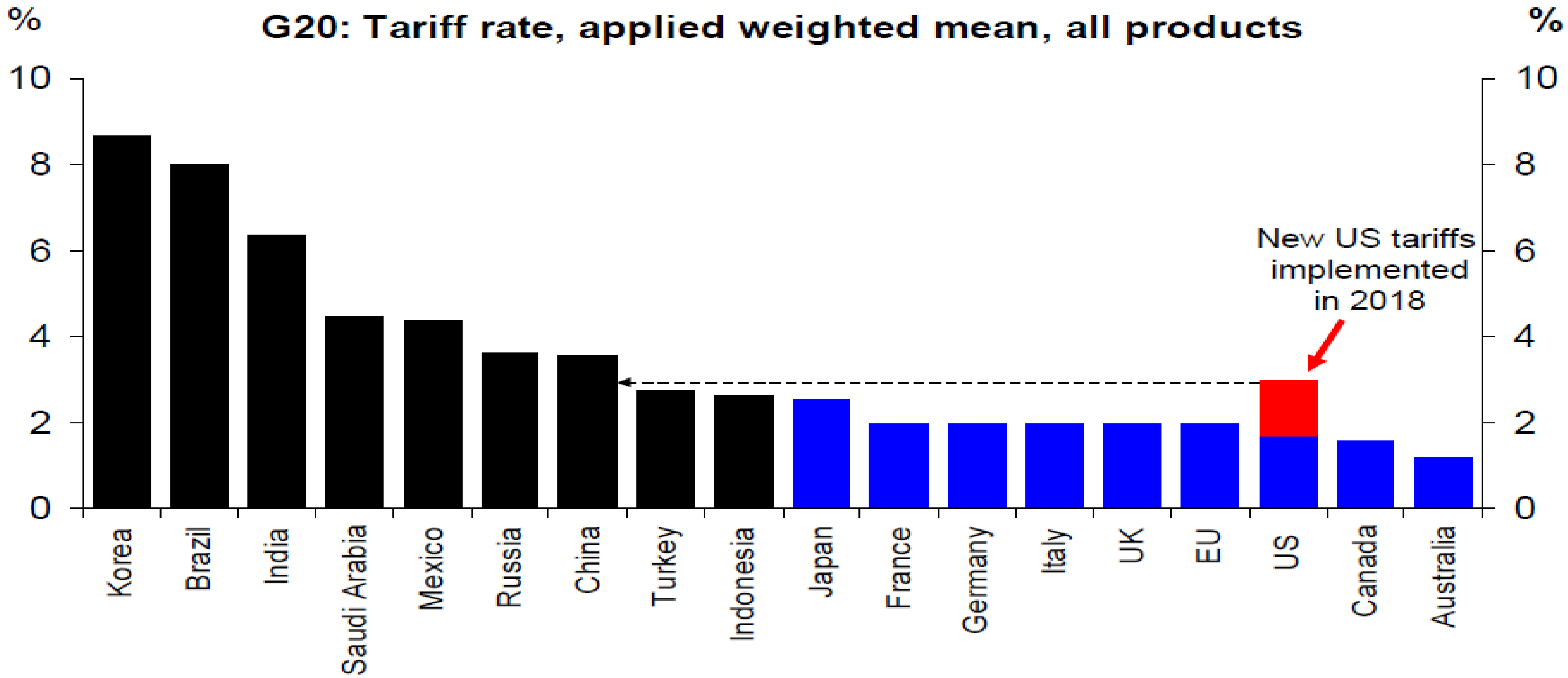
# Trade tensions remain a key risk in 2019

Source: Stock image

# Increasing evidence that trade is affecting growth

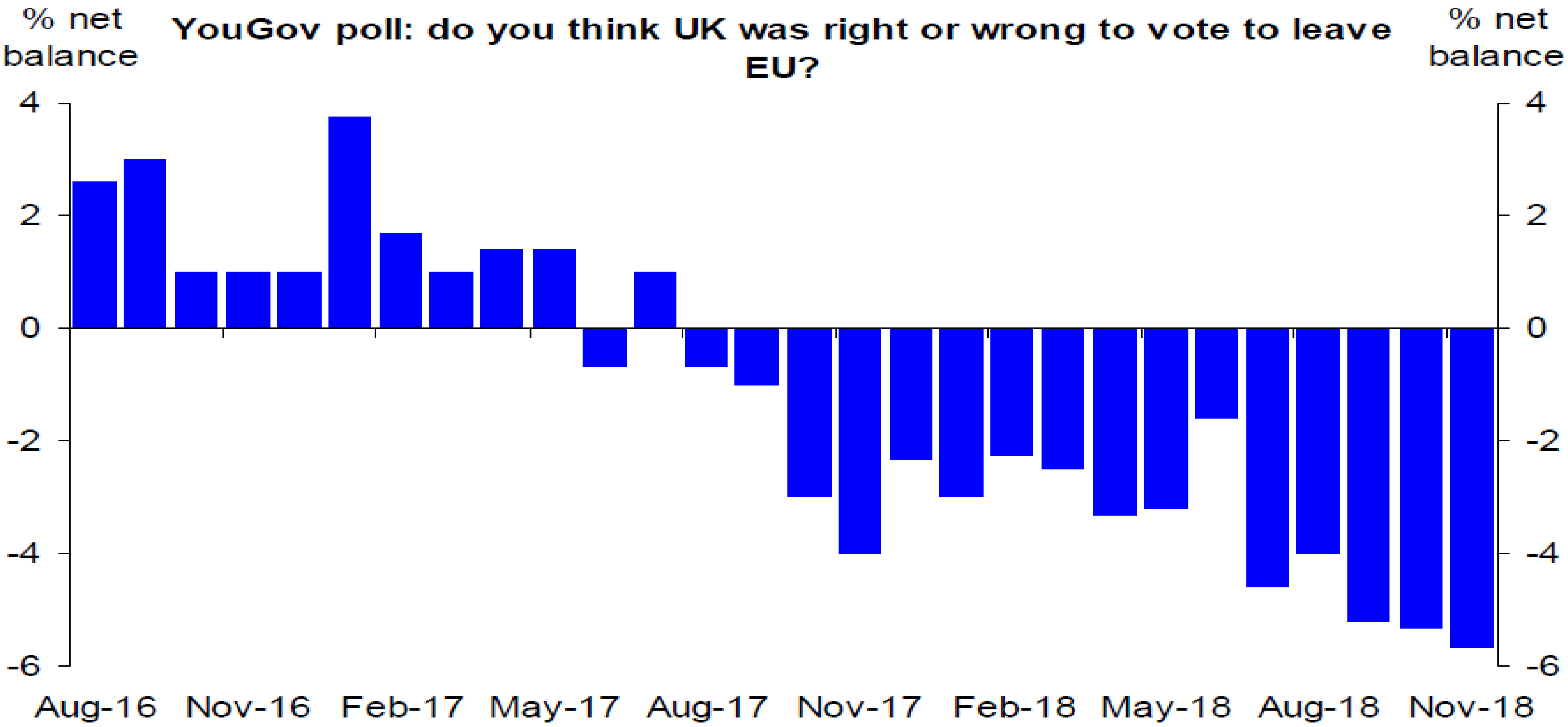


# Increasing evidence that trade is affecting growth




Source: World Bank data from 2016, Justin Weidner, Haver Analytics, DB Global Research

# Brexit referendum is a potential threat that can be used to reign in hardliners




Source: YouGov, DB Global Research

# Agenda

# Macro outlook conclusion

- The fourth quarter market turmoil was **more severe** than other bull market corrections
  - Outside the norms of what we have seen before, triggering our "crisis tools".

- Ultimately the 2019 call needs to determine if the 4th quarter correction was a warning signal or an aberration from which markets can rebound.

- Beyond the "warning", the **first principles of healthy growth, good earnings, reasonable valuations, low recession risks** and the clearing of much of the headwinds would point to healthy markets in 2019 for both equities and credits.

- Our approach to the start of 2019 is to **keep to our fundamental views**
  - But we respect our risk management process that moderates risk taking when we get severe market signals.

- Our broad recommendation remains driven by **fundamentals**, **staying invested and balanced**, and **following risk mitigation signals** to help deal with the market volatility.

Source: UOBAM, 29 Dec 2018

# 2019 fixed income outlook

We have already expressed our views that recession risks are low and we see modest growth with controlled inflation.

The fixed income outlook is supported by:

1. **Peaking/pausing of interest rate hikes**

2. **Fatter yields now that rates have risen over the past 2 years**

3. **Abnormally wide credit spreads for this stage of the cycle**

Fixed income returns have struggled to stay positive in the past 18 months, but 2019 looks set to deliver healthy returns of 4% to 6%.

Source: UOBAM, 29 Dec 2018

# 2019 equity outlook

The first principles of our investing approach would point to a healthy outlook:

1. **Global growth is slowing but still at trend levels**
2. **Earnings growth forecasts are still supportive of equity returns**
3. **Valuations have turned from expensive to cheap**
4. **Recession risks based on fundamental indicators are not showing significant risks of a 2019 recession**

From oversold levels, equity returns should be healthy in 2019.

Earnings growth and valuation normalisation would imply returns of 10% to 15%.

The US market still has the best fundamentals, but a pause in US Fed rate increases would also make Asia attractive.

Source: UOBAM, 29 Dec 2018

# 1Q19 asset allocation views –
# Cycle countdown warrants caution at higher levels

| GLOBAL ASSET ALLOCATION | - - | - | N | + | + + |
|---|---|---|---|---|---|
| **Equities** | | | | ● | |
| **Fixed Income** | | ● | | | |
| **Commodities** | | ● | ← | | |
| **Alternatives (hedged strategies)** | | | | ● | |
| **Cash** | | → | ● | | |

Source: UOBAM, 29 Nov 2018
Note:
*3-6 months horizon
The weights are relative to the appropriate benchmark(s).
'- -' denotes maximum underweight, '-' slight underweight, 'N' neutral, '+' slight overweight, '+ +' maximum overweight; arrows show change from last quarter.

# Caution warranted but at higher levels

| GLOBAL ASSET ALLOCATION | - - | - | N | + | + + |
|---|---|---|---|---|---|
| Equities | ○ | ○ | ○ | ● | ○ |
| Fixed Income | ○ | ● | ○ | ○ | ○ |
| Commodities | ○ | ● | ◄ | ○ | ○ |
| Alternatives (hedged strategies) | ○ | ○ | ○ | ● | ○ |
| Cash | ○ | ► | ● | ○ | ○ |

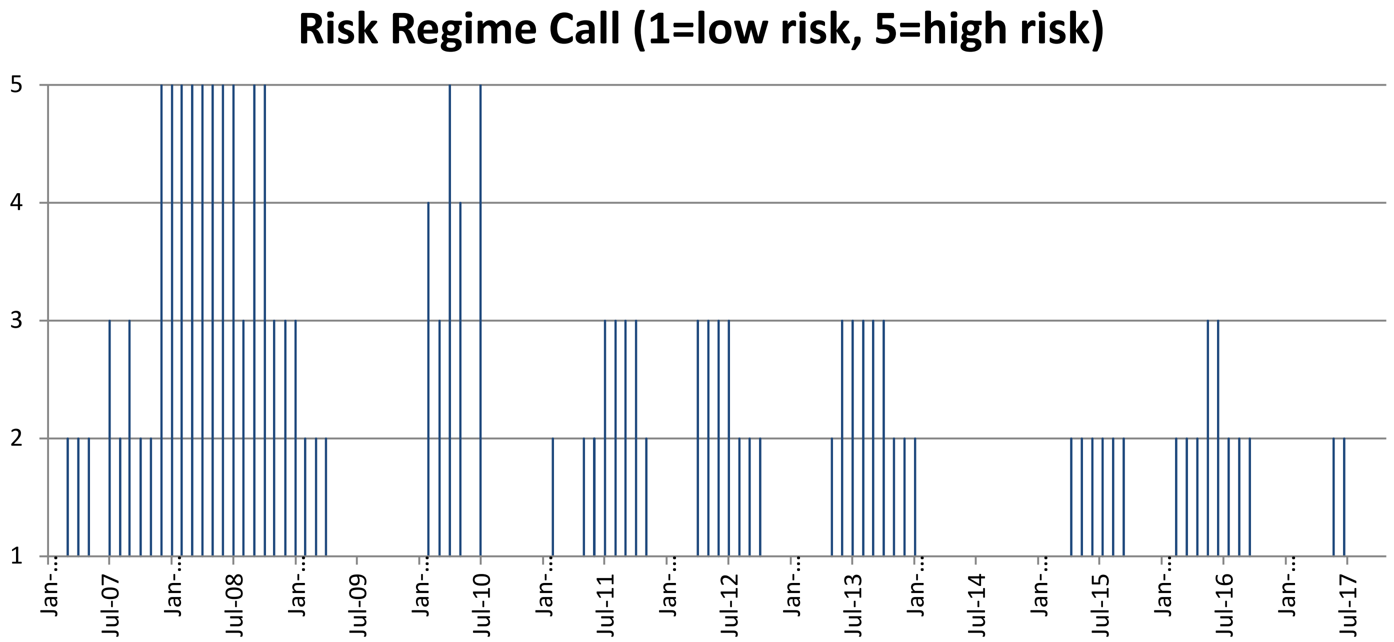
| FIXED INCOME | - - | - | N | + | + + |
|---|---|---|---|---|---|
| DEVELOPED MARKETS | ○ | ● | ○ | ○ | ○ |
| US T-Bills | ○ | ○ | ● | ○ | ○ |
| G7 Sovereigns | ○ | ● | ○ | ○ | ○ |
| IG | ○ | ○ | ● | ○ | ○ |
| HY | ○ | ● | ○ | ○ | ○ |
| Leveraged Loans | ○ | ○ | ● | ○ | ○ |
| Cocos | ○ | ○ | ● | ○ | ○ |
| Duration | ○ | ○ | ● | ○ | ○ |
| Yield Curve* | ○ | ○ | ● | ○ | ○ |
| EMERGING MARKETS | ○ | ○ | ● | ○ | ○ |
| EM IG | ○ | ○ | ● | ○ | ○ |
| EM HY | ○ | ● | ○ | ○ | ○ |
| EM Local Currency | ○ | ● | ○ | ○ | ○ |
| Asia IG | ○ | ○ | ● | ○ | ○ |
| Asia HY | ○ | ○ | ● | ○ | ○ |
| Asia Local Currency | ○ | ● | ○ | ○ | ○ |

| EQUITY REGIONAL ALLOCATION | - - | - | N | + | + + |
|---|---|---|---|---|---|
| DEVELOPED | ○ | ○ | ● | ○ | ○ |
| US | ○ | ○ | ○ | ● | ○ |
| EUROPE | ○ | ● | ○ | ○ | ○ |
| JAPAN | ○ | ○ | ● | ○ | ○ |
| CANADA | ○ | ○ | ● | ○ | ○ |
| AUSTRALIA | ○ | ○ | ● | ○ | ○ |
| EMERGING | ○ | ○ | ● | ○ | ○ |
| Asia Ex-Japan | ○ | ○ | ● | ○ | ○ |
| LATAM | ○ | ○ | ● | ○ | ○ |
| EMEA | ○ | ○ | ● | ○ | ○ |

| | - - | - | N | + | + + |
|---|---|---|---|---|---|
| COMMODITIES | ○ | ● | ◄ | ○ | ○ |
| Gold | ○ | ○ | ○ | ● | ○ |
| Base Metals | ○ | ○ | ● | ○ | ○ |
| Bulk Commodities | ○ | ○ | ● | ○ | ○ |
| Energy | ○ | ○ | ● | ○ | ○ |
| Agriculture | ○ | ● | ○ | ○ | ○ |

Source: UOBAM, 29 Nov 2018

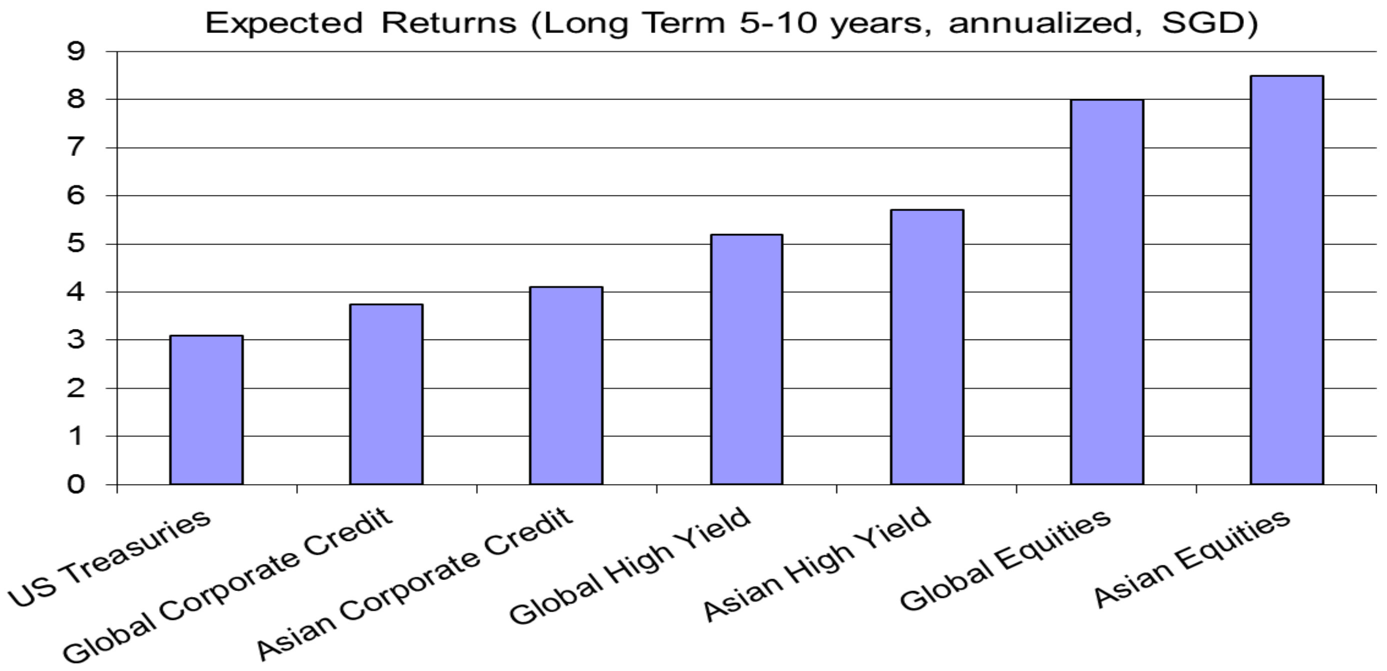
# Risk regime level 2 for 1Q19
# (market risks remain at low levels)




| | |
|---|---|
| Volatility/Stress indicator | 2 |
| Correlation indicator | 2 |
| Analytical assessment | 1 |
| Overall call | 2 |

Source: UOBAM, 29 Nov 2018

# Estimated long term asset class returns (as of 1Q19)




| Est. annualised volatility | US Treasuries | Global Corporate Credit | Asian Corporate Credit | Global High Yield | Asian High Yield | Global Equities | Asian Equities |
|---|---|---|---|---|---|---|---|
| | 3% | 4.5% | 5% | 9% | 10% | 14% | 16% |

* Fixed income returns primarily driven by current yields and expected long term interest rate shifts. Equity returns based on long term data and on equity risk premium analysis.

Source: UOBAM, 29 Nov 2018

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# Thank You

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