Investment strategy and key themes

Key themes: Cross-Asset

- Equities, led by the Euro area and the US, to outperform bonds and cash
- EM bonds (both USD & local currency) and Asia USD bonds to outperform other bonds
- USD to weaken; EUR, GBP, INR likely to be biggest beneficiaries of this weakness

Starting 2020 with some optimism

Over the next 6-12 months, our Global Investment Committee expects equities (led by the US and Euro area) to outperform bonds. Emerging Market (EM) bonds should outperform Developed Market (DM) bonds and the US Dollar should weaken.

Ever-present event risks and a long-in-the-tooth economic cycle mean taking these exposures within a balanced, well-diversified investment allocation, rather than on a standalone basis, remains paramount. We continue to see gold as an attractive long-term counterweight to risky assets.

After a late-summer scare in 2019, we believe economic growth and earnings data will stabilise, supporting equities and corporate bonds. In our assessment, the Euro area has the most room for a positive growth surprise given how pessimistic expectations are.

We expect major central banks to either stay on hold or maintain a bias towards easing policy further, supporting growth. Most major economies are likely to offer some form of fiscal stimulus, though none are likely to trigger a major upside surprise given already-significant deficits (such as the US) or legal constraints (in Europe). In the UK, we expect Brexit to be resolved with a deal relatively early in the year, a view reinforced by the recent UK election outcome.

Fig. 1 The recent global growth scare may be behind us...

JPMorgan global PMI manufacturing index

Source: Bloomberg, Standard Chartered

Fig. 2 ...though economic uncertainty remains high and rising

Global economic policy uncertainty index

Source: Bloomberg, Standard Chartered
A lot to continue worrying about

There continues to be plenty for the pessimistic investor to worry about: (i) Last year’s focus on broad geopolitical risks is likely to morph into a greater focus on US domestic political risks as US presidential elections kick off in 2020; (ii) Questions over US-China trade relations are likely to persist; (iii) Finally, worries of an abrupt end to the US business cycle will continue to loom over markets.

We do not downplay any of these risks, but instead have incorporated them into our views. First, our reasoning balances these risks against the historical experience of very strong late-cycle returns and offers the perspective of seeing 2019 as an unfinished rally. Second, we concede the path is unlikely to be smooth. Third, we see the key factors supporting our bullish outlook as being much stronger in the first half of the year, but potentially receding as 2020 matures.

The first point drives our preference for equities over bonds, particularly if the Fed supports a rise in USD liquidity by expanding its balance sheet. The second and third is why we suggest a balanced, diversified approach.

Downward pressure on USD to gather pace

We expect the USD to weaken over the coming 12 months. Interest rate differentials moved against the USD for most of 2019, but thus far this has failed to weaken the currency. We believe USD liquidity has been the missing ingredient. Tight liquidity supported the USD in 2019, but Fed efforts to avoid a repeat of the spike in overnight borrowing rates, arguably as a result of low interbank liquidity, means more USD liquidity should be available in 2020. This should finally start a modest decline in the USD.

Within currency markets, we expect Developed Market currencies (mainly the EUR and GBP) to be the biggest beneficiaries of a weaker Dollar, even if the most significant impact is likely to be on Emerging Market assets, which have a track record of doing well in USD-weak environments. We prefer implementing this weak USD/stronger EM theme via bonds rather than equities, a reflection of EM bonds’ more attractive fundamentals and our expectation of a continued environment favouring income-oriented assets.

Rise in US Treasury yields likely contained

Foreseeing a growth rebound inevitably raises the question of whether it would push US bond yields higher, potentially to the point where it begins to choke the recovery itself. We see this as unlikely, both because it would require a notable rebound in US inflation, but also because it would require the growth rebound to be far stronger than our expectations. Hence, while we see 10-year yields crossing above 2%, we expect the size of the move to be relatively muted.

We do expect the US yield curve (which is the gap between long- and short-term bond yields) to widen (steepen). This has two implications – in the equities space, this should be positive for financials. In the bonds space, this should result in risk/reward improving for longer-maturity bonds at some point in 2020.
The Euro area and the US should outperform within equities

Within equities, we prefer the Euro area and the US globally, and Chinese (offshore), Indian and South Korean equities in Asia ex-Japan.

In the Euro area, we see potential for an upside growth surprise relative to consensus. Valuations remain inexpensive relative to the US as the region lagged both global and US equity markets through the 2019 rally. Finally, ECB policy is as supportive as it has ever been and the possibility of a fiscal surprise is increasing.

In the US, we see room for both economic and earnings data to stabilise, or improve, amid contained bond yields and a weaker USD, even if equity valuations are not compelling on their own. We are also mindful of US equities’ reasonably strong track record of outperforming global equities in late-cycle environments.

In Asia ex-Japan, we favour China (offshore), India and South Korea equity markets. China and South Korea equities could significantly outperform the region should US-China trade tensions cool or at least not escalate further. Indian and Chinese equities should also benefit from policymaker efforts to support domestic growth.

EM bonds should outperform their DM counterparts

Within bonds, we expect Emerging Markets (EM) bonds, broadly, to outperform their Developed Market (DM) peers across both USD- and local currency-denominated bonds.

Across EM government bonds, USD bonds are still likely to outperform, in our assessment. The absolute level of their yields remains attractive in a still-low yield world, their valuations allow for further price gains and this asset class’ highly diversified nature continues to help shield against idiosyncratic risk (such as the political uncertainty in Chile, for example).

In addition, our increasingly bearish USD outlook improves the outlook for EM local currency bonds. Their yield remains attractive, as it has been for much of the last two years. However, what has changed is the EM FX outlook. With FX movements having been almost as important a driver of returns as the yield for local currency bonds, we believe a weaker Dollar (or even a stable Dollar) significantly improves the risk/reward for EM local currency government bonds.

We also favour Asia USD bonds. While their headline yield is less attractive than EM government bonds, the asset class continues to be less volatile than its DM peers. This makes for a very attractive risk/reward trade-off, in our view.

Finally, within DMs, it is difficult to ignore the level of yield offered in DM HY bonds. However, we believe this high level is offset by the risk of rising defaults, particularly in the US energy sector, and this could result in their total returns, net of defaults, lagging those in EM bonds.

**Fig. 5** EM bonds are still an attractive source of yield in an income-seeking world…

**Fig. 6** …with EM local currency-denominated bonds more attractive if the USD follows its eroding yield advantage lower

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Source: Bloomberg, Standard Chartered

*Yield data as of 9 December 2019*
**Key asset class views**

<table>
<thead>
<tr>
<th>Equities</th>
<th>Bonds (Rates)</th>
<th>Bonds (Credit)</th>
<th>Alternative Strategies</th>
<th>Cash</th>
<th>Gold</th>
</tr>
</thead>
<tbody>
<tr>
<td>Euro area</td>
<td>Govt EM local</td>
<td>Govt EM USD</td>
<td>Equity hedge</td>
<td>USD</td>
<td></td>
</tr>
<tr>
<td>US</td>
<td>Govt DM IG</td>
<td>Asia USD</td>
<td>Event-driven</td>
<td>EUR</td>
<td></td>
</tr>
<tr>
<td>Asia ex-Japan</td>
<td>Corp DM HY</td>
<td>Corp DM IG</td>
<td>Relative value</td>
<td>GBP</td>
<td></td>
</tr>
<tr>
<td>UK</td>
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<td>Global macro</td>
<td>JPY</td>
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<tr>
<td>Japan</td>
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<td>CNY</td>
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<tr>
<td>Other EM</td>
<td></td>
<td></td>
<td></td>
<td>AUD</td>
<td></td>
</tr>
</tbody>
</table>

Source: Standard Chartered Global Investment Committee
Legend: ▲ Most preferred | ▼ Less preferred | ◆ Core holding

**Key themes**

<table>
<thead>
<tr>
<th><strong>Global growth to stabilise</strong></th>
<th>Likely out-performers</th>
<th>Likely under-performers</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>USD to weaken</strong></td>
<td>Global equities</td>
<td>Bonds (rates)</td>
</tr>
<tr>
<td><strong>Treasury yields to stay capped</strong></td>
<td>EUR, GBP, INR, EM bonds</td>
<td>USD</td>
</tr>
<tr>
<td><strong>Equities: DM to outperform EM</strong></td>
<td>US, Euro area equities</td>
<td>Senior floating rate loans</td>
</tr>
<tr>
<td><strong>Equity sectors: Adding financials</strong></td>
<td>US financials, technology</td>
<td>DM IG government bonds</td>
</tr>
<tr>
<td></td>
<td>Euro area financials, healthcare</td>
<td>China energy</td>
</tr>
<tr>
<td></td>
<td>China consumer staples, discretionary</td>
<td>DM IG corporate bonds</td>
</tr>
<tr>
<td><strong>Bonds: EM to outperform DM</strong></td>
<td>EM USD government bonds</td>
<td></td>
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<tr>
<td></td>
<td>Asia USD bonds</td>
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<tr>
<td></td>
<td>EM local currency bonds</td>
<td></td>
</tr>
<tr>
<td><strong>Geopolitics vs. domestic politics</strong></td>
<td>Equity long/short strategies</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Gold</td>
<td></td>
</tr>
</tbody>
</table>

Source: Standard Chartered Global Investment Committee
Macro Overview – at a glance

Key themes

Our Global Investment Committee expects growth worldwide to stabilise around long-term trends and inflation to remain subdued. Monetary and fiscal stimulus are likely to extend the record US economic expansion and revive Euro area growth; China should stabilise following targeted policy stimulus and no further escalation in trade tensions, which should also be supportive for Europe and Emerging Markets. Political uncertainty around the outcome of the US presidential election is a growing risk.

Key chart

Monetary and fiscal stimulus are likely to support global growth in 2020
G4 central bank balance sheet and US/Euro area fiscal deficits, % of GDP

Renewed expansion of G4 central bank balance sheets and fiscal stimulus is likely to help extend the economic cycle

Source: Bloomberg, Standard Chartered; G4 comprises of the central banks of the US, Euro area, Japan and UK.

<table>
<thead>
<tr>
<th>Country</th>
<th>Description</th>
<th>Growth</th>
<th>Inflation</th>
<th>Benchmark rates</th>
<th>Fiscal deficit</th>
</tr>
</thead>
<tbody>
<tr>
<td>US</td>
<td>Fed’s dovish policy shift and ongoing fiscal spending should stabilise growth near its long-term trend; strong job market will sustain consumption; Fed may cut rates once in 2020</td>
<td></td>
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<tr>
<td>Euro area</td>
<td>Monetary and fiscal easing should support a modest growth recovery; ECB should ease further amid subdued Euro area inflation; German fiscal easing could be a potential game-changer for growth</td>
<td></td>
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<tr>
<td>China</td>
<td>We expect significant, but targeted, fiscal and monetary easing to support economic growth amid external headwinds, such as trade tensions with the US</td>
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<tr>
<td>Japan</td>
<td>External risks to the manufacturing sector and exports will be partly offset by resilient business spending due to structural factors; BoJ on hold for now, but its stance could change as growth slows further</td>
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<tr>
<td>UK</td>
<td>PM Johnson’s new majority in parliament means a soft Brexit is likely; reduced uncertainty and a proposed fiscal stimulus could potentially revive business confidence</td>
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<tr>
<td>Other Emerging Markets</td>
<td>Weaker USD, easier global and domestic monetary policies are likely to support the outlook; idiosyncratic country risks remain</td>
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</tbody>
</table>

Source: Standard Chartered Global Investment Committee

Legend: ○ Significant deceleration | ◼ Neutral | ● Significant acceleration
The strong performance in 2019 across both government and corporate bonds mean they start 2020 with a lower yield and more expensive valuations than a year ago, leading us to expect lower, but still positive total returns in 2020.

Relatively more attractive valuations, expectations of global growth stabilisation and a weaker USD lead us to prefer EM bonds over DM bonds, across both government and corporate categories.

**Key chart**

Strong performance in 2019 mean most bond markets start 2020 at yields close to 10-year lows

Yields largely higher in Emerging Market bonds relative to their Developed Market counterparts


**Preference order**

<table>
<thead>
<tr>
<th>Asset Class</th>
<th>Preference Order</th>
<th>Key Driver</th>
<th>Macro factors</th>
<th>Valuation vs govt bonds</th>
<th>Rates policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>EM USD government</td>
<td>▲</td>
<td>Macro factors</td>
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<td>Valuation vs govt bonds</td>
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<td>Rates policy</td>
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<td>Asia USD</td>
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<td>Macro factors</td>
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<td>DM HY corporate</td>
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<td>Attractive yield</td>
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<td>Valuation vs govt bonds</td>
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<td>Valuation</td>
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</tbody>
</table>

Source: Standard Chartered

Legend: ▲ Most preferred | ▼ Less preferred | ◆ Core holding | ○ Not supportive | ○ Neutral | ● Supportive | □ Key driver
**Our thoughts on...**

**PREFERRED**

**EM USD government bonds**
- Well-balanced credit quality (+)
  - Investment Grade: 54% | High Yield: 46%
- **Highly-diversified geographically (+)**
  - Gives exposure to 73 countries
- Attractive yield (+)
  - Offers 5%+ yield, with reasonable valuations
- Idiosyncratic risks (-)
  - Watch event risks closely

**EM local currency bonds**
- Easy Central Bank policy (+)
  - EM Central Banks expected to cut rates further
- Attractive yield (+)
  - Offers a yield of over 5%
- **EM FX tailwind (+)**
  - Support likely from a weaker USD
- Higher volatility (-)
  - Volatility (~2x vs EM USD govt bonds) poses a risk

**Asia USD bonds**
- Defensive asset class (+)
  - Volatility well-contained over the past 5 years
- **High credit quality (+)**
  - Offers a ~4% yield for an average BBB+ credit quality
- Strong regional demand (+)
  - Well-supported by regional investors (>70% of demand)
- Concentration risk (-)
  - Nearly 60% issuers are from mainland China + Hong Kong

**CORE HOLDING**

**DM high yield bonds**
- Attractive yield (+)
  - Offers ~6% yield
- Reasonable valuations (+)
  - Yield premiums in line with historical averages
- **14% allocation to energy sector (-)**
  - Deteriorating energy sector credit quality a risk

**LESS PREFERRED**

**DM IG government bonds**
- Low absolute yield (-)
  - Average yield of ~1%
- High interest rate sensitivity (-)
  - 1% higher yield = ~8% price decline
- **Portfolio hedge (+)**
  - Benefits from high credit quality during risk-off

**DM IG corporate bonds**
- Increasing corporate leverage (-)
  - Debt/EBITDA has risen to multi-year highs
- Expensive valuations (-)
  - This could limit returns
- **Strong foreign demand (+)**
  - USD12 trn in negative yielding bonds adds demand tailwind
Equity – at a glance

Key themes

The backdrop for global equities in 2020 remains positive, in our assessment. Low interest rates and rising excess liquidity is expected to encourage investors who have watched from the sidelines to join the bull market. Earnings are forecast to recover somewhat globally, yet valuations are elevated in the US.

Euro area equities are most preferred in 2020. The outlook for Euro area banks has improved following ECB action to reduce the impact of negative interest rate on the sector. Historically, Euro area equities tend to outperform global equities when Euro area banks are outperforming the market. Both Euro area banks and US technology are amongst our preferred sectors.

Key chart

A recovery in global M1 money supply has historically been positive for global equities. Combined with lower interest rates and a resumption of QE, the backdrop for equities in 2020 is positive.

Global equities tend to rally when money supply is rising

MSCI All country World index and Global M1 Money supply

Why do we like...

US Equities

- **Share buybacks**
  - USD 800 bn

- **Lower corporate taxes**
  - from 35% to **21%**

- **Less exposed to trade war**
  - S&P500 foreign sales: **38%**

EM ex-Asia Equities

- **Exposure to China growth**
  - Brazil supplies **22%** China iron ore imports

- **Exposure to commodities**
  - **30%** of the index

- **Country diversification**
  - **15** markets | Brazil is the biggest: **27%**
High dividend yield
FTSE100 5%, MSCI World 2.6%

Exposure to commodities
Energy & materials = 25% of the UK equities market

Leveraged to global growth
FTSE100 overseas sales: 76%

Improving outlook for banks
ECB policies

Exposure to China growth
China: Third largest export destination for Euro area exports

Lower interest rates compared to peers
20-year average
Euro area base rate: 4%, US: 5%

UK Equities

Innovation leader
Semiconductors / automation / robotics

Japan Equities

Leveraged to global growth
Industrials & Auto share of the index: 30%

Corporate reform
Higher share buybacks & dividends

Asia ex-Japan Equities

Exposure to China growth
38% of index

Superior earnings growth
10-year average annual EPS growth: 12%

Growth at a reasonable price (GARP)
Asia ex-Japan average valuation 10% below global equities

Outlook 2020
FX – at a glance

**Key themes**

We believe that the USD is peaking after trending higher since early 2018, and will begin a broad-based downtrend. We expect the USD index (DXY) to decline by around 5% during 2020 as the Fed adds fresh global USD liquidity.

The EUR and the GBP are likely to be the biggest beneficiaries on the back of fading US economic exceptionalism, narrowing economic growth and interest rate differentials as well as political uncertainty shifting from Europe to the US Presidential election.

**Key chart**

**USD to weaken as the Fed provides the world with more liquidity**

USD index (DXY), USD monetary base, y/y (RHS, inverted)

The Fed’s policy shift to supply the world with more dollar liquidity, via an expanding balance sheet, is a key driver of our bearish USD view

<table>
<thead>
<tr>
<th>Key driver</th>
<th>Relative interest rates</th>
<th>Relative growth rates</th>
<th>Flows &amp; sentiment</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD (DXY)</td>
<td>▼ ◇ △</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Narrowing interest rate and growth differentials as well as rising dollar liquidity should drive USD capital outflows</td>
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</tbody>
</table>

<table>
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<th>Relative interest rates</th>
<th>Relative growth rates</th>
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</tr>
</thead>
<tbody>
<tr>
<td>EUR/USD</td>
<td>▼ ◇ △</td>
<td></td>
<td></td>
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<tr>
<td>The EUR should benefit from USD outflows as Euro area growth improves and chances of fiscal stimulus rise</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Key driver</th>
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<th>Relative growth rates</th>
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</tr>
</thead>
<tbody>
<tr>
<td>GBP/USD</td>
<td>▼ ◇ △</td>
<td></td>
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<tr>
<td>A quick Brexit deal could finally unlock strong pent-up demand for undervalued UK assets and the GBP</td>
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</tbody>
</table>

<table>
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<tr>
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<th>Relative growth rates</th>
<th>Flows &amp; sentiment</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD/CNY</td>
<td>▼ ◇ △</td>
<td></td>
<td></td>
</tr>
<tr>
<td>We see US-China trade tensions peaking. This should reduce the volatility of USD/CNY</td>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Key driver</th>
<th>Relative interest rates</th>
<th>Relative growth rates</th>
<th>Flows &amp; sentiment</th>
</tr>
</thead>
<tbody>
<tr>
<td>USD/JPY</td>
<td>▼ ◇ △</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The JPY will likely be caught between bouts of safe-haven inflows and Japanese investors’ return-seeking outflows</td>
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</tbody>
</table>

<table>
<thead>
<tr>
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<th>Relative interest rates</th>
<th>Relative growth rates</th>
<th>Flows &amp; sentiment</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUD/USD</td>
<td>▼ ◇ △</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The AUD should see support from improving domestic fundamentals, but RBA monetary policy may deter strong gains</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Bloomberg, Standard Chartered

Legend: ▲ Bullish view  | ▼ Bearish view  | ◇ Range view  | ◆ Not supportive  | ● Neutral  | ◆ Supportive  | ▼ Key driver

Source: Standard Chartered
Gold

Preferred – Fundamentals still supportive

Still preferred; opportunistically add long exposure on dips

- We retain gold as a preferred holding and see the current pause in gold’s rally as an opportunity to add exposure to the precious metal.
- Real (net of inflation) interest rates, inflation expectations and the USD remain key drivers. We believe the historical negative gold-USD correlation should reassert itself, which should benefit gold as the USD retreats.
- In the near term, catalysts for gold to move higher are lacking. An unexpected flare up of trade tensions and/or any indications of global growth weakness could see renewed upside for gold given its safe-haven characteristics.

Fig. 1 Will gold rise in 2020?

<table>
<thead>
<tr>
<th>Bullish factors</th>
<th>Bearish factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opportunity costs of holding gold are still low as real yields are unlikely to</td>
<td>Gold is sensitive to higher interest rates given its non-yielding attributes. A</td>
</tr>
<tr>
<td>rise significantly</td>
<td>falling stock of negative-yielding debt, as global yields gradually rise, would</td>
</tr>
<tr>
<td></td>
<td>reduce the attractiveness of holding gold</td>
</tr>
<tr>
<td>A broadly weaker USD provides an additional tailwind for gold prices</td>
<td>Physical demand has been relatively subdued, but seasonal buying could provide a</td>
</tr>
<tr>
<td></td>
<td>floor for prices</td>
</tr>
</tbody>
</table>

The precious metal remains a safe-haven asset and continues to offer investors diversification benefits. Central bank buying also remains supportive of net demand for gold.

SCB’s net assessment

Source: Standard Chartered Global Investment Committee

Fig. 2 Still-elevated global policy uncertainty supportive of gold

Gold (USD/oz), Global economic policy uncertainty* (RHS)

Source: Baker, Bloom and Davis, Refinitiv, Standard Chartered

*For more information on the index, visit policyuncertainty.com

Fig. 3 Real bond yields unlikely to rise significantly from here, limiting gold’s downside

Gold prices (USD/oz), 10-year US TIPS* (%), inverted; RHS

Source: Refinitiv, Standard Chartered

*Real bond yields are proxied by US Treasury Inflation Protected securities

Our net assessment:

- Gold remains a preferred holding
- We expect a test of 1,600 in 2020, but the risk-on environment may limit gains near term
- Real interest rates, inflation expectations and the USD remain key drivers of our bullish outlook

Source: Standard Chartered Global Investment Committee
# Asset allocation summary

<table>
<thead>
<tr>
<th>Summary</th>
<th>View</th>
<th>ASIA FOCUSED</th>
<th>GLOBAL</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Conservative</td>
<td>Moderate</td>
</tr>
<tr>
<td>Cash</td>
<td>▼</td>
<td>12</td>
<td>4</td>
</tr>
<tr>
<td>Fixed Income</td>
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<td>64</td>
<td>38</td>
</tr>
<tr>
<td>Equity</td>
<td>△</td>
<td>24</td>
<td>42</td>
</tr>
<tr>
<td>Gold</td>
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<td>6</td>
</tr>
<tr>
<td>Alternative Strategies</td>
<td>◆</td>
<td>0</td>
<td>10</td>
</tr>
</tbody>
</table>

## Asset class

| USD Cash                    | ▼   | 12           | 4       | 2           | 0          | 12           | 4       | 2           | 0          |
| DM Government Bonds*       | ▼   | 4            | 2       | 2           | 0          | 5            | 3       | 2           | 1          |
| DM IG Corporate Bonds*     | ▼   | 8            | 5       | 3           | 1          | 12           | 7       | 5           | 1          |
| DM HY Corporate Bonds      | ◆   | 8            | 5       | 3           | 1          | 12           | 7       | 5           | 1          |
| EM USD Government Bonds    | ▲   | 15           | 9       | 6           | 2          | 12           | 7       | 5           | 1          |
| EM Local Ccy Government Bonds | ▲ | 15           | 9       | 6           | 2          | 12           | 7       | 5           | 1          |
| Asia USD Bonds             | ▲   | 15           | 9       | 6           | 2          | 12           | 7       | 5           | 1          |
| North America              | ▲   | 7            | 13      | 18          | 26         | 13           | 22      | 30          | 43         |
| Europe ex-UK               | ▲   | 6            | 11      | 14          | 21         | 3            | 5       | 7           | 11         |
| UK                          | ◆   | 1            | 2       | 3           | 4          | 1            | 2       | 3           | 4          |
| Japan                       | ◆   | 1            | 2       | 3           | 4          | 1            | 2       | 3           | 4          |
| Asia ex-Japan              | ◆   | 6            | 11      | 15          | 22         | 4            | 7       | 10          | 15         |
| Non-Asia EM                | ◆   | 2            | 4       | 5           | 7          | 2            | 4       | 5           | 7          |
| Gold                        | ▲   | 0            | 6       | 5           | 5          | 0            | 6       | 5           | 5          |
| Alternatives               | ◆   | 0            | 10      | 9           | 4          | 0            | 10      | 9           | 4          |

All figures in %. Source: Standard Chartered.

Legend: ▲ Most preferred  ▼ Least preferred  ◆ Core holding

Note: (i) For small allocations we recommend investors to allocate through broader global equity/global bond solutions; (ii) Allocation figures may not sum to 100% due to rounding effects.

*FX-hedged
2019 was the year where many sustainability issues came to the forefront and this is set to accelerate in 2020, with an increasing number of businesses having it on their corporate agendas as material risks and opportunities – from climate change to data privacy and diversity and inclusion.

According to a global survey by the UN Principles for Responsible Investment (PRI) network and the CFA Institute, more than 50% of investors in Asia Pacific believe that environmental and social factors will impact share prices by 2022\(^1\). The figures are similar for investors in Europe, the Middle East and Africa\(^2\).

Governance is the ESG (environmental, social and governance) factor most investors are integrating into their process, while environmental and social factors are increasingly gaining acceptance. The main drivers of ESG integration are risk management and increasing client demand.

With increasing demand, fund managers in both public and private markets are also building their capabilities to meet the needs of its investors.

According to Morningstar, approximately USD 41 billion flowed into European sustainable fund products in the first half of 2019, more than any other semi-annual period. In addition, the report also noted that sustainable equity funds benefited from inflows while conventional equity funds suffered from net outflows. To match investor demand, there was a 27% increase in the number of ESG fund launches from 2017 to 2018, and the pace in 2019 is on track to match or even exceed the number of new product offerings in 2018.

However, ESG integration remains in its relative infancy, with investors calling for more guidance on exactly “how” they can “do ESG” and integrate ESG data into their portfolios. On top of that, there are also concerns of “greenwashing” or “ESG-washing”, where fund manager claims of ESG integration are exaggerated.

Fig. 1 Impact of ESG issues in 2017 and the expected impact in 5 years’ time (2022) on share prices, corporate bond yields/spreads and sovereign debt yields

<table>
<thead>
<tr>
<th>ESG ISSUES IMPACT ON SHARE PRICES</th>
<th>AFFECTED IN 2017</th>
<th>AFFECTED IN 2022</th>
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<tr>
<td></td>
<td>ASIA PACIFIC</td>
<td>EUROPE, THE MIDDLE EAST AND AFRICA</td>
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<tr>
<td>Governance</td>
<td>64%</td>
<td>60%</td>
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<tr>
<td>Environmental</td>
<td>24%</td>
<td>24%</td>
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<tr>
<td>Social</td>
<td>30%</td>
<td>24%</td>
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<table>
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<tr>
<th>ESG ISSUES IMPACT ON CORPORATE BOND YIELDS/SPREADS</th>
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<td>ASIA PACIFIC</td>
<td>EUROPE, THE MIDDLE EAST AND AFRICA</td>
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<tr>
<td>Governance</td>
<td>43%</td>
<td>47%</td>
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<tr>
<td>Environmental</td>
<td>15%</td>
<td>18%</td>
</tr>
<tr>
<td>Social</td>
<td>17%</td>
<td>16%</td>
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<table>
<thead>
<tr>
<th>ISSUES IMPACT ON SOVEREIGN DEBT YIELDS</th>
<th>AFFECTED IN 2017</th>
<th>AFFECTED IN 2022</th>
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<tbody>
<tr>
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<td>ASIA PACIFIC</td>
<td>EUROPE, THE MIDDLE EAST AND AFRICA</td>
</tr>
<tr>
<td>Governance</td>
<td>32%</td>
<td>39%</td>
</tr>
<tr>
<td>Environmental</td>
<td>14%</td>
<td>11%</td>
</tr>
<tr>
<td>Social</td>
<td>19%</td>
<td>19%</td>
</tr>
</tbody>
</table>

Note: Percentages represent respondents who answered “often” or “always”

1. ESG Integration in Asia Pacific: Markets, Practices and Data, UN PRI and CFA Institute
2. ESG Integration in Europe, the Middle East and Africa: Markets, Practices and Data, UN PRI and CFA Institute
How to get started with ESG investing?

ESG investing is the use of ESG criteria as a set of standards to screen for potential investments, which allows for alignment with the investor’s values or interests. Investors can choose from various ESG investment strategies such as:

- **Exclusionary screening**
  When exclusion screens are applied, stocks are excluded from an investment universe which prevents investors from investing in companies not aligned with their values. Some common exclusions are tobacco, pornography, gambling and civil weapons and most, if not all, ESG funds employ exclusions to some extent.

- **ESG integration**
  ESG integration refers to the systematic consideration of ESG factors alongside financial metrics in the analysis of a company. In a sophisticated ESG integration strategy, ESG factors will be weighted accordingly by the materiality of those factors depending on the sector. For example, health and safety metrics will be more relevant for a mining company than in the financial industry. A sample list of high level ESG metrics by category can be seen below:

```
Environmental
- Resource Use
- Emissions
- Innovation

Social
- Workforce
- Human Rights
- Community
- Product Responsibility

Governance
- Management
- Shareholders
- Corporate Social Responsibility (CSR Strategy)
```

- **Best-in-class/positive screening**
  Unlike exclusionary screening, best-in-class or positive screening is the active and intentional selection of companies that display leading sustainability practices based on ESG factors. The idea is that strong ESG performers are companies better positioned to outperform their peers, encouraging companies to improve their ESG score. For example, some industries may face a higher stranded asset risk due to environmental issues. How a company responds to future risks can be teased out by analysing specific ESG factors.

- **Sustainability-themed investing**
  Thematic investing focuses on assets linked to a specific area of ESG interest for an investor. These interest areas will address a social and/or environmental issue, sometimes aligned with the Sustainable Development Goals, such as clean water and sanitation, climate action or good health and well-being.

- **Impact investing**
  Impact investing are investments made that have specific targets, typically social or environmental, that the investor would like to solve. This is a strategy more commonly seen in the private markets, although there are also listed equity fund managers launching impact funds.

Of course, ESG investing strategies are not mutually exclusive as multiple strategies can be applied at once, and there are various investment instruments an investor can invest in, both in the public and private markets, where some are higher risk and have a longer lock-in period than others. What is critical is selecting the strategy and investment instrument, that is in line with the investor’s risk profile and financial/non-financial goals are taken into consideration.

Sustainable investing is a space that will continue to grow and evolve as new lessons emerge through successes and failures. Some are ahead of the curve and others are playing catch up, but it has gone mainstream and it is here to stay.
The Annual Outlook highlights our key investment themes for the year, the asset classes we expect to outperform and the likely scenarios as we move through the year.

Our monthly publication which presents the key investment themes and asset allocation views of the Global Investment Committee for the next 6-12 months.

Our weekly publication which provides an update on recent developments in global financial markets and their implications for our investment views.

Global Wealth Daily is an early morning update of major economic and political events and their day-to-day impact on various asset classes the previous day.

Market Watch focuses on major events or market developments and their likely impact on our investment views.

360 Perspectives provides a balanced assessment of the outlook for an asset class. It presents both the positives and negatives of the asset class, as well as the major drivers, instead of offering a specific view.

Investment Brief explains the rationale behind our views on an asset class, incorporating the fundamental and technical drivers.
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