Quarterly Investment Strategy
Fourth Quarter 2019

Late cycle investing

UOB Asset Management

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Investment Strategy

We continue to recommend being cautious though not necessarily bearish. The global expansion is very mature and at the same time, global growth has slowed significantly compared to last year. Additionally, an elevated number of geopolitical risks pose risks to global markets. Our base case view is that the expansion should be able to continue at a muted pace. However, the combination of a muted return outlook and elevated risks warrant an investment approach that is cautious without being overly bearish.

We remain underweight equities and overweight fixed income. Within equities, we focus on high quality and strong dividend equities. Within fixed income, we focus on investment grade with short to medium duration. Given the elevated uncertainties, income strategies look more attractive. We are also neutral in alternatives and commodities, and overweight cash.

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Global Asset Allocation

Sector Allocation	View	Notes
Equities	–	**Rationale:** Growth has slowed and risks are elevated, but our base case view is for the cycle to extend. A slightly cautious approach on risk assets like equities is warranted. **Risks:** There are upside risks to equities if rate cuts help boost global growth faster than expected.
Fixed Income	+	**Rationale:** Markets are expecting interest rate cuts and the environment is benign for fixed income. During a time with many uncertainties, fixed income looks safer. **Risks:** Yields have fallen to low levels. A rebound in growth would put pressure on longer duration fixed income investments.
Commodities	■	**Rationale:** Gold and precious metals provide a healthy hedge. However, other commodities may suffer as the growth outlook is called into question. **Risks:** USD strength could continue and put pressure on commodities.
Alternatives	■	**Rationale:** Equity and fixed income trends have been lacklustre which give alternatives room to achieve returns on lower volatility. **Risks:** Extreme market volatility and market movements outside of individual company performance.
Cash	+	**Rationale:** Cash outlook is stable in a questionable environment. As retuns look low in other asset classes, money market returns look fairly reasonable at levels close to 2%. **Risks:** If interest rates are cut more aggressively than expected, cash rates will fall and investors may regret not locking up yields for longer.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

We are cautious but not bearish. The base case view is that interest rate cuts should be able to help extend the cycle. The return outlook looks low as equities see little earnings growth and fixed income yields have declined. At the same time, uncertainties are elevated. Thus we take a cautious approach to our asset allocation strategy. We argue that we are not adopting a "recession portfolio" strategy, but we are not aggressively investing in growth assets either by seeking a balanced approach. It would not hurt to be positioned as such if growth slows further or if it stabilises.

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Global Investment Strategy

Late cycle investing

The danger associated with pricing in a recession too early, that is turning pessimistic at this time, can mean missing out on asset rallies in both the equity and fixed income markets.

Regardless of a slow grind or hard landing, policymakers appear ready and responsive to manage frictions in the global economy. One of the key silver linings of recent global weakness is that inflation remains low around the world, implying central banks have much more flexibility than is usual at this stage of a cycle. We are of the view that the US Federal Reserve (Fed) will enact a minimum of two interest rate cuts up till the end of 2019. However, this may or may not be sufficient to prevent a recession or could have the effect of extending the recession onset further down the road.

The effectiveness of monetary stimulus has been diminished as major central banks have little or even no room to bring interest rates lower. In fact, the US is left as the only major economy with interest rates above zero. Monetary policy can only do so much in an era where more than one third of developed market debt is yielding negative returns. It is possible, and the case is growing, that governments would increasingly turn to fiscal stimulus to pick up the slack initially before enacting unconventional options.

> "Though the well-trodden paths of fiscal spending and massive quantitative easing helped to ease the effects from the 2008 global financial crisis, the economy is now facing a different set of demands."

Historically, the Fed has enacted interest rates cuts to extend a cycle and not all have achieved the intended purpose. The successful instances occurred in July 1995 and September 1998 when the markets rallied after the first rate cut. Conversely, markets slumped after rate cuts in January 2001 and September 2007. Our view is that a critical element in extending the cycle in 1995 and 1998 was support for businesses so that employment levels were not compromised. In 2001 and 2007 once employment levels started to drop, consumer confidence tumbled which led to weaker spending and in turn dismal hiring activity.

Hence we will be closely watching employment rates in major developed economies over the coming quarters. Throughout the G3 countries (Japan, US, European Union), employment has not yet shown significant signs of weakness. If rate cuts can solidify business confidence and margins, allowing employment to remain solid, then that provides strong evidence that the cycle can be sustained. Conversely, if we see weak employment trends and rising unemployment claims in the US, that would be a sign that the downward momentum is building toward a recession.

The US economy has seen business confidence, trade and manufacturing numbers taking a hit, while consumer spending, jobs and housing data are not raising alarm bells. Between these two camps, it is possible for healthy consumer spending to improve business or have the former drag on consumer sentiment.

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US Equity

Country Allocation	View	Notes
US	+	**Rationale:** In a world of uncertain growth, the US trajectory appears the most stable. A strong USD also improves the outlook for US investments. **Risks:** US policy is increasingly erratic and increases uncertainties. Tensions in trade, and the Middle East remain heightened.

Summary

Valuations that have been higher than other regions but these are justified with the strong return on equity on US companies. The US has outperformed, but we continue to think US equities continue to have the most stable outlook in a world of heightened uncertainties.

Europe Equity

Country Allocation	View	Notes
Europe Equity	–	**Rationale:** Economic trends remain a concern in Europe. Manufacturing and industrial production trends already appear close to recession-like conditions. Consumption remains stable but further economic slowness could put the region at risk of a broader recession. **Risks:** The Brexit process remains uncertain, and European politics continues to look fragile in places such as Italy.

Summary

Manufacturing and trade trends remain a significant concern. European Central Bank (ECB) policies are likely to be stimulative to growth with increasing expectation of supportive fiscal policies.

Japan

Country Allocation	View	Notes
Japan Equity	■	**Rationale:** Valuations are attractive (at a discount to developed market peers US, UK) but below-trend GDP growth is vulnerable to downside risks arising from the re-escalation in US-China trade tensions given the economy's high leverage to global industrial production. **Risks:** Deterioration in US/Japan trade negotiations, improvement in relations between US/China or Japan/Korea, sharp appreciation in the yen.

Summary

Japan equity valuations are attractive against the developed markets, but continued strength in domestic demand could partially offset sluggish overseas exports and accommodative monetary policy leaves limited scope for policy response.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

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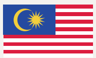
Asia Ex-Japan Equity

Country Allocation	View	Notes
China 	–	**Rationale:** Domestic economic slowdown deepens. Further risk of valuation de-rating and earnings cut due to increased tariffs amidst re-escalation in US/China trade tensions. **Risks:** US and China strikes a trade deal before year end. Stronger-than-expected domestic economic data and earnings outlook.
Hong Kong 	–	**Rationale:** Economy will take a hit from protests and capital outflow pressures. Property and consumer retail-related industries are particularly vulnerable. **Risks:** HK government and protesters agree on a compromise.
India 	–	**Rationale:** Relatively less correlated to US/China trade flows but domestic consumption remains weak and earnings downgrades have worsened. Fiscal and monetary easing measures can only partially offset the drag. **Risks:** A reversal in USD strength is supportive of a more stable INR, weak oil prices, larger-than-expected fiscal and/or monetary policy measures.
Indonesia 	+	**Rationale:** Political overhang has been removed following the re-election of President Jokowi. Scope for further monetary easing to lift pace of domestic consumption recovery. **Risks:** Sharp slowdown in domestic economy, elevated current account deficit, further IDR weakness.
Malaysia 	–	**Rationale:** Valuation broadly fair and earnings revision cuts have been more acute vs peers. Revival in mega projects against a tough economic backdrop is likely to limit upsides to GDP growth. **Risks:** Sharp spike in oil prices could strengthen MYR and boost the market.
Philippines 	■	**Rationale:** Inflation headwinds have faded and earnings revision have turned positive. Earnings growth for 2019 is strongest within ASEAN, but the market may be vulnerable to EM sell-off amidst USD strength. **Risks:** Continued healthy domestic demand. A reversal in USD strength could support the peso and the market.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

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Country Allocation	View	Notes
Singapore 	+	**Rationale:** Slowdown in GDP growth has been largely discounted and valuation is attractive. Government has fiscal flexibility to support growth. SGD is relatively resilient among Asian currencies. **Risks:** Adverse slowdown in GDP due to escalation in US-China trade tensions, quicker Fed rate hikes.
South Korea 	-	**Rationale:** Domestic economy slowing sharply and earnings outlook remains depressed. Further downside risks to cyclical industries especially export-led sectors which dominate Korea's economy from weakening global trade flows and/or Japan/Korea trade tensions. **Risks:** De-escalation in US-China trade relations, improved Korea/China trade relations, semiconductor memory prices and demand stabilising.
Taiwan 	+	**Rationale:** Worst of earnings revision for technology companies is likely over. Strong cash flows and high dividend yields are also supportive. **Risks:** Continued slowdown in the technology sector, further sanctions on China or unfavourable trade policies from the US which disrupts the technology component supply chain.
Thailand 	-	**Rationale:** Valuations are unattractive and economic growth slowdown could worsen owing to weak domestic consumption. Exports growth is slowing. A delay in budget approval for FY19/20 could limit size of additional government stimulus. **Risks:** Stronger than expected regional exports. Oil price rebound.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

Given the rapidly deteriorating US/China relationship, we maintain our defensive portfolio positioning. We do not expect a trade resolution in the near term given the large differences in between the two sides. We are now underweight North Asia except for Taiwan. We continue to favour South-east Asia given the region's lower exposure to global trade flows. We also underweight cyclical sectors and overweight more defensive sectors e.g. healthcare, utilities.

We have downgraded Hong Kong to an underweight position – with protests continuing. The economy and earnings will take a hit and there will also be increasing capital flight as it is no longer viewed as a financial safe haven. We see no easy solution in the near term.

The key upside risks to our cautious view include a de-escalation in US-China trade tensions or near term trade resolution. However, we assign this outcome a low probability in the near term given both parties still have large unresolved differences. We believe the US and China economies and markets likely have to go through more pain before both sides are pushed to reach a resolution.

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Global Fixed Income Strategy

Sector Allocation	View	Notes
Developed Market (DM)	+	**Rationale:** Event risks are increasingly fraught and we choose to park assets into the safer pockets of the developed market universe. **Risks:** Event risks could find quick resolutions, though we expect fundamental differences to linger.
DM Government	■	**Rationale:** While we assess that sovereign bonds could still provide some measure of safety in risk-off situations, overbought metrics are flashing red and we would wait for better entry levels. **Risks:** Fear of missing out could lead fund managers to pile into safe havens regardless of price.
DM Credit	+	**Rationale:** Credit spreads will tighten given the strong demand for investment grade credits. We recommend staying invested in investment grade focusing on defensive sectors as global central banks are likely to provide looser monetary policy support which will help to offset some of the negative sentiment on trade tensions. **Risks:** US-China trade tensions remain a key risk to global growth with negative impact on sectors that are exposed to the tariff hikes.
Emerging Market (EM)	■	**Rationale:** EM has delivered strong returns amid an easing external environment as returns have been driven by a risk rally on looser monetary policy, trade optimism, and a strong rally in US Treasuries. The US-China trade war has been cited as one of the reasons for the global slowdown, albeit a small one. Weaker overall global demand remains a key factor. Due to improved fundamentals, EM is expected to weather slower global growth. **Risks:** Protectionist measures, further US-China trade escalation, rapid FX depreciation, Chinese deleveraging, inflation surprises, and geopolitical risks.
EM Government	■	**Rationale:** With global growth easing, we anticipate increased volatilities in the near term. The rally with US Treasuries makes it more difficult for EM spreads to tighten amid the current more challenging backdrop. Lower government bond yields in major developed markets continue to make EM bonds appear relatively attractive. **Risks:** A return to populist policies, sensitivity to sharp commodity price declines and/or sharply higher USD funding costs and rapid FX depreciation.
EM Corporate	■	**Rationale:** With increased volatility likely to materialise, we prefer investment grade over high yield. **Risks:** Protectionist US trade policies, EM political risks, geopolitical risks. A potential recovery in the capital expenditure or mergers and acquisitions cycle would be cash flow negative.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

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Sector Allocation	View	Notes
EM Local Currency	–	**Rationale:** FX will be pegged back by monetary easing, slower growth, and weaker exports. **Risks:** Weaker USD led by aggressive Fed cuts and easing of trade tensions.
Duration	–	**Rationale:** Long duration had paid off nicely for us in the last few quarters, but with the yield curve finally inverting, being short would be more attractive from a risk to reward perspective. **Risks:** DM sovereign yields could keep on printing new lows, especially if the ECB and Fed easing proves more aggressive than expected and the Bank of Japan (BOJ) releases another round of easing.
Yield Curve	■	**Rationale:** With the yield curve finally inverting, we would prefer to stay on the side lines for the time being as we assess that there is limited room for the yield curve to invert more aggressively. **Risks:** A frantic search for yield could yet depress the yield curve on the long end, especially in the case of the US.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

Event risks are increasingly elevated in the form of escalating trade war tensions, violent Hong Kong protests and the possibility of a hard Brexit. While we seek refuge in DM markets, selection is paramount in the form of duration, geography and credit selection. We prefer investment grade names to high yield names, and short duration over longer duration. We take the view that there is limited room on the downside for yields on the longer tenors with the US Treasury yield curve finally inverting.

Regional Allocation	View	Notes
Latin America	■	**Rationale:** We favour investment grade sovereigns with firmer external balance sheets such as Panama, Bermuda, Chile and reform stories such as Brazil. Progress on pension reform in Brazil which would significantly improve fiscal balances remains encouraging, though we are wary of reforms being passed. We remain significantly underweight on Argentina where a potential return to populism would cause the sovereign's likelihood of escaping a restructuring to dwindle. We are neutral on Mexico, where a slow erosion of credit quality and policy uncertainty are mitigated by valuations. Broadly, stronger starting points on inflation should insulate most against a potential adverse external environment. **Risks:** Policy direction could shift, raising medium-term risks to growth.
CIS/EE*	+	**Rationale:** Firm external buffers and budget balances lower vulnerability to geopolitical risks. Regional fixed income exhibits lower volatility in times of global risk aversion. Among the largest regional sovereigns, Russia's external vulnerability remains low given its conservative central bank, a fiscal rule and twin surpluses. In Poland, growth is projected to increase while fiscal outlook will remain positive, buoyed by robust economic growth and a tighter tax system. **Risks:** Risk of further sanctions on Russia. Liquidity and solvency risk from Turkish banks.
Middle East	+	**Rationale:** We are constructive on investment grade sovereigns given their pegged currencies and limited exposure to trade frictions. Strong external balance sheets insulate and allow the higher rated sovereigns to weather a potential global growth slowdown well. **Risks:** Idiosyncratic geopolitical developments arising out of US-Iran tensions, weakening oil prices would adversely impact fiscal budgets.
Africa	–	**Rationale:** For Africa, overall higher vulnerability to a potentially more adverse external environment due to weaker budget balances, natural resource dependence and reliance on USD funding. **Risks:** Idiosyncratic geopolitical developments on US-Iran tensions, weakening oil prices would adversely impact fiscal budgets.
Asia	–	**Rationale:** Appetite for risk assets is cornered by too many potential headwinds. Though credit spreads had widened and began to look attractive, there remain rooms for widening as negative sentiment likely prevails for now. Committed efforts from global central banks to provide support for economy will help offset some of the negativities. **Risks:** Prolonged trade tussles as differences remain challenging.
Singapore	–	**Rationale:** Singapore saw two sharp downward revisions to growth within the year and negative growth is currently not an impossibility. **Risks:** Singapore's long-time status as a safe haven in Asia could see inflows come in at the expense of other countries such as Hong Kong that is tangled in prolonged uncertainty.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

* Commonwealth of Independent States and Central and Eastern Europe

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Currencies

FX Allocation	View	Notes
US Dollar **US$**	+	**Rationale:** Investors could still seek refuge in USD given wider global turmoil. **Risks:** The Fed could take a sharp dovish tilt and cut rates more aggressively than what is currently priced in by the market, which would induce weakness in USD.
Euro **€**	+	**Rationale:** The ECB might be readying a new easing package, but its status as a safe haven has not gone unnoticed. We expect EUR to stay strong in times of turmoil, as long as trouble does not originate from Europe. **Risks:** President Trump could start a new trade war with Europe which could see the Euro being sold off.
Japanese Yen **¥**	++	**Rationale:** The decision to overweight JPY in the past quarters had served us well and we continue to look for JPY to strengthen given its status as the safe haven of choice. **Risks:** The BOJ could introduce new easing measures, though its policies are severely limited.
Singapore Dollar **S$**	–	**Rationale:** With growth forecasts seeing a sharp downward revision, policymakers are expecting turbulent headwinds in the coming quarters. Monetary policy easing in the form of a weaker currency is set to follow. **Risks:** Inflation, though heavy, has not reached 2015's levels yet and the central bank could yet hold off on easing.
China Renminbi **CNY**	–	**Rationale:** Studies conclude that CNY would have extended downside should the entirety of the current trade tariffs be imposed, making CNY a firm sell. **Risks:** The unpredictable nature of trade war skirmishes means that the two opposing sides could as easily reach a resolution.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

In times of uncertainty such as now, investors are looking increasingly to avoid risk. This is why we are overweight on the Japanese Yen, and to a lesser extent, the Euro. Still, although the evidence from the Argentine Peso had shown us that while certain stresses still exist within EM, we expect some high beta EM currencies to outperform even in risk-off situations because of the need for yield, though geographical selection is important.

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Commodities

Sector Allocation	View	Notes
Commodities	■	**Rationale:** Safe assets like gold remain particularly attractive but the energy outlook is somewhat subdued as demand slows and hostilities between the US and Iran pose a risk of disrupting oil supply. **Risks:** Tensions in the middle east put oil production at risk. The strong USD environment is a headwind for most commodities.
Gold	+	**Rationale:** The current Fed monetary policy and the increasing influence of negative yield in Europe and Japan is helping make gold and attractive asset class to diversify into. Additionally, we see continued EM central bank reserves increasingly holding more gold. **Risks:** A rebound in global growth could reduce the need for central banks to stay so accommodative.
Base Metals	-	**Rationale:** Industrial metals are being negatively affected by the weak global growth outlook. Global industrial production has not stabilised yet and we don't expect a rebound in metals until the growth outlook improves. **Risks:** Trade wars could significantly disrupt supply chains and weaken demand for metals that are tied to industrial growth.
Energy	■	**Rationale:** Weaker global growth is hurting the outlook for energy, but tensions in the Middle East is constraining supply which helps put a floor on the price of energy. **Risks:** Middle east conflicts between Iran and Saudi Arabia threaten to disrupt oil supply.
Others	-	**Rationale:** The outlook for bulk and other base metals was improving earlier in the year when China growth appeared to be improving in 1Q19. However, the latest macro growth data from China is more questionable as trade conflicts increase uncertainties. **Risks:** There are upside risks for many commodities if China seeks to support growth with significant stimulus programs that are focused on property. Such projects would be supportive of most bulk and metal commodities.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

We are neutral on commodities as we see gold as attractive at this stage of the cycle but see global growth weakness as weighing down most other commodities. Energy prices remain at high risk in either direction as a recession could weaken energy demand alongside Middle East tensions that could trigger supply disruptions. We continue to recommend a diversified strategy with precious metals and energy providing an uncorrelated return outlook to most portfolios.

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Alternatives

Sector Allocation	View	Notes
Hedge Funds	+	**Rationale:** The macro environment remains volatile and unpredictable. Given the multiple distortions in the market, it is difficult to price or market time macro developments. Market neutral strategy can reduce overall risk while preserving return potential. We favour fundamental biased long/short strategies that can generate good returns without high market exposure, as well as macro managers who employ flexible trading strategies in response to pricing inefficiencies in the market. **Risks:** A broad-based market rally if trade talks reach a positive conclusion or major central banks signal willingness to use monetary policy to sustain the expansion. This may lessen the attractiveness of market neutral hedged strategies.
Private Equity	++	**Rationale:** Many fast growing companies with disruptive product offerings are benefitting from the long term technology trends. Generally, the verticals these companies fall into include internet, software, e-commerce, sharing/rental businesses, logistics, enterprise software and consumer industries. Emerging markets, accounting for 50% of global GDP growth over the next decade, will become more important - both as a source of capital and investment opportunities. **Risks:** Valuations are not cheap after a prolonged period of inflows amid abundant liquidity although this is in the process of correcting and more effort and greater discipline will be required to find attractively priced opportunities.

Maximum Overweight: ++ Slight Overweight: + Neutral: ■ Slight Underweight: - Maximum Underweight: --

Summary

One factor for inflows into the alternatives space is the responsiveness to change and evolve to meet new challenges. Successful investing requires talented managers to be nimble and responsive to data and market intelligence. Opportunities abound for funds that can spot and formulate strategies for delivering uncorrelated alpha. By diversifying sources of potential investment return, alternatives can provide superior risk-adjusted returns to its investors independent of the market's swings.

The performance of private equity (PE) funds since the global financial crisis has been a key driver of industry growth. A consistent strong performance has led to record levels of distributions to limited partnerships (LPs). As PE funds can provide superior returns with low correlation to the equity markets, many liquid LPs look back to the PE industry to re-invest their capital. This activity has driven up the level of capital available to fund managers and spurred further growth in the PE industry's assets under management in recent years.

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