FISHER INVESTMENTS AUSTRALASIA™

MARKET PERSPECTIVES
REVIEW & OUTLOOK

FOURTH QUARTER
2019

FOURTH QUARTER 2019 REVIEW & OUTLOOK

TABLE OF CONTENTS

The below table of contents contains hyperlinks allowing the reader to quickly navigate to the desired section.

FOURTH QUARTER 2019 REVIEW & OUTLOOK
EXECUTIVE SUMMARY

PORTFOLIO THEMES

- **Quality Tilt:** We prefer equities with stronger balance sheets and consistent margins.
- **Overweight to Information Technology:** The Information Technology sector is heavily skewed toward large, high-quality firms. The sector should benefit from robust global IT spending driven by the growing demand for products and services related to mobile, cloud computing and the "Internet of Things."
- **Overweight to Energy:** Energy demand remains robust and the sector often outperforms late-cycle, with tailwinds from physical demand via economic growth and financial demand via inflation.

MARKET OUTLOOK

- **Expect the Bull Market to Continue:** We expect global markets will continue climbing in 2020, likely at a slower pace with more volatility than 2019.
- **Strength in Services is Underappreciated:** In both Developed and Emerging Markets, a strong services sector more than offsets weakness in global manufacturing that should prove temporary.
- **Sentiment is Improving but Still not Euphoric:** As big fears from 2019 haven't materialised, strong returns have slightly closed the gap between sentiment and reality but equity markets are still far from euphoric.

Global equities capped the strongest year since 2009 with Q4's 9% gain, lifting full-year returns to 26.6%.[i] We expect the bull market to continue in 2020, although returns are unlikely to match 2019's magnitude. Emerging Markets (EM) equities finished the year up 18.4%[ii] after a strong fourth quarter.

In 2019, equities benefitted from a strong V-shaped rebound that normally follows deep corrections. Additionally, while US presidential fourth years are typically good for equities, they are usually smaller than third years and are often back-end loaded. It wouldn't surprise us if 2020 started slowly as political uncertainty escalates, with returns improving as the US Democratic presidential field narrows and potential political outcomes become clearer.

Sentiment also helps explain why 2020 will likely be more middling. Throughout 2019, investors fretted recession, trade wars, Brexit, US President Trump's impeachment, the yield curve and the manufacturing slow-down in Europe. These worries left a meaningful disparity between low investor expectations and a much brighter reality. When these fears proved baseless, investors noticed. Pundits now say hindsight proves they were too pessimistic. Professional investors are more cautious than we have seen in over 20 years of measuring forecasts with predictions for very modest positive returns in 2020 on average. We believe a meaningful upside surprise is less likely compared to last year, however we expect healthy returns that are stronger than most anticipate. We don't make specific numerical forecasts, but for example, we would not be disappointed with a 10% year for global equities-around the market's historical average-with inflation below 2%.

i Source: FactSet, as of 02/01/2020. MSCI All Country World Index return with net dividends, USD, 31/12/2018 – 31/12/2019 and 30/09/2019 – 31/12/2019.

ii Source: FactSet, as of 02/01/2020. MSCI Emerging Markets Index return with net dividends, USD, 31/12/2018 – 31/12/2019.

Equities didn't have a correction in 2019 and they easily could in 2020, but the timing is impossible to predict. Corrections always strike without warning. Even if we don't get a correction, expect volatility. Political polarisation will almost surely make media coverage exceptionally tumultuous. All the shouting probably keeps sentiment in check through the summer.

We will discuss the US election in more detail in the full Review & Outlook, but it is impossible to know now who will win. Whoever prevails probably won't have a significant majority in Congress. It is hard to see how any of the current Democratic challengers create broad national enthusiasm. None of the frontrunners seem to embody the national mood as President Obama did in 2008. It is similarly hard to see how President Trump could generate national enthusiasm given how polarising he has been. Without a landslide win by either party, Congress seems unlikely to swing far in either direction.

In the UK, the Conservatives won an 80 seat Parliamentary majority in 12 December's general election-their biggest since the 1980s-providing Prime Minister Boris Johnson with the support to pass his Brexit deal. The Conservatives' strong showing also technically erases gridlock-ordinarily not a positive. With its majority, a Conservative government could fulfill most of its election manifesto and pass a flurry of domestic legislation. That could stoke new uncertainty as markets assess winners, losers and potential unintended consequences. However, Brexit's hold on UK politics will last for a while longer, which we think creates gridlock despite the Conservatives' large edge. Furthermore, having a definitive Brexit timetable reduces uncertainty, allowing businesses and investors to move on-a positive-though questions still linger.

Emerging Markets rallied alongside Developed Markets in Q4 as progress on global trade likely improved sentiment in the quarter. Investors digested a new regional trade pact, Regional Comprehensive Economic Partnership (RCEP), an initial agreement between the US and China, and the US, Canada and Mexico signed a revised version of the USMCA (NAFTA's replacement). We believe Emerging Markets should benefit from the ongoing global bull market in 2020, though-similar to Developed Markets-returns likely slow somewhat from 2019's pace as the gap between sentiment and reality doesn't appear as wide as it was a year ago.

As for economic drivers, the mid-cycle slowdown discussed last quarter seems to be easing. Data show some green shoots in European manufacturing, and Chinese indicators have improved. While troubles in the shale oil industry likely weigh on US manufacturing a bit longer, echoing 2015 – 2016, the services sector, which generates the vast majority of economic activity, is performing well. Loan growth remains ample despite the flat yield curve. Inflation is mild, keeping long-term interest rates low. While we don't expect economic growth to surge, the backdrop looks good. A positive economy with positive corporate earnings should be good for equities.

Big interest rate moves up or down look unlikely in 2020. Inflation and inflation expectations are tame, which should put a halt on long rates. But they probably won't fall much, as people don't expect a vastly weaker economy. Forecasters expect one of the smallest 10-year US Treasury yield moves in years. They have often overshot significantly since 2000. Now they are correcting. Perhaps this is the year they will be more accurate.

We are always watchful for a bear market, but we don't see a good reason to be bearish now. Bull markets end one of two ways: atop the wall of worry, when euphoria makes investors' expectations outlandish; or with a shock wallop capable of knocking a few trillion dollars off global GDP. Neither looks likely now. Sentiment doesn't flip fast from scepticism to euphoria-the process takes time. As for wallops, we don't see a negative factor with sufficient size and surprise lurking.

GLOBAL UPDATE AND MARKET OUTLOOK

03 FEBRUARY 2020

Q4 RECAP

FROM GREAT TO GOOD

As mentioned in the Executive Summary, global equities enjoyed their strongest year in a decade in 2019 as they recovered from the sharp correction in late 2018. While many pundits credit developments such as monetary policy and trade talk progress, we think the calendar played a big role. Markets ended 2018 about a week removed from a deep correction's low. Equities regularly surge after sharp downturns—forming the right half of a "V." Late December's bottom aligned the ensuing V-shaped recovery near perfectly with 2019's start, setting up an early year surge.

As we wrote in our Q4 2018 Review & Outlook:

> Late-2018's pullback appears to be a correction that ended on Christmas Eve. Assuming so, it will have ended closer to calendar yearend than any preceding S&P 500 correction or bear market. That means timing-wise, calendar-year 2019 will align very closely to the 12 months following a correction low. Therefore, simply achieving average post-correction 12-month returns implies an outstanding year ahead.

So it went. Global equities jumped 16.0% from the year's start through April.[iii] After a breather through Q2 and Q3, they resurged in Q4, rising 9.0%.[iv] Consistent with our view that we are in the latter stages of a bull market where returns are typically robust, we benefited by being positioned for rising markets.

2020: GOOD—ALBEIT, MILDER—RETURNS

2020 looks likely to be good for markets as well. Investor sentiment is not as dour as it was a year ago, narrowing the gap between reality and expectations. However, it doesn't appear euphoric. Nor do we see any probable shocks capable of wiping out trillions of dollars of global GDP. In our view, this speaks to a continuing bull market. With warmer sentiment reducing positive surprise potential, returns may not rival 2019's, but we expect equities to rise.

ROBUST EQUITY AND BOND RETURNS DO NOT SIGNAL NEGATIVITY AHEAD

Both equities and bonds enjoyed a great 2019. Some think this "everything up" backdrop means a reversal looms. However, history shows that is not true—particularly for equities. Since 1970, global developed equities and US Treasurys returned at least 20% and 10% (respectively) five times before last year.[v] Global developed equities rose the next year every time. While past performance is not predictive, this counters fears that equities must retreat after an "everything up big" year.

EXHIBIT 1: HOW GLOBAL EQUITIES FARE DURING "EVERYTHING UP BIG" YEARS

	MSCI World		ICE BofA US Treasury (10+ Years)	
	Year's Return	Following Year	Year's Return	Following Year
1985	40.6%	41.9%	31.5%	24.0%
1986	41.9%	16.2%	24.0%	-2.7%
1993	22.5%	5.1%	17.2%	-7.4%
1995	20.7%	13.5%	30.7%	-1.0%
1998	24.3%	24.9%	13.5%	-8.6%
2019	27.7%	?	14.3%	?

Source: MSCI World Index annual returns with net dividends, 29/12/1969 – 31/12/2019.

---

iii Source: FactSet, as of 03/01/2020. MSCI All Country World Index return with net dividends, 31/12/2018 – 30/04/2019.

iv Source: FactSet, as of 03/01/2020. MSCI All country World Index return with net dividends, 30/09/2019 – 31/12/2019.

v Source: FactSet, as of 19/12/2019. MSCI World Index return with net dividends and ICE BofA US Treasury 10+ Year total return, 1979 – 2019.

CATEGORIES THAT LED IN 2019 PROBABLY CONTINUE TO LEAD IN 2020

Nearly 11 years into this bull market, typical late-stage leaders should continue leading as they did last year. Tech and Tech-like equities, in particular, embody the characteristics investors usually reward during the late stages of a bull market: size, stability, global presence, diverse revenue streams, strong balance sheets and name recognition. Not only have Tech and Tech-like equities led, but as discussed in last quarter's Review & Outlook, they explain the vast majority of US outperformance. Our Tech overweight should keep adding value.

Conversely, we expect low-margin, cyclical firms to continue lagging. The global economy is on more stable footing than many have recently feared, but it isn't surging. Slow, steady growth with low inflation can be great for equities, but it isn't likely to drive heavy demand for more economically sensitive sectors. We think investors will continue favouring large, high quality, growth equities less reliant on a cyclical economic upswing.

STILL NOT VALUE'S TIME TO SHINE

Some pundits noted value equities' recent improvement, suggesting a style leadership change may be forthcoming. We believe this to be unlikely. Value equities tend to lead early in bull markets. This is when equities in economically sensitive sectors—typically the hardest hit during a recession—are irrationally cheap. As economic recovery approaches, value firms can easily exceed overly dour expectations. Value's time is more likely to come after the next bear market than during this maturing bull.

That doesn't mean value lags uninterrupted. It can have short periods of outperformance later in the market cycle—especially during mid-cycle slowdowns. We saw value outperform for months during 2012 – 2013 as well as 2016—right before those slowdowns reaccelerated. Even 2019 featured a short-lived value surge later in the year as long-term bond yields bottomed. That gave Financials—the quintessential value sector, which had been suffering from flat yield curves—a spurt of outperformance.

INTEREST RATE FORECAST

The 10-year US Treasury yield started 2019 at 2.69% and fell in the year's first eight months.[vi] After bottoming at 1.47% on 4 September, yields rose 45 basis points to close 2019 at 1.92%.[vii] We don't expect such a wide range in 2020.

The yield curve spent much of Q2 and Q3 inverted, with short rates exceeding long. It normalised in early October but remains flat. That likely dampens loan and money supply growth, forestalling fast inflation—and capping long rates. However, with few projecting a vastly weaker economy, rates likely won't fall much. This isn't an uncommon view, but we think it is correct.

vi Source: Federal Reserve Bank of St. Louis, as of 06/01/2020. 10-Year Treasury Constant Maturity Rate on 31/12/2018.

vii Source: Federal Reserve Bank of St. Louis, as of 06/01/2020. 10-Year Treasury Constant Maturity Rate on 04/09/2019 and 31/12/2019.

SENTIMENT: GUARDED OPTIMISM, YET FAR FROM EUPHORIA

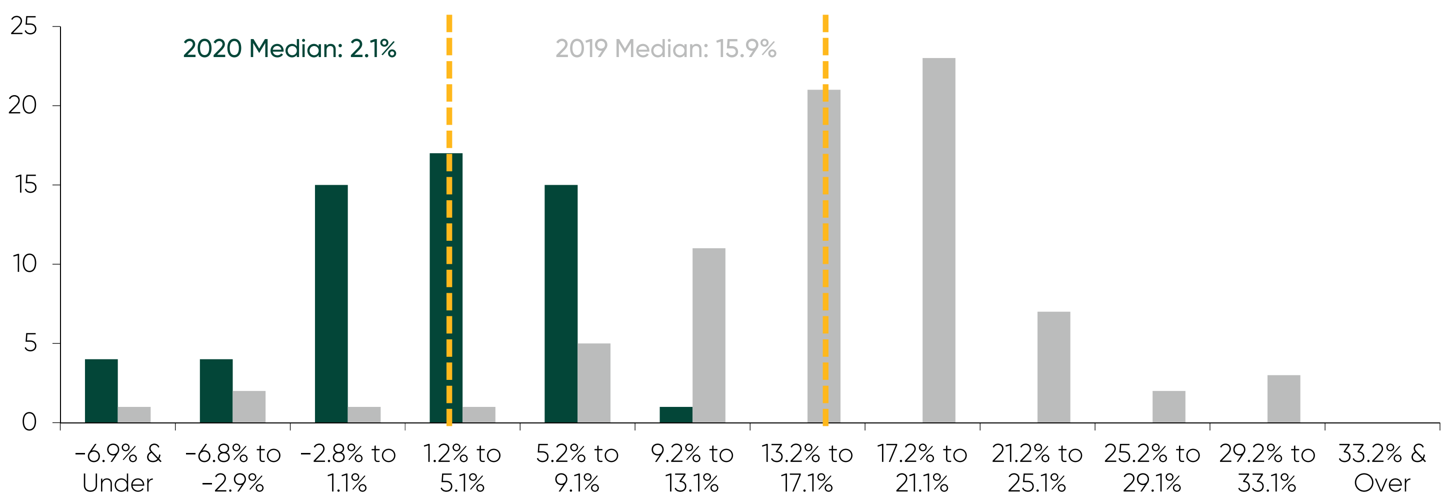
History's longest bull market is also the least-loved. Despite the decade-plus run, investor sentiment remains far from the euphoria typifying bull market peaks. As mentioned in the Executive Summary, many professional forecasters expect significantly lower returns this year. While the median S&P 500 forecast entering 2019 was 15.8%, it is just 2.1% for 2020 (Exhibit 2).

Market returns usually differ from the crowd's expectations—landing on either end of the bell curve, as 2019 illustrates. Given positive economic and political drivers, a negative 2020 seems unlikely. Instead, a positive surprise seems more probable, in our view. A big year would require investors' "animal spirits" stirring in a major way, which seems unlikely with sentiment still middling. However, that also delays euphoria—extending this long, fluctuating bull market.

Sentiment improved in 2019 as investors overcame many misplaced fears. Investors gradually learned the "trade war" lacked impact. A recession never materialised. Global manufacturing's struggles did not fell Germany and Europe. As fears proved false, sentiment moved closer to reality. That benefited returns last year, but it shrinks positive surprise potential in 2020.

It is hard to envision sentiment jumping from mid-year scepticism to full-on euphoria quickly. Sentiment measures don't show uniform positivity even now. Equity fund flows were negative for most of 2019. Consumer and investor sentiment surveys show broader optimism, albeit with muted outlooks—no sign of euphoria. Another measure, US margin debt, has been falling.[viii] Rapid rises can indicate building euphoria, but the opposite is happening now.

EXHIBIT 2: THE 2019 AND 2020 SENTIMENT BELL CURVES



Source: FactSet and Fisher Investments Research, as of 03/01/2020. S&P 500 price index and guru forecasts.

viii Source: Financial Industry Regulatory Authority (FINRA), as of 24/01/2020. Debit balances in customers' securities margin accounts, December 2017 – December 2019.

DON'T FEAR NEW MARKET HIGHS

Since passing 2018's pre-correction high on 20 June 2019, global equities have notched 38 new all-time highs—the latest on 17 January 2020 as of this writing.[ix] The bull market's climb, particularly after a strong Q4, has some wondering if equities have risen "too far, too fast". We do not think so. For one, 2019 put global equities' annualised return at just 8.0% over the past two years—slightly below equities' long-term historical average and far short of annualised bull market average returns.[x]

Also, index levels—including record highs—reflect past performance. They do not predict. Bull markets can generate hundreds of new all-time highs before ending. On 7 May 2013 when global equities passed their pre-financial crisis high, pundits worried new highs showed an irrational disconnect from underwhelming economic growth. Over six years later, the bull has set 229 more record highs.[xi] We never try to pinpoint a bull market peak. There is too much risk of a correction or mere volatility fooling you. We believe it takes time to assess whether markets have accurately priced the negative factor you identified.

TRADE TENSIONS EASE AS DEALS ARE MOVING FORWARD

Trade deals long in the works are moving forward, relieving sentiment. On 13 December, the US and China agreed to a "phase one" trade deal, which was signed on 15 January. On the US side, the agreement cancels tariffs that were supposed to take effect 15 December, while halving tariffs imposed in September on $120 billion of Chinese goods to 7.5%.[xii] As for China, it cut tariffs on a broad array of products for all trading partners, including the US. Chinese officials claim they cut broadly to avoid criticism that their policies were favouring American goods. Additionally, US officials say China committed to increasing its American imports by $200 billion over the next two years and protect against intellectual property theft.[xiii] This leaves around $380 billion in Chinese goods subject to tariffs-and US negotiating leverage for a potential "phase two" deal, supposedly covering more contentious topics like state subsidies for favoured industries.[xiv]

Also in December, the House approved NAFTA's replacement-the US-Mexico-Canada Agreement (USMCA)-which was subsequently approved by the Senate and signed by President Trump on 29 January (Canada's Parliament must also approve). While the USMCA updates some provisions-notably broadening market access to digital services-it also raises trade barriers in some respects, including local content requirements. Overall, though, we think the changes are very small-too small to matter much to markets. In our view, December's trade actions show tariff threats over the last two years are mostly a political means to somewhat freer trade-nothing too exciting, but a reality that exceeds earlier dour predictions.

---

ix Source: FactSet, as of 30/01/2020. MSCI World Index return with net dividends, 20/06/2019 – 01/29/2020.

x Source: FactSet, as of 09/01/2020. MSCI World Index return with net dividends, annualised, 31/12/2017 – 31/12/2019.

xi Source: FactSet, as of 30/01/2020. MSCI World Index with net dividends, 07/05/2013 – 29/01/2020.

xii "U.S., China Agree to Limited Deal to Halt Trade War," William Mauldin, Lingling Wei and Alex Leary, The Wall Street Journal, 14/12/2019. https://www.wsj.com/articles/us-china-confirm-reaching-phase-one-trade-deal-11576234325

xiii "Trump Says He Will Sign Phase-One Trade Deal With China on Jan. 15," Bob Davis, Andrew Restuccia and Lingling Wei, The Wall Street Journal, 31/12/2019. https://www.wsj.com/articles/trump-says-he-will-sign-phase-one-trade-deal-with-china-on-jan-15-11577802332

xiv "Trump: US-China Phase One Trade Deal Signing to Occur Next Month," Jonathan Garber, FOXBusiness, 31/12/2019. https://www.foxbusiness.com/markets/trump-us-china-phase-one-trade-deal-signing-january

THE REGIONAL COMPREHENSIVE ECONOMIC PARTNERSHIP IN PERSPECTIVE

Often touted as the world's largest potential free-trade agreement, the Regional Comprehensive Economic Partnership (RCEP) took a step closer to completion in November. The RCEP, a multilateral trade agreement in the works since 2012, would deepen ties among the 10-member Association of Southeast Asian Nations (ASEAN), China, Australia, South Korea, Japan and New Zealand. In Q4, prospective members agreed in principle on the agreement's main provisions, with one notable exception—India, which was involved in talks but pulled out at the last moment. That said, by population and GDP, the RCEP would still cover an expanse surpassing 2018's Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). However, despite its size and billing, it is unlikely to confer any great economic—or equity market—benefits for its members.

There is no questioning the RCEP's size. Even without India, the combination of ASEAN (Indonesia, Thailand, Singapore, Philippines, Malaysia, Vietnam, Brunei, Cambodia, Myanmar and Laos) and Asia-Pacific's largest economies would cover about one-third of global GDP and population. However, it isn't exactly a free-trade agreement. The RCEP would do little to lower existing trade barriers between those in it. Unlike the CPTPP, it doesn't do much to cut tariff and non-tariff barriers to trade, protect intellectual property rights or address state-owned enterprises. The CPTPP—which encompasses 11 countries and around 13% of global GDP—eliminated nearly all tariffs across the board. It also aims to facilitate increased trade in services and digital commerce, protect intellectual property and increase investment access—all areas where the RCEP falls short.

In contrast, the RCEP mostly consolidates ASEAN's trade agreements into one omnibus deal that harmonises non-tariff barriers among participating countries. It does so at the lowest common denominator, basically enshrining Chinese standards across the region. This should cut some red tape and paperwork for trade between RCEP members. But existing tariffs would remain the same between RCEP countries—and negotiations over them would still be bilateral rather than for the whole group. It also leaves many politically sensitive sectors—such as agriculture—alone.

We do see some upside to the RCEP, but we think it is limited. Less-developed countries would have easier access to bigger markets in China, South Korea and Japan. This should position countries such as Vietnam, Laos, Cambodia and Myanmar to keep benefiting as RCEP gives multinational firms in larger member nations incentive to invest more in expanding their supply chains across the region. For larger, more developed RCEP members, more diversified supplied chains are likely only a marginal benefit.

> "WE DO SEE SOME UPSIDE TO THE RCEP, BUT WE THINK IT IS LIMITED. LESS-DEVELOPED COUNTRIES WOULD HAVE EASIER ACCESS TO BIGGER MARKETS…FOR LARGER, MORE DEVELOPED RCEP MEMBERS, MORE DIVERSIFIED SUPPLIED CHAINS ARE LIKELY ONLY A MARGINAL BENEFIT"

The RCEP would also be the first trade deal between China and Japan, but we doubt that carries much weight. Some pundits tout it as the basis for better relations between the world's second- and third-largest economies, possibly advancing talks on a more comprehensive China-Japan-South Korea free trade agreement. While that is possible, it seems far off at best. These trilateral trade talks have stagnated for over seven years due to political differences. As for the RCEP itself, it doesn't meaningfully change China and Japan's existing trade relationship. Since the RCEP's November agreement, China has lifted an 18-year-old ban on beef from Japanese cows under 30 months old.[xv] However, this seems mostly symbolic, particularly since tariffs and most non-tariff barriers didn't change.

xv "China Lifts 18-Year-Old Ban on Japanese Beef Imports as Beijing Seeks to Warm Trade Ties With Tokyo," Orange Wang, South China Morning Post, 23/12/2019. https://www.scmp.com/economy/china-economy/article/3043274/china-lifts-18-year-old-ban-japanese-beef-imports-beijing

The RCEP would encourage intra-bloc trade, but it also potentially discourages trade with non-participating nations. In effect, it codifies extant protectionism, shielding the group from freer trade with the rest of the world. The RCEP implements common "rules of origin," meaning a certain amount of content for goods traded must come from companies in participating nations. Proponents of local content requirements argue it will keep—and possibly expand—production within the region. But the requirements effectively restrict trade overall. Hence, the RCEP's rules of origin seem likely to raise the costs to businesses and consumers by limiting competition from non-RCEP member firms.

While the RCEP doesn't prevent members from seeking other trade deals—seven belong to CPTPP—it could make it harder. In negotiations, China effectively vetoed more substantive trade liberalisation. As the largest economy in the group, it would likely be the de-facto standard setter for the bloc. This may discourage countries from reaching more liberal trade arrangements with partner countries outside the RCEP.

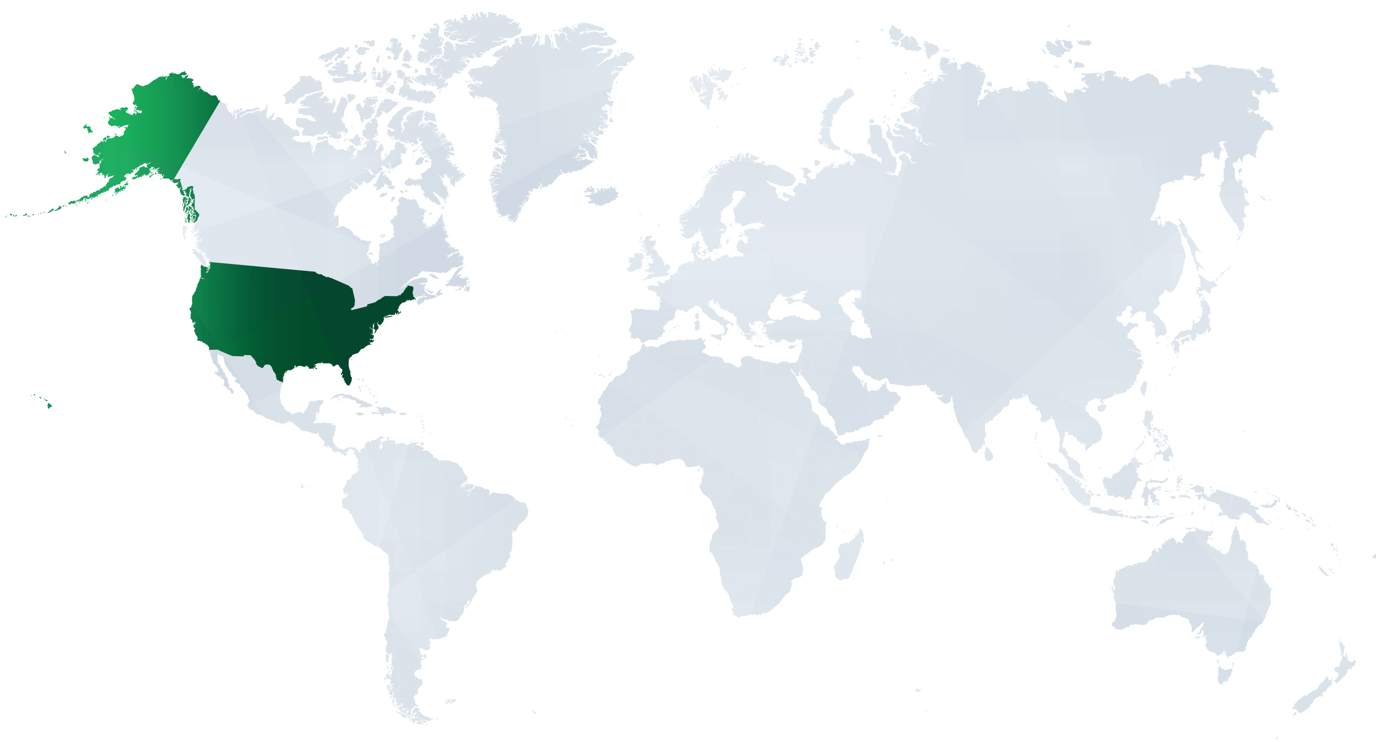
That said, the RCEP will also likely take years before full implementation, blunting its likely minor impacts—both positive and negative—still further. Even if all member nations signed it this year, the earliest it could possibly take effect would be 2021. Before countries can ratify the deal, all 15 signatories' governments must undertake extensive reviews of its provisions, produce impact reports and enact legislation needed to implement the RCEP. Given this slow rollout, we don't think the RCEP will affect markets much, if at all. Equities look at what is likely to impact profits most over the next 3 – 30 months, relative to what is already priced in, but focus mainly on the next 12 to 18 months. The RCEP is unlikely to have much material effect over this timeframe—and, quite possibly, even beyond.

GLOBAL MONETARY POLICY: A RISK WORTH WATCHING

One risk we are watching is central bankers' actions. Throughout this economic expansion, central banks have continually undershot their inflation targets despite a variety of policies aimed at achieving higher prices. As they pursued quantitative easing (QE) and negative interest rates, central bankers veered away from traditional concepts—such as focusing on money supply and loan growth. Now the European Central Bank (ECB) is oddly studying whether money supply even makes sense to monitor when assessing monetary policy's efficacy.

Central bankers' policies seem persistently misguided in this cycle—possibly stemming from their lack of banking experience. An example of this is the installation of former International Monetary Fund head and French finance minister Christine Lagarde at the ECB. Ms. Lagarde is a career politician with no banking training. Her early comments conveyed interest in issues such as climate change and inequality—worthy issues but unrelated to monetary policy and outside central bankers' traditional purview. Similarly, the UK government announced Andrew Bailey—a classic career bureaucrat whose background was in banking regulation—will replace Bank of England Governor Mark Carney. While it is impossible to know how Bailey will act as Bank of England Governor, the trend of bureaucrats and politicians ascending central banks' ranks—rather than actual bankers—fosters groupthink. The situation may be fine in the near term, but if trouble arises, what experience will they draw on? The inexperience suggests an increased risk of big monetary mistakes.

UNITED STATES COMMENTARY



ELECTION YEARS ARE FINE FOR EQUITIES

2020 is the fourth year of President Trump's term—generally good for equities. Presidents usually front-load legislation in their first two years, when their political capital is highest. This can increase uncertainty as markets assess potential winners and losers, rendering more variable equity returns. However, the president usually loses relative power at midterms, bringing gridlock for years three and four, which have historically been overwhelmingly positive. Beyond gridlock, politicians have little incentive to pass big bills in election years as such legislation could frustrate swaths of the electorate—a poor campaign strategy. Moreover, politicians may be better off fundraising on what they will do regarding an issue if re-elected than actually doing something. It may sound cynical, but we think remembering politicians' primary aim is to win elections is crucial. Passing divisive legislation in an election year may hinder that.

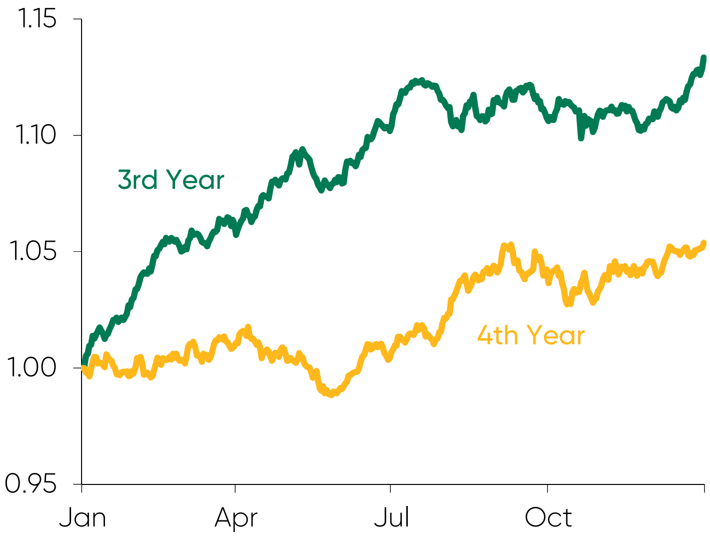
While fourth years are positive most of the time, they are usually milder than third years. This is another factor suggesting 2020's returns won't be as robust as 2019's—though still nicely positive. Fourth years are also typically back-end loaded, as political uncertainty is highest early, when a crowded presidential primary field makes the outcome unpredictable. The noise can dampen sentiment as markets digest extreme campaign rhetoric. Yet as the field narrows and presumptive nominees emerge, equities generally benefit from falling uncertainty.

EXHIBIT 3: THE PRESIDENTIAL TERM ANOMALY

	Inaugural Year		Second Year		Third Year		Fourth Year	
>20%	1933	52.90%	1954	52.40%	1935	47.20%	1928	43.30%
0% to 20%	1945	36.50%	1958	43.30%	1995	37.60%	1936	32.80%
0% to -20%	1997	33.40%	1938	33.20%	1975	37.30%	1980	32.30%
<-20%	2013	32.40%	1950	30.60%	1927	37.10%	1976	23.70%
	1989	31.70%	1998	28.60%	2019	31.50%	1996	23.00%
	1985	31.60%	1982	21.50%	1955	31.40%	1944	19.70%
	1925	29.50%	1942	21.10%	1991	30.50%	1972	18.90%
	1961	26.80%	1986	18.60%	2003	28.70%	1952	18.50%
	2009	26.50%	2006	15.80%	1943	25.80%	1988	16.60%
	2017	21.80%	2010	15.10%	1951	24.60%	1964	16.40%
	1949	18.10%	2014	13.70%	1967	23.90%	2012	16.00%
	1965	12.40%	1926	11.10%	1963	22.70%	2016	12.00%
	1993	10.10%	1978	6.40%	1983	22.50%	1968	11.00%
	2005	4.90%	1970	4.00%	1999	21.00%	2004	10.90%
	1953	-1.10%	1994	1.30%	1979	18.40%	1992	7.60%
	1981	-5.10%	1934	-2.30%	1971	14.30%	1956	6.60%
	1977	-7.40%	1990	-3.10%	1959	11.90%	1984	6.20%
	1969	-8.50%	2018	-4.40%	2007	5.50%	1948	5.10%
	1929	-8.90%	1946	-8.20%	1947	5.20%	1960	0.50%
	1957	-10.90%	1962	-8.80%	1987	5.20%	1932	-8.90%
	1941	-11.80%	1966	-10.10%	2011	2.10%	2000	-9.10%
	2001	-11.90%	2002	-22.10%	2015	1.40%	1940	-10.10%
	1973	-14.80%	1930	-25.30%	1939	-0.90%	2008	-37.00%
	1937	-35.30%	1974	-26.50%	1931	-43.90%		
Percent Positive		58.30%		62.50%		91.70%		82.60%
All (Average)		10.50%		8.60%		18.40%		11.10%
Positive Years (Average)		26.30%		21.10%		22.10%		16.90%

Source: Global Financial Data, as of 01/02/2020. S&P 500 Total Return Index, 01/01/1925 - 31/12/2019.

EXHIBIT 4: AVERAGE RETURNS IN YEARS THREE AND FOUR



Source: Global Financial Data, Inc., as of 21/01/2020. S&P 500 Index daily price returns, 31/12/1928 – 31/12/2019, indexed to 1.

US ELECTIONS SUMMARY

As always, our political commentary is non-partisan by design. We favour no party or candidate and assess political developments solely for their potential market impact.

After months of debates, policy proposals and attention seeking, the Democratic primaries finally arrive in Q1, and with them a lot of talk as some candidates win delegates, while others drop out. However, it is unlikely that a clear winner is established soon. Between the sheer number of candidates and the Democratic National Committee's (DNC) rule changes, it may be several months more before we get a presumptive nominee.

THE PRIMARIES KICK OFF

Primaries through March's end will decide about 65% of the party's pledged delegates, helping narrow the contest. Yet it will still likely be too early to have a presumptive nominee, due in part to DNC rule changes after 2016. Then, the DNC faced criticism for what many deemed a coronation of Hillary Clinton and deliberate sidelining of her popular challenger, Bernie Sanders. His supporters claimed the outsized influence of unpledged "super delegates" stacked the contest in Clinton's favour. In response, the DNC barred super delegates from voting in the convention's first ballot. That, combined with the fact Democratic primaries and caucuses award delegates proportionally (not winner take all), makes it unlikely any candidate runs away with 2020's nomination early.

We suspect this nuance explains the tactics of former New York City Mayor Michael Bloomberg, who entered the Democratic race in November. He is skipping the early primaries, concentrating instead on Super Tuesday, 3 March, when about one-third of pledged delegates are up for grabs (Exhibit 5). He likely hopes to have a big enough impact to force out candidates who cannot compete financially, thinning the field of candidates. We have no idea whether this will work, but it may explain Senator Cory Booker's announcement that he could not go the distance financially despite exceeding his Q4 fundraising targets.

EXHIBIT 5: THE PRIMARIES IN Q1

Primary Dates	States/Territories	Total Delegates
03 February	Iowa	41
11 February	New Hampshire	24
22 February	Nevada	36
29 February	South Carolina	54
03 March	Alabama, American Samoa, Arkansas, California, Colorado, Maine, Massachusetts, Minnesota, North Carolina, Oklahoma, Tennessee, Texas, Utah, Vermont, Virginia, Democrats Abroad	1357
10 March	Missouri, North Dakota, Washington	352
14 March	Northern Marianas	6
17 March	Arizona, Florida, Illinois, Ohio	577
24 March	Georgia	105
29 March	Puerto Rico	51

Source: The New York Times, as of 30/12/2019.

The Democratic National Convention could even arrive without a presumptive nominee. All it would take is three or four candidates doing consistently well, leaving none with a majority of delegates. If this happens, the outcome is very unclear. After the first ballot, all delegates become unbound and super delegates are able to vote as well. Will the delegates rally around an existing candidate and risk alienating voters, or will they pick an outsider they think stands a better chance of energising and exciting voters?

The latter is not unprecedented. It is how Adlai Stevenson won the nomination in 1952. He didn't run in the primaries. TennesseeW Senator Estes Kefauver was the delegate leader after the primaries, but outgoing

President Harry Truman and other party leaders didn't support him. While they argued over alternate candidates, Stevenson delivered the convention's welcoming address to great fanfare, much as Barack Obama shined at 2004's convention. Capitalising on this popularity, Stevenson put his name in and won on the third ballot.

Today's Democratic field is much bigger—hence, more susceptible to unexpected outcomes. Its sheer unpredictability probably makes uncertainty fall slower than it typically would.

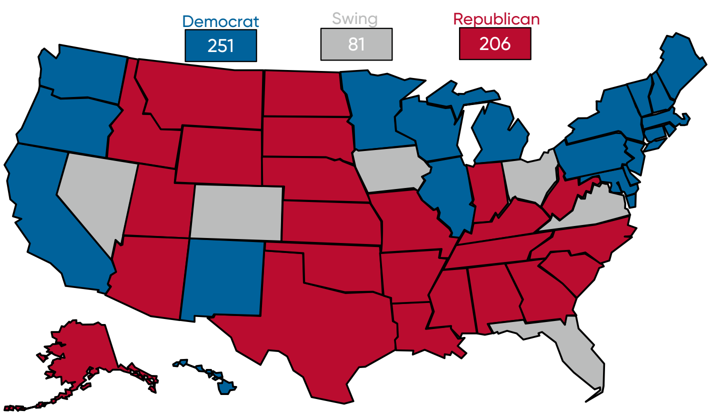
NOVEMBER: TOP-DOWN OR BOTTOM-UP?

While it is too early to project November's winner, President Trump's and the Democratic nominee's paths to the White House parallel 2016. Back then, we introduced a new framework for viewing presidential elections: top-down versus bottom-up.

Most state-level political analysis is top-down (Exhibit 6), assessing the likelihood a state goes for a candidate based on the prior five presidential elections. For example, Texas is a red state because no Democratic candidate has won Texas since Jimmy Carter in 1976. Top-down analysis gives its 38 electors to the Republican Party. This is fine and generally reliable, but it isn't the only method. By contrast, bottom-up analysis weighs party control of the state legislature, which may capture recent, subtle shifts.

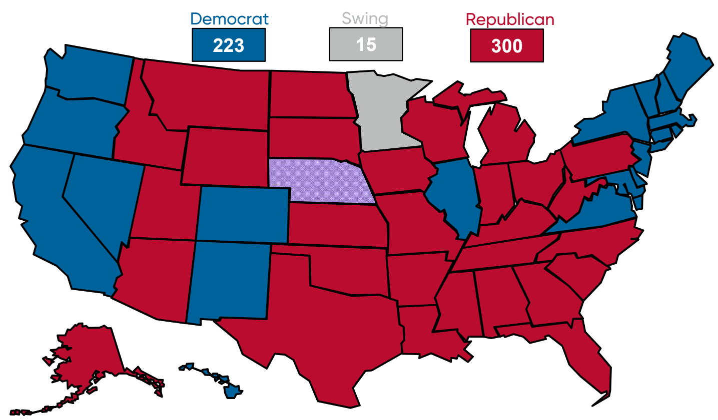
In 2016, top-down analysis favoured Hillary Clinton. There were 257 Electoral College votes in solidly liberal (blue) states versus 206 in red (75 votes were in "swing" states). Yet bottom-up analysis revealed the opposite. Republicans controlled most state governments—including key states such as Pennsylvania, Michigan and Wisconsin. That meant 309 electoral votes were in red states versus 141 in blue (with 88 in swing states). Ultimately, President Trump took 306 electoral votes to Clinton's 232. This divide remains today. A top-down vote still favours the Democrats, while a bottom-up election favours President Trump (Exhibits 7). Yet there has been a subtle momentum shift. Many of 2016's swing states, which had split legislatures, flipped Democratic at 2018's midterms. So did seven governorships, including Michigan and Wisconsin. President Trump still has a bottom-up advantage if people vote as they did in state legislative elections, but the outcome is far from a foregone conclusion.

EXHIBIT 6: ELECTORAL COLLEGE MAP USING TOP-DOWN ELECTION ANALYSIS



Source: The Wall Street Journal, US National Archives and Fisher Investments Research, as of 19/11/2019.

EXHIBIT 7: ELECTORAL COLLEGE MAP USING BOTTOM-UP ELECTION ANALYSIS



Source: National Conference of State Legislatures, US National Archives and Fisher Investments Research, as of 19/11/2019. Nebraska has a non-partisan, unicameral legislature but leans Republican. Washington D.C. is counted as Democratic based on the city council's breakdown. Swing state defined as a state without uniform party control of the legislature.

Therefore, national polls will not help assess the potential winner. As 2016 illustrates, the national polling leader may not win even if polls are accurate. The final poll before 2016's election, taken 7 November, showed Hillary Clinton 3.2 percentage points ahead of President Trump.[xvi] This nearly matched the popular vote, which went to Clinton by a 48.0% to 45.9% margin.[xvii] However, it did not reveal how people in Wisconsin, Michigan and Minnesota would vote.

This could repeat in 2020. For example, California has about 10% of the country's registered voters and President Trump will probably lose it by 20 points.[xviii] That knocks two points off his popular vote share, but it says nothing of the Electoral College. That, as always, hinges on swing states and on who will campaign best there and resonate with voters. This is unknowable now. All we know is President Trump has a structural edge if voters echo their state government preferences, while the Democratic nominee does if they follow national election trends.

CONGRESS WON'T SWING BIG

Entering the contest, the Republicans have a 53 – 47 Senate majority, and the Democrats hold 232 House seats to the Republicans' 197.[xix] Either or both chambers could change leadership, but big swings seem unlikely given the lack of broad national enthusiasm for any presidential candidate (including President Trump). Absent a massive shift in the national mood, no one looks likely to generate huge down-ballot effect.

When assessing the Senate and House, we think structural factors mean more than polls. In the Senate, the question is simple: Which party must defend more seats in states that have historically voted for the other party? To weigh this, we assess the structural breakdown. (Exhibit 8) It shows every seat up for election this year and the presidential candidate their state picked in the past two elections.

EXHIBIT 8: 2020 SENATE RACES

Senator	Party	State	2016 % Vote for Trump	2012 % Vote for Romney
Enzi, M. (OPEN)	R	WY	70%	69%
Moore Capito, S.	R	WV	69%	62%
Inhofe, J.	R	OK	65%	67%
Jones, D.	D	AL	63%	61%
McConnell, M.	R	KY	63%	60%
Rounds, M.	R	SD	62%	58%
Alexander, L. (OPEN)	R	TN	61%	59%
Cotton, T.	R	AR	60%	61%
Sasse, B.	R	NE	60%	60%
Risch, J.	R	ID	59%	65%
Hyde-Smith, C.	R	MS	58%	55%
Cassidy, B.	R	LA	58%	58%
Daines, S.	R	MT	57%	55%
Roberts, P. (OPEN)	R	KS	57%	60%
Graham, L.	R	SC	56%	55%
Sullivan, D.	R	AK	53%	55%
Cornyn, J.	R	TX	53%	57%
Ernst, J.	R	IA	52%	46%

Senator	Party	State	2016 % Vote for Trump	2012 % Vote for Romney
Loeffler, K.*	R	GA	51%	53%
Perdue, D.	R	GA	51%	53%
Tillis, T.	R	NC	51%	50%
McSally, M.*	R	AZ	50%	54%
Peters, G.	D	MI	48%	45%
Shaheen, J.	D	NH	47%	46%
Smith, T.	D	MN	45%	45%
Warner, M.	D	VA	45%	47%
Collins, S.	R	ME	45%	41%
Gardner, C.	R	CO	45%	46%
Booker, C.	D	NJ	42%	41%
Coons, C.	D	DE	42%	40%
Merkley, J.	D	OR	41%	42%
Reed, J.	D	RI	40%	35%
Udall, T. (OPEN)	D	NM	40%	43%
Durbin, R.	D	IL	39%	41%
Markey, E.	D	MA	34%	38%

Source: Fisher Investments Research, US Senate, as of 08/01/2020. *Special election in 2020. "OPEN" indicates the incumbent isn't contesting the seat.

xvi Source: RealClearPolitics, as of 16/12/2019.

xvii Source: The New York Times Election 2016 tracker, as of 16/12/2019. https://www.nytimes.com/elections/2016/results/president

xviii Source: World Population Review, as of 03/01/2020. Number of Registered Voters by State, 2019.

xix Source: US House of Representatives Press Gallery, as of 30/01/2020. There is also one Independent and five vacant seats.

Of the 35 seats up in November, only 3 are starting out in an especially vulnerable position: Democrat Doug Jones in Alabama and Republicans Susan Collins and Cory Gardner in Maine and Colorado. Maybe some marginal seats will be in play, but major shifts look unlikely. Impeachment adds a wrinkle to these races, with polls showing voters are split on it, and many viewing it as a hyper-partisan exercise. How senators vote in the trial of President Trump could sway voters' opinions.

> "MAYBE SOME MARGINAL SEATS WILL BE IN PLAY, BUT MAJOR SHIFTS LOOK UNLIKELY. IMPEACHMENT ADDS A WRINKLE TO THESE RACES, WITH POLLS SHOWING VOTERS ARE SPLIT ON IT"

As for the House, incumbency is a strong advantage, giving the Democrats an edge. Yet the impeachment battle might change the outcome here, too. Voters—especially in swing states—may punish Democratic lawmakers for pursuing it. In 2018's midterm election, 31 Democrats won in districts that voted for Trump in 2016, suggesting a voter rebuke over impeachment is possible. That could tilt the chamber toward the Republicans, but not by much.

UPDATE ON US IMPEACHMENT TRIAL

The House voted to impeach President Trump on two counts in December, largely along party lines. Our viewpoint has not changed. Impeachment is not inherently bearish. Equities rose through President Clinton's impeachment, Senate trial and acquittal in 1998. Richard Nixon's 1974 resignation (under the threat of impeachment) coincided with a bear market, but equities' troubles began long before then, and had much more to do with Nixon's price controls, the Arab oil embargo and the ensuing deep recession.

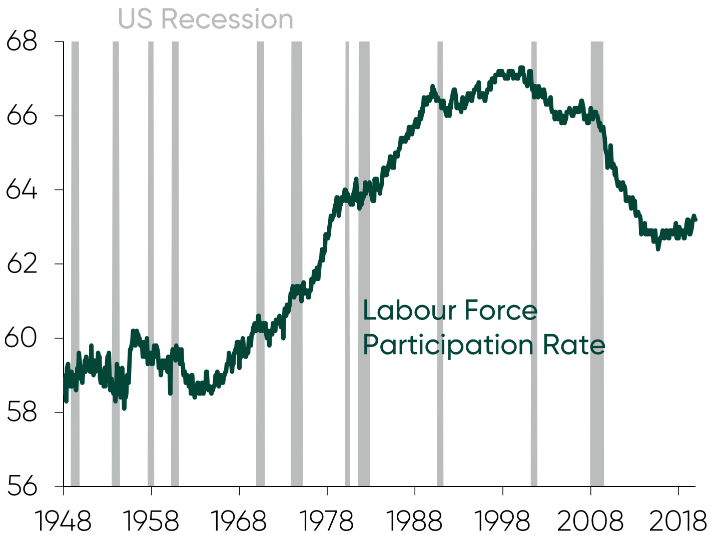
Based on the evidence available today, President Trump's removal from office looks exceedingly unlikely. It takes a Senate supermajority, 67 votes, to convict and remove a president. Thus, 20 Republican Senators would have to vote to convict, along with all the Democratic Senators. This seems like a tall order; especially considering a Republican Senate acquitted Democratic President Clinton. Most likely, this political saga ends with a whimper, markets see through it, and everyone moves on.

THE END OF THE LINE?

Many who fear recession looms point to labour market conditions. They see the US unemployment rate's 50-year lows as unsustainable and contend there is no room for improvement. They may be right that the unemployment rate won't fall much further from today's 3.5%.[xx] Yet they ignore another key factor: the labour force participation rate (LFPR).

In this expansion's first six years, the LFPR—the share of Americans employed or seeking employment—tumbled to levels unseen since the mid-1970s. (Exhibit 9) There are several reasons why: Demographic factors such as baby boomers retiring; more younger workers seeking higher education; and, of course, some unemployed workers became "discouraged"—meaning they didn't seek a job in the prior four weeks. Economic statisticians exclude these people from the headline unemployment rate.

EXHIBIT 9: CIVILIAN LABOUR FORCE PARTICIPATION RATE



Source: Federal Reserve Bank of St. Louis, as of 07/01/2020. Labour Force Participation Rate and US recessions (per the National Bureau of Economic Research), January 1948 – December 2019.

Even so, recent years' strengthening job market has led many to seek work again—and find it. Hence, the LFPR has stabilised—and even ticked up. Anecdotally, we see many stories of retirees choosing to return to work or discouraged workers finding jobs. The strong job market is tapping a shadow labour source the unemployment rate overlooks.

There is no reason this can't persist. We believe continued economic expansion should bring back more jobseekers, letting the workforce and economy grow without the unemployment rate materially declining. Even if it ticked higher, that may not necessarily be negative, but instead another sign people outside the labour force see opportunities. Of course, jobs data lag economic growth and the equity market, so they aren't useful for forecasting. However, jobs numbers can impact sentiment, and we think they could continue fostering optimism.

xx Source: FactSet, as of 31/12/2019. Unemployment Rate, 16 Years & Over, November 2019.

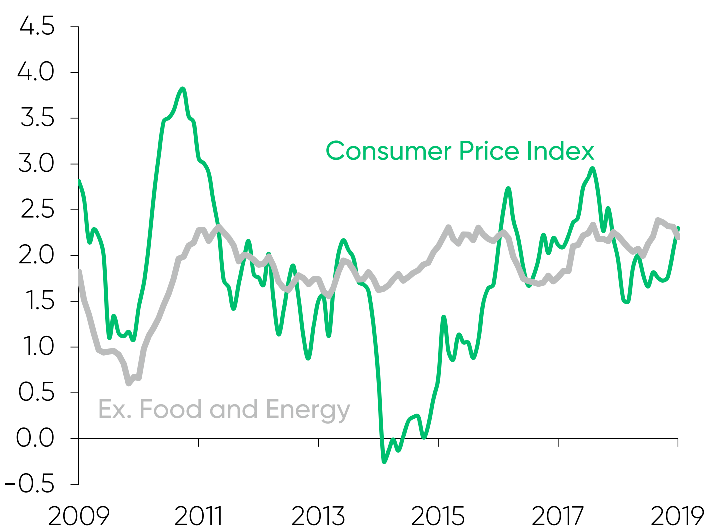
INFLATION—FOLLOW THE MONEY (SUPPLY)

Many think strong labour markets mean inflation will rise. Yet the link between jobs and prices is weak. Hence, while we expect a robust jobs market, inflation should remain modest—matching long-running trends. Exhibit 10 illustrates this using the US Consumer Price Index with and without food and energy prices—outliers that can sway the index dramatically in the short term.

Inflation, as Nobel laureate Milton Friedman famously said, is a monetary phenomenon. It isn't about wages pushing up prices. It isn't about government spending or deficits. It is about too much money chasing a finite amount of goods and services.

Money supply growth has been slow in this cycle. While US M4 money supply growth has accelerated somewhat recently, a longer view shows it largely extends the prior trend. Monthly M4 growth averaged 5.4% y/y in 2019—not far from 2018's 4.5%.[xxi]

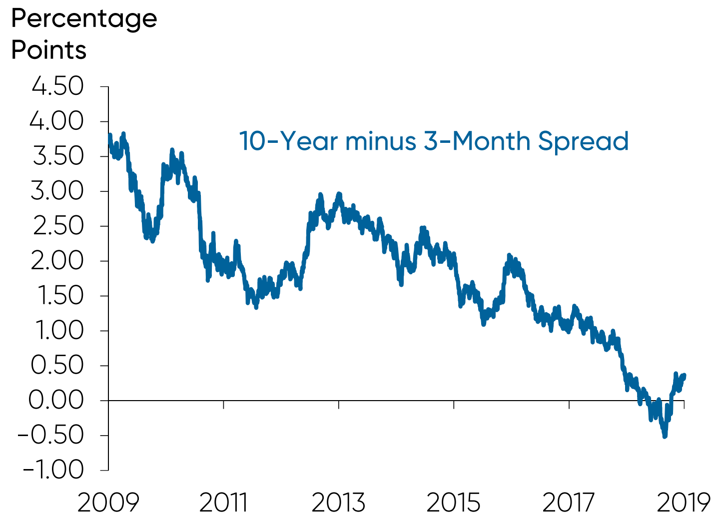
EXHIBIT 10: CONSUMER PRICE INDEX OVER THE LAST DECADE (YEAR-OVER-YEAR PERCENTAGE CHANGE)



Source: Federal Reserve Bank of St. Louis, as of 07/01/2020. December 2009 – December 2019.

Flat yield curves globally suggest inflation likely won't surge. While the US yield curve flipped positive in October, it remains relatively flat. (Exhibit 11)

EXHIBIT 11: US YIELD CURVE POSITIVE, BUT FLAT



Source: Federal Reserve Bank of St. Louis, as of 07/01/2020. 31/12/2009 – 31/12/2019.

Money supply swings most on loan growth. Banks borrow short term to fund long-term loans, making the spread between short and long rates a key influence on lending's profitability—and future loan growth.

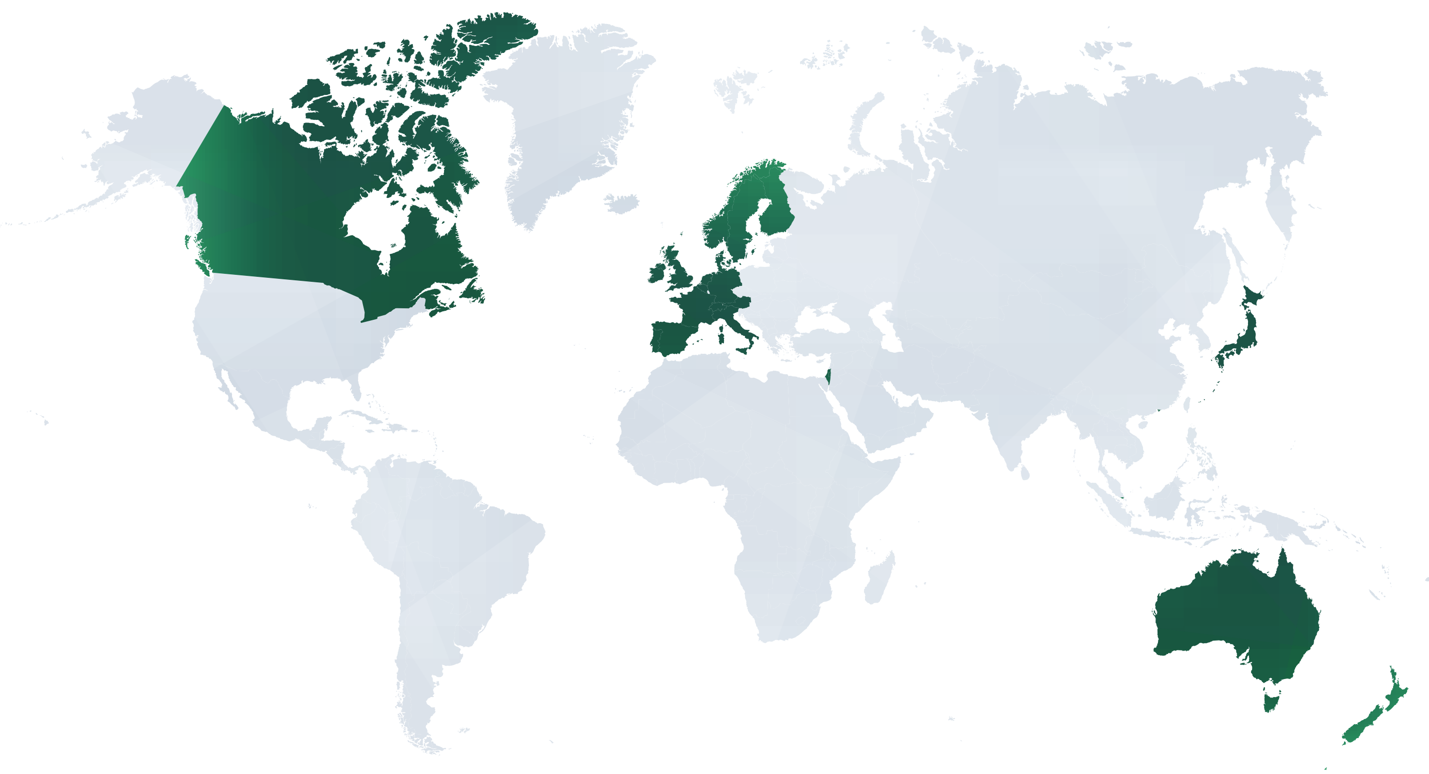
As explained in past Reviews, the US Treasury yield curve is only a proxy for loan profitability. Banks' funding costs are generally far below 3-month yields. Significant excess reserves resulting from quantitative easing have delayed deposit-cost pressures. That gives banks enough incentive to keep lending: US loan growth averaged 3.9% annualised in 2019, milder than 2018's 4.7%.[xxii] However, low long rates mean curves are likely too flat to spur a large enough uptick to generate high inflation or far faster GDP growth.

In our view, this positions equities to enjoy the same "Goldilocks" economy—moderate growth—that has buoyed the bull market over the past decade.

xxi Source: Center for Financial Stability, as of 07/01/2020. M4 Money Supply, average monthly year-over-year growth in calendar years 2018 and 2019.

xxii Source: Federal Reserve Bank of St. Louis, as of 03/01/2020. Percentage change in loans and leases in bank credit, seasonally adjusted annual rate, 31/12/2018 – 31/12/2019 and 31/12/2017 – 31/12/2018.

GLOBAL DEVELOPED EX-US **COMMENTARY**



LOOKING BACK AT BREXIT UNCERTAINTY

Brexit uncertainty likely weighed on British data in Q4, though perhaps less than it did earlier in the year. Before the first Brexit deadline on 29 March, many businesses built huge inventory stockpiles, while several auto manufacturers brought forward annual maintenance closures. That created major volatility in production and import data, as PMIs and monthly GDP numbers show. Yet perhaps because lawmakers had already proven they didn't view the 31 October deadline as carved in stone, the impact was more muted the second time around. While monthly GDP fell -0.5% q/q in April (and then rose in five of the next six months), after the first Brexit deadline came and went, it slipped just -0.3% in November.[xxiii]

Brexit occurred on 31 January and uncertainty should start fading soon. Unfortunately, businesses won't get total clarity, as the UK and EU must complete a trade deal by December 2020—when the transition period preserving tariff-free trade between the two is set to expire. That said, completing Brexit is a step toward getting businesses more clarity, regardless of whether or not the outcome is ideal. Given this, we think a Brexit-driven recession remains unlikely.

THE UK GETS A NEW GOVERNMENT AND A DOSE OF BREXIT CLARITY

As mentioned in the Executive Summary, Q4 was tumultuous for British politics. It started with Prime Minister Boris Johnson losing a series of key Parliamentary votes, forcing him to delay Brexit from 31 October to 31 January. It ended with that Brexit date enshrined in law after Prime Minister Johnson's Conservative Party won its biggest majority since the 1980s in December's general election. Fueling this landslide was a collapse in support for the Labour Party, which suffered its worst showing since the 1930s. The Conservatives breached Labour's infamous "red wall" in the industrial north of England, taking several seats for the first time ever.

This may have some implications for the US election. As in the US, Labour and the Conservatives have largely swapped constituencies over the past few decades. Like the US Democrats, Labour did best among urban centers, while the more rural, working-class constituencies voted Conservative—much as rural and Rust Belt voters now lean heavily Republican in the US. We suspect Democrats have also noticed that Labour ran—and lost—on its most left-wing platform in decades, suggesting party leadership badly misread public sentiment. It wouldn't surprise us if rural and industrial voters' rejection of massive state intervention inspires US Democratic candidates to moderate their rhetoric as November nears.

As for the election's impact on UK equities, it does help reduce Brexit uncertainty—a positive, in our view. UK businesses spent much of their energy navigating last year's shifting Brexit deadlines, preventing long-term investments. This short-term focus can now end. Some uncertainty will likely linger as Prime Minister Johnson and EU officials negotiate a trade deal, which they must finalise by yearend. But just knowing they have left the EU should help businesses and investors move on—a tailwind for UK equities.

On paper, the UK appears to have lost one consistent long-term positive: political gridlock. Prime Minister Johnson has an 80-seat majority, theoretically enabling him to push through big changes. Ordinarily, that would create some legislative risk aversion, as big changes—no matter how allegedly "market friendly" on the surface—create winners and losers. However, Brexit trade talks could counterbalance this. The process will likely inspire significant arguing within the Conservative Party, potentially draining Prime Minister Johnson's political capital before he can push non-Brexit-related changes. Intraparty gridlock could materialise as individual Members of Parliament debate, mirroring Republican lawmakers since President Trump took office. The Scottish National Party's strong showing—and subsequent push for another independence referendum—likely throws further sand in the legislative gears. With so many distractions, it will likely be difficult for Prime Minister Johnson to pass sweeping economic overhauls.

SPAIN'S LEFTIST COALITION

After spending 326 days as caretaker prime minister following the collapse of his minority Socialist government in April 2019, Prime Minister Pedro Sánchez is back—heading a new coalition between the Socialists

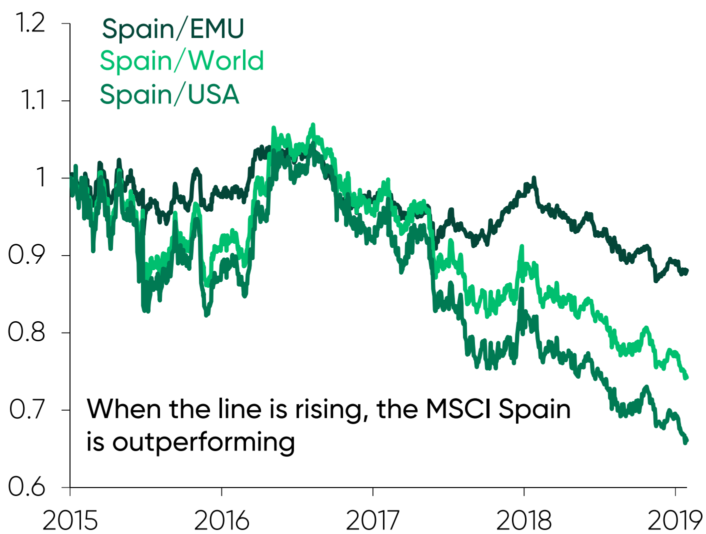
---

xxiii Source: Office for National Statistics, as of 13/01/2020.

and the far-left populist Podemos party. To many investors, this scenario is the worst-case outcome, as the two parties talk of rolling back many of the market-oriented reforms that contributed to Spain's resurgent economic growth after Europe's sovereign debt crisis. In addition, the new government has pressed for punitive taxes on banks—a headwind for the Financials-heavy Spanish market. We think these fears are a large factor behind Spanish equities' noteworthy lag in 2019. That said, we also think they tee up a positive surprise in 2020 as reality proves more benign than feared.

Spanish equities' lagging is nothing new. For much of this bull market, the country has trailed not only the world, but the eurozone as well. While the early years' lag was largely about the eurozone's sovereign debt crisis—Spain was central to many folks' fears of the eurozone splintering—its lag since roughly 2015 comes against a backdrop of solidly positive economic fundamentals. During this stretch, Spain has averaged 2.5% annualised real GDP growth—topping the eurozone (1.9%) and the US (2.3%).[xxiv] Yet, as Exhibit 12 shows, its markets lag the eurozone, world and US considerably.

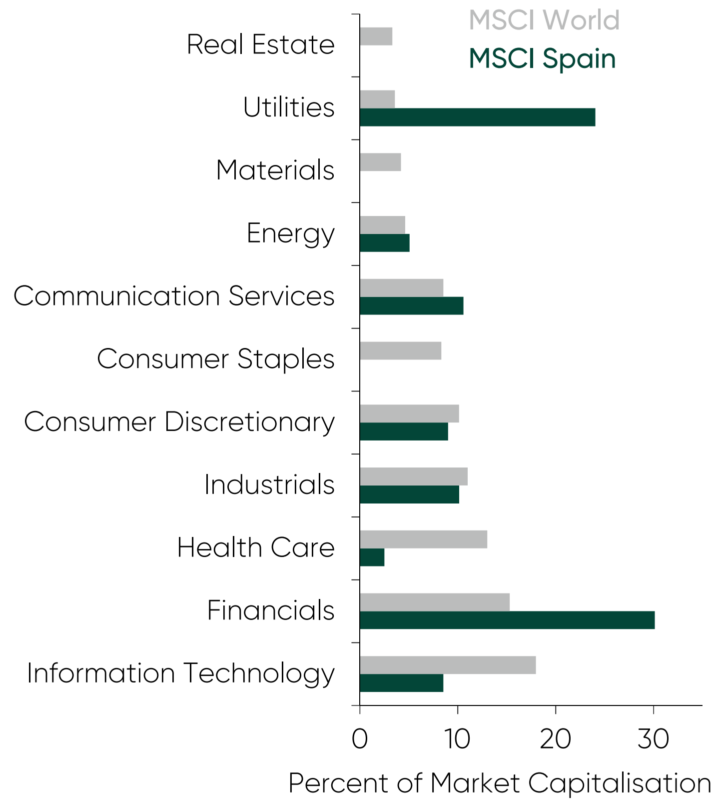
EXHIBIT 12: SPAIN'S LAG



Source: FactSet, as of 28/01/2020. MSCI Spain, EMU, USA and World indexes, with net dividends and in USD, 31/12/2015 – 27/01/2020. Indexed to 1 on 31/12/2015.

Part of the explanation, in our view, lies in market structure. Beyond banks, Spanish markets heavily tilt towards defensive sectors. As Exhibit 13 shows, Utilities is Spain's second-biggest sector, at 24.1% of the MSCI Spain's market capitalisation.

EXHIBIT 13: SPAIN'S MARKET STRUCTURE



Source: FactSet, as of 28/01/2020. MSCI World and MSCI Spain Sector weights. Spain has no weight in Real Estate, Materials or Consumer Staples.

Another defensive category hides in the newly created Communication Services sector, which combines Tech-like Media and Interactive Services firms with old-line Telecommunications firms. The former define growth, while the latter are defensive. Spain's Communication Services sector exceeds the world's weight, 10.6% vs. 8.5%. However, it is entirely Telecommunications, while the world sector is almost half Tech-like. Hence, it is no surprise Spain's Communication Services sector fell -5.5% in 2019 while the MSCI World's rose 27.4%.[xxv]

xxiv Source: FactSet, as of 28/01/2020.

xxv Source: Factset, as of 27/01/2020. MSCI Spain Communication Services sector return with net dividends and MSCI World Communication Services sector return with net dividends, both in USD, 31/12/2018 – 31/12/2019.

MARKET STRUCTURE COMPOUNDS POLITICAL HEADWINDS

Of course, Spain's biggest sector is Financials, which stands at the center of the country's political fears.

Spain's latest political theatrics date back to March, when Prime Minister Sánchez's minority government joined with Podemos to design a budget rife with tax hikes and spending measures. They proposed a 22% increase to the minimum wage. The array of new taxes included a 3% Digital Services Tax, a Financial Transactions Tax and a 15% minimum corporate tax rate. The minimum tax, combined with a special 18% tax on firms with more than €20 million in annual net turnover, would boost many larger banks' effective tax rate to above 30%—topping the country's headline 25% corporate tax rate.[xxvi]

Yet in March 2019, the Popular Party (PP), Ciudadanos and several smaller secessionist parties joined forces to shoot the proposal down. With this, Prime Minister Sánchez's minority government fell, necessitating new elections, which he set for 28 April. However, this election, too, proved indecisive. While Prime Minister Sánchez's Socialists improved on their standing, increasing their seats from 85 to 123, they remained far from a majority in the 350 seat Chamber of Deputies. Even if they had united to form a coalition with Podemos then, it would have totaled just 165 seats. Talks dragged on for months, but no party could form a coalition or get enough votes to abstain to allow a minority government to take office. Hence, Prime Minister Sánchez called another election, which he set for 10 November.

THE NOVEMBER VOTE

Little changed in the November vote itself. The Socialists lost three seats, so they still lacked a majority. Podemos lost seven, too, while the PP added 23 to remain the primary opposition.

In the wake of the vote, many expected talks to drag out once again. But they didn't. Instead, within days of the election concluding, Podemos and the Socialists had a draft agreement to form Spain's first coalition government since the fall of Franco's dictatorship. Yet even with this, the coalition has only 155 seats. It needed Catalan secessionist parties to abstain to take power. After quick talks, this happened in early January.

THE IMPACT ON EQUITIES

This political uncertainty—particularly the specter of a union between Podemos and the Socialists—have weighed on bank equities. Consider: In 2019, French Financials surged 29.7%.[xxvii] EMU Financials rose 19.4%.[xxviii] Meanwhile, Spanish Financials struggled, finishing the year down -0.9%.[xxix] We think this stems largely from fears of a union leading to the passage of an aggressive budget on par with the March proposal that could not only hit banks hard, but potentially put the country at odds with the European Union.

In our view, these fears overrate the minority coalition government's ability to pass anything. The two parties glossed over large internal divisions in the name of national unity, but that unity may not extend to matters of policy. Further, the secessionist parties' abstention may not last. As we wrote last quarter, the Socialist government has a very unclear approach to their demands, which has created disagreement before. This government could struggle to enact much.

Further, markets seem to have already priced in a very negative backdrop for banks. Anything less negative coming to fruition seems likely to prove a positive surprise for markets. It would take a great deal, in our view, to generate negative surprise for Spanish equities from here.

---

xxvi "Spain 2019 Draft Budget Includes Significant Corporate Tax Changes," Staff, PwC, 15/10/2018. https://www.pwc.com/us/en/tax-services/publications/insights/assets/pwc-spain-2019-draft-budget-includes-significant-corp-tax-changes.pdf

xxvii Source: FactSet, as of 28/01/2020. MSCI France Financials sector return with net dividends, in USD, 31/12/2018 – 31/12/2019.

xxviii Ibid. MSCI EMU Financials sector return with net dividends, in USD, 31/12/2018 – 31/12/2019.

xxix Ibid. MSCI Spain Financials sector return with net dividends, in USD, 31/12/2018 – 31/12/2019.

THE GLOBAL NON-RECESSION

Throughout 2019, recession fears swirled. In September, the percentage of fund managers expecting a worldwide downturn in the coming year hit a 10-year high, according to one survey.[xxx] Headlines cited tariff fears, yield curve inversions and manufacturing weakness to argue the long expansion was ending. Yet the world economy kept growing—tepidly, but growing. As 2020 begins, we expect economic growth to continue on this trend—fine for equities, which don't need rapid growth.

SERVICES KEEPS EUROPE AFLOAT

Europe appears to have logged yet another year of economic growth. This comes despite widespread fears over manufacturing weakness, which many presumed would infect the services sector and drive recession. Those fears relied mostly on IHS Markit's eurozone manufacturing PMI, which slipped below 50 in February 2019—and remained there the rest of the year.

Yet services and consumption dominate even more in developed nations than Emerging Markets such as China. Exhibit 14 breaks down the eurozone and its four biggest economies by sector. While manufacturing and industrial production sagged throughout 2019, IHS Markit's eurozone services PMI topped 50 every month.[xxxi]

EXHIBIT 14: VALUE ADDED BY ECONOMIC SECTOR

	Services	Heavy Industry	Agriculture
Euro Area	73.1%	25.2%	1.7%
France	79.2%	19.0%	1.8%
Germany	68.7%	30.5%	0.9%
Italy	74.0%	23.9%	2.2%
Spain	74.8%	22.1%	3.1%

Source: OECD, as of 09/01/2020. Value added by activity. Heavy Industry includes manufacturing, energy and construction. May not sum to 100% due to rounding.

Services and consumption are also why German GDP flipped from a contraction in Q2 to slight growth in Q3.[xxxii] Many feared struggling manufacturing would drag the eurozone's largest economy into a recession. Yet in the end, services and consumption pulled it along.

UPDATES ON JAPAN

The Upper House approved the Japan–US trade agreement, which will take effect in January. The deal benefits select industries such as Japanese manufacturing and US agriculture and leaves the door open to a broader agreement-though nothing looks imminent at the moment. The government also confirmed its fiscal stimulus plans: around ¥26 trillion (~$239 billion), which appears larger than the initial ¥10 trillion proposal. However, over half the total figure comes in the form of loan guarantees and other measures outside direct government spending. The actual increase to central and local government spending is a far smaller ¥9.4 trillion (~$87 billion).

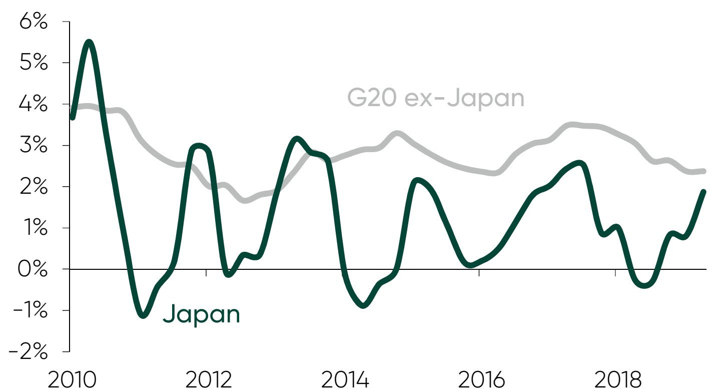
xxx "Global Fund Manager Survey," Michael Hartnett et al, Bank of America Merrill Lynch, 17/09/2019.

xxxi Source: FactSet, as of 06/01/2020. IHS Markit Eurozone Services PMI, January 2019 – December 2019.

xxxii Source: FactSet, as of 07/01/2020.

Overall, we expect skewed Japanese data for the near future. On 1 October, the country hiked its national sales tax from 8% to 10%. As is typical, many consumers front ran the hike. Retail sales surged 9.1% y/y in September, then fell -7.0% and -2.1% in October and November, respectively.[xxxiii] In 2014, a similar move caused a technical recession, as consumption plunged. Thus, weak Q4 GDP wouldn't surprise us. Yet we don't think it changes much. Japanese domestic demand and GDP growth was already anemic and likely stays that way (Exhibit 15). Hence, we remain underweight to the country and prefer its large, multinational exporters. That said, should sentiment deteriorate in the wake of rocky sales-tax driven data, it could present an opportunity. We don't see it today, but it is possible.

EXHIBIT 15: Y/Y GDP GROWTH – JAPAN VERSUS G20 EX-JAPAN



Source: FactSet, as of 31/01/2020. Latest data available: 30/09/2019.

PROTESTS RAISE UNCERTAINTY IN HONG KONG, BUT UNLIKELY TO TROUBLE BROADER MARKETS

As massive antigovernment protests rage on, Hong Kong's Q3 GDP contracted -3.2% q/q (-2.9% y/y)–putting the territory in technical recession following Q2's -0.5% q/q slip.[xxxiv] Uncertainty is high as the demonstrations show no signs of abating, but regional tensions don't necessarily imperil broader markets. 2014's protests didn't derail the global bull market or expansion, and Hong Kong comprises just 3.5% of the MSCI EAFE.[xxxv] Though an attention-grabbing social issue, we don't believe Hong Kong's recent tumult spells trouble for developed Asian and European markets.

xxxiii Source: FactSet, as of 06/01/2020. Japan retail sales, year-over-year percentage change, September, October and November 2019.

xxxiv Source: Census and Statistics Department, Government of Hong Kong, as of 04/11/2019.

xxxv Source: FactSet, as of 31/12/2019.

EMERGING MARKETS COMMENTARY

(JUST) FINE CHINA

China's slowdown continues sparking fear. Headlines say manufacturing weakness means tariffs are hurting. This isn't new—when it comes to China, pundits have hyped trade and tariffs for a year and a half. We think these fears remain false—mistaking the government's efforts to shift from manufacturing to services and liberalise its financial system for trade-war fallout.

Yes, China's manufacturing sector has been flat. The government's monthly manufacturing purchasing managers' index (PMI)—a survey tallying the breadth of growth—averaged 49.7 in 2019. Readings below 50 indicate more than half of firms reported contraction.[xxxvi] However, heavy industry no longer drives China's economy. In 1980, it accounted for 48.2% of output, while services generated just 21.9% (agriculture made up the rest).[xxxvii] The most recent data, from 2018, show heavy industry falling to 40.8%, with services jumping to 51.7%.[xxxviii] While manufacturing growth has flattened, the service sector remains strong—at 53.5, China's services PMI was nicely expansionary at 2019's close.[xxxix]

Meanwhile, China's financial reforms continue, a positive many misread by dwelling on symptoms like the occasional default.

The story starts a decade ago, when China's small private businesses struggled to access credit. These firms—China's underrated economic engine—faced a simple problem: State-run banks preferred lending to state-run borrowers, which gave the loan implicit government backing. This historically meant many small businesses would turn to loan sharks, pay high interest rates and, potentially, face personal risk.

To fix this, China legalised private lending and encouraged smaller, regional banks to boost credit to private firms. Much of this activity took place outside the traditional big banks—in the so-called shadow-banking sector. The industry—a mix of regional banks, asset managers and other entities involved in off-balance sheet lending—became a vital credit source for smaller Chinese businesses, supporting GDP growth. Yet shadow lenders grew bloated and non-performing loans rose. Officials, worried over long-run stability, cracked down in mid-2018.

That is a positive in the longer term, as it should help modernise China's banking system. However, in the short term it squeezed many smaller firms' credit access and caused trouble for lenders as their non-performing loans moved from the shadows to the books. Officials hope further reforms will entice large state-run banks to extend more credit to smaller, private companies.

Headlines painted this as a gathering storm in Q4, as Chinese corporate defaults ticked higher. We think this is backwards—illustrating a wide gap between sentiment and reality. Occasional defaults show officials are letting market forces take hold—a big long-term positive for China and the world. China's historical practice of preventing default and propping up or merging shaky borrowers directed capital to inefficient uses. Allowing defaults means capital finds a better home. The process won't be smooth—opening an economy as vast as China's to market forces involves trial and error, but for now the results are better than many fear. Credit growth is improving and the private investment slowdown has stabilised. Economic growth is slowing, but slightly—from a fast 6.2% y/y rate in Q2 to a still-quick 6.0% in Q3.[xl] To us, persistent worries over China suffering a severe slowdown—the "hard landing" dotting so many headlines since 2010—remain wide of the mark.

---

xxxvi Source: FactSet, as of 03/01/2020. Official China manufacturing PMI, January 2019 – December 2019.

xxxvii Source: OECD, as of 09/01/2020. Value Added by Activity. Heavy Industry includes the Industry (including Energy) and Construction categories.

xxxviii Ibid.

xxxix Source: FactSet, as of 03/01/2020. China official non-manufacturing PMI, December 2019.

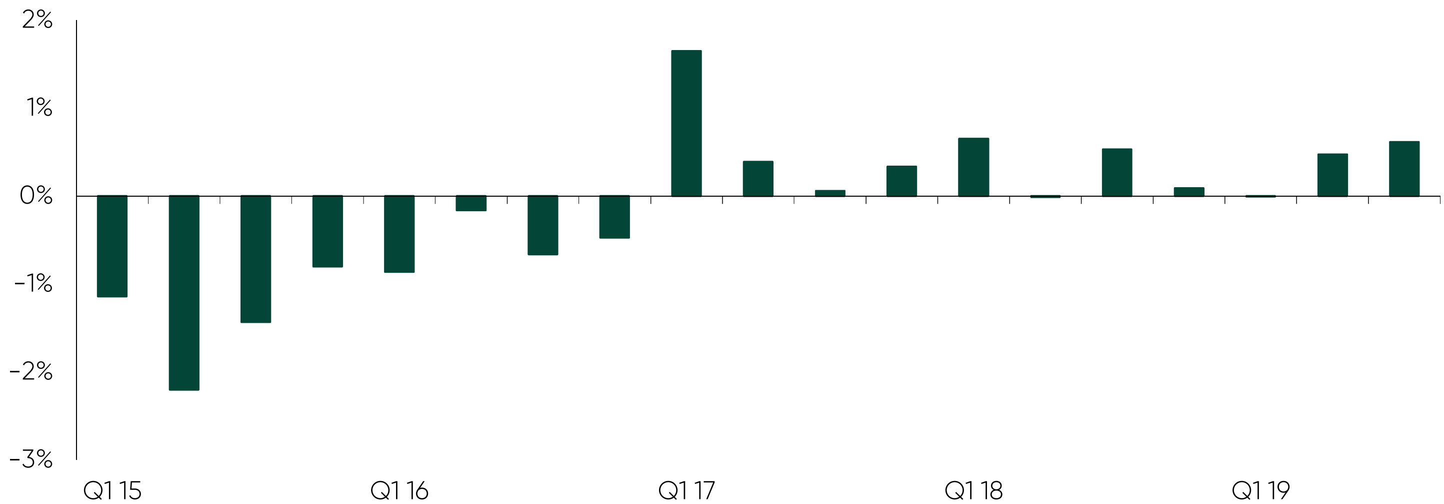
xl Source: FactSet, as of 07/01/2020.

POSITIVE REFORM IN BRAZIL

After years of back and forth, Brazil's parliament approved a pension reform bill on 22 October that proponents argue averts future fiscal disaster and paves the way for further market-friendly reforms. While it is too soon to say whether these materialise, the pension overhaul should be a long-term economic positive as well as a potential near-term sentiment boost. Brazilian equities fell in November as we believe investors bid up Brazilian equities ahead of the government's finalising pension reform in October, but rallied nicely to finish the year. While some fear President Bolsonaro's administration has now spent its political capital, we think this is too hasty of a conclusion.

Aiming to build on its pension success, last month the administration proposed measures intended to further improve Brazil's public finances by reducing spending and boosting its efficiency. Whether they pass likely depends on the economy's performance. Recent data on that front are encouraging. While not forward-looking, Brazilian GDP grew 0.6% q/q in Q3, good for its fastest pace since Q1 2018 (Exhibit 16).[xli] Should this continue, President Bolsonaro may have more latitude to keep pushing for difficult but helpful reforms.

EXHIBIT 16: BRAZILIAN REAL GDP GROWTH – Q/Q (IN PERCENT)



Source: FactSet, as of 10/12/2019. Seasonally adjusted quarter-over-quarter percentage change in Brazilian GDP, Q2 and Q3 2019.

xli Source: FactSet, as of 03/12/2019.

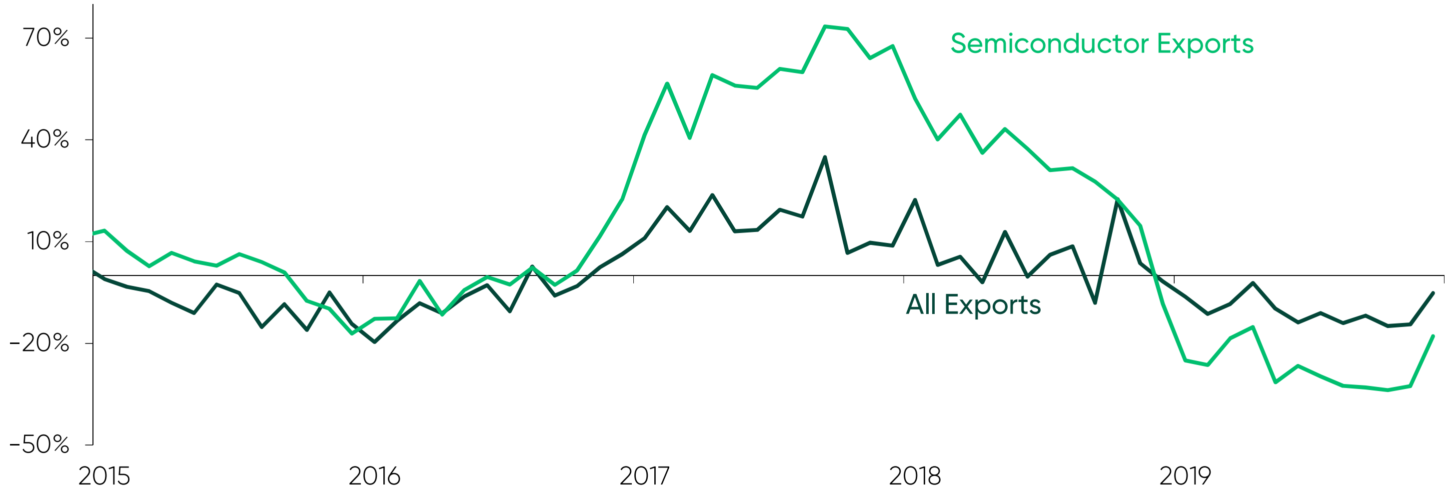
SOUTH KOREA

South Korea's government approved an expansive 2020 budget in December amid fears of the US/China trade dispute and a global semiconductor supply glut weighing on exports and growth.

The budget increases government expenditures by 9.1% y/y, building on 2019's 9.5% increase. Korea's finance ministry plans to frontload the outlays, with 70% coming in 2020's first 6 months. While the spending increase may incrementally boost Korean GDP in the next couple quarters, it seems more like an attempt to appease voters before next year's election than a lasting economic boost. Fiscal stimulus tends to have a modest impact outside recessions when private sector demand stagnates.

But we don't think Korea is in dire need of stimulus. Exports of manufactured goods receive significant attention, but Korea's economy is services-driven. The sector accounted for nearly 60% of GDP in 2017.[xlii] Moreover, while not all-telling, December's export figures included some encouraging details. The -5.2% y/y decline was the smallest since last April, and shipments to China rose 3.3%, their first increase in 14 months (Exhibit 17).[xliii] Stabilising prices for semiconductors-South Korea's top export-is also potentially beneficial.

EXHIBIT 17: SOUTH KOREAN EXPORT GROWTH SINCE 2015



Source: Thomson Financial Datastream as of December 2019, shows Y/Y % change in exports, based on monthly data.

xlii Source: Moody's Analytics, as of 02/01/2020. https://www.economy.com/south-korea/indicators#FACTBOOK

xliii "South Korea Dec. exports top forecasts as China demand, chip prices recover," Choonsik Yoo and Joori Roh, Reuters, 31/12/2019. https://www.reuters.com/article/us-southkorea-economy-trade/south-korea-dec-exports-top-forecasts-as-china-demand-chip-prices-recover-idUSKBN1Z01H3

CONTINUED CAUTION WITH INDIA

The MSCI India struggled in Q4 amid protests over a controversial citizenship bill.[xliv] The protests are disrupting some economic activity, particularly tourism. The law suggests Prime Minister Narendra Modi's administration may be more focused on social policy than needed economic reforms.

Recent economic data has generally been disappointing. Indian GDP growth slowed for the sixth straight quarter in Q3, to 4.5% y/y from Q2's 5.0%. The underlying data weren't encouraging, either. Imports and exports contracted for the first time since Q1 2016 (-6.9% and -0.4% y/y, respectively), implying weak domestic and external demand. Gross fixed capital formation—which includes business investment—limped along at 1.0% y/y. After rising by double digits from Q3 2017 – Q4 2018, it has been relatively flat this year. Fiscal stimulus and central bank rate cuts seemingly haven't helped the economy.

We suspect reform optimism has been a key support for Indian equities since Prime Minister Modi's reelection campaign. In our view, these hopes are likely still too high. Where the government did tweak economic policy last year, we think it was largely not a net benefit. Policymakers implemented several impediments to foreign companies expanding in the country-a turn towards protectionism that we view as a slight headwind. Hence, we don't anticipate Indian equities leading EMs in the near future.

> "WE SUSPECT REFORM OPTIMISM HAS BEEN A KEY SUPPORT FOR INDIAN EQUITIES SINCE PRIME MINISTER MODI'S REELECTION CAMPAIGN. IN OUR VIEW, THESE HOPES ARE LIKELY STILL TOO HIGH."

LATIN AMERICA ILLUSTRATES POLITICS' MARKET IMPACT

Protests and political upheaval hit Peru and Chile in October, with vastly different consequences and outcomes in each. Although each nation represents just a sliver of MSCI Emerging Markets (EM) market capitalisation, we think comparing and contrasting their fortunes helps illustrate the impact of political risk in this category.

Since Q4 2019 began, the MSCI Peru Index has risen 0.9%.[xlv] That is far behind the MSCI EM's 10.7% gain, and we think the culprit for this lag is political uncertainty.[xlvi] Yet it trounced the MSCI Chile's -14.9% plunge.[xlvii] In our view, exploring these countries' divergent political paths explains why.

PERU—PROTESTS AND PROGRESS?

Peru's protests erupted at the beginning of October, after President Martín Vizcarra's dissolved Congress in order to end a year-long stalemate with the far-right Popular Force (PF) party, which held a legislative majority, over reforms aimed at tackling corruption. In response, PF lawmakers refused to leave the chamber, instead voting to suspend President Vizcarra and elevate Vice President Mercedes Aráoz to the presidency. Protestors turned out nationwide in support of President Vizcarra, decrying what they saw as a coup by PF, which is led by Keiko Fujimori—daughter of Peru's former dictator. At the time, Fujimori was in jail awaiting trial on bribery charges—part of a scandal that ensnared Brazilian building company Odebrecht, four former Peruvian presidents and other high-profile figures. Many Peruvians see Vizcarra as a reformer who can tackle the corruption many think drives the nation's inequality. The courts eventually sided with President Vizcarra as well, declaring PF lawmakers' move illegitimate.

xliv Source: FactSet, as of 02/01/2020. MSCI India Index return with net dividends, in USD, 29/11/2019 –31/12/2019.

xlv Source: FactSet, as of 28/01/2020. MSCI Peru Index return in USD with net dividends, 30/09/2019 – 27/01/2020.

xlvi Source: FactSet, as of 28/01/2020. MSCI EM Index return in USD with net dividends, 30/09/2019 – 27/01/2020.

xlvii Source: FactSet, as of 28/01/2020. MSCI Chile Index return in USD with net dividends, 30/09/2019 – 27/01/2020.

Meanwhile, President Vizcarra scheduled a snap legislative election, signaling to markets that although the situation was unusual, it didn't threaten Peru's democratic institutions. That contest took place on 26 January, and PF was decimated, winning about 7% of the vote, meaning it will lose many of its 73 seats (out of 130) that it held until September. The tally hints at centrist opposition candidates collectively dominating the contest, likely making it easier for President Vizcarra to pass anti-graft measures, healthcare reforms and other policies he has pushed. However, time may limit how much he can accomplish, as the next presidential and legislative elections will occur on schedule in April 2021. With that said, however, easing political uncertainty, reform progress and the resolution of the Odebrecht scandal likely benefit Peruvian equities over the foreseeable future.

ONGOING UNCERTAINTY IN CHILE

Chile's path, however, is much more perilous. Over the years, Chile has emerged as one of South America's biggest free-market success stories. But after protests erupted in response to a subway fare hike, its entire system has been called into question. Months of rioting and looting have taken a severe economic toll. Monthly GDP fell -3.4% y/y in October and -3.3% in November as looters destroyed businesses. Protests continued in December and January, leading to a brutal police crackdown. Meanwhile, the government's response didn't inspire markets' confidence. After President Sebastián Piñera's pledges to freeze subway fares, raise wages and pensions, overhaul the tax system and replace his cabinet didn't placate protestors, he caved to their demands for a referendum on a new constitution. That vote will occur in April.

A constitutional referendum makes Chile's future totally unclear. It will ask voters two questions. One, do they want a new constitution. Two, if so, should ordinary citizens or a committee of citizens and legislators draft it. If the referendum passes, voters will pick the writers during October's local elections. Once selected, these writers won't have long to deliberate: The constitution must be published 60 days before a referendum on its final text, which would occur alongside November 2020's general election.

Since Chile's constitution is a hand-me-down from Augusto Pinochet's dictatorship, most observers agree some reform is necessary. However, rushing the process while the political environment is so unstable introduces risk. Investors' primary fear is that a leftist constitution will prevail, upending Chile's market structure and throwing its long-term prosperity in doubt. Even if the new text is less radical than feared, rushing a constitutional rewrite raises the risk of ill-considered changes and unintended consequences. History has repeatedly shown rushed constitutional rewrites that occur during periods of political instability create problems down the road, while the more deliberate processes (e.g., Spain) have more stability and success.

"INVESTORS' PRIMARY FEAR IS THAT A LEFTIST CONSTITUTION WILL PREVAIL, UPENDING CHILE'S MARKET STRUCTURE AND THROWING ITS LONG-TERM PROSPERITY IN DOUBT."

At the moment, markets appear to be pricing in investors' worst expectations. This raises the possibility for positive surprise if reforms are more incremental, but that possibility is impossible to predict now, and uncertainty looks likely to remain elevated for the foreseeable future.

ARGENTINA: UPDATE ON THE NEW GOVERNMENT

After winning October's presidential election, the left-wing Peronist ticket of Alberto Fernández and former president Cristina Fernández de Kirchner (no relation) took office on 10 December promising to end austerity and turn around Argentina's struggling economy. Despite their busy first couple months, we don't think the government's moves thus far will alleviate Argentina's considerable economic woes. Some look poised to make matters incrementally worse.

> "DESPITE THEIR BUSY FIRST COUPLE MONTHS, WE DON'T THINK THE GOVERNMENT'S MOVES THUS FAR WILL ALLEVIATE ARGENTINA'S CONSIDERABLE ECONOMIC WOES. SOME LOOK POISED TO MAKE MATTERS INCREMENTALLY WORSE."

On 21 December, the Senate passed an emergency economic reform bill. The sweeping legislation gives the president additional powers to raise taxes, increase wages and negotiate with Argentina's creditors without Congress's input. It also will allow the administration to tap up to $4.6 billion in central bank currency reserves to pay down dollar-denominated debt. Further, it will implement "tourist taxes" of 30% on transactions using foreign currency, including swapping pesos for other currencies, buying international flights and purchasing items overseas on a credit card. Finally, on the domestic front, it will freeze utility prices for six months and raise taxes on exports of select commodities, particularly agricultural products. Separately, the government has extended price caps on staple foods and doubled mandatory severance for laid-off employees.

In our view, these measures amount to reversals of quite a few reforms former President Mauricio Macri's government enacted. They amount to a range of economic negatives and will likely make it tougher for Argentina to achieve President Fernández's oft-stated goal of alleviating its debt load—currently 90% of GDP—via faster economic growth.[xlviii] The tax increases and higher employee severance costs may deter hiring and investment, while price caps typically create shortages and eventually stoke higher inflation. That said, the changes are largely in line with what Fernández telegraphed on the campaign trail and were less extreme than many feared. In our view, widespread concern over the administration's policy goals means further moderation could positively surprise.

However, politics aren't the only force affecting equities. Economic fundamentals matter, too, and Argentina's appear to be in poor shape. Argentine GDP grew 0.9% q/q in Q3, ending a recession (using one common definition of two or more months of quarterly GDP contraction) that started back in Q1 2018.[xlix] But significant headwinds still abound. Inflation—as measured by the headline Consumer Price Index—has exceeded 50% y/y since last February.[l] Capital is fleeing, despite government limits on converting Argentine pesos to foreign currencies. Between August and November 2019, Argentines withdrew $13.6 billion from their bank accounts (42% of the total) in anticipation of a weakening peso and further capital controls.[li] Meanwhile, dwindling central bank foreign currency reserves make it harder to service Argentina's debt. Big interest payments are due in the coming months, and there are signs Argentina may not honor them. The government already delayed payment on

xlviii "Fernández walks tightrope as he celebrates first month in office," Yemeli Ortega and María Lorente, Buenos Aires Times, 09/01/2020. https://www.batimes.com.ar/news/argentina/fernandez-treading-a-tightrope-as-he-celebrates-first-month-in-office.phtml

xlix Source: FactSet, as of 13/01/2020. Quarter-over-quarter percentage change in Argentine GDP, Q3 2019.

l Ibid.

li "What Argentina's Economic Crisis Means for Policy, in 7 Charts," Scott Squires, Bloomberg, 04/12/2019. https://www.bloomberg.com/news/articles/2019-12-04/what-argentina-s-economic-crisis-means-for-policy-in-7-charts?sref=5pwDyjiB

$9.1 billion worth of bonds in December and recently declined to help the distressed Buenos Aires province service its debt.

This may explain why a key component of the government's debt management strategy appears to be negotiating the burden down. The administration is seeking to restructure about $100 billion in debt, $44 billion of which it owes to the IMF. Since it isn't yet clear whether the IMF (or other private bondholders) will offer debt relief or extend maturities, default is a distinct possibility. Argentine 10-year and 100-year sovereign bonds trade around half of par value, suggesting bond markets sense the trouble.

Equities also seemingly recognise Argentina's troubles. The MSCI Argentina Index closed 2019 down -20.8%, with most of the decline coming directly after Fernández's August primary victory.[lii] In our view, this reflects markets' dim view of Peronist policies—unsurprising, given many blame former President Kirchner's Peronist administration (in office from 2007 to 2015) for sowing the seeds of Argentina's current problems. While the MSCI Argentina has risen 29.0% from its 2019 low on 3 September, we think this mostly reflects a "sell the rumor, buy the news" bounce once Fernández's victory seemed assured.[liii] In order to continue, the rally will likely require political moderation combined with more evidence the economy is turning up.

Looking ahead, we think Argentina's economy will likely continue to stagger. How equities fare likely depends on how debt negotiations go and whether the government's policies prove more moderate than expected. But at just 0.16% of the MSCI EM Index, Argentina's problems shouldn't threaten EM equities overall.[liv]

lii Source: FactSet, as of 13/01/2020. MSCI Argentina Index return with net dividends in USD, 31/12/2018 – 31/12/2019.

liii Source: FactSet, as of 22/01/2020. MSCI Argentina Index return with net dividends in USD, 03/09/2019 – 21/01/2020.

liv Ibid.

Should you have any questions about any of the information provided, please contact FIA at: Email: Australia@Fisher-Investments.com.au

Phone:+61 2 8211 0625

Mail: Level 25, Aurora Place, 88 Phillip St, Sydney NSW 2000

For clients in Australia, Fisher Investment's (FI) wholly-owned subsidiary, Fisher Investments Australasia Pty Ltd (FIA), which holds an Australian Financial Services Licence (#433312) with the Australian Securities and Investment Commission (ASIC), serves as the investment manager. In this arrangement, FIA delegates portfolio management to its parent company, FI. FI is an investment adviser registered with the United States Securities and Exchange Commission (US SEC). As of 30 September 2019, FI managed assets valued over $163 billion AUD. FI maintains two principal business units – Fisher Investments Institutional Group (Fisher) and Fisher Investments Private Client Group (FIPCG). FIPCG manages and serves a variety of equity, fixed income, and balanced assets for significantly all of FI's private client accounts. FIIG services significantly all of FI's institutional accounts. FI's Investment Policy Committee (the IPC) has ultimate decision-making authority and accountability for the firm's strategies.

Unless otherwise specified, references to investment professionals, operations personnel, and middle and back office personnel are references to FI employees. "We", "our," "us" and "the firm" generally refer to the combined capabilities of FIA and FI.

The foregoing information constitutes the general views of FI and should not be regarded as personalised investment advice or a reflection of the performance of FI managed strategies. There can be no assurances that they will continue to hold this view; FI may change its views at any time based on new information, analysis, or reconsideration. This analysis is for informational purposes only. It has been formulated with data provided to FI and is assumed to be reliable. FI makes no claim to its accuracy. Investing insecurities involves the risk of loss.

This material is designed for use with wholesale prospects and clients.