NUS INVESTMENT SOCIETY

GLOBAL MACRO AY2019/2020

SEMESTER 1 RESEARCH REPORT

GLOBAL MACRO RESEARCH TEAM – AY 2019/2020 SEMESTER 1

Director	: Steven Sebastian	
Deputy Directors	: Zuo Hao Lin, Rohit Idnani	

American Markets

Lead Research Analyst	: Davin William	United States
Research Analysts	: Joseph Tan	Mexico
	Justin Tan	Brazil & Canada

European Markets

Lead Research Analyst	: Liu Jiamin	EU & Switzerland
Research Analysts	: Woo Yu Xuen	EU & Switzerland
	Robinson	United Kingdom & Russia

North Asian Markets

Lead Research Analyst	: Nicholas Thong	China
Research Analysts	: Tan Wei Jie	Hong Kong & Taiwan
	Laura Poon	Japan & South Korea

South Asian Markets

Lead Research Analyst	: Stanley William	Indonesia & Philippines
Research Analysts	: Lee Jun Hao	Thailand & Vietnam
	Janessa Ng	India & Singapore

Oceania & Commodities Markets

Lead Research Analyst	: Raymond Chang	Oil & Coal
Research Analysts	: Delphine Lim	Australia & New Zealand
	Kevin Lee	Gold & Silver
	Edison Tan	Copper & Iron

Table of Contents

*GLOBAL MACRO RESEARCH TEAM – AY 2018/2019 SEMESTER 2.*Error! Bookmark not defined.*2*

UNITED STATES 4

MEXICO..... 14

CANADA..... 19

BRAZIL..... 24

EUROPEAN UNION 29

SWITZERLAND 44

UNITED KINGDOM 50

RUSSIA..... 58

CHINA 68

HONG KONG 74

TAIWAN..... 81

JAPAN..... 87

SOUTH KOREA..... 97

INDIA 105

SINGAPORE 111

VIETNAM..... 115

THAILAND 121

INDONESIA..... 127

PHILIPPINES..... 132

AUSTRALIA..... 138

NEW ZEALAND 146

CRUDE OIL..... 151

COAL..... 160

COPPER 165

IRON..... 169

GOLD 173

SILVER 177

[All information accurate as of 13th December 2019]

UNITED STATES (Neutral)

The U.S. economy is currently the largest economy in the world in terms of nominal GDP which stands at USD 20.49 trillion as of 2018 official GDP data. The U.S. makes up almost 25% share of the global economy. One of the main economic engines of the U.S. economy is the consumer sector which contributes almost 70% of its GDP. As of 3Q2019, the real GDP growth was reported at 2.1% Q-o-Q. Expectedly, growth is still mainly driven by still-buoyant consumer spending amidst weak macro backdrop that we believe has slowly reverberate into the U.S. economy. This was partially nullified by weak business investment, inventories and net exports which we believe were the side effect of the unending trade war.

The U.S. labour market is very strong now, unemployment rate is currently sitting at 3.5% the lowest in five decades. At the same time, the most leading indicators for the business activity in the U.S. signalling for a recession in the industrial sector. It is interesting to see how long the low unemployment rate can sustain the current consumption level before the industrial downturn poses a greater threat to the economy.

Trade War: The Dark Cloud Has Lifted

For the past 19 months, the U.S.-China has been on a “Fiery Fist O’ Pain” roller coaster ride. The market has been constantly switching between a skyrocketing exuberance to gut-wrenching slides. At the time of writing, the investor sentiment on the trade issues has improved and the completion of phase-one deal has sent the market to a risk-on mode. Both sides have agreed to a truce, lowering tariffs and agreeing on new rules. While the details are yet to be announced, the U.S. will halt the 15% tariffs on USD 156 billion in annual import of Chinese-made goods and cut the existing 15% tariffs on USD 120 billion of goods to 7.5%. On the other hand, China also has agreed to purchase up to USD 200 billion of U.S. exports over two years and the agricultural purchases will rise by as much as USD 40 billion to USD 50 billion a year.

Date	United States	China
July – Aug 2018	**25%** on **USD 50 billion** of imports from China (List 1 and List 2)	**5% - 25%** on **USD 50 billion** of imports from the US (List 1)
Sep – Nov 2018	**10%** on **USD 200 billion** of imports from China (List 3)	**5% - 25%** on **USD 60 billion** of imports from the US (List 2)
May 2019	**10% ☹25%** on **USD 200 billion** of imports from China (List 3)	Suspension of soybean imports
Sept 2019	**15%** on **USD 120 billion** of imports from China (List 4A)	Higher tariffs on USD 60 billion of imports from the US (List 2)
Dec 2019	Agreed on **Phase 1** deal. **15% ☹ 7.5%** on USD 120 billion of imports from China (List 4A)	Agreed on **Phase 1** deal. Import more goods and services from the U.S., implement intellectual property safeguards, and have a tariff exclusion process in place

Figure 1: Timeline of the Escalation of U.S.-China Trade War

While the development has been greatly positive so far, we are holding onto a moderately optimistic stance on this trade truce. We have witnessed previous deals fallen apart and we do not know how long this phase-one deal will survive. If it does survive, we should expect a phase-two and phase-three deal by 2020. Much will depend on politics and how well it will be received by both countries. One thing that is clear, though, is that the phase-one deal offers a rather muted benefits to the U.S. economy. The U.S. essentially just repeated another trade truce that we saw in early 2019, as this is still a "phase-one" of a possibly longer talks between both sides. China agreed to purchase up to USD 50 billion of the U.S. agricultural products annually, but it clearly is not a great stride forward in the development. In March 2019, the Chinese has expressed their willingness to buy USD 30 billion of U.S. agriculture products annually. From the Chinese perspective, diverting their agricultural import from other economies to the U.S. is a comparatively small cost to the damage by the ongoing trade war to its economy.

Heading to an election year, markets are expected to be heavily influenced by the rhetoric on the U.S. campaign trail and it will have implications on how the Trump administration choose to act on the trade deals. Geopolitics risk in 2020 will be emphasised even more by the election rhetoric. The U.S. House of Representatives approved the *Uighur Act of 2019* that would require the Trump administration to take a tougher stance on the Chinese brutality on the Muslim minority in Xinjiang. On top of that, the U.S. involvement in criticising Beijing's policies in Hong Kong will only makes their relationship more complicated. The Chinese government undeniably sees this as a way for the U.S. to interfere in China's domestic affairs. This might be a downside risk that has a potential to threaten the phase-two and phase-three deal, or even the survivability of the phase-one deal.

This boils down to one point: phase-one deal has limited upside to the U.S. growth. Implications of trade war uncertainty will certainly remain unless U.S. corporates are convinced that the trade deal will last. This deal offers a hope of easing tension, not a hope of improving growth. At best, it will only remove some of the business uncertainty that has slowed the U.S. economy down. In other words, it will do little in lifting the business sentiments, but it will help the U.S. corporates to find bottom. Note that trickier issues such as government subsidies to state enterprises and technology transfer remain unresolved, which leaves a considerable risk on the table. As such, we do not want to get too excited for this trade truce and maintain a moderately optimistic stance on the trade war between the U.S. and China. Global market uncertainty has definitely been reduced but we should not be surprised if the trade development takes a different turn in coming months, as we have witnessed before.

Fed: 'Wait and See'

After four hikes in 2018 as part of the Fed's policy normalisation course that was started in 2017, the Fed in 2019 embarked on a "mid-cycle adjustment" amid a weakening global macro backdrop which was weighted down by the trade war between the U.S. and China. Jeremy Powell, the Fed Chairman, cautiously label these rate cuts as *insurance cuts* and has since cut the Fed policy rate three times at 25 bps each from the 2.25% - 2.50% at the start of 2019 to 1.50% to 1.75% now. The final FOMC meeting of 2019 did not give much surprise to the markets. The Fed maintained its policy rate at 1.5% - 1.75%. Furthermore, the U.S. central bank expects its policy rate to remain steady and stay unchanged till next year. In our view, the Fed has shifted from a mid-cycle adjustment or "insurance cut" to an accommodative stance.

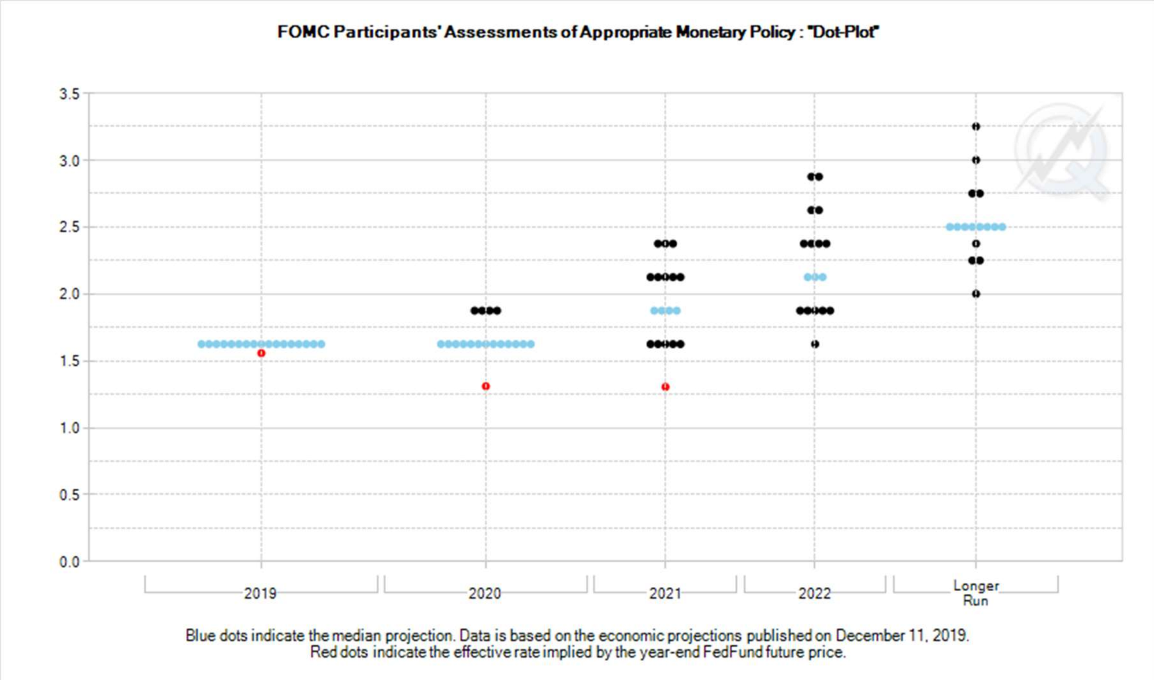


Figure 2: FOMC Dot-Plot *(Source: CME FedWatch Tool)*

A closer look at the movement of the Fed's dot plot, it is the first unanimous vote to maintain the interest rate target range since May. Four members (previously nine) still envision rate hike by 25bps in 2020, compared to September meeting where seven members believed that the target range will be above 2.0% by year end. In addition, only minor adjustment was made to the October statements. The committee will continue to monitor a "material" changes to their outlook. The committee also included "global developments and muted inflation pressures" as part of their consideration in future Fed fund rate target range.

With that in mind, there is an inconsistency in the committee approach to inflation. Looking at their Summary of Economic Projections (SEP), we notice that there is a slight upward movement in inflation rate to 2.05% in 2020 and 2.10% in 2021. We also notice there is a broad consensus that the Fed fund rate will rise from 2020 and 2021 (in Figure 2 where the median rises from 2020 to 2021). With the Fed trying to commit to its "symmetric" objective, raising interest rates when inflation slightly rises above 2% shows a misalignment in their approach on inflation. With the Fed trying to gain credibility, they should not be inconsistent in their approach.

Regarding the repo market, it seems that the committee is content with the steps that were being taken so far. The committee is committed to relieve any liquidity pressure that could potentially spill over to the Fed funds market and threatened the financial stability. The Fed plans to continue buying T-bills or short-term coupon-bearing bonds if needed.

Overall, we believe that the Fed will not change their policy stance as shown in the dot plot over the next six months unless there is a "material" change in the development of either global economy or the U.S. economy. At this stage, the single main factor (trade war) that dragged the growth around the world has shown signs of improvement as they finalise the phase-one deal. On top of that, Brexit development, covered by the Europe team, has also shifted to a more optimistic one and the global slowdown has also found bottom. We believe that the dark clouds have lifted from the markets for now, and hence there should not be any "material" changes to the Fed's stance.

Manufacturing: Has it Found a Bottom?

This is where the U.S.-China trade war wreak havoc in the most. As seen from the J.P. Morgan Global PMI, global manufacturing sector has performed poorly in 2019. We can see it edges closer to the natural mark of 50 which indicates a possible stabilisation, but it's still very much related on the development of trade war. This forward-looking business sentiment is somewhat suggesting a heightened recessionary risk in the economy.

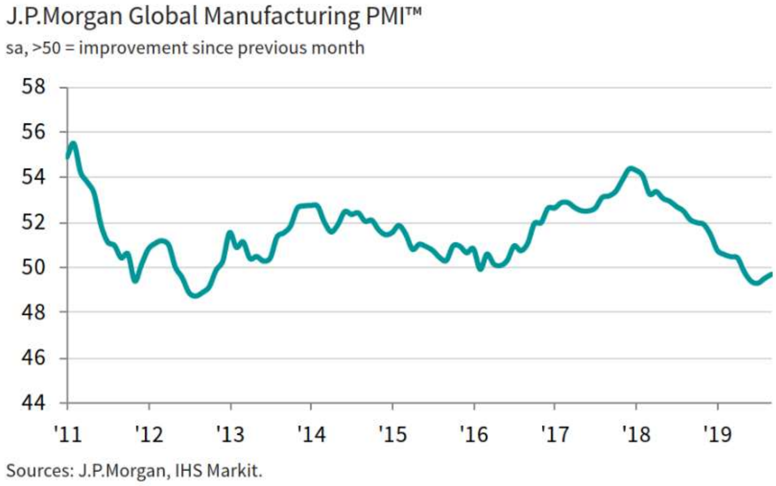


Figure 3: Global Manufacturing PMI (*Source: IHS Markit*)

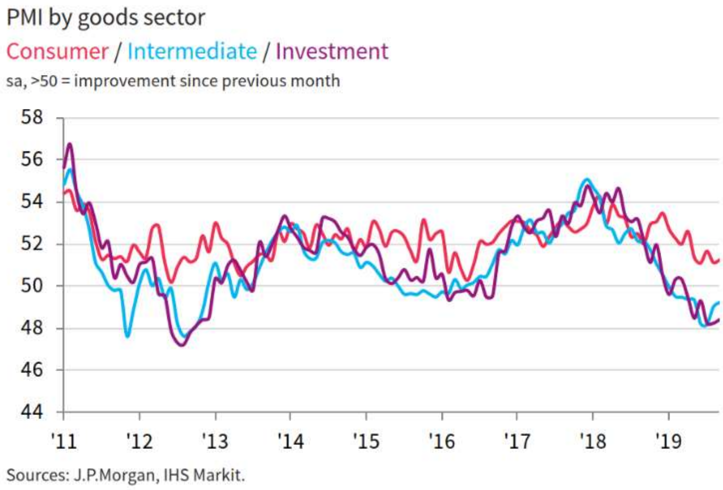


Figure 4: PMI by Goods Sector (*Source: IHS Markit*)

In the early half of 2019, the U.S. was immune to the global weakness in manufacturing sector or, more precisely, the broader global weakness. Recently, however, the data has suggested otherwise. The ISM index has fallen under contraction level in the month of September, worse than market's expectation. The ISM index points to the same trend as the U.S. industrial output. This is hardly surprising if we look at the breakdown of the industrial output which was mainly dragged by the manufacturing sector. While trade war is part of the reason, the recent United Auto Workers month-long strike at GM is the main cause of the weakness in manufacturing as the vehicle and auto parts fell by 4.2% m-o-m (the Germans can explain why).

The weakness in the U.S manufacturing sector is further compounded by the strength of USD which is lamented by Trump. As of the time of writing, Dollar has appreciated by slightly less than 10% against a basket of major foreign currencies since January 2018. Strong greenback does affect U.S. companies which operate overseas as their sales (in Dollar terms) shrunk considerably, on top of the increase in tariffs for imported components and metals which has resulted in higher cost.

While many believe that the manufacturing sector has found a bottom amid a more optimistic trade war development, we should err on the side of caution and wait for more manufacturing data to come in the next few months to see if manufacturing has indeed picked up. If not, the U.S. consumer resilience is also going to be tested while we wait for the manufacturing sector to pick up.

Is the U.S. Consumer Health Deteriorating?

The weakness in U.S. manufacturing poses a big question: How will this affect the health of the U.S. consumers?
Surprisingly buoyant U.S. consumer is the main engine that critically drives the U.S. economic growth; it contributes roughly 60% to the economy output. While weakness of manufacturing started to emerge, there are still plenty of evidences and data that points to the fact that Americans are still healthy. Referring to the following figures, the current U.S. Household Net Worth is sitting near record high. This suggests that the U.S. households balance sheet is still in good shape.

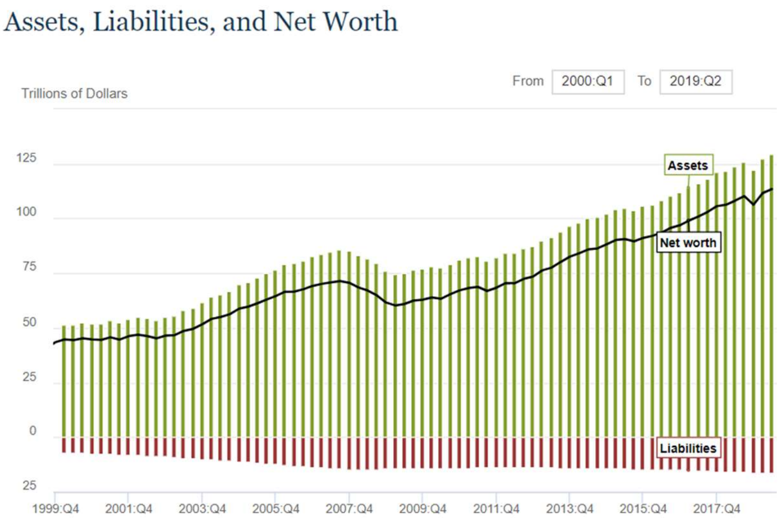


Figure 5: Asset, Liabilities and Net Worth of U.S. Household (*Source: FRED)*

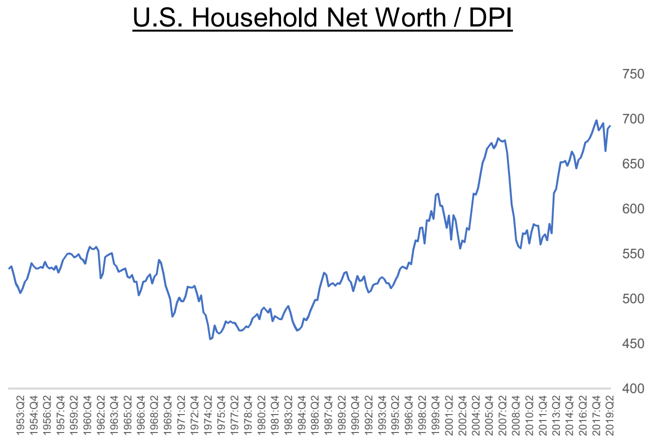


Figure 6: U.S. Household Net Worth / DPI (*Source: FRED*)

Looking at the labour market, the unemployment rate is sitting at 3.5%, the number of Americans filing for unemployment benefits has recently fallen to 203,000 as of 30th November 2019. But looking at the big picture, the Initial Claims has been ranging at the lowest level in 50 years. The recent strength in labour market is supporting consumer spending that has fuelled the longest economic expansion in the U.S. history. While business sentiments are somewhat lifted by recent trade developments, U.S. corporates have not been too optimistic as they recognised there are downside risks to the trade war deals.

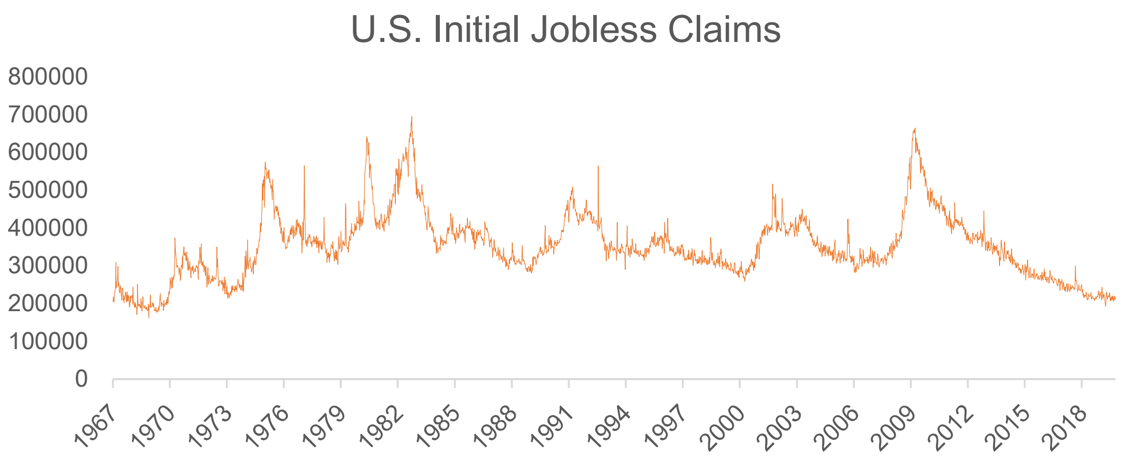


Figure 7: U.S. Weekly Initial Jobless Claims (*Source: FRED*)

Again, these data do not try to paint an overly rosy picture of the U.S. economy. We know that consumers and labour markets are lagging indicators of budding economic downturns, but we cannot discount the fact that consumer spending is the main engine for the U.S. economy.

We expect the consumer data will support the future economic growth. Considering the current developments, real consumer spending is expected to remain stable for the next six months. We believe that manufacturing sector has found a bottom and hence will pick up. If trade development progresses to Phase 2 and Phase 3, we should expect the business sentiments to improve, and business will increase their hiring. This will increase the real income among the household and further strengthening the household consumptions.

<u>U.S. Election: Dollar Implication</u>

Going to an election year, we expect to see the U.S. politics to dominate the market sentiments in 2020.

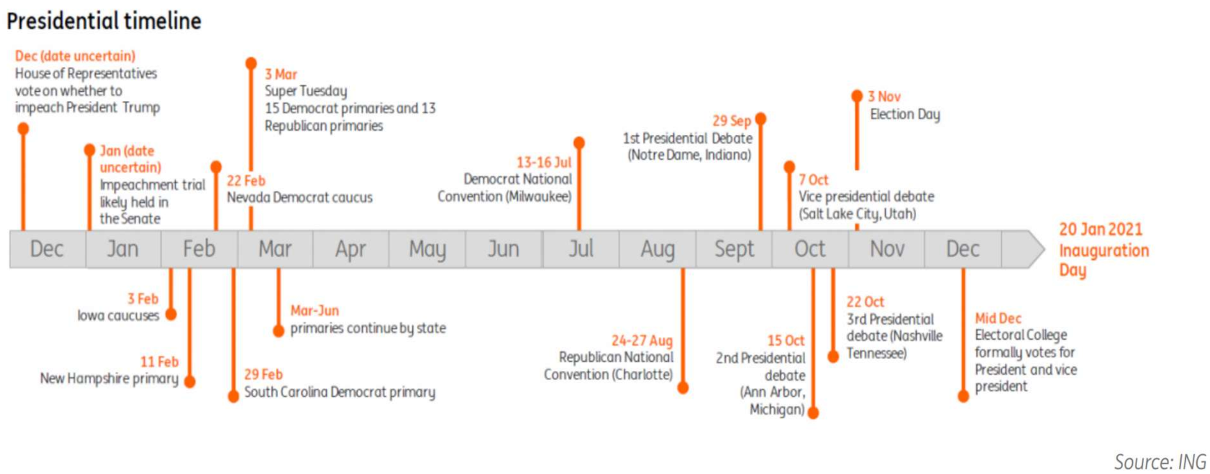


Figure 8: 2020 Presidential Election Timeline (*Source: ING*)

When looking at the U.S. elections there are two key areas that we believe will have implications to the markets. They are fiscal policy and trade policy. On fiscal policy, low taxes and high government spending normally results in more economic expansion. A loose fiscal policy may also give the additional boost to the confidence of the U.S. businesses, on top of accommodative monetary policy. Historically, loose fiscal policy is responded by tighter monetary policy which has a positive impact on the greenback. However, this time is different. The Fed is now faced with low unemployment and low inflation which is not the case that can be explained by traditional economics (Phillips Curve). There might be structural changes since the Great Recession in 2008 which causes this relationship to weaken. Since the transition mechanism from loose fiscal policy to higher inflation may not have worked as well, we do not expect Fed to respond by hiking rates. Hence the dollar implication of looser fiscal policy this time round will be limited.

Moving on to protectionism policy, we have witnessed how implementation of tariffs under Trump's administration has created a lot of uncertainty and significant headwinds for the U.S. businesses. As of now, trade tension has cooled down and sentiments have improved. Trump might want to take re-election in mind while considering his trade policy with China in coming months. We know that the U.S., despite of slow down, has performed relatively well compared to other developed markets and that has resulted in a safe haven bid for the USD. Once the trade developments have finally made way (we mean Phase 3 and beyond) for global growth, we should see a considerable investment outflow from the U.S. to more risky assets in EM resulting in weakening of USD.

Different candidate of course has different policy preferences, we will quickly sum up the policy preferences by each candidate so far. **Trump**: we believe he will still continue to utilise loose fiscal policy in lowering taxes and his will still stand firm to his protectionist stance. At the same time, we expect him to constantly push the Fed to cut their rates further. This will result in a rather bullish USD. **Biden**: As a centrist, he might pursue a looser fiscal policy by spending on infrastructure. He is much less a protectionist as compared to Trump. Resulting in a neutral impact on USD. **Warren & Sanders:** Both are in favour of redistributive tax hikes on and prefer the Fed to print money to support plans that will make the U.S. carbon neutral. They are stance on protectionism should not be as extreme as Trump. Resulting in negative impact on USD. **Buttigieg & Bloomberg:** Both aim to support Fed and we are expecting more infrastructure spending. More trade friendly policies should be expected. Overall, either one will have a neutral impact on USD.

FX TRADE IDEA: LONG EURUSD

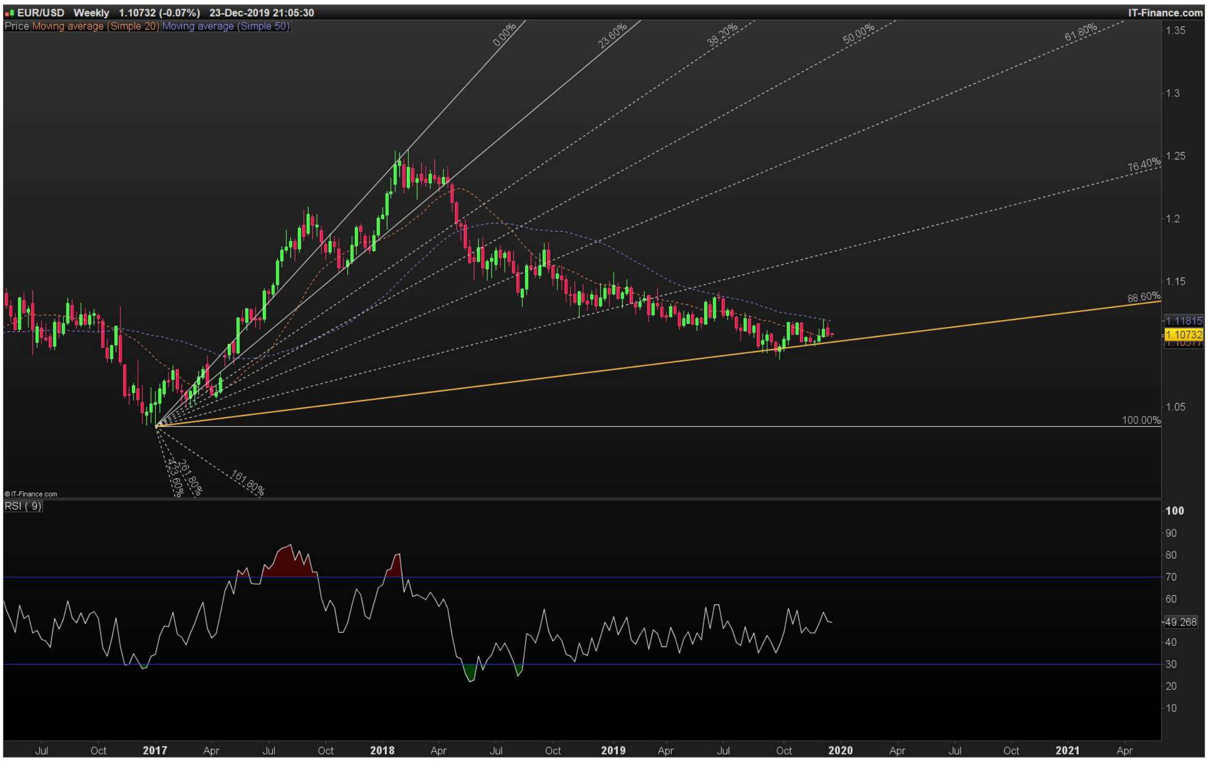


Figure 9: Weekly Chart of EURUSD *(Source: IT-Finance)*

We will be analysing the EURUSD chart using multiple timeframes. To start off, we will analyse the weekly chart. We can see that the pair was bullish in 2017 and it was not able to sustain the 2017 rally to date. We utilised the 2017 swing low and swing high to from a Fibonacci Fan. For those who are not familiar with Fibonacci Fan, it is formed by connecting starting point to each Fibonacci retracement level. The 88.6 level usually indicate a deeper retracement and thus can be a critical support level. As seen from the chart, the price struggled to move past this 88.6 fan line at the last week of September 2019 and has since unable to break the level. This increases the probability of a reversal, which we believe is on its way.

Figure 10: Daily Chart of EURUSD *(Source: TradingView)*

Moving on to the daily chart, the symmetrical triangle that formed in the second half of 2019 provides a topside breakout. This formation provides a stronger narrative for our bullish thesis. The current prices are in the progress of testing the bullish trend line and this level is confluent to with the 38.2% Fibonacci retracement level of the same move (swing low at early-October to swing high at mid-October), which we believe will provide a support to the movement. The earlier retracement level at 61.8% in mid-November and end-November helped to set a swing-low support before we see the bull took control of the market. This 38.2% is being tested again now, but we believe just like the 61.8% level, the bull will take control of the market again.

Figure 11: Daily Chart of EURUSD with SMAs *(Source: TradingView)*

As seen from the daily moving average, 20DMA has move above 50DMA and 100DMA, which often suggest a bullish momentum. Looking at the stochastic, it is moving towards the oversold level at 20. When it reaches the oversold level, it should provide a good entry point of this trade.

Combined with the above analysis, this put EURUSD in a bullish position with a very high chance of trend continuation. To take a safer approach, a price above the 23.6% level will be a safe anchor for bullish exposure and if the price can clear the resistance level of November high at 1.11757, we believe that this will validate our bullish thesis.

But it has not been a one-sided story, we also can observe an ascending wedge formation. This formed by our bullish trend line and another important level at 1.11762 that has been tested multiple times. While one can argue for a bearish scenario for this move (and accordance to the conventional bearish ascending wedge formation). A more dovish monetary policy on Eurozone or significant shift in fundamental macro themes, such as the U.S.-China trade wars or Brexit, might potentially threaten EURUSD to a dramatic downside break to December low at 1.09812 level. This will be our stop loss level.

However, when looking at the most traded currency in the world, it is that the USD movements will mainly dictate the EURUSD movements more than the EUR movements. The narrative for USD is that the easing of trade tension already has switch the market into a risk-on mode. This would mean that there will be more outflow of funds from the U.S. to riskier EM assets possibly; such outflow will expectedly weaken the USD.

Figure 12: Weekly Chart of Dollar Index *(Source: TradingView)*

Looking at the Dollar Index weekly chart, first we can see that the price movement has stopped to respect to ascending channel formed since October 2018. Furthermore, as price movement started trend upwards since October 2018, we can see that the MACD has been trending down. This is commonly believed to be a trend reversal signal. This support our bearish thesis for USD.

Entry Level: 1.11757
Take Profit: 1.1457 (61.8% retracement from Sep 18 swing low to Sep 19 swing high)
Stop Loss: 1.09812
Risk to Reward Ratio: 1.65

MEXICO (Underweight)

Mexico's GDP stands at USD 243,824 million and it is facing a slowdown largely due to the slowdown in the global manufacturing industry in light of the trade war. Mexico also faces trouble in its political sphere, and they will be experiencing even more trouble when their lacklustre infrastructure is unable to keep up with the inflow of FDIs.

As we speak, Mexico's inflation rate has fallen to a 3-year low of 2.97%, which is considered significantly lower than Mexico's boom in 2018, where the inflation hit 6.8%. This reflects the slowdown in the global and Mexico's domestic economy. The fall in employment to 96.35% (mainly from the effects on the manufacturing sector) goes in tandem with the inflation rate. Moving forward, we advise reducing our weight on Mexico's investments in light of the major uncertainty, only cautiously returning our positions when the manufacturing industry picks up or if Mexico gets the United States Mexico Canada (USMCA) Trade Deal approved.

Weakening Demand from Mexico's Export Partners

Mexico's economy is largely dependent on its manufacturing industry, which puts them at the risk of a recession in this quarter. Mexico's exports consist mainly of manufacturing goods, with U.S., Canada, and China being amongst their top importers for these vehicles and components. The U.S. remains the top export destination, with a significant 51% coming from the United States and with China trailing behind at 15%.

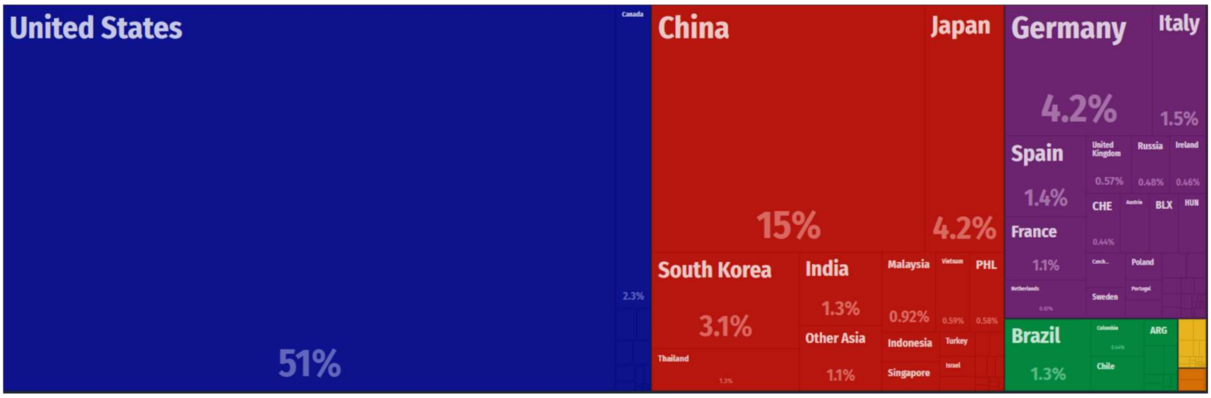


Figure 13: Percentage of Mexico's Exports by country (*Source*: *OEC World*)

In light of the fall in manufacturing imports in the U.S., Mexico's economy is also negatively impacted. The ISM Manufacturing Index is nearing a 10-year low of 48.1, the previous time it hit this low was during the previous financial crisis in June 2009. The ISM has missed many estimates due to the actions of the trade war negative sentiments from different countries. Being the top importer of Mexico's manufacturing products, the lacklustre performance from the ISM Manufacturing Index will affect investor's confidence in the manufacturing industry.

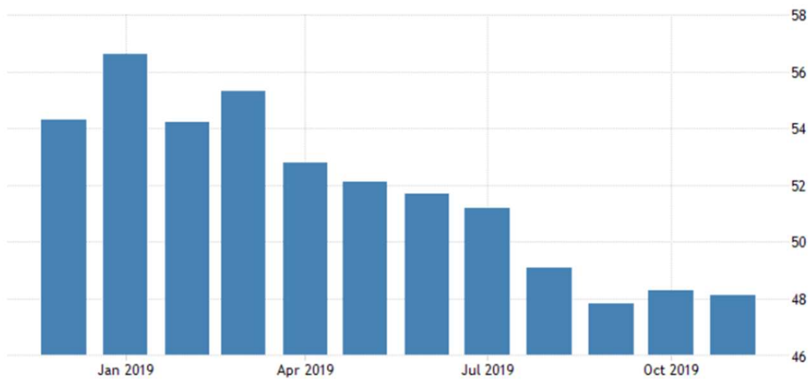


Figure 14: U.S. Purchasing Manager's Index (*Source*: *Statista*)

China's manufacturing industry is also looking bleak, as their factory sector contracted for the fifth month due to the negative economic outlook. China's widgets are losing their pricing power due to the increasingly savvy markets in light of the possible recession, which causes many factories to take special measures to let go of the inventory that they are having a hard time selling due to the trade war. The trade war's implications on China's exports also support this movement, ultimately affecting the demand for manufacturing and manufactured goods that come from Mexico.

In the west, the Eurozone manufacturing sector is also facing trouble. There has been a huge fall in domestic and foreign demand for the European Union's (EU) manufacturing industry in September and October, which also, in turn, leads to the fall in imports for Mexico's goods.

Mexico is heavily reliant on the sentiments of foreign markets and the recent negative sentiment will heavily affect consumer behaviour, as both the wealthy and retail customers choose to hoard cash and save rather than splurging on widgets and vehicles.

While we look at the demand in the manufacturing industry, we also take into account the demand from households for their personal vehicles. In light of the cautious outlook of the economy, U.S. citizens are also saving more money to prepare for a recession.

Vehicles are also considered a luxury good for the middle income, which may result in a greater fall in demand for automobiles from the perspective of the more price-sensitive middle-class households, where a significant portion of their income and savings will go towards buying a vehicle.

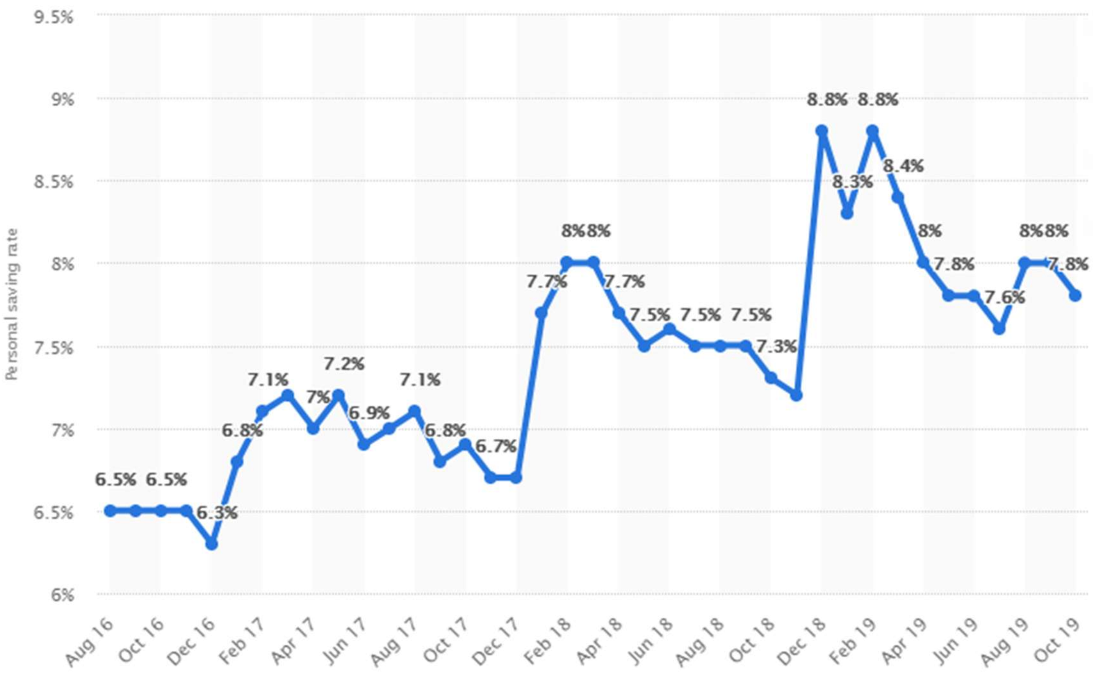


Figure 15: Personal saving rate in U.S. (*Source*: *Statista*)

The savings rate in households remain at a high of 7.8%, even after the amicable trade talks. Especially amongst the more price sensitive middle-income households, they will be holding back on their vehicle purchases to keep dry powder both for investing as well to prepare for a recession.

At the same time, there is a slight dip in the auto loan rates in the U.S.

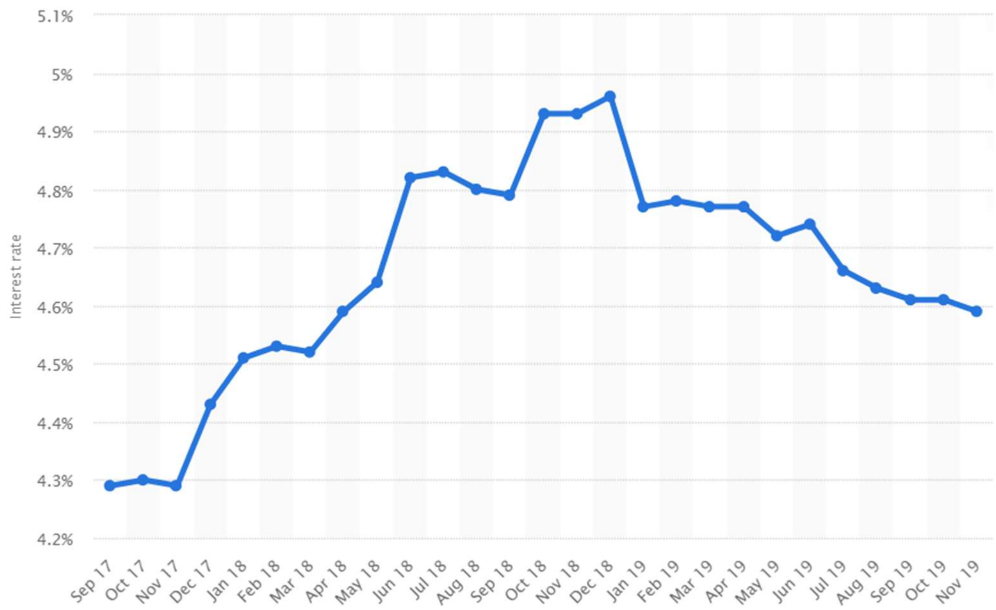


Figure 16: Historical Auto Loan Rates in U.S. (*Source*: *Statista*)

However, despite the slight dip in interest rates, we notice that these interest rates do not affect the delinquency rates of the auto loans, as shown in the diagram below:

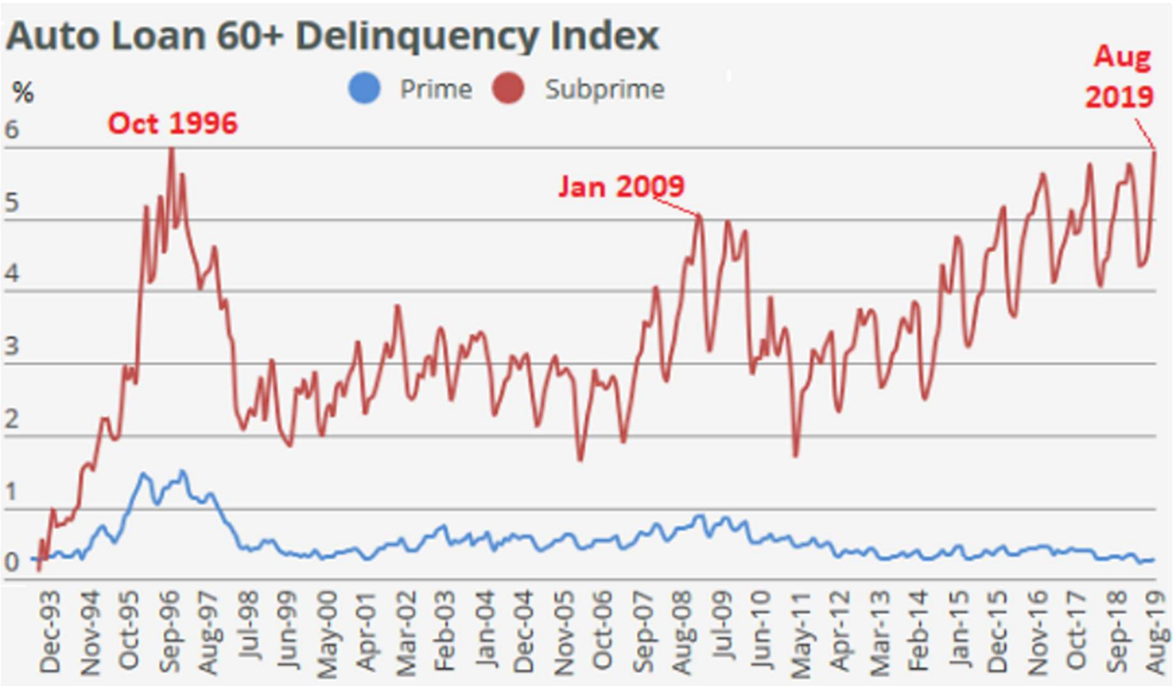


Figure 17: Auto loans delinquencies rates in U.S. (*Source*: *Wolfstreet.com*)

Paying attention to the subprime delinquencies, we see a peak in the number of delinquencies, which will negatively affect the number of cars being produced, as manufacturers predict a high number of delinquencies, we expect that individuals' credit ratings will be stricter to lower the rate of delinquencies. At the same time, there is a high risk of interest rate loans increasing as car sellers take on more risk in light of the rise of the rate of delinquencies.

Looking forward, a lot of these aspects of the manufacturing will be banking on the outcome of the Trade War. Although our outlook reflects a moderately positive stance, we can expect more headwinds as households increase their savings rates in light of the uncertainty. The impeachment of U.S. President

Donald Trump and possible political risks stemming from the upcoming U.S. presidential elections will also result in more uncertainty in the market, causing households to be more conservative with their spending on luxury goods such as auto mobiles for the middle-income households.

Unstable Political Sphere and The USMCA

AMLO has recently passed an austerity law that will cause dissatisfaction in the political sphere. By capping the salary of government officials and reducing government spending on fiscal activities, it has led to many government officials leaving. The remaining officials are also said to be not as capable as the rest.

AMLO also has the USMCA Trade Deal on his plate, which is a trade deal that is beneficial for themselves, U.S. and Canada. The Trade Deal significantly lowers the tariffs placed on each other. This Trade Deal will create a more balanced, reciprocal trade that will create more jobs within the three countries and further grow their economies. From Mexico's perspective, the surge in demand for Mexico's exports will support the development of the country's infrastructure to equip themselves for the rise in demand. At the same time, there will be a rise in Foreign Domestic Investments as investors regain confidence in Mexico's struggling economy.

There is still a higher likelihood for the USMCA Trade Deal to go south even if the Trade Deal gets approved due to the high probability of failure of Mexico to uphold their promises given their unstable political state. In that event, the U.S. will exercise the withdrawal article under NAFTA

Banxico's Move

Considering Mexico's current interest rates of 7.5%, Banxico still has a lot of room for interest rate cuts as juxtaposed to their manufacturing counterparts such as the U.S. and EU, who are turning to quantitative easing and fiscal policies as their main form of market stimulation. We foresee Mexico's interest rate to fall to 7.00% by the middle of 2020 and this may not stop depending on the outcome of the U.S. elections and development of the trade war.

However, although this protracted easing cycle is expected to bolster the economy, this may conversely result in the erosion of the currency's carry advantage, especially if there are multiple rounds of interest rate cuts. A fall in the demand for the Mexican Peso will in turn weaken the strength of the currency, leading to a fall in exports as foreign goods appear more expensive while increasing imports as foreign countries perceive Mexico's goods to be cheaper. This will in turn affect the Balance of Trade of Mexico, which will greatly affect their economy.

Weak Flow of Foreign Domestic Investments

Another main challenge that impedes a bull case for Mexico is weak investment flows into Mexico. After AMLO decided to cancel the construction of the airport in Q4 last year, FDIs weakened, the peso plummeted, and Mexico's growth slumped. Although much of the effects of this cancellation have been priced into the markets, this move reflects AMLO's focus on reducing the country's debt which was standing at 53.62% of debt to their GDP. He chose to reduce this level of debt over the potential growth and improvement of Mexico's infrastructure and economy.

While Mexico has a significant advantage over the U.S., China and EU in terms of cost of labour, geography and cost of capital, their lacklustre infrastructure slaps a ceiling on their ability to deliver quality products and sustain a return of investment for investors. In the long run, infrastructure such as their transportation will hinder the sustainability of these returns of investments, and we hope to see AMLO act to aid in the inflow of FDIs.

AMLO can also increase the quality of their labour force through investment in education and training. This method will be similar to other emerging markets countries such as Brazil spending 16.1% of their government expenditure on education.

On the other hand, Mexico can explore the possibility of using tax benefits to increase the inflow of FDIs. As established earlier, AMLO's short term vision may not place too much emphasis on the development of the country’s infrastructure. Furthermore, his austerity law will bring great savings within the government. The fall in the need for taxes will then open up the possibility of tax benefits for FDIs.

FX TRADE IDEA: SHORT MXNUSD

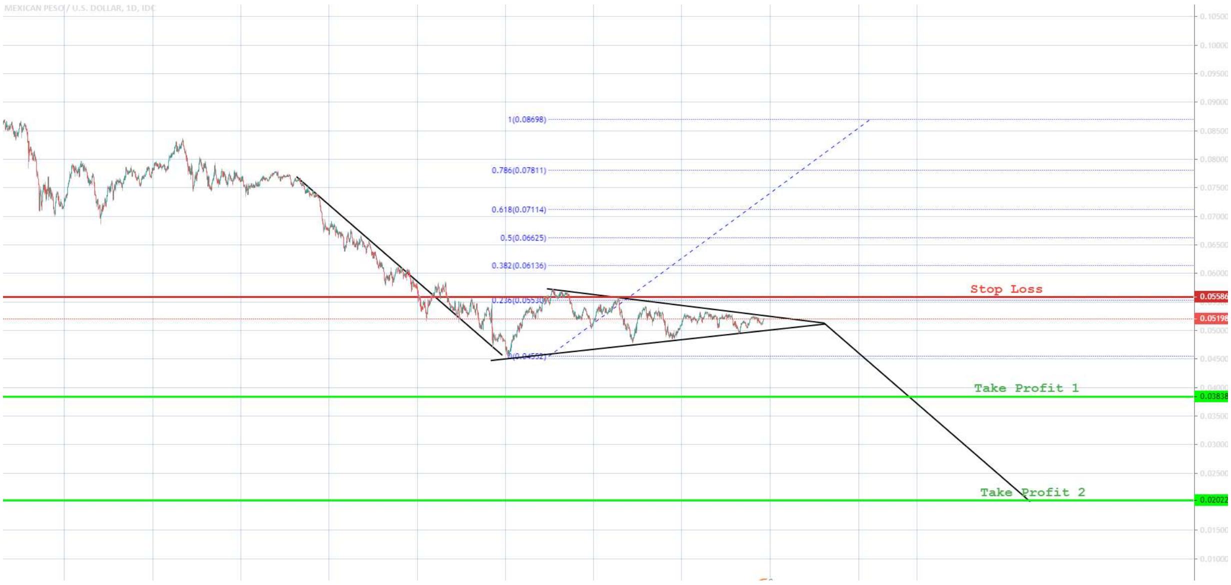


Figure 18: MXNUSD Price Chart (*Source: TradingView)*

Entry Level: 0.05198
Take Profit 1: 0.03838
Take Profit 2: 0.02022
Stop Loss: 0.05586
Risk to Reward Ratio: 3.51

Being moderately optimistic for the ongoing Trade War, we expect the USD to appreciate more than the Mexican Peso. As the U.S. nears the next election, we also expect Trump to be taking measures to improve the U.S. economy, even for the short run just to prove the success of his 4-year presidency. On the other hand, the unstable political sphere, coupled with the global slowdown in manufacturing will erode the appreciation of the Mexican Peso, and conversely cause it to depreciate due to the negative outlook from investors towards Mexico. All in all, Mexico is very heavily reliant on its exports and balance of trade as their domestic economy is not strong. This is why the global outlook will have a large weight on the performance of the Mexican Peso. Therefore, the USDMXN price chart will be bearish.

On the other hand, should the USMCA deal gets signed by all parties, we will see the chart breaking out upwards, which is why we set a high stop loss for this event. However, we expect the strengthening of the U.S. economy to cause the USD to outperform the Mexican Peso due to the aforementioned reasons.
We place our stop loss at 0.05586 as indicated by the 0.236 Fibonacci retracement level. On the other hand, we see a bearish pennant forming from the convergence of the resistance and support lines, signalling a breakout towards the downside. We will then be taking profit at 0.02022, as indicated by the bearish pennant formed.

CANADA (Overweight)

Canada is the world's 10th largest economy (in nominal terms) and ranks third globally in terms of natural resources. The 2018 GDP was estimated to be USD 1.71 trillion, representing an estimated 2% of the global economy. It is estimated that Canada's possesses up to USD 33.2 trillion worth of commodities, making it a global leader in energy and mineral exports.

Like many developed economies, Canada's economy is mainly driven by its services sector which contributes up to 78% of the country's GDP. Manufacturing follows closely behind, accounting for approximately USD 174 billion, or more than 10% of the country's GDP. The natural resource sector is the third main driver of the economy which is largely made up of forestry, fishing, agriculture, mining and energy sectors.

At the core, Canada is heavily reliant on exports with the U.S. being its largest trade partner and China following behind. Months of escalating Sino-U.S. trade and geopolitical tensions have been taking a toll on the Canadian economy. However, Canada is starting to show signs of recovery after the Trump lifted steel tariffs on Canada in May this year; coupled with high hopes of the United States-Mexico-Canada Agreement (USMCA) being ratified.

Economic Indicators Up, but Canada Remains Vulnerable

Not all is pessimistic for Canada. While economic performance has not been too positive for the economy, recent economic indicators suggest that Canada is expected to grow healthily amidst an uncertain global outlook. PMI rose to 51.4 from 51.2 in October 2019 (Fig 19), signalling optimism in business confidence. An increase in manufacturing PMI indicates increasing optimism despite headwinds from global uncertainty. Given the significance of the manufacturing sector to Canada, we believe this optimism translates to expectations of continued economic growth.

Figure 19: Canada manufacturing PMI (*Source: Trading Economics*)

Unemployment remained unchanged at an all-time low of 5.5% (Fig 20), as compared to the September 2019. All indicators are showing signs of the economic health of the Canadian economy.

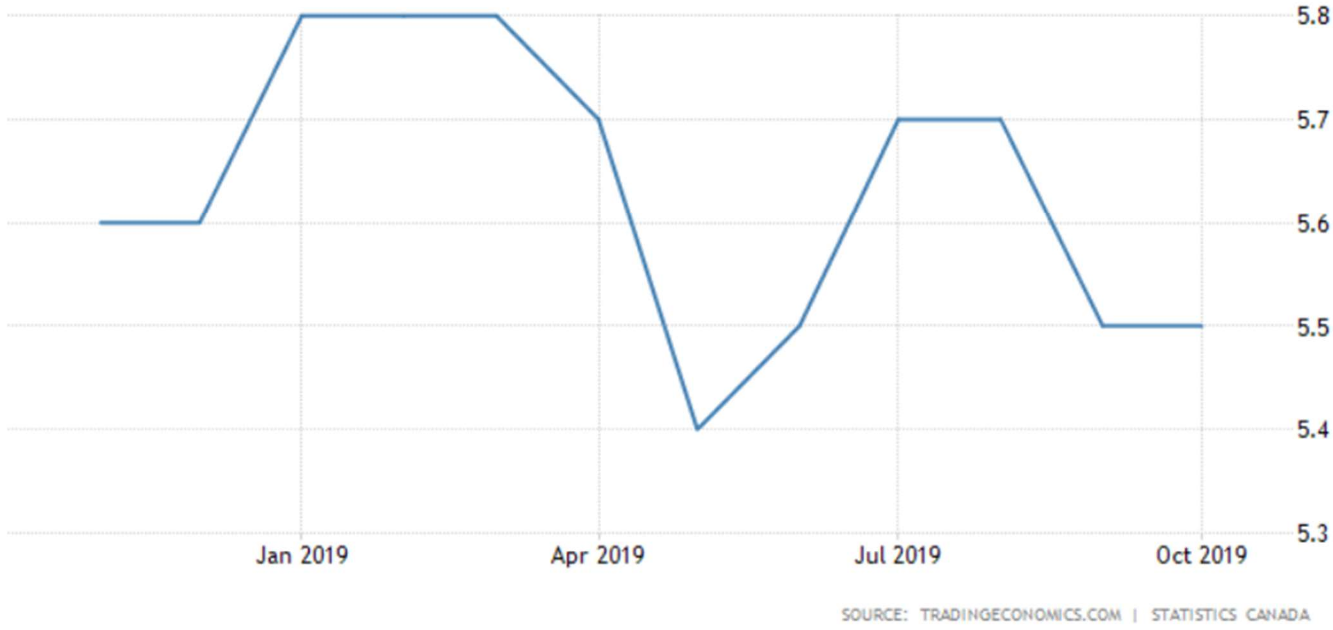


Figure 20: Unemployment in Canada (*Source: Trading Economics*)

Consumers spending rose by 3.5% and showed healthy signs with increased spending on big ticket items such as cars and furniture after four consecutive drops.

Despite the healthy economic indicators, Canada's economy advanced 0.3% in Q3, slowing from a 0.9% expansion in the previous period. We believe that trade woes between the two superpowers continues to take its toll on Canada. Although a "Phase 1" deal is already in sight and about to be ratified, China has expressed concerns and doubts about a complete deal between the two giants. Further, we believe that President Trump's December 15th tariffs on China would prove to be risk-off for the global economy as trade uncertainty looms. Canada remains vulnerable due to its high exposure to underlying trade tensions between the two superpowers.

Regardless, we believe that a recession will not be likely within the next six months, given the strong economic indicators considering improving trade relations.

Loonie set to be the Highest-Yielding G10 Currency after Fed Rate Cuts

The Bank of Canada's benchmark interest rate as of October 2019 is 1.75%. With the divergent interest rate decisions between the U.S. Federal Reserve and BOC this month, the loonie is currently the best performing currency within the Group-of-10 countries.

The Canadian dollar has appreciated 4.4% this year against the greenback (Fig. 21). Canada's two-year yields climbed above the U.S.' as the rate cuts pushed yields lower. Stable interest rates coupled with healthy indicators is attracting investors to direct their money into Canada. Capital inflow into Canada increased to USD 18.7 billion, highest in four years; and is currently up 5% year-on-year. Large capital inflow means there is increasing demand for the loonie as investors investing in Canadian bonds. The increase in demand for the loonie results in its appreciation against the greenback.

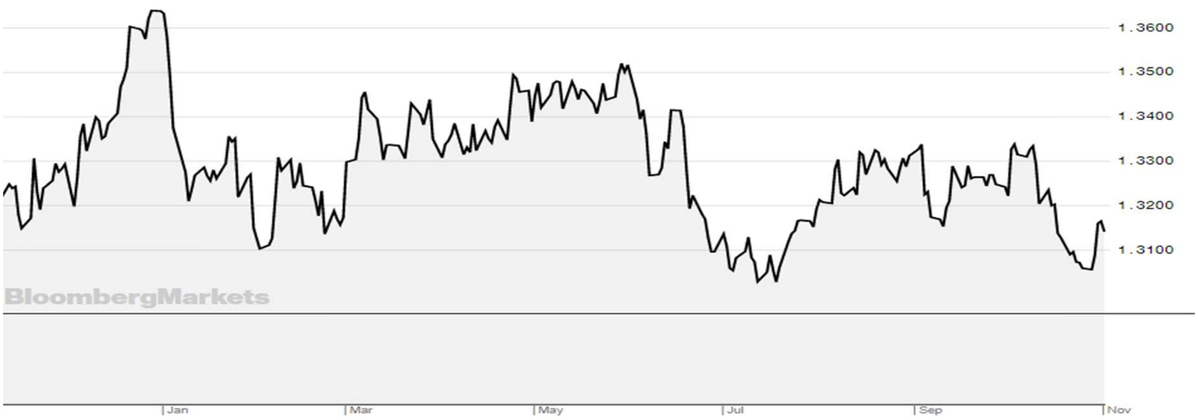


Figure 21: USDCAD Spot Rate (*Source: Bloomberg*)

The appreciation of the loonie is deteriorating Canada's trade balance. A stronger Canadian dollar means demand for imports increases as it appears cheaper. On the other hand, demand for Canadian exports decreases as they appear more expensive. Ultimately, this results in a downward pressure on Canada's trade balance.

Despite this fact, the exports of crude and aircraft is offsetting its negative effects. Exports rose 1.8% in August after falling for two consecutive months in June and July 2019. Metals and minerals contributed the largest to the gain, while gold peaked in over two years. This indicates increased asset acquisitions by local companies.

Willingness to Pass USMCA a Boon to Canada

Considering global trade tensions, a new and improved USMCA – which seeks to replace the North American Free Trade Agreement (NAFTA) – will be a boon to Canada.

The USMCA facilitates greater trade between the U.S. and Canada in a myriad of industries, including automobiles and metals, two major exports to America. Canada's current account deficit stands at USD 4.79 billion, the lowest in more than a decade. With the implementation of the USMCA, Canada will enjoy increased exports to the U.S. and thus, increased export revenue. While import expenditure still exceeds export revenue, the rising import prices in Canada is signalling increasing prices of imports. We believe that this will result in a future decrease in import expenditure as consumers will choose to purchase the relatively cheaper local products as compared to the more expensive imports. Therefore, the USMCA seeks to further decrease the current account deficit.

The automobile industry will experience significant impact as a result of the USMCA. With stricter requirements for automobile parts to be made in U.S., Mexico or Canada to enjoy zero tariffs, automobile prices around the world is sure to rise. However, Canada will enjoy zero tariffs on automobile parts or final products. The impact on trade balance will be significant since cars and vehicle parts make up around 15% of Canada's total exports. Further, the USMCA effectively removes all tariffs on Canadian metals, which make up to 8.5% of Canadian exports. This removal of tariffs translates to increased demand for Canadian metals, thus increasing export revenue.

However, the USMCA has yet to be ratified by the U.S. and Canada. American politics revolving President Trump's impeachment seem to be stalling the ratification of the trilateral trade deal. Regardless, House Speaker Nancy Pelosi is showing signs of positivity, signalling Congress' willingness to ratify the pact. Meanwhile in Canada, they are still waiting for their American counterparts before they follow suit. Nevertheless, all three countries have signalled strong interest in this trade pact and we believe that it is only a matter of time before official ratification.

Moving forward, global uncertainty and trade tensions between the superpowers remain the biggest risks for Canada's economy over the next 6 to 12 months. In the meantime, positive economic indicators and positive hopes of the USMCA serve as catalysts for economic growth. Strong consumer expenditure is also paving the way for a healthier Canadian economy in the upcoming months.

FX TRADE IDEA: SHORT USDCAD

The slightly bearish sentiment on USDCAD is supported by the following factors.

Firstly, the BOC has kept interest rates at the benchmark rate of 1.75% and signalled no intention to change it anytime soon. Meanwhile, the U.S. Federal Reserve just cut rates a third consecutive time this year. With such tight monetary policy, capital inflows into Canada and outflows out of the U.S. will be expected, as investors seek to move their money out of the U.S. in search of higher returns.

Secondly, strong economic indicators are making Canada look very attractive. FDI into Canada has increased to a high in the last four years. The positive investment outlook in Canada will increase the demand for the loonie and hence, lead to its appreciation. With the reputation of the best performing currency in the G10 this year, we can expect the CAD to rally further against the greenback.

Thirdly, in terms of trade, markets are already pricing in the ratification of the USMCA. Trade balance is set to improve, thus driving the Canadian economy as the U.S. is Canada's largest trading partner. There are also signs of the trade deal with Mexico falling into place, which may provide a positive outlook on trade as well.

However, it is important to consider the headwinds to a falling USDCAD. An appreciation in the loonie may lead to a decrease in consumption of Canadian imports in America. Trade deficit may turn south should the effects of a stronger CAD offset the gains in CAD due to the high amount of trade between the U.S. and Canada.

Another headwind that the CAD might face would be the falling demand for oil in recent weeks due to the rivalry between the U.S. and the Organisation of Petroleum Exporting Countries (OPEC). The U.S. shale oil boom has been a concern among the OPEC in recent years and the market is currently oversupplied. Moreover, the falling demand for oil is exacerbating such oversupply and thus may lead to a further fall in oil prices. Oil prices has decreased 9.6% since 2Q2019. Canada earns the most amount of USD from the sale of crude oil to the U.S., hence any increases/decreases in oil prices would increase/decrease the value of the CAD respectively. Regardless, with the ratification of a Phase 1 trade deal between the U.S. and China, the increasingly optimistic economic landscape might lead to increased demand for oil, thus pushing up prices and ultimately increase the value of the loonie. Currently, we believe that the tailwinds will ultimately outweigh the potential headwinds the loonie might encounter.

Entry Level: 1.29767
Take Profit: 1.25490
Stop Loss: 1.30597
Risk to Reward ratio: 5.15

Figure 22: USDCAD Daily Chart (*Source: TradingView*)

As mentioned above, we believe that the CAD is likely to be of higher value as compared to the USD given Canada's strong economic indicators, trade optimism within the North America with the ratification of the USMCA, and the weakening headwinds which proves to be risks for the CAD. Therefore, we believe that the CAD is likely to appreciate against the USD.

From a technical standpoint, the USDCAD chart seems to be a steady decline from May 2019. A bearish pennant can be made out from May 2019 to date. The yield-to-date return of USDCAD is currently at -3.63%. This signals a bearish outlook on the USDCAD since it is lower when compared to other major pairs like USDJPY or USDCHF, therefore further supporting our trade idea of shorting the USDCAD. In addition, both the 50-day and 200-day SMAs are downward sloping, with the latter being above the initial, thus signalling a strong downtrend. Meanwhile, prices were just recently rejected off the downward sloping resistance line, making its way to the support area. Hence, we suggest taking a short position when the price breaks the support area (confirming the bearish breakout) at price level 1.29767. We also recommend limiting risks by placing stop loss level at 1.30597 if prices were to return above the support area into the pennant. We recommend taking profit at 1.25490 (5550 pips).

Since the U.S. and Canada have similar interest rates at 1.75%, there would be a neutral carry trade.

BRAZIL (Underweight)

Brazil is Latin America's largest economy in terms of purchasing power parity (PPP). The 2018 GDP was estimated to be USD 1.869 trillion. The service sector, mineral exports and manufacturing remain as the main drivers for the economy, contributing up to 95% of GDP. Growth has slowed to 1.7% this year, down from the estimated 1.95%. Global market uncertainty is a major contributor to the economic slowdown. This is exacerbated with political instability within Brazil, with President Bolsonaro facing accusations of assassination.

Global Market Weakness Exacerbating Brazil's Already Poor Economic Health

The weakening global market, mainly due to trade tensions between the U.S. and China has taken a toll on the global economy, and Brazil is not an exception. The country barely slipped out of a recession in the first quarter this year, but it is still facing a hard time due to sluggish consumer spending and investments, which resulted from the slight increases in household income. Consumer spending for 2018 was USD 1.2 trillion, 8.52% decline from 2017. We believe there would be no change in consumer sentiment, especially in this uncertain economic landscape with trade tensions in the backdrop, hence the Brazilian economy is unlikely to experience increased stimulus from consumer spending.

China's third quarter growth slowed further to 6%, the lowest in almost three decades. China is Brazil's largest trade partner, contributing to more than 40% of Brazil's total exports. With the bleak economic outlook, decreased demand for Brazilian exports is sure to follow, placing further strain on Brazil's trade balance. In addition, the decrease in soy exports – which makes up 12% of Brazil's exports – have also taken a hit as the African swine fever killed millions of pigs in China, resulting in plummeting demand for animal feed. The downward pressure on trade balance caused the Real to depreciate around 8% against the greenback since the start of 2019 (Figure 23).

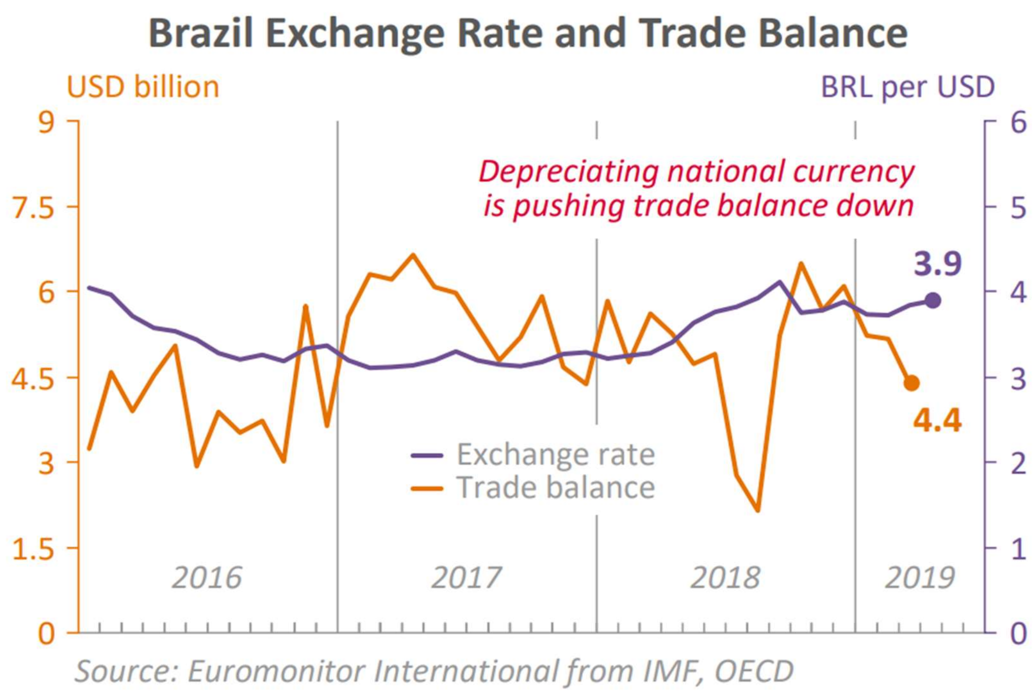


Figure 23: Brazil's Exchange Rate and Trade Balance (*Source: Euromonitor International*)

Mexico's manufacturing weakness is also straining Brazil's trade balance. Brazil is Mexico's largest trade partner and automotive trade represents almost half of bilateral trade flows. The weak manufacturing outlook, which is a main driver of Mexico's economy is placing it at risk of a recession this quarter. A weaker Mexico will mean that Brazil's export revenue to Mexico will decrease, placing downward pressure on

Brazil's trade balance. We believe that Brazil will feel significant impacts from the deteriorating trade from one if its main trade partners, further worsening economic outlook in Latin America's largest economy.

Just last week, President Bolsonaro was taken by surprise when President Trump decided to reinstate tariffs on Brazilian metals. Brazil was the tenth-largest steel exporter in 2018, with steel exports amounting to 13.9 million tons last year. Brazil has been maintaining a large trade surplus in steel products; and the reinstated tariffs will not bode well for Brazil as the U.S. is responsible for importing up to 42% of Brazilian steel exports in 2018 (Figure 24). We believe that this heightened tariffs, coupled with the upcoming ratification and implementation of the United States-Mexico-Canada Agreement (USMCA), Brazil is sure to suffer a significant decrease in demand for steel from its largest trading partner, which will certainly place significant downward pressure on Brazil's trade balance.

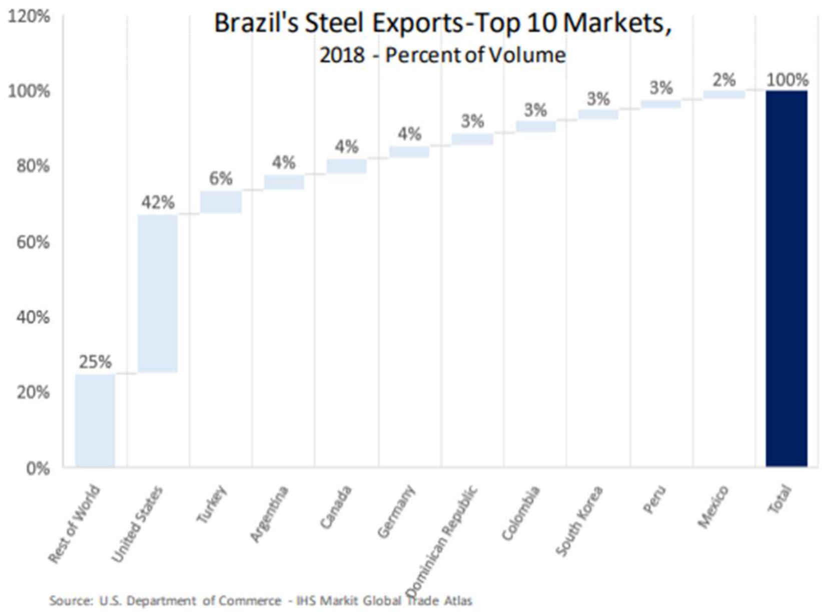


Figure 24: Brazil's Steel Exports – Top 10 Markets (*Source: U.S. Department of Commerce*)

Despite the relatively good relationships between the two country's leaders all this while, President Trump accused Brazil and Argentina of devaluing their currencies which caused American farmers to suffer due to the decreased demand.

<u>Pension Reform is the Key to Economic Stimulus</u>

The Banco Central do Brasil (BCB) has cut the Selic rate for the third time this year, to a record low of 5%. This is partly in line with the U.S. Federal Reserve interest rate path, in hopes of boosting the economy. On the other hand, foreign direct investments have decreased 9.4% from 2017 to 2018. In light of poor manufacturing outlook, PMI has dipped further into "pessimistic" territory, causing investors to steer away from investments into the country. The fiscal health of the country is in poor shape too – with poor consumer spending and deteriorating trade balances – hence rendering any sort of stimulus ineffective as proven from the multiple rate cuts and fiscal stimulus. Therefore, the answer may lie in the pension system.

The pension system in Brazil is the main cause of their large budget deficit, which is further exacerbated with the already weak growth and falling tax revenues. President Bolsonaro announced his victory over his pension reforms which is seen as a crucial step to a healthy budget balance and boosting investors' confidence. While this may seem optimistic, sufficient fiscal reforms also need to be in place for the pension reform to be effective. Future actions by the government will be crucial in determining the performance of the economy in the upcoming months.

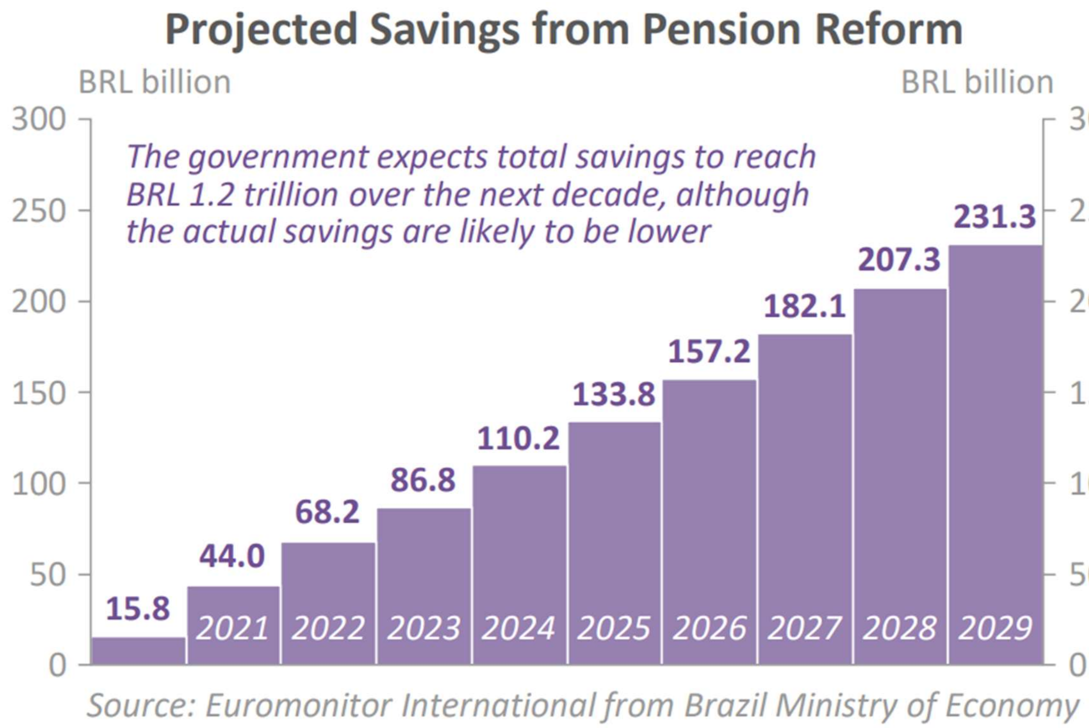


Figure 25: Projected savings from pension reforms (*Source: Euromonitor International*)

Leftist Argentina Not a Good Sign for Brazil

The election of Alberto Fernandez in Argentina is no good sign for Brazil, given the tensions between the leaders of both countries. President Bolsonaro and President Fernandez have been constantly exchanging crude remarks about each other and this may prove to be detrimental between the two economies as both leaders take on an increasingly hostile stance towards each other.

With regards to the future of Mercosur, both countries take opposing views. Brazil wishes to liberalize trade in the short-term, while Argentina prefers a steadier approach. Other conflicting ideas regarding Venezuela and China will also be important topics in which the two countries have diverging ideas on.

Just last week, President Bolsonaro decided not to send a delegate to President Fernandez's inauguration ceremony in Argentina, signalling an escalation in tensions between the two leading economies in Latin America. He also declared that he would not call President Fernandez to congratulate him. While such feud between the two leaders might not seem to amount to much, we believe that it is certainly detrimental to the economies as hostile relations serve as barriers to trade, which in turn places downward pressure on their trade balances, preventing economic stimulus.

Hence, it is likely that both leaders will struggle to establish a beneficial relationship for the upcoming years ahead. While Argentina is not one of Brazil's top trading partners, exports to Argentina still make up a significant amount at USD 14.95 billion. A recent study by the Brazilian Institute of Economics showed that the sour relationship between the two economies could shave off up to 0.5% of Brazil's GDP in 2019. We believe that the rocky relationship between the two countries will persist in the near future. This further place downward pressure on Brazil's trade balance and the Real.

FX TRADE IDEA: LONG USDBRL

We suggest a long trade on USDBRL with the following considerations:

Firstly, economic outlook is bleak in Brazil due to sluggish consumer expenditure, coupled with global market weakness is manifesting into a slower GDP growth expected. On the trade front, tensions between the President Bolsonaro and Argentinian leader Fernandez are set to weaken trade tensions and provide pessimism on trade relations between the two neighbours. Moreover, the African swine flu outbreak in China is severely affecting soybean exports to China, decreasing Brazil's trade surplus to a 52-week low. This places downward pressure on export-driven Brazil. Thus, the BRL is set to depreciate.

Secondly, while pension reforms have been put in place, weak fiscal stimulus is not serving as a catalyst for improving budget balance. Monetary stimulus is also only slightly effective. Simultaneously, low interest rates are causing investors to move their money elsewhere in search of higher returns, thus resulting in a depreciated BRL.

President Bolsonaro is rising in popularity after struggling, and finally executing pension reforms for Brazil. On the other hand, he is also facing backlash after he made threats to a major national media outlet after being accused of murdering Marielle Franco, a Brazilian politician. Nevertheless, President Bolsonaro's far-right policies serve as a consolation to investors who is likely to view him as a market-friendly president.

On the other hand, the most recent U.S. economic indicators signalled a stronger than expected economy. Non-farm payrolls exceeded expectations at 266,000, GDP grew 1.9% vs an expected of 1.6%. Despite underlying uncertainties regarding trade and domestic affairs, consumer spending remains strong which acts as the main driver in the U.S. economy. Therefore, we believe that the greenback will remain strong as compared to the Real.

Entry Level: 4.1078
Take Profit: 4.3363
Stop Loss: 4.0326
Risk to Reward ratio: 3.62

Figure 26: USDBRL Daily Chart (*Source: TradingView*)

From a technical standpoint, the USDBRL appears to be on a gentle uptrend channel with prices testing the support and resistance levels multiple times. The USDBRL recently had a false breakout from the long-term resistance line at 4.2526 before immediately falling back into the channel again.

The 50-day SMA still exceeds the 200-day SMA, signalling a relatively strong uptrend. We suggest waiting for the price to bounce off the 0.618 Fibonacci retracement level before entering into a long position at 4.0984. We suggest placing a stop loss at 4.0345, near the 0.786 Fibonacci level which would be a clear signal that the bullish breakout has failed, and prices are likely to move towards the support level. We have set a take profit at 4.3382, near the 0.786 Fibonacci extension level. The MACD currently indicates bearish movement in prices. Thus, we suggest waiting for a bullish crossover before entering into a long position.

However, the interest rate spread between the U.S. and Brazil is a significant risk factor. As such, a long carry trade for too long would prove too risky as the returns may not outweigh the cost of holding the trade for too long, especially given the low volatility of this pair. Therefore, we do not recommend holding the position for more than half a year as the returns would not be ideal given the high cost of carrying the trade.

EUROPEAN UNION (Underweight)

The European Union (EU) is an economic and political union of 28 member states located in Europe. The EU is the second largest economy in the world (in nominal terms), after the United States (U.S.). The 2018 GDP was estimated to be USD 18.8 trillion, representing 22% of the global economy. The Euro (EUR), is the second largest reserve currency and the second most traded currency after the USD. It is managed by the Frankfurt-based European Central Bank (ECB). 19 EU member states use the Euro as their official currency. Notably, Christine Lagarde has taken over as the President of the ECB, from former President Mario Draghi. The ECB left its key interest rates unchanged during Lagarde's first policy meeting, with the main refinancing rate at 0% and the deposit rate at -0.5%.

The EU economy is largely driven by the services sector which makes up 74.7% of GDP, while the manufacturing industry contributes to 23.8% of GDP. Germany is the largest economy in the eurozone, accounting for over 18% of the union's GDP, followed by France and the United Kingdom (UK), which each contributes to over 12% of the EU's GDP. Over 64% of EU countries' total trade is done with other countries in the bloc, highlighting the interdependence of the member countries' economies. The bloc's main exports include machinery and equipment, motor vehicles, pharmaceuticals, and other chemicals, while main imports consist of fuels and crude oil, foodstuffs and clothing.

Divergence Between Sluggish Industry Sector and Resilient Services Sector

According to analysts, forecasted GDP for the EU has decreased to 1.2% in 2019 and 1.3% in 2020. Even though GDP growth in 3Q2019 had beaten expectations, given that activity in the economy's manufacturing sector remained subdued, we believe that the EU will miss the forecasted estimate. The eurozone economy slowed down significantly in Q2, with the growth of less than half than the beginning of the year. GDP grew at an annualised rate of 0.8% in Q2, a slowdown from 1.8%. This is largely due to the weakness in the manufacturing sector (-0.75%) and negative data from net exports (-0.1%). In Q3, the Eurozone economy kept its slow cruising speed as global trade tensions continued to muffle growth.

The weakening manufacturing sector can be linked to the fall in industrial output in the two powerhouses Germany and Italy, seeing a downward trend since mid-2018, with major headwinds from the global trade conflict. Industrial output in France and Spain has remained steady, showing a slightly positive trend over the same period.

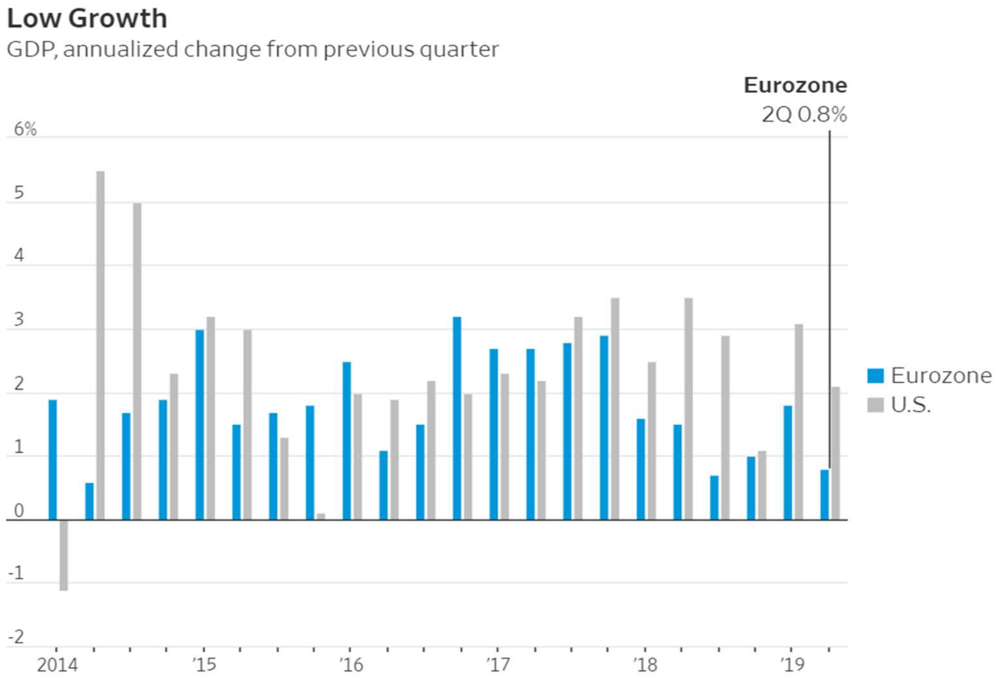


Figure 27: Europe's Stalling Economy Sounds Alarm for Global Growth *(Source: The Wall Street Journal)*

Among the big eurozone economies, the slowdown in Germany was the strongest, with a -0.1% growth in Q2 as compared to +0.4% in Q1. Spain and France continued to outperform, with the former showing the highest quarterly growth rate amongst major member countries, and the latter seeing business and consumer sentiment rebounding.

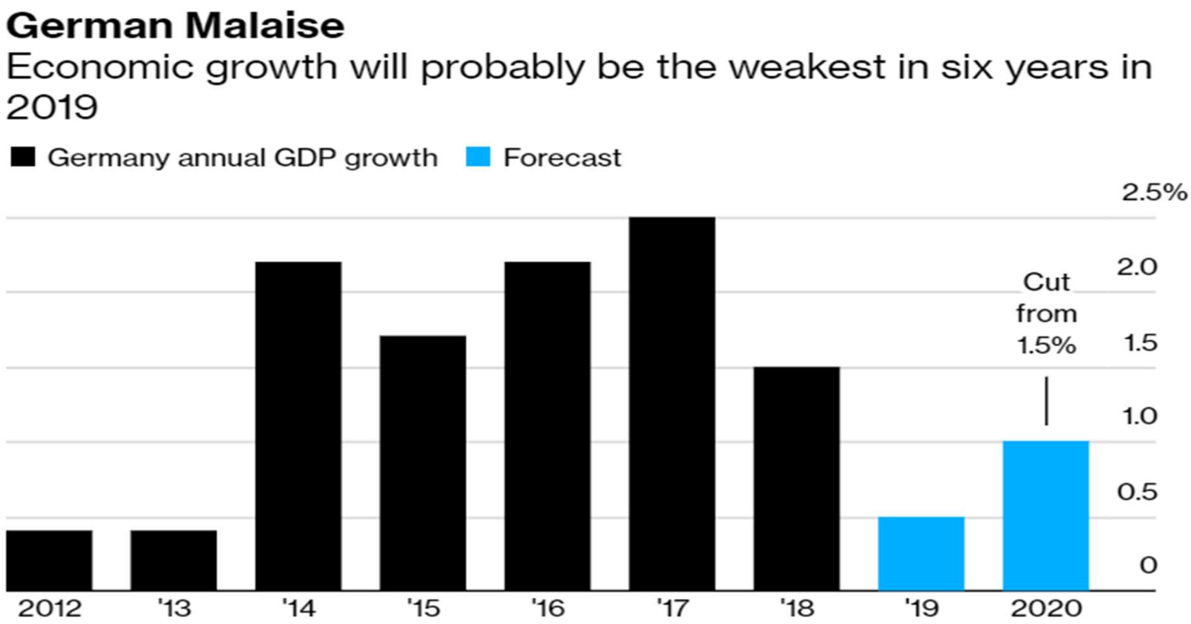


Figure 28: Germany Lowers 2020 Growth Forecast as Slowdown Persists *(Source: Bloomberg)*

Germany is experiencing a slowdown due to waning global demand as Brexit and trade disputes continue to spill over into next year, especially since Germany is highly exposed to and influenced by external demands. On its own, Germany's domestic economy may remain resilient, but its manufacturing sector has been critically hit by lower demand for exports. In fact, Germany's economy will remain weak compared to the past 6 years as seen in Figure X.

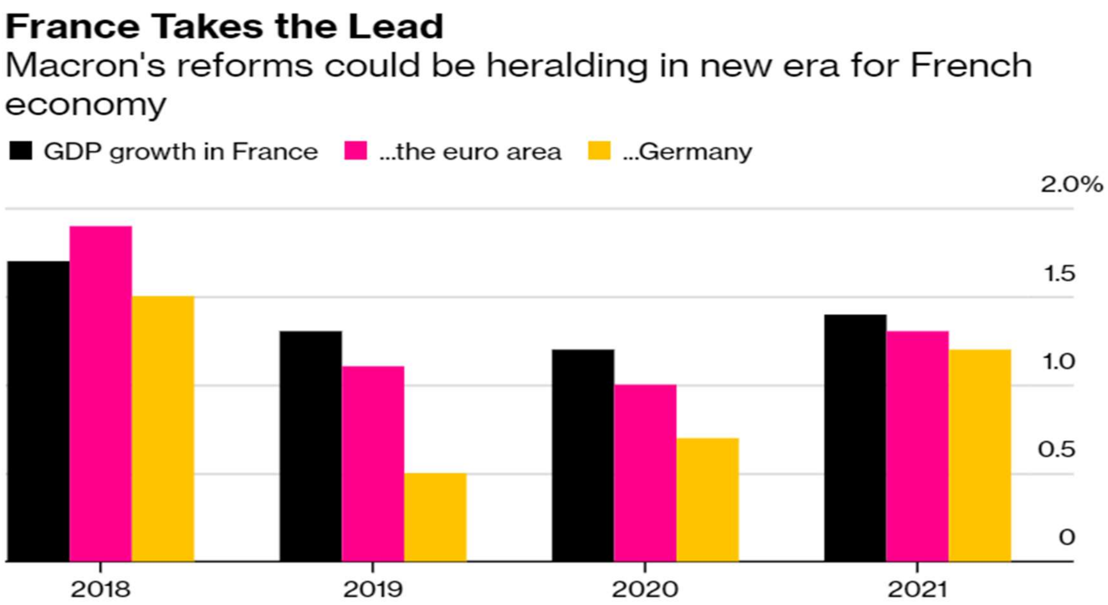


Figure 29: France Is Europe's New Economic Growth Engine *(Source: Bloomberg)*

France is experiencing economic growth mainly due to timed tax cuts and less reliance on exports, with global demand for exports decreasing. There is more to the story than timing seen in the robust business investment that followed President Emmanuel Macron's corporate-tax cuts and changes to labour law that increased employment. Shown in Figure X, France is likely to take the lead in Europe in boosting economic growth. Moreover, in 3Q2019, the French economy posted better-than-forecast 0.3% growth, with domestic demand a key driver.

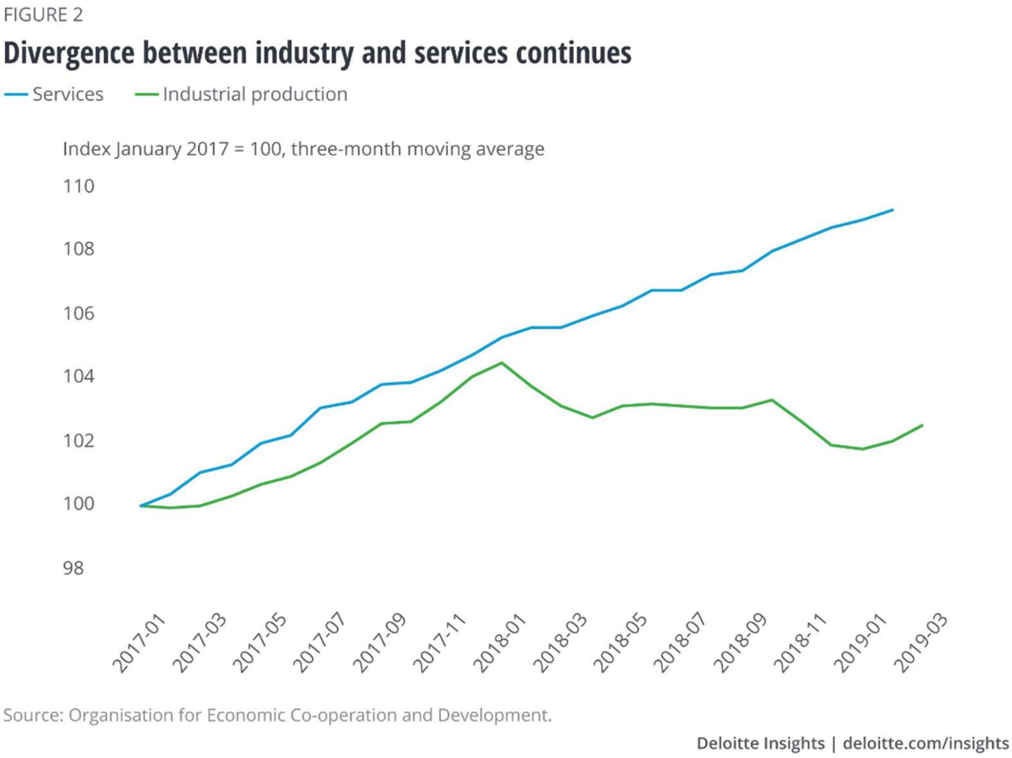


Figure 30: Divergence between Industry and Services Continues *(Source: Deloitte Insights)*

There is a broad diverging trend between the struggling export-oriented industry sector and the resilient services sector, which is powered by robust private demand. The strong private demand is supported by a strong labour market, where employment in the eurozone continues to grow. There are about 159.5 million people employed in the eurozone in August 2019, which is the highest figure ever recorded. The unemployment rate fell from 7.6% in May 2019 to 7.5% in June 2019, reaching its lowest level since July 2008.

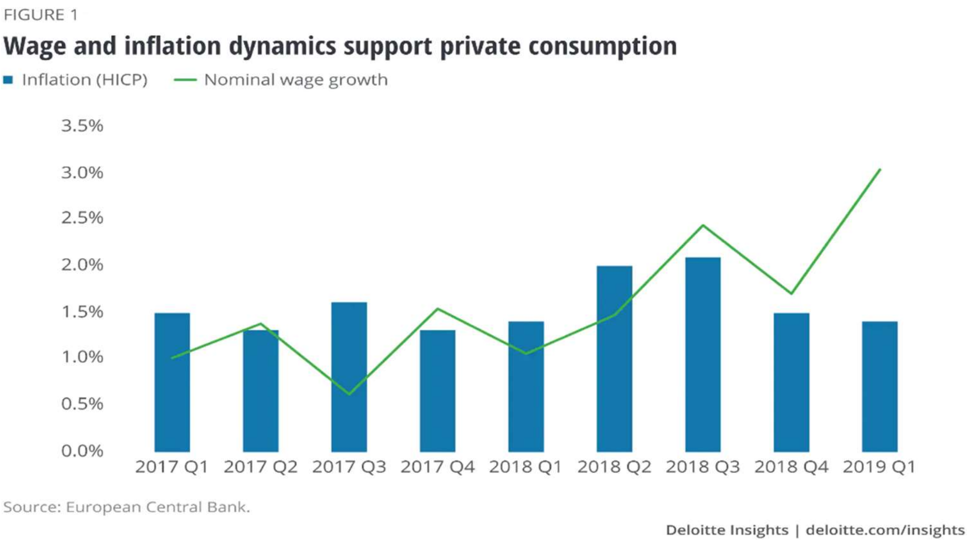


Figure 31: Wage and Inflation Dynamics Support Private Consumption *(Source: Deloitte Insights)*

The strength of the labour market is matched with renewed wage growth. After growing slowly for a long time, wages are now picking up momentum, rising at their fastest pace since 2011. Combined with persistently weak inflation, this would continue to power private consumption in the coming quarters.

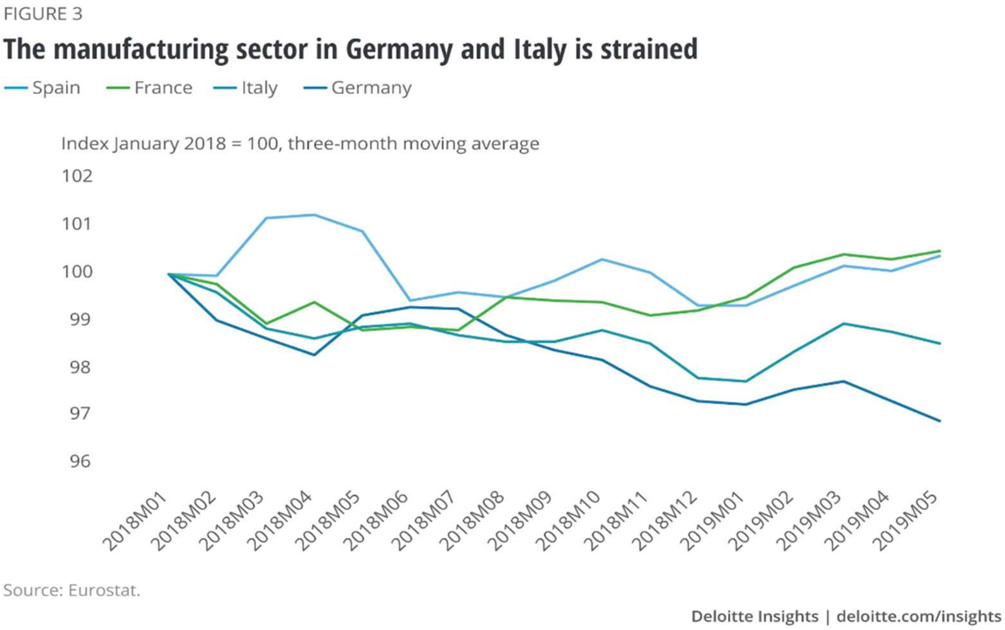


Figure 32: The Strained Manufacturing Sector in Germany and Italy *(Source: Deloitte Insights)*

The manufacturing sector is driven mainly by exports and investment. According to the World Bank, Eurozone exports to the U.S. and China have been stagnating since late 2018, and global trade growth is projected to fall from 4.1% last year to 2.6% this year. Without a rebound in world trade, exports would continue to drag down manufacturing growth. On the investments side, many corporates are showing a decreasing appetite for investments. Investments in equipment and machinery are growing considerably weaker than last year, as European manufacturers state more customers are reluctant to place big new orders, and instead, are making short-term small orders. Eurozone industrial confidence has seen a downtrend since 2018.

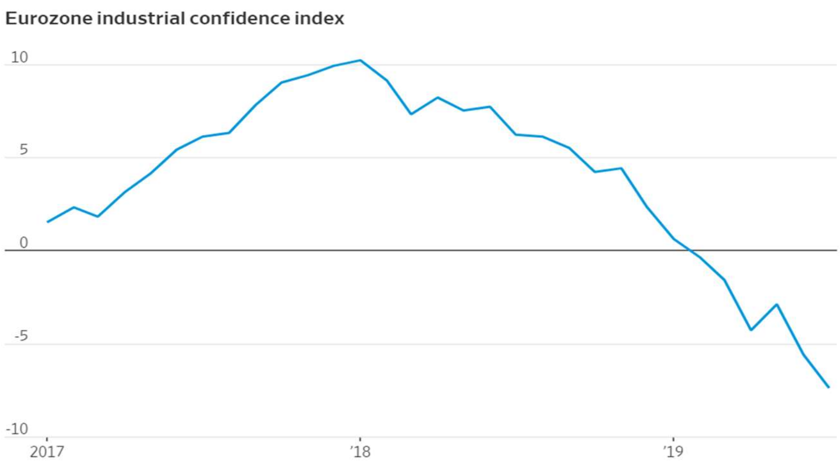


Figure 33: Falling Eurozone Industrial Confidence Index *(Source: The Wall Street Journal)*

As the diverging trend between manufacturing and services continues, the main driver of growth in Q3 and Q4 will be private consumption supported by good labour market conditions. The IMF forecasts real GDP growth of 1.5% in 2019 and 1.6% in 2020. With the slowdown of the global economy and the above mentioned poor economic releases, the GDP growth for the EU in 2020 will likely be slower as well. The strong labour market may prove to cushion the impact of slowing manufacturing industry. However, we believe that as the latter is showing no signs of improving, growth in the Eurozone would ultimately be stifled by it.

<u>Draghi's Last Dance - ECB's "Lower-For-Longer" Stimulus Package</u>

In light of slowing growth in the Eurozone and persistently weak inflation rates, ECB President Mario Draghi unleashed a wave of stimulus measures in September 2019 to prevent the economy from grinding to a halt. It is the central bank's largest dose of monetary stimulus in 3.5 years, as Draghi departs in November and hands over the reins to Christine Lagarde.

The ECB lowered its key rate on the deposit facility - the rate that banks earn (or in this case, pay) on overnight deposits with the ECB - by 10 basis points (bps) from -0.4% to -0.5%. This marks its first rate cut since 2016, setting a record low that is second only to Switzerland (at -0.75%).

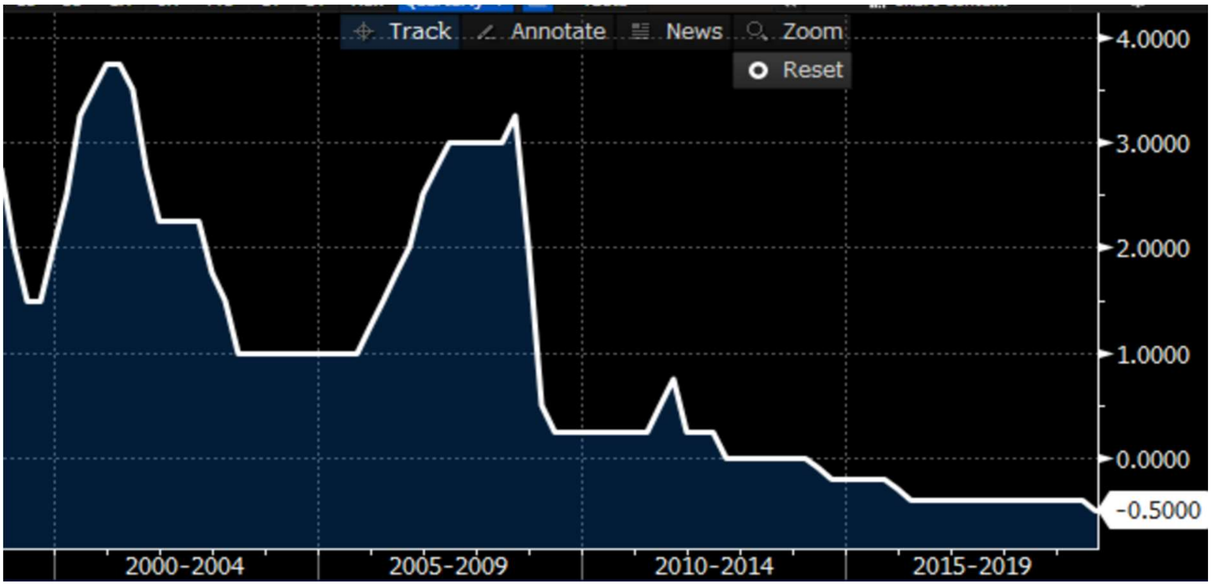


Figure 34: ECB Deposit Facility Rate *(Source: Bloomberg)*

With an even lower negative rate, it would be costlier for commercial banks to place funds within the central bank, encouraging banks to lend to consumers and businesses rather than parking money with the ECB. However, such negative rates may hurt banks' profits as the banks are unable to pass on the negative interest rate costs on to depositors. As a result, these lenders may instead choose to increase borrowing rates to make up for falling profits, achieving the exact opposite effect.

The ECB had also introduced negative-rate tiering, whereby as much as 6 times of required reserves are exempted from incurring the negative interest rate charges. Roughly a third of reserve balances will be charged at 0% after this change, up from around 5% previously. The Northern banks - those from Germany, France, and the Netherlands - would stand to benefit most from this policy as they account for over 40% of all the Euro area excess reserve. The cost savings to the banks may come to only a few bps. However, such a structure provides the flexibility to tweak the exemption multiple alongside a deposit floor cut in the future, if needed.

There is a risk that adding tiering could undo some of the stimulus sought from the negative rates. The larger banks that lend excess cash to domestic rivals at negative rates can now choose to deposit at the ECB for free, preventing smaller banks of an opportunity of financing. Another worry is that banks who currently have fewer reserves than the maximum amount exempted would have an incentive to borrow to fully benefit from the tiering, leading to a rise in demand for borrowing that could drive rates up instead.

The ECB has also revived a program called the Targeted Longer-Term Refinancing Operations (TLTROs), to get financial institutions to boost lending to companies and households to stimulate economic activity. Banks would be able to borrow from the ECB under this program at the current Main Refinancing

Operations (MRO) rate of 0%. However, if the bank lends enough money to companies and households, they would be charged the deposit rate of -0.5% instead, essentially being remunerated for making loans. The more favourable TLTRO-III terms will mostly benefit the Southern banks (Italian and Spanish), given that more than half of the current balance of the previous TLTRO-II of 693b is in the hands of these banks.

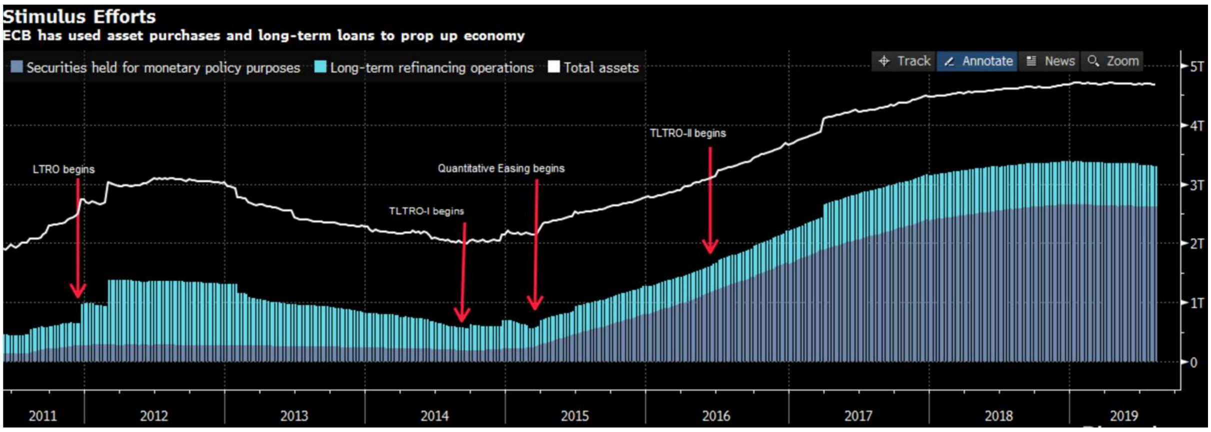


Figure 35: Why ECB Is Stuffing Free Cash into Bank Pockets Again *(Source: Bloomberg)*

The effectiveness of the TLTROs remains to be seen. Past rounds of TLTROs achieved their intended goal of passing on cheaper borrowing costs to the private sector, but inflation remains subdued. The ECB has also restarted a monthly 20 billion Euro bond-buying programme for "as long as it deems necessary." This involves buying government and corporate bonds from commercial banks and other financial institutions. However, this is estimated to run for only 9-12 months, without changing rules that prohibit the bank from buying more than a third of any government's debt. As such, its effectiveness would be limited to the short-term until changes have been implemented to such rules.

Lastly, Draghi has decided to ditch calendar guidance. The accommodative policy would stay until inflation outlook converges to levels sufficiently close to the target of 2%. Draghi's stimulus package creates a foundation of loose monetary policy for years to come, forcing Draghi's successor, Lagarde, to follow suit with this Quantitative Easing (QE). The Eurozone is especially reliant on loose monetary policy as it is highly dependent on trade for growth. The weakening of the Euro in response to the increase in liquidity has given exporters a much-needed boost.

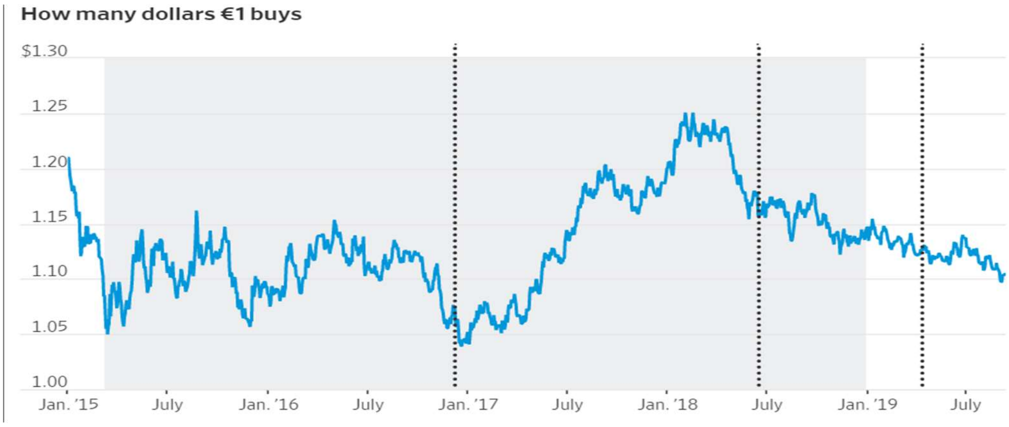


Figure 36: How the EUR Moves with ECB's Policies *(Source: The Wall Street Journal)*

The record-low interest rates and the QE programme also risk leaving the ECB with virtually no ammunition should the economy sink further. Moreover, extended QE programmes will continue to distort yields and exacerbate the risk of asset bubbles by encouraging excess lending.

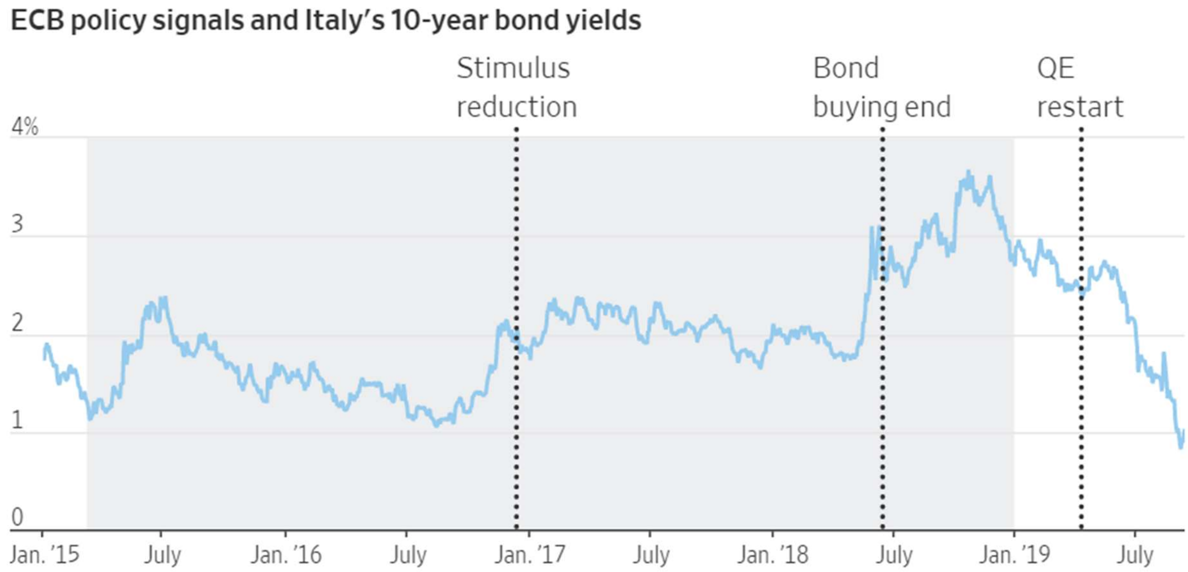


Figure 37: Mario Draghi's Plan for Final Jolt of Stimulus Runs into Opposition *(Source: The Wall Street Journal)*

We believe that Draghi's stimulus package would not be enough to get growth and inflation back on track. Its monetary policy is already losing its potency, and the need for fiscal stimulus is ever-growing. Lagarde has signalled the need for more fiscal stimulus to complement the ECB's policy. Draghi has also argued that a common budget for the EU was necessary, of adequate size and design - one large enough to stabilise the union but designed not to create excess moral hazard. Germany has long been against such a move, fearing that its taxpayers would have to foot the bill for the fiscal irresponsibility of other countries.

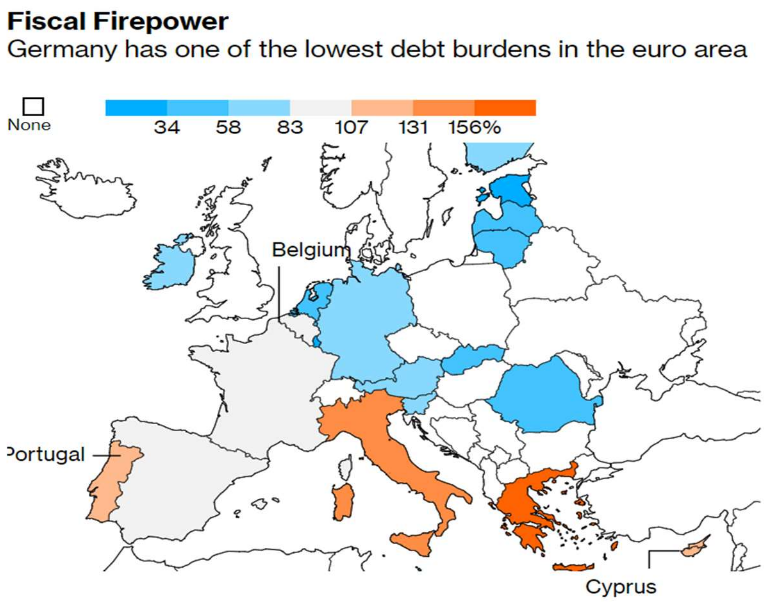


Figure 38: Germany Has One of the Lowest Debt Burdens *(Source: Bloomberg)*

With interest rates at a record low and expansionary monetary policy having diminishing impacts, we forecast that interest rates will remain on hold until at least mid-2021. We foresee that the Eurozone may face the same fate as Japan, being stuck in a liquidity trap, where the economy stagnates despite the very loose monetary policy. This is coupled with very low inflation and growth. Although borrowing rates are exceedingly low, consumers still remarkably prefer to save rather than invest.

Germany's Manufacturing Recession Spilling Over to Labour Market

Germany, often referred to as the powerhouse of the EU, makes up nearly a fifth of the Eurozone's GDP. However, the German economy has been suffering a year-long slowdown that has accelerated in recent months.

The German economy narrowly avoided a technical recession in Q3 with a growth of 0.1%, after shrinking 0.1% in Q2. Exports account for almost half of the nation's GDP, and it is the world's third largest exporter after the U.S. and China. As Germany's export-dependent companies are deeply exposed to fallout from U.S.-China trade disputes along with a delayed Brexit, the economy is experiencing its worst downturn in almost seven years.

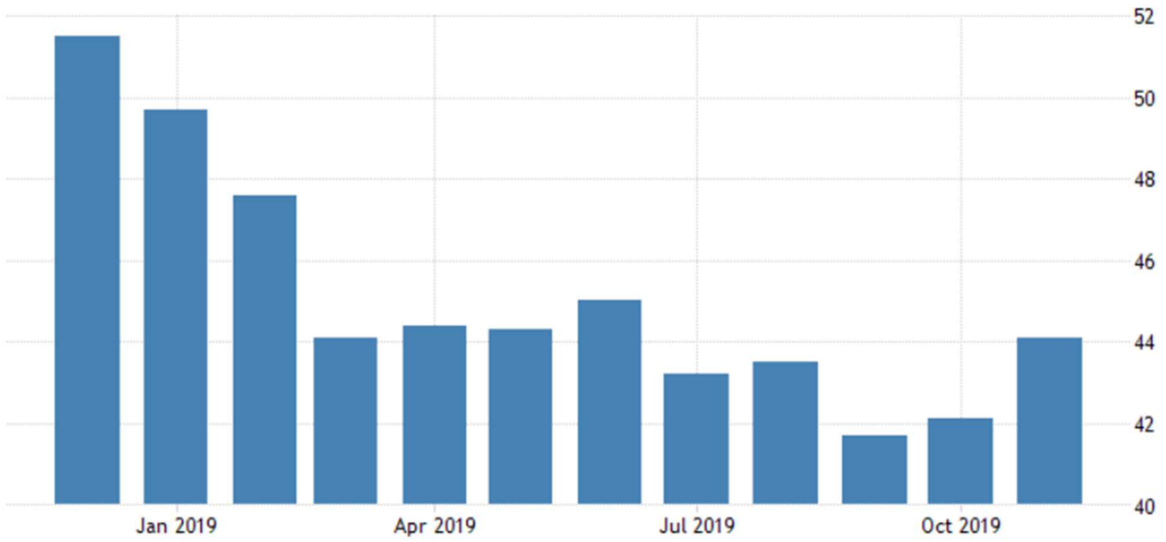


Figure 39: German PMI Bounces Back from Decade-Low *(Source: Trading Economics)*

Germany's manufacturing PMI in September 2019 fell to a level of 41.7, its lowest since 2009, down from 43.5 in the previous month, while output fell at the sharpest pace since 2012. However, with the easing of global trade tensions, sentiment bounced back with increased PMIs in October and November.

The downward trend in new orders, which fell the most in more than 10 years, continues to drive cutbacks in factory output, employment, and prices. The job losses in manufacturing broadened in September 2019, reaching a scale at which they could start to weigh more heavily on the relatively resilient consumer morale.

Additionally, carmakers and parts suppliers have also been struggling to manage the shift from the combustion engine to the electric motor. With emissions regulations set to tighten starting next year, concerns are mounting that German companies are ill-equipped to deal with the technology transition and mounting pressure from environmentalists.

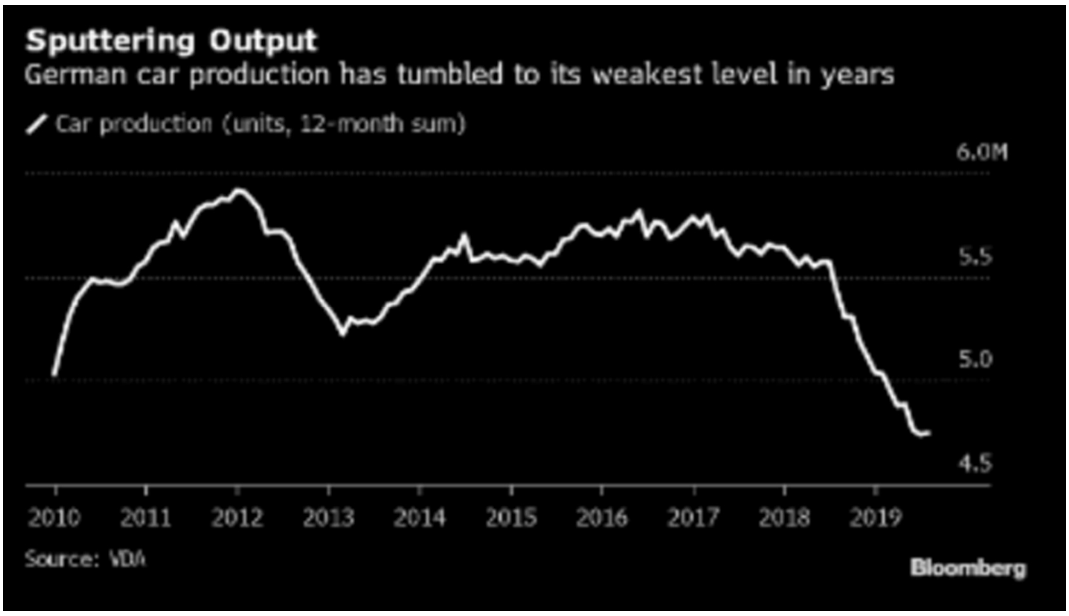


Figure 40: German Car Production has Tumbled to its Weakest Level in Years *(Source: Bloomberg)*

As perspectives for international trade remain negative, the performance of Germany could deteriorate further with exports and manufacturing activity continuing to struggle to provide negative spillover to the rest of the Eurozone. For now, Germany's labour market is still robust, with an unemployment rate at a low of about 5% in September.

Figure 41: German Joblessness Fall for First Time in Five Months *(Source: Bloomberg)*

The fall in unemployment has helped offset manufacturing weakness and propelled wages higher, underpinning solid domestic demand. However, cracks are starting to appear, and employment growth is losing momentum. Vacancies declined, showing signs of caution among companies about hiring, while demand for new workers eased. The above decline in joblessness was registered exclusively among those receiving basic security benefits, a category that includes the long-term unemployed and low earners. Unemployment claims which reflect economic momentum continued to increase.

The manufacturing sector is already in a recession and there are fears that the far-larger services sector could follow if rising jobless damages consumer spending. Additionally, if Trump follows through with his threat to slap tariffs on European cars, it would most certainly deal a fatal blow to Germany's automobile sector.

Italy's Political Shake-Up and Brewing Debt Crisis

Italy, the EU's 4th largest economy by GDP, was thrown into a political crisis in August 2019, following the announcement of then-Deputy Prime Minister Matteo Salvini that he would quit his post and announced a motion of no confidence against Prime Minister Giuseppe Conte to trigger snap elections. This provoked the resignation of Conte, resulting in the formation of a new cabinet.

Through 2018 and the first half of 2019, the Italian government was a coalition between the Five Star Movement (M5S), a leftist anti-establishment party led by Deputy Prime Minister Luigi Di Maio, and the Northern League, a right-wing party led by Deputy Prime Minister Matteo Salvini. After Italy's government reshuffling in 2019, the coalition of M5S and the centre-left Democratic Party took power, shutting out the League and its leader Salvini, with Conte being put back at the helm again.

Such a political crisis could not have occurred at a worse time, with the economy flatlining for more than a year as GDP expanded 0.1% during 3Q2019.

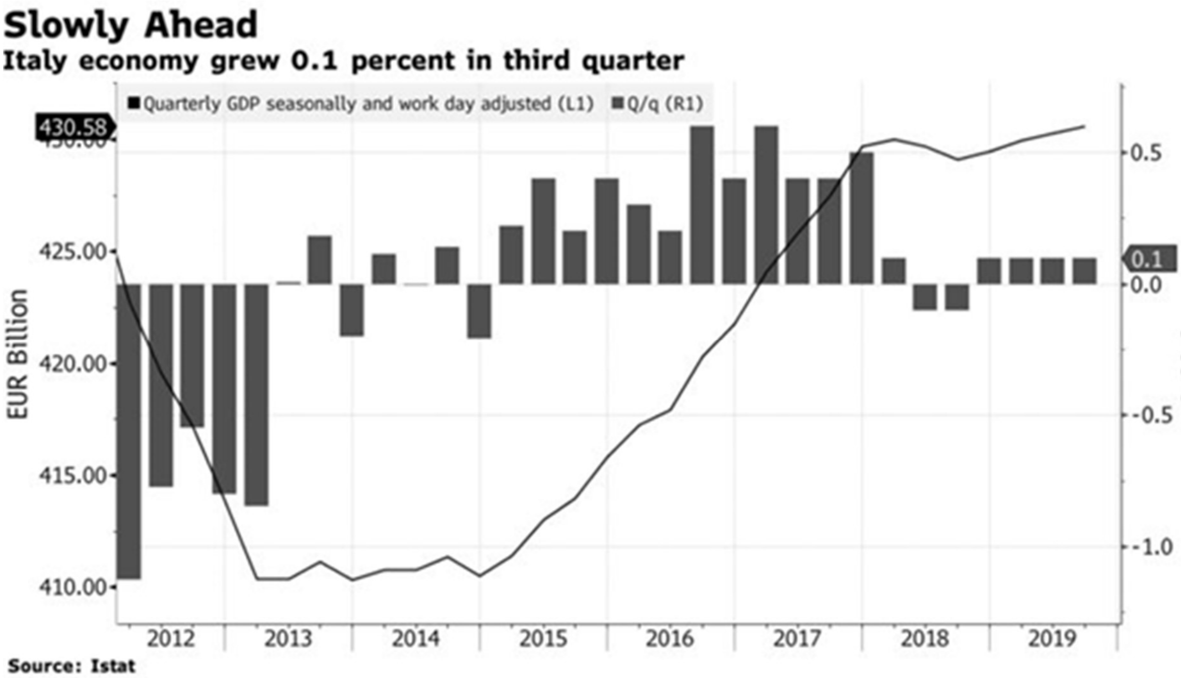


Figure 42: Italy's GDP Growth has Been Stagnating at 0.1% for Over a Year *(Source: Bloomberg)*

Business confidence has also taken a nosedive, with manufacturing PMI plunging to 47.8 in September, down from 48.7 the previous month. Lower business confidence has an effect on affecting both consumers and businesses by lowering consumption and business investment respectively. Consequently, it lowers the aggregate demand and lowers the GDP of Italy, which can be exacerbated by the negative multiplier effect.

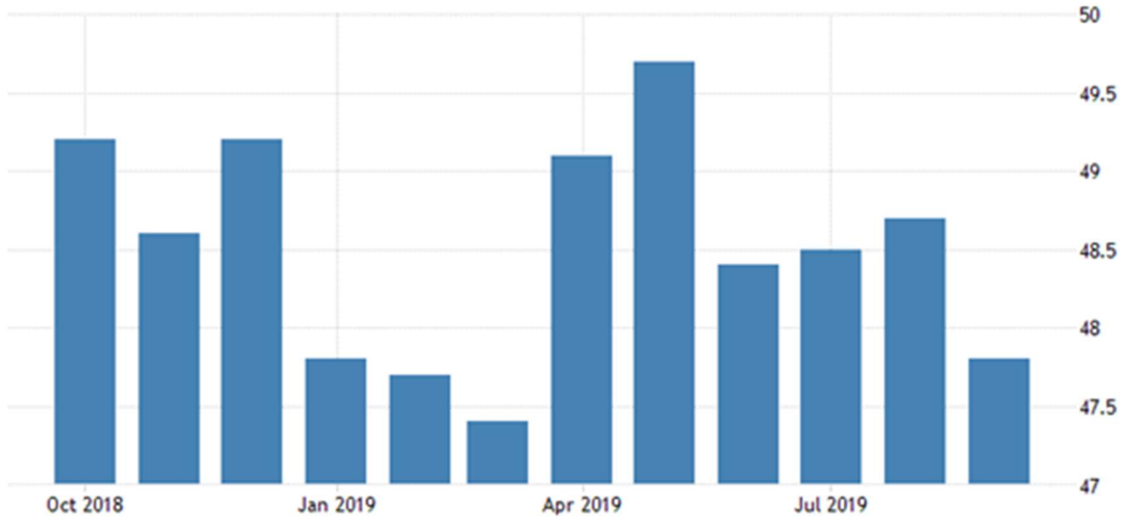


Figure 43: Italy's Manufacturing Business Sentiment sees its Lowest Reading in Half a Year *(Source: Trading Economics)*

Italy's manufacturing sector has suffered heavily from global trade headwinds, along with close production and trade links with Germany, whose manufacturing industry has also seen a drastic contraction. At the same time, Italy's debt is almost at a record high, with public debt rising to 138% of GDP in 2Q2019. The dollar amount of debt is fourth highest, behind the U.S., Japan, and China.

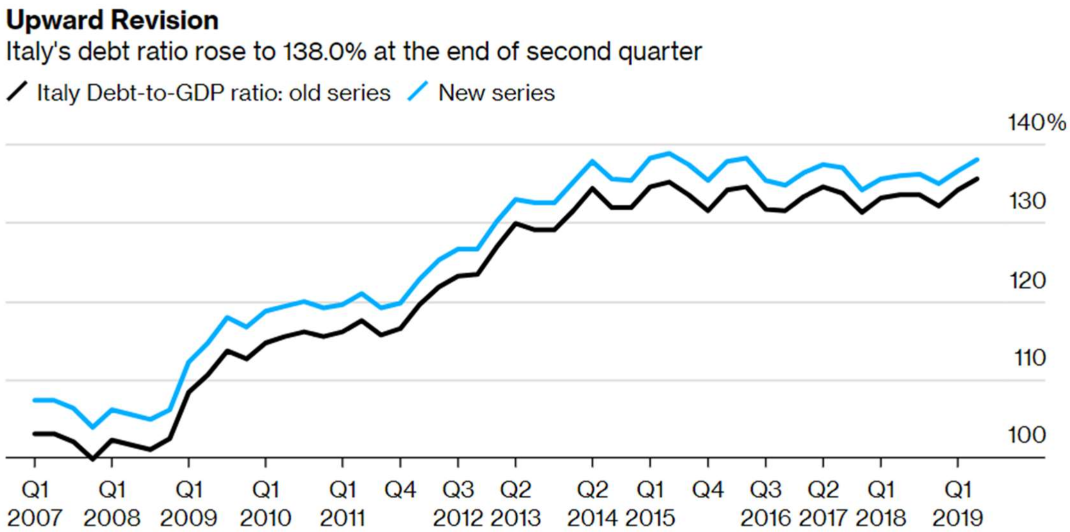


Figure 44: Italy's Rising Debt *(Source: Bloomberg)*

This debt mountain threatens the financial stability of Italy and the future of the Euro, due to the credit exposure of other EU countries to Italy's debt.

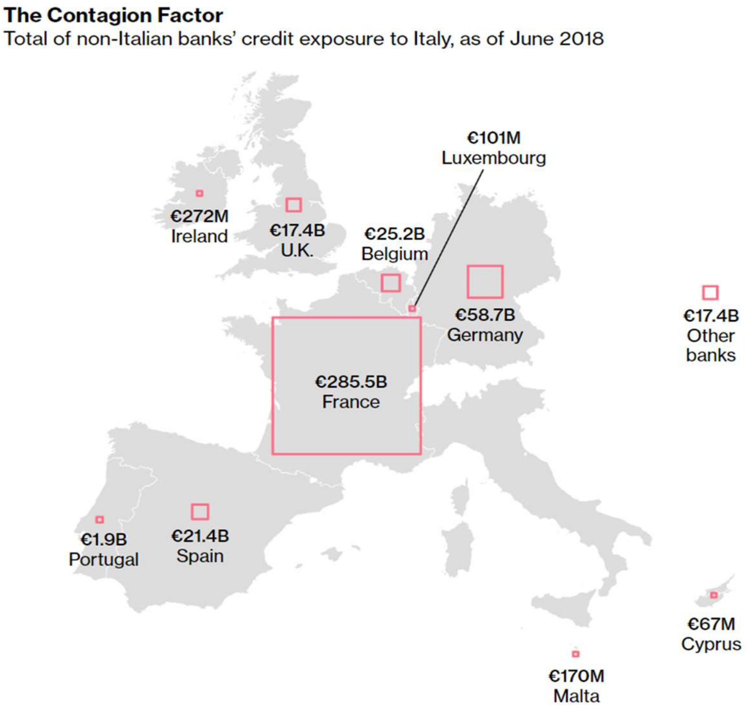


Figure 45: Many EU Nations Own a Piece of Italy's Debt *(Source: Bloomberg)*

The political turmoil has renewed concerns about Italy's debt as the new government's budget plan has faced resistance from the EU, with Conte's administration committing to an expansionary fiscal stance. Italy's plan does not comply with the EU's debt reduction benchmark, as under EU law, Italy should cut its public debt every year by 1/20 of the difference between 60% of its GDP and its current size, which the country has consistently failed to do so.

Resilient French Growth

Figure 46: Consumer Confidence Unexpectedly Rises to Its Highest Since Early 2018 *(Source: Bloomberg)*

The French economy is one of the largest in the world with USD 2,777.54 billion in 2018. This is about 4.48% of the world's economy. The GDP figure in 2Q2019 was USD 678,154 million. The consumer sentiment in France has been picking up in Q3, which is helping to drive the EUR higher, since France is the Eurozone's second largest economy. Consumer confidence has unexpectedly risen to its highest since early 2018, which is in huge contrast to Germany's manufacturing slump.

As a result of optimistic economic data in late 2019, the GDP growth for 2020 is likely to continue at a similar rate, despite the slowing down of the global economy. The GDP growth forecasted by analysts is 1.3% and 1.4% for 2019 and 2020, respectively. France will likely hit the estimate for 2019 because it has not been as exposed to the global trade turbulence as compared to the other Eurozone economies. Furthermore, President Emmanuel Macron has injected a fiscal stimulus after protests (known as Yellow Vests) about low incomes. The growth in France is also attributed to tax cuts and strong household disposable income growth.

Effects of Brexit on the EU

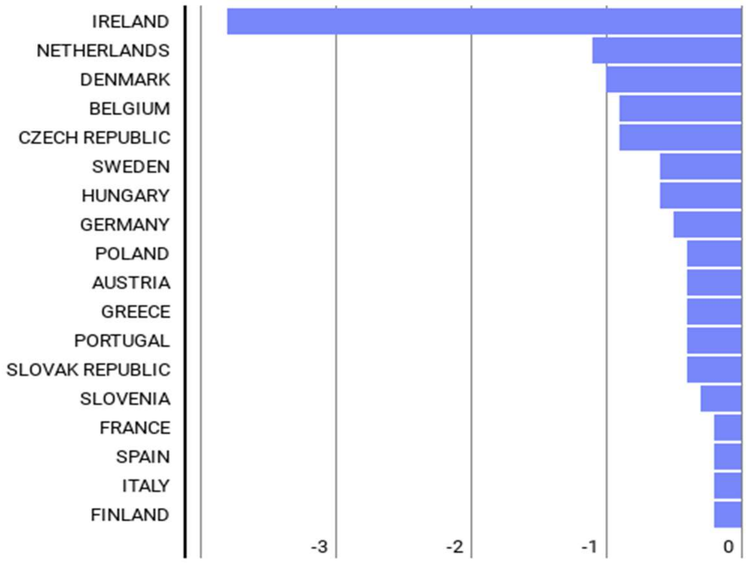


Figure 47: The Long-Term Impact of Brexit on the EU *(Source: IMF Blog)*

Figure 47 shows the decline in the level of output for each country if Brexit were to occur as compared to a non-Brexit scenario, with Ireland taking the biggest hit due to the high volume of trading done between the two countries. The decline in the level of output can be attributed to the direct and indirect trade effects resulting from higher tariffs and non-tariffs barriers for both goods and services.

The EU will lose a staggering 16% of its GDP when the UK leaves. There are significant economic and trade impacts of Brexit on the EU, though the impacts on the EU are much smaller than the impacts on the UK. These impacts are due to the higher barriers to trade, capital flows, and labour mobility, which will affect output and jobs in both the UK and the EU. After Brexit, the EU and the UK would become the biggest trading partners of each other and some of the member states, such as Germany and the Netherlands, would be more exposed to a Brexit-induced economic shock. Most notably, the economy of the EU members, the Republic of Ireland, would be largely affected by Brexit due to its common land border and close agribusiness with the UK.

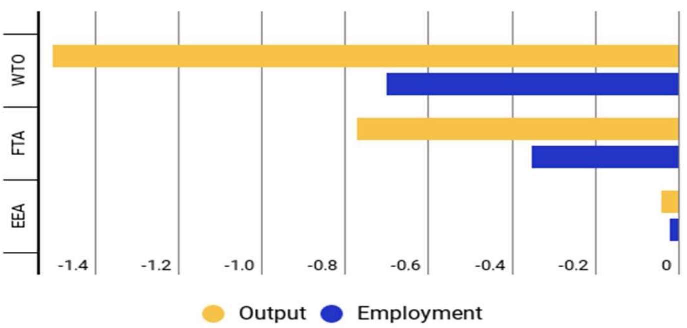


Figure 48: Change in Output and Employment for EU after Brexit *(Source: Financial Times)*

The reversal of integration due to Brexit will hurt income and employment in the EU, regardless of the agreement reached.

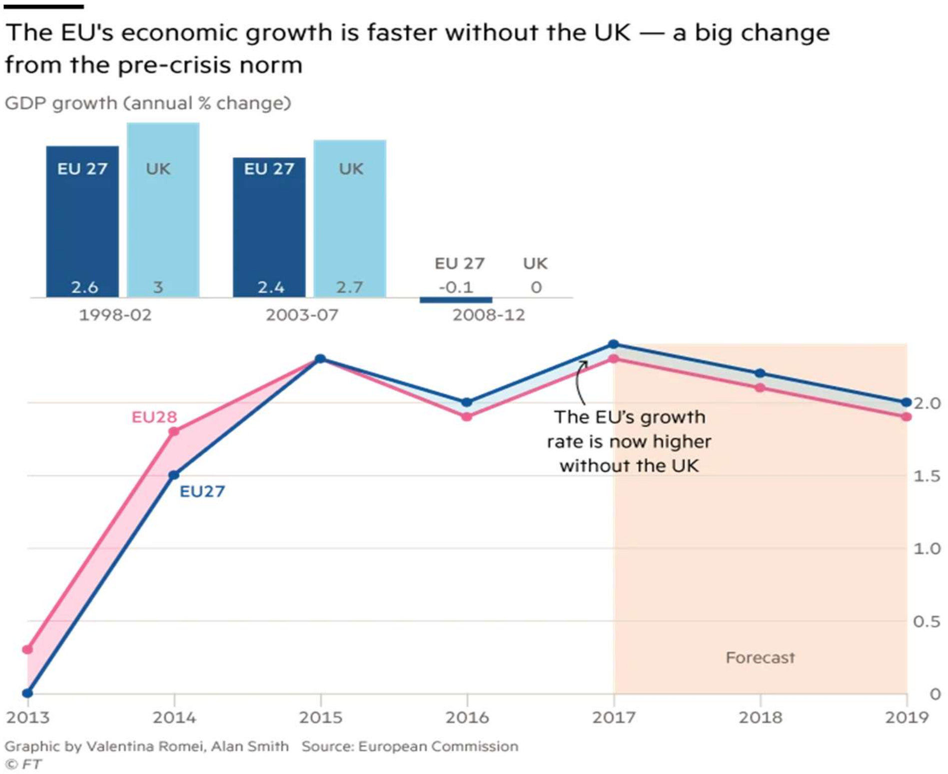


Figure 49: What Will the EU Look like After Brexit? *(Source: Financial Times)*

The overall impact of Brexit on the EU is not all negative as analysts forecast growth and exports to be stronger, while unemployment is likely to be lower. Over the past two years, the economy of the rest of the EU has been growing faster than that of the UK.

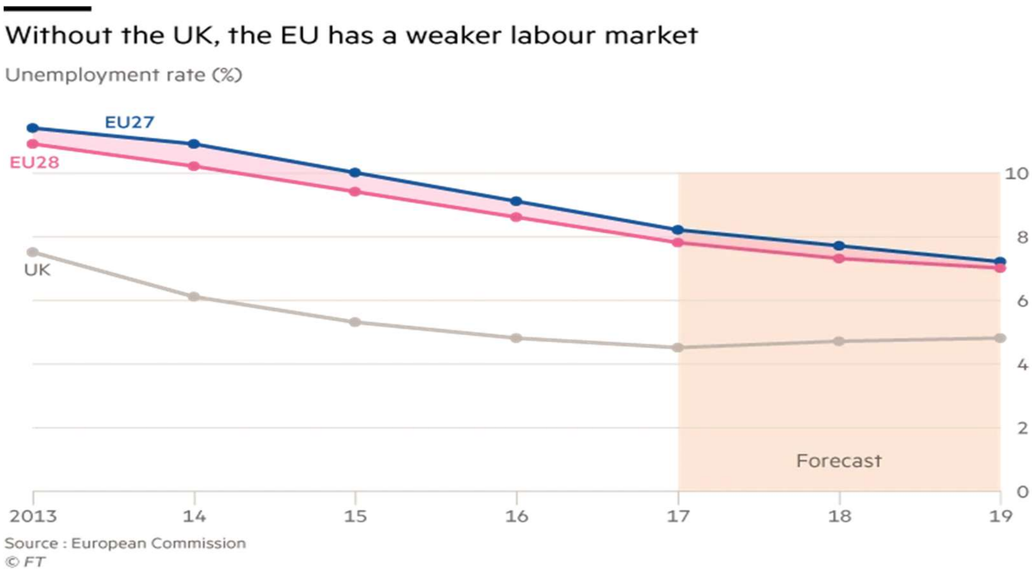


Figure 50: EU Labour Market after Brexit *(Source: Financial Times)*

Moreover, UK has higher labour productivity than most of the other members of the EU. When the UK is eventually out of the bloc, the EU27 will be less productive and poorer on average than it is today.

FX TRADE IDEA: SHORT EURCAD

Figure 51: EURCAD Chart *(Source: TradingView)*

Entry Level: 1.46396
Take Profit: 1.44120
Stop Loss: 1.47460
Risk to Reward ratio: 2.14

Fundamentally, the EUR will be weak due to the impending Brexit and weakening of the eurozone economy as a whole. This is coupled with the ECB's willingness to cut rates, given the recent rate cut. Moreover, the EU's interest rate is only second to Switzerland as being the world's lowest interest rate. Excluding the UK, Germany, and Italy account for and both account for the largest and third largest economy in the EU respectively. Due to Germany's slowing growth and Italy falling into a technical recession, the overall growth for the EU would inevitably slow down.

For the CAD, the Canadian economy is still fundamentally strong and interest rates have remained at 1.75% (which has risen since 2017 to curb inflation due to growth) after the recent interest rate policy, suggesting a strong economy. Moreover, despite the current global uncertainties the Canadian economy managed to post a strong quarter of growth, expanding 3.7% in 2Q2019.

The EURCAD has begun trading at a downtrend since the start of 2019 and is currently at a resistance level that has been tested four times and is being tested for the fifth time. The resistance level is currently holding, and the price has formed a shooting star candlestick pattern. the price will likely continue to go in the downtrend. The price has also bounced off the upper bound of the Bollinger Bands and is currently at the 100 exponential moving average (EMA), which may hold as a resistance as well. The interest rate for the eurozone is -0.5%, while the interest rate for Canada is 1.75% which means that going short on the EURCAD results in a positive carry trade that will profit even if the trade goes sideways.

SWITZERLAND (Underweight)

Switzerland is not just a country of chocolates and watches, in fact, banking is a huge industry with financial markets perceiving Switzerland as a country with minimal volatility and lower employment (3%), high wages, high standards of living and a very safe banking and financial system. Moreover, Switzerland is one of the few countries around the world that traditionally has positive trade balance figures which means more money is coming into Switzerland than leaving. Thus, we have a Swiss Franc (CHF) that is forever being sought after. Switzerland is mainly driven by its services (73.7%) and industrial (25.6%) sectors. Its main exports include gold (25%), medicaments (12%), vaccines (7.4%), watches (4.6%) and surgical appliances (1.9%).

The GDP was USD 703.750 billion in 2018 and the GDP in 2Q2019 was USD 137.903 billion. The Swiss Franc is the currency of Switzerland and is highly regarded as a safe haven currency because Switzerland has a strong economic and political system and people have confidence in the Swiss National Bank (SNB). Moreover, Switzerland is a traditionally neutral country when it comes to war and conflict.

The CHF also moves along with gold because more than 25% of Switzerland's money is backed by gold reserves. Switzerland currently has the lowest interest rate in the world of -0.75%, which can be attributed to the safe haven characteristics especially in the economic climate of uncertainty and a potential recession.

Interest Rates Remains World's Lowest

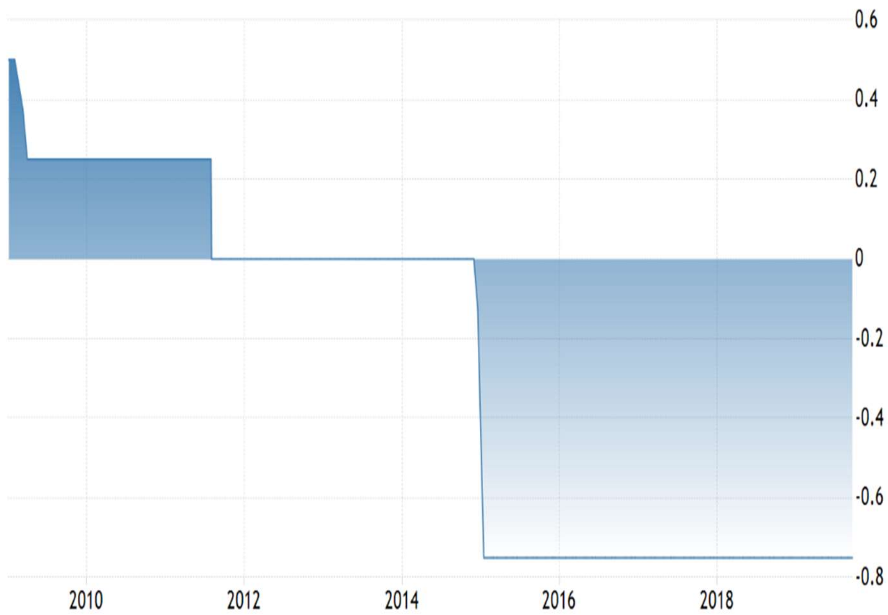


Figure 52: Switzerland's Interest Rate *(Source: Trading Economics)*

The interest rate of Switzerland has constantly been at -0.75% since 2015. Expansionary monetary policy continues to be necessary given the latest international developments and the inflation outlook, while the CHF remains highly valued. The lower interest rate is to prevent large amounts of capital inflow into Switzerland due to its safe haven characteristics.

As CHF is a safe haven currency, the negative interest rate and the willingness to intervene are important to counteract the attractiveness of CHF and thus ease pressure on the currency. The USDCHF has generally been trading sideways since 2015 and is likely to continue to do so. The key interest rate was unchanged, but the SNB reduced the penalty that banks must pay for excess reserves, which happened right after the ECB took action to protect the eurozone banks against the detrimental effects of negative interest rates as well. This raised the exemption threshold for banks and reduced the negative interest income for the SNB. The low interest rate policy has been effective in spurring growth especially in construction investment and has continued to support Switzerland's growth, despite a slowdown in global economic growth.

Although interest rates remained unchanged, the appreciation of CHF may suggest that there are expectations of the rates to be cut soon, especially after ECB's rate cut. A further cut to negative Swiss interest rates could have the undesired effect of strengthening the Franc as foreign investors pile into the country's outperforming stock market to reap superior returns over bonds. These investment opportunities do not go unnoticed by foreign investors and often result in upward pressure on the Franc. The Swiss Market Index increased to a record high and was up 19% this year, outperforming the Euro Stoxx 50 Index.

The future interest rate policy, given the current dovish economic climate, is expected to remain low and is not likely to increase, especially with the economic slowdown and uncertainty. We believe that SNB will likely keep its key interest rate unchanged at -0.75%, despite the rate cut by the European Central Bank (ECB). Nevertheless, SNB is still expected to intervene if the upward pressure on the CHF becomes too strong.

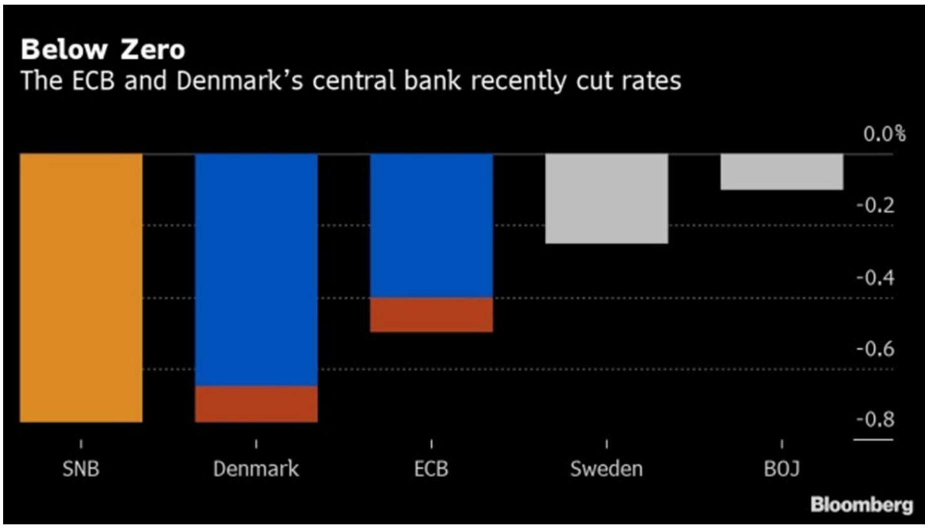


Figure 53: The ECB and Denmark's Central Bank Recently Cut Rates *(Source: Bloomberg)*

However, when its neighbouring countries and central banks, such as the EU, continue to cut rates, it might be inevitable for the SNB to cut rates as well to prevent upward pressure on the CHF.

<u>Lower GDP Forecasted for the Swiss Economy</u>

Credit Suisse Forecasts for the Swiss Economy

	'19 Q1	'19 Q2	'19P Q3	'19P Q4	'20P Q1	'20P Q2	'20P Q3	'20P Q4		'19P	'20P
GDP (YoY, in %)	1.0	0.2	1.1	1.7	1.6	1.6	1.3	1.2		1.1	1.4
Consumer spending	0.6	0.9	1.2	1.2	1.3	1.3	1.3	1.3		1.0	1.3
Government expenditure	0.9	1.0	1.0	0.9	1.0	1.0	1.0	1.0		1.0	1.0
Gross capital investment	-0.5	-0.9	1.7	2.0	1.3	1.1	1.1	1.1		0.6	1.1
Construction investment	1.4	0.2	0.2	0.9	1.2	1.2	1.2	1.2		0.6	1.2
Investment in plant and equipment	-1.5	-1.6	2.5	2.5	1.0	1.0	1.0	1.0		0.5	1.0
Exports (goods and services)	2.7	2.3	2.5	0.4	2.5	2.5	2.5	2.5		2.0	2.5
Imports (goods and services)	-0.9	-1.7	3.2	3.5	2.0	2.0	2.0	2.0		1.0	2.0
Inflation (in %)	0.6	0.6	0.3	0.3	0.5	0.3	0.5	0.6		0.5	0.5
Unemployment (in %)	2.3	2.3	2.3	2.3	2.3	2.4	2.4	2.5	#	2.3	2.4
Employment growth FTEs (YoY, in %)	1.5	1.2	1.0	0.9	0.9	0.9	0.8	0.8	#	1.2	0.9

Source: Federal Statistics Office, State Secretariat for Economic Affairs SECO, Credit Suisse

Figure 54: Credit Suisse Forecasts for the Swiss Economy *(Source: Credit Suisse)*

Given the significant slowdown in economic growth, the forecast for Switzerland's economic growth has declined from 1.5% to 1.1% for 2019 as well as from 1.8% to 1.4% for 2020, according to Credit Suisse. However, as much as GDP growth is forecasted to be lower than previously expected, we believe that the Swiss economy is not yet due for a recession. Due to low interest rates, consumer spending and construction investment is expected to support growth.

We believe that it is likely that Switzerland will hit the modest estimate as the country is likely to continue experiencing modest growth that is fueled by consumer spending and construction investment

forecasts for:	2019		2020	
date of forecasts:	Sept. 19	June 19	Sept. 19	June 19
GDP	**0.8%**	1.2%	**1.7%**	1.7%
Consumption expenditure:				
Personal Consumption	**1.1%**	1.2%	**1.3%**	1.4%
Government Consumption	**1.1%**	1.2%	**0.8%**	0.8%
Construction Investment	**0.6%**	0.6%	**0.6%**	0.6%
Investment in Equipment and software	**0.2%**	0.8%	**1.6%**	2.8%
Exports	**2.3%**	3.1%	**3.0%**	3.2%
Imports	**1.1%**	2.3%	**2.4%**	3.2%
Employment (full time equivalents)	**1.1%**	0.8%	**0.8%**	0.8%
Rate of unemployment	**2.3%**	2.4%	**2.5%**	2.6%
Consumer price index	**0.5%**	0.6%	**0.4%**	0.6%

Figure 55: Selected Forecasts for the Swiss Economy *(Source: SECO - State Secretariat for Economic Affairs)*

The GDP for the Swiss economy is expected to be slightly downwards in the coming quarters. This is due to the weaker development than previously assumed and uncertainty is high, which is weighing on the export economy and investment. The international environment and outlook for the Swiss economy have worsened. Analysts have forecasted GDP growth of 0.8% for 2019.

There have also been negative impacts on the export sectors, such as the metal and machinery industry, especially because they are quite sensitive to business cycle fluctuations. The appreciation of the CHF over the past few months is also curbing exports. Overall, exports are forecasted to grow merely below-average in 2019 for the first time in several years.

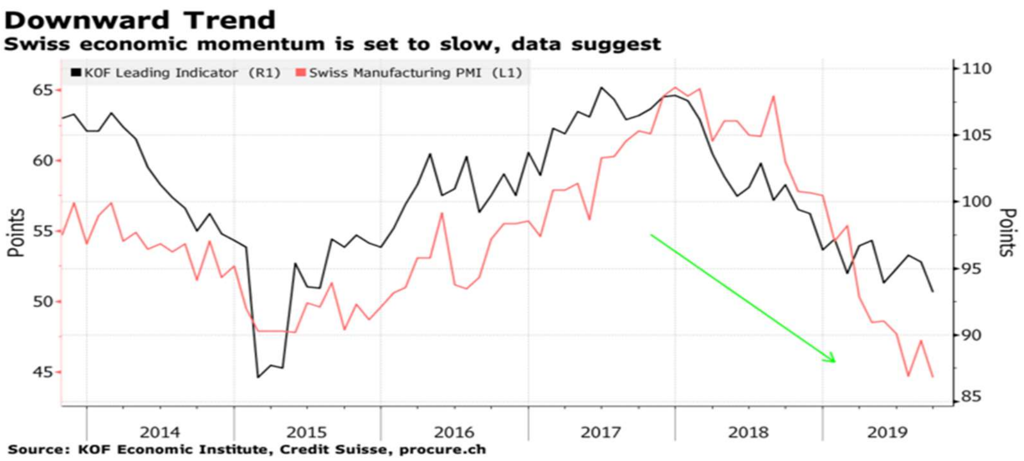


Figure 56: Swiss Economic Momentum is Expected to Slow Down *(Source: Bloomberg)*

The global economic downturn is affecting the Swiss economy as its momentum slows down due to lower exports. This fall in exports is attributed to a strong currency, negative effects of the trade war and also the weakening of Germany's economy, one of Switzerland's main exporters.

We believe that the domestic economy appears gloomy due to the declining utilisation of their production capacity and economic uncertainty. Companies are set to hesitantly invest in equipment in the near future, despite favourable financing conditions. In addition, the Investment in Equipment and Software forecast has fallen from 0.8% to 0.2%. Despite negative interest rates, companies are not taking loans to invest due to the negative and bleak global and domestic outlook. We believe that this would negatively impact economic growth in Switzerland.

Rising Real Estate Market Bubbles

Figure 57: Switzerland's Home Vacancy Creeping up in Recent Years *(Source: Bloomberg)*

The negative interest rate has significantly driven the Swiss real estate market, leading to high vacancy rates. Real estate has become the asset class of the moment due to its potentially attractive returns. On the contrary, the Swiss Home Vacancy Rate has hit a 20-Year High, which is becoming a serious problem for Switzerland.

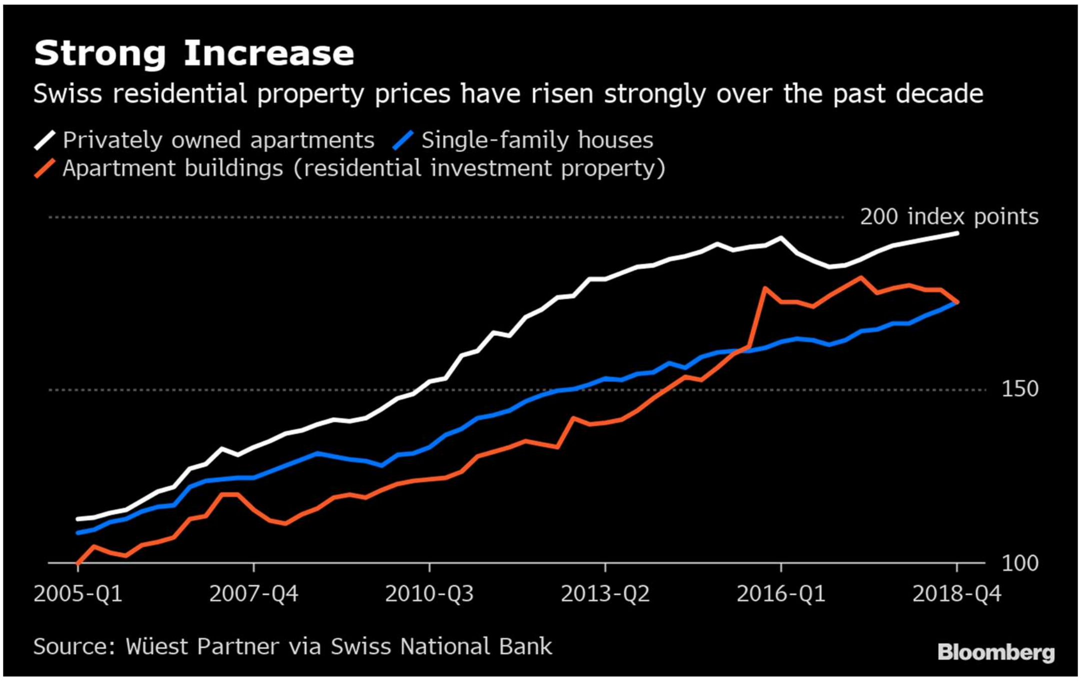


Figure 58: Swiss Residential Property Prices Have Risen Strongly over the past Decade *(Source: Bloomberg)*

According to Figure X, properties in the Swiss Real Estate Market has risen by over 200 index points from 2015 to 2018. This figure is likely to continue rising due to the negative interest rate, which will cause the real estate market bubble to become even bigger. The number of occupants will fail to keep up with the increase in the number of housing properties.

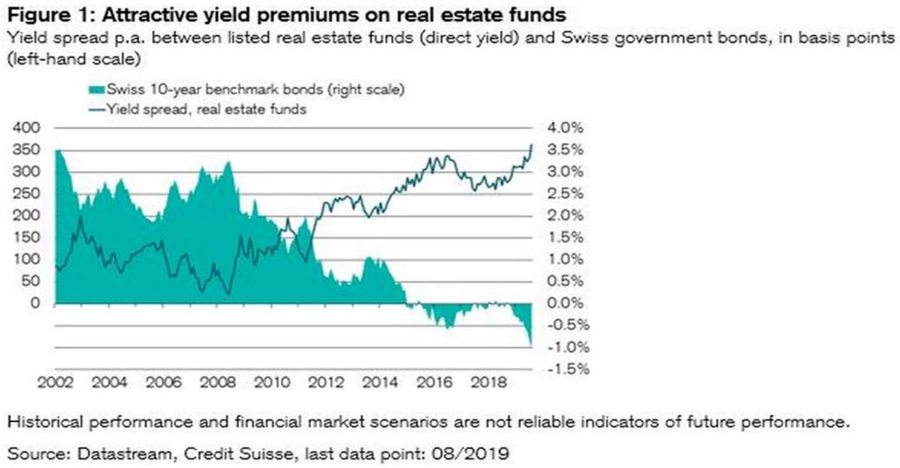


Figure 59: Attractive Yield Premiums on Real Estate Funds *(Source: Credit Suisse)*

With the volume of bonds and loans offering negative interest rates, more and more capital is flowing into the real estate market, pushing prices even higher and causing the bubble to grow even bigger. The bubble is likely to burst when the supply of housing continues to increase, while the demand starts to decrease, resulting in a fall in prices, which is detrimental to the real estate market and construction companies and homeowners alike are going to suffer in terms of the fall in their investment. When these repercussions are not contained, it may have spillover effects on other aspects of the economy and possibly triggering a recession.

Contagion Risk to Labor Markets is Low

Switzerland's unemployment rate came in at 2.3% in November 2019, which is the highest level since April this year. The Swiss unemployment rate inched higher to a non-seasonally adjusted 2.3% in November 2019 from 2.2% in the previous month. Nevertheless, these figures are still consistent with a healthy level of the unemployment rate.

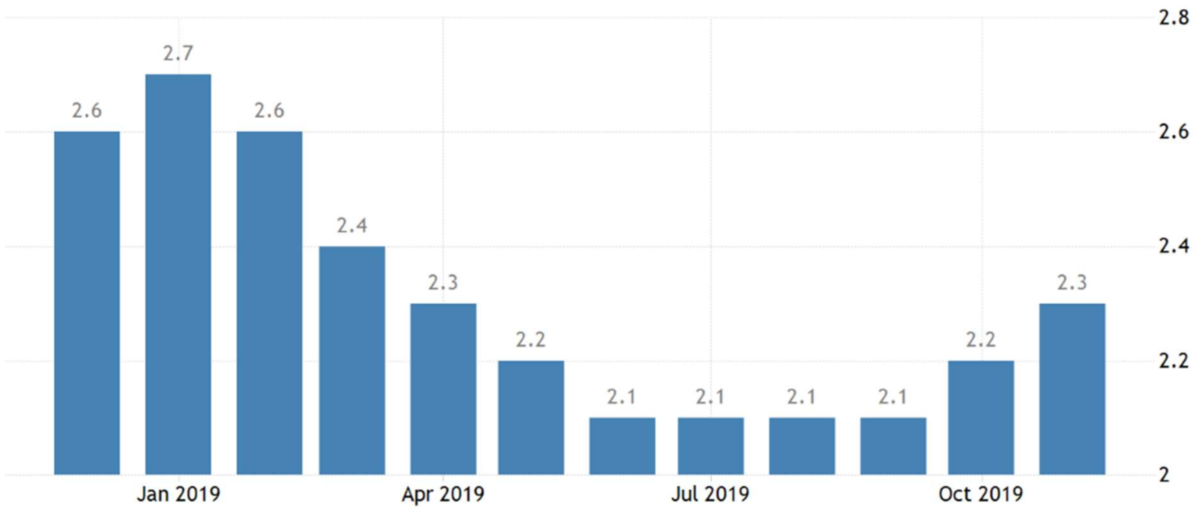


Figure 60: Switzerland Unemployment Rate *(Source: Trading Economics)*

Although there is a threat of job cuts in the mechanical and electrical engineering (MEM) industries, it is unlikely to lead to a significant increase in unemployment as the strong labour market in Switzerland would continue to drive private consumption. This is good news for the Swiss economy, especially in times of global turbulence, as growth will be more dependent on domestic consumption and less dependent on external demand.

In Q2, the youth unemployment rate in Switzerland dropped from 6.4% to 6.2%, a rate far lower than the EU-28 average, which fell from 15.0% to 14.1%. The unemployment rate in Switzerland has historically been low. Currently, the unemployment rates of Switzerland have been one of the lowest in the past 10 years and small fluctuations should not be alarming, but if it continues to increase, it may be a sign of trouble that the economy is weakening as the labour force weakens.

<u>FX Trade Idea: LONG USDCHF</u>

Figure 61: USDCHF Daily Chart (*Source: TradingView*)

Entry Level: 0.98360
Take Profit: 0.99710
Stop Loss: 0.97960
Risk to Reward ratio: 3.375

Fundamentally, the CHF will be kept weak due to the SNB's willingness to intervene in cutting the rates, given the fact that it is already at the lowest negative interest rate in the world. This is coupled with the slowing of the Swiss economy and poor economic data amidst the global economic downturn. The timing is right as the CHF has already appreciated significantly due to fear of economic downturn and the CHF's characteristic of being a safe haven currency. For the USD, the U.S. economy is fundamentally still strong, with the recent U.S. Non-Farm Payrolls (NFP) of 266K, which is way above the consensus of 180K and previous data of 156K, this suggests a healthy and robust economic growth because of more job additions and consumers who have both money and a job tend to spend more.

Moreover, the recent third Fed rate cut suggests that the Fed is likely to hold its interest rate in the future. Looking at the development of the U.S.-China trade war, it is likely that Trump will be willing to negotiate further to end the trade war, with s the 2020 presidential elections looming ahead. As such, we believe that the USD is likely to stay strong at least in the 1Q2020.

The USDCHF has begun ranging since Sep 2019 and is currently on a support level that has been tested four times and is being tested for the fifth time. If this support level holds and price manages to go upwards, the price will likely continue to go in the uptrend. The Stochastic and RSI indicators are both currently oversold as well. Moreover, the price is currently at the bottom of the Bollinger Bands which tends to work well in a ranging market, which can be evidently seen in the charts for the past few months. The interest rate for the U.S. is 1.75%, while the interest rate for Switzerland is -0.75% which means that going long on the USDCHF, results in a positive carry trade that will profit even if the trade goes sideways.

UNITED KINGDOM (Overweight)

The United Kingdom (UK) is a region in Europe that consists of England, Wales, Scotland, and Northern Ireland. Its official currency is the Pound Sterling (£), the world's oldest currency. It is the 80th largest country but it has the 5th largest nominal GDP in the world (USD 2.8252 trillion in 2018) and 2nd in the European Union (EU) behind Germany. The EU is the UK's largest trading partner, which accounted for 46% of total exports and 54% of total imports in 2018.

The UK economy is mainly driven by the services sector, which accounts for more than 75% of the total GDP. The financial service industry is the most crucial, with the UK's capital, London, being an established global financial hub. London is also the world capital for foreign exchange, with an average daily turnover of USD 2.426 billion in 2016. Furthermore, manufacturing is the second largest sector, contributing about 25% of the total GDP. The UK aerospace industry is the third-largest national aerospace industry, which includes BAE Systems, a British defence and aerospace company which is also the largest defence contractor in Europe.

Export accounts for 30% of the UK's total GDP and some of the main export items are cars, packaged medicaments, and crude petroleum. Cars are the largest exports in 2018, where 81.5% of all vehicles made in Britain are exported. In 2018, the UK exported GBP 24.7 billion worth of pharmaceutical products and 20% of the world's best-selling prescription drugs were developed in the UK. In addition, although the UK is not known as an oil country, crude petroleum was its 3rd biggest exports in 2018.

<u>The UK and its Rates Dilemma</u>

The UK has maintained its interest rate policy to stay at 0.75% in 2019 after the interest rate hike from 0.5% in August 2018. Recently, the U.S. has cut their interest rate three times, in June, September and lastly in October 2019 from 2.5% to 1.75% while European Central Bank (ECB) cut its interest rate from -0.4% to -0.5% as part of pre-emptive measures to support the economy. Despite the dovish approach of other central banks, the Monetary Policy Committee (MPC) in the Bank of England (BoE) still maintain their view in keeping their interest rate at 0.75%.

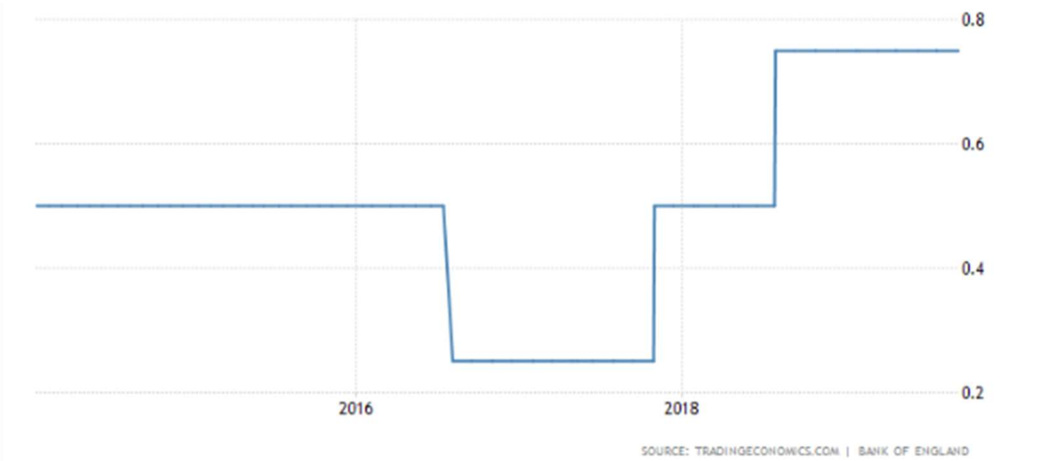


Figure 62: UK's Interest Rate *(Source: Trading Economics)*

The main reason for maintaining interest rates would be the uncertainty over Brexit. While interest rate cuts will certainly be plausible amidst the weakening global economy, holding interest rates would give BoE room to manoeuvre in the case of a chaotic, no-deal Brexit. This is especially if there is no-deal Brexit which will likely lead to a short-term recession in the UK. As a result, the central bank has sought to add levers that can be used if some measure of stimulus is needed for the British economy.

Moreover, the initial reason for hiking the interest rate to 0.75% is to hit the inflation target of 2% which has certainly been a success. Inflation managed to fall from 2.7% in 2Q2018 to 1.7% in 2Q2019. The lower inflation is also supported by the falling oil price which has lowered energy costs. However, the Brexit uncertainty has still caused the Pound to fall, increasing the cost of imports and the expectation of higher inflation in the future. Nonetheless, the interest rate policy has been effective as inflation is currently on target.

Figure 63: UK's Inflation Rate *(Source: Trading Economics)*

Looking ahead to 2020, BoE will certainly be put in a tough position. Its approach will be highly dependent on the result of Brexit, which is likely to reach a deal as the Conservative Party received a parliamentary majority. On one hand, interest rate cuts seem likely in the case of an orderly Brexit as the global economic uncertainty combined with the falling consumer confidence will require some monetary easing to revive the falling business investment. The recovery of business investment takes time and loosening of monetary policy will help to boost the business sentiment. On the other hand, rate cuts might elevate the UK inflation rate which is currently at 1.7% and on track to hit 2%. In the case of an orderly Brexit, the Pound is expected to rise between 10-15%, which gives the UK a good cushion in terms of inflation impact if BoE cuts interest rate.

However, in the highly unlikely scenario of no-deal Brexit, BoE will likely to be hawkish to push up its base rate to 5.5% mark based on BoE's model to combat inflation. Following no-deal Brexit, the Pound will certainly fall hard, raising the cost of imports and inflation. Moreover, goods will generally become more expensive as domestic supply cannot match domestic demand since imported goods are bound to be more expensive once Britain exits the EU. Thus, this will cause inflation to increase. Moreover, the demand side of the economy will take a hard hit. Businesses will postpone and cancel all investment plans while households will cut their spending. As such, interest rate cuts would be an immediate solution to boost the UK economy. Hence, the UK will likely engage in massive fiscal spending and tax cuts to boost the economy and help businesses.

Will the UK Housing Market Gain Its Momentum Again?

The United Kingdom's (UK) housing market has been in a weakening trend as house price inflation has been falling since 2016 and is currently at 0.9% as of June 2019 (Refer to Figure 64). House prices are expected to stabilize in 2019 and rising at an average rate of 1%, given that the UK is able to reach a deal-Brexit. However, moving forward, housing prices are expected to rebound if a deal is reached, which is the likely scenario given the current situation.

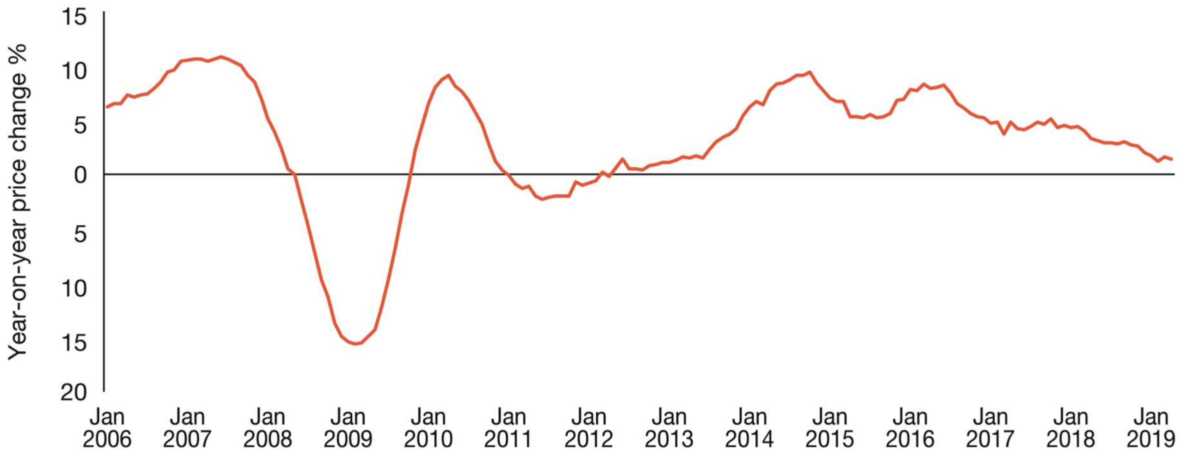


Figure 64: Falling UK House Price Inflation since 2014 *(Source: ONS, Land Registry)*

The drivers of the weakening housing market stem from both demand and supply side. On the demand side, Brexit uncertainty has negatively impacted both domestic and foreign buyers. Driven by a reluctance to make big-ticket purchases and concerns about job security, the IHS Markit Household Finance Index sank to 43.1 in September 2019, which indicates the most negative outlook since November 2013. Moreover, the tightening of monetary policy by the BoE since November 2017 has pushed up mortgage rates, dampening the demand for big-ticket items. The weak demand in the housing market can be seen from the modest decline in the number of housing transactions in Britain, despite the weakening housing price inflation as seen from Figure 64 and rising UK real wage growth.

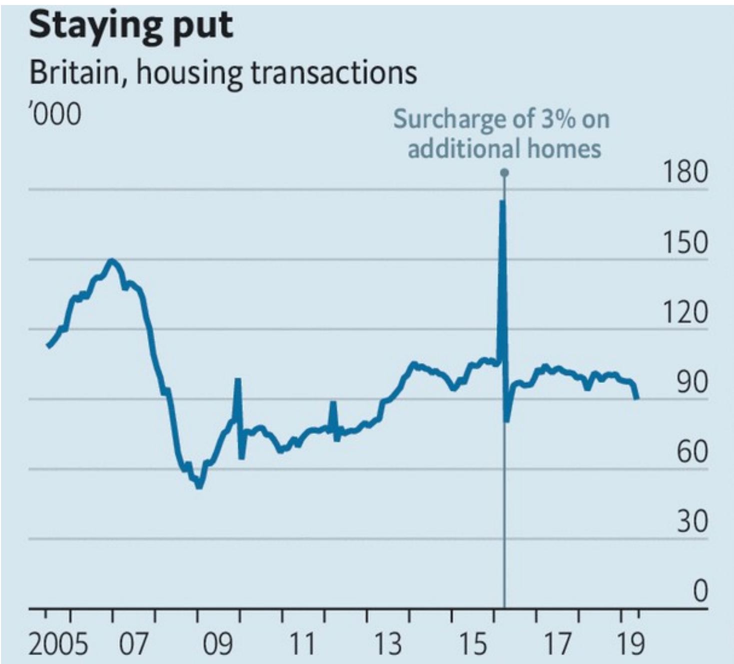


Figure 65: Declining Number of Housing Transactions in Britain *(Source: Bank of England)*

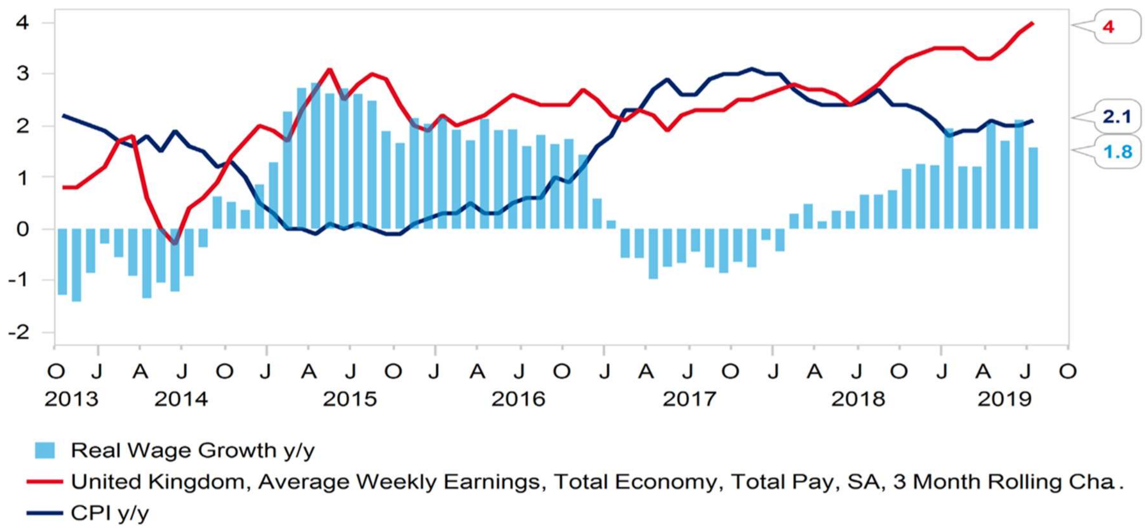


Figure 66: Falling UK House Price Inflation since 2014 *(Source: ONS, Land Registry)*

On the supply side, the implementation of stamp duty surcharges introduced in 2014 and 2016 has raised the costs for prospective buyers, especially for high-value homes and second homes. While the weakening housing market is good news for first-time homebuyers, the effect is likely to be detrimental for the economy, indebted homeowners, and banks. The housing market is closely linked to consumer spending. Homeowners will feel "richer" when the value of their home increases and this will increase consumer confidence. As such, declining house prices will further lower the already-low consumer confidence. Figure 67 shows that GfK consumer confidence in the UK has been in a declining trend since 2017 and remained unchanged at -14 in November 2019. This is mainly driven by prolonged Brexit. Therefore, in the case of no-deal Brexit, housing prices will fall significantly, and this will cause consumer expenditure to fall further, although not likely to happen in the current situation.

Figure 67: UK's Consumer Confidence has been in Negative Territory since 2017 *(Source: Trading Economics)*

Moreover, the mortgage is the greatest source of debt for households in the UK. 47% of homeowners are taking up mortgages to finance their purchases. According to the Council of Mortgage lenders, there are 11.1 million mortgages in the UK, with loans worth over £1.3 trillion. The number of mortgage approvals is also increasing since 2018, reaching 43,342 in July 2019, as seen from Figure 68. Those with low-deposit mortgage often rely on increasing household prices to offset the cost of repaying the mortgage and if negative equity occurs in the case of declining house prices, this will likely lower the consumption expenditure – an important pillar of the UK growth.

Figure 68: UK's Finance Mortgage Approvals *(Source: Trading Economics)*

Moreover, in the case of no-deal Brexit, the UK is likely to face a severe downturn and thus, unemployment will rise. As a result, household owners who are unemployed and unable to repay their mortgages could potentially put banking systems at massive risk. However, given the current development of Brexit, the UK is likely to secure its deal in the near future and the housing market will likely rebound although gradually, given an orderly and timely Brexit.

Business Investment Falls Back into Contractionary Territory

The UK has seen its business investment declining as the Brexit uncertainty continues. The UK Foreign Direct Investment (FDI) has also been in a declining trend since 2017, and there has been an FDI outflow of GBP 15,010 million in 1Q2019 although it increased by GBP 25,425 million in 2Q2019. Overall, UK business investment growth has been very weak since 2016. The data shrank 0.5% quarter-on-quarter during 2Q2019, against the forecast of 0.4% decline after four consecutive quarters of decline throughout 2018. Business investment is now forecasted to decline by 1.5% this year and by 0.1%, given an orderly Brexit. Businesses are now focused on taking contingency plans such as stockpiling important inventories in the case of no-deal Brexit rather than investing in the capital for long term growth. Furthermore, even if there is a Brexit deal, it will take time to improve business sentiment as businesses are not confident about the UK trading relationships with the EU and other countries. Declining business investment is detrimental to UK long-term growth as it limits productivity growth and potential growth.

Figure 69: UK Net Foreign Direct Investment *(Source: Trading Economics)*

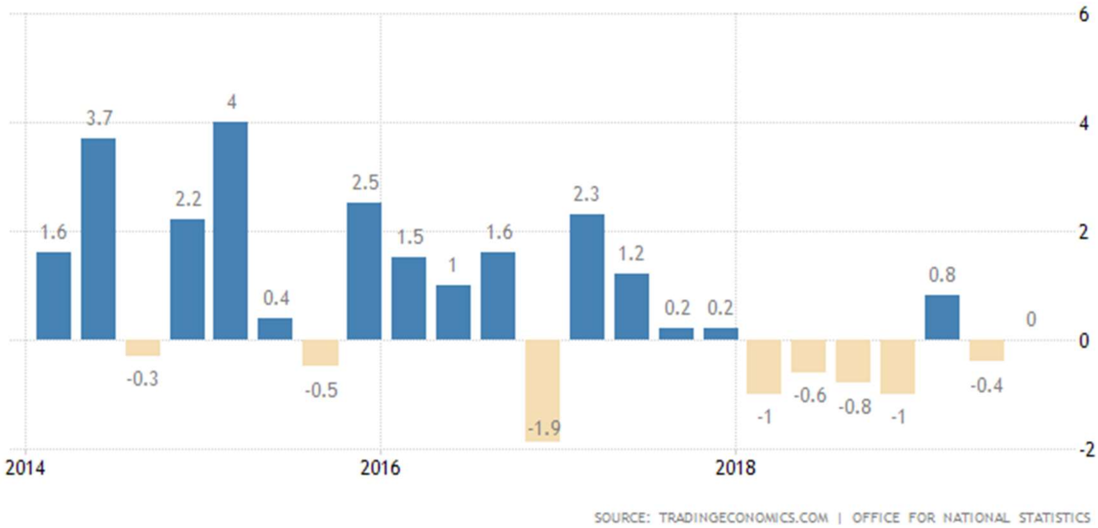


Figure 70: UK Business Investment has shown Negative Growth *(Source: Trading Economics)*

Despite Brexit uncertainty, the interest rate hike by the BoE has reduced investors' willingness to invest as the cost of borrowing increases although BoE decided to keep the interest rate at 0.75% during Monetary Policy Meeting (MOC) on 7th November 2019. Moreover, leading indicator UK Manufacturing Purchasing Manager Index (PMI) further suggests that the manufacturing sector is contracting as the Manufacturing PMI has been below 50 since May 2019. The decline in PMI suggests that managers are expecting lower demand in the future.

Moving forward, we believe that with Brexit deal likely to be reached, business sentiment and investment are likely to rebound, although at a moderate pace as investors' confidence starts to increase, propped up by a more stable political situation as Brexit uncertainty eases.

Figure 71: United Kingdom Manufacturing PMI Contracting since May 2019 *(Source: Trading Economics)*

Startling Wage Growth and Unemployment Rate

The unemployment rate has fallen to an all-time low and UK wages are rising at the highest growth rate in more than 10 years. Despite the slowdown in Brexit-induced UK economy and weak global economy, the UK labour market is unexpectedly strong. Figure 72 shows that the unemployment rate of 3.8% from May to July period was the lowest since 1974. The main driver is the all-time low proportion of unemployed women. The strength of the labor market is driven by the fact that firms prefer hiring workers rather than spending on capital equipment because employment decisions are easier to reverse in a downturn.

Figure 72: UK Unemployment Reaches All-time Low *(Source: Macrobond, UOB Global Economics & Markets Research)*

The tight labor market forces employers to increase their salaries, in line with the increasing UK real wage growth at a moderate pace since the start of the year. During the May to July period, earnings (excluding bonuses) are growing at an annual rate of 3.8% y.o.y, a small decline from the previous reading of 3.9% y.o.y. The annual growth rate of earnings including bonuses reaches 4.0% y.o.y, the fastest rate since mid-2008 (Refer to Figure 73). However, the productivity growth could not match the wage growth, putting pressure on the profit margin for firms. As a result, firms are pressured to increase their prices, although the effect is offset by the hike in interest rate.

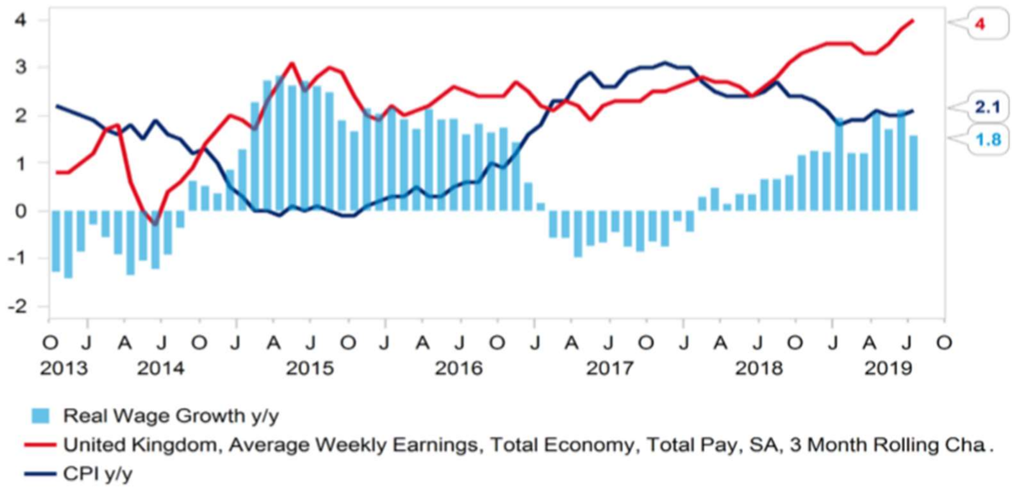


Figure 73: UK Real Wage Growth year-on-year *(Source: Macrobond, UOB Global Economics & Markets Research)*

Going into 2020, it is likely that the labor market remains solid given the high likelihood that the UK will have an orderly Brexit. In the scenario of a deal being reached, business investments will increase and thus, there will be a higher demand for labour, and this will inevitably strengthen the labour market.

FX TRADE IDEA: LONG GBPINR

Figure 74: GBPINR daily chart *(Source: Investing.com)*

Entry Level: 95.099
Take Profit: 99.503
Stop Loss: 94.148
Risk to Reward ratio: 4.63

GBPINR has been in an increasing trend since October and rebounded three times before breaking out of the upper channel, suggesting a bullish flag breakout. Currently, GBPINR is testing another resistance at 95.068. The 50-day simple moving average (SMA) line broke the 200-day SMA line in November, and this suggests that the golden cross might continue the bullish breakout. The 10-day SMA line is also currently above the 50-day and 200-day SMA line which further strengthens the bullish movement of GBPINR.

Moreover, we should also take note that GBPINR is currently trading based on headlines and we should take note that technical indicator should take a backseat until Brexit result is finally decided on 31st January 2020 and GBPINR reaches a "steady state" As such, we will enter our long position at 95.099. We will take profit at the next major support level at 99.503. We will cut loss when price reaches 94.148.

Fundamentally, the UK is likely to achieve a deal despite the technical delay to avoid chaotic UK departure. EU leaders have approved the revised Withdrawal Agreement which paves the way for an orderly Brexit. Although Boris Johnson currently faces opposition from the UK Parliament in getting the approval for Brexit deal, the deal is highly likely to be achieved as the Conservative Party received a parliamentary majority. As a result, this will likely reduce the Brexit deadlock in the parliamentary. Although the UK Parliament will scrutinize the new revised agreement, the Conservative Party parliament majority will likely increase the probability of reaching an orderly Brexit deal. Thus, GBP is likely to strengthen as the economy gains momentum and investor confidence increases.

For India, we expect a sluggish trend in GDP growth to continue into 2020. The sharp slowdown in import demand reflects weak investment and domestic demand. This is due to stagnating wages and tightening lending conditions as a result of ailing health of financial institutions which pushed consumers to delay discretionary spending. While FDI remains strong, the fall in global liquidity and trade uncertainties is likely to weigh on capital flow. India's PMI index fell to 48.7 in September from 52.4 in August and it's GDP has fallen to six year low, further highlighting manufacturing weakness. We expect another rate cut in the first quarter of 2020 to boost the slowdown in India's economy. Hence, this supports our trade idea of longing GBPINR.

RUSSIA (Neutral)

Russia, previously known as the Soviet Union, has transformed from a centrally planned economy to a free market economy. Nonetheless, the government still holds a particular role in various industries such as energy and banking sector.

Russia is the 11th largest economy based on GDP adjusted by PPP in 2018 (USD 1.6576 trillion). It is mainly dependent on commodity exports, especially energy products such as oil and natural gas. It is the world's third-largest oil producer behind the U.S. and Saudi Arabia and has the eighth largest oil reserves in the world. In 2018, oil export revenue contributed to 7% of its GDP and half of the federal revenues. This explains the strong correlation between Ruble and oil prices.

Russia is also the world's largest diamond producer and is believed to have the largest diamond reserves in the world. It is estimated that Russia contains over 30% of the world's natural resources.

Russia's economy has grown significantly as its GDP per capita has approximately doubled since 1999. The economy is mainly driven by the service sector which accounts for more than 60% of the total GDP. Some important segments include wholesale and retail trade, public administration (health and education) and real estate. Moreover, the industrial sector accounts for more than 30% of the total GDP with mining, construction, and manufacturing being the most important industry. Russia has a large and sophisticated arms industry, which produces high-tech military equipment such as fighter jets, nuclear-powered submarines, and ballistic missiles.

Soaring Consumer Debt Reveals Russians' Struggles

Household credit has been increasing over the years as more Russian households are taking up loans, reaching 44% of total households taking up debt as seen from Figure 75. As of 2Q2019, Russians' consumer loan grew at 23.5% y.o.y compared to last year, reaching RUB 16,400 billion in July 2019.

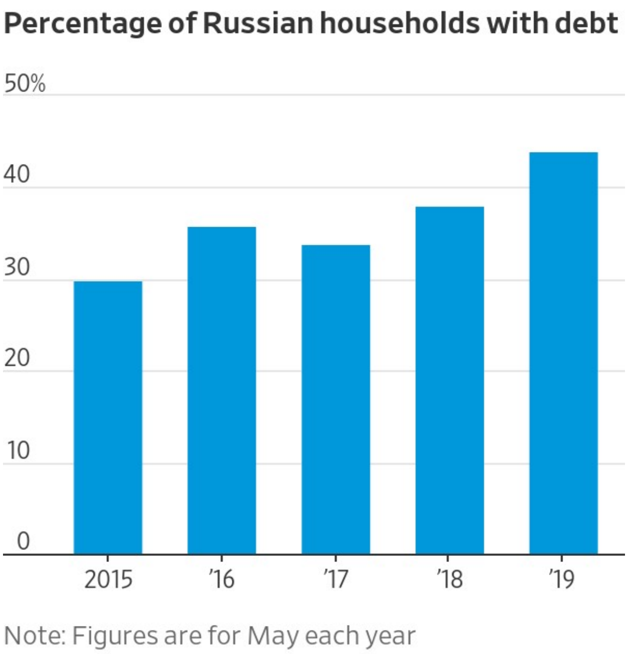


Figure 75: Russian Households Debt is on the Rise (*Source: The Central Bank of the Russian Federation*)

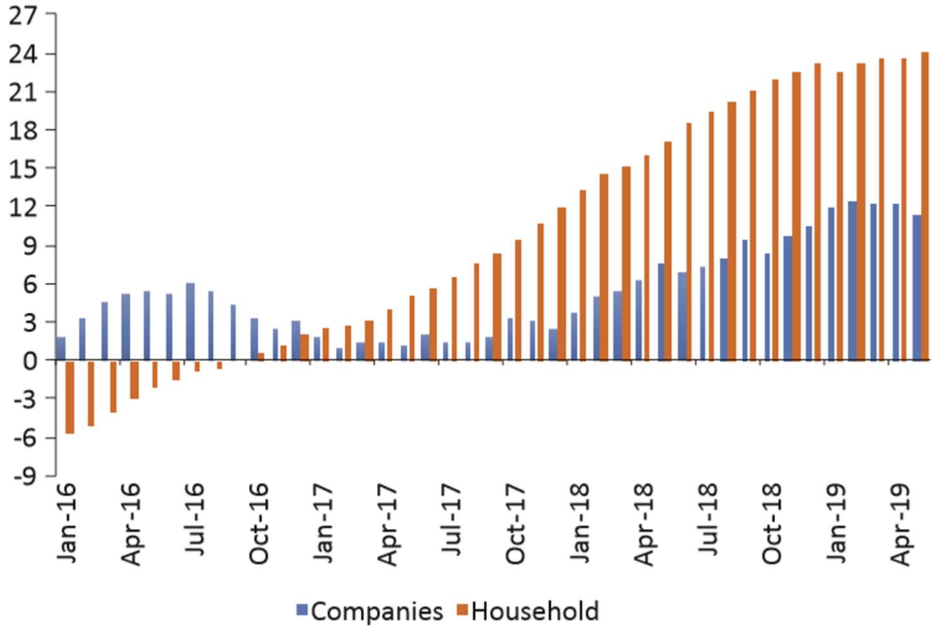


Figure 76: Russians' Consumer Debt is Increasing Logistically *(Source: The Central Bank of the Russian Federation)*

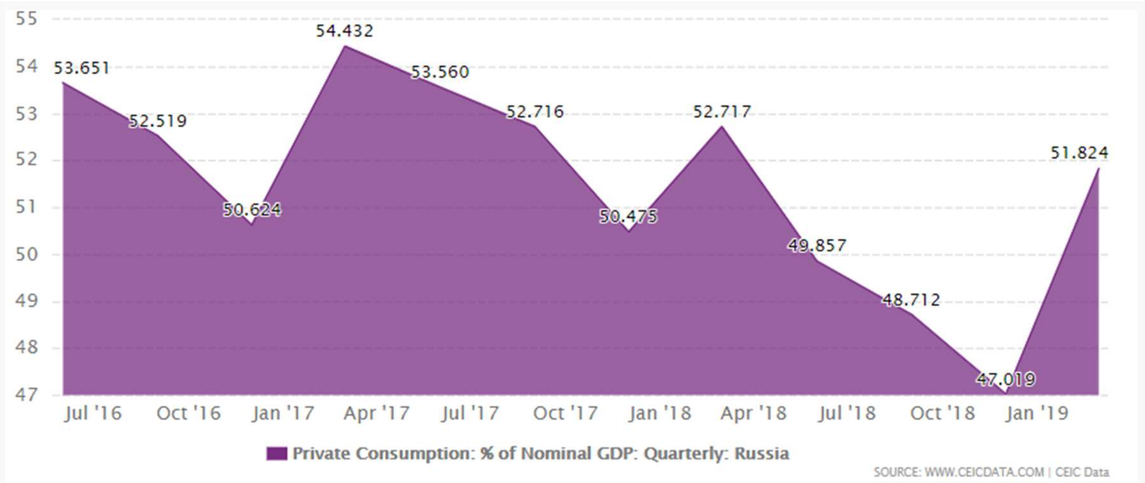
People in Russia are taking up more loans to maintain their standard of living. The main driver of the rising consumer debt is the falling real disposable income, despite the unemployment rate declining and reaching an all-time low at 4.3% in August 2019.

Figure 77: Falling Real Disposable Income *(Source: Trading Economics)*

The falling real disposable income is worsened by the elevated inflation due to increased Value-Added Tax (VAT) from 18% to 20% as well as the depreciation of Ruble which causes upward pressure on inflation due to increased cost of imports. Moreover, the poverty rate in Russia has been hovering on average of 12% and reached 14.3% in 1Q2019, a 13.9% y.o.y growth for the same period from the previous year. Hence, fundamentally, the purchasing power of Russians is low and likely to decline further, fueling strong personal credit growth.

In addition, the Bank of Russia lowered its interest rate further from 7% to 6.5% in October 2019. This will likely push the bank lending rate down, potentially driving the consumer debt further.

As a result, rising household debt increases the risk of households' being unable to service their debt as almost one-third of indebted households take up more than 50% of their monthly income to service their debt. As such, in the long term, this poses a downward risk to future economic growth as consumers cut back on their spending to repay their loans, weakening future economic growth. As seen from Figure 78, household consumption contributed to more than 50% of Russia's GDP. Domestic demand is an important source of Russia's growth and thus, rising consumer debt will likely weigh on Russia's economic growth in the future.



In response to rising consumer debt trends, the Bank of Russia has implemented a series of regulations to dampen rising consumer debt. The new regulation imposed a limit that lenders can charge borrowers for consumer loans with a maturity of up to one year to ensure that the household debt burden does not increase excessively and maintain the default risk. Moreover, effective from October 2019, some banks would need to consider the prospective borrower's debt load, which affects the true interest cost. These new regulations should prevent excessive issuance of consumer loans. However, as the economy of Russia is weakening due to sanctions and expected lower oil prices, the problem of declining real disposable income is likely to persist. Thus, it is in our view that despite the tightening of lending rules by the government, consumer debt is in an increasing trend.

Tepid Growth Driven by Structural Weaknesses

Russia's GDP for 2Q2019 was modest at 0.9% y.o.y and increased to 1.7% y.o.y for 3Q2019. Russia's overall growth forecast for 2019-2021 is modest at 1.2% to 1.8%. This modest growth can be attributed to internal structural weaknesses such as poor demographic outlook and declining foreign investment which makes the country less competitive.

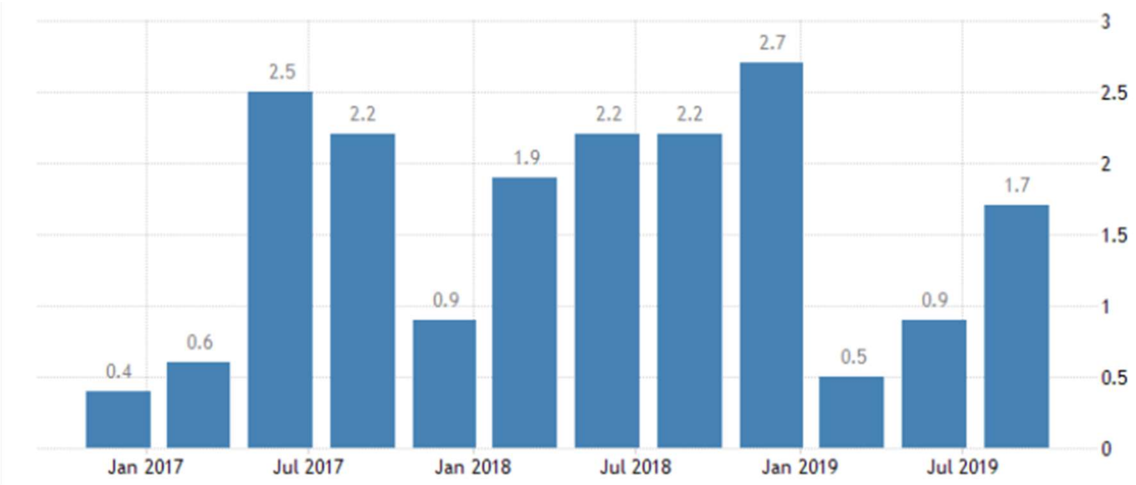


Figure 79: Russia GDP Annual Growth Rate *(Source: Trading Economics)*

Internally, structural weaknesses have also been impending Russia's growth. Russia is faced with a poor demographic outlook which will affect its potential growth and investment attractiveness. Russia's total population is also increasing at a very modest growth from 2015 to 2018, reaching 147 million in 2018. However, the working age population has been falling, representing about 60% of the total population and expected to decline to 50% by 2050, based on the estimation of historical long-term decline.

The main reason for this is the declining birth rate since 2013. Moreover, brain drain is also a problem for Russia which directly affects Russian's skilled workforce and working population. The number of Russians migrating out of the country has tripled since 2012, reaching about 250,000 in 2016. Furthermore, Russia's retirement age is one of the lowest in the world (55 for women and 60 for men), and this is mainly due to unhealthy lifestyles and low healthcare expenditure by the government. This results in a shorter life expectancy. The above-mentioned factors exacerbate Russia's skills shortage - a key aspect that foreign investors consider- is one of the drivers of the declining foreign investment which further lowers both Russia's potential and actual economic growth.

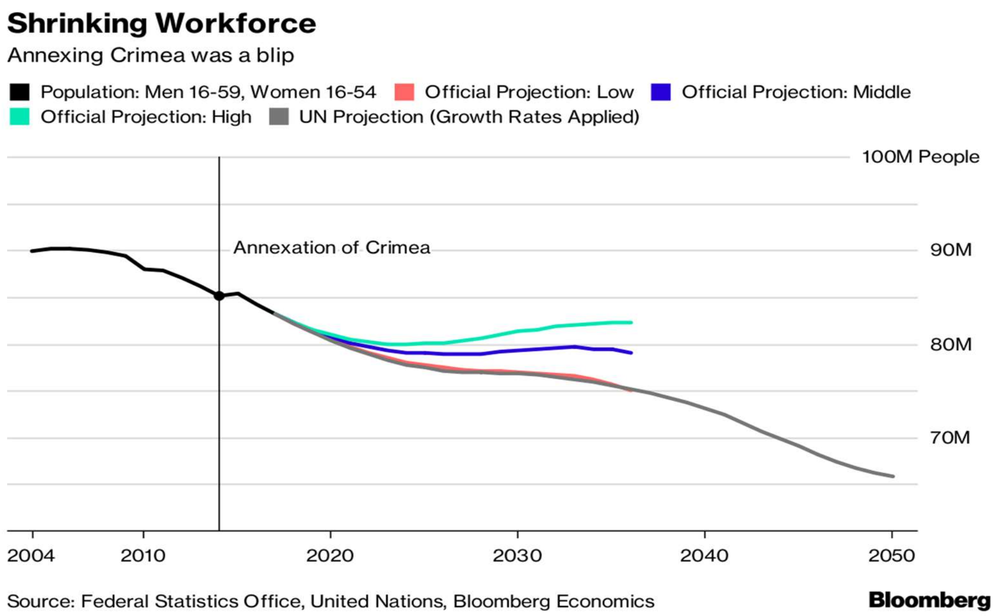


Figure 80: Russia's Shrinking Workforce *(Source: Bloomberg)*

Apart from a skills shortage, the declining workforce could lead to problems in financing pension. We can infer from the declining inverse dependency ratio that there will be fewer employees paying for social security contributions. As a result, the government might need to increase income taxes which will aggravate the problem of falling real disposable income - a good indicator of well-being and standard of living – and this could potentially worsen consumer debt. Alternatively, the government could increase federal subsidies to the pension fund. However, this will depend on the government's financial capacity as the federal budget is highly dependent on oil export revenue.

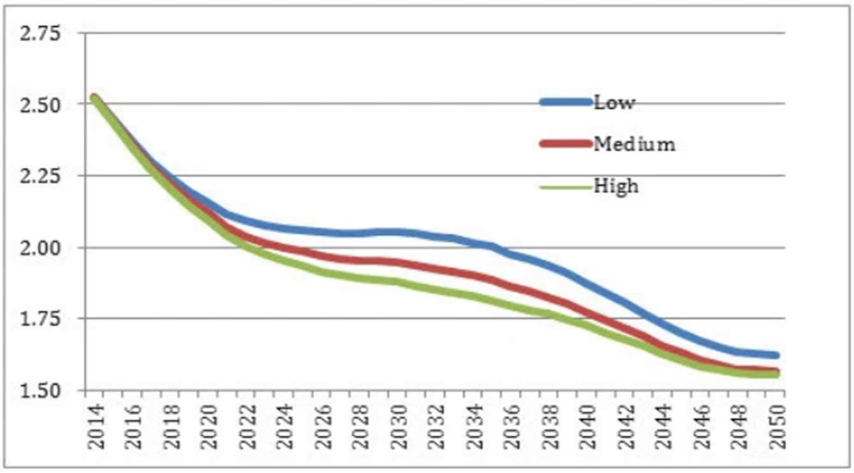


Figure 81: Working Age to Above Working Age Population Ratio in Russia *(Source: The Brookings Institution)*

Moreover, Russia's weak investment demand is putting a significant brake on Russia's long-term growth. Total capital investment in Russia has been in a declining trend since 2014, reaching about $375 billion in 2018. Both domestic and foreign companies are reluctant to invest in Russia not only because of the sluggish economic growth but also due to the lack of competitiveness and innovation in Russia. In 2016, only 8.3% of Russians companies engaged in innovative activities such as technological and marketing innovation, which is extremely low compared to companies in the EU, where 49% of the companies focused on innovation. Moreover, a declining workforce is one of the concerns that has dampened investment demand growth. Geopolitical tension is also limiting the upside of growth as Ukraine-related sanctions imposed by the EU and U.S. have affected foreign involvement in the energy sector, the main destination for foreign direct investment (FDI) in Russia. Moreover, the sanctions also discourage investment that is not directly banned as investors fear of violating the terms of the sanctions and affect their confidence in investing in Russia.

The net flow of FDI has generally been weak since 2014, reaching negative net flow in October 2018 (Refer to Figure 82. Russia's net FDI, excluding reinvestment, fell to $1.9 billion in 2018. Furthermore, other than a few big deals with China, Russia is the recipient of little FDI.

Figure 82: Russia's FDI – Net Flows *(Source: Trading Economics)*

In short, Russia's economic growth has been weak over the past 3 quarters and the economy is expected to grow at a disappointing 1.2% in 2019. With the weak global economic sentiment especially driven by trade tensions and also expected lower oil prices, Russia's economic growth will likely be dampened by these factors. We believe that it is imperative for Russia to tackle its structural weaknesses to boost its economic growth.

Lifeblood of Russian Economy Expected to Fall Further

Despite the tight oil supply, the mid-term outlook of oil prices is expected to be bearish, driven by weakening global growth.

The supply of oil is expected to tighten as OPEC+ - Organization of the Petroleum Exporting Countries (OPEC) and allied non-OPEC members - agreed in December 2019 to extend supply cuts until March 2020 to support oil prices. The members pledged to reduce supply by 1.7 million barrels per day. The cartel is expected to potentially cut crude production further as the market remains oversupplied, given the lacklustre demand in the short-term. Moreover, although U.S. crude oil production has grown considerably and doubled its oil production in the last 10 years to become the world's largest oil producer, shale oil production is expected to slow down due to dwindling margins. However, OPEC also faces rising output from other countries such as Brazil, Norway, and Guyana (non-OPEC+ members). As a result, there is likely to be a supply glut at least in the first half of next year although OPEC+ considering deeper production cuts.

The demand for oil is expected to fall, given the weak global economic sentiment. This is further fueled by the looming uncertainty of the U.S-China trade war and evident from slowing global industrial production and the continual contraction of the global manufacturing Performance Manufacturing Index (PMI). Although progress has been made, investors are still cautiously optimistic as concrete deals have not been made.

Furthermore, the Urals crude, Russia's main export blend, will likely face lower demand and value when the International Maritime Organization (IMO) 2020 is enforced. The main reason is that Urals crude oil has a sulphur content of about 1.6-1.8%, while the IMO 2020 regulations will only allow a maximum of 0.5% in marine fuel. As such, refineries are starting to switch to sweeter grades to meet the future demand and this will result in a higher discount for Urals crude. Therefore, this would lower oil prices. Although it can be argued that supply can be adjusted to prop the oil prices up, the potential increase in oil prices will be offset by the lower demand for oil in general. As Russia is a net exporter of oil, oil prices will cause Russia to suffer in terms of export revenue and result in slower growth. Moreover, as the Ruble is positively correlated to oil prices, falling oil prices will cause a depreciation of the Ruble. This would increase the cost of imports and lead to elevated inflation, which has already been worsened by the increase in VAT. Moreover, lower oil prices will likely dampen Russia's economic growth as seen from past track records.

The effect of the change in oil prices on Russia's economic growth is substantial given Russia's high reliance on the oil and gas sector. Oil prices dropped from above USD 100/barrel in June 2014 to USD 35/barrel in early 2016. During the mid-2014 to early 2016 period, the huge 70% drop in oil prices coupled with Western sanctions had caused Russia's balance of trade to fall mainly due to falling export revenue. This resulted in falling GDP growth and recession in 2015 and 2016. This historical evidence further emphasizes the significance of the price of oil for Russia's economy which can limit Russia's upside growth.

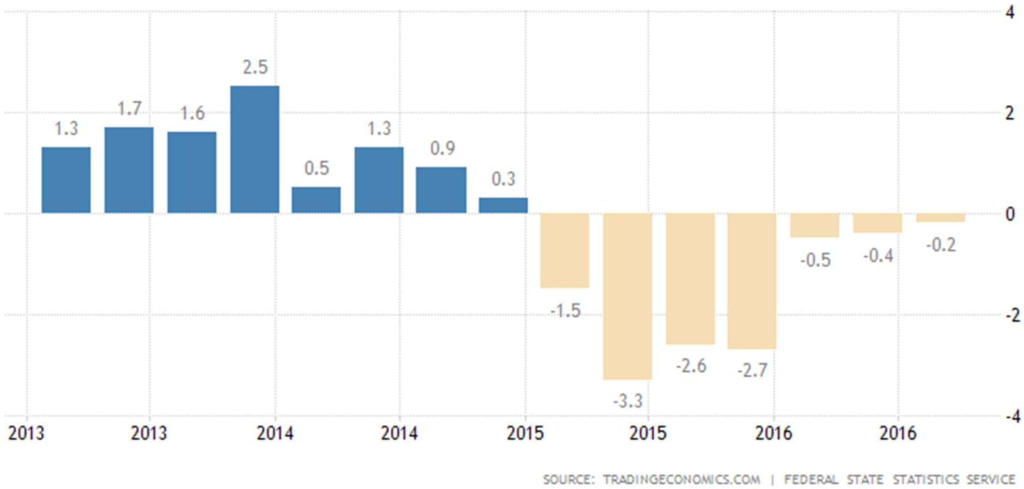


Figure 83: Russia GDP Annual Growth Rate During Drop in Oil Price *(Source: Trading Economics)*

Broad-Based National Plan - a Much Needed Model

Russia's economy has been growing at a modest pace since the recession in 2015 and the country risks falling behind other countries. The heavy reliance on the oil and gas sector is unsustainable in the future and thus, Russia would need to diversify its key drivers of growth. Moreover, Russia also has the biggest budget surplus among other major economies which reached 3.7% of GDP in January through August period. Given the sluggish growth and falling real disposable income, Putin will need to take some actions to boost the economy.

As such, Putin eased budget rule by proposing a new broad-based stimulus package, called National Projects. The program established very specific targets to hit by 2024 in various categories from social services, infrastructure to technology and ecology with a budget of USD 400 billion (RUB 25.6 trillion) over six years. This program aims to improve Russia's falling labour productivity, foreign investment inflows, and quality of life indicators.

Aiming Big

This is what Russia wants to achieve by 2024 from its $400b investments

	Baseline	Target
Population growth	-135,000 ppl/yr	>0
Life expectancy	72.7 years	78 years
Share of population living in poverty	13.2%	6.6%
Global economy ranking	6 *	top 5

Figure 84: What Russia Wants to Achieve by 2024 from Its $400b Investments *(Source: Kremlin.ru, Morgan Stanley)*

The success of the spending program ultimately lies in three factors. Firstly, it depends on how well the plan is implemented. Secondly, success is dependent on how reactive the economy is to fiscal spending. Thirdly, it depends on whether the external environment supports the plan.

External factors such as continuing Western sanctions will make it harder for Russia to achieve higher economic growth. Moreover, given that corruption is rampant in Russia, stricter regulations need to be implemented to ensure fiscal spending is effective. Furthermore, detractors of the spending program believe that instead of revitalizing the economy, Putin's new spending program is more likely to deepen Russia's increasingly state-led economic model. The National Projects seems to increase Russia's autonomy and they contain few provisions for attracting FDI. As such, foreign investors might even be more unwilling to invest in Russia due to the increased involvement of government in businesses. Even if the spending program successfully brings the intended effects, further reforms to solve the above-mentioned structural weaknesses are needed to sustain the long-term growth of the economy. Furthermore, Russians are getting more skeptical with regards to the execution of the projects as a similar promise made 6 years ago by Putin remains unfulfilled.

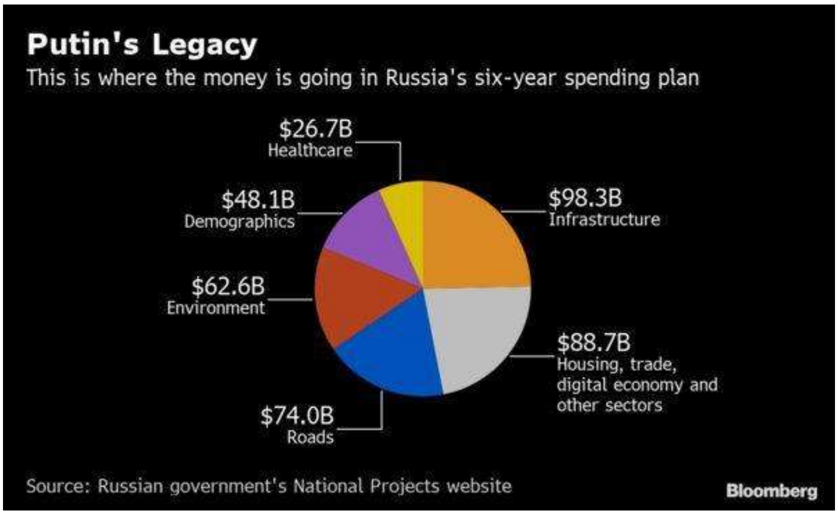


Figure 85: Putin's National Projects Budget Allocation *(Source: Bloomberg)*

In conclusion, the stimulus package will likely bring improved economic growth, but not significantly and sustainably. The main problem will be the endemic corruption which makes government spending less effective. Moreover, extensive nationalization under Putin has made economic growth mostly dependent on the government, which is not sustainable. Without enough private investment, it is difficult for Russia to reach economic growth beyond 2%.

Thus, the key is to improve productivity and ensure the inflow of FDI in the long term to ensure sustainable economic growth. More importantly, the government needs to solve its structural weaknesses such as its unfavorable demographics to ensure that growth is supported. The Russian government will need to reduce its state footprint to attract more FDI – although we believe this is unlikely to happen as it would mean that Putin's political influence will be undermined.

FX TRADE IDEA: LONG USDRUB

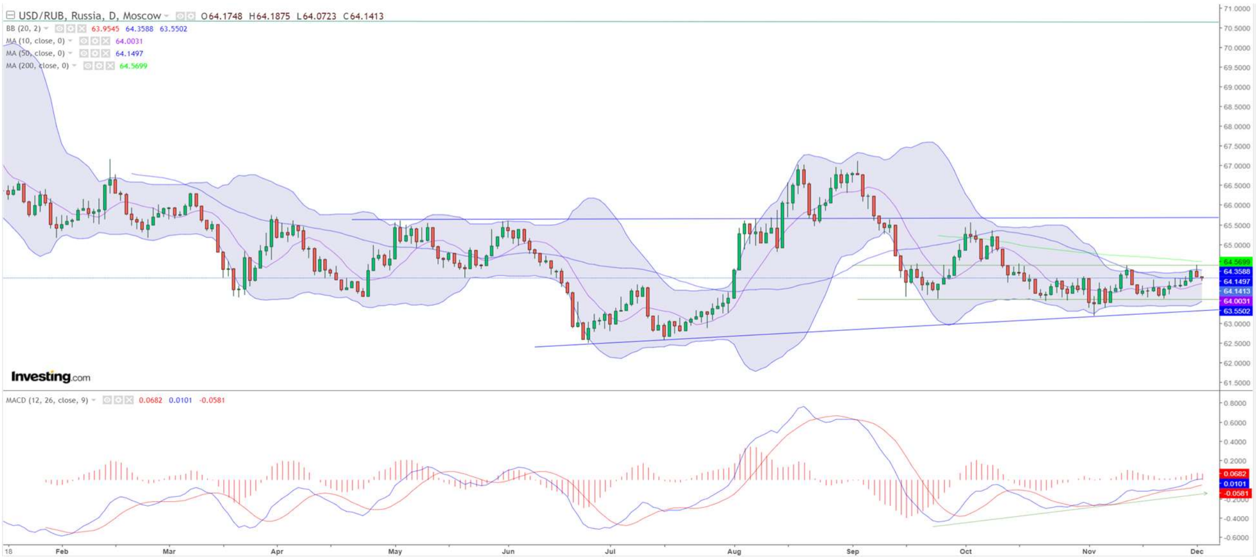


Figure 86: USDRUB daily chart (*Source: Investing.com*)

Entry Level: 63.61
Take Profit: 65.68
Stop Loss: 63.00
Risk to Reward ratio: 3.4

The USDRUB has been in a consolidation between the range of 63.50 and 64.50 for the past two months. The Bollinger Bands indicator shows a squeeze at the current price range. If the USDRUB is able to break the minor resistance at 64.48, this will likely lead to a bullish divergence. Moreover, the current price range is still in the major upward channel.

Thus, the entry point will be at 63.61 which is the minor support level, as USDRUB is likely to go down to the minor support level from the current price at 64.15 as USDRUB rebounded after hitting the resistance level at 64.48. The take profit level will be at 65.68, which is the major resistance level. The cut loss level will be at 63.00.

Fundamentally, on the U.S. side, the recent third Fed rate cut suggests that the rate cut is necessary as insurance to keep the U.S. economy strong amidst ongoing global risks. However, the Fed implied that they are likely to hold their interest rates in the future while gauging the economic risks. Moreover, looking at the development of the ongoing U.S.-China trade war, we are cautiously optimistic that the trade war will end, given the upcoming 2020 presidential elections. Moreover, consumer spending which accounts for more than two-thirds of the economy grew at 2.9% in 3Q2019 and expected to grow at least at the same rate in 4Q2019 as consumer sentiment rose in November. The rise in consumer sentiment is mainly driven by rising household wealth. In addition, strong U.S. job growth indicates the economy's resilience with a solid rise U.S. non-farm payroll by 266,000 in November and the unemployment rate reaching 3.5, the lowest in a half-century. As such, USD is likely to stay strong at least in the 1Q2020.

The Ruble is expected to fall further in the future as oil prices are expected to fall in the short term. The fall in demand due to the weakening global economic growth is expected to remain until at least the first quarter of 2020. In July, OPEC, alongside allied non-OPEC members, agreed to extend a 1.2 million barrels a day production cut for nine months. The ongoing OPEC cuts and slowing shale activity has helped to offset the downward pressure on the price of oil, stabilising the price. Nonetheless, when the IMO 2020 regulation is reinforced from 1st January 2020, the Urals crude will face lower demand due to the restriction on sulphur content. As such, there will be more limited usage of Urals which results in more discounts and lower oil prices for the Urals. Thus, as oil price, especially Urals crude – the main type of Russia oil export – is expected to fall in the short term, Ruble is likely to depreciate due to its positive correlation with the oil price. However, in the long term, once the demand for oil picks up and oil price climbs, Urals crude price will still follow the general price direction, although with a discount since Urals exceeds the sulphur content requirement when International Maritime Organization 2020 comes into force.

Thus, the arguments above support our trade idea of buying USDRUB.

CHINA (Overweight)

China's economy has been faced with headwinds in 2019 that has caused its GDP growth for 3Q2019 to fall below consensus at 6% instead of 6.1% according to Trading Economics. According to The Straits Times, the economy has grown at its weakest pace in the last 3 decades but is on track to achieving its goal in doubling the size of its economy by 2020 from 2010. The trade war has been the main concern with the slowdown, causing the PBOC to enact monetary and fiscal policies to help China expand. However, with a Phase 1 deal looking to be signed within the next few weeks, strong performance by equities and policies to bring in more inflows into the country, we will see China's reengage gears and enter 2020 strong.

Breakthrough for U.S.-China Relations

The world heaved a sigh of relief with a breakthrough in U.S.-China relations on 13th December 2019. The South China Morning Post reported that the Vice Minister of Commerce, Wang Shouwen, made a statement on Friday and said that an agreement would cover a wide range of issues including IP protection, technological transfers, purchasing of agriculture and expanding trade. The office from the U.S. trade representative confirmed the statement adding that "the U.S. and China has reached a historic and enforceable agreement on a phase one trade deal". Over the next few weeks, both countries will conduct a legal review of the deal with the final signing being between Robert Lighthizer (U.S. Trade representative) and Liu He the Chinese Vice-Premier.

According to OCBC, for the first 3 quarters of 2019, fixed asset investment in manufacturing slowed down to 2.5% yoy from 2.6% yoy, which is the lowest since China started to publish the data (started in 2004). These factors have resulted in a 5.3% decline, as reported by the National Bureau of Statistics in industrial profits for China in September. This worsened the slowing growth of China as the industrial sector plays a huge part of China's GDP, consisting of almost 40% of the economy. The immediate effect from this news was the rolling back of the 15% tariffs scheduled on 15th December 2019, which was estimated to affect 160 billion worth of Chinese goods, specifically consumer electronics like smartphones and gaming consoles. Additionally, a 15% levy on 120 billion Chinese goods was cut to 7.5%. However, the 25% tariff which included products like steel will still remain (and affect 250 billion worth of goods). This news sent the USDCNY to break past the psychological 7 level (investors were bearish on trade which led to a weaker Yuan to make Chinese goods appear cheaper).

We are moderately positive in relation to the trade war with this agreement representing a Phase 1 deal. The U.S. has kept some tariffs in order to use as leverage for future negotiations. Tai Hui, the Chief Asia Market Strategist for JP Morgan Asset Management, shared that the Phase 1 deal represents some of the lower hanging fruits of the conflict between these 2 countries. We feel that China will be more willing to play ball with the U.S. due to the trade war having a heavier effect on their economic performance in 2019. We see the roll back of the scheduled tariffs as a big win for China in the short-term future. With China also agreeing to making more agricultural purchases from the U.S. in the future (exact quantities have still not been released), we see both sides extending goodwill to move forward with further negotiations.

We are confident that the Phase 1 deal will be signed. However, we understand that there are some sticky points in relation to other matters that have not yet been discussed during the Phase 1 deal. Challenges in regard to dumping steel in the U.S. will go through a few rounds of discussion before being brought to the deal table. The aggressor (U.S., particularly President Trump) has 11 months in 2020 to achieve a deal that will rebalance U.S. and China's trade in order for Trump to have a strong platform to run for his re-election. He has an urgency to deal. President Xi, on the other hand, would have seen the country's economic performance in 2019 and know how much these tariffs can hurt this country. If terms are not to his liking, he has to think twice to anger the U.S. We feel that the damage to exports and the weaknesses of the Chinese economy would make President Xi easier to negotiate with. However, if he is willing to play the long game, he could be stubborn to deal for Phase 2 and wait and see if Trump gets re-election. We currently view Phase 1 as the new baseline which would be sufficient to provide a springboard for the Chinese economy.

PBOC still has room to cut

China's central bank cut their 1-year and 5-year Loan Prime Rate (the rate at which commercial banks lend to their customers) by 5 basis points on 20th November 2019. This move was widely expected by analysts according to the South China Morning post. The cut was a direct result of the central bank lowering the medium-term lending facility rate (the interbank funding rate) for the first time since 2016 to 3.25% from 3.30%. China is beginning to take a more active stance in her monetary policy but is adopting a wait and see approach with cuts of 5 basis points at a time as opposed to conventional central banks who cut rates in increments of 25 basis points. This safe approach could be the reason why we still see a weakness in growth for the Chinese economy due to the expected policy lag. We will potential see stimulus bearing results during 2020.

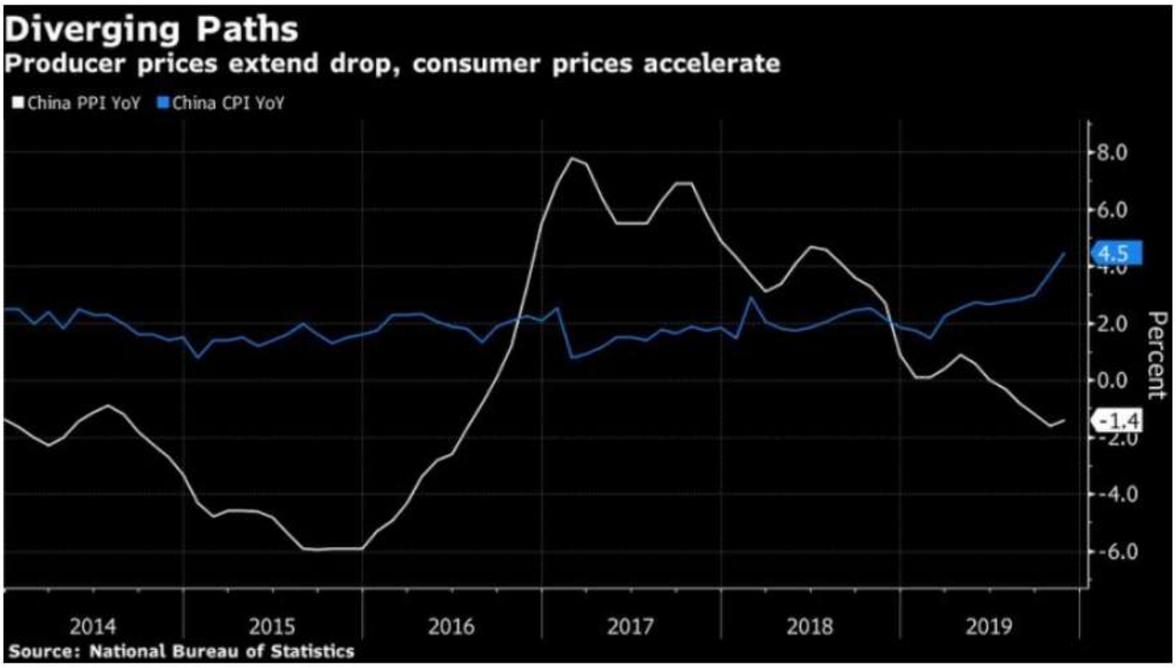


Figure 87: China's producer price index and consumer price index *(Source: Bloomberg)*

Bloomberg has reported that China's consumer inflation accelerated at a seven year high in November while producer prices extended their run of decline. After taking a deeper look at the situation, we realized that the African Swine Flu outbreak which led to the culling of a huge number of pigs caused pork prices to surge by 110%. This was the root cause of the increase in the consumer price index as pork prices are a major constituent in the weighted basket. Even though China's CPI is at 4.5% (with the PBOC's target being 3%), there should not be much concern as core inflation actually dropped to 1.4% from 1.5% in November 2019. Reuters reported that a combination of imports of foreign pork as well as high prices changing Chinese consumer habits, we will likely begin to see pork prices stabilize and eventually fall. We feel that even though the consumer price index is currently above the PBOC's target, the root cause of inflation is down to the pork prices and not an overheating economy. This will allow the PBOC to continue utilizing expansionary policies to stimulate the economy and would provide sufficient ammunition should the phase 2 deal stall or Trump reverses his decision.

Equities, the Case for China's Rebalancing

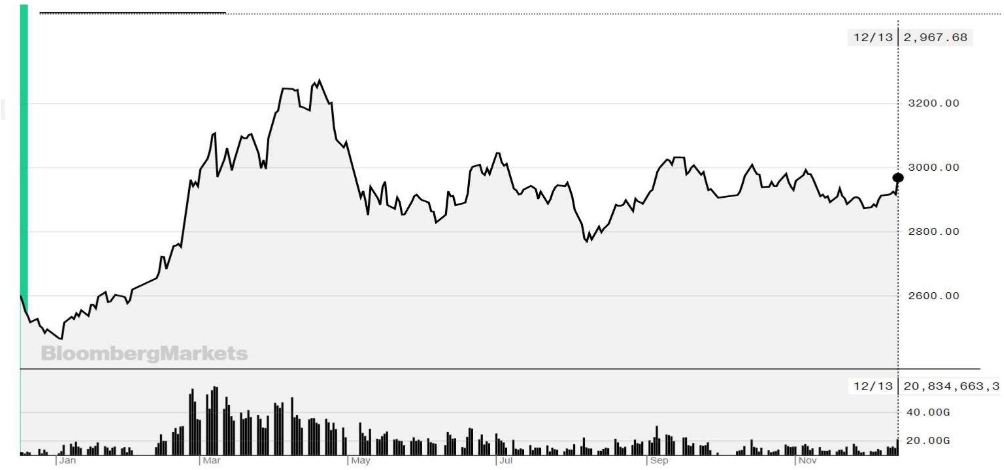


Figure 88: Shanghai Composite Index 2019 *(Source: Bloomberg)*

The Shanghai Composite Index (SHCOMP) was reported by Bloomberg as the worst performing in 2018 with it dropping 25% from the start of that year with 2.4 trillion in loss. This was caused by the breakout of the trade war, weak consumer spending (which hurt consumer stocks) and a vaccine scandal (which sparked a sell-off in the healthcare sector. However as of 12th December 2019, the Shanghai Index rose by 18.55% in the past 52 weeks and is poised for its best annual performance since 2014. It exceeded gains of the MSCI AC Asia Pacific Index (+14.11%) which tracks the performance of stocks in APAC. This strong performance happened even though 2019 was plagued with negative trade sentiment as well as slowing economic growth for the country. Figure X highlights a rapid increase from the high-tension points in Jan with the peak of the index being in April when the tariff rolls out was put on hold. The dip in August was caused by the roll out of the first tariffs for the war. However, the stock market has held resilient throughout this conflict. We foresee the market rallying further to end the year stronger due to the moderately positive sentiment due to the trade war.

Stock name	Industry	Returns since Jan 2	Returns to the SHCOMP
Kweichow Moutai	Consumer Staples	91.47%	2.38%
Ping An Insurance	Financials	22.31%	1.09%
China Life	Financials	66.59%	1.09%
China Merchants Bank	Financials	48.30%	0.89%
Industrial & Commercial Bank of China	Financials	12.60%	0.67%

Figure 89: Best performing stocks in SHCOMP as of 12/12/19 (Source: Bloomberg)

Only energy stocks have had a negative performance for the year with it slumping -6.38%. The top 5 performing sectors for the index have been consumer staples (59.48%), IT (48.23%), Healthcare (32.05%), Financials (22.31%) and real estate (17.52%). In terms of the sectors which contributed the most to the positive returns of the index, it was led by financials (7.12%), consumer staples (3.80%), IT (2.54%), healthcare (1.33%) and industrials (1.18%).

It is interesting to note that the companies that have performed well and contributed the most to the index are driven by consumer demand. Moutai is an alcohol company which markets within China with banks and insurance companies also looking at domestic demand. The growth in these companies this year have shown that there is a stronger Chinese middle class which are consuming more expensive goods (alcohol, insurance and banking are seen as products for the middle class). The top 5 sectors that performed well this year are also linked to consumer and internal consumption and demand.

The stock markets strong performance shows the financial strength and spending power of the Chinese consumer. With an estimated 372.8 million people still living below the international poverty line, we see a large potential market for Chinese companies to tap on to grow further.

2020 could be a potentially interesting year for Chinese technology. Even though none of the companies made it into the top 5 performing stocks, their aggressive expansion into South East Asia will begin to bear fruit. Abacus news reported that China's technological firms have been stepping up their efforts to expand into Southeast Asian Markets. With a strong stock market performance amidst economic weakness and global uncertainty, 2020 will prove to be a strong year for Chinese stocks as their economy gets back on track. This will increase the spending power of her citizens and improve the top lines of companies and sectors which are targeted at the middle class.

A Second Push for Yuan Internationalization

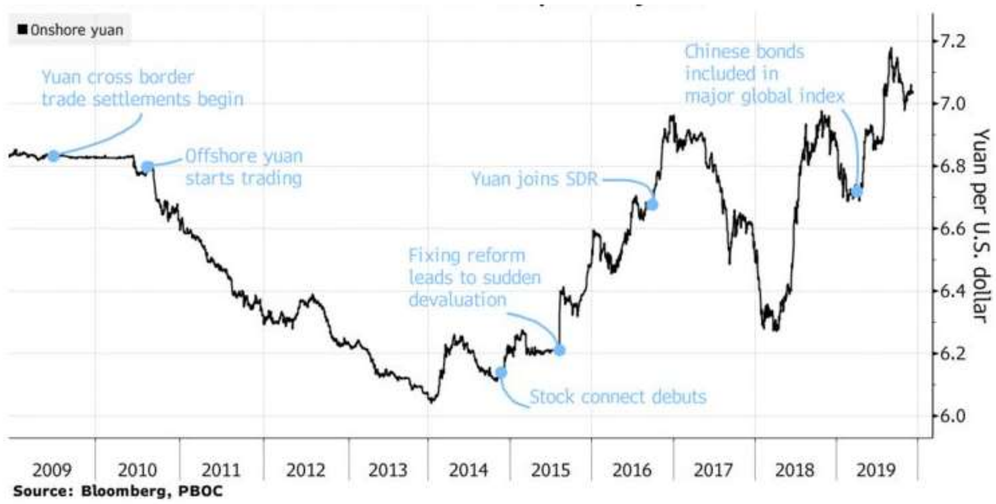


Figure 90: Dollar Yuan chart tracked by major currency events *(Source: Bloomberg)*

China sought to internationalize their currency since the late 2000s with their push for Yuan cross border trade settlements, establishing the dim sum bond market (yuan denominated bonds) and creating a pool of offshore RMB liquidity. It has been close to a decade since the CNH (offshore RMB) was trading with the onshore spot very close to 6 at its strongest in 2014. It all came crashing down in 2015 when China was forced to devalue the Yuan due to them battling an economic slowdown and a stock market crash. This sudden shift in policy spooked investors and led to a huge outflow of foreign money which forced the PBOC to spend $650 billion of their foreign exchange reserves as well as tighten capital control to pad this decrease. This massive overhaul never gave the Yuan a chance to recover with Bloomberg reporting that the Yuan's share of global payment and in central banks remain low at about 2% with the dominate currency still being the USD (61.6%). The first wave of Yuan internationalization failed with the trade war weakening the Chinese economy causing a depreciation of the currency to stimulate growth.

However, China has set some groundwork in place in 2019. With a better economic outlook for 2020, China looks to push towards Yuan internalization to increase the value of its currency. China has pushed to encourage a broader inclusion of its onshore stocks and bonds with the increase of weight of China A shares in the MSCI index earlier in the year. Yuan denominated commodities derivatives for Iron Ore and Oil also made its debut in 2018. The recent trade war discussions have also pushed Chinese security watchdogs to abolish foreign ownership limits on securities, futures and fund management firms with limits set to roll back in different phases during 2020. This deregulation paves the way for foreign institutions like UBS, JPMorgan and Nomura to set up majority owned securities entities in China. This improves the business sentiment as foreign firms are not required to give majority ownership to their Chinese partners. We feel that this would lead to an inflow of institutional money with more huge foreign players entering the market. The increased buying of Chinese securities (which are denominated in Yuan) will lead to an increase in demand for Yuan in the forex. The strong performing equity market would definitely create more appeal for foreign investors to explore the market.

It is important for investors to understand the history of the internationalization of the Yuan as well as its current usage in financial markets to see that this new wave of internationalization come to fruition. The tension in Hong Kong has also increased the urgency for Shanghai to take over as an access point for investors into the Chinese market. We feel that with the trade war coming to a close, the Chinese economy would begin a steady recovery. The liberalization of the financial markets would be a strong case to push for an increase in demand for Yuan which would lead for it to appreciate. A strong Yuan is important for a Chinese economy who is looking to rebalance itself from being dependent on trade and export to growing its domestic consumption as well as foreign investments especially in areas like South East Asia. China's vast credit and equity market will provide new markets for price discovery for foreign investors.

FX Trade Idea: SHORT USDCNH

Entry Level: 7.0187
Take Profit: 6.8725
Stop Loss: 7.0731
Risk to Reward ratio: 2.69

The USDCNH pair has been highly scrutinized due to the U.S.-China trade war. 2020 will be the year China gets her growth story back on track should the trade deal proceed smoothly. We believe that there will be no more interest rate cuts in the next 6 months and that there will be an increase in demand for Yuan due to the strong equity market and the liberalization the financial industry. The Yuan would be driven by an improvement in the Chinese current account and an inflow in institutional money to both invest and set up funds and securities firms in the country.

After 3 cuts by the Fed in 2019, we have finally seen rates holding with strong language from Jerome Powell to maintain their rate at 1.5-1.75% into 2020. This has led to the U.S. spot dropping from its peak of 99.3770 on 30th September 2019 to 97.1720 due to the 3 cuts. However, with no cuts in the horizon, we see these levels as a norm for this short run. The U.S. economy has had weaknesses in its manufacturing sector which shrank for a fourth straight month in November with construction spending also shrinking unexpectedly as reported by the Business Times. The upcoming presidential elections has also created an air of uncertainty for the future of the country.

In 2019, the U.S. has performed better than China. However, we feel that with the Phase 1 deal, the trajectory of both economies has changed, with China having a better relative performance. The Phase 1 trade deal does create some immediate benefits for the U.S. such as an increase in agricultural exports but the main crux of their gains from the deal will be better IP protection and preventing currency manipulation. This will some time to come to fruition and will not create an immediate boost to the economy in our 6-month time horizon. This is in contrast to the rolling back of tariffs for the Chinese economy, whose effects would be immediately felt and would act as a catalyst to spur exports and investments in 2020.

The risk of the pair appreciating could happen if there is a breakdown in the Phase 1 deal. From the language of both parties during the press releases, it looks like they are ready to put their words into writing and settle the "less contentious issues". We will continue to see tariffs at 7.5% and 25% upheld by the U.S. as we go into 2020 in search of brokering peace. China has seen the extent of the damage that the U.S. can inflict when tariffs are imposed and will be a more willing party. Additionally, we see the improved regulations for the financial market and the PBOC cuts as mitigating factors which would get the Chinese economy running better with an increase in demand for Yuan for the 6-month time horizon.

Figure 91: USD/CNH Daily chart *(Source: HydraX)*

In terms of searching for an entry point for the trade, we have seen the pair break through the psychological 7 price level on the onset of the Phase 1 deal being announced. This has led to the price candle going past the Bollinger bands and trading below the 50 and 200-day SMA. We see the RSI move from the oversold position to 41 in the span of one day showing that there is some room for buying. We expect the pair rebound in the next few days as reverts to levels within the Bollinger bands. The entry point for our short position will be at the 38.2% Fibonacci level 7.0187. We will set a stop loss at the 61.8% Fibonacci level at 7.0731.

Figure 92: USD/CNH weekly chart *(Source: HydraX)*

For the weekly chart, we see that the pair is trading above both the 50 and 200-day SMA. We see resistance levels forming at 6.8725 level which was the previous support before the tariffs were implemented in August 2019. This will be our take profit level. Due to the higher Chinese interest rates as compared to the U.S., a carry trade will not be possible.

HONG KONG (Underweight)

Hong Kong's economy operates as a free market and relies heavily on the finance sector and international trade. Due to low taxes and its open economy, Hong Kong is referred to as the "number one financial center in Asia". Hong Kong has a GDP of USD 362.99 billion in 2019 and relies mainly on service-oriented businesses such as trade, financial services, tourism and professional services, which consist of more than 60% of its GDP. The largest percentage of exports is gold, as Hong Kong is known to be the primary gold hub in the region, comprising 19% of total export values. Integrated circuits are the largest imports of Hong Kong, consisting of 28% of total import values.

The Raging Hong Kong Protest

In February 2019, the Hong Kong government considered a bill that might open up the possibility of extraditing Hong Kong residents to China, which does not guarantee civil liberties to the same extent as Hong Kong's. The bill prompted one of the most significant demonstrations in Hong Kong's history, with the organizers claiming that more than 2 million people participated in the protest. Although current Chief Executive Carrie Lam has suspended the bill, the unrest did not stop as the Hongkongers believed that their civil liberties were compromised and that the bill has undermined the region's autonomy, thus demanding the bill to be scrapped completely. The unrest has continued for 6 months, with no signs of slowing down and had a various negative impact on the Hong Kong economy, which would be covered below.

The riots are taking a sharp toll on the Hong Kong economy, which has already been affected by the U.S.-China Trade War. Tourism, being one of Hong Kong's key businesses, has suffered tremendously with a 40% decrease in tourists since the start of the protests mainly due to fall in the number of tourists from Mainland China. This has also resulted in a decrease in consumer spending. According to a release by the Hong Kong government, retail sales by value contracted by 24.3% in the month from a year earlier, the fourth month of double-digit declines while in terms of volume while sales contracted by 26.2%. This has also affected Hong Kong's status as a luxury hub as due to the political turmoil in Hong Kong, brands are likely to reconsider their presence in Hong Kong. Prada is leading the exodus and plans to close its largest Hong Kong store in Causeway Bay in 2020. With the ongoing protests looking to continue, we predict that other brands may soon follow suit and relocate their operations elsewhere, thus further decreasing the retail sales numbers in the coming year.

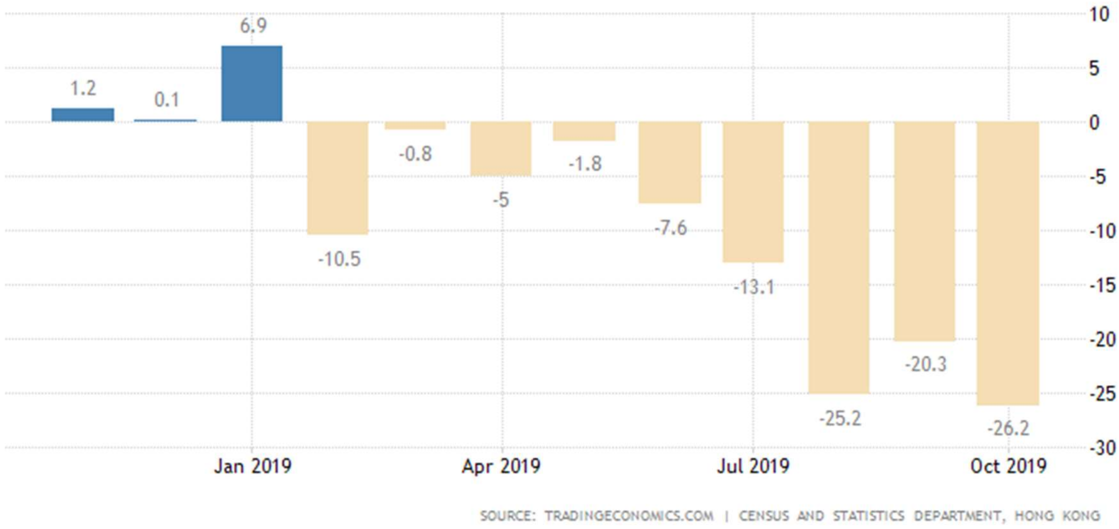


Figure 93: Decline in retail sales in Hong Kong *(Source: Trading Economics)*

With retail sales and tourism being two of the more prominent contributors to the Hong Kong GDP, as a result of the protests, these two pillars has been affected negatively, resulting in a technical recession in Hong Kong. The protest in Hong Kong will likely persist into the year 2020, allowing a little leeway for the economy to recover.

Figure 94: Falling Number of Tourists to Hong Kong *(Source: Bloomberg)*

Ultimately, these factors will continue to lead to a further loss of investors' confidence and a decrease in investments, which Hong Kong relied on upon deeply due to its market nature. This may also lead to a flow of funds from Hong Kong as investors view other places such as Singapore to be a safer holding ground for their funds amidst the issues faced by Hong Kong currently. Reports from Goldman Sachs have indicated that more than USD 4 billion worth of funds have left Hong Kong and have been parked in Singapore. According to the top banks in Hong Kong, although the funds have largely been staying put, there is a trend of many clients opening offshore accounts in other countries such as Singapore and Taiwan. We feel that the clients and investors have been rattled by the ongoing tensions in Hong Kong, thus activating contingency plans to prepare for the worst-case scenario. With the situation not looking to be resolved anytime soon, we feel that this would eventually lead to an outflow of capital from Hong Kong to safer havens such as Singapore, whereby the political scene is stable. This will also result in uncertainty over the outlook for Hong Kong as a wealth management hub, as wealth managers mostly go where their clients prefer to park their riches. This would ultimately affect the financial services industry, which accounts for about 20% of the country's gross domestic product.

The world's most expensive housing market has also taken a hit as Bank of America predicts a 10% drop in housing prices. According to Bloomberg, there has been a 17% decrease in the main index of property stocks since early July 2019. These factors have resulted in the highly competitive market suffering as a result, with property developers suffering the most as the number of transactions significantly decreased as well as protests threatening retail rental and residential property sales. They have also caused a 20% dip in the share price of Sun Hung Kai since mid-July, Hong Kong's largest property developer. However, we feel that the property sector in Hong Kong will be resilient, and the decline in the property prices in most likely short-term. The property market is looking to recover due to the lack of supply as compared to the high demand, thus pushing the prices of the property back up.

Overall, we predict that the negative outlook for tourism, retail sales as well as the financial sector will look to continue into 2020, while the property market will bounce back. However, the negative growth stemming from the decline of tourism and retail sales will not offset the recovering property sector. With the two main pillars of the Hong Kong economy suffering due to the protests, this spells for a negative outlook of the Hong Kong economy for the next year.

Technical Recession hits Hong Kong

According to Financial Secretary Ben Chan, the five months of citizen protests have battered Hong Kong's economy, sending the city into recession and it is unlikely for the city to achieve any positive growth this year. The riots have affected Hong Kong's economy significantly, with tourism suffering a massive hit and the decline in retail sales due to protestors vandalizing the stores. With the damage already done with due to the trade war, coupled with the ongoing protests, the economy shrank by 3.2% in the three months to September, after shrinking 0.4% the previous quarter, marking a technical recession in Hong Kong.

Figure 95: Hong Kong's Growth *(Source: Bloomberg)*

Hong Kong has intervened by injecting more than USD 2.5 billion into the economy in order to revitalize the economy and also topping up with an extra USD 511 million on 4th December 2019. These efforts mainly target small and medium-sized businesses, in order to safeguard jobs in those sectors. However, we feel that monetary stimuli can only reduce the short-term impacts from the protests, and to help alleviate the technical recession. In the long run, the economy will continue to suffer from business activities dragging down by the effects of the protests and also slowing global demand. With the economy already experiencing a technical recession in Hong Kong, the outlook of Hong Kong's economy remains bleak despite the monetary stimulus. The technical recession has formalized the extent of the damage caused by the protest and will be a cause of concern for investor sentiment.

Hong Kong's Inevitable fall to China

Just as how Eurasian writer Han Suyin famously described Hong Kong as existing on "borrowed time in a borrowed place", it is inevitable that one day China will "reclaim" back the city of Hong Kong. In 1997, Hong Kong was handed over to China, in the adoption of the "One country, Two systems" arrangement, whereby Hong Kong would continue to enjoy its financial freedom, political and socio dynamics under the highest command of China until 2047. The contract signed between the British and the Chinese Hong Kong has always been an integral part of China as it provides a gateway for trades and investments into China. However, in recent times, the value of Hong Kong has been diminishing. Also, given the "One country, Two systems" rule, if the "Two systems" part has become a tool to damage the "One country" part which is China, it would provide lesser autonomy for Hong Kong.

As seen in the recent riots and protests, the erratic behavior of the Hongkongers has been a threat to Hong Kong's status as Asia's financial hub, as well as China's influence over Hong Kong. This calls for a huge reform in 2047 as the Chinese government may not wish for the same things to happen. This may result in

Hong Kong losing some of its autonomy and face harsher policies as China looks to tighten its grip on Hong Kong. This may ultimately result in a further loss in investors' confidence in the future.

In addition, the public opinion of one of the biggest roles for Hong Kong is that it is a center for the initial public offerings (IPOs) of Chinese firms, drawing a significant amount of global capital into China. Hong Kong was the home of 73% of mainland companies' IPOs overseas between 2010 and 2018. According to the Hong Kong Monetary Authority, Hong Kong accounted for 60% of overseas bond issuance of mainland companies and 26% of their syndicated loans. However, although the Hong Kong market has been an important source of capital for mainland companies, offshore listings have grown significantly. By February 2019, there were 156 Chinese companies listed on U.S. exchanges, with a total market capitalization of USD 1.2 trillion, including at least 11 Chinese state-owned companies. In the long run, this will diminish the importance of Hong Kong's role to the listing of Chinese companies as they can do so in the U.S. exchange as well. Similarly, with the rise of the offshore bond market, it could eventually replace Hong Kong as the source of capital. Currently, there are USD 308 billion worth of offshore bonds issued by Chinese companies, which is almost twice as much as the USD 177 billion worth of bonds trading in Hong Kong.

Moreover, Hong Kong was used as a controlled testing ground for the Chinese currency, the renminbi, for it to find its feet as an international currency. Due to the nature of Hong Kong's market, the renminbi can trade more freely in Hong Kong as compared to China because of China's strict control over capital movement across its borders. However, due to the astounding growth that China has experienced, investors all over the world are willing to look past some of the deficiencies in the system of China and are more willing to invest directly in China's economy. In the past, China A-shares were traded in the Hong Kong Exchange., However, they can be currently traded in the Shanghai and Shenzhen exchanges. According to Deloitte, more than 40 specific policies and measures have been formulated to promote the open and fair competition environment and to enhance the attraction of foreign investments. An example of such measures includes the removal of shareholding limits on foreign ownership of securities, insurance, and fund management firms in 2020, as well as scrapping entry barriers for foreign insurance companies. Previous requirements like having 30 years of business operations and a 25% equity cap on foreign ownership of insurance asset management firms will thus be scrapped.

With slowing growth and the trade war dampening the economic growth in China, Beijing is quickening its measures to encourage more foreign investments. Given the actions that China has taken in opening up its economy, the importance of Hong Kong gradually diminishes as it no longer serves as the only gateway for funds to flow directly into the Chinese economy. As we can see from these initiatives, China has been constantly improving its investment environment in order to attract more foreign direct investments into its economy. Thus, this threatens the position of Hong Kong as the financial hub in Asia as a large percentage of the capital flowing into Hong Kong may now be invested directly into China, leading to a decrease in foreign direct investments to Hong Kong.

Furthermore, China has identified two main cities, Shanghai and particularly, Shenzhen as their model cities for the rest of China to follow suit. The Chinese government recently issued a policy paper outlining a plan to make the city of Shenzhen, just a 30-minute train ride from Hong Kong, into a leading global metropolis that would be attractive to international business and a model of stable prosperity. This policy plan of making Shenzhen into the "future's city" was issued when the protests were happening in Hong Kong, and this could be seen as a message sent to the Hongkongers to stop their protests. Also, Shanghai is establishing itself as a strong competitor, helped by the government's loosening of policies in an attempt to encourage companies to rely less on borrowing and more on equity markets for financing. In 2019, it may raise more money via IPOs than Hong Kong for the second time in a decade.

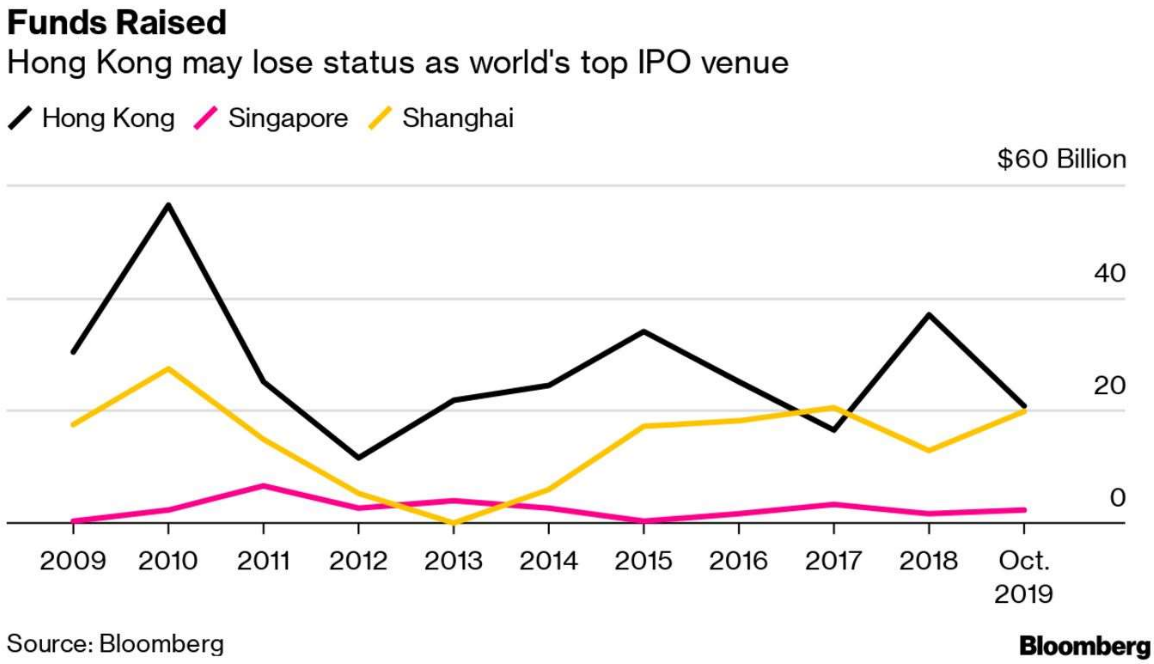


Figure 96: Chart showing IPO funds raised *(Source: Bloomberg)*

Although Hong Kong still plays an important role in China's economy, China has been known for prioritizing their political agenda as compared to their economic gains. This can be inferred from President Xi's statement - Any attempt to split China in any part of the country will end in crushed bodies and shattered bones, referring to Hong Kong and his view on it. With alternatives such as Shanghai and Shenzhen that could eventually replace Hong Kong in the long run, there is fear that China may give up on Hong Kong if things continue the way it is. This would definitely compromise Hong Kong's status as a financial hub in Asia, and the uncertainties arising in it may lead to investors preferring other alternatives such as Shenzhen or Shanghai in the long run.

FX TRADE IDEA: LONG USDHKD

Hong Kong's economy will continue to suffer from negative quarterly growth going into 2020. As reported by ING, more companies will close down, leading to a decline in employment rate, putting further pressure on the retail sales sector which is already facing many obstacles such as the decline in tourism and consumer spending. With investors' confidence dropping after the protests, it is safe to say that the demand for the HKD will certainly be falling dropping as well. However, the HKD has no immediate danger of falling out of the range that it has been allowed to trade with regards to its peg with the Dollar. This is due to its strong currency reserves. As seen from the chart, Hong Kong has always maintained more than twice the required amount of foreign reserves needed to cover the monetary base (MB). As such, in the case of emergencies, Hong Kong is able to keep the USDHKD currency pair within the peg.

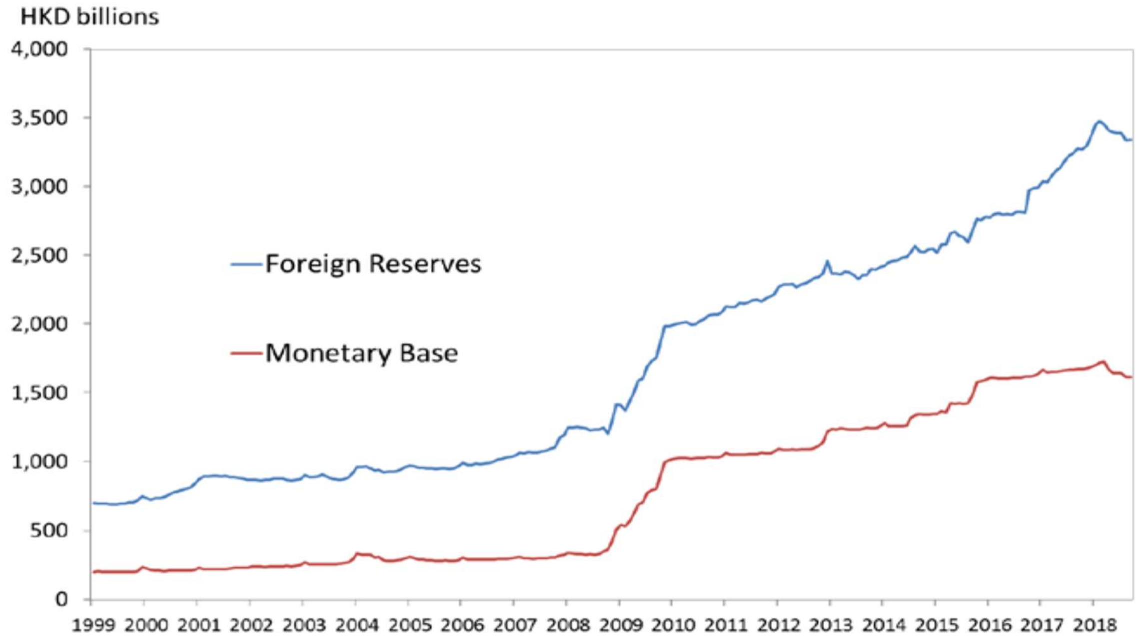


Figure 97: HK's Foreign Reserves against the Monetary Base *(Source: HKMA)*

Hong Kong's dollar climbed into the strong half of its trading band against the greenback for the first time since July, as seen in the chart. The liquidity in Hong Kong is also alarmingly tight. The three-month HIBOR-LIBOR spread is used as an indicator for liquidity tightness in Hong Kong. This will prevent any carry trades from happening as the one-month interbank funding costs for the currency, known as HIBOR, have been higher than the greenback's funding costs, known as LIBOR, for 24 straight sessions. Coupled with the year-end regulatory checks on banks that typically sees higher demand for cash, we can foresee that the Hong Kong dollar will remain resilient towards the end of the year.

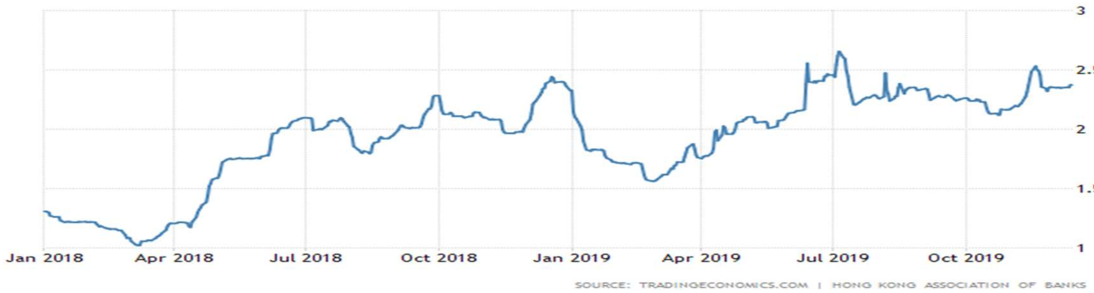


Figure 98: HIBOR in Hong Kong *(Source: Trading Economic)*

However, we predict that the Hong Kong dollar will likely return to the weak half of the band as year-end effects fade. Hong Kong does not have major drivers for strong inflows, and the economy will continue to face significant pressures in the first half due to the effects from the continual protests.

There are no more expected rate cuts from the Feds for the year, which will prevent both the Dollar and the Hong Kong dollar from depreciating. However, as compared to the Hong Kong economy, the U.S. economy has been healthy, and in the long run, provides a brighter outlook. With global central banks continuing to hold more than 60% of their allocated reserves in dollars, it is clear that the dollar will not go down as it is the safe haven, and people will still hold the USD in times of uncertainty.

Figure 99: USDHKD Chart *(Source: TradingView)*

Entry Level: 7.8074
Take Profit: 7.8255
Stop Loss: 7.7997
Risk Reward ratio: 2.35

As of 2005, the Hong Kong dollar has been allowed to trade between the band of 7.75 and 7.85 to the USD. The Hong Kong Monetary Authority controls the HKD by buying USD if the local currency is too strong or selling them if it is too weak. As such, as illustrated in figure 99, there is currently no danger of the HKD unpegging itself from the Dollar as there are sufficient foreign reserves in USD to prevent that from happening.

The currency pair USDHKD has been trading between 7.85 and 7.80 for the past year before breaking past the 7.8 mark due to the tightening liquidity. We have identified a resistance line around the 7.84935 region and a support line around the 7.8 region. Currently, as seen from MACD indicator, the 26 weeks signal line is below the 12 weeks signal line, an indicator for a bearish run. The RSI indicator also indicates that the market is currently overselling this currency pair. In the short run, we predict the Hong Kong dollar continuing to strengthen. However, after the year-end effects fade away, we predict that the Hong Kong dollar will depreciate against the Dollar. We will thus wait for the recovery of the Dollar against the Hong Kong Dollar before longing this currency pair.

TAIWAN (Overweight)

As part of the 4 Asian Tigers, Taiwan experienced rapid industrialization and built a strong export-driven economy which saw an excess of 7% GDP growth year on year from the 1960s to 1990s. Heavy government involvement pushed sectors like chip and semiconductor manufacturing to become one of the best in the world. Taiwan has always had strong macro-fundamentals and might have flown under the radar in recent times.

Strong Government Balance for Expansionary Policy

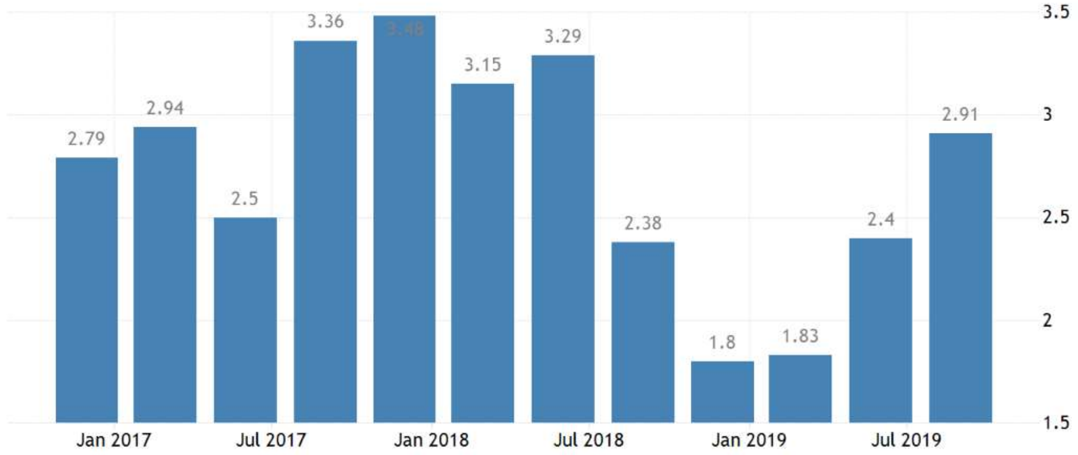


Figure 100: Taiwan Annual GDP Growth Rate *(Source: Trading Economics)*

It was reported on the 31st October 2019 that Taiwan's GDP grew 2.91%, beating the market's expectation of 2.5%. Overall, the Taiwanese government has raised its full-year GDP growth estimate to 2.53% (originally 2.46%) with the statistics bureau estimating an economic expansion of 2.9% in 4Q2019.

ING reported that this growth was mainly driven by a 3.68% increase in government spending. The government estimated that about USD 26 billion of fiscal spending (in the form of subsidies) would happen in 2019, which is around 4% of Taiwan's nominal GDP. These subsidies prompted some Taiwanese manufacturers to return from the mainland but economic data showed that these investments might have only been registered and not built because capital formation contracted by 1.01% in the same quarter. We suggest keeping an eye on this situation to ensure that concrete action is being taken regarding the return of the Taiwanese companies.

Back in July 2017, the Legislative Yuan passed the Special Budget Statute for Forward-Looking infrastructure that would allow the cabinet to spend up to NTD 420 billion over the next 4 years. Lawmakers also approved an additional NTD 222.95 billion in a special budget phase for the period of 2019-2020. This shows that the bulk of economic growth would be supported by the government, and this statute would definitely cushion the impact of the trade war on Taiwan.

Taiwan has a strong kit of policy tools to weather an economic downturn should one come. Disciplined government spending (with deficits running less than 5% of GDP for the last 10 years) as well as decreasing government debt (dropping from a high of 34% to 30.9%) will allow more room for fiscal spending. This is coupled with an interest rate of 1.375% (which has been unchanged since mid-2016) that provides clear room for Taiwanese policymakers to make cuts should things slow down. We feel that the Taiwan economy is well poised to enter 2020. With global uncertainties like the U.S.-China trade war wrapping up, the Taiwanese government would have the bandwidth to expand their economy if needed.

Increase in Investments for Taiwan

According to the statistics bureau, drivers of the strong growth in Taiwan included domestic production as well as external demand and investments. The investments are mainly driven by the return of overseas-based Taiwanese companies that are seeking to avoid the effects of the trade war between U.S. and China. According to Bloomberg, Taiwanese companies have pledged to invest almost NTD 1.2 trillion ($39 billion) at home since the government initiated a program at the beginning of the year to attract investment from local companies with facilities in China. The efforts of the Taiwanese government is paying off, and major Taiwanese companies such as Hon Hai Precision Industry have been shifting their production to Taiwan in order to shield themselves from the effects of the trade war and to protect their profit margins that had been reduced due to the tariffs implemented. On top of that, the investment in offshore wind will likely reach its peak next year and the application of 5G and other emerging technologies will drive overseas demand and exports. Taiwan, being the leading producer in the region for technology based products, will definitely look to benefit from this. Another factor to take into account is that these investments have not yet been priced in. As such, this would strongly boost the economy in Taiwan as GDP will look to remain strong when more companies come back to Taiwan.

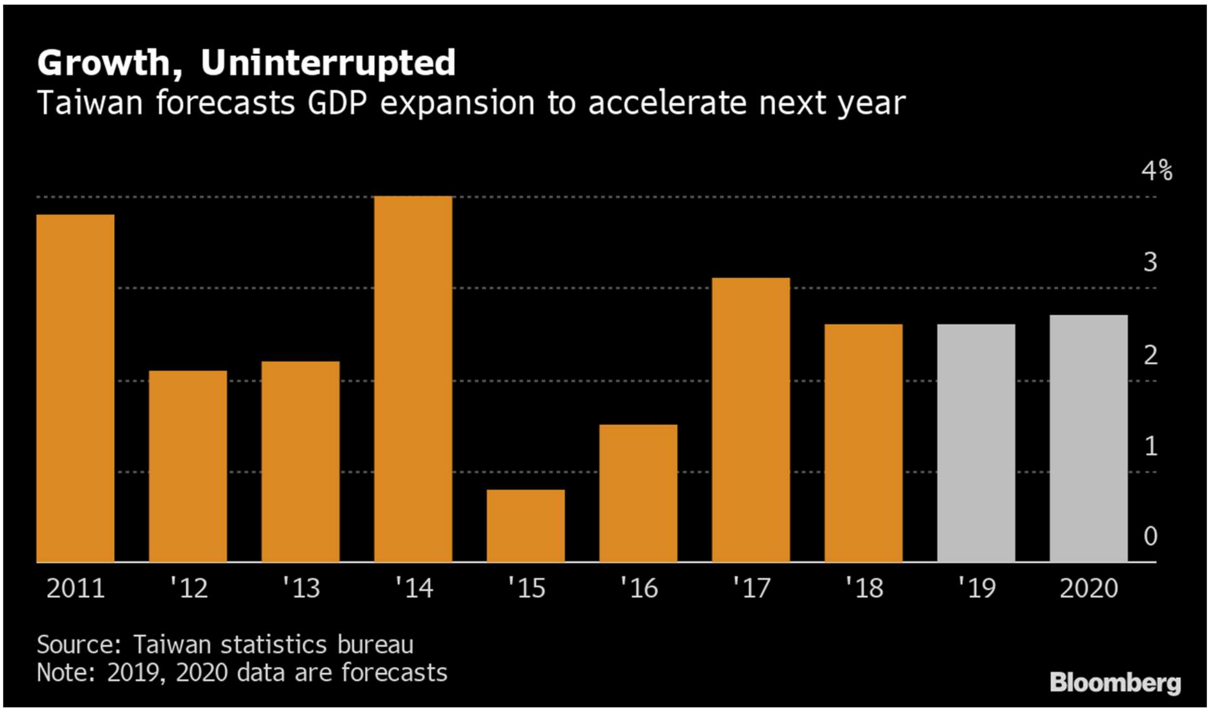


Figure 101: Taiwan's Forecasted Growth in the Coming Years *(Source: Bloomberg)*

Taiwan's Trade Stance with China

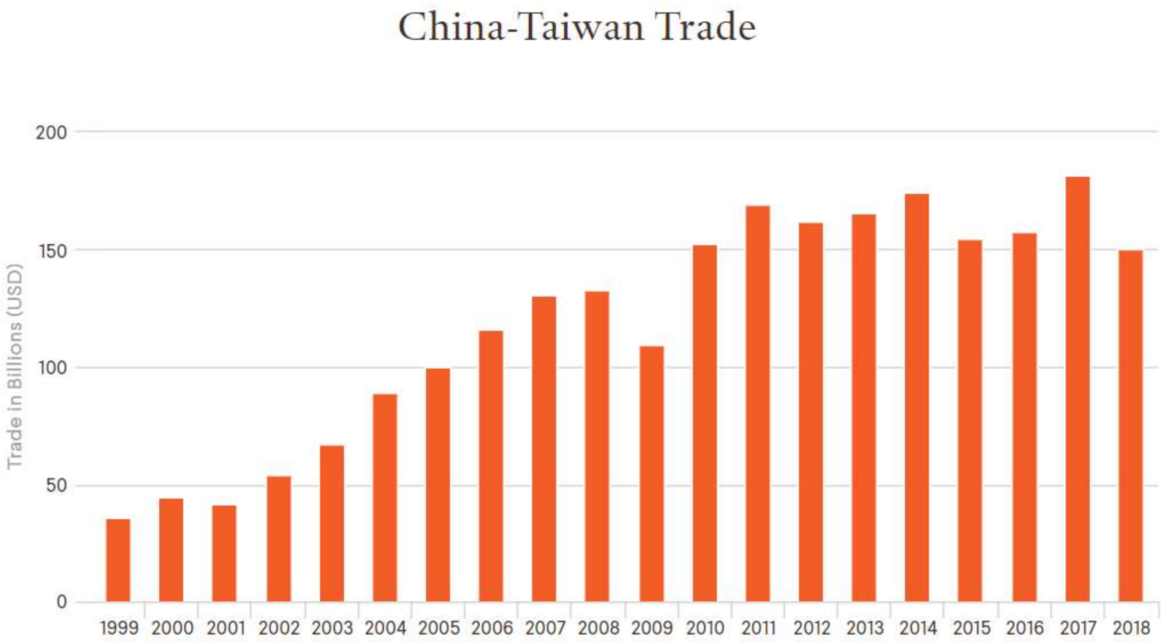


Figure 102: China-Taiwan Trade *(Source: China Ministry of Economic Affairs)*

Taiwan began investing in China after the country began reforming under the leadership of Deng Xiaoping in the 1970s. As seen from Figure 102, there has been a steady increase in trade as China industrialized. Taiwan's economic growth is based on exporting intermediate goods to mainland China for final assembly. Unfortunately, there has been a slowdown in recent times with Taiwanese investments in the mainland declining for its 4Q2018 and a slowdown in mainland investments into Taiwan. Due to the recent trade war between U.S. and China, we have also seen a shift in orders as well as production to Taiwan from China to avoid the higher tariffs.

Although China has been Taiwan's largest trading partner, it is important to note that its importance has dropped to 37% in the first half of 2019 from its peak of 84% according to the East Asian Institute. It is essential that Taiwan begins to decouple from China as her economy begins to slow down. In a bid to avoid completely depending on the Chinese economy, Taiwan has signed a trade agreement with New Zealand in 2013 as well as looked towards South East Asia as a potential future partner. Bloomberg also reported that the Taiwanese government pledged to invest USD 9 billion to pursue Taiwanese firms to return home to manufacture their goods as mentioned above.

Due to the trade war between U.S. and China, many Asia's export reliant countries have taken a toll on their growth, however, for Taiwan's case, Taiwan is actually benefiting from the trade war. According to the recent United Nations Conference on Trade and Development report, the island's shipments to U.S. rose almost USD 4.2 billion in the first half of 2019, gaining from China's loss of exports to America.

Figure 103: Relationship between Taiwan's Growth and the Trade War *(Source: Bloomberg)*

The high correlation of the Taiwanese economy's performance in conjunction with the Chinese one is slowly breaking down which is something important for investors to take note of. Coupled with the fact that Taiwan is actually benefiting from the trade war between U.S. and China, we predict that the strong growth of the Taiwan economy to continue into 2020. However, being the export reliant country that Taiwan is, we still have to be wary of the trade war between U.S. and China going haywire, which will still damage Taiwan on a significant scale. Given that the current stance of the trade war is cautiously optimistic, the outlook of the Taiwan is good, with strong growth looking to continue into 2020.

<u>Taiwan's Dwindling Allies</u>

Figure 104: Taiwan's Allies *(Source: Bloomberg)*

Taiwan has lost 7 allies (with the latest being Kiribati in September) since the election of the opposition president and currently only has 15 official allies. As seen from figure 104, the list of nations does not contain any noteworthy superpower states. China has been the driving force in reducing Taiwan's ally, reportedly spending USD 500 million USD to help lure the Solomon Islands to make a switch early this year. Bloomberg reported that since 2011, China has spent a total of USD 1.6 billion in the Pacific Islands region which outstrips Taiwan by more than 4 times. This also reported led to two 2 other relationships becoming shaky. The risk is that in the near future, should Taiwan cease having any official allies on the world stage, the ability to join trade agreements and have an influence on the world stage will diminish significantly and have an effect on their economy.

Frank Chen from Asia Times proposed an alternative solution in which Taiwan could be granted "observer status" which is similar to what happens to Palestine. Additionally, he feels that should Taiwan lose all its allies, it has sufficient "unofficial" allies that would help back Taiwan's agenda on the international stage as well as back their participation in international bodies that do not require sovereign status, and that Taiwan wouldn't be completely isolated, even if it loses every formal ally. Foreign officials from places like the U.S., Japan and Europe occasionally visit Taipei, a form of de facto recognition, and Taiwan also maintains memberships in some international agencies including the World Trade Organization and the Asia Pacific Economic Cooperation forum.

This issue provides a risk for the medium term and we feel that it is important that potential investors in Taiwan need to be aware of this. With the trend of countries abandoning Taiwan for China looking to continue, there is a risk of the changes in trade policies between Taiwan and those countries that we need to be aware of.

FX TRADE IDEA: SHORT USDNTD

Taiwan has been an unexpected beneficiary of the U.S.-China trade war. The Taiwanese dollar has been generally appreciating against the Dollar since August. The currency strength came as foreign investors turned net buyers of Taiwanese stocks, with USD 2.5 billion worth of inflows in September, the most among all Asian markets tracked by Bloomberg, excluding China. With other factors such as the returning Taiwanese firms and the generous amount of fiscal stimulus that is expected to pump into the Taiwanese economy, the strong growth for the Taiwanese economy will look to continue into 2020, which will thus strengthen the local currency.

Figure 105: USDTWD chart *(Source: TradingView)*

Entry Level: 30.425
Take Profit: 30.228

Stop Loss: 30.515
Risk to Reward ratio: 2.19

We see a recent intersection between the 26 weeks signal line and the 12 weeks signal line, with the 12 weeks signal line looking to overtake. This is an indicator for a bearish run by using the MACD indicator. Furthermore, the RSI shows that for the past month, the market has been selling more of this currency pair, which will further put pressure on the bearish signs of this currency pair. As such, we predict that this would lead to the currency pair testing the resistance line at around 30.320, and that is where we take profit.

With the Dollar being relatively resilient in the chaos amidst the trade war, we expect this currency pair to trade sideways for, however, based on the technical analysis and the outlook of the Taiwanese economy, we predict a bearish trend incoming, and we can make use of this and take profit.

JAPAN (Underweight)

Japan's economy is the third largest in the world and the latest numbers revealed that it is growing at an annualised rate of 0.2% in 3Q2019. This brings the annualised growth for 2019 to 0.1%, falling short of the median forecast of a 0.2% gain. This was due to the slowing global demand due to the U.S.-China trade war as well as Japan's own trade war with one of their largest trade partners, South Korea.

In the wake of the asset price bubble collapse in 1991, Japan suffered from the 'lost decades' until Shinzo Abe became the Prime Minister in 2012 and implemented 'Abenomics' to try to lift the country out of deflation and stagflation. Since then, the 3 'Arrows' of Abenomics – aggressive monetary easing, fiscal policies/stimulus and structural reforms have all been implemented. The 2020 Tokyo Olympics has been touted as the 4th Arrow – expected to uplift Japan further and into a new future.

The Japanese economy is likely to face continuous global headwinds into 2020 as the outlook surrounding the U.S.-China trade war is only moderately positive. The 2020 Olympics will bring further positive inflows in terms of tourist arrivals and spending and infrastructure building, but all these have already taken place in the past 2-3 years since the news of the host country was announced. There will be further positives from such flows, but they will likely peter off towards and post the event, as evidenced in host countries of the past. In fact, the positive flows may even decline post-event if the Japanese government is not able to keep the flows afloat. With the stimulus package of JPY 26 trillion (about USD 239 billion) spread over the coming years and fiscal measures around half that figure, all aimed to boost the economy and mitigate the negative impact of the sales hike tax in October 2019, the Japanese economy would stay above water but would only produce a low, above zero GDP growth for 2020. Thus, we are not bullish Japan and continue to stay underweight.

Japan's Trade Balance – 'Hovering Around Breakeven'

Up till 2017, Japan held a trade balance surplus as it imported less than it exported. However, with the economic slowdown of China and the onset of the U.S.-China trade war in July 2018, the dynamics for Japan changed.

In September 2019, Japan unexpectedly posted a trade deficit of JPY 124.82 billion (USD 1.15 billion) shifting from a JPY 124.1 billion surplus (USD 1.149 billion) in the same month a year earlier, missing market expectations of a JPY 54 billion (USD 0.5 billion) surplus. This was the third straight month of shortfall, as exports slumped 5.2% from a year earlier to JPY 6.37 trillion in September 2019, compared to a forecast of a 4.0% decline and August 2019's 8.20% decrease. It is the 10th consecutive month of decline amidst weakening global demand and the U.S.-China trade dispute, with the year-to-date trade balance at JPY 182.6 billion. Imports also dropped 1.5% to JPY 6.49 trillion, the fifth consecutive month of decline, compared to expectations of a 2.8% fall and after a downward revision of 11.90% in the previous month.

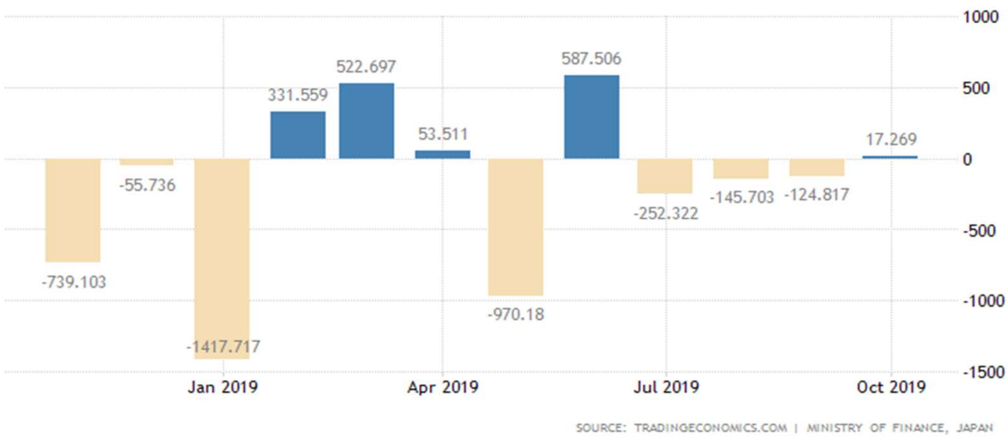


Figure 106: Japan's Trade Balance in 2019 *(Source: Trading Economics)*

However, in October 2019, Japan clocked a trade surplus for the first time in 4 months, after a plunge in imports amid falling prices of crude oil and other commodities that more than offset a fall in exports. The country's trade surplus stood at JPY 17.27 billion, marking a turnaround from a revised deficit of JPY 124.82 billion in September 2019. The decline in imports was partly attributable to heavy rains and a powerful typhoon that hit Japan in the reporting month, which disrupted supply chains and suspended factory operations. Hence resulting in a surplus.

The data showed that Japanese exports fell 9.20% y-o-y, exceeding economists' expectations of a 7.60% decline. This was driven by the fall in shipments of car and aircraft parts to the U.S. as well as the fall in semiconductor production equipment, car parts and electronic parts to China. Exports to the U.S., China and Asia fell by 11.4%, 10.3%, and 11.2% respectively in October 2019.

Although U.S. announced on 13th December 2019 that they had reached a preliminary deal with China, suspending fresh tariffs on USD 160 billion of Chinese goods that were due to kick in on 15th December 2019 and will likely move to negotiate 'phase two' of the deal soon. However, this does not spell the end of the trade war yet, although it will bring some relief to all. We are not out of the woods yet, supply chain adjustments that have taken place will not stop in their tracks. Prevailing headwinds from the trade war, coupled with Japan's domestic challenges will continue to cloud the outlook of Japan's export-reliant economy. Thus, the trade surplus is deemed to be only temporary. In addition, Japan is involved in its own trade dispute with the South on its economic front. Since the start of the dispute, Japan has restricted the export of 3 important chemicals to the South and have removed them from their "Whitelist". In retaliation, South Korea has also removed Japan from its "Whitelist" and enrolled them in their own lower-tier category with unfavourable trade terms. Japan is only experiencing a relatively lighter impact from the Japan-Korea trade dispute than Korea for now. However, in the long run, when there is sufficient time for Korean companies impacted to rethink and fundamentally re-adjust their supply chains and diversify their resources, Japan will start to feel the real impact. In the meantime, as expected, the Tankan result showed business conditions across large and small, manufacturing and non-manufacturing sectors continued to decline, unemployment slight improvement in line with a tight labour market and output prices having mixed results.

GDP Growth – Not Saved by Olympics & Stimulus Package

Japan's GDP has been on a decline since 1997, where it hit JPY 523.5 trillion, as shown in the chart below. This was due to low real growth and ongoing deflation.

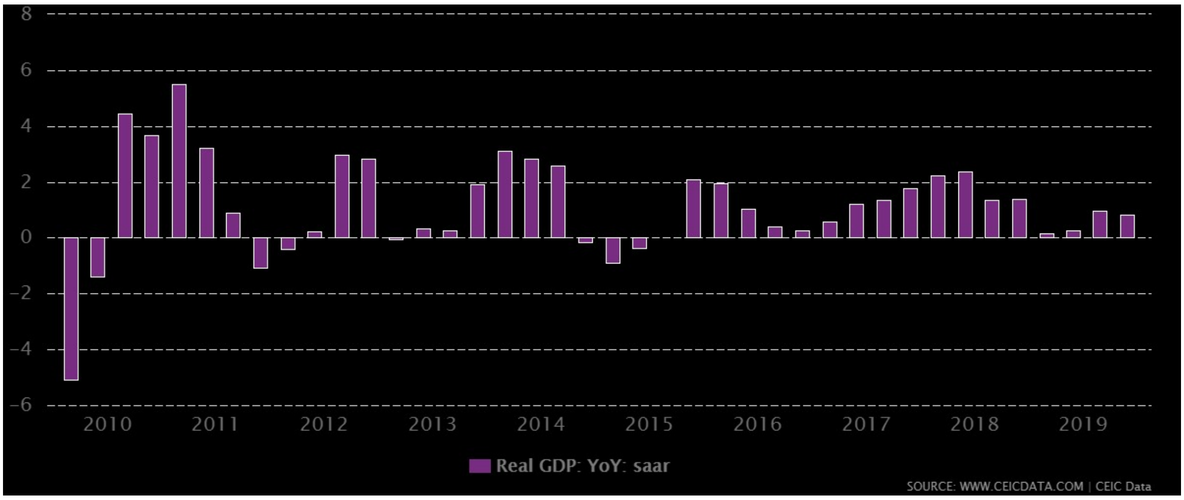


Figure 107: Japan's Real GDP *(Source: CEIC Data)*

Japan's latest inflation-adjusted GDP for July 2019 to September 2019, grew at an annualised rate of 0.2% in 3Q2019, slowing sharply from the revised 1.8% expansion in April 2019 to June 2019. It fell short of the median market forecast of a 0.8% gain. This brought annualised growth for 2019 to 0.1%, smaller than the median forecast of a 0.2% gain. This means that there is a high chance of the economy slipping into contraction in 4Q2019.

Private consumption accounts for up to 60% of the Japanese GDP and is an important driver in their economy. For the reporting period of July 2019 to September 2019, it rose 0.4% versus 0.6% expansion in April 2019 – June 2019 period. This indicates that spending from consumers ahead of the consumption tax hike was not as strong and there was no front load. This was also exacerbated by bad weather that happened around September 2019. With weakness in private consumption, the hike in consumption tax in October 2019 will likely translate into even slower growth numbers, as private-sector analysts expect the hike to shave off 0.4% off overall 2019 GDP. This is significant, given the already weak state of the spending.

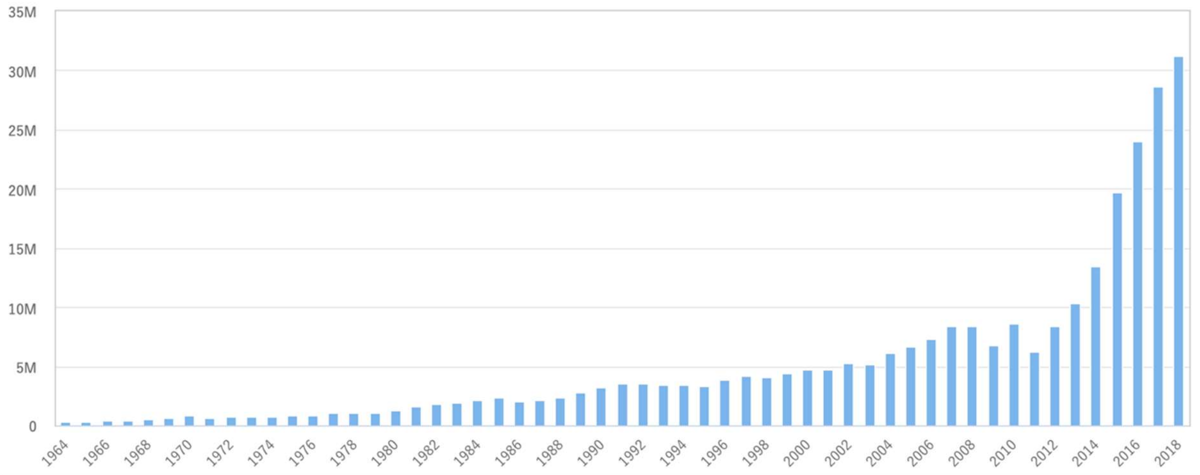


Figure 108: Japan Tourist Arrivals *(Source: Japan National Tourism Organisation)*

The 2020 Tokyo Olympic Games offer an opportunity to revitalise Japan. The Game cast the country in a more positive light and attracted greater foreign investor interest and tourism after the announcement of Tokyo as the next venue. As seen from the figure, tourist arrivals have increased from 10,363,904 in 2013, when they were first announced as the host country, to 31,191,856 in 2018. These were expected to continue even post the Olympics but will tail off as most of these would have taken place pre-event. This is similar to infrastructure spending to support the event. With an increase in pre-Olympics tourist arrivals, as shown in the diagram below, spending on consumer goods definitely increased and would have added to Japan's GDP and economic state the past 2-3 years.

In addition, the Japanese government has just unveiled its JPY 26 trillion stimulus package on 5th December 2019, which we feel, is very timely. From the past experience of previous hosting countries, tourism flows and dollars and infrastructure spending will have started to plateau off before the start of the event. Stimulus packages take time to take effect as well. To roll out the packages around this time to overlap the last segment of Olympic momentum is just right to pick up any slack expected post-event. The stimulus package is expected to boost consumer spending through rebates to consumers for cashless payments and general public works, amongst other measures. The package also allocated JPY 11.7 trillion for public works related to the Olympics and Paralympics next year.

However, we believe that the Olympics and the Stimulus Package. which is expected to add 1.2% to overall GDP next year, will only mitigate but will not be enough to negate all of the negative impacts of the consumption tax, which is expected to slash Japan's GDP by 0.4%, more bad weather with climate change, declining trade cycle, Japan-Korea trade dispute and overall macro challenges presented by the U.S.- China trade war but they will certainly help to avoid a contraction into the negative territory. However, this does not give us enough cheer to be optimistic about Japan.

Japan Likely to Continue Holding Low Interest Rates

Figure 109: Japan's Interest Rates *(Source: Trading Economics)*

The Bank of Japan first used Quantitative easing to combat deflation in the late 1990s to 2000s. It was used as a monetary tool after the collapse of the asset prices in the 1990s after a couple of decades of economic exuberance. Since then, the BOJ has maintained short-term interest rates at close to zero, but the economy continued to decline until Abenomics was implemented.

The Bank of Japan introduced "Qualitative and Quantitative Easing" (QQE) in April 2013 and made several revisions to it throughout the years. The new policy framework consisted of 2 components: The "Yield Curve Control" (YCC) in which the Bank controls short-term and long-term interest rates through market operations and an 'inflation-overshooting commitment' in which the Bank commits itself to expanding the monetary base until the year-on-year rate of increase in the observed CPI exceeds 2% and stays above the target in a stable manner.

QQE was assessed to have improved economic activity and prices through the decline in real interest rates and have lifted Japan's economy out of deflation. With yield curve control (YCC), BOJ has lowered real interest rates controlling short-term and long-term interest rates. The negative interest rate policy, introduced in January 2016, charged banks for keeping their extra balances instead of lending out. This combined with the purchases of Japanese government bonds (JGBs), supplied the system with fresh JPY, thereby lowering interest rates in the process and was effective for yield curve control. BOJ also introduced new tools of market operations, such as fixed-rate purchase operations, to facilitate smooth implementation of yield curve control.

All these aimed at encouraging banks to lend more to stimulate both corporate and consumer activities and growth. At the same time, low-interest rates were also essential for Japan to manage its debt servicing in view of its well-known huge JPY denominated debt that is about 250% of GDP.

As part of the policy to complement YCC, BOJ introduced yet another measures - an 'inflation-overshooting commitment' – under which it continued expanding the monetary base until the year-on-year rate of increase in the observed CPI (all items less fresh food) exceeded 2% and stayed above the target sustainably. This helped in maintaining the public's confidence in price levels and gave more assurance to corporate and consumer spending and investment activities.

However, all these monetary tools can only work if the economy is on an upswing and is less effective when an economy is less robust. The BOJ is also in a bind. Years of heavy money printing have dried up bond market liquidity and hurt commercial banks' profits, raising concerns that its massive easing program is not sustainable. Subdued inflation has left the BOJ well behind its counterparts in dialling back stimulus. Some economists also argued that the BOJ has little ammunition left to fight another serious economic downturn. In short, there are not many tricks left in the hat for BOJ.

Japanese corporates' foreign direct investment (FDI) outflows reached record highs this year, even as global growth slowed. According to J.P. Morgan, Japanese corporates are sitting on more than JPY 200 trillion in cash and deposits and given the low prevailing interest rates and lack of domestic investment opportunities, the corporates have to seek alternative investments overseas and this will continue. This will put more pressure for JPY to be 'less strong' going forward as corporates flow – selling JPY and buying foreign currencies for foreign investments overseas to earn better returns will cap any JPY strengths or keep JPY under pressure. As these flows continue throughout the investment year or cycle, JPY will continue to weaken. Therefore, it will help JPY exports to be more attractive to overseas buyers.

On the other hand, a weaker JPY means foreign investors invested in Japan will not only have to grapple with a low rate of return, but they will also have to contend with a gradually depreciating or at least weak JPY compared to their home currencies. This makes it less attractive for these investors and makes for less compelling reasons for more foreign investors to be invested in Japan unless it is for political (eg: China buying JGB's) reasons or for diversification purposes as Japan has a high rating in the investment arena.

In addition, according to J.P. Morgan, Japan's long-term yields remain negative – a trend not seen since 2016 and will likely continue into 2020. This will continue to encourage Japanese investors to remain net sellers of JPY on the back of portfolio investment outflows to seek better returns overseas, especially institutional and corporate investors who have investment mandates or need to return to their shareholders or investor clients or beneficiaries a minimum rate of return. Entities like insurance companies, GPIF (Government Pension Investment Fund), corporate pension plans, etc will need to meet certain return criteria. With a low rate, low return environment in Japan, these investment entities and funds will need to see alternatives elsewhere.

Even retail foreign exchange speculators – known collectively as 'Mrs. Watanabe's' – execute 'carry trades', selling JPY (or short JPY, paying low-interest rates) and buying higher-yielding currencies like USD, GBP, AUD and earning the interest differentials. These 'Mrs. Watanabe's' were a formidable force for decades in the foreign exchange markets. All these institutional, corporate and retail flows collectively weaken JPY throughout the investment cycles.

All these flows are sometimes left 'unhedged' by the investors – which means they do not try to put on a buy JPY and sell foreign currencies Foreign Exchange Forward contract for when they need to repatriate their principal. This is because some of these principal amounts stay overseas for a long time and partly unattractive as the cost of such hedges, due to interest rate differential, erodes the gains from the higher-yielding foreign investments.

We believe that Japan will continue to hold its interest rates low for as long as possible but will hold back cutting interest rates further for the time being with the recent rollout of the fiscal stimulus package on 5th December 2019, the upcoming 2020 Tokyo Olympics, which will bolster Japan's economy further, even with the tail end effect. BOJ and the Japanese Government will likely wait for the stimuli to work their effect on GDP and assess the sufficiency of the stimulus package of the economy before any further action is taken on rates, to 'save the last bullet'. In addition, we also believe that BOJ will also be reserving any cut in interest rates to 'weaken' any unforeseen and sudden appreciation in the JPY as they had done in the past, especially if JPY should break 105.00 psychological level towards 100, a line in the sand, in a short span of time. Japan being export-reliant, is very sensitive to the strength of JPY versus other currencies.

For years, Japan has maintained low to negative interest rates and very creative monetary policies to date that were aimed at stimulating the economy - which is becoming less and less responsive to such policies and this is what worries us. With every stimulus package and every monetary policy rolled out, the ratio of national debt to GDP increased and with that comes the need to continue to keep interest rates low to manage debt servicing. Yet, the marginal utility with every extra dollar of stimulus decline with each rollout. It is a vicious cycle.

Japan needs more structural reforms beyond leveraging interest rates and fiscal measures to solve the economic problems. It will get increasingly challenging for Japan if phase two of the U.S.-China trade deal and subsequent phases run into roadblocks. It can only exacerbate the current declining trade cycle, providing more reasons to remain cautiously negative Japan. Thus, we will need more trade war resolution progress before we allow ourselves to get less pessimistic about Japan.

The size of Japan's debt is a well-known one. It is the most indebted country in the world with a debt burden of about 250% of GDP. Next in line is Greece with about 177%. The debt problem started when the asset prices crashed in Japan in 1989, after the increase of the inter-bank lending rate from the Bank of Japan then. Banks and insurance companies were left with mountains of bad debt. The Japanese Government and BOJ stepped in to bail them out and provided low-interest credit. However, this did not manage to save them, and many had to be consolidated and nationalized. Throughout the decades, fiscal stimulus packages continued to be rolled out to help reboot the economy that was hard hit by the collapse of the financial and commercial systems. All these led to the piling of Japan's debt levels. Most of these are held by Japanese and only a portion by foreign investors and countries and at very low or negative interest rates. However, the amount is still growing, especially with the recent stimulus package, that it is doubtful Japan can ever repay the full amount. But they are not alone in this.

Like most economies, Japan Government funds its public services by levying taxes on citizens and corporates. If its tax collection is less than its spending, then the Government is running a deficit. The Japan Government has been running a deficit for some time now.

One of the lesser-known policies in Japan is its excellent and high level of public welfare and social security. But the Japanese government only collects about 18% of GDP as tax, which ranks them 28th position out of 30 developed countries in this respect. However, they rank the top 15 in terms of social security expenditure out of the world's top developed countries. Thus, they spend a disproportionate amount on their citizens. With an aging population, the tax receipts can only decrease over time, ceteris paribus. With an aging population, the amount to be spent on health care, public welfare and social security can only increase. Without additional sources of receipts to backfill an ever-yawning gap between receipts and expenditure on public welfare, it will add to the increasing tax burden on current labour and corporate pools to carry the weight. This trend is irreversible – and that is very worrying.

To lower its debt servicing burden, interest rates in Japan have been intentionally kept low, in addition to its other objectives of encouraging borrowing and spending to stimulate the economy.

From the graph below, it can be seen that the Japanese Government definitely has more interest expense to cover versus its tax receipts. With a shrinking labour force (unless Japan increases income tax rates or other taxes or admits more foreign workers – that will lead to other social problems as evidence by other countries who have been more liberal in this respect), the tax receipts will even go down over time. In fact, that was the reason behind the 2% hike in consumption tax in October 2019 and it has had a lot of backlashes that Japan is still trying to deal with. Thus, they introduced the Stimulus Package on 5th December 2019 together with many mitigating measures to take the sting out of the consumption tax hike for the consumers (read mention of the consumption tax hike on consumer spending and economy in this paper).

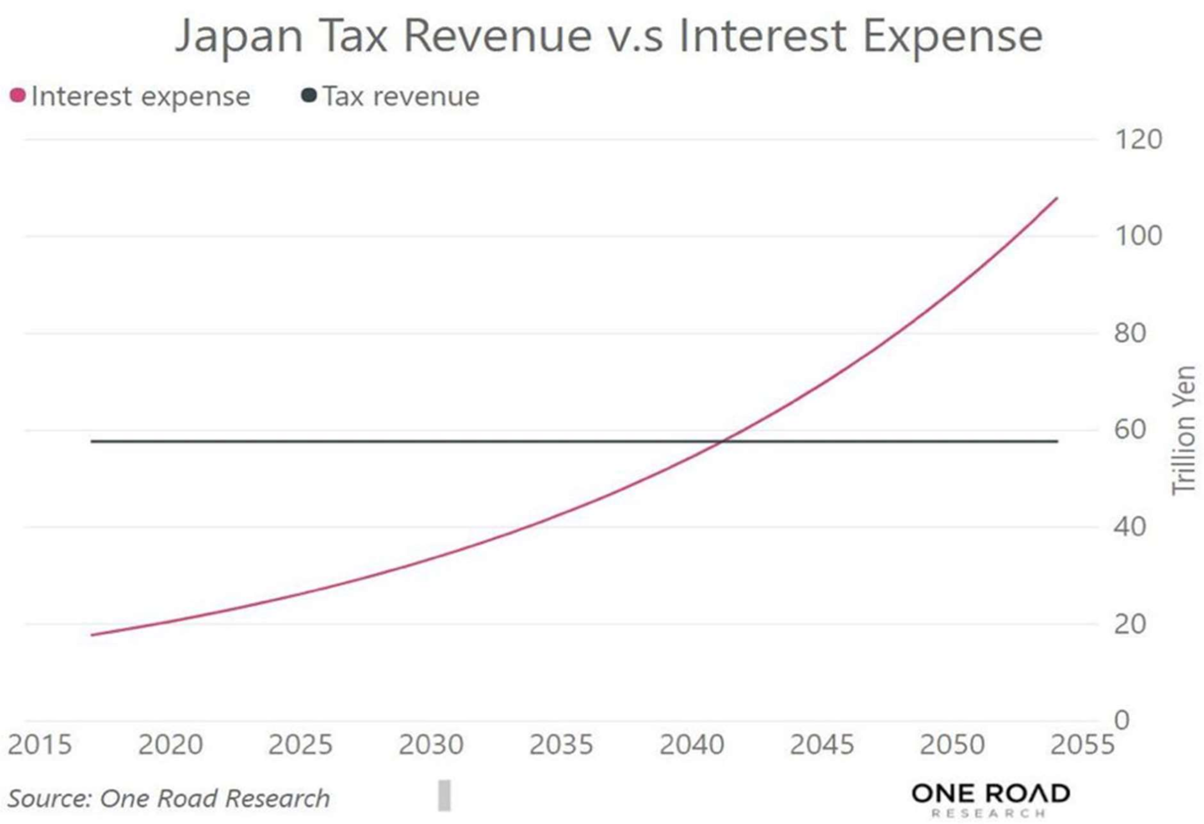


Figure 110: Japan Tax Revenue vs Interest Expense *(Source: One Road Research)*

Decades of deflation has made holding JGB’s for Japanese attractive so far as deflation has increased the pick-up in real interest rates. However, with Abenomics over the years where he was trying to raise price level and thus inflation to hit 2% through encouraging corporates to increase wages of Japanese workers so they have more disposable income to spend more and thus stimulating the economy, it has resulted in declining 'real' yield for holders of JGB's. With a domestic pool of holders declining due to declining population and decline in real yield pickup, investing in JGB's is becoming less and less attractive. Ironically, Japan continues to need to 'borrow' more through the issuance of JGB's to fund itself. It is a perverse and vicious cycle. Japan is a net importer of goods and the only way to reduce debt is to either structure its economy out the circularity of its own action or to increase the percentage sale of JGB’s to foreign investors.

When we drilled down, we saw that the largest holder of Japan's foreign debt used to be the U.S. but this is now replaced by China. These are usually held for political reasons as the yields are not attractive to such foreign holders. For now, the percentage held by non-Japanese investors are still relatively low - only about 6.4%. They do not pose any financial nor currency-related risk yet due to current low-interest rates and hence debt servicing burden. Being denominated in JPY, they currently pose no currency risks to Japan, unlike other emerging or developing economies where most of their debt burdens are in USD or foreign currencies and they are constantly exposed to currency fluctuations.

If the foreign holding should increase over time, it can be politically sensitive for Japan, where it can be in a ‘hostage’ position to foreign sovereign due to their amount of JGB’s held. If foreign investors start to demand higher interest rates, then debt servicing will become an issue that will impact Japan’s credit standing and its economy. This is a debt trap.

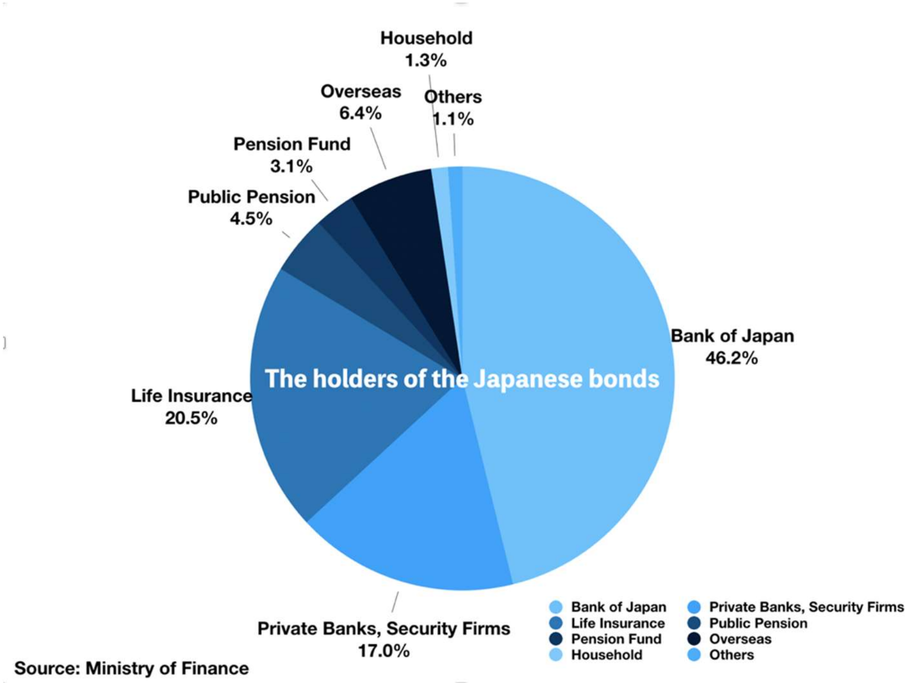


Figure 111: Breakdown of Holders of Japanese Debt *(Source: Ministry of Finance)*

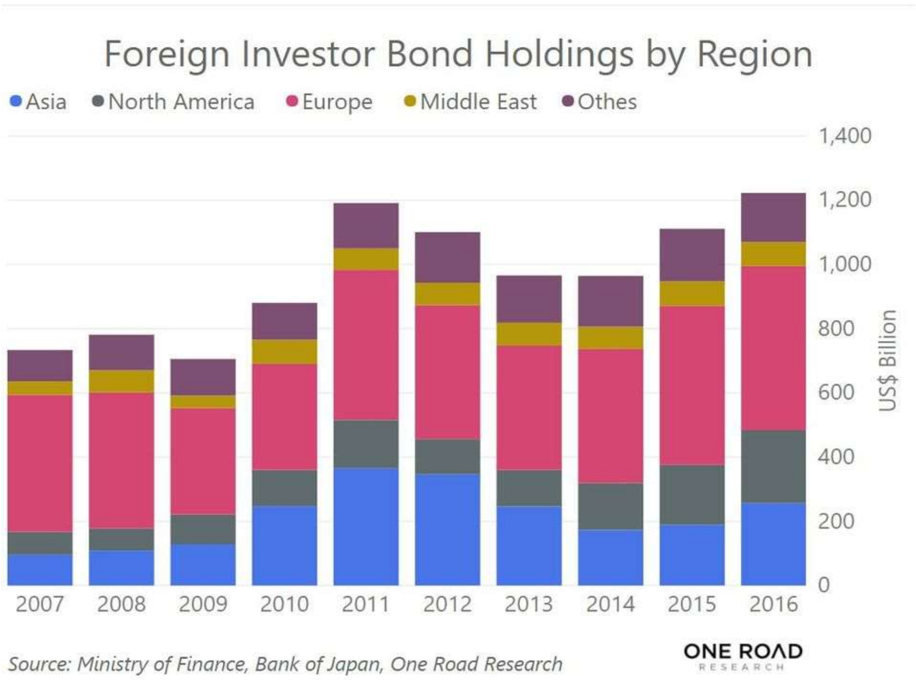


Figure 112: Foreign Investor Bond Holdings by Region *(Source: Bank of Japan)*

Over time, the burden can only get heavier unless there are policies and structural reforms that are innovative enough to allow them to stimulate their economy, support the social welfare and social security and still bring about the economic growth sufficient enough for them to rely less and less on debt. For now, this will continue to remain a matter of concern for Japan.

FX TRADE IDEA: LONG USDJPY

Entry Level: 107.00
Take Profit: 109.80
Stop Loss: 106.30
Risk to Reward ratio: 4

Figure 113: USDJPY Trade *(Source: TradingView)*

JPY has remained fairly strong in 2019, outperforming the USD for the second year in a row due to a 'risk-off mode' most of the time, due to the prolonged trade war hurting “risk-on” sentiment. This is despite Japan’s economic data grinding lower towards H2 amidst a gloomy macro environment. A usual 'observation' for JPY in the investment market has always been: weak global conditions and will trigger JPY strength as investors head for 'safe haven' JPY as a hedge for their portfolio while improving global growth or 'risk-on' mood will trigger a JPY weakness as investors reduce their 'safe haven' holdings of JPY and reduce their hedges. In addition, JPY specific economic weakness will also bring about JPY weakness. Currently, JPM sees an 85% chance of Japan falling into a recession. This will translate into JPY weakness when stacked against the USD. With the Fed already of the view that the U.S. economy is doing well, and the labour market remains tight, it will likely be slower on the draw for further rate cuts. This will keep the interest rate differential wide between USD and JPY and thus supportive of up move in the USD vs the JPY.

Due to the challenging macro environment since the U.S. – China trade war, there have been less JPY short positions ('risk-on' trades) out there and thus there is less probability of a sharp JPY buyback actions that will see sharp USD sell-off versus the JPY. In addition, given the current dim domestic outlook, JPY buying by Japanese corporates for repatriation and by investors is also expected to be limited. All these are more supportive of a higher USD. With domestic interests at a very low level and negative in the long run, they have no choice but to seek overseas investment opportunities. Thus, Japanese investors and corporates will likely be continuous sellers of JPY and buyers of USD and foreign currencies. This is again, supportive of a weaker JPY and stronger USD and higher-yielding currencies versus the JPY.

2020 is the U.S. election year, where we would expect the Trump administration to bring about a positive outcome, though not necessarily a conclusion, to the trade war. He would want the U.S. economy and stock markets to be running hot into the polls. This is supported by the recent progress in the trade war resolution with China during the 13th December 2019 meeting. This would result in positive spillovers in Japan's economy. However, the benefits would be limited due to the trickled-down effect. In contrast to Japan's economy, the U.S. economy has been doing well. Nonfarm payroll numbers out on 6th December 2019 showed an increase in 266,000 jobs in November 2019, exceeding expectations of about 180,000 and following an upward revision of 156,000 for October 2019. This was the largest jump in payrolls since January 2019.

We believe the USDJPY will trade a range of 107-112 in the near to medium term, although the news of Phase One of the trade negotiations between the U.S.- China on 13th December 2019 has seen the USDJPY moved from around 108.30 before the news to 109.70-ish after the news. From the chart, we can see that the USDJPY 50SMA has crossed over the 100 SMA in late October 2019 and has remained above since, suggesting an uptrend. While it still lies below the 200 SMA, the 2 lines appear to be converging and may see the 50SMA crossing over the 200 SMA, signalling a potential higher USD. The USDJPY is also trending in an upward channel (orange channel lines). This is further confirmed by the MACD, where we see that the MACD line has crossed over the signal line, with the histogram now lying above the baseline. The RSI also appears to be on a downward trend towards the oversold position. The indicators all suggest that the currency is on an uptrend and a buy signal should be placed in the near future. We suggest buying USD vs JPY at 107.00, to give ourselves a more comfortable entry-level, with stop loss at 106.30, avoiding the previous low in October 2019 and take profit at 109.80 as the 110.00 psychological level may be typically tricky to 'trade through' at first try. This will give us a risk ratio of 1.9:1. With the interest rate for the U.S. is at 1.75% while that of Japan at -0.1%, there is a positive interest rate differential. Hence going long on USDJPY would result in a positive carry trade of 1.85% that will add to the expected profit. Both 105 and 110 are psychological support and resistance respectively and as long as they are not broken, the USDJPY price action will gyrate within the expected range.

SOUTH KOREA (UNDERWEIGHT)

Roughly 5 decades ago, South Korea was known to be the poorest country in the world, with little hope for economic revival. However, having experienced one of the largest economic transformations in recent history, they made their mark as an electronic hub and the 12th largest economy in the world. Their 2018 GDP reached a high of KRW 1619.42 billion, accounting for 2.61% of the world's economy. South Korea's main economic drivers are the Service, Industrial and Agricultural sectors, making up 52.8%, 35.9% and 2.0% of the GDP respectively while their main exports include Electronics, Machinery, and Vehicles.

Having faced both the U.S.-China trade war and their trade dispute with Japan on their economic front in 2019, South Korea's economy slowed more than expected and the Q3 growth rate of 0.4% that fell short of the expected 0.5% was considerably softer than the growth of 1.0% in Q2.

On the trade war front, the long-anticipated 'phase one' of the trade deal was announced on 13th December 2019. President Donald Trump announced a preliminary deal with China, suspending fresh tariffs on USD 160 billion of Chinese goods that were due to kick in on 15th December 2019. He also said that the U.S. would start negotiations on 'phase two' deal immediately, rather than wait until after the November 2020 presidential election. All these sent stocks across major bourses higher.

Nevertheless, we remain underweight South Korea for the time being, until we see further confirmation and more concrete details in the talks in the months ahead between U.S. and China to indicate that the 'coast is getting clearer' as we believe that the little bits of silver lining – FTA's between South Korea and the U.S. and China, early signs of bottoming of semiconductor prices, potential early, preliminary de-escalation of U.S-China trade tension, are not deep enough to turn the tide yet for the South Korea economy.

Sandwiched Between U.S.-China Trade War Woes

South Korea is a political ally of the United States. Yet, it also needs China. It relies on the U.S. for its security and on U.S. and China for its economy. Both China and the U.S. are South Korea's two largest trading partners. This is clearly shown in the figure below, where China and the U.S. are both South Korea's largest import and export partners. With South Korea having an export-oriented economy that is sensitive to demand shocks, the countless number of tariffs the U.S. and China imposed on each other have impacted the trade balance and the GDP of South Korea. We expect this trend to continue and for the GDP to contract further, even with the latest development on 13th December 2019, which is only as good as headlines for now.

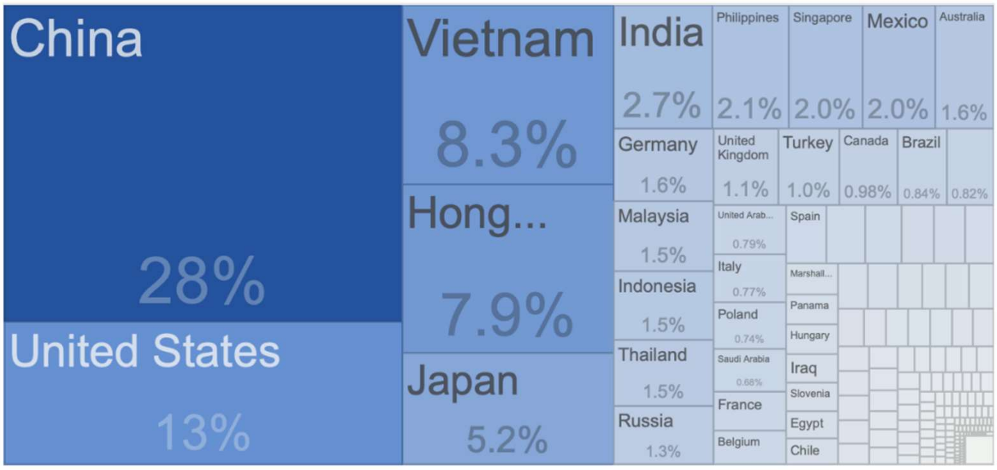


Figure 114: South Korea's Exports to Different Countries *(Source: Trading Economics)*

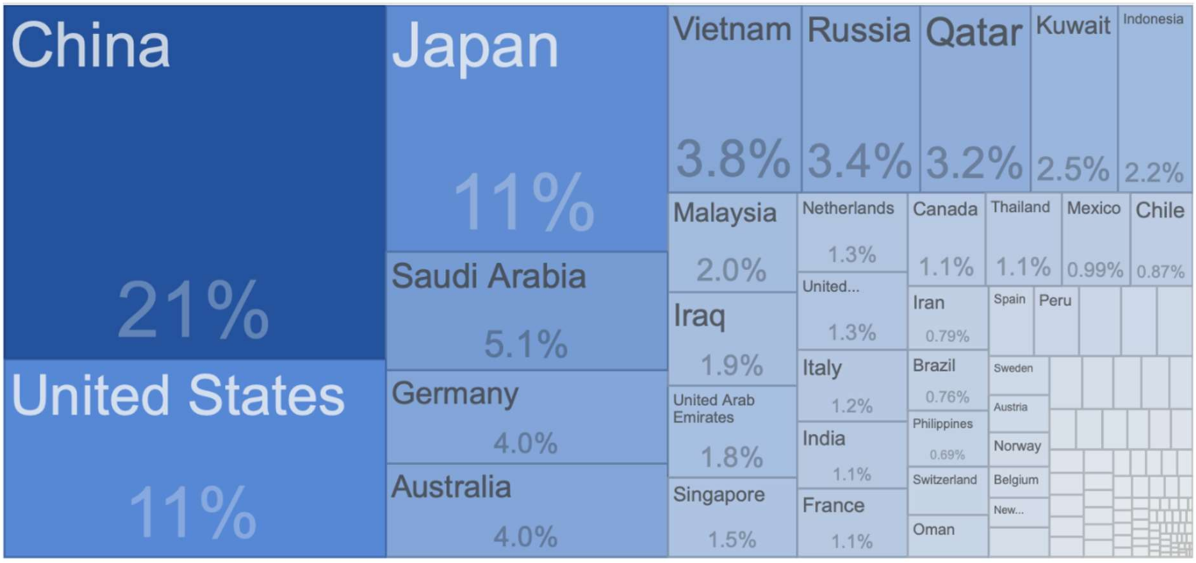


Figure 115: South Korea's Imports from Different Countries *(Source: Trading Economics)*

About 40% of South Korea's outbound shipments are sent to either the U.S. or China. The tariffs imposed on each other has resulted in a fall in Korean exports to these countries, with exports to China falling by 20%. South Korea's economy has been among those worst-hit by cooling global demand as a prolonged U.S.-China tariff war disrupted world supply chains that dealt blows to business confidence and investment. Furthermore, the U.S. tariff measures against Chinese imports are likely enforced on Korean imports as well due to the similarity of their products. President Trump believed both the Korean and Chinese governments manipulated their currency values to boost their exports and hence view both China and Korea unfavourably as currency manipulators. This does not help South Korea at all.

However, the trade war does have a silver lining. South Korea signed Free Trade Agreements with both China and the U.S. which serve as an economic opportunity as they may have the option to act as an intermediary between both countries, allowing them to trade through South Korea, to avoid the tariffs. South Korea could aid in completing the manufacturing process of Chinese goods such that the origin of products would be switched to South Korea. This would allow the South to capitalise on the tensions between the U.S. and China. That said, the negative impacts of the trade war on their exports are likely to overshadow the potential opportunities to be gained by being an intermediary, as the fall in exports accounts for a significantly large percentage of their GDP, more than the positive effects of re-routing of trades and manufacturing processes. Furthermore, the revised Free Trade Agreement signed between South Korea and the U.S. does not protect South Korea entirely from being a target of additional tariffs, which could hamper South Korea's potential role of being an intermediary.

Thus, due to the impact of exports carrying a heavier weight, the FTA's signed between South Korea and the U.S. and China, they are still not sufficient leverage to swing things around for South Korea.

The Triple P's – Consumer, Product, Export Prices All Down

Consumer Prices - With Asia's fourth-largest economy headed for the slowest expansion since the global financial crisis, the government is ramping up spending while the BOK cut its interest rates for the second time on 15th October 2019, to 1.25%. This cut came after the country saw its consumer prices fall for the first time in September 2019, by 0.4%.

Producer and Export Prices - The prices of semiconductors fell from 2018 up till the earlier half of this year, before the start of the Japan-Korea trade dispute. Despite the fairly robust global demand for semiconductors at that time despite the trade war, the fall in prices had a negative impact on South Korea's total exports. The semiconductor industry was seeing declining profitability, with manufacturers making plans to cut production as prices fell and inventory grew. Recently, a growing number of market watchers believe that memory prices have hit bottom, and this can be a precursor of early signs of stability before recovery next year. However, we will caution against being too optimistic until we see more signs of recovery.

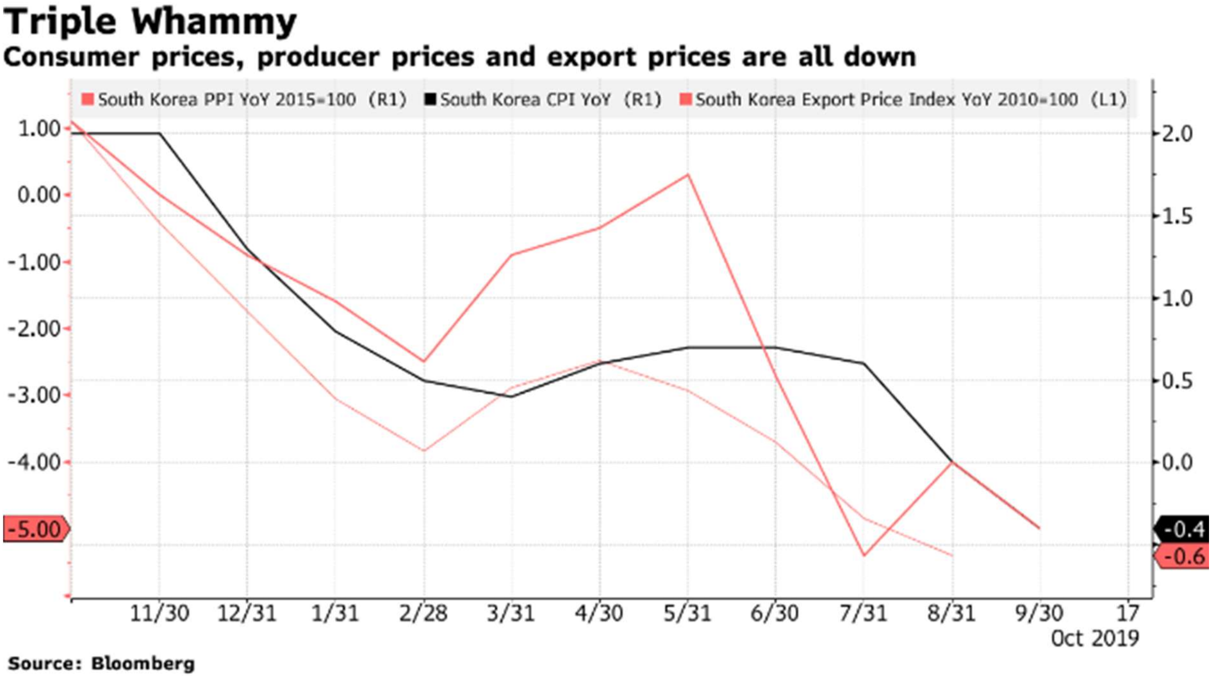


Figure 116: Fall in Consumer Prices, Producer Prices and Export Prices *(Source: Bloomberg)*

Economic Structure – the Korean economy is not multi-dimensional, complex nor diversified, relying heavily on exports, especially in the Electronic and Machinery Industry and is thus much more vulnerable to any economic downturns. As the trade war and poor economic drags into 2020, South Korea's economy is likely to remain weak. Even if or when the trade war works towards resolution, it will be a multi-stepped process and the South Korean economy will also need time to recover from the initial shocks. It is not likely to be a 'V' or 'U' shaped recovery. In fact, what is needed for the economy is for the government to take this opportunity to restructure their economy, put in measures to diversify more their import sources and export destinations and to better 'future proof' themselves for further unforeseen trade and economic shocks. Cutting rates has limited and short-term impacts, especially with current rate levels. Stimulus packages need more fundamental shifts in the economy to be sustainable and effective.

Disputes with Japan Affecting South Korea's Economy

The trade dispute between the two Asia's powerhouses dated back to the Japanese treatment of Koreans during World War II. Despite apologies from Shinzo Abe and previous settlements established in 2015, the Koreans were still not satisfied. In late 2018, the South Korean Supreme Court ordered Japanese companies to compensate the South Korean War Victims. Feeling unjustified, Japan retaliated by tightening controls of the exports of 3 chemicals – Fluorinated Polyimide, Resist and Hydrogen Fluoride, crucial to the production of semiconductors, to South Korea and further removed the South from their "White List" resulting in greater delays in exports. In response, South Korea counterattacked. They removed Japan from their "White List" and enrolled Japan in a newly created lower-tier category with unfavourable trade terms. Unhappy South Koreans also boycotted Japanese brands, products and companies like Uniqlo. However, many of these companies have Korean investments and hire large numbers of Koreans, resulting in a "boomerang" effect on the Koreans.

The figure below shows the impacts of the trade war on both countries. Since then, both Japan and South Korea have agreed to a meeting on 16th December 2019 to resolve the tensions. While the possibility of some easing of tension cannot be ruled out, a quick resolution will not be in sight soon, as historical tensions tend to be sensitive and would not be resolved easily. Furthermore, the restriction on chemicals "has hit South Korea where it hurts the most" said Professor Ha at the Hanshin University in Seoul, as Korea has yet to find a good replacement for some of the chemicals from Japan. Politics wise, South Korean President Moon Jae-in will need to have a robust outcome ahead of legislative elections next year.

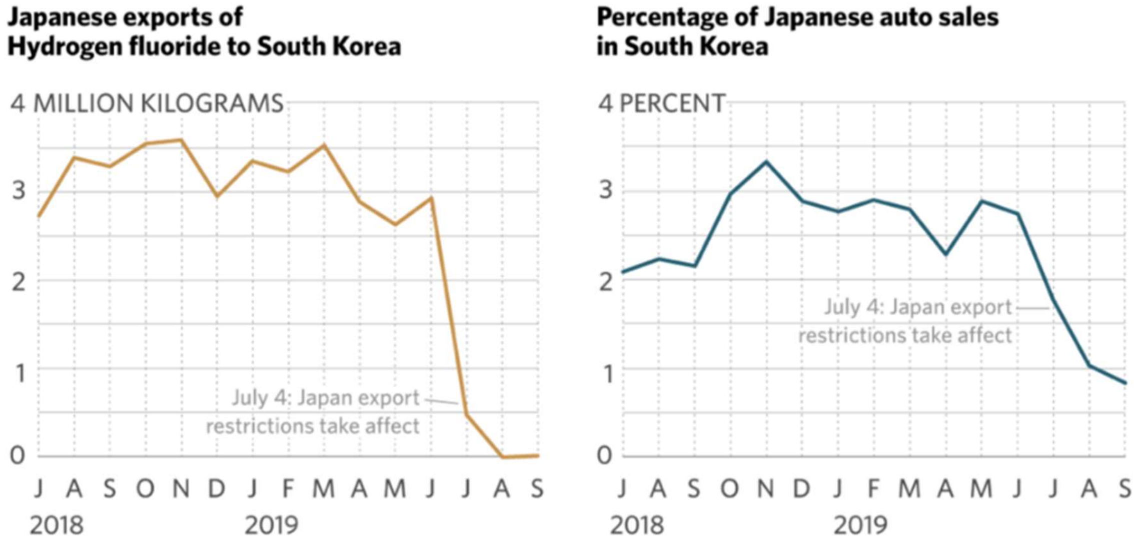


Figure 117: Impact of The Restriction on Exports from Korea to Japan and of Koreans Boycotting Japanese Products *(Source: The National Interest)*

While both economies will be hurt, the impact of the trade dispute is skewed more negatively against the export-driven South Korea in the short run. The sale of semiconductors accounted for 92% of South Korea's export growth in 2018. The South is also home to electronic giants, Samsung Electronics and SK Hynix, which rely on these chemicals for production. On the other hand, Japan is a dominant global supplier for the chemicals, producing up to 90% of the chemicals. While South Korea has tried to source for these materials locally and through other foreign sources, they have not been very successful. South Korean suppliers in the industry are not able to produce chemicals of comparable quality as they lack the relevant experience, technology and Research Development funding. Although the South had invested one trillion won in developing home-grown materials locally, it would take a considerable amount of time for the industry to build up on its expertise and quality of chemicals produced. Japan thus has leverage over the South in the short term.

However, there have been some positives for Korea. Previously, the prices of DRAM chips, a type of semiconductor, dipped to new lows due to the abundance in supply, causing the worst drop in profits in 4 years for Samsung Electronics. The restriction of chemicals reduced the supply of DRAM chips, driving prices higher, increasing manufacturers' profit margins. However, as much of the semiconductor sales are locked in by contracts signed previously, South Korea is unable to benefit that much from the rising prices for now. Instead, they face troubles in meeting current demands at much lower prices. Thus, we believe that the costs of the trade war would ultimately outweigh the benefits.

BOK Governor Lee Ju Yeol admitted in July 2019 that friction with Japan was one of the factors in the recent growth forecast downgrade for Korea. Amidst the backdrop of the U.S.-China trade war, should their dispute with Japan drag on, the Korean economy would experience significantly more damage. Due to Japan's near-monopoly power on the chemicals and the South's heavy reliance on them for their export goods, South Korea is on the losing end and their economy would face far greater damage than Japan from the trade tensions.

The impact of the trade war is reflected in South Korea's unemployment rates. The manufacturing, as well as the retail and wholesale sector, has been hit by the trade dispute, shedding 24,000 and 53,000 jobs in August 2019 respectively. The unemployment rate continued to rise in the following months, due to months of trade tensions. This trend is expected to continue unless the government is able to come up with countermeasures in the next few months.

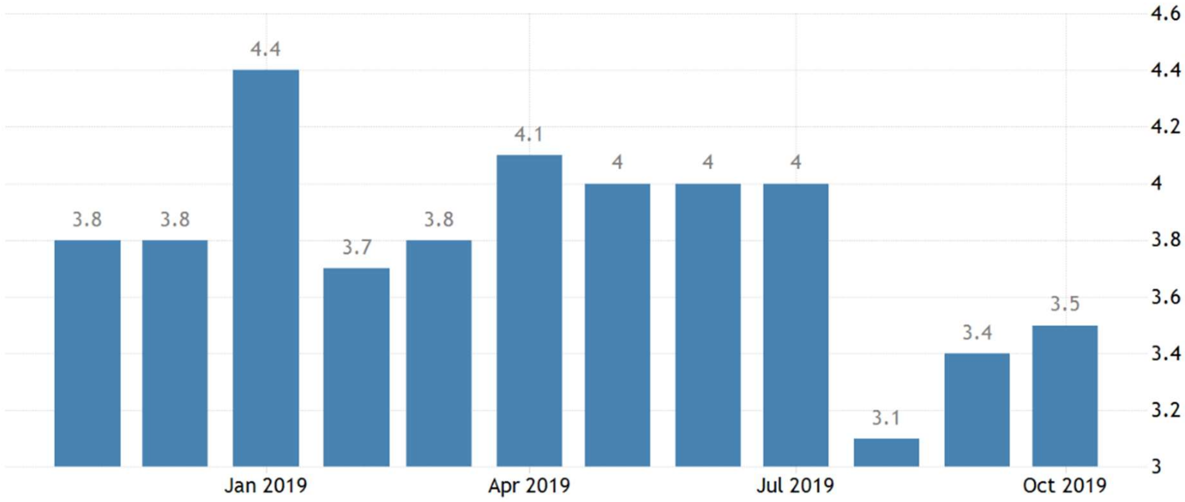


Figure 118: South Korea's Unemployment Rate *(Source: Trading Economics)*

The impact of the trade dispute has hurt South Korea more in the short run. Although in the long run, they will benefit more from diversifying their sources imports, this would take a considerable amount of time. Thus, we remain negative in our outlook of South Korea.

<u>Rising Government Debt and 'Deflation'</u>

Rising Government Debt - With countries and central banks around the world cutting rates to shore up their domestic economies, IMF has been encouraging countries to implement more fiscal measures to battle the trade war, rather than relying solely on rate-cutting. While lowering interest rates is effective in boosting the economy, its benefits are limited. As the outlook of the South Korean economy is poor, investor confidence will remain low and the increase in spending would be on a smaller scale. On the other hand, fiscal stimulus would ensure more money is circulating in the economy, increasing jobs and the disposable income of the citizens. This is especially relevant for the South Korean economy, where only certain sectors are facing a fall in employment. As mentioned above, the manufacturing industry, as well as the retail and wholesale sector, shed 24,000 and 53,000 jobs respectively, in August 2019. On the other hand, the social services sector added 174,000 jobs. With the fiscal stimulus, the government could direct spending towards specific projects or sectors which are slowing, to prop up the economy.

For the fiscal year 2020, South Korea is prepared to implement the most expansionary budget since the global financial crisis in 2008/2009. The finance ministry has proposed a spending of USD 424 billion, up 8% this year, to prop up the slowing economy. The bulk of the fiscal stimulus would be spent on creating jobs, expanding welfare and developing areas in the country that are identified as new growth drivers.

South Korea currently has a relatively healthy debt to GDP ratio of around 37% or so in recent years. The expansionary budget will bring the ratio to 39.80% from 37.10% currently. With prevailing macro headwinds, the effectiveness of such a stimulus will be limited. This is unavoidable and the economy does require some boosting to weather the global trade war. We believe that South Korea has enough room to accommodate the rise in debt for now, but the ratio will rise further and could reach unsafe levels if more stimulus packages are introduced in the future.

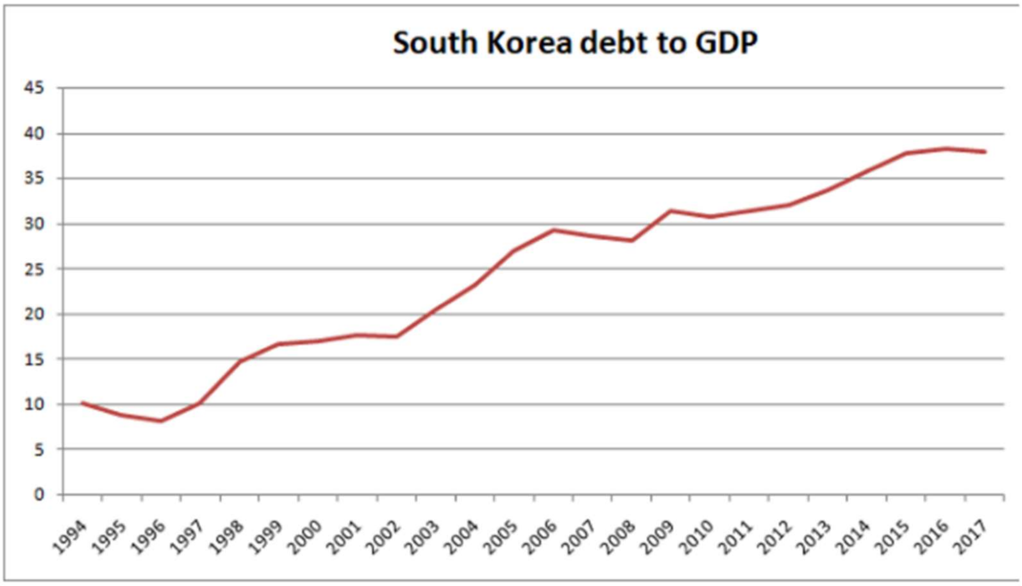


Figure 119: South Korea's National Debt to GDP ratio *(Source: Ministry of Economy and Finance)*

'Deflation' Knocks - Korea's inflation slid below zero for the first time in September 2019. On Reuters, economists opined that the September 2019 data reinforced the view that the slump in South Korea's trade-reliant economy would continue beyond this year. South Korea, however, is confident that the country would not undergo any deflation. They claimed that the weak inflation was due to technical reasons and weather conditions which impacted the farm product prices. However, negative inflation was also due to the trade war. Despite the rate cuts in South Korea, falling global demand, as well as the fall in semiconductor exports, has contributed to the downward pressure on price levels. Inflation hovered around 0 since the start of the trade dispute with Japan in July 2019. While South Korea had below-target inflation rates for the past few years, this was the first time that the inflation figures were accompanied by falling prices. Furthermore, the extended run of export weakness and weak overall growth are weighing on investments. Going forward, the expansionary budget and with sluggish tax receipts, the debt to GDP will also rise further and will weigh further on overall investment sentiments, leading to pressure on price levels.

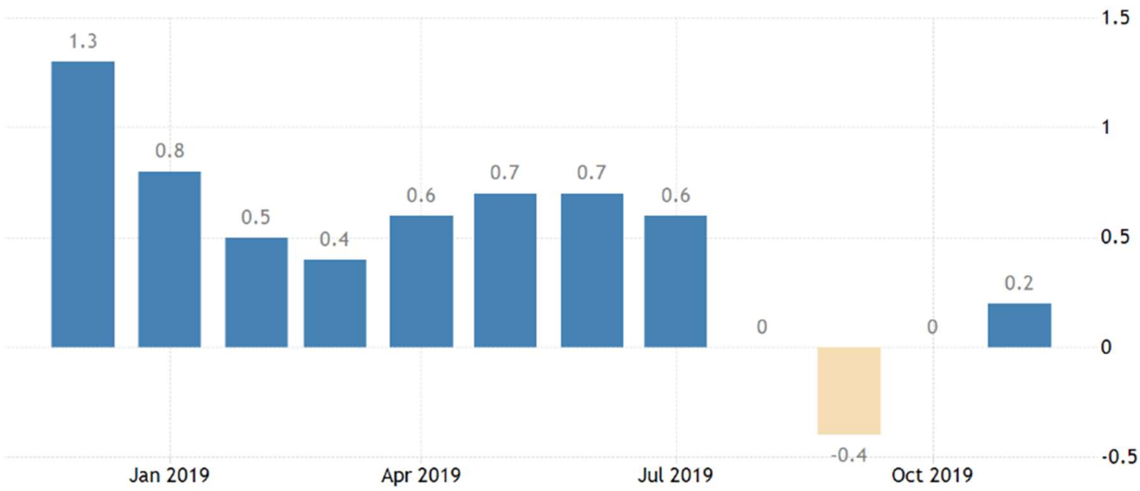


Figure 120: South Korea's Inflation Rate *(Source: Trading Economics)*

Lowest Interest Rates in 10 Years

Figure 121: South Korea's Interest Rate in 2019 *(Source: Trading Economics)*

South Korea has seen its exports dropping for the eleventh month, together with falling consumer and producer prices. South Korea is headed for the slowest expansion since the global financial crisis. Being embroiled in the Japan-Korea trade war as well as suffering impacts from the U.S.-China trade war, IMF slashed South Korea's 2019 and 2020 economic growth forecasts by 0.6 basis points each to 2.0% and 2.2%, respectively. The BOK surprised the market in mid-July 2019, cutting its benchmark rate from 1.75% to 1.50%. This is an attempt on BOK's part to shore up a slowing economy and address mounting deflationary pressure. They have cut rates for a total of 2 times this year to the current 1.25% in October 2019, as shown in the diagram below, and have left it unchanged during their most recent meeting in November 2019. With such cuts already being priced into the market, the focus is on whether the cuts are sufficient to put the economy back on track and if there would be future rate cuts in the pipeline.

A Bloomberg survey conducted in October 2019, has shown that half of the 25 respondents expected the policy rate to remain unchanged at 1.25% in 2020. A slightly smaller group expects rates to move from 1.25% to as low as 0.75% and only 2 out of the 25 expect a hike sometime in 2020. Despite the previous 2 cuts in 2019, we expect that South Korea would cut interest rate once more at the start of 2020 as we believe economic growth would not pick up sufficiently to allay further cuts. South Korea's economy has tumbled in the recent quarters, in the face of cooling global demands and the trade wars, due to its heavy reliance on the export of chips, cares and ships.

While further rate cuts are possible, BOK is cautious and is exploring other means to bolster the economy. This is due to the financial risks associated with extremely low interest rates. There is an intimate link between the long-run interest rates and long run economic growth. Low interest rates are a signal to investors that the economy is not doing well, dampening investor sentiments and hence reducing foreign direct investment in South Korea. There is increased concern that having extremely low interest rates could lead to a property bubble. There was a KRW 9.32 trillion rise in Korean household spending during the August 2019 – September 2019 period, related to home purchases. This debt build-up is the highest since 2006 and poses as a concern. Koreans currently has a debt load of 1.6 times of their annual disposable income, an amount higher than the 1.4 times ratio in the U.S. before the global financial crisis. This is one of the highest ratios amongst developed economies. This is definitely a negative for South Korea and will become a bigger risk if rates were to be cut further.

FX TRADE IDEA: LONG USDKRW

Entry Level: 1158.00
Take Profit: 1200.00
Stop Loss: 1141.60
Risk to Reward ratio: 2.56

Figure 122: USDKRW Trade Idea *(Source: TradingView)*

South Korea's economic and domestic outlook remains pessimistic. Any interim truce from the U.S.-China trade war is likely to be temporary and would be subjected to the ebbs and flows driven by politics and would run-up to the U.S. elections in 2020. On the other hand, their dispute with Japan is not likely to be resolved quickly. Even if a resolution was reached, there is a high risk for long-term trust issues. The fiscal and monetary stimulus should buffer domestic demand; however, we would still expect South Korea to undergo another round of rate cut in early 2020 as they suffer the impacts from the 2 ongoing trade disputes. While analysts expect a modest recovery in 2020, the growth outlook still undershoots Korea's potential growth rate and the long-term trend growth is expected to slow further on rising labour costs and aging trends. Thus, we remain bearish on the Korean economy and currency.

2020 is the U.S. election year, where we would expect the Trump administration to bring about a positive outcome, though not necessarily a conclusion, to the trade war. He would want the U.S. economy and stock markets to be running hot into the polls. While this would also result in positive spillovers in South Korea's economy, the benefits would be limited due to the trickle-down effect. Furthermore, due to the U.S. dollar smile theory, USD would always outperform other currencies in all situations except for when the U.S. economy slows while the rest of the economies are in a synchronised growth cycle, which is highly unlikely. Thus, USD would most likely strengthen against KRW in the near future.

We can see that the 50SMA crosses over the 100SMA and 200SMA around end-February 2019 and mid-April 2019 and has remained above both the 200SMA and 100SMA since, indicating an uptrend. SMA is less prone to whipsawing up and down in response to light, temporary price swings and would thus provide a more stable level indicating support or resistance. The RSI has been hovering around and below 50. Both indicators suggest an uptrend and hence signals a buy in the near future. On the back of current weak conditions globally and domestically, USDKRW is currently on an upward trend. This is confirmed by the channel between the support and resistance levels which have been tested several times and suggests that USDJPY has been trading at an uptrend with a higher low and a higher high., a buy trade can be entered just above the double bottom, at 1158.00. The stop loss would be at the previous resistance/congestion area at 1141.60, while the take profit level is set at 1200.00. The risk-reward ratio is at 2.6:1. The interest rate for the U.S. is at 1.75% while that of Korea is at 1.25%. Going Long on USDKRW would thus result in a positive carry trade that will profit even if the trade goes sideways.

INDIA (Underweight)

Despite global volatility and external vulnerabilities, India stands as the world's second fastest growing economy falling behind China merely by 0.1% in 2019. In 2018, India's GDP was USD 2726.32 billion. Agricultural production accounts for more than half of all jobs in India. It is the world 's largest consumer of gold and has the 10th largest gold reserves globally. The gold holdings of the country jumped from 598.6 tonnes in the last quarter of 2018 to an all-time high of 607 tonnes in the first quarter of 2019 reported by the World Gold Council. Over 80% of the jewellery market in India is dominated by gold jewellery.

India's top 5 export partners are United States, United Arab Emirates, China, Hong Kong and Singapore. The services sector is the key driver of India's economic growth. Apart from dominating India's GDP, the sector has also attracted significant foreign investment flow. The sector has contributed 54.17 per cent of India's Gross Value Added in 2018-19. As an export hub for software services, India's IT industry grew 8.38% y-o-y in FY19. In the face of external headwinds, India is unlikely to maintain its strong momentum for 2020.

Another Repo Rate Slash?

Figure 123: India's monthly interest rate *(Source: Trading Economics)*

In the light of India's faltering economy, the Reserve Bank of India cut its repo rate by 25 basis points to 5.15% from 5.40% during its October meeting. This marks the country's fifth straight cut for this year. The RBI has now cut rates by 135 basis points since the start of 2019.

This move came after the revise of GDP growth forecast from 6.9% to 6.1% for FY 2020 which is reflective of the economy's loss of momentum. The tumbling GDP growth to a six-year low of 5% y-o-y for the June quarter driven by weak investment growth and sluggish demand also supported this action. RBI's latest rate-cutting is an attempt to strengthen private consumption and spur investment activity to restore growth momentum given that private consumption has been one of the engines of the economy.

However, although RBI has reduced repo rate cut for the fifth time, this rate-cut has failed to translate into effective reduction cost for corporates and consumers due to slow transmission. Transmission is slow and difficult because public sector banks do not borrow from RBI but instead rely on public deposit for their business. And the biggest issue with this is that a majority of the deposits are at a fixed rate hence this means that these banks are unable to change rates immediately which hinders transmission to end customers. According to the central bank, while RBI had cut rates by 110 basis points prior to the October cut, commercial banks' weighted average lending rate fell just by 29 basis points. Hence, latest rate-cuts on top of new fiscal measures appears inadequate to boost India's economy.

In December's review, RBI unexpectedly kept its interest rate unchanged due to a spike in inflation which rose above its 4% medium target rate. Given the persistently high food prices, RBI has prioritized to address inflationary pressure that risks spurring social unrest rather than slumping growth. Furthermore, the recent government measures to spur economy such as the USD 20 billion corporate tax cuts, were expected to boost demand.

Going forward, in the backdrop of rising unemployment, ongoing stress on the banking system and low output of capital goods, a dovish monetary policy is very likely. We expect another round of rate cut in the first quarter of 2020 since an impetus is required for the recovery of economic growth which has slowed to 4.5%, weakest pace since 2013. Furthermore, given that the latest rate cut by 25 bps is disappointingly below market's expectations, we postulate another repo rate cut.

Surprise Narrowing for India's Perpetual Deficit

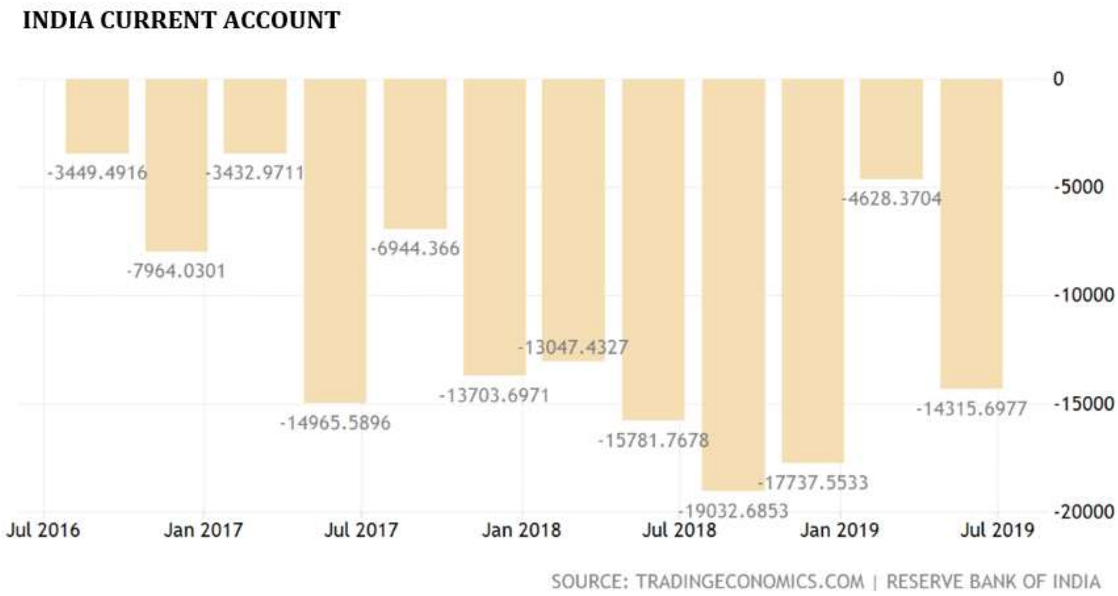


Figure 124: India's Quarterly Current Account Balance *(Source: Trading Economics)*

In 2018, India has constantly registered a widening current account deficit mainly due to high crude oil and merchandise imports. However, 2019 saw a shrank in current account deficit to 2% of GDP from USD 15.8 billion in April-June of 2018 to USD 14.3 billion in the same period this year. The narrowing of CAD is mainly due to lower trade deficit. A decline in imports is a result of lower imports of the two volatile commodities, crude oil and gold. India's is also experiencing shrinking exports. India's exports of gems & jewellery, engineering goods and petroleum products contracted 5.56%, 6.2% and 18.6% respectively. However, on a positive note, while exports are declining, they are falling at a much slower pace than imports. Exports declined 2% in the first 7 months of the year compared to that of exports which declined 5%.

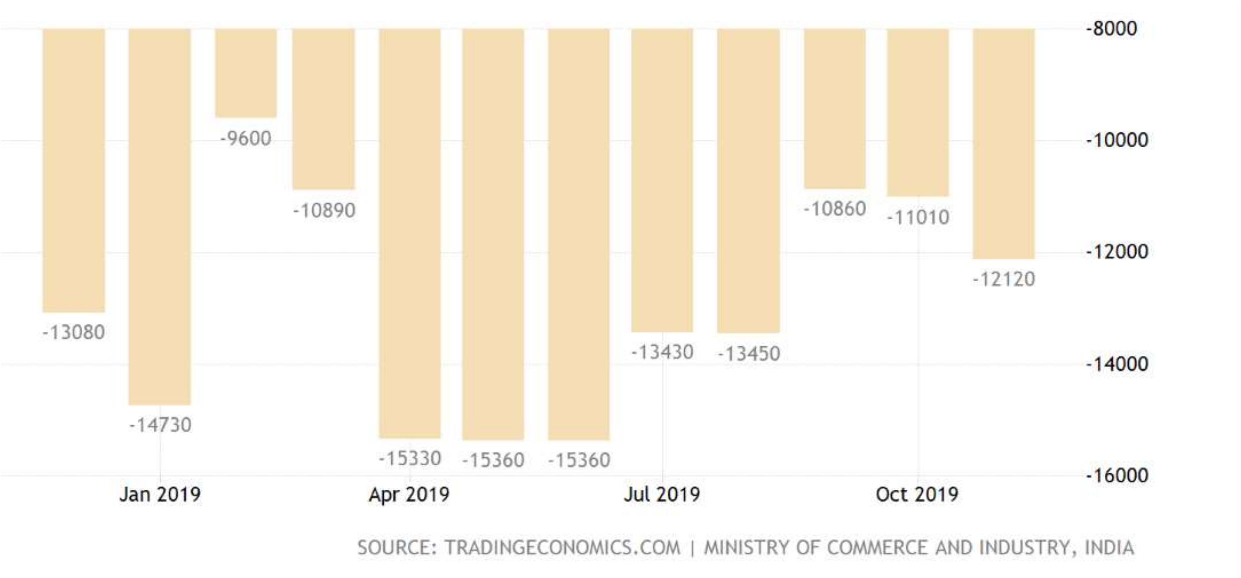


Figure 125: India's Monthly Trade Deficit *(Source: Trading Economics)*

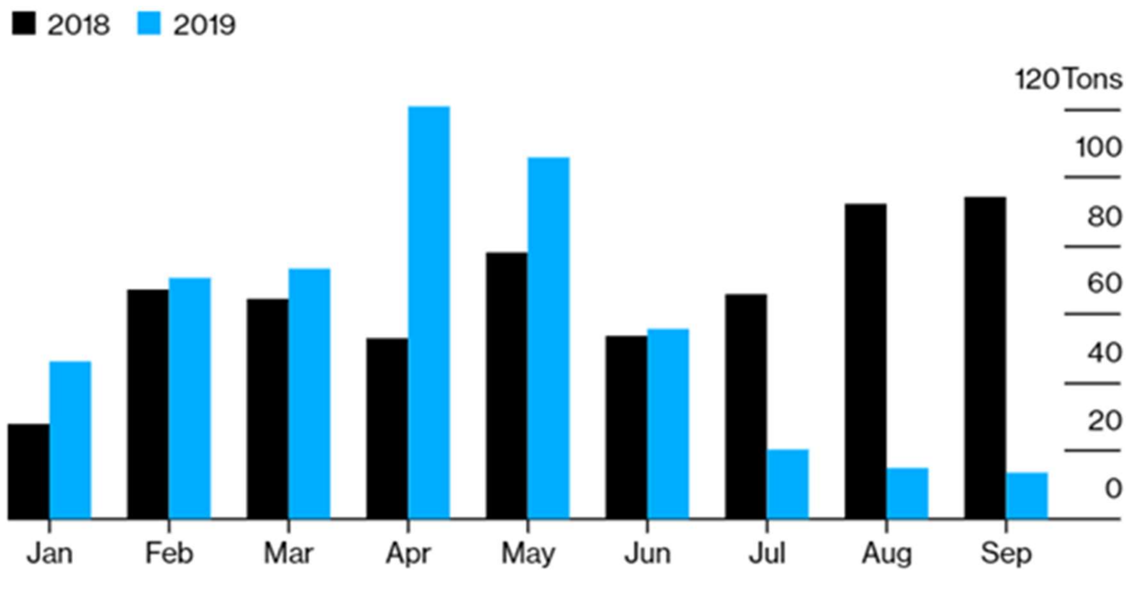


Figure 126: India’s Gold Import *(Source: Bloomberg)*

India, the world's second largest consumer of gold. Gold has been a combination of investment tool and status symbol in India. Almost all of India’s demand for raw gold is met through imports. Gold imports in India plummet to 13.5 tonnes in September 2019, lowest in 3 years. In October, the imports of gold fell despite the country’s festive season. Imports of gold in India declined 33% in October to 38 tonnes, down from 57 tonnes a year ago. The fall in gold imports is mainly due to escalating gold prices which weigh on consumer demand during the festival season. The depreciation of the Rupee also make gold relatively more expensive for retail purchase. In order to mitigate the impact of gold imports on current account deficit, the government increased the import duty on gold to 12.5% from 10% this year, which helped deter gold import and contain current account deficit. Gold imports made up about 12% of India's total import. Given the significant weightage that gold import has, the decline in gold import has significantly improve India account deficit. Similarly, signs of moderation in domestic consumption and industrial demand has led to lower oil imports. India is the world’s third biggest oil importer. With that, the current account deficit has shrunk.

However, while current account deficit is improving, it is due to weaker imports and exports. This signals weak domestic demand in an economic slowdown and a loss of its previously strong growth momentum. While India's trade balance has improved, its sluggish demand is worrisome. Moving forward, revival of gold imports may push up CAD in 2020 as we see signs of higher gold demand in November where gold imports jumped 78% from October.

Inflationary Pressure Amidst Slowdown

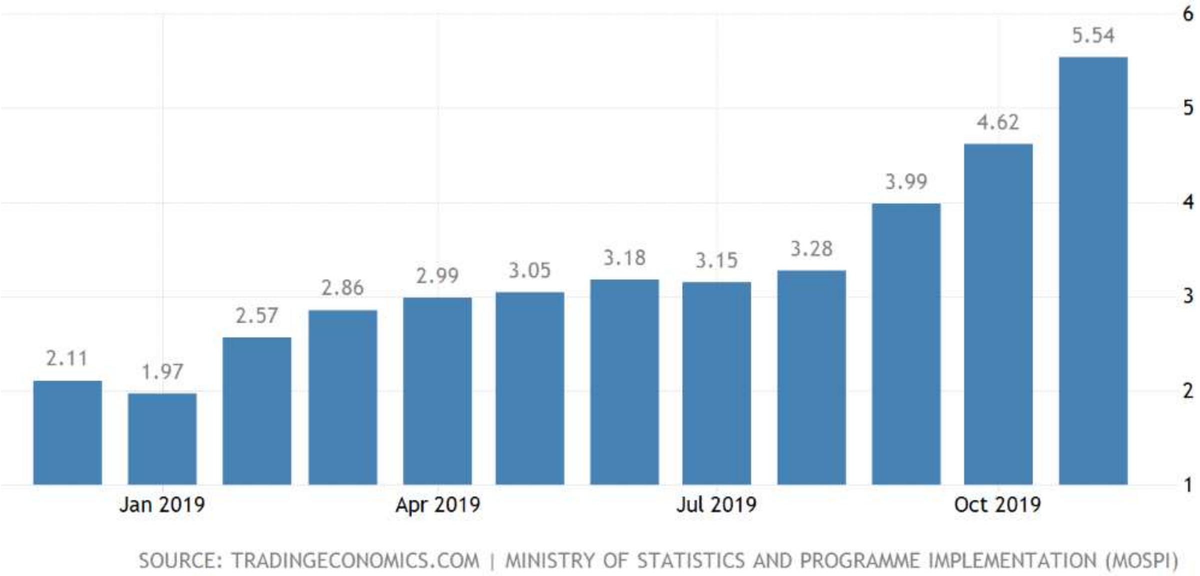


Figure 127: India's Inflation Rate *(Source: Trading Economics)*

India's consumer inflation rate rose to 5.54 % y-o-y in November 2019, up from its previous 4.62%. This was the highest inflation rate since its monthly increment from start of 2019. This surpass RBI's target rate of 4%. The rise in inflation was mainly due to an increase in food prices as a result of unfavourable weather conditions and monsoon season which drives up prices. The disruption in supply chain due trade policy further escalate inflation. Although RBI has cut rates in a bid to boost growth momentum, the rise in inflation pressure in October is more likely to be driven by supply factors rather than the recent rate cuts in hope to improve consumer demand since monetary policy is more effectual in stimulating consumer behaviour rather than supply conditions. Going on, India is particularly vulnerable to changing world oil prices as it is heavily reliant on imported oil and gas for its domestic energy requirements. A further easing of global oil prices will help dampen consumer price increase and curb inflationary threat.

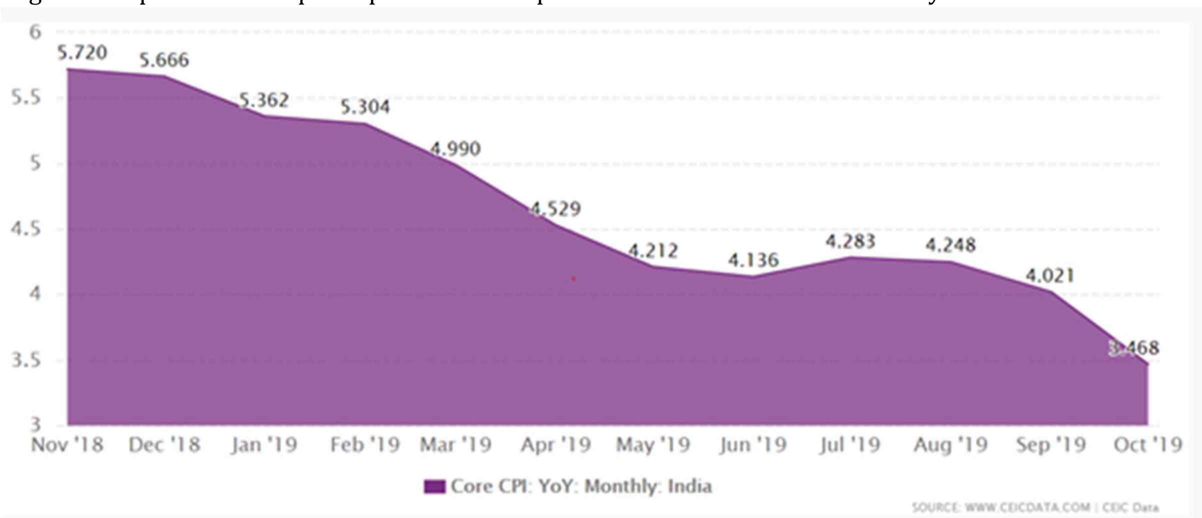


Figure 128: India's Core Inflation *(Source: CEICdata.com)*

Core inflation on the other hand has been on a downward trajectory suggesting weak economic activity and demand. The softening of commodity prices is also reflected in the dwindling core inflation. Core inflation fell to 3.46% in October 2019, underlining the ongoing slow down. In fact, it is the high gold price in the past few months that has kept inflation from decelerating even further. Therefore, we believe that the dwindling core inflation further justify another round of rate cut in the first quarter of 2020.

Moving forward, a weakening rupee due to growth slowdown and equity outflow is likely to result in imported inflation. However, RBI has announced to pause rate cuts for 2019 to tame inflation. Hence, we speculate that the inflation rate is likely to moderate and stay slightly above RBI target rate of 4% in 2020.

RBI Rescue to NBFC Liquidity Crunch

Since IL&FS collapsed in late 2018 amid fraud allegations, NBFCs have been putting up against a credit crunch. The Reserve Bank of India (RBI) implemented a few key measures to cushion the liquidity constraints being faced by NBFCs.

First, the central bank has decided to raise a commercial bank's exposure limit to a single NBFC to 20% of Tier-I capital from previous 15%. The move was aimed at boosting credit flow to stressed NBFCs or shadow banks. The increase in exposure limit helps to ease liquidity pressure on NBFCs since it allows some commercial banks to notably lend more. In particular, large NBFCs whose funding came from these banks will be able to receive additional funding.

Next, the central bank has also grant bank lending to registered NBFCs, other than micro-finance institutions for on-lending to agriculture, small enterprises and housing which will be classified as priority sector lending. This measure is implemented to address prolonged slump in agricultural and housing as well as facilitate higher credit flow to certain priority sector. By granting bank lending to NBFCs for on-lending to priority sector credit flow may be amplified to sectors which contribute significantly to economic growth in terms of exports and employment. This allows tapping of business opportunities among financially excluded areas which were previously overlooked. We can expect this to improve India's export competitiveness and employment level given that potential economic activities are being facilitated to give a boost to the economy.

Following, RBI allowed commercial banks to tie up with NBFCs for co-origination of lending to priority sector. Under the co-origination scheme for priority sector lending, loans would be originated by NBFC with a minimum exposure of 20% and commercial banks would fund the rest of the loan with pre-agreed rates of lending by the two players. This will render such loan much cheaper to the end-borrower than a typical loan given by an NBFC. This scheme provides a win-win situation for both parties. For NBFCs, their profitability is being enhanced without much funds being invested. As for commercial banks, they can achieve their priority lending targets without bearing costs of operation with low credit risks.

However, while easing the flow of liquidity of NBFCs provided some relief, it is inadequate. RBI's restriction on banks to lend only those NBFCs which enjoy investment rating of A+ or above is likely to lead to a further slowdown in credit disbursal to the sector as most NBFCS in India enjoy a rating lower than that. Another reason why these measures are unlikely to ease pressure substantially is due to the fact that only NBFCs with strong asset profile are granted support given that banks and financial institutions have become more risk-averse in view of limited capital and deteriorating asset quality. Further, a pickup in overall credit growth is unlikely. Growth in loans to the industrial sector and services is not expected to see a substantial improvement unless firms starts expanding their capacities at a large scale.

We project that the Indian economy will continue to experience the spillover effects of the NBFCs crisis since the combo of rate and liquidity easing have limited effects in giving impetus to the NBFCs sector.

FX TRADE IDEA: LONG USDINR

Figure 129: USDINR daily chart *(Source: TradingView)*

For India, we expect a sluggish trend in GDP growth to continue into 2020. The sharp slowdown in import demand reflect weak investment and domestic demand. This is due to stagnating wages and tightening lending conditions as a result ailing health of financial institutions which pushed consumer to delay discretionary spending. While FDI remains strong, the fall in global liquidity and trade uncertainties is likely to weigh on capital flow. India's PMI index fell to 48.7 in September from 52.4 in August and its GDP has fallen to six-year low, further highlighting manufacturing weakness. We expect another rate cut in the first quarter of 2020 to boost the slowdown in India's economy. Hence, INR is likely to weaken.

For the U.S., the economy is expected to be back by strong labour market due to tax cuts. Consumer spending will strengthen the U.S. economy. Household spending will also be supported by gains in wages. Further, the easing of policy by the Fed over the course of 2019 has helped boost credit, particularly to U.S. households. This support should remain in 2020 although we do not expect further rate cuts. The announcement of partial trade agreement also shows possibility of positive resolution. Hence, we believe that the USD is likely to remain robust.

Entry Level: 70.510
Take Profit: 71.190
Stop Loss: 70.249
Risk to Reward ratio: 2.60

Taking a look at the USDINR chart, price has been consolidating between 70.31 and 72.00. The currency pair may test previous support at 70.31 due to strong momentum of Rupee. There is a possibility for a further decline towards key support namely the 50% Fibonacci level before heading for the bull. RSI indicates oversold condition of the currency pair and signal potential upside of the USDINR pair. Although SMA period of 50 and 100 indicates a neutral position and further signal is needed for confirmation, the shorter period SMA is still currently above the 100 SMA.

SINGAPORE (Neutral)

With a small endowment of resources and the absence of natural economic hinterland, Singapore's small economy is highly driven by exports. Singapore holds a status as the premier port of call in Southeast Asia, making trade a key part of the economy with manufacturing and service industry being the key drivers. The Gross Domestic product in Singapore was SGD 491.2 Billion in 2018.

While manufacturing remains a key pillar of Singapore's economy, accounting for around 20% of our GDP, Singapore heavily invest in research and development to ensure that Singapore is at the forefront of innovation. However, according to MAS, given the slowing global tech sector, Singapore's growth drivers will shift from trade-related to modern services cluster.

Potential Rebound to Singapore's Tepid Economic Growth

Figure 130: Singapore's Quarterly GDP Growth (*Source: Trading Economics*)

Singapore's economy struggled over the past two quarters. The Singapore economy grew by 0.1% and 0.5% y-o-y in the second and third quarter respectively which is a significant dip from the 1.2% in the fourth quarter of 2018. The fall in economic growth was attributed to the downswing in electronics which contributed to the weakening manufacturing sector. The manufacturing sector which makes up about one fifth of the economy contracted by 1.7% y-o-y in the third quarter, though an improvement from the 3.3% decline in the previous quarter. Furthermore, weakening sentiments has resulted in a lower spending on discretionary goods which explains the sluggish retail sector which contracted by 3.3% y-o-y in the third quarter.

However, in general there was a steady growth across most sectors compared to the prevailing quarter. The construction sector expanded by 2.9% y-o-y. Modern services which accounts for two-thirds of the economy remain the main driver of domestic growth. The service sector proved instrumental in Singapore's aversion from a technical recession with support from the ICT and finance and insurance sectors which grew by 3.4% y-o-y and 4.3% y-o-y respectively. Digitalisation has boost electronic and credit card transactions which is the key contributor to the stable growth of the two sectors.

On the investment side, we can expect investment to continue with its slow growth amidst perpetuating policy uncertainty which leads to dipping business sentiments as well as downturns due to external shock. However, instability in neighbour country Hong Kong have encouraged stronger inflow of capital and more property investors searching for a safe haven. Singapore has received HKD 4-5 billion in capital flow from HK as of August. This will help buffer the impact of a weaker investment.

Despite the poor manufacturing data in the third quarter, we can expect growth momentum to pick up in 2020. This is due to the fact that the manufacturing sector is poised to recover to positive growth in the later quarters. There is a progress in the growth of semiconductor equipment billings and consistent increment in semiconductor shipments from USD 32 billion per month in April to USD 34 billion in August. This implies a potential reversal in Singapore's key sector. While further reduction in retail sector due to continued cutbacks in discretionary spending is not unforeseen owing to softening labour market with unemployment rate rising to 3.2%, which is a 0.1% increment from the second quarter, other service sectors are expected to remain steady due to demand for digital facilities and ecommerce platforms. Thus, we can expect a gradual pickup in economic growth.

U.S. - China Trade War takes a Toll on Singapore's Trade

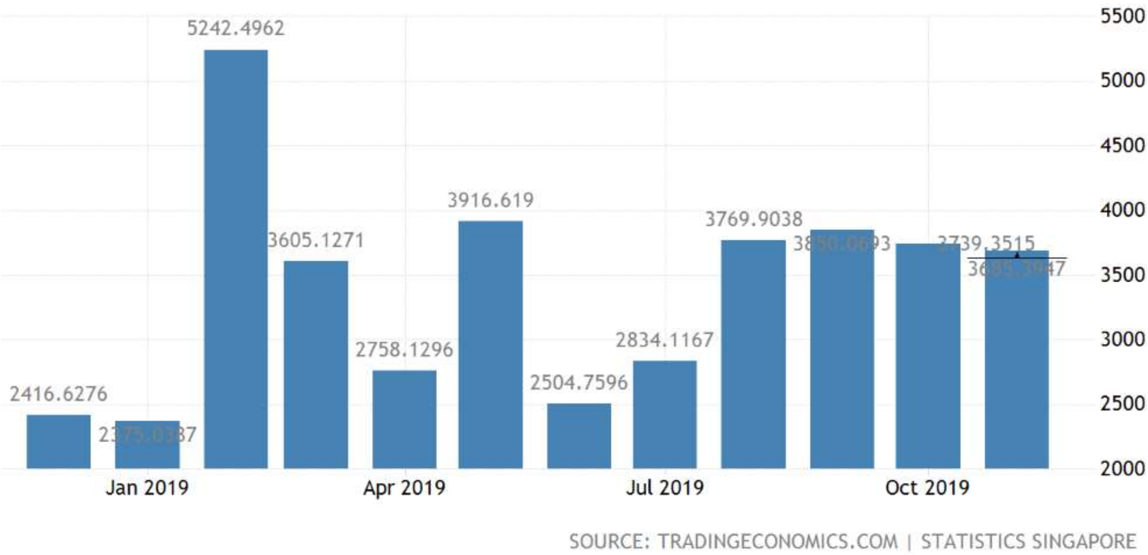


Figure 131: Singapore's Trade Balance (*Source: Trading Economics*)

With Singapore's economic growth being largely dependent on trade, in which exports makes up 176% of Singapore's GDP in 2018, the U.S.-China trade war further triggers economic slowdown to the already weakening economy. The ongoing trade war threatens export growth since both China and the U.S. are Singapore's key trading partners. 14.5% of Singapore's exports goes to China while 6.3% goes to the U.S. Hence, sluggish electronic demand amidst the downturn in China have adversely impacted Singapore's key manufacturing industry which saw a contraction of 3.3% y-o-y and 17% y-o-y in the second and third quarter respectively. Furthermore, certain products such as solar cells and commodities like steel and aluminium are directly affected by U.S. tariffs. With tariff imposed, Singapore's global supply chain will be disrupted given that goods produced which are used in China's export to the U.S. will experience a lower demand. The products account for a moderate 0.1% of Singapore's exports. Besides, a global dip in demand for tech products and its components has put a downward pressure on the semiconductor segment. These also rationalise for Singapore's persistent PMI level of below 50. A pessimistic economic backdrop and heightened uncertainties ensues.

Singapore's GDP is forecast to grow by 0.5 to 2.5 in 2020. Upon closer inspection, we believed that Singapore is likely to meet this forecast in 2020 in light of the gradual recovery of global electronics and resilience in various sectors. Besides, despite significant headwinds facing Singapore, if manufacturing and trade picks up in Asia owing to China's shift in production offshore, Singapore can look to benefit from the rise in maritime activity and shipping deliveries as a transport and logistics hub. Looking ahead, Singapore is also pursuing closer economic ties with emerging markets to diversify supply chains and enable companies to access more markets. For instance, Singapore is looking into FTAs with the Eurasian

Economic Union, the Pacific Alliance, and ASEAN region. As such, goods can flow more freely. Further, cheaper and sourced raw materials in the region will lead to lower manufacturing costs which makes Singapore's product being more price competitive.
Moreover, the U.S.-China trade war can generate positive spill-over effect. Singapore may benefit from trade diversion. Fundamentally, trade flows from China can be channeled from China to another competing producer. However, this will only happen if U.S. importers perceive sourcing from China too costly and opt for a shift in their procurement sources to ASEAN countries including Singapore.

Stop Button on MAS Monetary Policy Tightening

In view of a weaker GDP growth and a slowdown in Singapore's economy, the Monetary Authority of Singapore announced to keep its exchanged rate-based monetary policy unchanged in April 2019, after tightening it twice last year. This stance is due to the fact that a sharp slide in both global IT industry and demand from the Chinese counterpart have weighed on trade. Furthermore, weakening global oil prices have exerted a dampening effect on inflation. Besides, the two rounds of monetary policy tightening in 2018 will continue to have a restraining effect on inflation.

However, since the April policy review, global trade and GDP growth slowed significantly which saw MAS easing monetary policy slightly in October 2019. Benign inflation and softening labour market also supported this move. CPI inflation came in at 0.5% y-o-y while core inflation dipped to 0.8% in the third quarter compared to 1.4% in the first half of the year. We supposed that this is due to prior optimism towards Singapore economy to buffer the spill-over effects from the trade war.

Looking ahead, we envisage that the MAS will continue with a dovish monetary policy given that the trade -related sectors are expected to stay sluggish and rising policy uncertainty will continue to dampen business confidence and investment. While labour markets are currently resilient, signs of softening are starting to surface. Further, the persistently below historical average core inflation rate of 2.0% does put pressure on MAS to loosen monetary policy. However, this dovish step may not be warranted now due to the possibility for the economy to pick up at the later quarter.

Spill Over from Hong Kong Protests

Given the close trade and investment ties between Singapore and neighbouring Hong Kong, negative spillover is inevitable. Hong Kong was Singapore's fifth biggest trading partner in 2018 and trade between Singapore and Hong Kong accounts for approximately 1.2% of Singapore's GDP in 2018. Singapore's business operations in the lifestyle and retail sectors in Hong Kong have been directly affected. Retail sales have fallen by some 11.4% in July, marking six months in a row of declining sales. While the repercussion of tensions in Hong Kong has yet to be significant but in the longer-term, Singapore's economy is sure to absorb the shock. We posit that the instability in Hong Kong only extent global economic uncertainty and adversely affect investor confidence which will weigh on investment and economic activities near the region. Singapore is likely to suffer a drop-in trading volume.

However, the unrest in Hong Kong has brought positive spill over to Singapore. Singapore has seen a rise in both businesses and tourists. According to the Singapore Tourism Board, Chinese tourist arrivals in July showed a 46.3% climb. Although, Singapore has reaped benefits as a neighbouring financial centre, it has taken a cautious approach so as to preserve diplomacy.

FX TRADE IDEA: LONG USDSGD

Figure 132: USDSGD daily chart *(Source: TradingView)*

Fundamentally, SGD will be weak due to Singapore's weakening manufacturing sector with its PMI level persistently remained below 50 over the past few months. Further, the labour market is expected to continue softening. The unemployment rate rose to 3.2% up 0.1% from the previous quarter. Besides, Singapore is undergoing structural transition such as automation in manufacturing, this will mean that some jobs will become obsolete and hence permanent loss of job. Given Singapore's trade dependent nature, it implies that Singapore will be vulnerable to any unexpected negative shock. The devaluation of the Chinese yuan also contributes to a weakening SGD. This is due to the high trade volume with China. When China devalue its yuan, it attempts to strengthen its exports. This puts Singapore's exporters at a disadvantage as they will face a price disadvantage compared to their Chinese competitors. This will affect SGD given the high degree of exposure to China. While the manufacturing sector is expected to recover in the year ahead, global uncertainties remains.

For the U.S., while the economy is expected to slow down it is fairly resilient. Unexpected decline in U.S. retail sales in September shows weakness in the manufacturing sector and hence adversely affect the economy. However, in view of dissipating trade tensions and strength in consumer spending, GDP growth is expected to be stable. Consumer spending growth rise by 2.9% in the third quarter. This is due to strong consumer confidence and moderation in income growth. Also, there is an improvement in housing market aided by falling mortgage rates as well as rising real income. This will help the economy to remain resilient in 2020.

Entry Level: 1.36013
Take Profit: 1.37068
Stop loss: 1.35621
Risk to Reward ratio: 2.69

From a technical perspective, it can be seen that prices have been on a downward momentum since August. Price broke the neckline of the head and shoulder pattern, before declining again which indicates that the USD is attempting to push against SGD hence upside is being tested. Although the faster 50 SMA crosses below the 100 SMA and there is increasing divergence between the 100 and 50 SMA which may signal continuation of bearish trend, RSI is in the severe overbought zone with RSI way below 50 which indicates that downward pressure may ease. Hence, we expect a reversal of trend towards the bull. If USD breaks above the previous key resistance of 1.36, USDSGD is likely to rally further upside.

VIETNAM (Overweight)

Vietnam's GDP for 2018 currently stands at USD 244.95 billion and has enjoyed high GDP growth consistently, ranking among one of the fastest growing countries in South Asia. Vietnam's GDP is driven mainly by their services sector, and the value of her exports alone counts for almost 98% of its GDP. Vietnam's economy is also set to outpace that of their fellow rivals in South Asia, with analyst predicting it to surpass that of Singapore's in 10 years' time.

The main exports of Vietnam comprise of electrical equipment including phones (41%), footwear (8%) and machinery (6%) with its major export partners being the U.S. (19%), China (16%), Japan (8%) and South Korea (7%).

The Emerging Market Poised for Growth

Vietnam's gross domestic product expanded by 7.3% y-o-y in 3Q2019, following a marginally revised 6.7% growth in the previous quarter. This was the strongest GDP growth rate since the fourth quarter last year. Current analyst estimate for the end of year GDP is expected to come at USD 255 billion. We believe that Vietnam is well positioned to beat this estimate as the trade war serves as a tailwind for Vietnam's economy, in the form of relocating firms to Vietnam such as Apple's air pods manufacturer, GoerTek. Several Chinese companies are also shifting production out of China as well. TCL, a Chinese electronics company, is moving its TV production to Vietnam. As China's economy grows, together with rising labour costs and wages in China, Guangdong, which is the southern manufacturing powerhouse of China is now no longer the low-cost platform it used to be. For many of the firms looking to lower their cost of production in view of U.S.-China tensions, Vietnam is seen as a more attractive alternative with a lower cost of production in terms of cheaper labour costs. It seems that Vietnam has succeeded in positioning itself as the main low-cost regional alternative to China for export-orientated manufacturing and the ongoing U.S.-China trade war will only serve to accelerate the shift of such firms from China to Vietnam. This can be seen from Vietnam's foreign direct investments (FDIs) steadily rising in previous years, which could be attributed to foreign investors relocating firms to Vietnam.

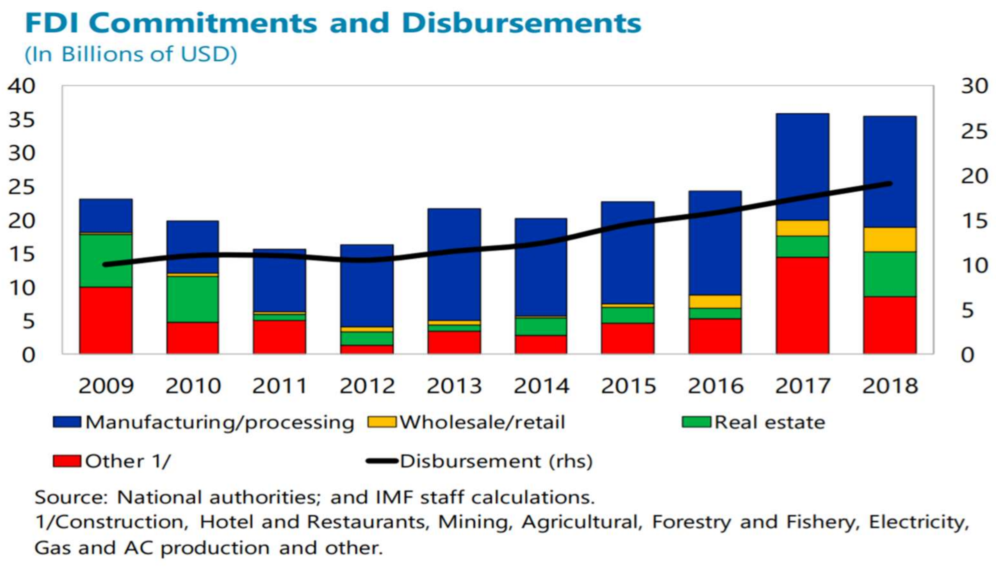


Figure 133: Vietnam's FDIs (*Source: imf.org*)

We see this as creating more jobs for a thriving economy, Vietnam, meaning a boost in income levels, increased spending, and higher GDP growth. Currently, investment expenditure accounts for 26.5% of Vietnam's GDP, which is a considerable percentage of its GDP and the large FDIs inflows can also support the booming tourism sector for Vietnam.

Additionally, Vietnam has good and sound economic fundamentals for the current year with low rates of unemployment and healthy levels of inflation. The unemployment rate as of 2018 stands at a low 1.9%

while inflation is at a healthy 3.5%. At current percentages, we believe the economic conditions are suitable for robust growth in Vietnam, which will in turn cause higher tax monies to be collected for the Vietnam government to increase its fiscal budget to spend more on government expenditure. The expanding of the export sector will also help to boost the size of Vietnam's economy which leads to higher indirect taxes.

In addition, Vietnam's consumer confidence index (CCI) currently stands at 128 in 3Q2019, up 5 points previously from 2Q2019. Vietnam's CCI is also ranked 3rd in the global economy behind India and the Philippines. An index level above 100 indicates optimism while a level below 100 indicates pessimism. Coupled with an accelerating pace that Vietnam is growing at, the current optimism of consumers in Vietnam is likely to spur consumers to spend even more and drive further GDP growth.

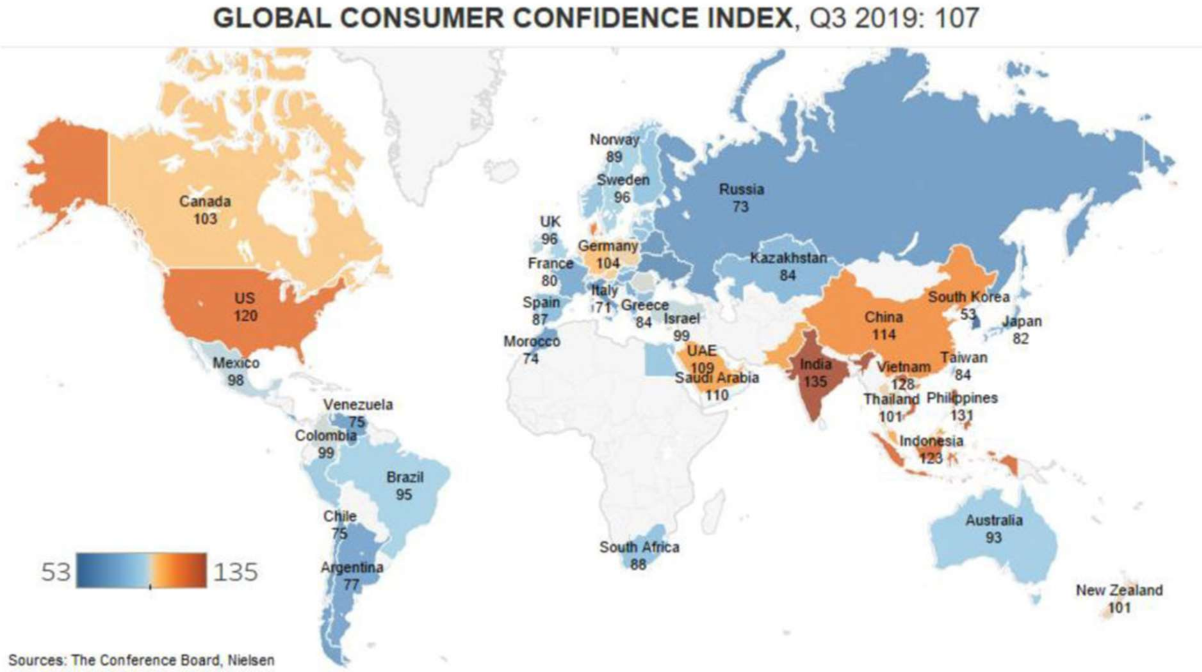


Figure 134: Global Consumer Confidence Index (*Source: The Conference Board, Nielsen*)

Vietnam Working Closely with U.S. to Crack Down on Transshipment

In July, Vietnam was slapped on more than 400% on import duties of steel due to suspected transshipment of firms to bypass U.S. trade tariffs. Vietnam recently seized 4.3 billion in falsely labelled Chinese aluminium by a company based in the southern province of Ba Ria-Vung Tau that tried to sidestep the U.S. tariffs. The Vietnamese customs have been working closely with American authorities during the investigation and is currently working hard cracking down on transshipment, on fears that it could put the country's relationship in conflict with the U.S.. As a result, the Vietnam government is increasing its scrutiny on product origins and have also tightened its issuance on certificates on origins for exports.

The measures done by Vietnam shows the serious and professional stance she has taken on this issue, likely done to strengthen their relation ties with the U.S.. This is important because the U.S. currently stands as the number one contributor of exports for Vietnam's economy. The measures aforementioned are likely set to strengthen economic ties even further between the two countries as Vietnam focuses on eliminating the trade tariff evasions for U.S..

The increased bilateral cooperation with the U.S. would serve as a tailwind for Vietnam as she has been increasingly reliant on the U.S. for further economic growth in terms of exports. This can be supported by figure 135 below, where the change in U.S. imports from Vietnam has increased by a staggering 34.9% or USD 49.0 billion y-o-y. It is hence imperative that Vietnam maintains and establishes good relations with the U.S. as this will place Vietnam in a favourable position to stand at in the U.S. – China trade war.

Figure 135: U.S. Imports from Trade Partners (*Source: statista*)

<u>Exports in Vietnam Lose Steam</u>

Export growth for Vietnam has decelerated in the previous 4 months, which reflects an increasingly uncertain global economic outlook. In particular, the agricultural and commodities areas actually contracted, with goods like rice, seafood and phones declining. Areas in labour-intensive manufacturing exports continued to grow albeit at a slower pace.

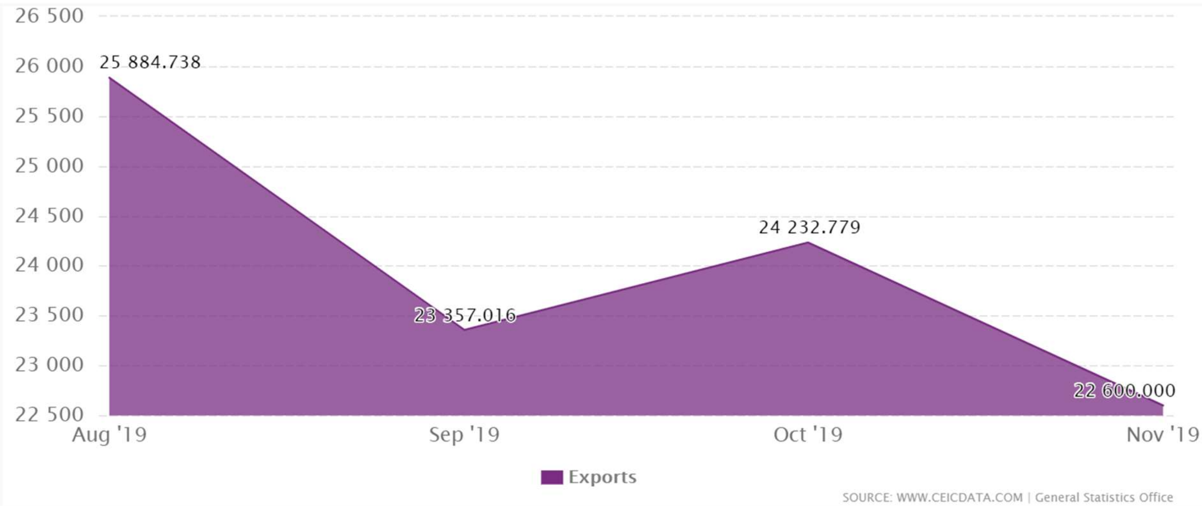


Figure 136: Vietnam's Exports (*Source: CEICdata.com*)

The slow in exports could be explained by a fall in the prices of industrial crops for the agricultural sector in addition to trading partners setting stricter standards for imported agricultural products. Specifically, the Chinese market heightened the standards of quality of imported agricultural products, as well as its management and border trade standards. Similarly, the U.S. has placed anti-dumping duties on Vietnamese seafood goods and continued an inspection programme for catfish under the Agricultural Bill. Japan and Korea have also regularly reviewed and adjusted their regulations on food safety and increased the frequency of checking imported agricultural and fishery products, causing detrimental effects for Vietnam's exports to these markets. Given the stringent conditions imposed, Vietnam's agricultural sector needs to restructure to stay ahead in the competitive global market.

However, among the developing countries, Vietnam's exports remain strong as compared to her competitors. Based on the U.S. trade data imports up to 3Q for the year (as discussed previously), Vietnam is among the top beneficiaries of the trade tensions in terms of increased exports to the U.S.. This has helped Vietnam to sustain a current account surplus for the 7th consecutive year in 2018. The slow in exports are hardly evitable as the U.S.-China trade war has a global impact on weighing down countries' exports. But given resilient domestic demand as the CCI remains high in Vietnam, it is very possible that the positive factors (including strong FDIs) are able to offset the negative impacts of slowing exports and we believe that GDP growth in Vietnam will continue to remain robust. Moving forward, a current account surplus is still likely to continue on for Vietnam in 2019 as the country still remains one of the top beneficiaries of the trade war, though a marginally lower surplus is to be expected due to the trade war dampening on international trade flows as well as the global economic outlook.

A Flourishing Tourism Industry?

The number of international tourism arrivals to Vietnam has nearly increased four folds, from 4.2 million in 2008 to 15.5 million in 2018. The tourism industry in Vietnam has been flourishing and expanding at an increasing pace in recent years; Figure 137 shows the number of tourist arrivals in Vietnam with a record high of 1.8 million arrivals in November 2019.

Figure 137: Vietnam Tourist Arrivals (*Source: Trading Economics*)

According to the World Economic Forum's (WEF) Tourism Competitiveness Index, Vietnam has achieved the largest overall improvement in competitiveness among its regional peers, with the largest coming from areas of Information and Communications Technology (ICT) readiness, international openness, safety and security, as well as ground and port infrastructure since 2015.

Being a labour intensive sector, tourism generates many jobs and income opportunities for locals while also providing export diversification away from manufactured products. According to the General Statistics Office (GSO) of Vietnam, the majority of international visitors are from China, which makes up 32% of the visits in 2018. It is likely that Vietnam's tourism industry will be set to grow even further as a result of China's growing middle class with their household income increasing at a steady pace y-o-y.

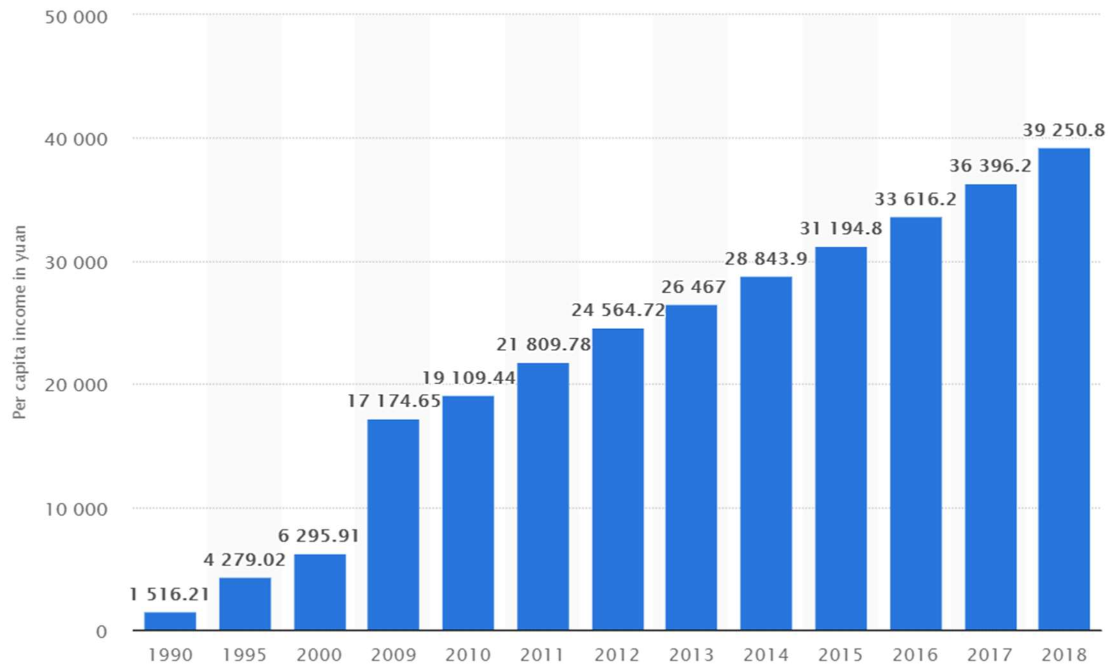


Figure 138: China's Per Capita Income (*Source: statista*)

In Ho Chi Minh City alone, it is estimated that around 21600 workers are needed in 2020 which translates to a whopping 8% of the total workforce, according to the city Department of Tourism. This leads to a key problem that Vietnam is currently facing regarding the tourism industry. Tourism is part of a service sector, which means that specific skill sets are required in order to qualify as a tour guide or the related. The spike in growth of Vietnam's tourism industry will mean that the limited supply of qualified tourism workers needed might not be able to keep up with the demand. In fact, Vietnam is currently in a dire need for more qualified tour guide workers and is facing a shortage of workers needed.

This shortage could be mitigated by improvements in the international mobility of tourism workers from ASEAN. With Vietnam's integration into the ASEAN Economic Community, key positions in the tourism sector are more likely to be filled by foreign labours due to the free movement of skilled and certified tourism workers across national borders. For Vietnam, the ASEAN Mutual Recognition Arrangement for Tourism Professionals (MRA-TP) has allowed multiple benefits for Vietnam's tourism industry. The benefits of MRA-TP include improving the quality of human resources for tourism, as well as enhancing the quality of tourism products and services. Vietnam also has to consider training reform, in the form of tourism training to be improved in terms of both quality and quantity to provide the industry with a sufficient number of qualified workers for Vietnam to cope with demand while ensuring that the quality of workers is not being compromised.

With Vietnam's current healthy economy, we believe that inflow of labour would be strong as workers can be compensated with higher and more attractive pay wages as GDP grows in Vietnam. The demographics in Vietnam are also rapidly improving as we speak, in terms of higher educational standards in the recent years. As more students pursue tourism as part of their major, together with increasing training institutes and enterprises being developed for these students, the supply of skilled tourism labour can be improved. However, the shortages of workers are still likely to persist, since the demand for tourism has also been increasing at a fast pace, with the aforementioned solutions only be able to mitigate the shortage. There is still a need to improve Vietnam's tourism industry, be it through increasing local or foreign workers to better meet the spike in demand for tourist workers.

ETF TRADE IDEA: LONG VanEck Vectors Vietnam ETF

To capitalise on the growth of Vietnam's economy, the VanEck Vectors Vietnam Exchange-Traded Fund (ETF) is an appropriate instrument to look at. The VNM ETF tracks the MVIS Vietnam Index, with over 70%

of its net assets composing of Vietnam's with the top 3 sectors including real estate (27.0%), consumer staples (13.9%) and information technology (13.3%).

NYSEARCA: VNM

Figure 139: VNM Price Chart (*Source: TradingView*)

Undeniably, Vietnam's economic growth remains one of the highest in 2019, rivalling with that of India and the Philippines. Strong consumer confidence, large inflow of FDIs and a thriving tourism industry have all contributed to Vietnam's development. In addition, though the U.S.-China trade war has been detrimental to Vietnam's exports, she has been one of the largest beneficiaries of the trade war. It appears that Vietnam stands at a favourable condition and her economy is blessed to flourish in this scenario.

From a technical standpoint, we observe that the price of the VNM ETF recently broke out of the downward price channel. This can be supported by the 20-DMA (orange) reversing its trend. In addition, the MACD line (blue) can be seen crossing over the signal line (orange), signifying bullish momentum. Also, note that the RSI in early December actually went to an oversold condition below 30.00 before rising steadily after, seemingly reverting the trend back to the bullish mean. We can see that the price level of 15.97 has been tested several times in previous months and recently tested once again in the current trading session. This forms a nice support line where traders can look to enter the trade should the 15.97 price level gets tested again.

Entry Level: 15.97
Take Profit: 16.53
Stop Loss: 15.70
Risk to Reward ratio: 2.07

The take profit price of 16.53 is set at the previous resistance level in a 6-month window, for a risk-reward ratio of 2.07. Stop loss order can be placed roughly at 15.70, where the RSI reached an oversold condition back in early December.

THAILAND (Neutral)

Bangkok is the capital state of Thailand, but few will know Bangkok actually has this long and extremely interesting ceremonial name. Bangkok's ceremonial name is "Krungthepmahanakhon Amonrattanakosin Mahintharayutthaya Mahadilokphop Noppharatratchathaniburirom Udomratchaniwetmahasathan Amonphimanawatansathit Sakkathattiyawitsanukamprasit" which roughly translates to "City of angels, great city of immortals, magnificent city of the nine gems, seat of the king, city of royal palaces, home of gods incarnate, erected by Visvakarman at Indra's behest".

Thailand is also the world's largest orchid exporter and its GDP currently stands at USD 504.99 billion as of 2018. The main drivers of Thailand's GDP are its services and industrial sector, which combined, made up over 90% of its GDP.

The Thai baht, which originated from a unit of mass in tradition, is now one of the more popular used modes of payment currency, ranking among the top 15 in the world. Thailand has also one of the lowest unemployment rates globally, at a low 0.67% in 2018 which is largely attributed by the informal sectors of the economy in addition to zero unemployment benefits in Thailand.

Thailand's Central Bank Slashed Key Interest Rate for First Time in over Four Years

On 7th Aug 2019, Thailand announced a cut by 25 basis points from 1.75% to 1.50% on its interest rate, citing weaker demand for the country's export due to slowing down of the global economy. In addition, Thailand's currency has jumped more than 7% against the dollar since the beginning of the year, which effectively increases the price of Thailand's exports. This has hurt Thailand as she is especially reliant on their exports, which contributes nearly 70% to their GDP, with the tourism industry alone accounting for 20% of its GDP. The thriving tourism industry in Thailand has led to a strong current account surplus for them which in part, explains the strengthening of the baht and coupled with strong direct investment inflows raises the demand for the Thai baht even further among many other reasons such as a healthy reserve and low inflation. As such, the strengthening of Thai baht does have its own serious consequences by dragging down the export competitiveness of Thailand's economy.

The rate cut decision possibly aims to bolster economic growth in the following ways. First, a rate cut can revive the faltering economy, by encouraging consumers to save less and spend more to boost consumption expenditure. Second, businesses are able to borrow more at a lower cost and in turn spend more on capital and investment expenditure, boosting GDP. Third, the rate cut typically eases the upward appreciation of the Thai baht, which can help to improve Thailand's export competitiveness, in an effort to offset the effects of a weakening global economy. The Bank of Thailand (BoT) left its policy rate unchanged at 1.5% on its 25th September 2019 meeting but did another unexpected rate cut by 25 basis points, down to 1.25% on its 6th November meeting. Moving forward, the next BoT meeting would be on 18th December, which we believe that the interest rate will likely remain unchanged due to the unexpected cut on the previous meeting and thus we believe that the BoT is likely to adopt a neutral stance on its interest rate policy. Moreover, the interest rate cuts have not been helping much with the easing of Thai baht when the actual problem here stems directly from the strong demand for the baht due to inflows of investment. The BoT has notion that it would instead ease capital controls by revamping its Exchange Control Act (ECA) in a bid to make moving money abroad smoother for the locals to curb the strengthening of Thai baht. If done correctly, this can largely improve the export competitiveness of Thai products, and the BoT would not have to lower their interest rates further. Until there is actual progress about how the U.S.-China trade war plays out, the BoT's next move would likely continue to remain neutral.

In addition, there are also many repercussions associated with easing interest rates too aggressively. Thailand's household debt levels have been slowing climbing up following several years of low interest rates as seen in the chart below where the rate at which the household debt levels have been accelerating. This is a major cause of concern because it can steer investors, both local and foreign away and also, lower consumer's confidence. An interest rate cut will only serve to exacerbate the household debt problem which further supports the stance that though economic growth may be sluggish, the BoT is unlikely to cut rates any further for now and adopt a more neutral stance on their part.

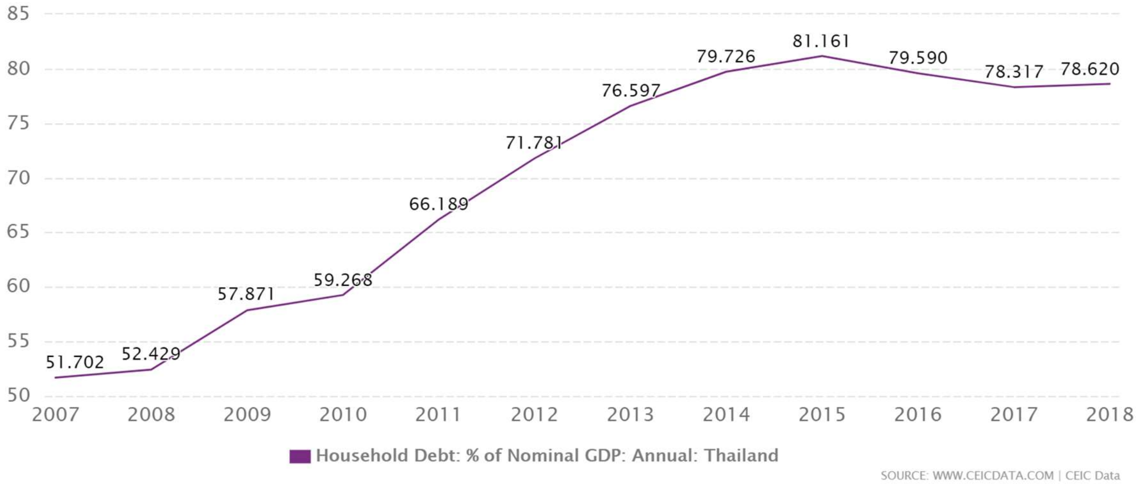


Figure 140: Thailand's Household Debt (*Source: CEICdata.com*)

This is not to mention that future rate cuts will be also increasingly difficult when interest rates are already painstakingly low at the current 1.25%. The dire state of the negative interest rate trap might be something that Thailand wants to avoid falling into, taking into consideration of how fellow countries like Japan, whom have been suffering from cryptic deflation, or the EU with persistent low economic growth, unable to implement effective monetary policy to revive their faltering economy.

<u>Weakening Outlook for Thailand</u>

The Thai economy grew 2.4% y-o-y in 3Q2019 below the market consensus of 2.6% as trade wars and global slowdown continues to weigh on their exports, driving the government to downgrade the overall growth outlook for the year. Moreover, Thailand's strong baht is also not helping with their economic growth and the BoT in September has reduced its growth forecast to 2.8% in 2019 and 3.3% in 2020, from previous estimates of 3.3% and 3.7% respectively. The manufacturing purchasing managers index (PMI) is also down to 49.3 in November, signaling a contraction in the economy for the first time since February 2019.

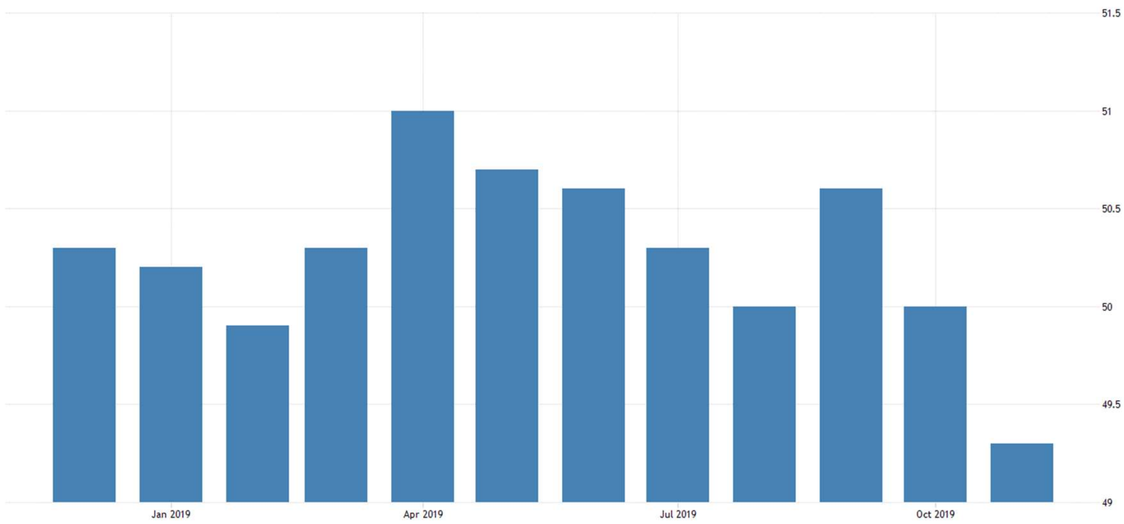


Figure 141: Thailand's Manufacturing PMI (*Source: Trading Economics*)

In addition, there has been persistent low inflation plaguing the Thailand economy where she even experienced deflation in the year 2015.

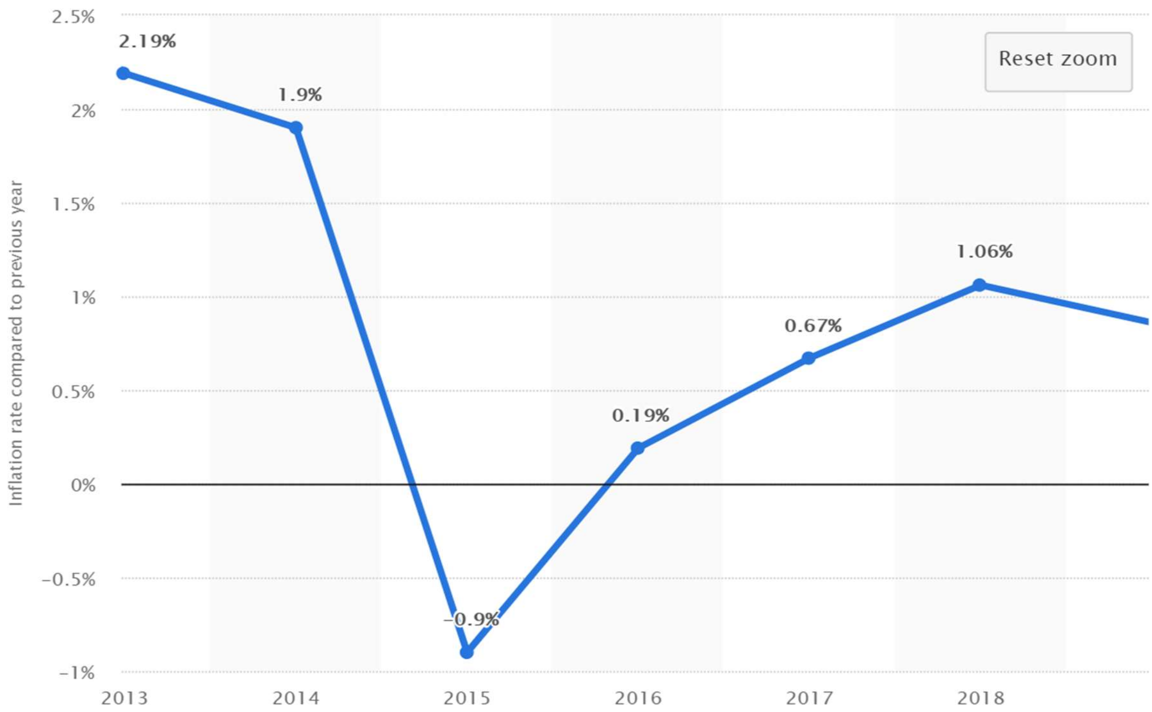


Figure 142: Thailand's Inflation Rate (*Source: statista*)

This low inflation is likely to persist as domestic demand remains soft in Thailand, which could largely be attributed by increasing decline in consumer confidence according to data from the University of the Thai Chamber of Commerce, coupled with moderate household income and recent decline in employment (particularly in export-related manufacturing sectors).

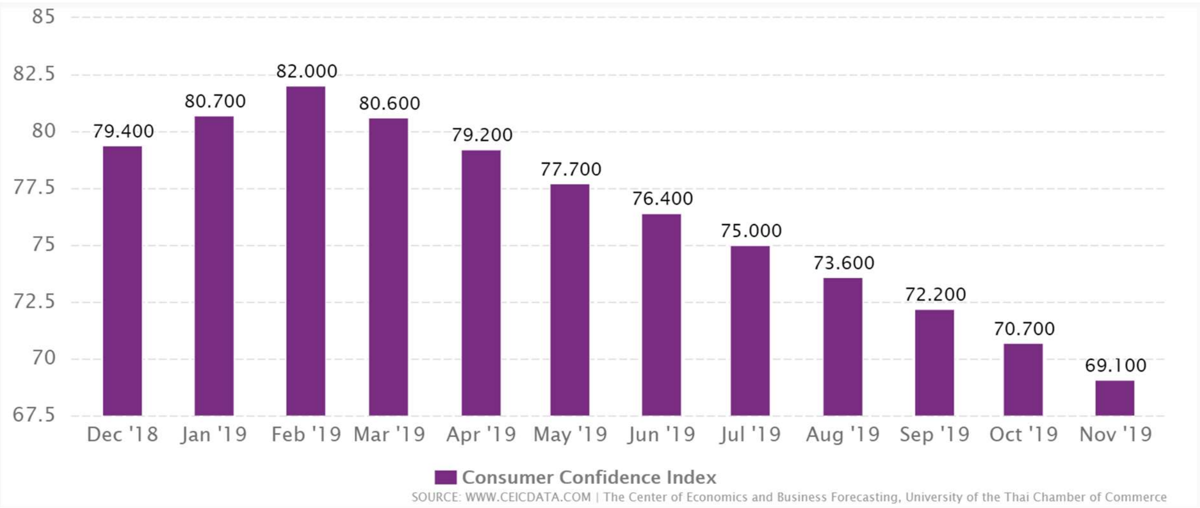


Figure 143: Consumer Confidence Index in Thailand (*Source: CEICdata.com*)

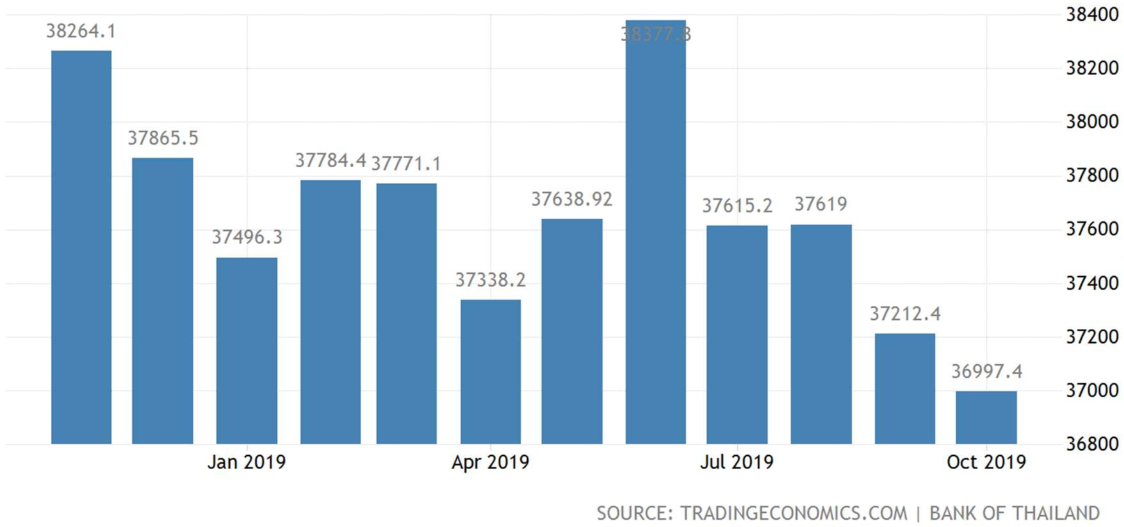


Figure 144: Number of Employed Person in Thailand (*Source: Trading Economics*)

This will lead to declined consumption expenditure and not to forget the elevated household debt Thailand is facing. Given a bleak economic outlook, the government will be careful to raise its value-added tax (VAT) to avoid dampening on consumer's sentiment too, leaving the government with fewer tax monies to spend on public infrastructure. Investment expenditure is expected to grow at a slower pace than previously assessed, with Thailand benefiting from FDIs inflow due to relocation of firms due to the U.S.-China trade conflict. However, more U.S. tariffs will only seek to aggravate this and dampen the outlook, which will take a further toll on investment, in addition to the fall in exports for Thailand. Private investment would likely hence expand at a lower rate than previously assessed.

China's slowdown in economic growth is not helping either, given that China is Thailand's biggest export partner. The recent interest rate cuts might push economic growth in Thailand, but with many other trading and regional partners of Thailand doing the same by cutting their interest rates as well, export competitiveness for Thailand will be mitigated too. This will mean that a monetary stimulus like a rate cut is likely to be ineffective in promoting economic growth, which might be why Thailand might need to resort to other fiscal stimulus to bolster and revive its economy.

Thailand's Measures to Boost a Faltering Economy

Fiscal stimulus measures have been implemented to boost domestic demand in Thailand. As announced in August previously, the government spent a staggering THB 316 billion (USD 10 billion) on a fiscal stimulus package which includes agricultural subsidies, cash handouts for low income earners and incentives for domestic travelers. The latest round of another fiscal stimulus package was unveiled in November again, which includes a budget of THB 144 billion (USD 4.7 billion) to upgrade the infrastructure in villages, more incentives and loans for farmers as well as improving the financial burden of house buyers.

Though these fiscal stimuli implemented are a way to offset the weakening growth in Thailand but are by no means a long-term solution to the problem as such fiscal stimulus is only temporary. Weak consumer sentiments and slowing exports still remain the crux of the issue that the Thailand government has to better deal with order for the economy to revive back.

There has also been the development of a large special economic zone, the Eastern Economic Corridor (EEC), based on new and upgraded transport links covering the Rayong, Chon Buri, and Chachoengsao provinces, which are key strategic hubs near Thailand's ports, expected to be completed by 2020. The drive to boost investment will also include the continuation of the sector-specific "Thailand 4.0" industrial policy package, which will provide significant investment incentives such as exemptions for duty imports and tax for foreign investors within and outside the EEC. The EEC acts as a key component of Thailand 4.0, which aims on building an innovation-driven economy including focus on the digital economy, automation and robotics, as well as biotechnology to name a few. The Thailand government also announced on 7th September 2019 to spend another USD 10 billion on a relocation package, which offers a 50% corporate income tax reduction for another five years for firms with real investment of at least 1 billion baht (USD 33 million), as well as a higher tax deduction on advanced technology training and for investment in automation.

The relocation of companies to Thailand and public-private partnership projects for infrastructure investment might support investment in the period ahead as it comes at an opportune timing for Thailand as many firms are sourcing for cheaper cost of production in emerging markets and coupled with increased production cost in China due to the trade conflict, this could prove to be a turning point for Thailand's economy. However, it is important to note that a tax incentive alone may not be able to promote an investment if the implementation of the EEC projects remains sluggish. This is because the EEC play an important role in Thailand's future economy. The completion of the EEC will attract more foreign companies and together with the Thailand 4.0 initiative, the relocation package will even be more so attractive to foreign companies. Currently, Thailand may be attracting some foreign firms looking to relocate production from China to escape U.S. tariffs, but Vietnam appears to still be the top destination for firms hit by the trade war. This is mainly in large due to lower wages and land prices in Vietnam as compared to Thailand. As the government heavily invests on the construction of the EEC, it is imperative to ensure no delays for the development to ensure that their private investment expenditure can flourish in 2020.

Finally, the commerce ministry of Thailand has also been rushing to finalise the Thailand-EU free trade agreement (FTA) and the country's participation in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), as well as the Regional Comprehensive Economic Partnership (RCEP). These measures seek to boost its weakening exports of manufactured goods and Thailand's active participation in the policies have allowed their exports to gain more market accessibility.

Trade Preferences for Thailand Cancelled by U.S.

On 25th October 2019, the Office of the U.S. Trade Representative (USTR) announced the suspension of duty-free access for USD 1.3 billion of Thailand's exports under the Generalised System of Preferences (GSP) scheme. These exports will now be subject to tariffs of up to 5% from 25th April 2020. Under the GSP, the U.S. grants selected goods from developing countries a preferential tariff-free access to the U.S. market as a form of economic development assistance. Goods that are susceptible to tariffs now include all seafood products, as well as some machinery and vehicle parts.

Part of the eligibility criteria under the GSP is the assurance of specific rights for workers, in which the USTR then quoted a lack of providing sufficient improvement in this area as the reason for withdrawing the special trade terms for some of Thailand's exports. However, because the U.S. State Department had actually upgraded this rating back in 2018, the move was seen as designated to reduce the balance of trade deficit with Thailand. As such, U.S.'s move on this part might come as a surprise and it is plausible that the trade deficit of the U.S. with Thailand actually played a role in the USTR's decision. As the measure covers only around 0.5% of Thailand's goods exports, the actual impact of the tariffs is likely to be limited.

However, the bigger picture in mind here is to note that the U.S. suspension of the Thailand trade preferences goes well beyond the concerns of the working conditions of the Thai fishermen. It can be seen that the U.S. can easily abuse the power that they hold, citing reasons it wants to, to achieve their aims. It might also be cautioning to firms thinking about diverting production from China to the emerging markets as a means to avoid U.S. tariffs. More U.S. tariffs may be on Trump's backhand and there is a need to remember that the Trump administration offense on trade is global. This move might cause firms to think twice from relocating to Thailand, and the potential benefits of the trade war for Thailand is being washed away by the very threat of the tariffs.

FX TRADE IDEA: SHORT USDTHB

Figure 145: USDTHB Price Chart (*Source: TradingView*)

Though economic growth for Thailand has been dwindling, it is undeniable that Thailand remains an emerging market with huge upside growth potential. Moreover, the baht has also contested against the weakening of economic data in Thailand, due to the huge influx of foreign capital as the Thailand economy enjoys a strong surplus of current account. In contrast, the U.S. Federal Open Market Committee (FOMC) had lowered the federal funds rate three times this year, putting further downward pressure on the USD.

The USDTHB chart can be seen to be on a downtrend and is currently trading in consolidation. A descending triangle pattern with the USDTHB making lower highs and a support level at 30.150 can be observed. The idea here is to short the USDTHB. We can see the 50-SMA (orange) seems to cross under the 200-SMA (purple), further signaling that a downtrend is likely to continue. Traders can wait for a more defined death cross to be formed for confirmation of a bearish trend in case of a false signal before entering this trade. Should the price of USDTHB fall below the support level at 30.150, we recommend entering this trade at an entry price slightly below the support level.

Entry Level: 30.140
Take Profit: 30.020
Stop Loss: 30.201
Risk to Reward ratio: 1.967

A stop loss of 30.201 can be set at the 0.786 Fibonacci retracement level should the USDTHB rebound back while the take profit should be ideally close to 30 because the USDTHB price has never manage to dip below the psychological round number of 30 as of yet. Assuming the take profit price of 30.020 is set, we are looking at a risk-reward ratio of 1.967.

INDONESIA (Neutral)

Indonesia is the world's 4th most populous country with population of more than 250 million and is currently the 7th largest in terms of GDP in terms of PPP boasting $3.5 trillion output in 2018. The economy has been growing steadily but has been stagnated at around 5% over the last 5 years. Being an agrarian country, Indonesia's agriculture sector has always been an important sector contributing 14.4% of GDP. In its attempt to stay competitive, developing human capital has been one of the government's current focus due to concerns of Indonesia being too dependent on its rich natural resources. Being an archipelagic country, there are also concerns about uneven growth across the country which the government is trying to address with a more even infrastructure development.

Resilient Domestic Growth Despite External Headwinds

Indonesia GDP growth is expected to grow at 5.0% - 5.1% for the year ending 2019, which undershoots the Government target of 5.3% but is aligned with analysts' expectation of ~5.1%. This year GDP Growth is mostly supported by growing private consumption due to strong labor market, controlled inflation and optimism around Jokowi's second term. We also see a one-time hike in contribution by non-profit organizations' spending this year due to the campaigns around the re-election on April. On the contrary, we see slowing investment growth, from around 7.0% on Q3 2018 down to 4.0% on Q3 2019, due to slowing global trade and companies withholding investments due to election. Export has continued to fall given the trade-war condition, exacerbated by generally falling commodity price for Indonesia's main export. Nevertheless, for the first time in 8 quarters we see positive contribution to GDP from net trade due to more significant contraction in import too due to reduced capital spending and partly due to Indonesia's import limitation policy adopted last year, which we will further discuss in the following macroeconomic theme.

Private consumption, the biggest contributor to Indonesia's GDP (~55%) has maintained its robust growth at 5.1%, partly boosted by the sharp increase in spending of +15.3% in Q2 by political parties for the April election. This robust growth has been supported by low inflation and strong labor market. Inflation currently stands at around 3.0% Y-o-Y, undershooting the government target of 3.5±1%, while unemployment continues to lower to record low of 5.0%. With inflation and unemployment level kept in check, consumers spending continue to grow steadily despite the gloomier climate in the global economy. Consumer Confidence Index (CCI) also shows strong optimism by consumers as it maintained a level above 122 throughout the year, except for a temporary dip to 118 on October. Along with newfound political stability as Jokowi takes on his second term, we believe there's reason to believe the strong consumption growth continues to persist given that no deteriorations in unemployment or inflation occur.

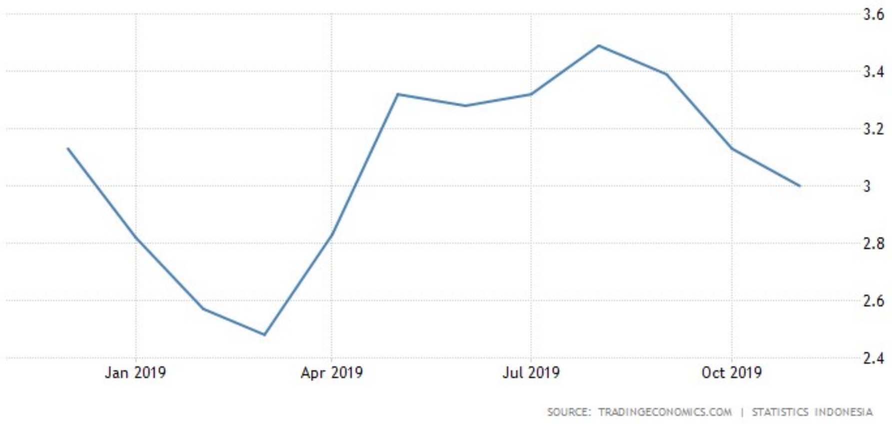


Figure 146: Indonesia's Inflation Rate *(Source: Trading Economics)*

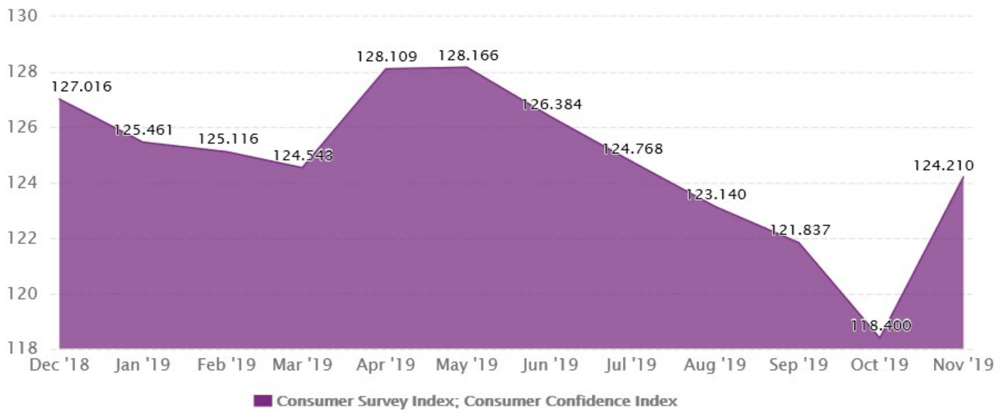


Figure 147: Consumers Confidence Index *(Source: Bank of Indonesia, CEIC Data)*

<u>Multiple Headwinds Faced in Export Sector</u>

Exports has contracted for the first time in ten quarters by 8.5% by Q3 due to combination of slowing global economy, protectionism policies and falling commodity price. Weakness in global economy around the globe along with the on-going U.S.-China trade war hurt emerging market exports particularly as demand for their export weakens. More importantly, falling commodity price has been the more significant factor for Indonesia's export weakness. In general, Indonesia's main export products have shown decreasing trend in their price compared to last year, including coal, palm oil and rubber. While export volumes for certain products have reactively increased, Indonesia's main export products still shows on average -18.9% decrease on value basis. Going forward, palm oil is likely to face further weakness in demand side due to new EU regulation against the use of palm oil.

The depressed commodity price can be primarily linked to the weakness from demand-side globally due to slowing manufacturing activity such as the slumping auto sales. This is not a surprise at all given the economic uncertainty we have borne throughout 2019. Going forward, we are moderately optimistic in the de-escalation of trade war situation in U.S. and China thus we expect steady recovery in commodity prices going to 2020 on the back of recovering demands worldwide.

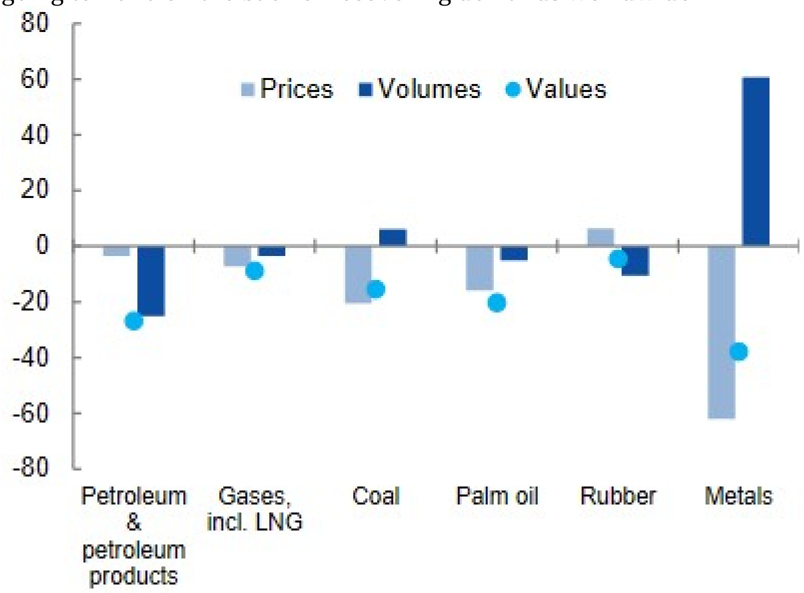


Figure 118: Y-o-Y Change of Commodities Value as per Q3 *(Source: World Bank)*

On the other hand, from import side we are seeing more drastic decrease than export decrease, at -12.0% by Q3. In response to the slowing global economy climate, investment has seen weakening growth in Indonesia which eases import too as capital spending on imports decrease. Government policy on import restriction has played a role on why import contracts. In light of widening Current Account Deficit (CAD) in 2018, Indonesia implemented control on import by implementing tax on imported goods (by 2.5% –

7.5%) and passing regulation to prioritize crude oil production for domestic demand. All in all, the policy has delivered -22.9% decrease in oil and gas import by Q1 2019.

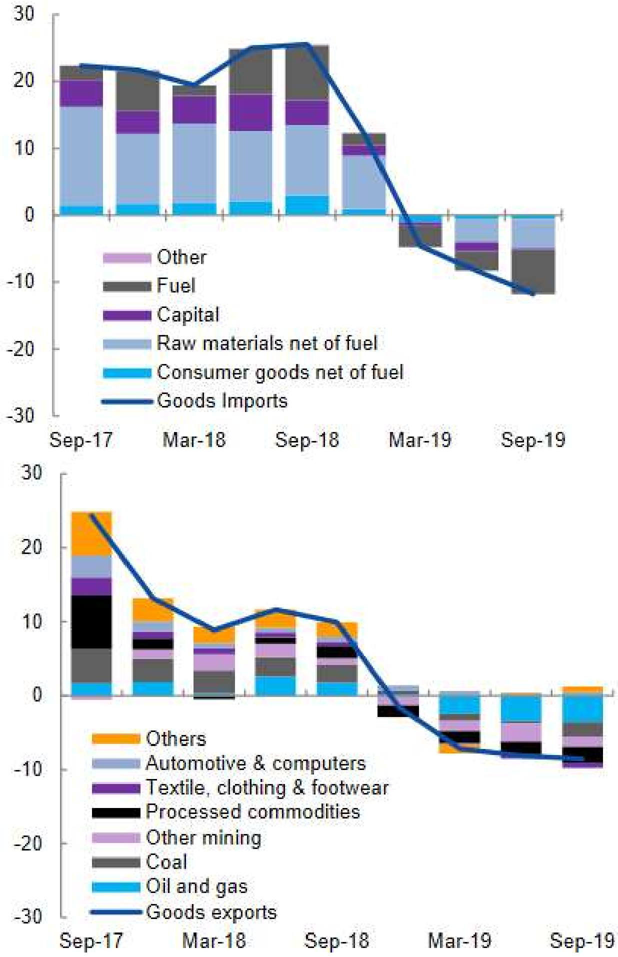


Figure 149: Export and Import changes by Q3 *(Source: World Bank)*

While all in all the simultaneous fall in export and import has resulted in positive GDP impact from net export perspective, weakness in export is not desirable and we regard it as headwind for Indonesia economic growth. Firstly, government policy on prioritization on crude oil alone will not be sufficient to reduce dependency on imported oil as inherently Indonesia does not produce enough oil for domestic consumption. Moreover, an increased retention in oil for domestic usage too will impact the export for oil. As oil import normalize, we expect Indonesia's Balance of Trade will worsen too given that commodity prices remain depressed. This highlights the structural problems in Indonesia trade as it is too reliant on commodities.

Easing Macroeconomic Policy to Drive Growth

Following interest rate hikes policy in 2018 to curb capital outflow, Bank of Indonesia (BI) cuts interest rate four times in a row from 6.0% to 5.0% this year. Along with the rate cuts, BI also lowered banks' reserve requirements by 50 basis points for the first time in 3 years in an effort to provide further liquidity in the banking system. The accommodative macroeconomic policies come in light as pre-emptive measures to keep growth momentum strong given slowing global economy. In particular, the slowing investment growth domestically has been of concern thus lowering interest rate may help kick start loans and investments by companies. This policy is also in line with government's goal to keep currency stability as the easing cycle is in tandem with U.S. easing policy starting July 2019 and with other emerging countries similar policy.

Through the year, USDIDR has been kept relatively at stable level of 14,000, peaking at 14,500 on May, partly due to recovery in FDI and Capital Inflow in 2019. Going forward, BI stated that it will remain data-dependent on the next macroeconomic policy.

Improving Foreign Investors' Appetite in Indonesia

Following investors sell off in 2018, investors' appetite for emerging markets seem to recover in 2019. 10-Year Bond Yield in Indonesia has fallen more than 100 basis point since the start of the year indicating renewed demand for risky assets by investors as they search for yield. Auctions for Indonesian bonds have been generally oversubscribed showing investors' confidence. This is also in line with recent Indonesia's credit upgrade by S&P to BBB in May which also helps to affirms investors' confidence. However, the falling yield trend seems to reverse in Q4 as optimism among trade war de-escalation puts investors to a risk-on mood towards equities.

Figure 150: Falling 10Y-Bond Yield *(Source: investing.com)*

On investment side, we see returning FDI in 2019 as FDI figure increased by 9.6% Y-o-Y as quoted by BKPM (Investment Coordinating Board). Part of the renewed confidence is due to investors' trust in Jokowi as he is re-elected, as he vows to push to make Indonesia's an investment destination and make the process as frictionless as possible along with the general reduction in political uncertainty associated with a change of government. Although global trade uncertainty still clouds over investors' confidence as portfolio investment drops momentarily in May due to renewed trade tension, the overall capital flow to Indonesia thus far has been positive. As trade war stops escalating in Q3 2019, we expect Indonesia to stay attractive for foreign investors, particularly Japanese investors.

Despite this, there is still downside risk if investors' sentiment worsen as this may again trigger the sell off to safe haven causing investors to pull their capital and may cause cost of borrowing to increase. Indonesia's poor trade position too is not helping this situation as export is weakened by commodity price, exposing

IDR to depreciate if sentiments worsen. With the risk of capital outflows ever present, Indonesia may have to choose to tighten its monetary policy again which will affect the already slowing investment growth.

FX TRADE IDEA: SHORT USDIDR

Figure 151: USDIDR Daily Chart (*Source: TradingView*)

With investors' confidence to emerging markets improving since 2018, it is not surprising to see USDIDR in a bearish trend from its absurd high back in 2018 due to sell off. With investors coming back to Indonesia market, we see reason to believe that USDIDR will fall to more reasonable level as in 2018. Moreover, we also believe Indonesia will continue to be driven strongly by domestic consumption which will also create a favorable environment for investors.

However, we also aware that there is significant downside risk if investors' sentiment worsens particularly in Indonesia given its poor balance of trade and over reliance on the commodity price which may instead depress IDR valuation. Given this we recommend a rather tight stop loss.

Entry Level: 14000
Take Profit: 13750
Stop Loss: 14175
Risk to Reward ratio: 1.43

From technical perspective we can see that USDIDR has been trading in consolidation in a triangle for the past months. With the bearish trend since November 2019 in mind, we expect a downward break through the triangle confirms a continuation in the bearish trend. Therefore, our entry price is set at 14000 which is the lower end of the triangle and also a strong psychological support if the market is able to break through. We put our take profit at a conservative 13750 which is the nearest support from 2018.

PHILIPPINES (Overweight)

Over the last 5 years, Philippines has maintained impressive resilient GDP growth of above 6.0%, on the back of strong domestic consumption, overseas remittances and investment driven growth. However, continuing challenging global economic environment in 2019 has raised doubts if Philippines can maintain a GDP Growth above 6.0% this year. Since the election of President Rodrigo Duterte in 2016, Philippines has shifted its focus more towards inclusive growth, with increased commitments in human and infrastructure developments, as part of his key policy "Build, build, build". To finance the ambitious plan, Tax Reforms have been key part of his presidency policy as well as attracting investments by improving Ease of Doing Business in the country. With these policies in mind, we are confident that Philippines will continue to have strong sustainable growth into the future, although this is contingent to improvements on its low tax-to-GDP ratio to finance the infrastructure developments and its success to achieve inclusive economic growth.

Low Inflation and Strong Employment Paves Way for Strong Domestic Consumption

Amidst slowdown in global economy and trade along with the budget impasse that affected Philippines in the first half of 2019, Philippines' growth rate at Q2 2019 was at 5.5%, the slowest it has been in more than 3 years. While this was much lower than the government target of 6%-8%, we were confident that Philippines can reach the lower end of the target of 5.9%-6.0% by end of 2019 supported by robust domestic consumption and government spending picking up, as later proved by Q3 GDP Growth at 6.2%.

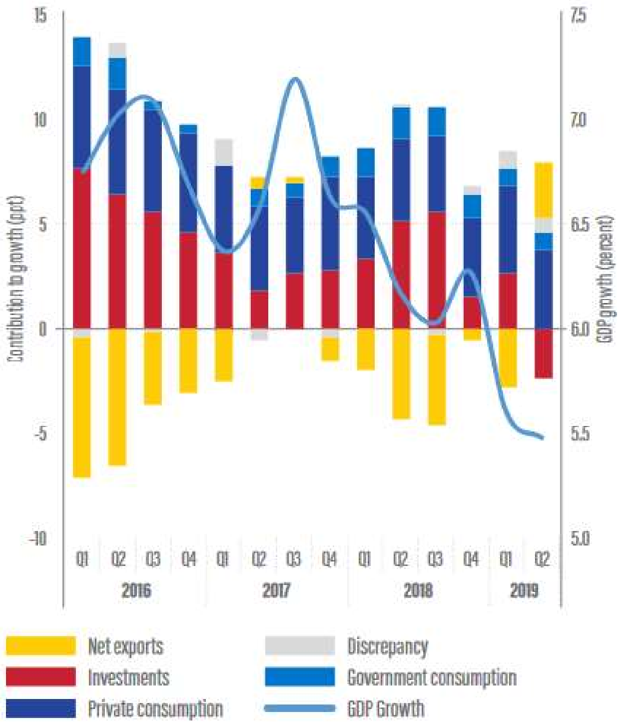


Figure 152: GDP Growth for H1 2019 *(Source: Philippines Statistics Authority)*

Private consumption in particular grew strongly and supported much of the GDP growth in 2019. In the first half of the year alone, the growth in private consumption of 5.8% contributed three fourths of the GDP Growth during the period. The strength in private consumption mainly is driven by a much tamer inflation thanks to the stabilizing food price primarily. Headline inflation has fallen from 4.7% in 2018 to 3.1% in 2019 in the same YTD period. This moderating food inflation arises from the Rice Tariffication Law enacted by Philippines government recently in response to the uncontrolled supply-side inflation which happened in 2018 due to combination of National Food Authority's (NFA) rice stocks running out and Philippines' long-standing restriction on imported rice which results in surge in food price. While the new law has proved to be helpful in controlling inflation level in 2019 (which in turn allowed room for BSP's accommodative monetary policy in 2019 too), the law also greatly affected Filipino farmers as their long-protected rice market is now flooded with cheap rice import from Vietnam and Thailand, some of them even forced to sell at a cost. We expect that going forward Philippines government will either introduce further subsidies for the affected farmers or modify the import law to at least provide some protection for the local farmers. Other than inflation, strong employment also contributes to the strong spending by the public. In April 2019, the unemployment reaches a decade low level. With inflation and unemployment level in check, the public have renewed confidence in the economy and resume their consumption.

If we look at confidence level of both the consumers and businesses, we see that indeed their level of confidence has recovered since the dip during the second half of 2018 where inflation shot up uncontrollably to high of 6.7% on October 2018. As inflation recovers to a more controlled level, we expect that this trend on robust consumption will persist.

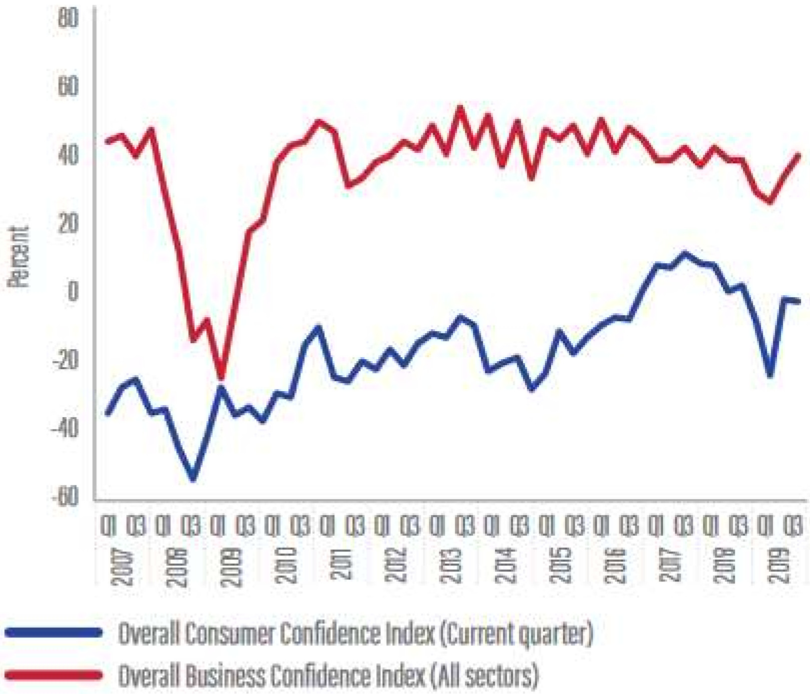


Figure 153: Confidence Level *(Source: BSP)*

<u>Government to Continue Powering Growth for The Second Half of 2019</u>

In the first half of 2019, budget impasse and midterm general election in Philippines has resulted in underspending by Philippines government, estimated at more than 43 billion Peso. Firstly, the budget impasse occurred due to 4 months delay in the finalization of 2019 budget due to disagreement between the two chambers in the Congress. The delay has prevented the government to continue their "Build, build, build" infrastructure investment program which was estimated to result in underspending of 740 million Peso per day for the period of January to February. Furthermore, the midterm election happening in May 2019 also restricted certain infrastructure projects to start. This partly caused the slower than expected economic growth this year as public construction contracted by 22.1% in the first half of 2019.

Nevertheless, we believe government spending will continue to contribute to GDP Growth especially in the second half of the year due to strong fiscal position and the need for "catch-up" fiscal stimulus as they attempt to reach the government target of 6%. Philippines fiscal deficit has been especially low in the first half of the year which is unsurprising given the gross underspending as mentioned above. The fiscal deficit was at 0.5% of GDP in H1 2019, well below the government deficit target of 3.2% of GDP. Furthermore, the fiscal position of the government is also well supported due to the growing tax revenue thanks to the Tax

Reform for Acceleration and Inclusion Act (TRAIN) and other tax reforms such as Run After Tax Evaders (RATE) program by Bureau of Internal Revenue (BIR) which together improved the efficiency of tax collection system. With the strong fiscal position and 6% GDP target to catch, the government implemented catch-up plan stimulus which fast-tracked the government infrastructure and social spending programs. With this in place, we expect that the government will be able to push GDP Growth via public investments, pushing GDP Growth to our forecast of 5.9%-6.0%.

<u>Peso Appreciating Against the Dollar Due to Strong Portfolio Inflow</u>

On the background of strong portfolio inflow along with stabilizing economic condition (such as taming inflation), Peso appreciated in 2019, recovering from its low level against dollar in 2018 due to uncontrollable inflation and major outflow which many emerging markets suffered in 2018.

Much of the strength of the Peso this year can be explained by the strong capital inflow to Philippines as global economy took a more dovish stance, drawing investors to Philippines. The improving economic condition such as the improving inflation condition has also contributed in the investors' confidence for Philippines. The strong inflow to Philippines capital and financial accounts have contributed to the positive overall balance of payment position Philippines enjoy in 2019.

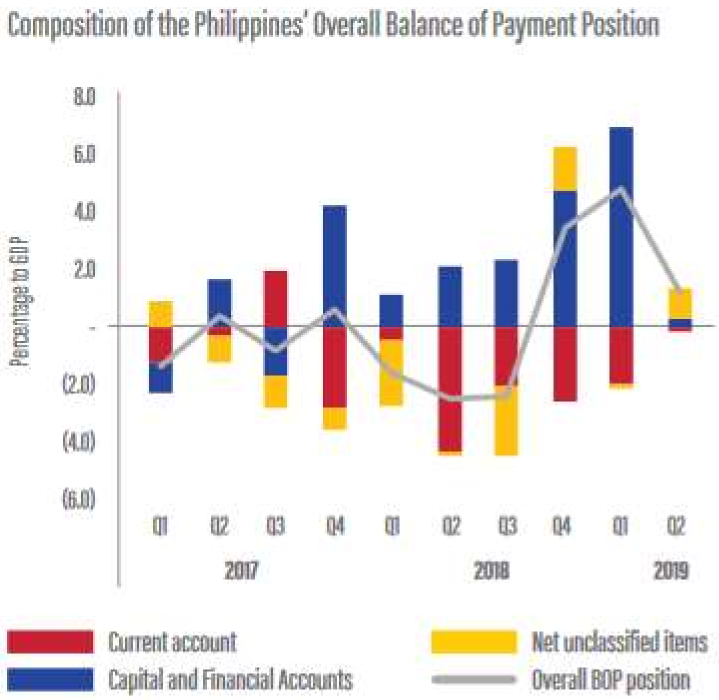


Figure 154: Balance of Payment *(Source: PSA)*

While on the other hand we see contraction in FDI (-38.8%) despite the inflow in financial account, we believe that this is merely a temporary effect brought about by corporate tax reform program, Corporate Income *Tax* and Incentives Rationalization Act (CITIRA). In contrast, we see that there are more upsides from investors' perspective considering investing in Philippines due to the recent implementation of Ease of Doing Business Law, which cuts down bureaucracy limitations in conducting businesses in Philippines, resulting in cheaper and more efficient business transactions. Part of the rationale of taking this program is the government attempting to make Philippines attractive for investors. Moreover, we also see strong domestic economic condition as mentioned above along with the recent credit rating upgrade of Philippines government to BBB+ stable by S&P which together surely will improve investors' sentiment and confidence in Philippines in the future. With that being said, we are optimistic that Philippines will continue to attract more investors in the future.

Trade's Poor Performance Weighs Down on Growth

Being part of the Asia supply chain particularly in the semi-conductor industry, it is unsurprising to see Philippines caught up in the ripples of trade war. In 2019, Philippines export, particularly in the electronic exports, grew merely 5.0% in the first half of 2019 compared to 12.6% in 2018. The sharp slowdown in export resulted in underperformance of net-export component of GDP despite the one-time slowdown in import due to slowing investments. Philippines also did not benefit much from the trade diversion due to the trade tariff between U.S. and China as Philippines only share electronic goods with the goods affected by tariffs. Philippines had indeed absorbed some of the trade diversion as its exports to U.S. particularly grew by 10.3% in 2019, yet it is a far cry from other countries such as Vietnam whose export to U.S. grew by 27% in the same period. All in all, the trade diversion while helped did not offset enough of the slowing export due to the slowing global trade.

Moderating Inflation Opens Room for a More Accommodative Monetary Policy by BSP

Figure 155: BSP Interest Rate Policy *(Source: Trading Economics)*

After the series of rate hikes in 2018 by Bangko Sentral Ng Pilipinas (BSP) in response to uncontrollable inflation from 3.0% to 4.75%, the moderating inflation level together with the more dovish stance taken by central banks around the world opens room for BSP to take a more accommodative stance in their monetary policy. In 2019, BSP has cut its key rate (RRR) three times from 4.75% to 4.0%. In their monetary policy decision, BSP quoted price stability as its main consideration for interest rate policy, thus the moderating inflation in 2019 primarily has given BSP room to cut rate this year to improve its economy.

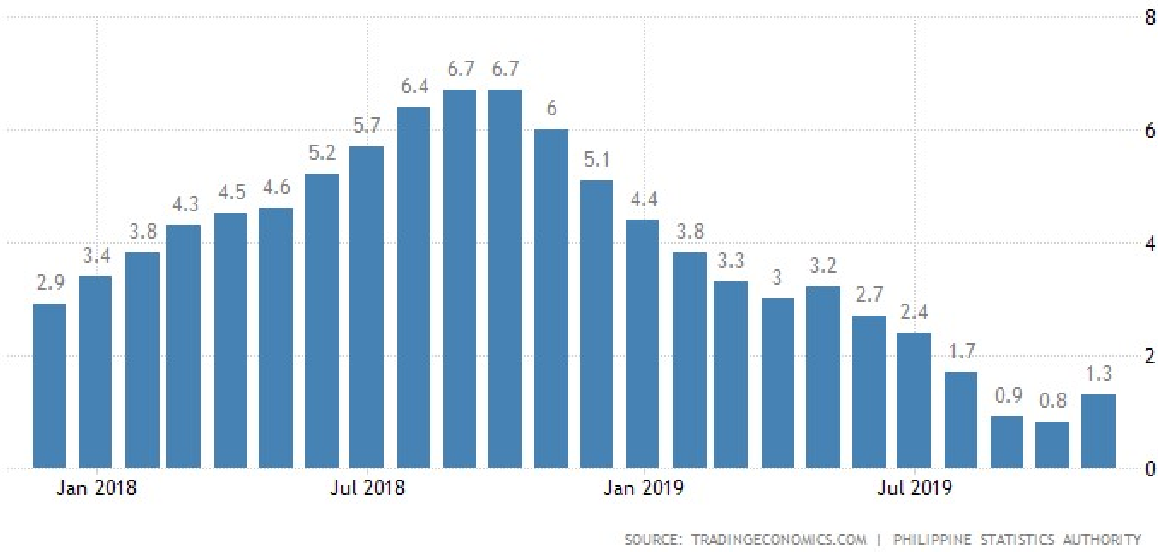


Figure 156: Easing Inflation Level in 2019 Compared to 2018 *(Source: Trading Economics)*

FX TRADE IDEA: SHORT USDPHP

Figure 157: USDPHP Daily Chart (*Source: TradingView*)

Philippines peso has been appreciating against the dollar for the whole of 2019 due to factors explained above namely the bettering economic condition in Philippines which draws foreign investors back to Philippines, reversing much of the outflow back in 2018. In addition to that, we see no more reason for USD to strengthen much more from safe-haven perspective as much of the escalation of U.S.-China trade war is dying down (despite no major breakthrough yet), thus it is safe to say much of the rally towards USD safe-haven is priced in by the market already. Following this, we also expect further de-escalation as talks are going on and Trump definitely does not want to escalate the situation further with upcoming U.S. election in mind. We therefore recommend a short position on USDPHP.

Entry Level: 50.80
Take Profit: 49.80
Stop Loss: 51.30
Risk to Reward ratio: 2.00

From technical perspective, we can see that USDPHP has been in down trending channel for a while and had just recently broke through both the channel and the previous low support at 50.84. With the supports broken, we expect that (supported too by the FA thesis) the market will test the next support at 49.80, the level back in 2018 before USDPHP rallied up. Despite our short stance on the pair, we observe that currently the pair is trading very sharply bearish with the RSI indicating oversold. Furthermore, with the recent better than expected NFP data from U.S., we may expect a minor retracement up, thus we recommend entering as the price hits the resistance at 50.80, which will also allow us to capture better risk/reward ratio.

AUSTRALIA (Underweight)

Australia offers a powerful combination of plentiful natural resources and a sophisticated service sector backed by a highly educated labour force. Its ability to adapt to change has enabled Australia to experience 28 years of consecutive annual economic growth, setting a record amongst developed economies for uninterrupted expansion. It has also managed to attain a feat of being the only major developed economy to have recorded no annual recessions from 1992 to 2018. As of 2Q2019, its quarterly Gross Domestic Product (GDP) stands at USD 275,141 million and its 2018 annual GDP was recorded at USD 1,420,045 million. This figure is expected to grow by 1.9% by the end of 2019.

Australia is globally successful in five key industries, namely: energy and resources, agribusiness, education, tourism and financial services industries. As the 24th largest export-driven economy in the world, Australia is heavily dependent on trade and its longstanding ties with Asia have helped it to prosper, with its top 5 trading partners being China, Japan, United States of America (U.S.), Korea and India. Due its natural endowment of mineral and energy resources, as well as high demand for its premium agricultural products, Australia plays a significant role in the global market for commodities which continues to be a vital contributor to the nation's wealth.

Currently, Australia is the world-leading producer of iron ore, gold, bauxite, coal and uranium. Besides that, by 2020, it will be the world's largest liquified natural gas (LNG) exporter. This nation is also a reliable provider of clean, green and safe agricultural products and premium food, with beef and wheat being its two largest agricultural exports, as well as its two largest agricultural commodities in terms of production value.

Being an open and trade-exposed economy, the Australian Dollar (AUD) is therefore susceptible to economic developments around the world, as well as movement in prices of commodities. Since January 2019, the Australian Dollar has been on a gradual decline against the USD due to lowering Australian interest rates and global uncertainties arising from the prolonged U.S.-Sino trade war. In the latest statistics published by the China National Bureau of Statistics, the Chinese economy grew at an underwhelming 6% in Q3, its weakest rate in at least 27 years. With Australia's fortunes being tied to its dominant trading partner, China, rating agency Fitch mentioned that a downgrade of their China growth forecast, alongside a more challenging outlook for commodity prices have prompted a modest cut to their 2020 and 2021 growth forecasts for Australia. Cyclical changes in the global economy proved to be a key weakness for Australia, with its economy showing signs of slowing down due to pessimism in global outlook and weakness in domestic spending.

Australia's Economic Growth Hits Decade Low

Australia's economy has enjoyed 28 years of expansion, a feat which many countries were unable to do so. However, 2Q2019 figures showed that Australia's economy has lost its momentum, fueling concerns about the economic outlook with growth falling to its lowest level since the global financial crisis in 2008. Though Australia's economy has bounced slightly in 3Q2019, it remained largely disappointing, particularly consumer spending, as interest rate cuts and government tax rebates failed to spur household spending, reinforcing expectations that the central bank will need to resume easing next year. According to the ABS, GDP advanced 0.4% from 2Q2019, when it rose an upwardly revised 0.6%. From a year earlier, GDP gained 1.7%, in line with Bloomberg economists' estimates.

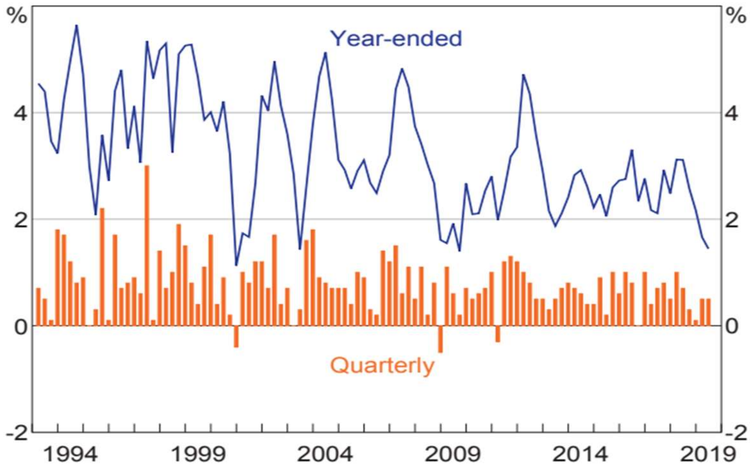


Figure 158: Australia's GDP Growth (*Source: ABS*)

Weak demand is concentrated in the private sector, which is now in technical recession owing to a per capita contraction in consumer spending and weak business investment. Flat retail sales and imports underscored a consumer unwilling to part with their cash, translating to a jump in saving ratio from an upwardly revised 2.7% in the prior three months to 4.8% in 3Q2019. Retail sales were unchanged from October with department stores and clothing sales slumping, and imports were also of little change. It seems that Australians are opting to save their tax cuts and use rate reductions to pay down mortgages faster to bolster their resilience. November's retail data due January 2020 will incorporate sales surrounding Black Friday and should signal whether shoppers are prepared to open their wallets.

On the flip side, government spending and exports were among the biggest contributors to growth in 3Q2019, though government spending lost pace following 2Q2019 surge which was associated with May general elections. According to data released by the ABS, the Australian government spending on operational items rose 0.9% in 3Q2019 from 2Q2019 to an inflation adjusted USD 87.29 billion, and investment in assets by the government and public enterprises also rose 1.9%. It is said that government spending likely added 0.2 percentage points to GDP growth in 3Q2019, while investment contributed 0.1 percentage points. Apart from government spending, Australia's exporters are benefiting from a 16% drop in the Australian Dollar since early last year and miners are reaping windfalls as China ramps up steep production - boosting demand for iron ore, to offset trade losses. This helped produce Australia's first back-to-back current-account surpluses in 46 years.

Comprising around 55% of the economy, domestic consumption remains the key to sustained growth and weakness is carried over 4Q2019. However, we expect Australia's economic growth to gradually shift into a higher gear next year, largely thanks to rising housing and mining investments, as well as a more accommodative monetary policy environment which should buttress domestic demand. This however is limited by the little rate ammunition remaining and the government reluctance to boost fiscal spending as it preferred to stick to a political pledge to deliver budget surpluses instead. On the external front, a sharper-than-expected slowdown in China and trade war remain key risks to the outlook. Currently, we remain cautiously upbeat on the trade war, as the talks regarding the phase-one trade deal are still ongoing despite a series of missed deadlines. Australia's economy largely hinges on both U.S. and China coming to an eventual fruition of the trade deal.

Possibility of Downward Revision of Interest Rates in Australia

Figure 159: RBA Cash Rate Trend (*Source: RBA*)

On the meeting held on 1st October 2019, the Reserve Bank of Australia (RBA) has trimmed its official cash rate to a historic low of below 1% for the first time. The cut of 25 basis points to 0.75%, is the RBA's third reduction since June after disappointing figures from the previous two quarters. A lacklustre domestic economy, threats to global growth resulting from U.S.-China trade conflict, as well as ongoing easing among the central bank's major peers have warranted the RBA's dovish October move. Since then, RBA has kept interest rates unchanged at 0.75% during the subsequent November and December meetings, in line with the expectations of most market analysts.

The decision to cut rates was predominantly taken to assist the weak Australian economy through supporting employment and income growth, and to lift the stubbornly low inflation closer to the Bank's 2.0%-3.0% target range. According to the latest labour information released by the ABS, the seasonally-adjusted unemployment inched up to 5.3% in October, reversing September's dip, which has marked the first drop since February. Though this matched expectations, the figure still far exceeds the 4.5% level which the RBA considers to be conducive for faster wage growth and inflation. Despite inflation rate also seeing an improvement from 1.6% in 2Q2019 to 1.7% in 3Q2019, a slow disposable income growth and weak investment activity continues to point to protracted weakness in household spending - a crucial driver of the economy. Moreover, this easing is also partly designed in view of the "global rat race" to cut interest rates, preventing a rebound in the depreciating Australian dollar which might have been triggered if the RBA stood pat.

In his opening statement to parliamentary panel in Canberra, Governor Philip Lowe remains upbeat on the effects of rates cuts, with quarterly growth outcomes expected to "strengthen gradually after a run of disappointing numbers" as the Australian economy may have reached a "gentle turning point." Besides that, in his December statement, Lowe mentioned that the lower cash rate has "boosted asset prices, which in time should lead to increased spending, including on residential construction," as well as "lower mortgage rates are also boosting aggregate household disposable income which in time will boost household spending." While improvement has been visible, Lowe's positive sentiment for the future was not entirely reflected amongst consumers. The Westpac-Melbourne Institute consumer sentiment index rose to 97.0 in November, from 92.8 in October, which had marked the worst result since July 2015. As we remain cautiously optimistic on the trade war situation, we believe that rising expectations of a U.S.-China trade agreement coupled with a healthy increase in the stock exchange in the last month likely supported consumers' fewer negative views. That being said, sentiment remained below the 100-mark indicates that there were more Australian consumers who remained in the pessimistic terrain. As there are several factors which could affect Australians sentiments and spending, it remains unclear as to whether the Reserve Bank's three recent interest-rate cuts will eventually deliver its intended effects.

On the international front, the RBA said risks remain tilted to the downside but have "lessened recently." Against the backdrop of ongoing global uncertainty abroad and soured consumers' confidence at home, we expect that an extended period of low interest rates will be on the cards as previous rate cuts have failed to boost domestic consumption. Entering 2020, it is likely that the volatile global economy will test Australia's performance and we will continue to see slow economic growth. Although Philip Lowe has hosed down prospects of future interest rate cuts to monitor the impact of earlier easing and recent government tax rebates, the possibility of future monetary easing is not ruled out, especially when RBA is not getting enough fiscal stimulus from Morrison in order to maintain the government's budget surplus. We believe that there might be a chance of further downward revision on interest rates, with one or two more rate cuts to a potential low of 25 bps if targets are still not met. Quantitative easing is a possible scenario, but it will likely not be utilised in the near term.

Rate Cuts Could Increase Australia's Inflation Through a Property Bubble

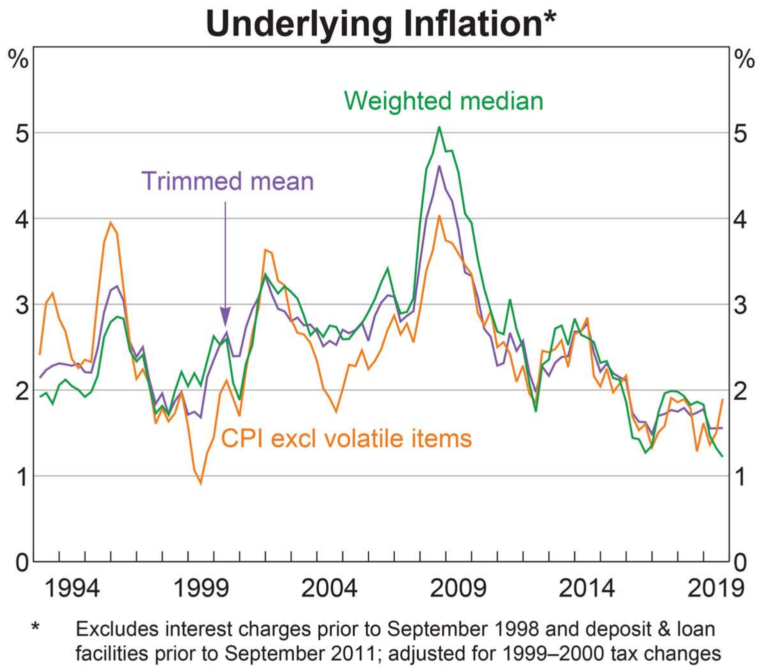


Figure 160: Australia's Underlying Inflation (*Sources: ABS and RBA*)

Generally, inflation has met expectations in 3Q2019, with the consumer price index (CPI) rising by 0.5% over the previous quarter following a 0.6% increase in 2Q2019. RBA Trimmed Mean CPI inflation also rosed 0.4%, unchanged from 2Q2019. On an annual basis, it is held at 1.6% against the RBA's target band of 2-3%. The biggest price increase in the quarter came not from the market sector, but from non-market sectors of childcare, medical and hospital services, while prices for fruits and vegetables, as well as automotive fuel all fell. Despite inflation having met expectations, the two key measures of underlying inflation - trimmed mean and weighted median - still undershot the RBA's goal, averaging around 1.4% for the year, indicative of the squeeze being felt by Australian households from the years of underwhelming wage growth. This underperformance is currently in its 15th straight quarter, the longest stretch since the series began.

RBA rate cuts may however be able to reverse this trend as Lowe said that lower rates are boosting property which should eventually lead to higher household spending and residential construction. Australia's property frenzy is back in full swing, with home prices surging the most in 16 years in November. Thus far, the impact of Lowe's stimulus has come mainly through housing - national property values jumped 1.7% last month, the largest gain since 2003, according to data from CoreLogic Inc. Sydney and Melbourne continued to lead the rebound, with prices up 2.7% and 2.2% respectively. At the rates which housing prices are increasing, it is likely that home value will recoup all their losses from the recent downturn and be back at record highs early next year.

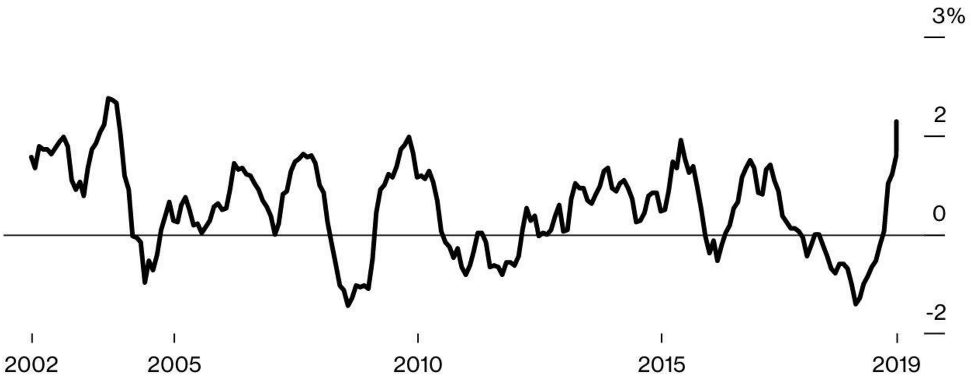


Figure 161: Australia's Home Prices Change, Month-on-month (*Sources: CoreLogic Inc and Bloomberg*)

Lower lending rates over the past couple of months have also helped to boost sentiment in the housing market where prices had been in a downfall since 2017 though activity elsewhere remains subdued. In addition to record-low interest rates and a loosening of lending curbs, prices are being driven by a shortage of properties on the market. With boosted sentiments, there is a chance that Australians will start to increase their spending, bringing the inflation closer to the healthy target range.

While the property market resurgence could provide a short-term relief to the slowing economy, in the long term, Australia could be bloated with debt that permanently reduces the economy's potential as more and more people take on loans to buy properties. Furthermore, as borrowers put more of their income toward servicing their mortgage, they are left with less to spend on everything from cars to appliances to clothes, robbing the economy of a key driver of growth. Besides that, it should be noted that such a high pace of capital gains may not be sustained in the long term. We believe that in the short term, Australia's falling economy could be bolstered by the hike in housing prices brought about by the rate cuts, but inflation is expected to pick up gradually. Inflation could potentially meet RBA's December's expectations of 2.0% and is expected to last into 2020 and 2021 as well. The long-term effects are contingent on whether the property bubble will eventually burst, and the time frame in which it takes place if it does occur.

Australia's Trade Balance Maintains Positive Outlook

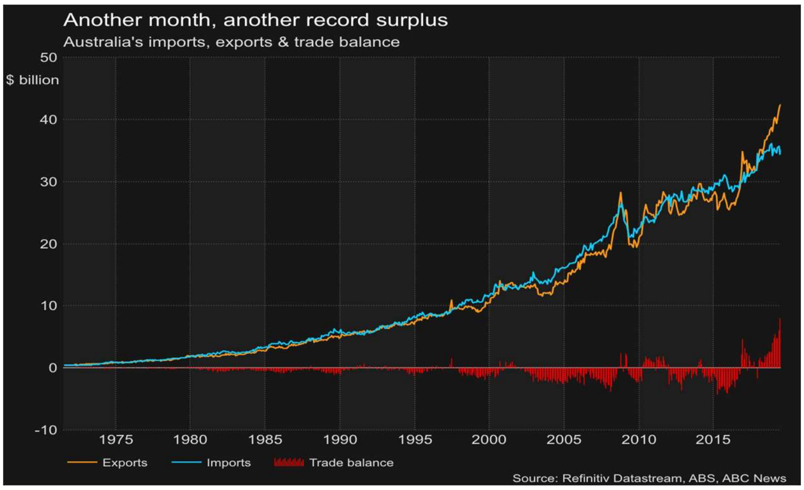


Figure 162: Australia's Trade Balance (*Sources: Refinitiv Datastream, ABS and ABC News*)

Australia's total exported goods represent 19.3% of its overall GDP, which represents Australia's dependence on the performance of its major trading partners and international relations. According to Lowe, the lower cash rate has put downward pressure on the exchange rate, which is supporting activity across a range of industries. The Australian Dollar, which has declined about 16% since early last year, is helping policy makers by improving export competitiveness.

The external sector supported the Australian economy in 3Q2019. Exports rose 0.7% in 3Q2019, supported by strong foreign sales of commodities, while imports dipped 0.3%, after contracting 1.1% in 2Q2019 due to subdued domestic demand. In 2Q2019, Australia sold USD 8 billion more goods and services to the rest of the world than it imported, making it a whopping USD 1.8 billion higher than the previous month, which was itself a record trade surplus. From data released by the ABS, in 3Q2019, the largest quarterly goods and services surplus was recorded at USD 21.1 billion, allowing Australia to record a seasonally adjusted USD 7.9 billion current account surplus for 3Q2019. The combination of higher exports, more favourable terms of trade and falling imports boosted Australia's current account surplus compared to 2Q2019, making it two consecutive current account surpluses for the first time in 46 years. Contributors of the improvement so far this year are the surging iron ore prices as well as shipments of LNG, where iron ore and other mineral exports rose 5%, adding a further USD 551 million in 3Q2019 while value of LNG exports rose by USD 270 million. The biggest fall was the value of non-monetary gold exports - a volatile component - seeing a slump of USD 525 million from 3Q2019. Without that large decline, the dollar value of exports would have been significantly larger.

Australia has so far been a winner of the global slowdown despite China, its largest export partner and most important strategic partner, engaging in a trade war. Ever since the first round of tariffs was implemented in March 2018, Australia's external sector has strengthened, with this 18th consecutive monthly trade surplus. Australia is also exporting more to both nations. In original terms, exports to China increased by 5.8% month-on-month, while exports to the U.S. increased by 9.9%. However, in view of easing trade tensions and possible trade agreements next month, it is possible that exports would affect Australian's economy, with LNG underlying its vulnerability. As part of a deal with the U.S., China will commit to buying more American LNG, thereby testing the stability of Australian's strong trade performance in the next few months. We believe Australian's terms of trade to decline gradually should the phase-one trade deal come to fruition as it could cut Australian exporters out of key markets.

Apart from the effects of the trade war, Australia's trade could potentially benefit from Brexit, with Britain being its eight-largest trading partner. In an effort to reduce the economic impact of Brexit, UK Trade Minister Liz Truss expects her Government to complete a wide-ranging trade deal with Australia within months of exiting the European Union (EU). A deal with Britain would particularly benefit Australia's agricultural sector worth around USD 60 billion, especially so when "market access to Britain in terms of agriculture products has been limited," said Australian Trade Minister Simon Birmingham. However, this scenario hinges on the UK's ability to remain afloat of a recession when it leaves the EU, or else it would definitely affect Australia's economy negatively.

FX TRADE IDEA: LONG AUDUSD

Figure 163: AUDUSD Daily Chart as of 13th December 2019 (*Source: TradingView*)

Entry Level: 0.6929
Take Profit: 0.7002
Stop Loss: 0.6875
Risk to Reward ratio: 2

The Australian dollar is a commodity currency as it is a country whose exports are largely comprised of raw materials. The relatively high liquidity of the AUD has made it an attractive tool for carry trades, making it very popular amongst currency traders. Across 2019, the AUD has largely depreciated against the USD, due to a poor global climate and weakened household spending of the Australian economy, attributed primarily by RBA's rate cuts.

The AUDUSD pair hit a multi-week high of 0.6908, underpinned by encouraging U.S.-China trade-related headlines, suggesting that a deal is "very" close, and that the U.S. is willing to give up on tariffs, cutting the existing ones by half. The American dollar has also strengthened with the news, limiting the pair's advance. We remain moderately optimistic about the situation and believe that the Australian dollar will appreciate against the greenback should the trade-deal is signed in the first week of January. In the longer term, with RBA forecasts of economic growth accelerating, it is likely to contribute to the appreciation of the AUDUSD as well.

From a technical perspective, it is important to note that there is a "double bottom" down at the 0.67 handle, so it is likely that the market has carved out a floor. In addition, the AUDUSD has made a couple of "higher lows", which is also a very bullish sign. Based on a 6-12-month horizon of this currency pair, we identified a key level support at 0.6929 which we believe that we will be looking for a longer-term "buy-and-hold" position, should the AUDUSD break about this level. Our key level of resistance is indicated at 0.6875 which we also identified as our stop loss. This translates into a risk-to-reward ratio of 2.

Besides that, the AUDUSD is currently testing the 200 days moving average, which is a longer-term technical signal. We can see that the current AUDUSD price has approached and crossed the 200 days moving average, signalling that AUDUSD may reverse its current trend to become bullish.

Considering fundamental and technical analysis, we believe that there is a strong chance for the AUDUSD to continue its upwards trend if U.S.-China proceeds with the trade deal and hence we would recommend a long position on AUDUSD.

NEW ZEALAND (Neutral)

New Zealand is Australia's smaller, less populated neighbour. It is one of the least populated countries in the world despite being of equivalent size to Japan. New Zealand's 1983 Closer Economic Relations agreement with Australia means that its economy aligns closely with that of Australia, hence it can be said that both countries experience similar economic effects. As a trade dependent economy, New Zealand is heavily reliant on trade and tourism, with total exported goods representing 20.1% of its overall Gross Domestic Product (GDP) in 2018. As of 2Q2019, its quarterly Gross Domestic Product (GDP) stands at USD 40.3 billion.

New Zealand's top industries include food processing, wood and paper products, textiles and machinery. Ranked as the 44th largest export economy in the world with annual exports totalling USD 32.5 billion, New Zealand's top exports destinations are China (USD 6.59 billion), Australia (USD 5.78 billion), United States (USD 3.7 billion), Japan (USD 2.08 billion) and South Korea (USD 1.04 billion). Currently, New Zealand's top 5 commodity exports are concentrated milk, sheep and goat meat, frozen bovine meat, aluminium and wool. Dairy farming is New Zealand's largest export earner, accounting for 21% of exports.

Being dependent on international trade has left New Zealand vulnerable to the global uncertainty in recent years. Especially with its largest trading partner, China, being engulfed in a prolonged trade war and a potential phase-one trade deal, New Zealand's economy is likely to be affected regardless of the direction the trade war chooses to head towards.

<u>Possibility of Downward Revision of Interest Rates in New Zealand</u>

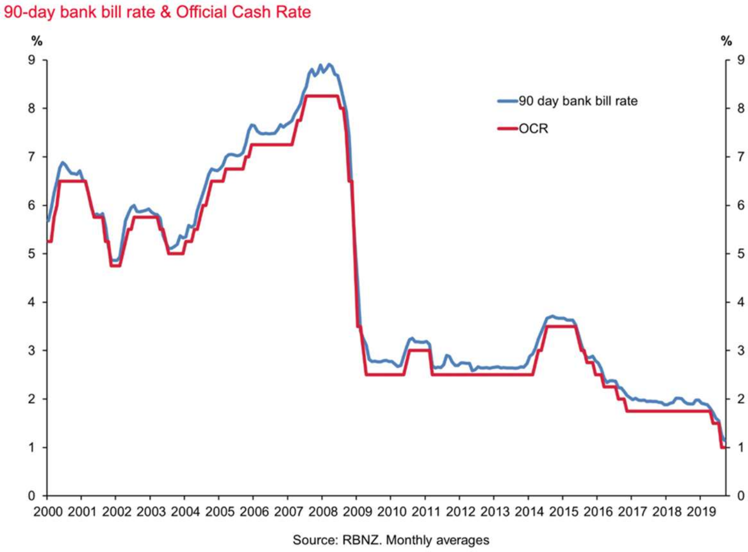


Figure 164: Monthly Averages of RBNZ OCR (*Source: RBNZ*)

On 13th November 2019, the Reserve Bank of New Zealand (RBNZ) has kept its official cash rate (OCR) unchanged, after slashing it to a record-low of 1.0% in August's meeting as it looks to prop-up a cooling economy in the face of intensifying global pressure. 16 out of 21 economists in a Bloomberg survey had initially expected the Reserve Bank to cut the OCR by 25 bps to 0.75% in November's meeting, with only five seeing no change. Many investors had increased bets on a cut after a report showed a further decline in inflation expectations, a key metric for RBNZ. Hence, RBNZ's move surprised markets, resulting in a boost for Kiwi Dollar which recorded its biggest daily gain against the USD in a year.

The bigger-than-expected cut of 50 bps was made in view of a global slowdown, weak business confidence and soft household spending, which impacted New Zealand's inflation and job creation. While the RBNZ has traditionally reserved 50 bps cuts for crises and other significant unexpected events, RBNZ Governor Adrian Orr repeatedly reinforced that this was not the reason for the cut on this occasion, but rather aimed at spurring spending. Although the RBNZ acknowledged that softness in economic activity was carried over into the second half of the year with data showing unemployment rate ticking up to 4.2% from an 11-year low of 3.9% in 2Q2019, it also noted that the monetary policy transmission mechanism is gradually translating into lower lending rates and weakening the exchange rate, thereby prompting the Reserve Bank to stand pat. Moreover, latest annual statistics showed that inflation remained within the target range of 1.0% - 3.0% in 3Q2019, and the Reserve Bank expects it to rise to the band's midpoint as wage growth strengthens and non-tradable goods inflation increases following the latest policy cut, while employment continues to hover around its maximum sustainable level.

The ANZ-Roy Morgan consumer confidence indicator rose to 120.7 in November, up from 118.4 in October, moving further above the 100-threshold that separates optimism from pessimism among consumers and printing the best result in five months. This resulted in private demand in New Zealand appearing to be solid, with household spending expected to grow 1.0% in 3Q2019 GDP growth data which is set to be released next week. Besides that, government spending is also likely to have contributed positively.

Though improvements in economic activity resulting from the rate cuts have been observed, economic growth remains relatively subdued. The RBNZ stated that it considers current loose monetary policy conditions to be providing adequate support to domestic demand. Whilst this may remove some downside risk, the Monetary Policy Committee conveyed that there remains scope for more fiscal and monetary stimulus, if necessary, to meet its employment and long-term inflation objectives. We believe that considering reignited trade tensions, weakening global growth and the dovish stance of major central banks could prompt the RBNZ to further cut rates to 0.25% in the near future. With little rate ammunition left, the possibility of an eventual quantitative easing could be on the cards.

New Zealand's Weak Economic Growth May See a Turning Point

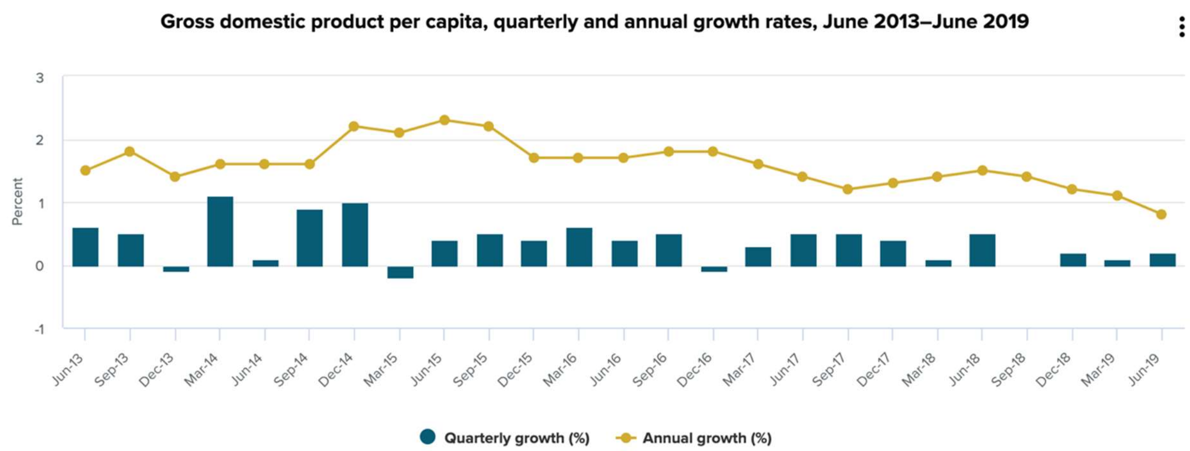


Figure 165: Australia's GDP Per Capita Growth (*Source: Stats.govt.nz*)

New Zealand's economy grew at its slowest rate in five-and-a-half years in the second quarter of 2019, as the country faces sluggish growth conditions amid trade tensions and global economic slowdown. Though the New Zealand economy is experiencing slipping growth and not a sudden tilt into recession, GDP growth has nonetheless halved, from 4.1% in 2016 to 2.1% in 2Q2019, which is the weakest rate of quarterly growth since the fourth quarter of 2013. Data published by New Zealand's statistics office showed that the New Zealand economy grew by 0.5% from the previous three-month period and by 2.4% on an annual basis.

New Zealand 3Q2019 GDP growth data is set to release next week. According to a Westpac research report, the economy is likely to have grown 0.5% quarter-on-quarter in 3Q2019 and the gains are expected to have been shared throughout the primary sector, manufacturing and services. The agricultural sector is likely to have grown 1.6%, driven by a rise in milk collections after a slow beginning to the dairying season. On the contrary, forestry is expected to have recorded a sharp fall in output, after a mid-year slump in log export prices led to a pullback in harvesting.

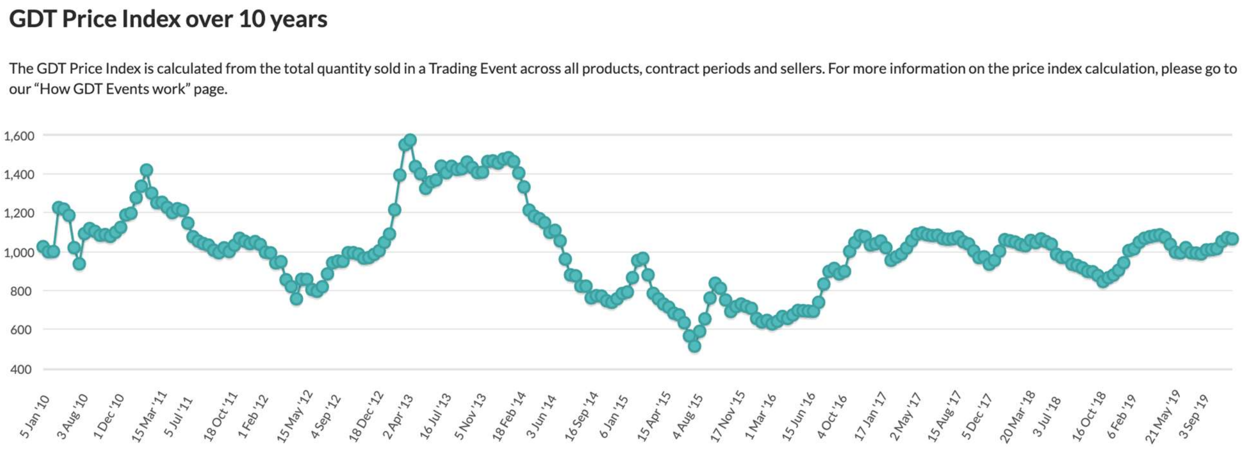


Figure 166: GDT Price Index (*Source: Globaldairytrade.info*)

The dairy sector is a major contributor to New Zealand's living standards and plays a crucial role in supporting regional economic development. In general, the diary markets have strengthened over the past six months on the back of improved returns for diary commodities and a softer New Zealand dollar. Looking ahead, New Zealand is also expected to have a solid production season, with it being one of the only major dairy-exporting nations whose milk supply is growing. ANZ research expects a stronger return forecast for the 2019/2020 season at USD 7.30/kg milk solids (MS), up from the current forecast of USD 6.40/kg MS. This increase in expected dairy price could potentially alleviate New Zealand's weak GDP growth.

Besides that, private demand is also predicted to be a contributing factor to economic growth in 3Q2019, with retail sales volumes rising by 1.6% in 3Q2019 and retail sales growth higher than market expectations. With a low OCR, improved consumer confidence and a strong dairy sector, we believe that New Zealand's weak economic growth could possibly see a gradual reversal in the year to come. This however is also contingent on the progress of the U.S.-Sino trade war, which is an important factor in determining the economic situation in New Zealand. We remain cautiously optimistic on the decision made regarding the phase-one agreement and believe that it could further boost consumer sentiments in New Zealand.

New Zealand's Export to Test Its Stability

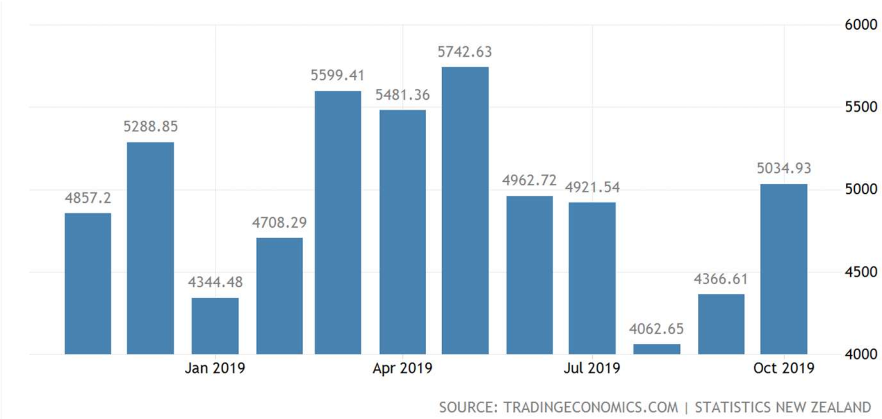


Figure 167: New Zealand's Top Exports Value (*Source: Trading Economics*)

Data released by the Statistics New Zealand showed that New Zealand's trade balance was a surplus of USD 2.1 billion in the year ended June 2019. Its trade surplus was down USD 2.2 billion from USD 4.3 billion in the year ended June 2018.

New Zealand exports went up 4.3% over a year earlier to NZD 5035 million in 3Q2019, after a 2.6% rise in the previous month, boosted by higher sales of milk powder, butter and cheese. This was mainly driven by its largest export partner, where strong Chinese demand has led to a 22.8% increase in exports. On the political front, the government announced in early November that New Zealand had reached a deal with China to upgrade its free trade agreement. By reducing compliance costs and making export activity easier, the upgrade is set to support the external sector going forward.

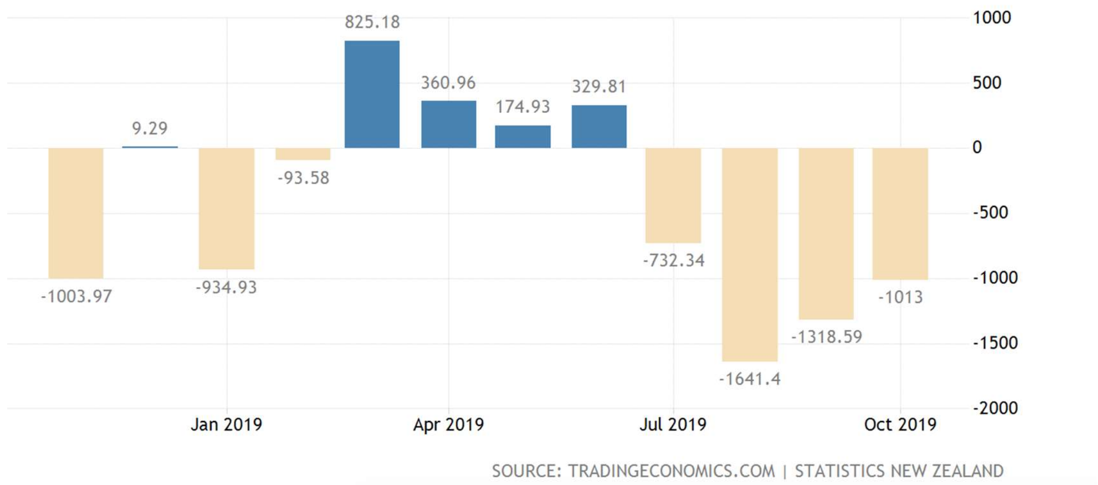


Figure 168: New Zealand's Trade Balance (*Source: Trading Economics*)

Besides an increase in exports, it is worth noting that the trade gap in New Zealand has narrowed to NZD1016 million in October 2019 from NZD 1305 million in the same month of the previous year and compared to market expectations of NZD 1621 million deficit. With exports increasing 4.3% and imports declining 1.4%, the twelve-month trade shortfall decreased to NZD 5037 million.

Despite 3Q2019's favourable outlook for New Zealand's exports and trade of balance, it remains vulnerable to its major trading partners, China and the United States. China's economy has decelerated to its slowest growth in 27 years, partly due to a slump in exports and the United States is not spared as well. Furthermore, this short-lived increase in exports to China is likely to come to an end soon. Current trade tensions have been slightly eased as China and the United States are making good progress on the "phase-one" trade agreement. In the terms stated, Beijing has promised to buy USD 40 – USD 50 billion worth of U.S. farm produce, which could potentially threaten New Zealand's exports. Regardless of the direction the trade war takes, we believe that the New Zealand economy is bound to suffer to different extents, with possible implications on the state of the NZD against major currency pairs.

<u>FX TRADE IDEA: SHORT NZDUSD</u>

Figure 169: NZDUSD Daily Chart (*Source: TradingView*)

Entry Level: 0.6615
Stop Loss: 0.6672
Take Profit: 0.6486
Risk to Reward ratio: 2

The New Zealand Dollar is the 10th most traded currency in the world. The NZDUSD has been on a downward path of depreciation in most of 2019, from with the NZDUSD pair falling from 0.68 to a low of 0.62 at the start of October. However, in view of positive progress regarding the trade war, it seems that the Kiwi is starting to pick up against the USD.

From a technical perspective, the RSI has reached a high level of 76.40, indicating that the NZDUSD is overbought. Thus, we recommend a short position on the NZDUSD However, that said, it must be noted that the RSI may offer a textbook sell-signal as the oscillator pulls back from overbought territory in view of pending finalization of U.S.-China trade agreements. In addition, we have noted the NZDUSD pair has reached a key resistance level at 0.6622, potentially reversing its upward trend to head south. Given that price is current at the upper bound of a rising trend channel and a bearish RSI divergence has presented itself, an incoming price correction is being signalled. As such, we recommend to short NZDUSD trade at an entry point of 0.6615, with the stop loss being placed at 0.6672. We also recommend taking profits at around 0.6486, which translates into a risk-to-reward ratio of 2.

CRUDE OIL (Overweight)

Crude oil is a naturally occurring fossil fuel that can be refined to produce a multitude of oil products including gasoline, diesel and petrochemicals. As oil is a commodity, the market is heavily influenced by supply and demand fundamentals.

The rivalry between the United States of America (U.S.) and the Organisation of Petroleum Exporting Countries (OPEC), a consortium of oil producers, continues to intensify as OPEC's monopoly over oil prices have been increasingly endangered by the U.S. shale boom in the past decade. While OPEC's production cuts have had success in propping oil prices since 2016, the past year's performance has been unfortunately suppressed due to soaring production in the U.S. which has left the market oversupplied. Demand has been dragged down by the gloomy global economic outlook amidst the underlying trade conflict between Washington and Beijing.

Bearing these considerations, OPEC and its allies have announced its latest deal to deepen output cuts by another 0.5MMBD, in addition to its existing pact, through 1Q2020. Washington's partial accord with Beijing – which includes China's commitment to purchase USD 50 billion worth of agricultural goods, along with energy and other goods – will also aid the global economy in potentially rebounding from the current bear market. We believe that these fresh rounds of discussions will rekindle optimism amongst oil bulls.

<u>Sluggish Global Oil Demand Outlook</u>

Both the International Energy Agency (IEA) and the OPEC have once again revised downwards their estimates for global oil demand growth for 2019 and 2020. IEA has cut their demand growth (see Figure) to 1.0MMBD for 2019 and 1.2MMBD for 2020. OPEC's projections fell to 0.98MMBD for 2019 and remained unchanged at 1.08MMBD for 2020. The weak demand outlook reflects the tough economic situation, a slowdown in the petrochemical industry – which has been driving oil demand growth in recent years – and the decline in global trade due to the U.S.-China trade tensions and the rise in protectionism.

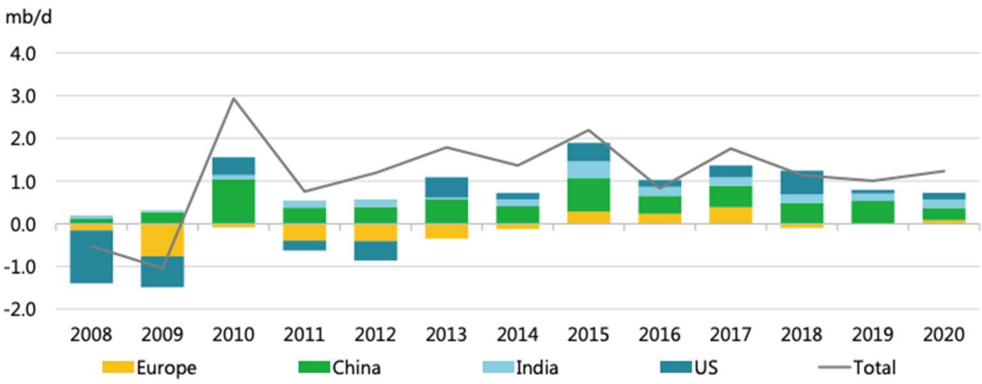


Figure 170: Global Oil Demand Growth, Year-On-Year (*Source: IEA)*

U.S. demand for refined oil products has showed mixed performance, resulting in a mere 0.12MMBD year-on-year growth for the first three quarters of the year. Manufacturing activity in the U.S. has been facing a slump due to the escalating trade war and the weak industrial production growth has impacted gasoline, diesel and residual fuel oil demand. Dwindling light vehicle sales (see Figure 170) has also resulted in a disappointing summer driving season and hence, weak gasoline demand (see Figure 170).

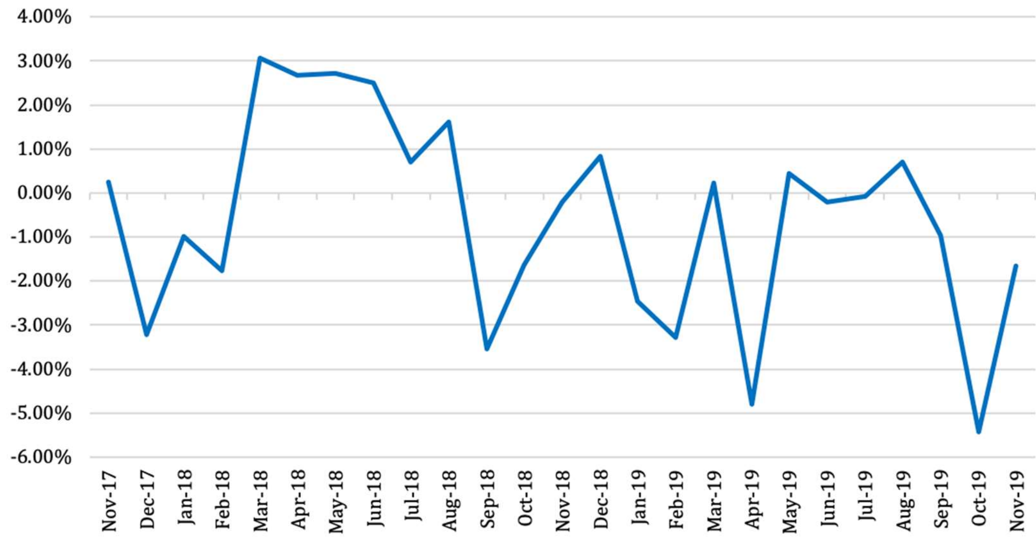


Figure 171: U.S. Light Vehicle Sales Growth, Year-On-Year (*Source: FRED)*

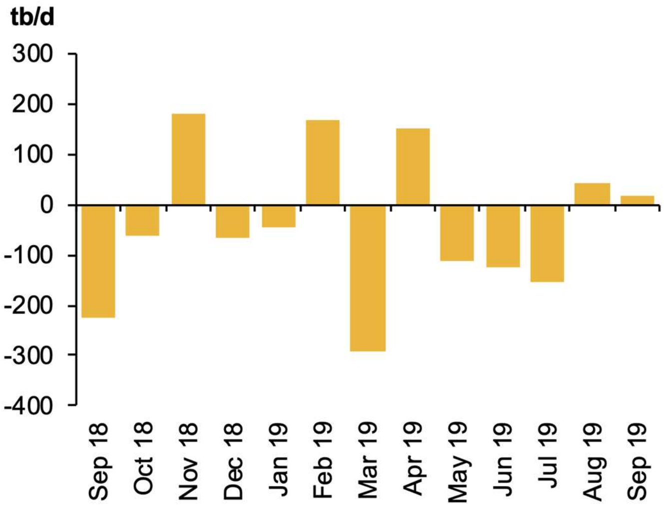


Figure 172: U.S. Gasoline Demand, Year-On-Year (*Sources: EIA and OPEC)*

Demand growth for liquefied petroleum gas (LPG) – feedstock for the petrochemical industry – and jet/kerosene has helped sustain growth for U.S. We continue to expect LPG demand to increase in the coming months, with the ramp up of LOTTE Chemical's 1.0MMtpy plant and Sasol's 1.5MMtpy plant. Enterprise Products Partners' latest 0.175MMBD expansion of LPG export capacity at its Enterprise Hydrocarbon Terminal on the Houston Ship Channel will ramp up through 2020 and the company had also announced expansion plans of another 0.26MMBD by 3Q2020.

Washington and Beijing announced a 'phase one' trade deal which includes a reduction in U.S. tariffs on Chinese goods and China's commitment to purchase American farm, energy and manufactured goods. This trade pact would be signed on the first week of January and it potentially signals a conclusion to the much-prolonged trade war. Regardless, we remain moderately optimistic on the partial accord as we believe that the limited deal serves merely as a ceasefire and not a complete resolution. We expect global manufacturing to rebound as the headwinds caused by the trade war has been alleviated, which would in turn boost oil demand growth.

Chinese oil demand has been a bright spot despite the prevailing trade tensions. Total apparent demand (see Figure 173) – estimated based on refinery output, trade flows and oil stocks – for refined products grew 0.58MMBD year-on-year on average during January to September. Demand for transport fuels – gasoline and diesel – have contributed the greatest to the demand growth. LPG and naphtha consumption have also risen as a result of the expanding petrochemical industry. China's Ministry of Commerce recently released the third batch of crude oil import quotas for independent refiners, bringing total allowed imports this year to 3.33MMBD compared to 3.03MMBD in 2018. According to data released by China's General Administration of Customs, the country has imported a staggering 10.09MMBD of crude oil in the first 11 months of 2019 – 10.4% more than the same period last year.

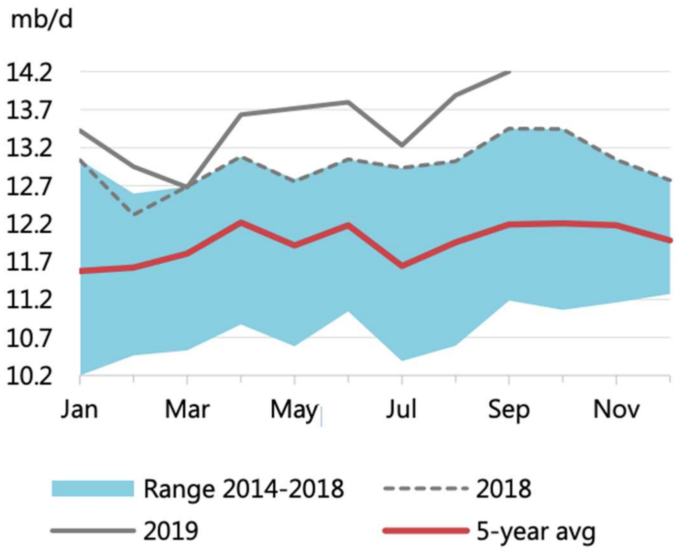


Figure 173: China Oil Products Demand (*Sources: IEA)*

Chinese refinery run rates typically peak around September-October – coinciding with the country's National Day holiday – and around January-February – coinciding with the Chinese New Year celebrations. We therefore expect crude throughputs to ramp up within the next coming months. The optimism in LPG and naphtha consumption will continue amidst a string of planned projects. Hongrun Petrochemical's 0.7MMtpy paraxylene (PX) plant in Shandong and Sinopec's 1.0MMtpy PX plant will ramp up production after beginning operations in 3Q2019. Fujian Meide Petrochemical's 0.66MMtpy and Zhejiang Huahong New Material's 0.45MMtpy propane dehydrogenation plants are both due to start-up in 1Q2020. Zhejiang Petrochemical's new complex, that includes a 1.4MMtpy ethylene and 4.0MMtpy PX plant, is slated to start-up in 1Q2020 as well.

We foresee that Chinese transport fuel demand will slow down given the slump in auto sales, with November marking the 17th year-on-year decline in the past 18 months. The auto market has been hurt by a slowing economy and stricter emission standards. 15 provinces that account for 60% of Chinese vehicle sales have implemented the new emission standards ahead of the 2020 deadline, which resulted in the reduction of sales of older, non-compliant, models.

India has been a significant contributor to global oil demand growth in recent years, but we expect the growth to moderate as the economy faces its worst cyclical downturn for more than a decade. Organisation for Economic Cooperation and Development latest forecasts of the nation's growth is pegged at 5.8% in 2019 and 6.2% in 2020. Unless the economy improves, oil demand in India continues to look slow. IEA's assessment shows that the demand growth for 2019 is at 0.145MMBD or 3.0% year-on-year but is expected to recover to 0.178MMBD or 3.6% year-on-year in 2020.

India's monsoon season usually stretches from June through September, however the start was delayed this year and extended into early-October. As a result, economic activity and diesel consumption were suppressed. Driving and construction activity was reduced, and hydropower resources were maximised. While diesel demand has recovered following the end of the monsoon season, demand will remain sluggish in the coming quarter due to the cyclical nature of diesel consumption in India.

Passenger vehicle sales have been plummeting this year – recording 12 months of decline in the past 13 months – apart from the blip in October when festival demand drove sales. A decrease in vehicle sales will adversely impact the demand for transport fuel. We expect gasoline and diesel demand in India to remain subdued as consumers continue to curb spending on automobiles, given the gloomy economic outlook, and the implementation of the Bharat Stage VI emission standard in April 2020 to reduce vehicular pollution will harm vehicle sales of non-compliant models.

U.S. Shale Boom Showing Signs of Slowing Down

The U.S. shale oil revolution propelled the country to become the world's largest crude oil producer, accounting for 17.10% of the global crude oil supply in 3Q2019. Non-OPEC supply continues to increase at 1.8MMBD with the U.S. dominating this rise – representing 87% of the total supply growth. However, U.S. production has slowed down in 2019 to 1.2MMBD and is forecasted to grow at a much slower pace than previously expected at 0.9MMBD in 2020.

The pace of U.S. expansion eased in 2019, largely attributed to slow production growth in the Permian Basin (see Figure). Crude oil production is expected to plateau as shale producers have been under immense pressure by investors to maintain operations within cash flow and boost returns. According to IEA, pure-play shale producers and independent shale drillers have posted a 6% decline in upstream spending as capital discipline has become a higher priority. Oil majors, on the other hand, have been observed to continue to increase activity.

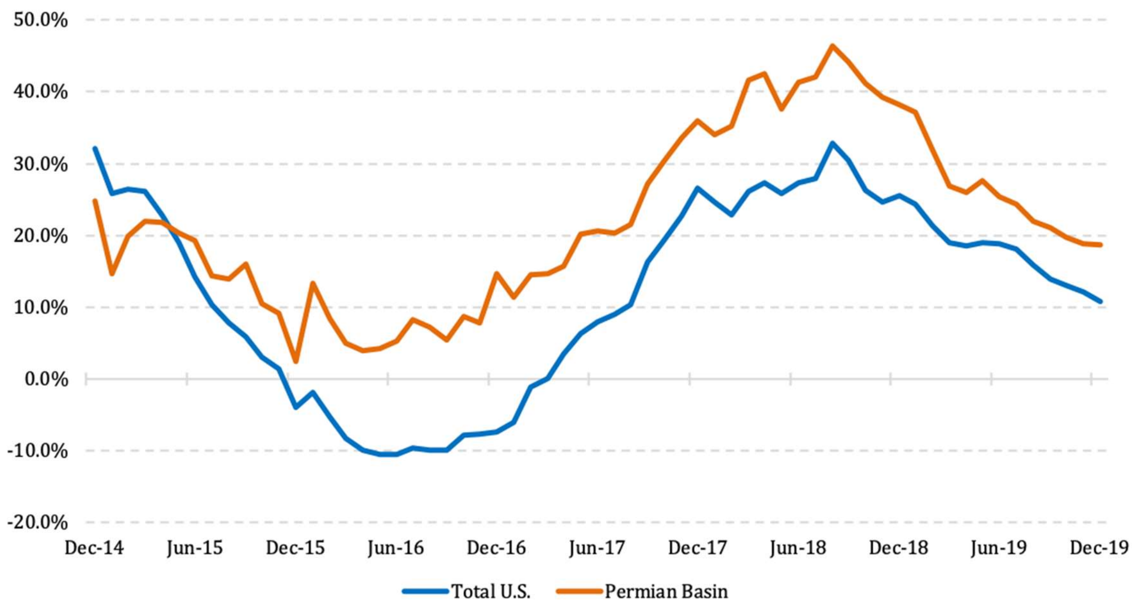


Figure 174: U.S. Oil Production Change, Year-On-Year (*Source: EIA*)

The overall U.S. rig count (see Figure 174) fell by 25.4% year-on-year to 799 units and oil rigs dropped by 23.6% year-on-year to 667 units in the week ending 13 December. The oil rig count – an early indicator of future output – has declined over the past year as exploration and production companies reduced spending to focus more on earnings growth rather than increasing output. The oil rig count in the all-important Permian Basin have decreased by 17.9% year-on-year in the same period to 399 units. While producers may have gained in output per rig deployed, we believe that the U.S. shale boom has already peaked. The wild U.S. production growth is expected to stagnate which would help support crude oil prices from the supply side.

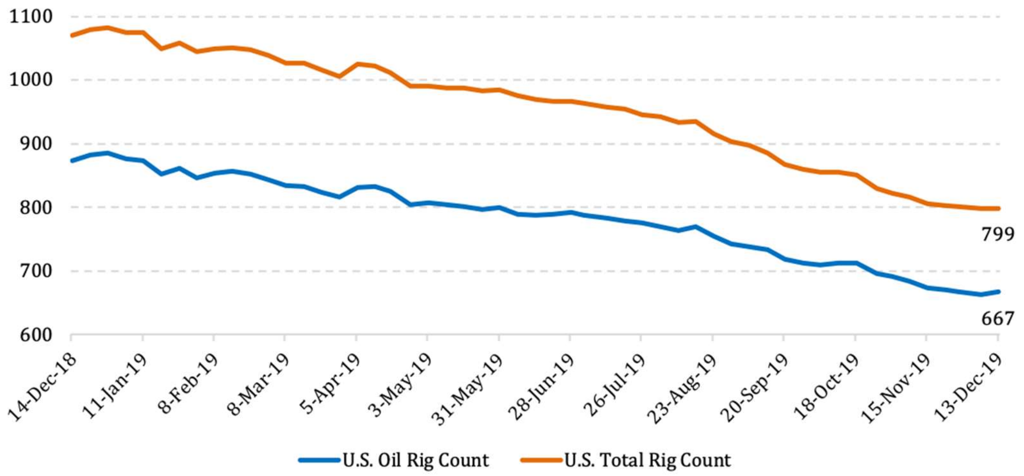


Figure 175: U.S. Weekly Oil Rig Count (*Source: Baker Hughes*)

New pipeline projects (see Figure 175) – Cactus II, EPIC and Gray Oak – in the Permian Basin will alleviate an inland bottleneck to move trapped barrels from the largest shale oil field in the country to export hubs. Plains All American Pipeline's 0.67MMBD Cactus II began initial operations in early-August and will be fully operational in 1Q2020. The 0.6MMBD EPIC also began interim crude operations in August – shipping up to 0.4MMBD – and will be completed in 1Q2020. Phillips 66's 0.9MMBD Gray Oak began service in November. We expect the ramp-up of throughput in these three new pipelines to boost Permian production in the coming months and partially offset the trend in declining upstream activities.

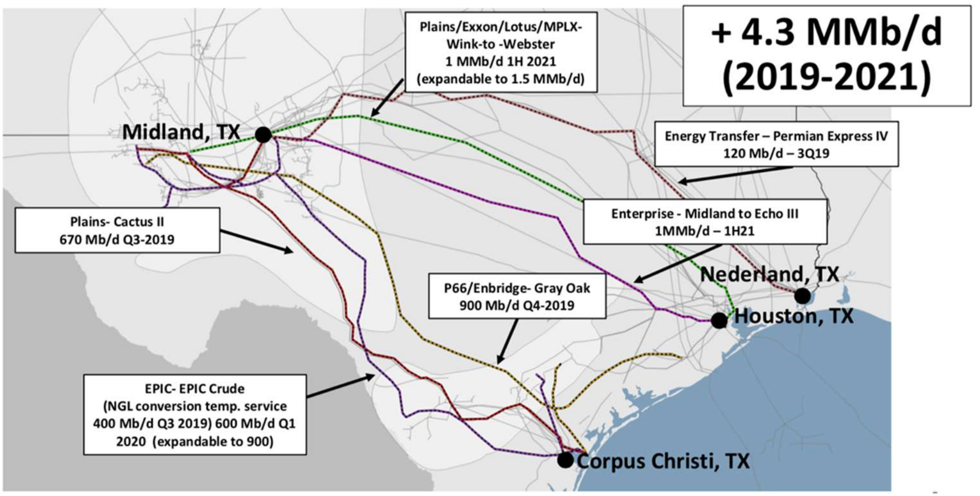


Figure 176: Upcoming Pipeline Projects in the Permian Basin (*Source: RBN Energy)*

The Future of OPEC+ Supply Cuts

The 14-member OPEC and 10 non-OPEC allies, known as OPEC+, agreed in December 2018 to reduce supply by 1.2MMBD from the start of 2019. OPEC+ extended their voluntary production cut agreement through March 2020, as they aim to prop up oil prices and prevent a supply glut as the global economy weakens and U.S. production soars. At the most recent meeting in December 2019, the cartel struck a monumental agreement to deepen the existing production cuts by an additional 0.5MMBD. Saudi Arabia's Energy Minister, Prince Abdulaziz bin Salman, argued that the pact may effectively remove as much as 2.1MMBD as Saudi will continue cutting more than its quota.

Projections by IEA, EIA and OPEC all reveal that complete compliance to the new target is required by the group to avert large builds in inventories in the first half of 2020. Even if the cuts are delivered in full, IEA's assessment shows a build of 0.8MMBD. While the bearish narrative surrounding sluggish demand continues to plague the market, we remain moderately optimistic after the announcement of the 'phase one' trade deal which would alleviate some headwinds. We believe that it is imperative to note that the deeper output cuts are merely to protect downside risks and combat the seasonal weakness, rather than seeking to push oil prices higher.

The coalition of producers boasted a high level of overall conformity with improved adherence since the start of 2019 (see Figure). OPEC adherence in October was 147% and non-OPEC allies stood at 103%, according to Bloomberg's calculations from IEA figures. However, we believe that these figures have been overinflated by Saudi Arabia's consistent over-compliance, with 643% of its cutback target achieved in September.

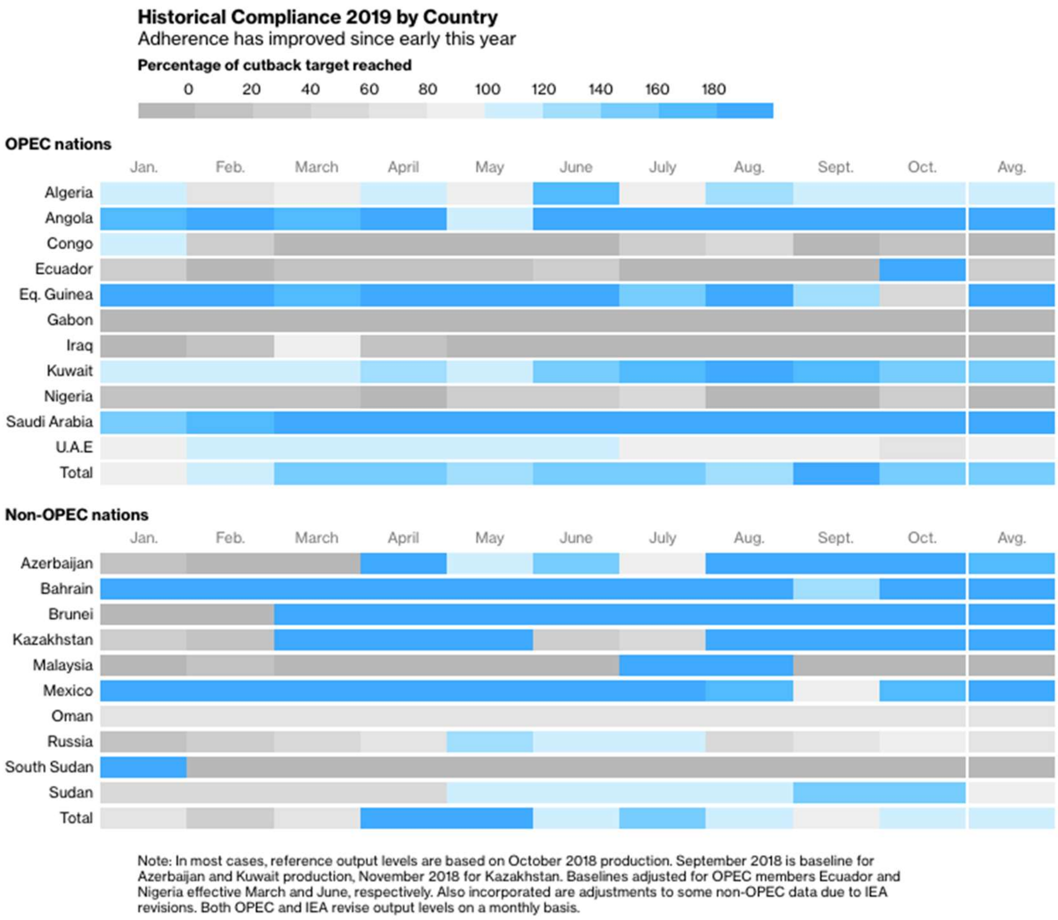


Figure 177: OPEC+ Production Cut Compliance (*Source: Bloomberg*)

Despite the organisation's efforts to manage production and maintain targeted price levels, members do not exactly comply with the production targets set by the organization. OPEC's second-largest crude producer, Iraq, has been guilty of chronically overproducing. According to Iraqi's oil minister Thamer Ghadhban, the autonomous Kurdish region has pumped and exported crude on its own without cooperating with Baghdad which led to the overproduction of oil. Ghadhban released a statement in September that Baghdad is in "advanced stages" of their talks with the Kurdistan Regional Government over unifying oil exports and will cut output from October. The Iraqi government has also slowed down their development of major oil fields, including West Qurna 2, Rumaila and Zubair, to comply with its pledge. However, according to the country's State Oil Marketing Organisation, Iraqi production rose to 4.595MMBD in November – representing Iraq's 9th month out of 11 of non-compliance. It is evident that the country's disastrous political climate is limiting the government's attempts to support the production cuts, as the Kurdish region continues to flout the supply pact.

The agreement and the prevailing crude price volatility has taken a toll on the Arabian Gulf economies, whose growth will more than halve this year from 2018 according to the International Monetary Fund's (IMF) estimates. The IMF has projected the region's oil GDP to contract 1.4% in 2019 compared to a 2.5% growth back in 2018. As a result, the breakeven oil prices for these Gulf countries – prices at which oil revenue will be able to fund fiscal deficits for oil producing countries – will remain high in 2019 and 2020 compared to current oil prices, with Brent hovering around USD 60/bbl. According to IMF's report, Saudi Arabia, the world's biggest oil exporter, needs a breakeven oil price of USD 86.5/bbl in 2019 and USD 83.6/bbl in 2020. The UAE needs a price of USD 70.2/bbl in 2019 and USD 70.0/bbl in 2020. There is undoubtedly increasing pressure for oil producers to prop up the prices of crude by extending the current production cuts, and we expect OPEC+ to extend the agreement beyond 1Q2020 at their next meeting in Vienna.

With increasing U.S. shale production, OPEC's share of the global oil market continues to shrink (see Figure 178). The organisation is in a precarious position in selecting between two inevitable consequences. Either OPEC loses its dominance to the prevailing U.S. shale boom or witnesses the fall in oil prices that it has tried to sustain for a long time. We foresee a likely extension in production cuts when OPEC meets again in March but prolonging the deeper output cuts would require significant discussions and further developments. The meeting would most likely consider the impacts of the 'phase one' trade deal between Washington and Beijing, the U.S. presidential elections and most importantly, the organisation's compliance, or lack thereof, to the deal set in December.

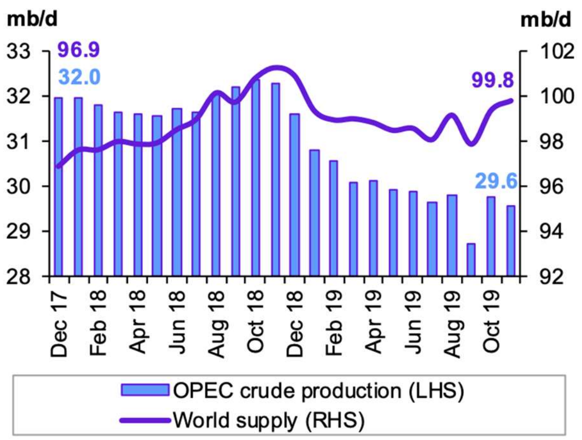


Figure 178: OPEC's Shrinking Share of Global Oil Supply (*Source: OPEC*)

Geopolitical Tensions' Limited Impact

The Trump administration restored its sanctions against Iran's vital oil industry, a crucial source of money for its anemic economy, back in November 2018 which effectively removed approximately 2.7MMBD. Washington stopped sanction waivers provided to importers of Iranian oil in late-April to increase pressure on the regime in Tehran. Oil prices roofed to USD 66.15/bbl as the market tightened on the back of the White House's decision.

Tensions heightened once again on 13thJune 2019 when two oil tankers, belonging to Norway and Japan, were attacked in the Gulf of Oman. The U.S. issued a statement accusing Iran of the attacks which Iran subsequently denied. A series of oil tanker seizures and harassment ensued in July and August along the Strait of Hormuz. Oil prices rebounded from weak performance in early-June, but the market's pricing-in of the Persian Gulf crisis was short-lived as its impact was nullified by the intensification of the U.S.-China trade war.

The market then witnessed the greatest supply disruption in mid-September when Saudi Arabia's Abqaiq plant and Khurais oil field were attacked by drones. The attacks crippled nearly 50% of the country's crude production as 5.7MMBD – approximately 6% of the global crude supply – was impacted. Prices rallied by 15%, which was the greatest rise in dollar-terms since futures started trading in 1988. U.S. President Trump tweeted that the attacks were" unquestionably sponsored" by Tehran which fuelled the U.S.-Iran tensions. However, Saudi Arabia's quick recovery from the aerial attacks within two weeks restored the market back into the pre-attack's prices.

The latest development in the Arabian Gulf involves an attack on Sabiti, an Iranian-owned oil tanker, on October 10 in the Red Sea off the coast of Saudi Arabia. However, oil prices only increased by a mere 2% which shows that the market has already accounted for the risk premiums, yet prices carry on to trade at subdued levels. This reaffirms our view that the underlying weak demand, due to the prolonged trade war and recessionary concerns, will continue to undermine supply-side mechanisms. Therefore, explaining the market did not observe a massive price hike after the announcement of the deeper OPEC+ production cuts.

TRADE IDEA: LONG WTI CFD

Figure 179: USDWTI CFD Daily Chart (*Source: TradingView*)

Entry Level: 59.80
Take Profit: 63.90
Stop Loss: 57.80
Risk to Reward ratio: 2.05

Given our moderately bullish analysis, we recommend entering the short USDWTI trade immediately at USD 59.80. As we can observe from the chart above, a triple bottom reversal pattern has developed which is a bullish signal, after prices plunged sharply in May. Prices are also trading in a rising channel which corroborates the upwards breakout after the triple bottom pattern.

The bullish signal is further supported by utilising the MACD indicator, which reveals a reversal in momentum after prices fell two weeks ago as seen from the divergence in the short-term 12 periods EMA away from long-term 26 periods EMA. The CCI indicator also portrays a buy signal as the indicator is above the +100 threshold.

By utilising Fibonnaci Retracement, we have set the take profit level at USD 63.90. As prices may continue to trade downwards in the channel without an upward break beyond the resistance line of the triple bottom pattern, we propose to set the stop loss at USD 57.90 This ultimately represents a risk-to-reward ratio of 2.05.

COAL (Underweight)

Coal is a primary fossil fuel that is rich in carbon and typically found in sedimentary deposits. The commodity plays an indispensable role in meeting the energy requirements of the world and is undoubtedly critical to infrastructure development. There are two main types of coal, namely thermal coal – which is used for energy generation – and coking coal – which is used for steel production.

Weak Fundamentals in Seaborne Thermal Coal Market

Imports from Japan, South Korea and the European Union (EU) decreased on a year-on-year basis in the first half of 2019. Persistently low spot liquefied natural gas (LNG) prices have encouraged fuel substitution from coal to gas, especially in the EU. As volumes of thermal coal in the seaborne market have increased despite waning demand, the market is currently oversupplied and thermal coal prices have been suppressed.

China's, the world's largest importer of thermal coal, imports have been strong during the first three quarters of the year and rose to 251M MT or an increase of 9.5% compared to the same period last year. Imports were supported by a tight domestic coal market in China as output has reportedly slowed after heavy rainfall, heatwaves and a national safety campaign at mines. Higher domestic prices relative to import prices have supported the seaborne market. However, Chinese domestic coal production (see Figure 180) is expected to grow at a faster pace, after three years of reforms, as newer and more efficient additions to capacity will boost output. Tighter restrictions on imported coal have weighed on buying sentiment as well. Chinese restrictions on Australian coal are expected to remain in place into 2020 as Beijing seeks to moderate the spike in imports to protect domestic supply. As Chinese ports are close to maxing out their assigned annual quotas for coal imports, we expect a sharp drop in import demand in the final quarter of 2019 and thus, adversely impact the seaborne market.

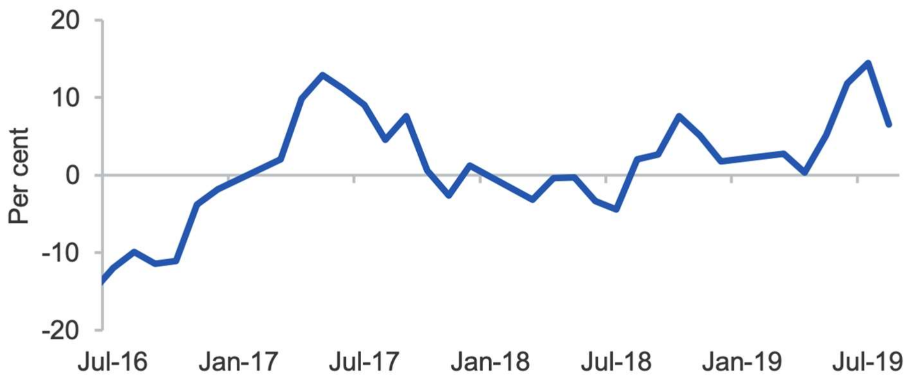


Figure 180: China's Year-on-year Coal Production Growth (*Source: National Bureau of Statistics of China*)

Imports of thermal coal by Japan, the world's third largest importer in 2018, have declined and was initially weighed down by a warmer than usual winter at the start of the year. Japan's transition away from coal is gradually picking up as the total number of cancelled or delayed coal-fired power projects have increased to three after Kansai Electric Power announced that the construction of its 1.3 GW Akita power station has been delayed indefinitely. However, we foresee that thermal imports will experience a slight boost till early 2020 due to a temporary fall in nuclear generation as maintenances of nuclear reactors have been scheduled through the period.

The energy transition in South Korea, the world's fourth largest importer of thermal coal in 2018, has accelerated causing coal imports to fall by 10% year-on-year in the year to July. Since South Korea President Moon Jae-in took office in 2017, the country has implemented a range of measures and regulations to decrease the country's reliance on coal-fired power generation. Seoul decided to lower taxes on LNG by as much as 74% while raising taxes on thermal coal by 27% from April this year. Cancellation of new coal-fired power plant capacity and plans to close several aging power plants continue to dampen the demand outlook in South Korea.

The market has been bolstered by South East Asia's increase in demand for thermal coal (see Figure 181). The region's collective imports rose by 15% in 2018 and is expected to be one of the few sources of demand growth, driven by new and planned coal-fired power plants. Vietnam has played a substantial role in this surge in demand as coal plays a central role in the country's Power Development Plan to meet the country's growing electricity demand. However, analysts expect the latest revision of the plan to further adjust policy and reduce its reliance on traditional sources as the country is increasingly embracing cheaper renewable energy. The country's Ministry of Industry and Trade has started to offer incentives for renewables and the high level of attractive feed-in tariffs is garnering attention. While coal is still king, we believe that renewables could potentially challenge coal as Vietnam's leading source of power.

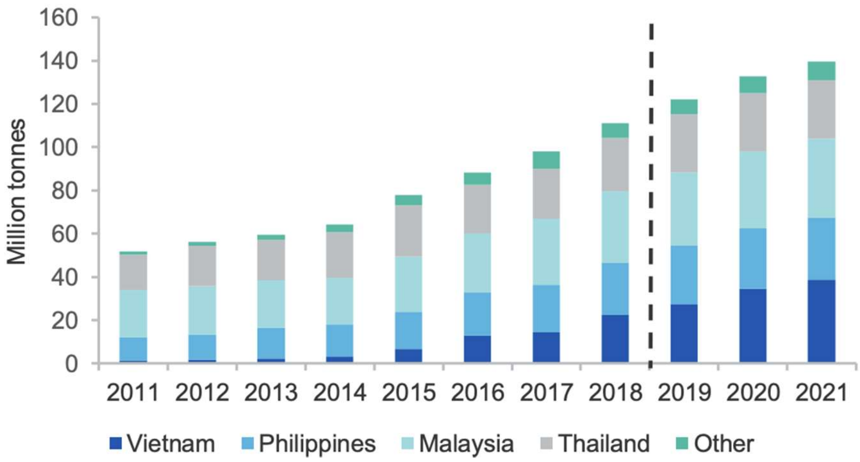


Figure 181: SEA Thermal Coal Imports (*Source: IEA*)

Despite the slowing growth in demand, Indonesia, Australia and Russia continues to increase the supply of thermal coal in the seaborne market. Indonesia – the world's largest thermal coal exporter – sustained its strong pace of growth with exports rising by 9.3% year-on-year in the first half of 2019. The Indonesian government has continued to stray away from production caps and has also reportedly approved requests from producers to increase output to 600M MT, from the target of 489M MT set earlier in the year. Australia – the world's second largest exporter – is expected to increase its export volumes due to a combination of productivity improvements and the ramp up of new capacity, most notably at the Mount Pleasant mine in New South Wales. Russia – the world's third largest exporter – experienced steady growth in 2019, although at a slower pace, with exports at 6.4% higher in the first half of 2019. The persistently weak Russian Ruble has supported this ongoing growth. We foresee the seaborne market to soften on the back of increasing exports and slowing demand.

Thermal Coal's Demise in the U.S. Domestic Market

According to the EIA, electric generation from coal in the U.S. is expected to decline to 25% in 2019 and 22% in 2020, down from 28% in 2018. With the growth of cleaner energy sources, non-hydropower renewables power generation will grow from 414B kWh in 2019 to 471B kWh. Given that 93% of the coal consumed in the U.S. in 2018 was used to generate electricity, the switch in the power sector, from coal to more environmentally friendly options, dampens the demand outlook.

The Trump administration attempted to revive the American coal industry by withdrawing from the Paris accord and repealing the Obama-era plan to curb emissions from coal-fired power plants. U.S. President Trump's efforts have been overwhelmed by the free market. Cheap gas from record shale production and rising use of renewables have kept electric prices low in recent years, thereby affecting margins for generators to continue operating older and less efficient coal plants. The relatively flat electricity demand combined with stricter federal and state environmental regulations have also added to such pressure. The aging fleet of coal-fired power plants are shrinking (see Figure 182) and new units are not being built to replace them.

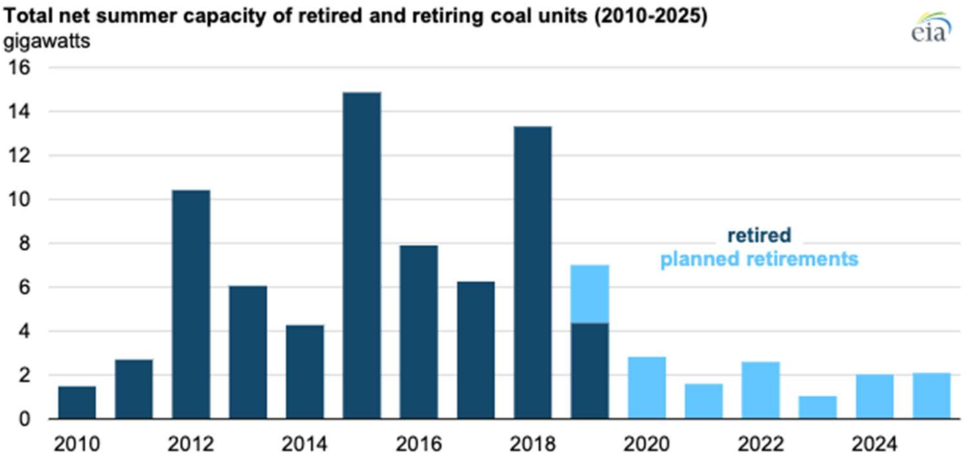


Figure: 182 Retirements in U.S. Coal-Fired Power Plants (*Source: EIA*)

Murray Energy, the largest coal miner in the U.S., filed for Chapter 11 bankruptcy protection in late-October. The private coal giant is the fifth coal company to go bankrupt this year, signaling the slow death of the industry. The EIA has assessed that U.S. coal production will decline 10% year-on-year to 679MT in 2019, affirming that producers are at the mercy of falling demand. We foresee further production cuts and consolidation as the domestic market remains bearish.

Softening Steel Market Represses Coking Coal Demand

Expansionary fiscal policies and accommodative financial conditions in China have boosted property construction and infrastructure investment, which have boosted demand for steel production in the past few years. In turn, coking coal demand has surged to satisfy the needs of increasing steel production (see Figure 183). However, we witnessed the prices for iron ore futures soar in July to a high of USD 123.19 and is currently trading more than 20% higher from a year ago. Combined with the fact that steel prices are down double digits year-on-year, steelmakers are inevitably facing declining profit margins. Share prices of Chinese steelmakers, and those around the world, have all plummeted in recent months – hinting that iron ore's performance has peaked and cannot sustain much longer. As a result, we foresee that iron ore prices will decline further which will pressure coking coal consumption and prices.

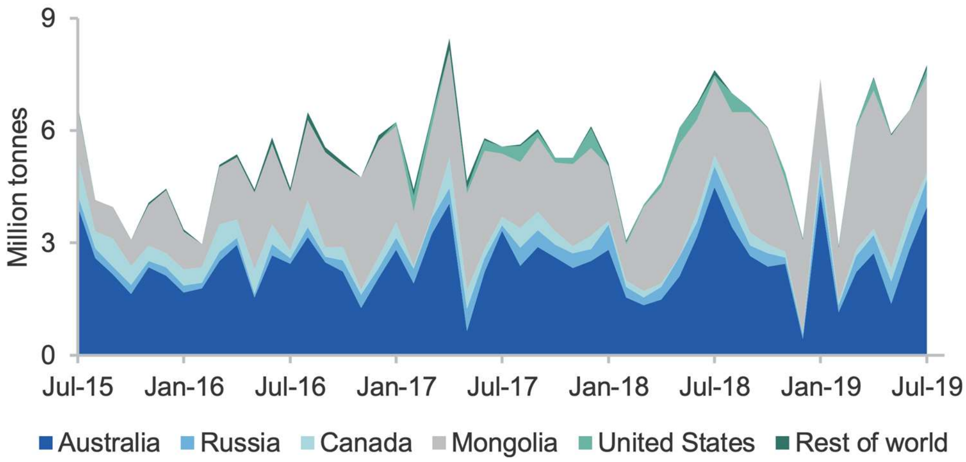


Figure 183: Chinese Imports of Coking Coal (*Source: National Bureau of Statistics of China*)

China has also renewed efforts to curb pollution by restricting steel mills operations, which will curtail coking coal demand. The Ministry of Ecology and Environment and four other ministries released a joint directive in May to ensure that steel plants in the country's most polluted regions meet ultra-low emission standards by 2025. Beijing expects 60% of steel mills in key regions to upgrade and be compliant with the new standards by 2020 and 80% of mills in the country by 2025. China's largest steelmaking city Tangshan recently extended existing curbs, which began from 24th September, on steel production and sintering operations to the end of October. Even though steel production has been temporarily reduced, the market continues to look oversupplied in the coming months as we enter the winter season where industrial activity slows down. We expect demand for coking coal to decline as the temperatures fall.

India stood as the largest importer of coking coal after China in 2018, accounting for 20% of global imports. However, steel production was adversely impacted by slowing investment and infrastructure projects as India faced political volatility before the general election in May. Steel demand continued to remain suppressed in the third quarter due to India's monsoon season. While India's construction and real estate sectors are expected to see increased activity, we reckon that the broader economic slowdown will cap gains. Weak GDP growth, low domestic demand and the private sector's unwillingness to invest in new capacity continue to raise concerns over India's industrial production, which contracted by 3.8% month-on-month in October, which marks the country's third consecutive month of deceleration. We believe that coking coal will continue to face headwinds from the dwindling steel demand.

TRADE IDEA: SHORT API2 ROTTERDAM COAL FUTURES (Current Contract in Front)

Figure 184: ATW1! Weekly Chart as of 13 December 2019 (*Source: TradingView*)

Entry Level: 53.65
Take Profit: 43.40
Stop Loss: 58.25
Risk to Reward ratio: 2.22

Given our earlier bearish assessment, we recommend entering the short ATW1! trade immediately at USD 53.65. As we can observe from the chart above, prices have been trading in a rising wedge since April. Prices are currently testing the established support line and we expect a downward break.

The Ichimoku Cloud indicator reaffirms the bearish sentiment as the current price is trading below the cloud. The downward trend is further strengthened as the bottom of the cloud is moving down as well. The CCI indicator also portrays a sell signal as it is hovering around the -100 threshold.

We expect a downward break to an earlier support line established back in 2016 and thus, we have set our take profit level at USD 43.40. A stop loss is set at USD 58.25 – a significant resistance line. This represents a risk-to-reward ratio of 2.22.

COPPER (Overweight)

Copper is used in a variety of applications, such as electronics, communications, equipment and infrastructure. Due to copper's widespread applications in the economy, mainly used in construction of home and transmission of electricity, demand for copper is often viewed as a reliable and key indicator of global economic health.

The IHS Markit Global Copper Users PMI is a composite indicator giving an overview of operating conditions at manufacturers identified as heavy users of copper and is based on data provided by companies around the globe. As copper is an essential raw material in a variety of sectors, including electronics, transport and construction, copper can be used as a leading indicator on the phase of the economy. A downswing in outlook of copper producers can lead to a notable rippling effect across the global economy. This proves the the copper market can be used as a leading indicator to provide a better outlook on the economic cycle.

Figure 185: Copper Users PMI vs World GDP growth (*Source: IHS Markit*)

Chile, Peru and China are the main producers of copper, with three of the biggest copper mines all located in Chile.

<u>Spates of Protests at Copper Mines Causes Unpredictable Levels of Supply</u>

The supply for copper has always been known to be notoriously volatile and this is attributed by the frequency and severity of labour strikes that have been tormenting copper producers and plaguing copper mines around the world.

Over the notion of poor working conditions and unfavourable employee benefits, these labour strikes organised by labour unions have hampered copper production as it has led to temporary halts in production and the resultant long idle time of man and machine. It has been estimated by the International Copper Study Group (ICGS) that copper production in the first half of 2019 dropped by 1.4% compared to the first half of 2018. Copper supply shocks tend to result in spike in copper prices.

In June 2019, it was reported that the union strike in Codelco's largest mine, Chuquicamata, located in Chile, wiped out 10,000 metric tonne of copper ores from the global market, with at least 3,000 workers involved in the protests. Codelco accounts for 11% of the world's global supply of copper. Just from this incident, copper prices leapt more than 4%.

There are still many ongoing protests in copper mines around the world, including the Las Bambas copper mine in Peru, which accounts for 16% of Peru's entire copper output, as well as the Mirador project in Zamora-Chinchipe, located in Ecuador. We expect that these events will continue to roil the global copper market and rattle copper supply.

Revival of Chinese Demand for Copper in the Face of Optimistic Trade War Deal

Escalating geopolitical tensions in the global economy over the past few months have evoked volatility in the copper markets. The effects of these tensions have also spread to Europe, the U.S. and the United Kingdom, where these economies are experiencing huge slumps in the manufacturing sector, as suggested by the low PMI index. The poor economic outlook of the manufacturing industry has resulted in faltering demand for base metals such as copper.

However, in December 2019, President Donald Trump signed off on a phase-one trade deal with China, averting the 15th December introduction of another wave of U.S. tariffs on about USD 160 billion of consumer goods from China. This has improved the global economic conditions significantly and therefore, the demand for copper.

With the dispute with the U.S. that has weighed on the market for more than a year now resolved, China's appetite for copper is likely to recover. Coupled with the fact that China consumes more than half the world's copper supply, copper price's sensitivity to economic conditions, due to its widespread use in industry, construction, transport and power distribution, could be a significant factor in the spike in the demand for copper in the global market.

This is the most evident in China. Ever since the signing of the trade deal, trade data showed that China's imports of copper increased to the highest since September 2018. Shipment totalled 483,000 tonnes in November 2019, which nearly 6% higher than the same month last year.

We foresee that demand for copper will be rekindled by the signing of the trade deal. This bullish demand will put upward pressure on copper prices.

Future Demand Stemming from Copper's Electrifying Role in Future Battle Against Climate Change

In the longer run, the war against excessive carbon usage will cement copper's position as a core base metal in climate change. As the world is moving to a low-carbon energy future, growth in copper demand is being driven by wider usage of elective vehicles (EVs) and increased use of renewable energy sources, both requiring significant amount of copper.

The growing market for EVs will positively boost demand for copper, especially in the next decade. with, EVs being the future of automobiles. With electric mobility growing at unprecedented rapid rates, conventional internal combustion engine powered vehicles will become increasingly obsolete. A study done by the International Copper Alliance predicts that by 2027, there will be an estimated 27 million electric vehicles on the road, up from 3 million in 2017. Also, this will raise copper demand for production and charging of electric vehicles from 185,000 tonnes in 2017 to 1.74 million tonnes in 2027.

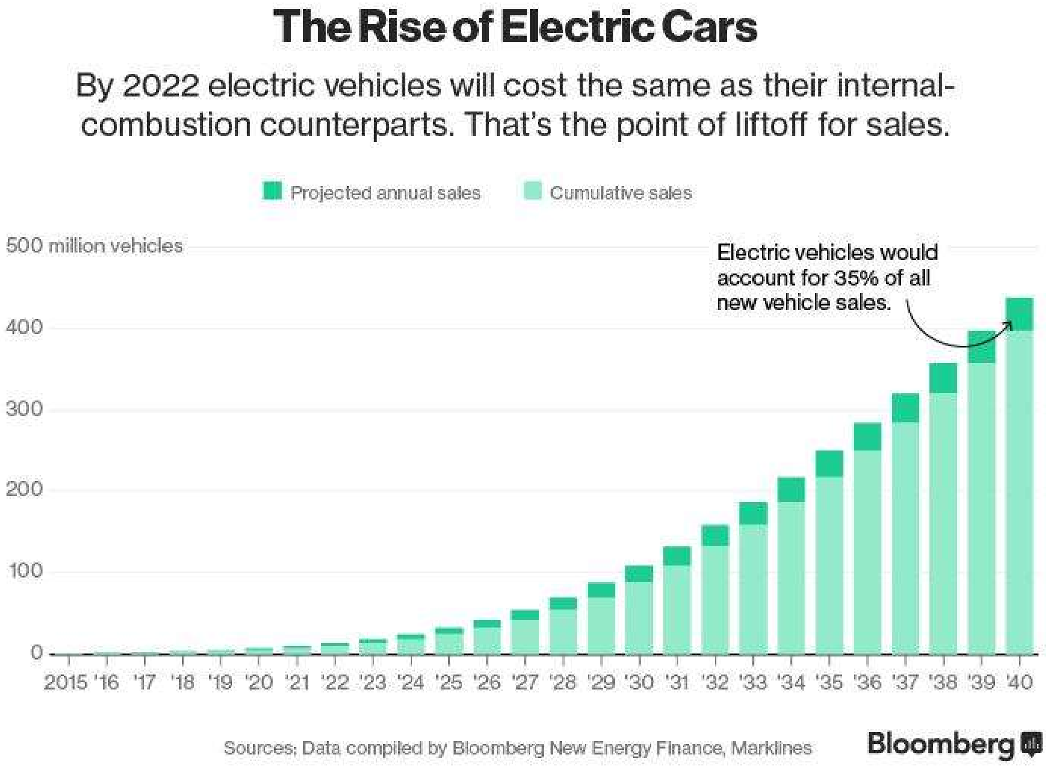


Figure 186: Sales of Electric Cars (*Source: Bloomberg*)

Furthermore, copper is a metal that is heavily recycled. ICSG estimates that, on average, 35% of global copper use came from recycled copper. By its nature, copper is a circular material as it does not lose quality when it is reused for another function. With many organisations and governments aiming to move towards a circular economy, the usage of copper as a base metal will be pivotal in many future economies. Therefore, we foresee that demand for copper will remain bullish in the upcoming years.

TRADE IDEA: LONG XCUUSD

Figure 187: XCUUSD Daily Chart (*Source: TradingView*)

Figure 188: XCUUSD Daily Chart (*Source: TradingView*)

Entry Level: 2.795
Take Profit: 2.830
Stop Loss: 2.785
Risk to Reward ratio: 3.5

Currently, there is an uptrend in copper prices since the start of October 2019, and this trend is likely to remain firm. Using Ichimoku Cloud, we observe that copper prices are currently trading above the green cloud area, suggesting that the upward price trend is likely to be sustained. We recommend entering a long position at USD 2.795, with the take profit level set at USD 2.830 and stop loss at USD 2.785. This represents a risk-to-reward ratio of 3.5.

The MACD line has crossed above the signal line at the start of December 2019, further confirming the bullish copper prices. The MACD line and the signal line has been diverging ever since, confirming a strong long signal. Additionally, RSI has been gaining momentum and is currently just above the 70% level. This may suggest the copper is being overvalued. However, the widening of the MACD line and signal line suggests that copper is not being overbought and is still gaining momentum.

Coupled with the fact that prices are trading above the 9-day and the 20-day MA, the 9-day MA has crossed above the 20-day MA in December 2019, further signalling taking a long position in copper.

Fundamentally, the supply disruptions all over the world and new-found demand will contribute to the spike in prices of copper. In the longer run, the driver for copper demand will be the increased use of EV. Also, many other geopolitical events such as the Zambia copper tax issue and stricter regulations on copper producers will continue to weigh on copper supply in the future. We remain bullish on copper prices on both the short and long term.

IRON (Overweight)

Iron, just like copper, has a widespread usage in the economy but is mainly used for infrastructure and industrial purposes in the form of steel. Movement in the steel markets has significant impact on any movement in the iron markets. Steel is essential for many industries as it is used in engineering applications, repair and construction of maritime equipment and vessels, automobile manufacture, construction and general industrial activities. A key ingredient of steel, iron ore remains to be one of the most important base metals in the global economy.

China, Australia and Brazil are the largest producers of iron. China is also the biggest importers of iron, due to the large steel-making industry in China, which accounts for 56% of total steel production.

China's Determined Campaign Against Carbon Emissions Sees Weakened Demand for Iron

The production of steel is one of the largest sources of carbon emissions, responsible for between 7% and 9% of global carbon emissions. This is due to the traditional method of making iron and steel by smelting raw materials at extremely high temperatures and the high reliance on blast furnace.

China has shifted their focus on enforcing regulations and monitoring steel mills producing unsustainable carbon emissions, in the battle for cleaner air in the environment. This is because the steel industry has recently overtaken the coal industry being the biggest polluter in China in 2017. In order to curb pollution, Chinese government are forcing steel plants to comply to ultra-low emissions standards, reducing the emission of particulate matters and harmful gases.

The goal is for 60% of steel mills in key regions to have completed the transformation by 2020, and 80% of steel plants in the country to complete it by 2025. Plants that complete the upgrades will receive more support on taxes, finance, and environmental protection policies.

Consequently, there will be diminishing demand for iron, as many steel mills may not be able to comply to these standards which would require high capital outlay for the purchase of greener technology or to innovate more sustainable ways of producing steel. Rising carbon taxes will also place pressure on steel mills that are engaging in unsustainable production. In the foreseeable future, we believe that if steel mills are not able to comply with these stricter regulations, there will be a shrinkage in steel-making operations in China and we expect that this will consequently result in a plunge of demand of iron ores.

Dwindling Margins For Steel Producers Resulting in Decreased Derived Demand for Iron

Chinese steel producers enjoyed a bull run between mid-2017 and October 2018 which was fuelled by strong domestic demand and high steel prices. The hitherto positive financial performances were aided in part by relatively low iron ore prices over much of 2017 and 2018. Incentivized by strong profits in 2017 and 2018, Chinese mills lifted steel production and brought on new capacity. These facilities are supposed to be replacing older dismantled ones, but the new operations will be larger and more efficient, and this means global steel capacity will continue to creep up. With larger inventory of steel in the global steel market in times of a recovering economic environment damaged by the trade war, the price of steel will fail to push to higher prices, and this will mean eroded profit margins for steel producers.

With lowered profits to sustain operations, steel mills may look to cut operations which will reduce demand for its main ingredient, iron ores.

Figure 189: Chinese HRC Margins (*Source: S&P Global*)

The headline China Steel Sentiment Index (CSSI) has averaged just 24.04 over January to August 2019, compared with 42.09 in the same period last year, when China's steel market was buoyant. A reading above 50 indicates expectations of an increase or expansion and a reading below 50 indicates a decrease or contraction. The CSSI is based on a survey of approximately 50 China-based traders and steel mills. The poor sentiments from Chinese steel mills could potentially reduce production of steel and this will greatly cripple demand for iron and consequently cause sinking iron prices.

Figure 190: CSSI Index (*Source: S&P Global*)

In the longer run, we predict that the underperforming steel industry will lead to a bearish demand for iron ores.

Supply Disruptions Continues to Boost the Global Iron Market

A deadly tailings dam burst at Vale's Brumadinho complex in January 2019 prompted several dams and mines shutdowns for safety checks, tightening global supply. The world's largest iron ore miner has been forced to take some 90 million tonnes of production capacity offline since the disaster, some voluntarily but much under pressure from courts and regulators aiming to avoid another disaster, which accounts for almost 25% of the company's forecasted annual production for 2019. The resultant supply shock resulted in a spike of iron ore prices that reached 5-years high in July 2019.

Since then, Vale has failed to restore production to normal capacity levels despite the promises to do so. Adding on to greater supply uncertainty, Vale announced that it would reduce its production forecast for 2020.

In November 2019, Vale, under pressure from authorities, announced that it would slash output from its Brucutu mine for up to two months as it evaluates the stability of the nearby Laranjeiras dam, where much of the mine's waste is normally disposed.

The move will leave Brucutu, Vale's biggest mine in Minas Gerais state, the industry's longtime heartland, operating at 40% of normal capacity for the period, cutting its output by 1.5 million tonnes. As a result, Vale lowered its iron ore production outlook for the first quarter of 2020 to a range of 68 million to 73 million tonnes from a previously announced range of 70 million to 75 million tonnes.

Furthermore, about 20 merchant mine leases in India will expire by March 2020 and this will lead to a shortage of supplies of iron ore from April 2020 as five of the six mine leases that are expiring will not feature in the auction already announced. The total production of the five mines that will be impacted is about 60 million tonnes.

We foresee that such events will leave a huge gap between demand and supply, that could bring about upward pressure on iron ore prices.

TRADE IDEA: LONG IRON ORE (SD1) (SGD)

Figure 191: Iron Ore (SD1) Daily Chart in SGD (*Source: IG*)

Entry Level: 658.8
Take Profit: 678.8
Stop Loss: 649.4
Risk-Reward ratio: 2.12

Iron ore prices have been on an uptrend since mid-November 2019 and are currently trading above the Ichimoku cloud, confirming the downward trend. It has broken the Ichimoku cloud at the start of December 2019, which acts as a resistance. This signals a strong buy call, which leads us to recommend entering a long position at USD 658.80.

The 9-day MA has crossed above the 20-day MA in late November 2019 and prices have been trading above both MA since start of December 2019.

Widening MACD and signal line, as well as the gain in momentum suggested by the RSI indicator, points towards taking a long position in iron ore.

Take profit and stop loss levels are being determined by support and resistance levels that have been tested many times. The take profit is set at USD 678.80 and stop loss at USD 649.40, ultimately representing a risk-to-reward ratio of 2.12.

Fundamentally, we expect that the effects of a supply shock due to the Vale mine collapse and the expiration of India's mine leases will result in an increase in iron ore prices. The mild recovery of demand due to the trade resolution in place will contribute to rise in demand as well. However, prices will likely falter once the market recovers from the supply shock. Weakened demand for iron due to battle against climate change and poorer margins from steel production will be seen over the longer run.

GOLD (Overweight)

Gold has been historically regarded as a "safe haven" asset due to its ability to retain value. This has been especially prominent in 2019, as a combination of falling interest rates and heightened geopolitical risks have seen a sharp increase in demand for gold. Gold has seen a steady rally since the beginning of 2019, reaching a six year high of 1550 and has since consolidated around the region of 1500. The drivers of gold prices are: i) economic expansion, ii) risk and uncertainty, iii) opportunity cost (interest rate, USD) and iv) momentum (capital inflow). Gold price is expected to remain strongly backed by all of the abovementioned drivers except economic expansion.

FED Monetary Policy Will Continue to Support Demand for Gold

FED Monetary Policy has shifted dramatically since the beginning of the year. The Federal Reserve had expressed their intention to continue hiking rates in 2019. Now, however, there has been 3 consecutive rate cuts. Moving forward, the FED is expected to continue cutting interest rates. Fresh updates out of the FED's September forecasts suggests that the central bank will continue to insulate the economy, as the majority of FED officials see the benchmark interest rate at around 1.50% to 1.75% in 2020. The FED is also not alone in their accommodative monetary policy. In September, the European Central Bank (ECB) had announced that it will restart its quantitative easing measures. Thus, the prospect of lower interest rates should support gold investment demand due to expectations of rising inflation.

Inflation is caused by increasing the money supply faster than the growth in real output. This results in rising prices in goods and services. However, incomes do not rise in tandem. On the other hand, precious metals preserve purchasing power over extended periods of time. When measured against Gold, the prices of other commodities such as Oil are relatively stable over long periods of time, as compared to the prices of commodities denominated in a fiat currency like the USD. Thus, gold acts as an inflation hedge, and with expectations of higher inflation, demand for Gold is expected to increase.

FED Rate Forecasts

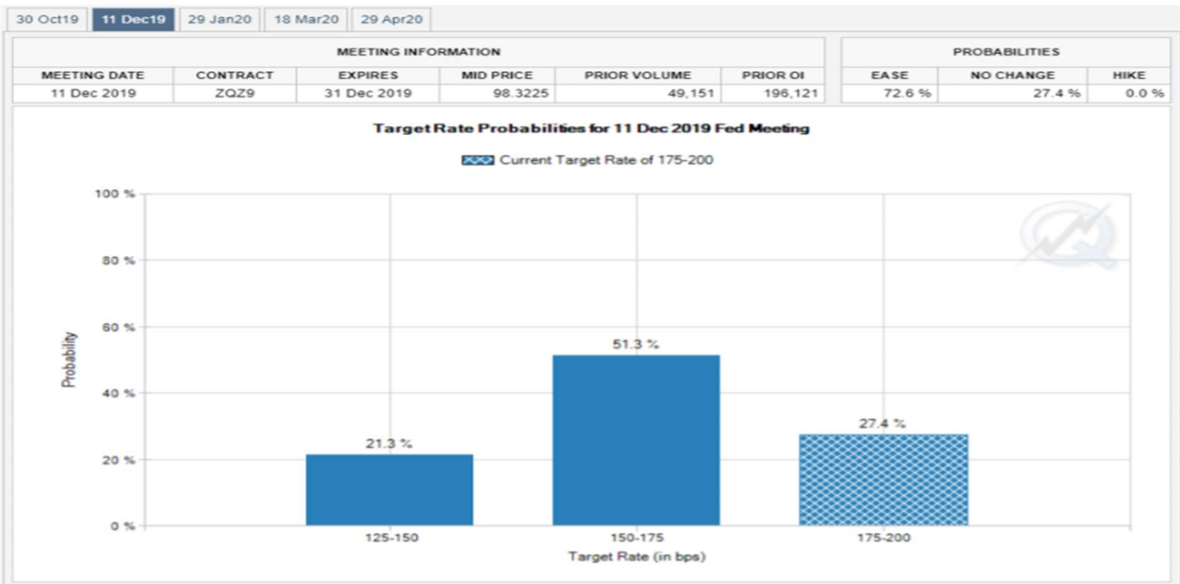


Figure 192: FED Rate Forecasts (*Source: CME Group*)

In addition, low and falling interest rates will continue to fuel a decade-long stock market rally and create further complications for the FED to continue easing due to limited room for further rate cuts. As such, the FED may need to use quantitative easing and/or other new measures to reinvigorate the economy. With uncertainty over the economy and the central banks' inability to cope with it, this will push investors towards defensive assets like bonds. However, more than USD 16 trillion of global debt is currently trading with negative yields. Against this backdrop, alternative liquid assets such as gold, will become more attractive to investors looking to hedge against their riskier investments.

Geopolitical Risks Remain on the Horizon

Geopolitical risks over the past year has been a major factor for pushing up gold prices. However, in recent weeks leading up to the month of October, geopolitical risks seem to have subsided slightly. Trade war tensions have taken a temporary reprieve as China and the U.S. have agreed on a Phase One deal, to be signed between the two countries' leaders at the Asia Pacific Economic Cooperation (APEC) Summit on 16th-17th November. However, we remain cautiously optimistic on the temporary truce, as more sensitive and thorny issues have yet to be touched on, particularly the issues on intellectual property theft and technology transfer. Despite early trade talks, the underlying long-lasting structural issues are expected to dampen the market's optimism on the trade truce.

Elsewhere, markets have gotten more optimistic after the UK (United Kingdom) and the EU (European Union) have agreed to a Brexit deal. Yet, any resolution still faces hurdles, as legislation still needs to be passed in Parliament, as the ruling party does not have a majority in the British Parliament. Thus, there are a wide range of possible outcomes with the worst being a no-deal Brexit.

Capital Inflows into Gold-backed ETFs

According to a report by the World Gold Council, global demand for gold-backed ETFs hit an all-time high in September, with a net inflow of USD 4.1 billion. This was despite a pause in the gold-price rally as prices fell as much as 3% in September, after having increased by 20% during the past four months. It implies a bullish sentiment towards gold, as investors are buying the dip in gold prices.

TRADE IDEA: LONG XAUUSD

Figure 193: XAUUSD Daily Chart (*Source: TradingView*)

Entry Level: 1475.00
Take Profit: 1540.00
Stop Loss: 1455.00
Risk to Reward ratio: 3

With the aforementioned factors that are expected to drive the demand for gold, we recommend going long on gold at the current entry price of 1476, judging from a six-month horizon. Currently, the chart shows that price is clearly above the 200-EMA, confirming our long bias. A moving average crossover pattern is also beginning to emerge, coupled with dynamic support provided by the 100-EMA.

With the completion of the 20- and 50-EMA crossover, a breakout is expected to breach the resistance level at 1507, opening the room for price to breach the crucial resistance level at 1537, which has only been breached in late August- the first time in six years. We then recommend a take profit level of 1540.

With an increasingly uncertain geopolitical outlook however, the price of gold is likely to be volatile moving forward, and thus we recommend a wider stop loss, to be set at 1455, the next significant support level. This would give the trade a favourable risk to reward ratio of more than 3.

SILVER (Overweight)

Silver is a material that is used for industrial purposes in the electrical industry, particularly in solar panels. It is also often dubbed "poor man's gold" and shares the same price drivers as gold. Thus, the price of silver is more volatile than that of gold, due to the multiple factors that influences its price. 2019 has also been a spectacular year for silver, as price bottomed at 14.50 in May and breached its 3 year high at 19.70 in a short span of 3 months. Currently, price is consolidating in a range, from 17.50 – 18. Due to the high correlation between the price of silver and gold, the price of silver is still expected to increase, in line with the expected increase in the price of gold.

Demand for Solar Energy is Likely to Translate into Demand for Silver

Silver is an important component in solar panels, due to its high electrical conductivity. With solar energy capacity set to increase by 30% over the next 5 years, demand for silver is likely to be driven higher.

However, a potential downside risk could arise from improvements in technology – known as 'thrifting'. Driven by higher silver prices, the solar energy industry looks to reduce the quantity of silver needed to produce a set amount of electricity. Yet, we are of the view that continued investment in solar energy will continue to support the demand for silver, far outstripping any reduction in silver usage arising from technological improvements.

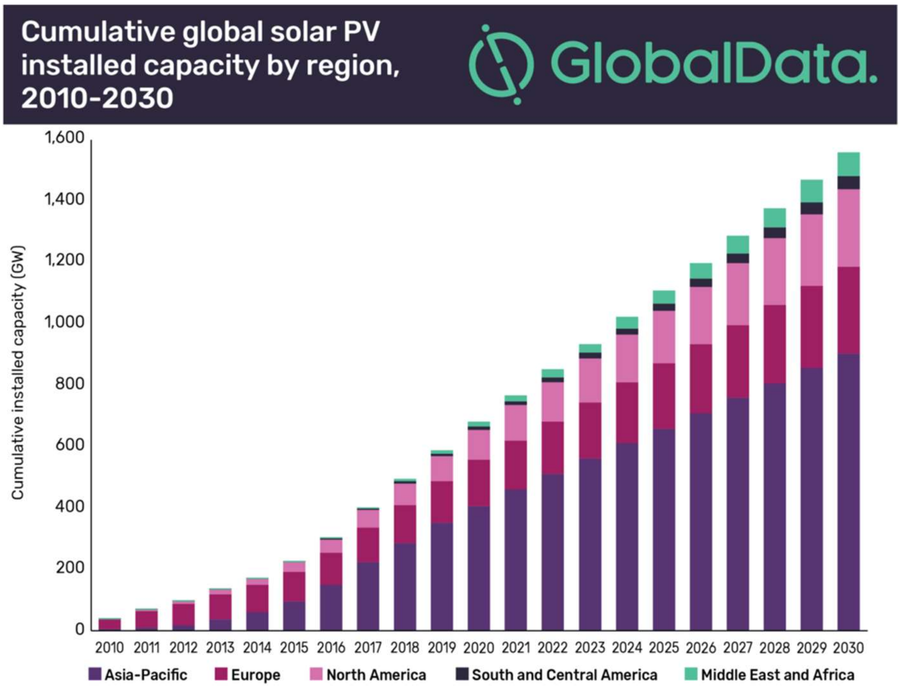


Figure 194: Global Solar Capacity (*Source: Global Data Power Intelligence Center*)

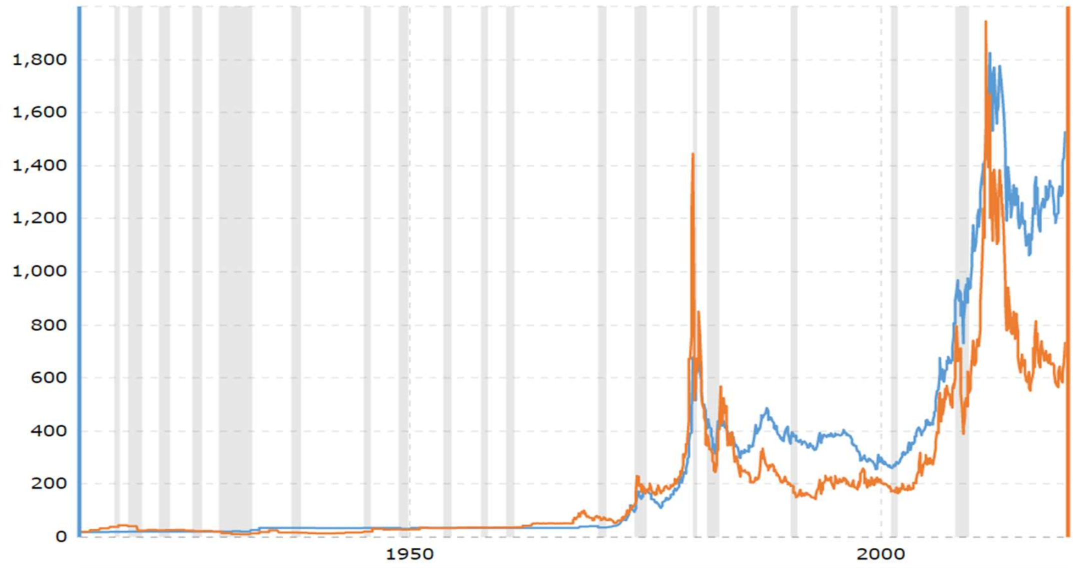


Figure 195: Gold and Silver Nominal Prices Comparison (*Source: MacroTrends*)

Gold/Silver Ratio of 87 Implies that Silver Remains Undervalued

The Gold/Silver Ratio is often used as a tool for investors to decide if they should overweight Gold or Silver within their portfolio that is dedicated to investing in precious metals. It is calculated by dividing the price of Gold over Silver. For example, if the price of Gold is USD 1600 and the price of Silver is USD 20, the Gold/Silver Ratio will be 80. Historically, investors should look to long or overweight Silver when the ratio hits 80 and long or overweight Gold when the ratio hits 50.

The effectiveness of the Gold/Silver Ratio lies in the historically close positive correlation between Gold and Silver. From 2012, this correlation remains above 90%. However, due to the volatile nature of the price of Silver, it might diverge from the price of Gold for periods of time.

Figure 196: XAUXAG Ratio (*Source: Tradingview*)

The Gold Silver Ratio currently stands at 87. The bullish outlook for Gold implies that as the price of Gold and Silver narrows, the price of Silver still has considerable upside as the Gold/Silver Ratio retreats to 80 and beyond.

TRADE IDEA: LONG XAGUSD

Figure 197: XAGUSD Daily Chart (*Source: TradingView*)

Entry Level: 16.60
Take Profit: 17.40
Stop Loss: 16.3
Risk to Reward ratio: 2.67

With the aforementioned factors in mind, we recommend going long on Silver. Due to the volatile nature of Silver prices, a more conservative approach should be taken when entering a Silver trade. Our trade entry will be at the next significant level of support, at 16.60.

Currently, the chart shows that price has been rejected off the 200-EMA, confirming our long bias. Furthermore, the 200-EMA is coincidentally at the significant level of support of 16.60. This confluence paves the way for further upside momentum. This bullish momentum is expected to pave the way for price to reach our intended profit target of 17.40.