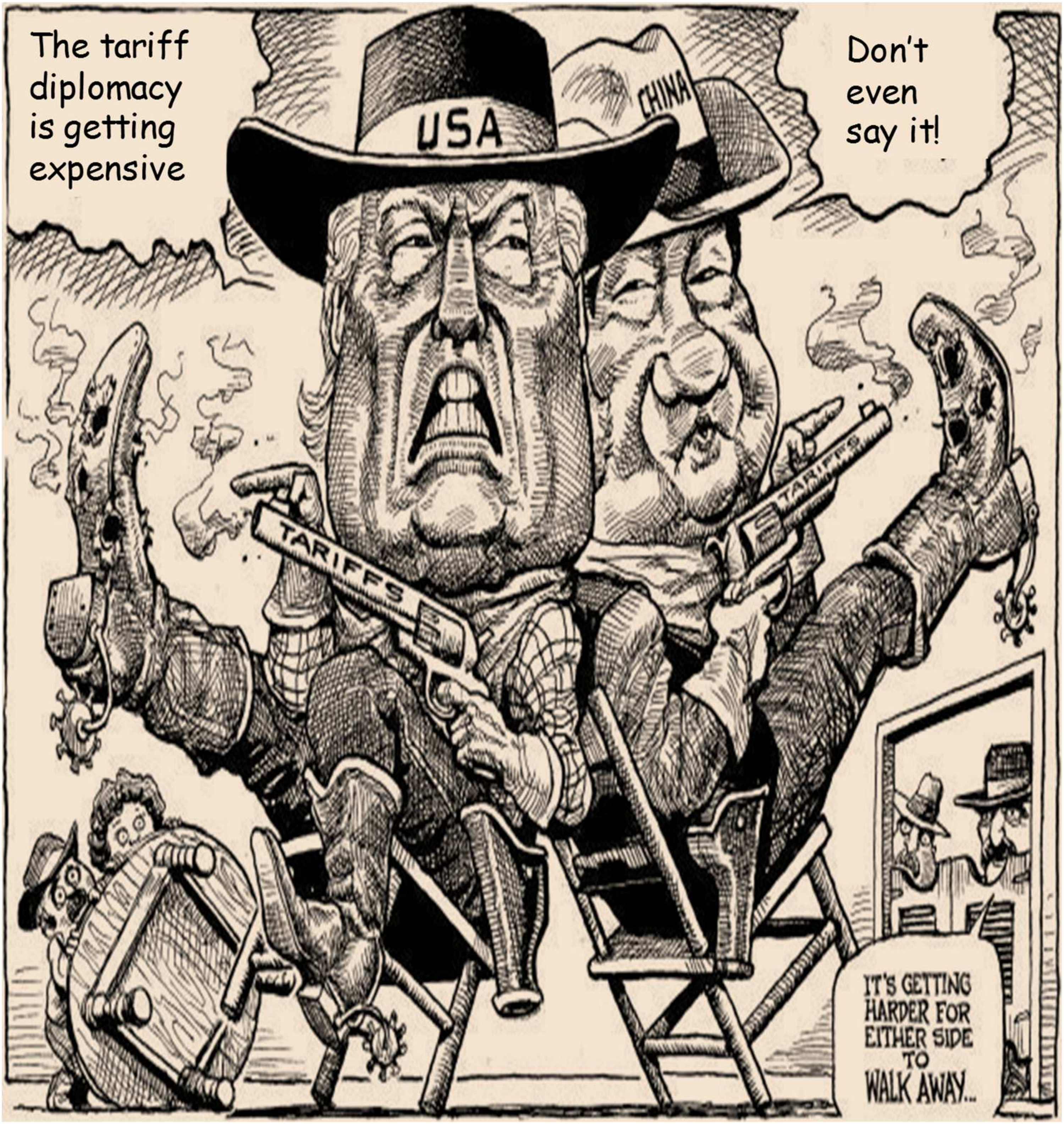
GLOBAL OUTLOOK

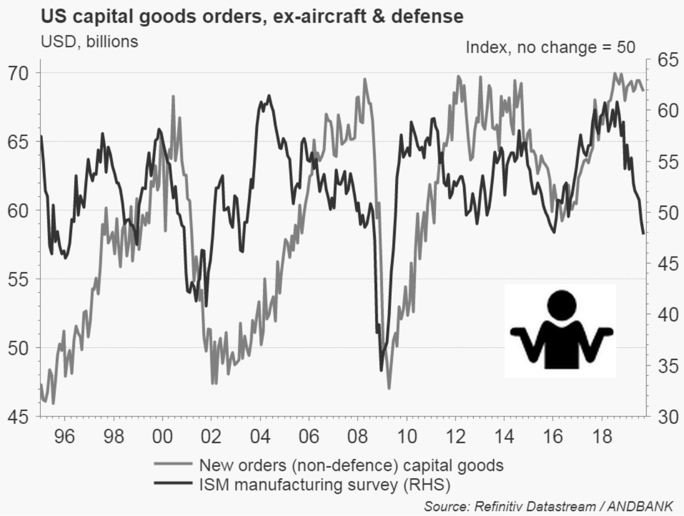
ECONOMY & FINANCIAL MARKETS

Andbank Monthly Corporate Review | Global Strategic Outlook – November 2019



EXECUTIVE SUMMARY

CHART OF THE MONTH



EQUITIES

US S&P: UW-MARKETWEIGHT. Target 2,900. Exit point 3,100. ***Stoxx 600 Europe***: MARKETWEIGHT. Target 387. Exit 406. ***Euro Stoxx:*** MARKETWEIGHT. Target 379. Exit 398. ***Spain IBEX:*** OVERWEIGHT. Target 9,425. Exit point 9,900. ***Japan N225:*** MW-UW. Target 22,250 (Exit 22,700) . ***China SHANGHAI Idx:*** MW-OW. Target 3,176. Exit 3,240. ***SHENZHEN Idx:*** MW-OW. Target 1,757. Exit 1,800. ***India SENSEX:*** MARKETWEIGHT-OW. Target 40,023. Exit 42,000. ***Israel TLV35 Index:*** MARKETWEIGHT (Fairly valued). ***Brazil IBOVESPA:*** MARKETWEIGHT (Target 103,000. Exit point 103,300). ***Mexico IPC Index*** : OVERWEIGHT. Target 43,000. Exit 45,400. MARKETWEIGHT.

FIXED INCOME

Fixed income markets performed poorly last month. Valuations continue to be extreme, especially in European bonds but we believe support from central banks will not disappear in the short term. ***UST 10Y:*** UW-MARKETWEIGHT. (10Y UST entry point 1.8%). ***German Bund:*** UNDERWEIGHT (Bund target -0.30%). ***Spanish bono:*** UNDERWEIGHT, target 0.50%. ***Italian bond***: MARKETWEIGHT, target 1.0%. ***Portuguese bond:*** UNDERWEIGHT, target 0.60%. ***Irish bond:*** UNDERWEIGHT, target 0.00%. ***EM bonds Asia:*** OVERWEIGHT (preferred Indonesia, India, Philippines, Malaysia and Singapore. Avoid Taiwan, South Korea and China). ***EM bonds Latam:*** OVERWEIGHT (preferred Mexico in local and Brazil in USD).

CORPORATE CREDIT

EUR Credit: Global economic deterioration, together with the increase in the supply of corporate paper in Europe and the recent profit taking by investors (following the 6% returns seen in IG and 8% in HY bonds), should lead to a widening of spreads. Default rate forecasts for US and European issuers have been raised to 3% and 2.8%, respectively. All said, reduced uncertainty around trade negotiations, the Brexit saga drawing to an end and the ECB implementing its APP could provide a tailwind for corporate bonds (specially the BBB-rated ones). We would continue betting on more defensive (non-cyclical) sectors, such as telecommunications, and utilities. ***IG € (Itraxx):*** UNDERWEIGHT (Target Spread 65). ***HY € (Xover):*** UNDERWEIGHT, target 270. ***US$ CDX IG:*** MARKETWEIGHT, target 50. ***Credit $ CDX HY:*** UNDERWEIGHT, target 390.

CURRENCIES

Preferred currencies: USD & BRL. The currencies that we like least are: JPY, CHF, MXN, RUB, CAD

COMMODITIES

Sell WTI above US$65. Russia fails to meet September pact target. Japan considering dispatch of naval assets to Middle East. US and Saudi Arabia step up efforts to protect kingdom's oil production. Loss of momentum as bullish bets hit a nine-month low.

USA

Partial deal with China. Corporate results above expectations

Geopolitics

Phase one of the partial deal between China and the US has boosted sentiment. We know that China has promised to buy more agriculture imports from the US, potentially up to USD 40–50 billion annually, which is certainly an attractive figure for the interests of the US, compared to USD10bn of purchases of agricultural products in 2018, after peaking at USD29bn in 2013. From the US side, the increase in US tariffs from 25% to 30% scheduled for 15 October has been postponed and negotiations on completing a phase 1 deal will continue. From here, we believe that the possibility could be opened to see a phase 2 of a trade agreement, which would represent progress in the areas of strengthening intellectual property protection laws and improving accessibility to the Chinese local market for financial services. In return, the US would offer to cancel the tariff's increase that was to be implemented in December. The key question is whether these agreements can be stable and give rise to a sequence of small developments that, taken together, represent a substantial improvement in the situation. There are two reasons that make us to be optimistic: First, there will be a monitoring mechanism on compliance with the agreed. Second, the promises do not seem difficult to keep (in April, the National People's Congress in China already strengthened the protection of intellectual property, and in July, Beijing softened restrictions on foreign investment). It was a very good initiative of Beijing to put in different baskets national security issues (on which understanding is difficult) and purely commercial matters (on which we are already moving forward). That is why we are faced with a partial agreement.

Fed

Fed speaker provided little pushback to market pricing for another 25 basis point cut this month. Vice Chair Clarida noted that while the economy is in good shape and the outlook remains favorable, "evident" risks remain. Clarida also re-emphasized that the Committee will "act as appropriate" to sustain the expansion. Most other Fed officials have indicated they are taking a meeting-by-meeting approach, given the nature of the trade policy uncertainties they are facing. The Fed's repo operations have clearly reduced volatility in the repo market, but this is by no means a permanent solution. Fed speakers have commented that the recent repo strains indicate the market may need more liquidity and that we are approaching the steep point of the demand curve for reserves. We also expect the Fed to rebuild aggregate reserves to $1.5 trillion, implying up to $220 billion more asset purchases.

Equities, bonds & credit

The corporate results season has begun and, although only 20% of the SP500 index have published so far, the results are above analysts' expectations. With no confirmation of a third interest rate cut this year by the Fed later this month, the SP500 is still expected to end the year at 2,900. Credit spreads have benefited from the positive news on trade and some technical aspects are also supportive, with very light supply, lower FX hedging costs, and investors cautiously positioned. High-yield bonds are up, with BB-rated bonds providing stronger gains than B and CCC-rated bonds. YTD total volume of defaults has now surpassed last year's full-year volume, with the US high-yield default rate currently fixed at 2.81%.

Financial market assessment

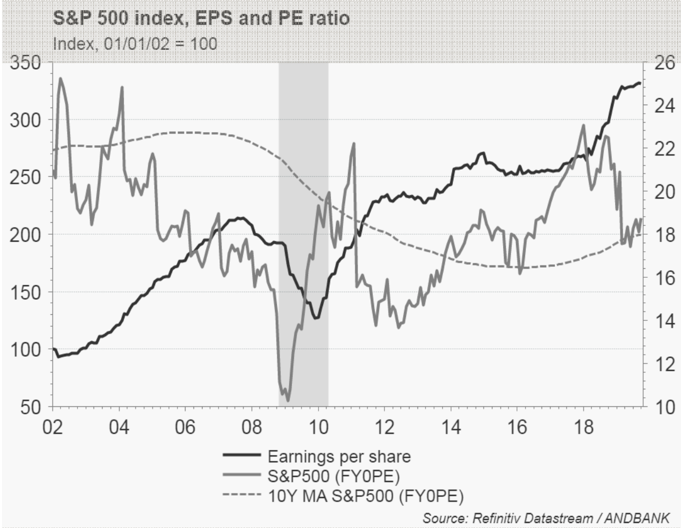
Equities – S&P: UW-MARKETWEIGHT. Target 2,900. Exit point 3,100)

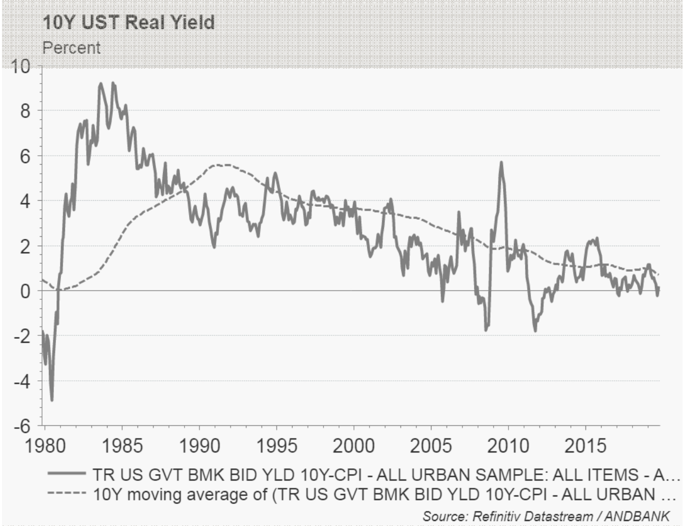
Bonds – Govies: UW-MARKETWEIGHT. (10Y UST entry point 1.8%)

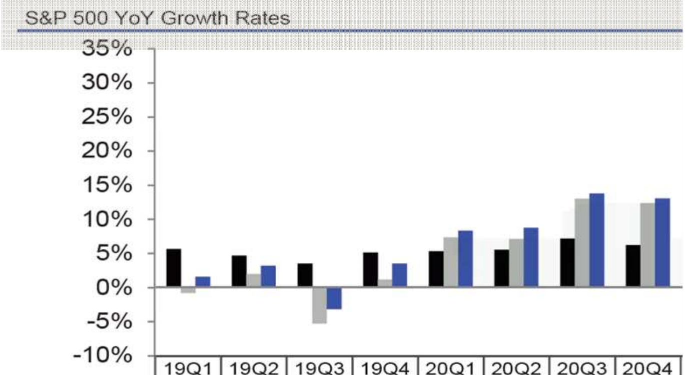
CDX IG: MARKETWEIGHT (Target Spread 50)

CDX HY: UNDERWEIGHT (Target Spread 354)

Forex – DXY index: MARKETWEIGHT







	19Q1	19Q2	19Q3	19Q4	20Q1	20Q2	20Q3	20Q4
Revenue	5.7%	4.7%	3.5%	5.1%	5.3%	5.5%	7.2%	6.2%
Net Income	-0.8%	2.0%	-5.3%	1.2%	7.4%	7.2%	13.0%	12.4%
Earnings	1.6%	3.2%	-3.2%	3.5%	8.3%	8.8%	13.8%	13.1%

Source: I/B/E

EUROPE

Equity market reaches our central target point

Economics & ECB

Industrial PMIs receded again in September and some contagion could also be felt in the service sector. Industrial production fell and we saw less dynamism from job creation and weak external numbers. Fiscal stimulus remains the mostly demanded policy, but willingness to increase public spending remains subdued. Germany has stated that "they have done enough"; meanwhile, the French Government's draft budget envisages a cut to the lowest income tax rate. The Eurogroup has recently agreed on the final key elements of a common €20bn budget to facilitate investments and reforms and boost poorer nations. As for inflation, low readings have come with a new target of 1.5%, suggested by some ECB members. Disagreement within the Council regarding QE has been remarkable and should limit Lagarde's first steps. Despite a likely downward revision in the December macro projections, the ECB may not act unless we face a shock

Geopolitics

The WTO authorized $7.5bn in US tariffs on EU goods due to illegal state aid for Airbus. The US Treasury announced it would impose tariffs of 10% on EU aircraft parts and 25% on EU consumer goods on October 18th. The EU has stated that it could retaliate soon. With the WTO ruling on Boeing subsidies to become public shortly and the EU having demanded ~$12 billion of tariffs on US products, a bilateral negotiation should avoid a tariff war.

Equities & Bond market (Govies & credit)

Equities: We have started the 3Q19 earnings season. Yoy profit growth is expected to fall -3.7%. 1Q and 2Q results showed yoy growth of -2% and -2.1%. According to Lipper (based on companies' projections), there will be a strong recovery in profit growth in 4Q19 (+9.1% yoy). That would leave us with FY19 EPS growth of +1.3%. We had set our forecasts for FY19 EPS growth at 1.1% and we maintain that level unchanged, resulting in an expected EPS of €26 for the Stoxx 600. Keeping our year-end PE multiple at 14.7x puts our central target price for this index at 387. Exit point at 406.

Bonds: We stick to our target for the bund (-0.3%). Should the Brexit issue be resolved, we would get a further spike in yields. As for the peripheral spreads, the Italian draft budget points to a "no-clash" scenario with the EU. Flows remain supportive of these assets, benefitting from the announcement by the Japanese Government Pension Investment Fund (GPIF) of plans to buy more forex-hedged foreign debt. ***Corporate bonds:*** Global economic deterioration, together with the increase in the supply of corporate paper in Europe and the recent profit taking by investors (following the 6% returns seen in IG and 8% in HY bonds), should lead to a widening of spreads. Default rate forecasts for US and European issuers have been raised to 3% and 2.8%, respectively. All said, reduced uncertainty around trade negotiations, the Brexit saga drawing to an end and the ECB implementing its APP could provide a tailwind for corporate bonds (specially the BBB rated ones). We would continue betting on more defensive (non-cyclical) sectors, such as telecommunications, and utilities. Underweight automakers and industrials.

Financial market assessment

Equities – Stoxx Europe: MARKETWEIGHT. Target 387. Exit 406

Equities – Euro Stoxx: MARKETWEIGHT. Target 379. Exit 398

Bonds – Core governments: UNDERWEIGHT (Bund target -0.30%)

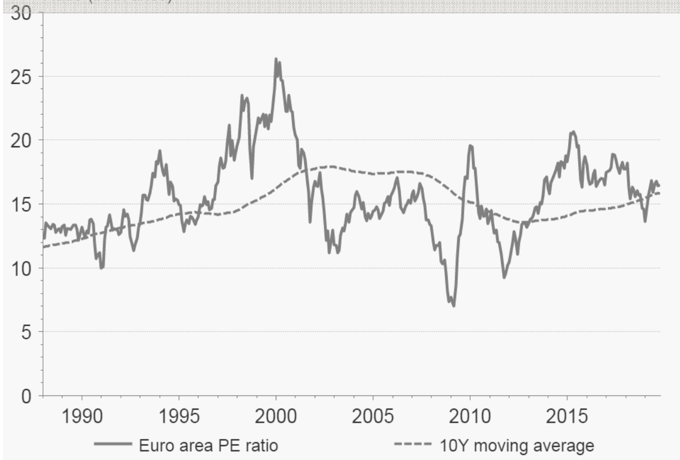
Bonds – Peripheral: UW (SP 0.50%, IT 1.0%, PO 0.6%. IE 0%)

Credit – Itraxx Europe (IG): UNDERWEIGHT (Target Spread 65)

Credit – Itraxx Europe (HY): UNDERWEIGHT (Target Spread 270)

Euro area price-to-earnings ratio

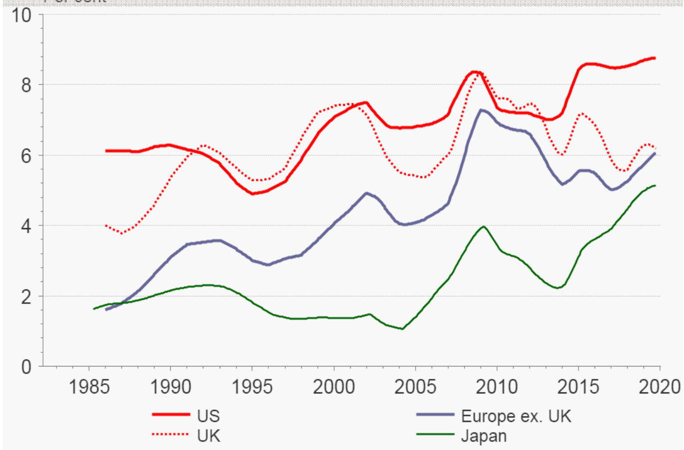
Ratio (both axes)



Source: Refinitiv Datastream / ANDBANK

Net profit margins

Per cent



Source: Refinitiv Datastream / ANDBANK

Euro STOXX banks Index

Source: Refinitiv Datastream / ANDBANK

SPAIN
General elections will not be disruptive, but will not help

Politics: The small risk premium on Spanish assets will continue.

Any doubts as to whether political instability (ungovernability) in Spain has a financial cost have just been dispelled. There is a financial cost for political ineffectiveness in terms of inability to form a government. This is evidenced by the fact that in Portugal, where a government coalition of left-wing parties has been revalidated, we see how the whole interest rate curve, at all maturities, is already trading at cheaper financing rates than in Spain. The question we ask ourselves is whether this risk premium in Spain will persist or not. The answer has a lot to do with the possible outcome of the November 10 elections, and of course, the willingness and ability of the parliamentary groups to negotiate and form a government. According to the polls, the new elections will leave us with practically the same result as in April: neither of the two political blocs will win a majority, so any government should have the support of at least two parties and the abstention of others. There are those who refer to certain “details” that would facilitate the formation of a government (although it will likely be a weak government). The two-party system has reasserted itself, with each of the major parties leading its bloc and with the “Third way” succumbing to the presumed electoral collapse of Ciudadanos (which would have to join the abstention bloc to allow the hypothetical formation of a minority government). Some Catalan parties could also join the abstention group that could facilitate the formation of a government. The bad news, from a market point of view, remains the inability of the two major parties to offer a stable grand coalition, an option that appears to have been discarded (whether due to the lack of a tradition of coalition government or some other reason). Similarly, the possibility of incorporating the left-wing party Podemos in a minority government with Sánchez’s PSOE also seems blurred. The formation of a stable government seems even more difficult today than it was before, which suggests that the small risk premium on Spanish assets will persist.

Economics

We update our macro outlook to reflect the changes in the methodology for GDP calculation, which has led the INE to cut nominal GDP growth by 0.4% in the period 1995-2018. Due to the statistical review in the 2016-2018 period, real FY18 GDP growth has been revised downwards and is now fixed at 2.4%, two tenths below the previous reading. This lower growth is explained by the downward revision of domestic demand, mainly private consumption demand (+1.8% for FY18, half a point less than in the previous series) but also, to a lesser extent, public consumption demand (+1.9%, or two tenths lower). At the same time, the investment figures and the external contribution are maintained. This change has caused us to reduce expected GDP growth for FY19 by 15 basis points, to 1.85%. On the other hand, we continue to receive data suggesting a slowdown in domestic demand. The good news is that we know where this drop in consumption has gone, as we have witnessed a sharp rise in the savings rate (which has gone from 6% to 8.7% of gross income in this first half). Reflecting our lower projections for growth in consumption (which we have reduced to 0.9%), this results in a cut in our projections for FY19 GDP growth, which we now estimate at 1.8%.

Financial market assessment

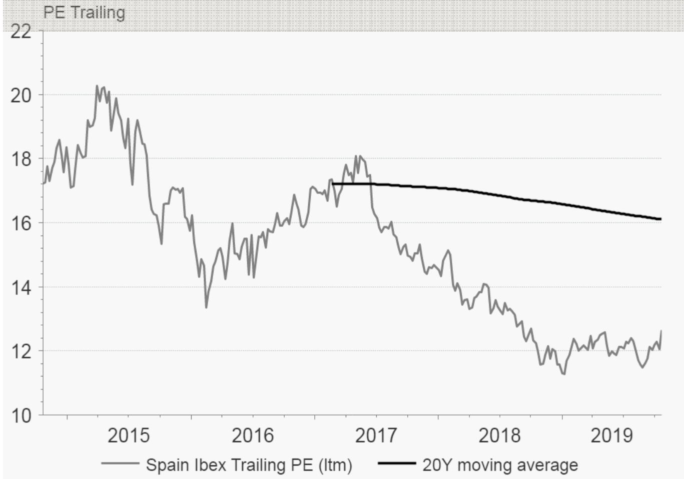
Equities – IBEX: OVERWEIGHT. Target 9,425. Exit point 9,900

Bonds – Government: UNDERWEIGHT (BONO target yield 0.50%)

Credit – Investment grade: UNDERWEIGHT

Credit – High yield: UNDERWEIGHT

SPAIN IBEX
PE Trailing

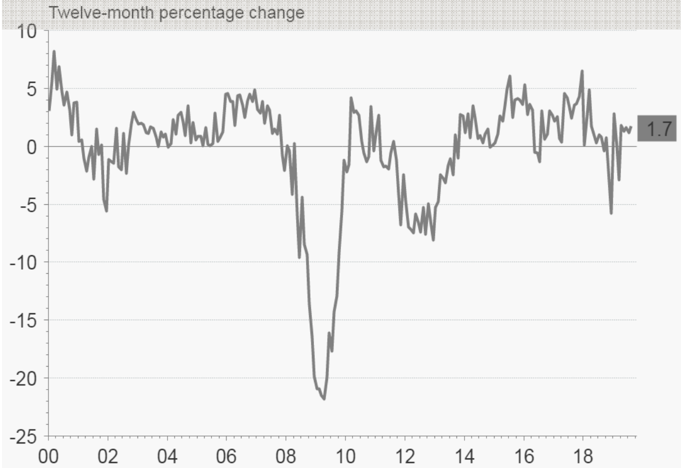


Source: Refinitiv Datastream / ANDBANK

Spain - 10Y government bond Real Yield
Percent

Source: Refinitiv Datastream / ANDBANK

Spain industrial production
Twelve-month percentage change



Source: Refinitiv Datastream / ANDBANK

JAPAN

BOJ on course to shrink bond holdings. Likely to rethink its tapering

Inflation falls again. Trade deal with US to boost Japan's GDP

Prices: September Overall CPI +0.2% yoy (vs +0,3% in August). Nationwide core CPI +0.3% y/y (versus +0.5% in August).

Activity: August final (revised) industrial production growth was -1.2% m/m vs +1.3% in prior month.

The government estimated that the US-Japan trade deal will boost GDP by ~0.8%, contributing around JPY4T to the economy based on FY18 levels. The agreement is also expected to create ~280K jobs in Japan. Meanwhile, IMF Deputy Managing Director Furusawa said that Japan could boost fiscal stimulus if the consumption tax hike derails growth. He noted that if growth slows by more than expected, fiscal support might be necessary and would be accompanied by continued monetary easing. Japanese Finance Minister Aso added that the government was ready to adopt fiscal measures flexibly if required.

BoJ: Readiness to ease policy if needed

Governor Haruhiko Kuroda reiterated that QQE will remain at least through spring 2020. Nevertheless, the BOJ could be on course to shrink its bond holdings next year for the first time in a decade if purchases continue to taper at the current rate, with gross purchases likely totaling ¥49.4T in 2020, compared with at least ¥55.9T in redemptions. The prospect of a fall in debt holdings may prompt the BOJ to rethink its tapering or even overhaul its policy. In the meantime, Kuroda also dampened projections over growth, saying that "the expected pickup in global economic growth will likely be delayed". Kuroda noted that "Japanese exports are weakening significantly against a backdrop of soft external demand, which in turn is affecting factory output". He reiterated the bank's readiness to ease policy "without hesitation" if risks threaten to derail its inflation goal, adding that there is room to act if needed. The effects of the NIRP are being felt in the private sector, with Toyota Finance issuing Japan's first zero-rate corporate bond 25-Oct, as subzero yields spill over from government bonds to private-sector debt.

Reforms: Tightening investment requirements for foreigners

The government has approved draft legislation that will require foreigners to report in advance when they intend to acquire more than 1% of shares in companies related to Japan's national security. That compares to the current threshold of 10%. However, foreign investors would be exempt from the requirement if they have no intention of influencing corporate decisions or the investment is in sectors that are not linked to national security. Asset management companies, including hedge funds, will be exempt from tighter foreign investment regulations designed to protect sensitive industries.

Corporate Japan steps up divestments. Business outlook is weak

Recof data showed that Japan's company divestments (excluding overseas units) totaled 219 in the nine months through September, the highest number since the global financial crisis. The story noted the proactive nature of such activity now, compared to the defensive restructuring strategies employed in the past. This trend is framed in an environment of negative expectations among businesses, as almost all Japanese companies in the Corporate Survey said the economy will level off or fall into recession in the coming months, which would mark an end to the "Abenomics" expansion that the PM launched in late 2012.

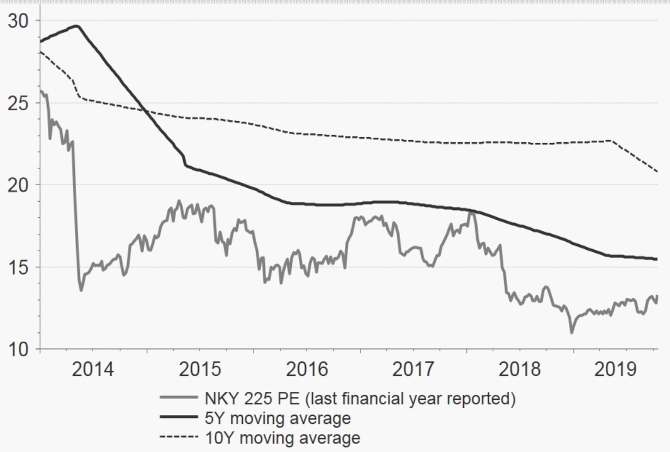
Financial market outlook

Equities – N225: MW-UW. Target 22,250 (Exit 22,700)

Bonds – Govies: UNDERWEIGHT. Target yield 0.00%

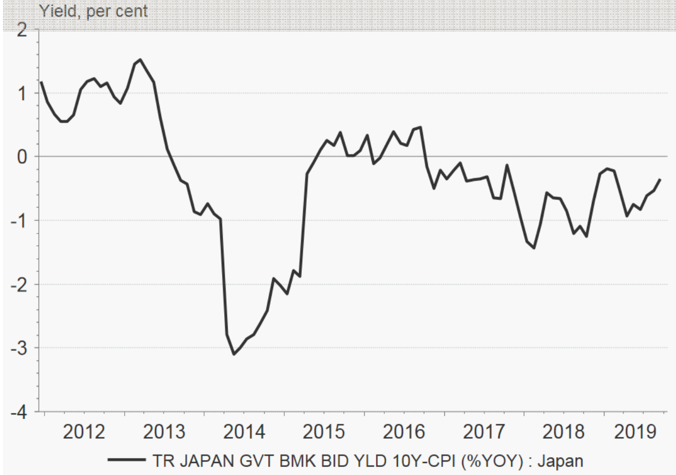
Forex – USD-JPY: UNDERWEIGHT. Mid-term target 112

Japan Nikkei 225 price / earnings
Ratio



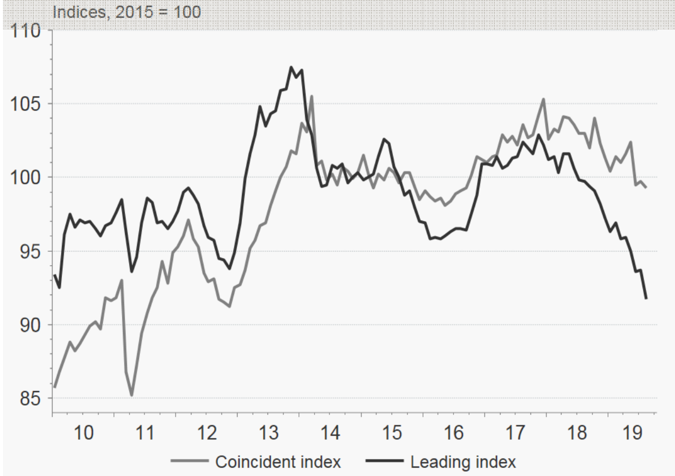
Source: Refinitiv Datastream / ANDBANK

10Y JGB - Real Yield
Yield, per cent



Source: Refinitiv Datastream / ANDBANK

Japan composite indices of business conditions
Indices, 2015 = 100



Source: Refinitiv Datastream / ANDBANK

CHINA

Liu confirms Phase 1 of trade deal is in progress. Kudlow points the good momentum

Trade war: Vice Premier Liu He commented at a conference in Nachang that China and the US have made substantial progress and laid an important foundation for a Phase one agreement. Also, the Ministry of Commerce said that Chinese officials are working on the text of an agreement on trade with US negotiators, while reiterating that "China wanted to end the trade war and remove all tariffs". On the US side, White House adviser Larry Kudlow told CNBC that "there is a lot of momentum to finish the trade deal, and that people shouldn't be so pessimistic on the talks". Government advisers from both sides suggested that Xi and Trump could sign a preliminary deal at the APEC meeting in Chile next month, ahead of a second-phase deal that encompasses managing the yuan. However, differences on how to ensure implementation could delay a Phase two deal until H2 2020. Meanwhile, sources reported the IMF Managing Director Georgieva as being encouraged by news of a tentative US-China trade deal. She estimated a potential impact of 0.6% to global growth.

Data

Q3 GDP +6.0% y/y vs consensus +6.1% and +6.2% in prior quarter. September industrial production +5.8% y/y vs consensus +5.0% and +4.4% in prior month. Fixed asset investment (YTD) +5.4% y/y vs +5.4% in prior month. Retail sales +7.8% y/y vs +7.5% in prior month. Unemployment rate 5.2% vs 5.2% in prior month. The vacancy rate in 17 major Chinese cities climbed to 21.5% in Q3, the highest since at least 2008. Overseas companies are waiting for an end to hostilities in the U.S. trade war before committing to new leases; skyscrapers built during the boom years are unleashing a wave of supply.

Stimulus: China more than doubles September approval for fixed-asset investment

The National Development and Reform Commission (NDRC) approved CNY177.8B ($25.15B) of investment in 14 fixed-asset projects in September, mainly in the transportation sector. That compares with CNY68.9B in August. The accelerated approvals this year have failed to provide a substantial boost to the actual investment growth. Many local governments are facing increasing fiscal strains as the tax cuts and the broader economic slowdown reduce revenues.

Reforms: Apple CEO Tim Cook met with China market regulator

The State Administration for Market Regulation noted that regulatory chief Xiao Yaqing met with Apple CEO Tim Cook in Beijing on Thursday. Topics included Apple expanding investment in China. The meeting comes after Apple was criticized by state media for an app (which it subsequently pulled from the App Store) that assisted Hong Kong protestors track police movements. China will introduce measures to foster a more enabling business environment. Restrictive measures outside the free trade zones concerning foreign investors' market access will be scrapped. Forced transfer of technology, including transfers in disguised forms, is not allowed. Trade secrets will be protected in accordance with the law.

Corporate profits: Bearish guidance

About 44% of more than 1,200 firms that have given profit guidance for the third quarter have predicted worse earnings than from a year earlier. Earnings are still deteriorating after a wave of profit warnings in the first half. The earnings guidance pool is dominated by Shenzhen-listed firms.

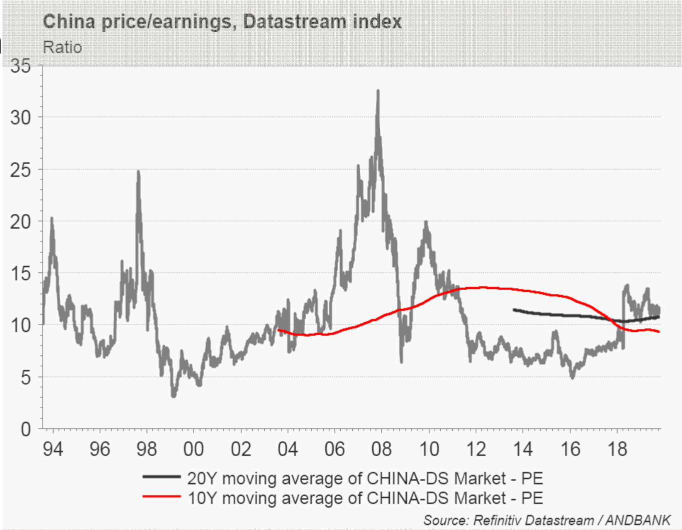
Financial market outlook

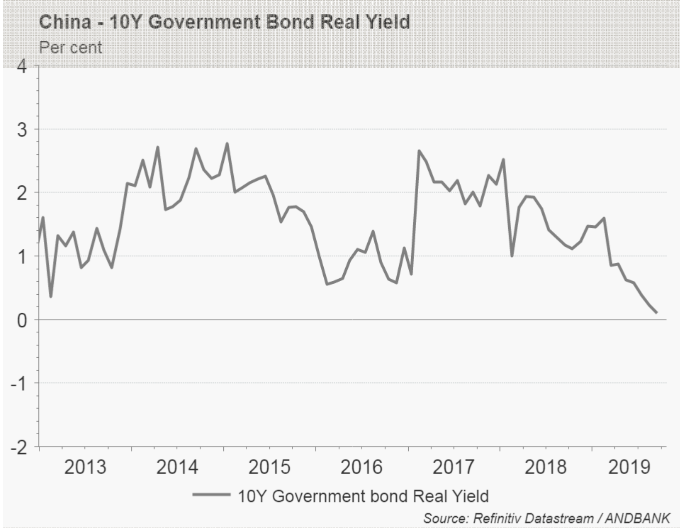
Equities– SHANGHAI Idx: MW-OW. Target 3,176. Exit 3,240

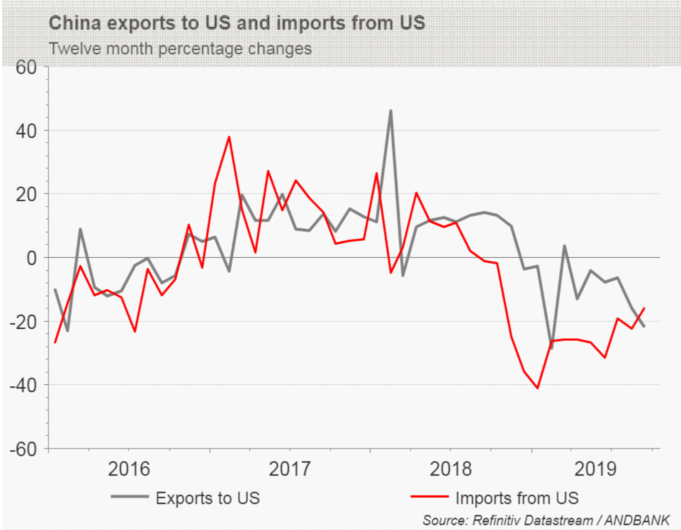
Equities – SHENZHEN Idx: MW-OW. Target 1,757. Exit 1,800

Bonds – Govies: MW-UW (target yield 3.25%)

Forex – CNY/USD: MW (target 6.9)







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MACRO ECONOMY

INDIA

Transformation and further liberalizing reforms

Politics now leaves space on the agenda for the economy

There is now another important election on October 21 in Maharastra, India's richest state, where the ruling BJP is poised to repeat the stellar performance shown in April's national elections, helped by an alliance with the right-wing Shiv Sena party (aligned with BJP's Hindu nationalist agenda). Indian PM Modi spent the first nine months of his second term prioritizing politics (e.g. repealing the 70-year old law that granted the Muslim-majority state of Kashmir internal autonomy in order to fire up nationalist voters), but with GDP growth now at its six-year low the economy has become Modi's top priority.

A 180º turn in economic policy demonstrates the ability to react

Back in July, with GDP growth falling to 5%, the finance minister Sitharaman inexplicably decided to raise taxes (in order to fix the deficit). Right after that, and as markets slumped, the government changed its mind and made a substantial cut to corporate taxes (from 30% to 22%), leaving India's corporate tax in a very competitive position at regional level, only surpassed by HK, Singapore, Taiwan and Cambodia). In September's trade meeting in Houston, Modi also tried to get the attention of international producers and lauded India's revised 15% tax rate for new manufacturing firms. The government followed by scrapping higher taxes on capital gains, dropped a surcharge on foreign investors, eased foreign investment rules and announced a plan to consolidate 12 state banks. With India close to signing a new trade agreement with the US and agreeing to join the Regional Comprehensive Economic Partnership—set to create the world's biggest free-trade zone—Modi is keen to show that India is open to the world. The message is clear: This government is friendly, not hostile, to capital.

More liberalizing reforms are coming

Even PM Modi's advisors seem to be surprised by the transformation and the sense that further liberalizing reforms will follow. Talk is of a middle-class income tax cut aimed at reviving sagging consumption. Another "possibility" is a renewed push to ease outdated land and labor laws (unfinished business for Modi). There are also reports indicating that privatization is back on the agenda (the state carrier Air India will be put back on the market, but this time without the onerous restrictions that put off buyers the first time). The government is also preparing to ask parliament to approve the sale of its entire shareholding in four big public companies (including Bharat Petroleum, sixth largest company by sales). One of the motivations for selling off state assets is to help fill the fiscal hole, specially if we consider that structural reforms always take a few years to achieve the desired results (the government saw this with the implementation of the GST reform and the new bankruptcy code). Corporate tax cuts will improve corporate profitability, helping companies to preserve jobs; but companies only start investing when consumer demand picks up. It will be a year or two before a new wave of direct investments materializes. Meanwhile, the recent failure of the Punjab and Maharashtra Co-operative Bank forced the RBI to release a communiqué denying there was a systemic threat to the banking system. The credit crunch in the shadow banking sector (a vital source of small loans) continues to weigh heavily. Non-bank financial companies still cannot get any money from banks. **The risk is that looser fiscal policy will push up interest rates.** Sitharaman recently instructed 32 large central public enterprises to spend more quickly. This, together with the rest of the fiscal measures, could push up interest rates. If bond investors take fright, the rupee could also come under pressure.

Financial market outlook

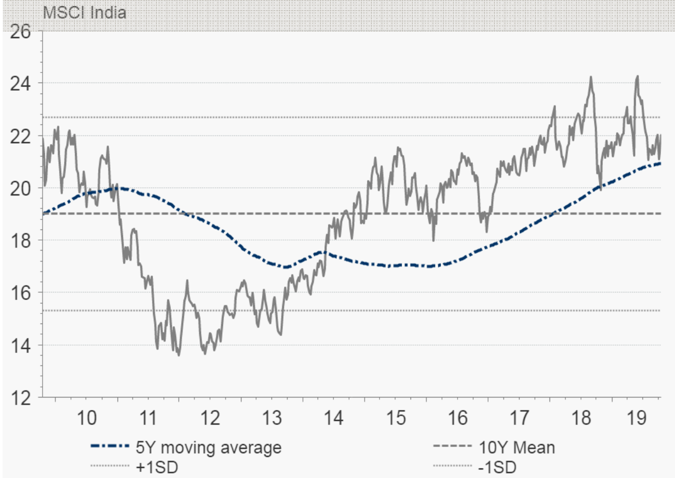
Equities – SENSEX: MARKETWEIGHT-OW. Target 40,023. Exit 42,000

Bonds – Govies: OVERWEIGHT(target yield 5.75%)

Bonds – Corporates: OVERWEIGHT

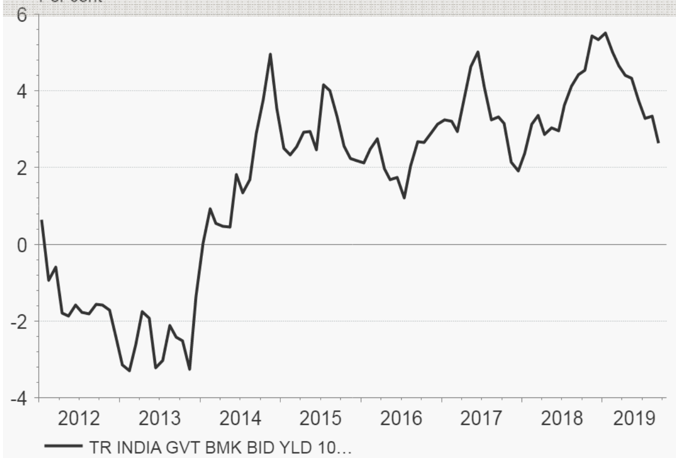
Forex – INR/USD: UNDERWEIGHT (target 72)

PE (ltm) - India
MSCI India



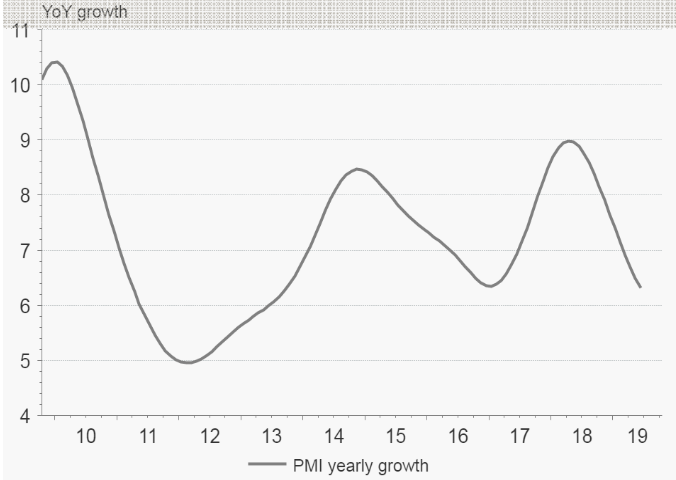
Source: Refinitiv Datastream / ANDBANK

India - 10Y government bond Real Yield
Per cent



Source: Refinitiv Datastream / ANDBANK

India composite leading indicator
YoY growth



Source: Refinitiv Datastream / ANDBANK

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Private Bankers

ISRAEL

Still neutral in equities. Stretched bond valuations, but not a bad alternative

Politics & Macro summary

A new government in Israel still seems to be a difficult obstacle for both leading candidates. However, the budget deficit has continued to decrease. At the end of September (trailing 12 months) it stood at 3.8% of GDP, but has been 1.75% of GDP since the beginning of 2019 (which compares well with a planned FY19 budget deficit of 2.9%).

Monetary conditions & Central Bank

Analysts believe a rate reduction remains possible this year as long as inflation stays very low. After making a surprise increase from 0.1% last November, the monetary policy committee (MPC) has left the key rate unchanged at its six subsequent meetings, the last being Aug 28. A strong economy and tight labor market could keep the central bank on hold this month, even as inflation remains below the government's annual 1-3% target range, at a 0.6% rate in August. The rate had dropped to a low of 0.5% in July from 1.5% in May. With no clear fiscal consolidation in sight, the central bank is unlikely to loosen monetary policy.

Equity market starts to seem a bit expensive (but we keep a neutral bias)

The TLV stock indices continued their positive momentum in October, reaching new peak levels and outperforming the S&P 500 and the EUROSTOXX 600. The positive trend is backed by a strong earnings season for the 2nd quarter and a Bank of Israel announcement on Oct 10th that no rise is expected in the base interest rate (which is 0.25%). The best performing sector is Alternative Energy, with + 6.8% BOM and the worse performing is Bio-Med with –3.5%. The real estate sector continued its strong momentum, reflecting higher book to value multipliers, mainly due to the low interest rate environment. The TLV 125 index was positively and exceptionally affected by a 19% increase in TEVA's share, due to a settlement reached in relation to pain relief drugs. We remain neutral on the Israeli major stock indexes and believe that the strong real-estate sector and bank sector will continue to outperform the other market sectors.

Bond market:

The fears of a global slowdown sparked a further drop in government debt yields worldwide and did not not skip over the Israeli bond market. The drop in Israeli government bonds was also fueled by the final announcement of FTSE-RUSSELL that the Israeli bond market will be included in their popular WGBI government bonds index as early as March 2020. The Israeli yield curve has flattened significantly in the past month but is still one of the steepest yield curves in all the developed countries (second only to Italy). The longest 28y bond is yielding around 2.04% (compared to 2.3% last month). Combined with the strong Shekel, it is still not a bad alternative, compared to European sovereign debt, which is trading in near negative territory. The credit spread in the Israeli investment grade index Tel-Bond60 gained another 10 bp, to 1.35%, while the credit spread in the Israeli high yield index Tel-Bond-Tsuot stayed about the same, at 2.97%. Our outlook remains negative on the Israeli bond market and we recommend 3-3.5 duration and prefer investment grade corporate bonds over high yield, due the sharp drop in the high yield credit spread.

FX: The currency continues its steady pace against the dollar, although recently it seems to have stabilized at levels close to 3.50. The Shekel has accumulated a YTD gain of 5.50% vs the USD.

Financial market outlook

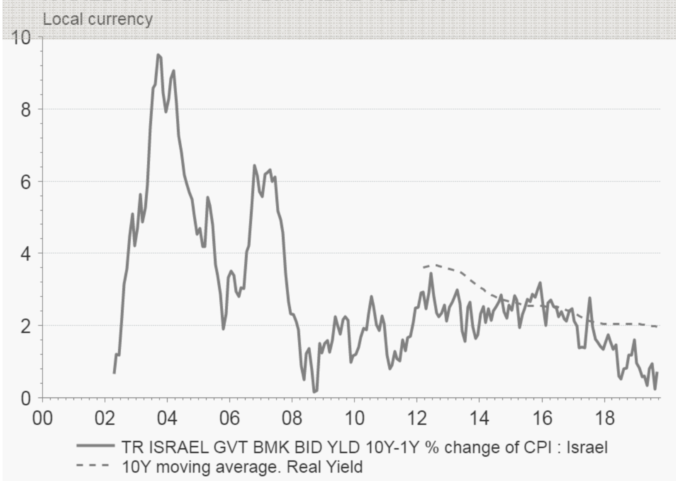
Equities – TLV35 Index: MARKETWEIGHT (Fairly valued)

Bonds – 10YGov USD: MW-UNDERWEIGHT (Real yield at 0.72%)

Israel price/earnings, Datastream index

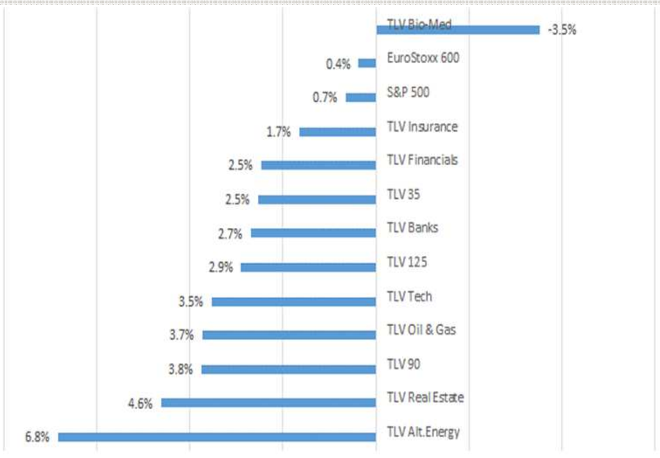
Source: Refinitiv Datastream / ANDBANK

ISRAEL GOVERNMENT BMK REAL YIELD 10Y



Source: Refinitiv Datastream / ANDBANK

Performance of selected equity indices in TLV stock exchange



BRAZIL
Political noise, but the liberal agenda goes ahead

Politics: After the pension reform has been passed, now it is the turn for the administration reform

Pension reform has been finally passed and will generate savings equivalent to almost 10% of GDP in 10 years. Despite new political noise between President Jair Bolsonaro and PSL president, and following the conclusion of the pension reform, a wave of actions such as the auctions in the energy sector (pre-salt oil) and the start in 2020 of Secretary Salim Mattar's privatization program will have strong positive fiscal impact, leading the government towards what has represented a virtuous cycle, which will be used to formulate and negotiate new reforms, to be voted on next year. The political climate has worsened, but the economic agenda remains a priority. A probable cause of this new political crisis is the campaign finance fund, which guarantees the nomination of party candidates in the elections. The Bolsonaros want to stay and command PSL by influencing the flow of money.

The government is expected to send its Administrative Reform to Congress in the coming days, as it seems that the new priority of the political agenda (overtaking the Tax Reform) is to control public spending and signal to the market that the country is on the road to sustainability. The main measures to be presented by the government require reducing civil servant expenses, reducing the number of hires, facilitating layoffs, and shrinking careers. The new rules will only apply to civil servants entering the public sector after the implementation of the reform.

Economics and Central Bank

Focus Report economic forecasts show stability in growth forecasts and falling inflation rates. Consensus for FY19 GDP growth was revised up from 0.87% yoy to 0.88% yoy, in the wake of better economic activity data at the margin. Expectations for 2020 GDP remains at 2%. On monetary policy, the market is still forecasting a 50bps cut in the Selic rate at the October Copom meeting but is now also envisaging a second 50bps cut in December (instead of the previous 25bps cut), leading interest rates to start 2020 at 4.50%. Further monetary stimulus in developed economies associated with the idle capacity of the economy should allow the Central Bank to cut the Selic interest rate. On the currency front, the real remains under pressure (above 4.00 reais per US dollar), which can be explained by a steady demand for dollars. Year-to-date, the foreign exchange flow balance is negative for Brazil (at US$ 19.8 billion), and the outflows over the last 12 months already add up to US$ 40 billion (exit of US$ 60.6 billion through financial accounts and entry of US$ 21.5 billion in trade). This relative weakness of the Brazilian Real is explained in the context of a global downturn, which traditionally has hit the flow of capital towards emerging markets as well as the expectations of a significant fall in the Selic rate, which narrows the interest rate differential between Brazil and other counterparties. In a way, it is good news that the relative weakness of the Brazilian real is not due to idiosyncratic factors, such as a fiscal deterioration of the economy, but to external factors (uncertainty over the trade war or the global slowdown) or factors such as the drop in rates of the Central Bank of Brazil, which is due, precisely, to a situation of absolute control of inflation in the country, which usually results in an increase in the strength of the currency. We are still very comfortable with the BRL, for which we set a level of 4.00 against the USD by the end of the year.

Financial market outlook

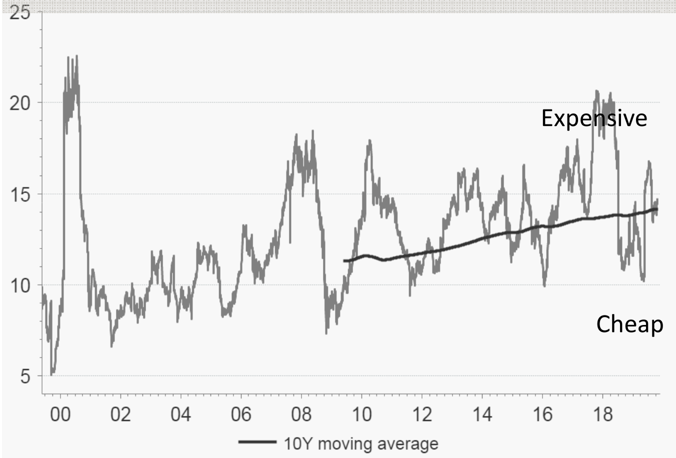
Equities – IBOV: MARKETWEIGHT (Target 103,000. Exit point 103,300)

Bonds – Gov. 10y Local: MARKETWEIGHT (Target 7.0%. Spread 515)

Bonds – Gov. 10y USD: OW-MW (Target 3.9% Spread 200)

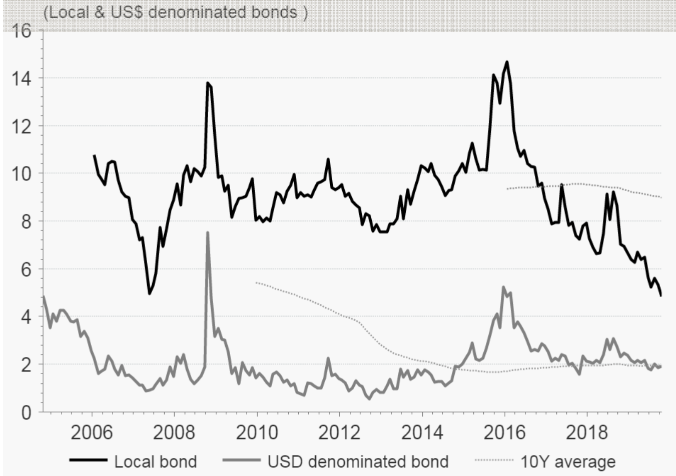
FX – BRL/USD: MARKETWEIGHT (Mid-term target 4.00)

Brazil price/earnings, Datastream index
Ratio



Source: Refinitiv Datastream / ANDBANK

BRAZIL - SPREAD 10Y GOV BOND vs UST
(Local & US$ denominated bonds)



Source: Refinitiv Datastream / ANDBANK

BRAZILIAN REAL - REER
vS USD

Source: Refinitiv Datastream / Fathom Consulting

MACRO ECONOMY

MEXICO
Investors view Pemex rescue favorably

Central bank and monetary conditions becoming more favorable

The central bank has begun to support the economy and Mexican assets, following the decision to cut interest rates by 25 basis points, which was non-controversial, as the Committee was very divided, with two members voting even to cut the reference rate by 50 bps. In the end, the cut was 25 bps, but this movement marks the end of a long process in which the central bank maintained a very restrictive stance, in part to defend the currency against possible leaks fueled by the market's political distrust of the new AMLO government. The rate is currently 7.75%, but the chances of a further rate cut in the final part of the year are very close to 100%; although the movement will be dependent on the decisions of the FED.

Inflation level points to continued support for Mexican assets from Banxico

The September figure for inflation in Mexico invites us to think that the central bank will continue to offer support to Mexican assets, since the general price index fell to 3.00% on a year-on-year basis, in line with the central bank's long-term goal. Most of the downward effect has been the result of the decline in agricultural goods and gasoline. The subscripts are also at a historically low level (YoY). Regarding economic activity, the growth forcast for 2019 continues to be cut by international organizations (IMF and OECD) and local surveys: the median growth is 0.4% for 2019 and 1.4% for 2020.

Political risk & Public Finance

The Budget approved in September is currently being discussed in Congress. The revenue budget was already approved by the lower house, with few changes regarding the executive's proposal. A fiscal miscellaneous resolution was passed containing some adjustments under which a broader definition of drinks with high sugar content and taxes on applications such as Airbnb do not apply yet. The expected fiscal result for the whole of 2020 is a primary surplus that remains at 0.7% of GDP. The deadline to approve expense items is November 15.

Successful placement of Pemex to modify its maturity profile substantially improved the perception of risk on the company, although the rating agencies have not yet reviewed its credit rating. The agencies consider that the recent injections and the favorable tax plan will not be enough to stabilize the company, taking into account all the investments it must make in order to meet its production targets.

Equity Market: IPC Equity Index

Certain internal and external risks (in particular the economic slowdown in the country) persist and require a selection of defensive values. Other latent risks concern the implementation of the AMLO administration's economic policy and possible rating action, particularly due to the spending decisions on Pemex. In the next few days, 85% of all companies will present their 3Q19 results, which could set the standard for the market and define the direction of the next movement. Central target price for the index at 44,000. Exit at 46,500.

Financial market outlook

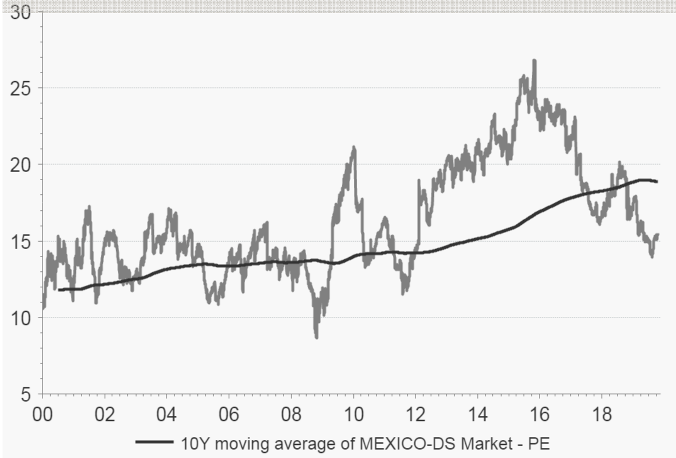
Equities – Mex IPC: OVERWEIGHT. Target 43,000. Exit 45,400

Bonds – Govies Local: OVERWEIGHT (Target spread 500 or 6.85%)

Bonds – Gov. USD: OVERWEIGHT (Target spread 150 or 3.35%)

FX – MXN/USD: UNDERWEIGHT (Mid-term target 20.00)

Mexico equities price/earnings ratio
Datastream index



Source: Refinitiv Datastream / ANDBANK

Mexico - 10Y Government Bond Real Yield
Per cent

Source: Refinitiv Datastream / ANDBANK

MXN/USD Real Effective Exchange Rate
Index

Source: Refinitiv Datastream / ANDBANK

ARGENTINA

Uncertainty regarding A.Fernadez's plan

Politics

The elections has cleared the doubts and has resulted in a victory for the Peronist candidate of the Frente de Todos (A. Fernández), who appeared alongside Cristina Fernandez de Kirchner as vice president. Perhaps an important note is that Macri managed to retain the first minority in Congress, which suggests a legislature of constant negotiations between the main political forces..

Uncertainty regarding Fernandez's Economic Plan

Fernandez has been very opaque regarding the specific economic policies he is going to implement and about who is going to be in charge of the Treasury and the Central Bank. We have some clues and some questions: i) On several occasions Fernandez has expressed a willingness to do a "2003 Uruguayan-style" debt reprofiling (extending maturities but not applying haircuts to principal and coupons). Our question is whether that would be enough and whether negotiation with creditors will take place before or after renegotiating with the IMF. One important aspect is that we believe there will be a different treatment for Local Law vs Foreign Law; ii) He has announced a hike on export duties and personal asset taxes to close the fiscal gap but has given no guidance over expenditures. Monetary financing could be a tool; iii) Social Economic Pact: freeze utility prices, limit layoffs at businesses, boost salaries and raise social security payments. How will he control inflation? ; iv) Administered Exchange Rate; v) Capital controls will remain in place and probably be strengthened, contributing to force ARS demand that will allow interest rates to be kept lower; vi) Limited or no labor and pension reforms. Is the IMF going to push for them? ; vii) Vaca Muerta in the center of Fernandez's economic development policies. Many doubts—perhaps too many—that still need to be clarified. However, Alberto Fernandez has been quite clear as to a possible return to federalism, promoting the idea (favorable in our opinion) of regional development, from clusters such as energy in Vaca Muerta, which should crystallize in nearby auxiliary industrial centers such as Bahia Blanca port, rather than continue to allow the city of Buenos Aires to monopolize large projects. Some ideas that will have to be monitored, to see if he adopts a more or less interventionist line of action, especially with regard to the danger of de-dollarizing certain economic sectors that are guided by international prices.

Inflation gives us no respite and accelerates again after the depreciation of the Peso in August-September.

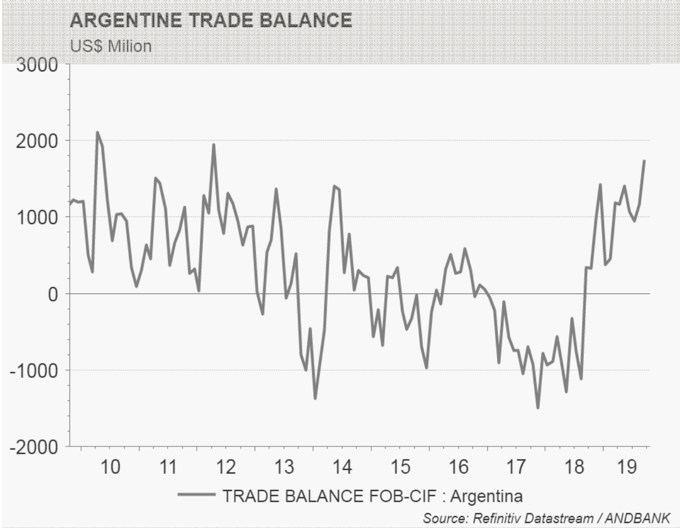
September CPI came in at 5.9% MoM (+4.0% MoM in August and +37.7% YTD). It seems that government measures partially offset the FX pass-through effects (VAT elimination on basic basket products, or government freeze on utility tariffs and gasoline), resulting in an overall CPI increase that was (maybe) below expectations, and services only increasing by +3.6% MoM.

Fiscal

The Treasury presented the September fiscal data, showing a YTD primary fiscal surplus of ARS 22.9 billion (or 0.1% of GDP), a much better figure when compared to -1.0% of GDP in 9M18, but well short of the ARS 70 billion 3Q19 cumulative primary surplus target committed with the IMF. For 2019 the fiscal target of -0.5% (including adjustments) seems unlikely to be achieved, given the spending burden and the measures implemented by Macri's government after the PASO elections.

Financial market outlook

Bonds – 10YGov USD: MARKETWEIGHT
FX – USD-ARS: UNDERWEIGHT (2019 year-end target 70)



GLOBAL EQUITY INDICES

Fundamental assessment

Index	Andbank's Sales growth 2019	Sales per Share 2019	Projected Net Margin 2019	EPS 2019	EPS Growth 2019	Current PE fw EPS 2019	Dec 2019 PE ltm EPS 2019	INDEX CURRENT PRICE	2019 Central Point (Fundam range)	2019 E[Perf] to Centr. Point	2019 Exit Point
USA S&P 500	5,5%	1.419	12,3%	174	6,2%	17,46	16,67	3.037	2.900	-4,5%	3.100
Europe - Stoxx Europe 600	5,3%	322	8,2%	26	1,1%	15,13	14,70	398	387	-2,9%	406
Euro Zone - Euro Stoxx	3,4%	354	7,4%	26	1,0%	14,92	14,50	391	379	-2,8%	398
Spain IBEX 35	3,5%	8.075	9,3%	754	0,4%	12,47	12,50	9.400	9.423	0,2%	9.895
Mexico IPC GRAL	6,7%	37.453	7,8%	2.933	-0,4%	14,95	15,00	43.851	43.988	0,3%	46.188
Brazil BOVESPA	7,1%	66.644	10,6%	7.080	8,1%	15,19	14,55	107.556	103.017	-4,2%	113.319
Japan NIKKEI 225	5,6%	22.928	6,3%	1.445	3,1%	15,90	15,40	22.974	22.250	-3,2%	22.695
China SSE Comp.	7,7%	2.965	9,3%	276	11,9%	10,64	11,50	2.939	3.176	8,1%	3.240
China Shenzhen Comp	8,2%	1.603	6,3%	100	14,6%	16,22	17,50	1.629	1.757	7,9%	1.792
India SENSEX	9,4%	18.689	10,7%	2.001	14,2%	20,01	20,00	40.045	40.023	-0,1%	42.024
Vietnam VN Index	8,4%	690	9,0%	62	10,8%	16,06	16,50	1.000	1.028	2,7%	1.079
MSCI EM ASIA	7,3%	488	9,7%	47	12,6%	11,13	11,60	526	548	4,2%	576

UPWARD REVISION DOWNWARD REVISION

ANDBANK ESTIMATES

GLOBAL FLOWS (Monthly)

By Asset Type & Region

POSITIONING, FLOW & SENTIMENT ANALYSIS

Perspective: No stress in markets

Final: +1.5 (in a +7/-7 range)

Aggregate (MW-OW bias): Overall, investors are positioned defensively, hedging portfolios also against violent moves (most likely linked to uncertainty in political backdrop and growth concerns). That being said, our contrarian view gives us a positive reading.

Market Positioning (Slight OW bias): Asset allocation in equity is in neutral area. The Put call ratio indicates that investors are hedging their portfolios (a positive sign under a contrarian perspective. Skew indicates a fear of violent downside movement). Political uncertainty and growth concerns are most likely the reasons behind this move.

Flow Analysis (MW bias): Small positive flows toward US equities indicate a neutral momentum in equity markets. China suffered outflows while other EM countries had positive inflows, signifying concern about a slowdown in China's economy. Germany also suffered outflows on growth concerns.

Surveys & Sentiment Analysis (MW bias): Not significantly biased answers from surveys, indicating a neutral stance from investors.

TECHNICAL ANALYSIS

Trending scenario.

Supports & resistances (1 month)

S&P: SIDEWAYS
Support at 2,822. Resistance at 3,028

STOXX600: SIDEWAYS-BULLISH
Support at 367. Resistance at 391

EUROSTOXX: SIDEWAYS-BULLISH
Support at 374. Resistance at 398

IBEX: SIDEWAYS-BULLISH
Support at 8,850. Resistance at 9,588

EUR-USD: SIDEWAYS
Support at 1.087 Resistance at 1.125

Oil (WTI): SIDEWAY-BEARISH
Support at 50,6. Resistance at 61

US Treasury (Yield perspective): SIDEWAYS-BEARISH
Support at 1.5%. Resistance at 1.9%

FI

FIXED INCOME - GOVERNMENTS

DEVELOPED MARKETS

Fundamental assessment

US Treasury: Floor 1.97%. Fair value 3%. Ceiling 3.50%

Swap spread: The swap spread up-ticked to -6bp (from -10p last month). For this spread to normalize at +3bp, with the swap rate anchored in the 2.0% area (according to our inflation expectation), the 10Y UST yield would have to move towards 1.97%.

Slope: The slope of the US yield curve rose to 18bp (from 4bp last month). With the short end normalizing towards 2% (today at 1.6%), to reach the long-term average slope (of 150bp) the 10Y UST yield would have to move to 3.50%.

Real yield: A good entry point in the 10Y UST would be when the real yield hits 1%. Given our mid-term CPI forecast of 2%, the UST yield would have to rise to 3% to become a "BUY".

GER Bund: Floor 0.63%. Fair value 1.22%. Ceiling 2.5%

Swap spread: The swap spread up-ticked to 37bp (from 33bp last month). For the swap spread to normalize at 37bp, with the swap rate anchored in the 1.00% area (today at 0.03%), the Bund yield would have to move towards 0.63% (entry point).

Slope: The slope of the EUR curve rose to 33bp (from 25bp last month). If the short end "normalizes" in the 0% area (today at −0.66%), to reach the 10Y average yield curve slope (122bp) the Bund yield would have to move to 1.22%.

Real yield: A good entry point in the German Bund would be when the real yield hits 1%. Given our CPI mid-term forecast of 1.5%, the Bund yield would have to rise to 2.5% to become a "BUY".

UK Gilt: Floor 1.9%. Fair value 2.5%. Ceiling 2.75%

Swap spread: The swap spread rose to 23bp (from 16 last month). For the swap spread to normalize at 10bp, with the swap rate anchored in the 2% area (today at 0.92%), the 10Y UK Gilt would have to shift to 1.9%.

Slope: With a 2Y bond normalized at 1%, to reach the average slope at 1.48%, the 10Y Gilt would have to move to 2.48%.

Real yield: Given our CPI mid-term forecast of 1.75%, the Gilt yield would have to rise to 2.75% to become a "BUY".

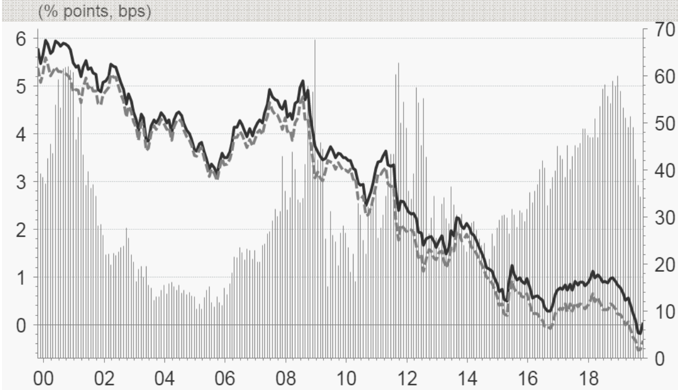
SWAP SPREAD USD

(% points & bps)

Source: Refinitiv Datastream / Fathom Consulting

SWAP SPREAD EUR

(% points, bps)



Source: Refinitiv Datastream / Fathom Consulting

EUROPEAN PERIPHERAL BONDS

Tactical targets – 10Y yields

Spanish bono: Target yield at 0.50%
Italian bond BTPI: Target yield at 1.0%
Portuguese Gov bond: Target yield at 0.6%
Ireland Gov bond: Target yield at 0.0%
Greece Gov bond: Target yield at 1.70%

EMERGING MARKET BONDS

Fundamental targets

To date, our rule of thumb for EM bonds has been "buy" when the following two conditions are met: 1) The US Treasury real yield is at or above 1%; and 2) EM bond real yields are 1.5% above the UST real yield.
Assuming that the first condition is met, we should only buy those EM bonds offering a real yield of 2.50% or more. The markets (and government bonds) that meet such requirements are shaded gray.

		10 Year Yield Nominal	CPI (y/y) Last reading	10 Year Yield Real	Projected change in Yield	Target Yield
EM ASIA	Indonesia	7,00%	3,39%	3,61%	-1,00%	6,00%
	India	6,66%	3,99%	2,67%	-0,75%	5,91%
	Philippines	4,53%	0,90%	3,63%	-1,00%	3,53%
	China	3,29%	3,00%	0,29%	0,00%	3,29%
	Malaysia	3,45%	1,54%	1,91%	-0,50%	2,95%
	Thailand	1,52%	0,34%	1,18%	-0,50%	1,02%
	Singapore	1,74%	0,48%	1,26%	-0,50%	1,24%
	South Korea	1,67%	-0,42%	2,10%	-0,75%	0,92%
	Taiwan	0,68%	0,44%	0,24%	0,00%	0,68%
EME	Turkey	12,75%	9,26%	3,49%	-1,00%	11,75%
	Russian Fed	6,38%	4,00%	2,38%	-0,75%	5,63%
LATAM	Brazil	6,48%	2,92%	3,56%	-1,00%	5,48%
	Mexico	6,84%	3,03%	3,81%	-1,00%	5,84%
	Colombia	5,90%	3,75%	2,15%	-0,75%	5,15%
	Peru	4,72%	1,85%	2,87%	-0,75%	3,97%

ENERGY – OIL

Fundamental view (WTI): Target range USD45-65/bbl.

Buy < USD45; Sell >65

Short-term drivers

(Price Positive) –Warren fracking-ban pledge a concern for producers: Analysts are processing the possible effects from energy policies advocated by presidential hopeful Elizabeth Warren, who has pledged to ban fracking everywhere and stop drilling on federal lands. A fracking ban would require legislation and would spur a torrent of opposition from companies, investors, and state governments. Analysts have warned that if enacted, oil could shoot to the $80-85/barrel range and could risk shooting to $150 during shocks.

(Price Positive) – Trudeau wins but loses majority. The federal election in Canada resulted in a tight victory for PM Trudeau's liberal party (156 seats), slightly above the 121 seats won by the conservatives. Trudeau retains power but loses his parliamentary majority, so his weakened position could force a leftward shift in his agenda if he allies with the New Democratic Party and/or the Green Party. This could be a blow to Canada's energy industry, with Platts considering the possibility there could be a specific risk to the 590K bpd Trans Mountain pipeline, a project which has been opposed by the left-leaning parties.

(Price Positive) – OPEC and its partners may deepen their production cut agreement when they meet in Vienna in December. The move would break with tradition, as the cartel typically waits for a glut to emerge before responding. The article noted that the IEA estimates a surplus of 1.2M bpd for the first six months of 2020, while demand forecasts are being hit by slower global growth.

(Price Negative) – Russia fails to meet September pact target: Russian oil output declined to 11.25M bpd in September (from August's 11.29M), but the country was not able to reach its production target under the OPEC+ output agreement. The Energy Minister Novak said the country was still striving to fulfill its obligation of cutting 200K bpd below its October 2018 baseline, but September data was impacted by increased condensate production ahead of the Russian winter.

(Price Negative) – Japan considering dispatch of naval assets to Middle East: Japan is considering a dispatch of its naval vessels to the Middle East to contribute to the stability of the region. The move "will not be part of the Strait of Hormuz security initiative that was proposed by the US. Just recall that Japan depends on the Middle East for 80% of its crude imports.

(Price Negative) – US and Saudi Arabia step up efforts to protect kingdom's oil production: The US and Saudi Arabia are holding joint efforts to connect Saudi missile defenses with US systems and investigating new anti-drone technologies. Additionally, the US Defense Department said it is deploying an additional 2,000 troops, two squadrons of jet fighters, three new anti-missile systems, and other equipment to Saudi Arabia to better prepare the kingdom to counter Iran. The move comes after months of frustration by US officials around concerns that Saudi Arabia had mismanaged its American-made Patriot air-defense systems, leaving its oil facilities vulnerable to strikes.

(Price Negative) – Loss of momentum as bullish bets hit a nine-month low: Bullish bets on crude are at their lowest level since 8-Jan in a sign that softening global demand and strong US production are dampening investors' outlook. Bloomberg observes that negative bets on WTI have nearly tripled since 17-Sep, with the net-long position down 8.8% for the week ended 15-Oct.

(Price Negative) – Venezuela sanctions have opened door for other producers: In the six months since Venezuelan crude imports to the US were halted, imports of crude produced by Brazil and Argentina have increased. Competition for selling oil is seen to increase as Canadian is skyrocketing crude freight rates. The US imported 4.13M bpd of crude from Canada in July, the highest on record.

Long-term drivers

(Price Negative) – Alternative energies picking up the baton: Conventional producers must bear in mind that the value of their reserves is dictated by the amount of time they can pump before alternative energies render oil obsolete. In order to push back this deadline as far as possible, it is in producers' interests to keep oil prices low for as long as possible (keeping the opportunity cost of alternative energy sources as high as possible).

(Price Negative) – Growing environmental problems will gradually tighten legislation over production levels. The value of producers' reserves depends on the amount of time they can pump at current levels before tougher environment-inspired regulations come in. With growing environmental problems that will likely continue to put a lot of pressure on the market for fossil fuels over the coming decades, OPEC's most serious risk is of sitting on a big chunk of "stranded reserves" that it can no longer extract and sell. Producers therefore have a powerful incentive to monetize as much of their reserves as soon as they can.

(Price Negative) – Are OPEC producers able to structurally fix prices? While it is true the agreement between the Saudis and Russia to strangle the global energy market has worked well in achieving a considerable increase in the price of oil, this has been at the cost of a loss of market share, meaning that OPEC producers are no longer able to easily fix prices without bearing costs. Back in the 1970s and the early 2000s, the exporters cartel agreed to cut output and the approach worked well, as the principal competition was among conventional oil producers (in particular between OPEC and non-OPEC producers). Today's biggest threat to any conventional oil producer comes from non-conventional producers and alternative energy sources. Energy cuts from conventional oil should therefore easily be offset (in theory) by a rapid increase in shale oil production.

PRECIOUS METALS - GOLD

Fundamental price for gold at US$1,200/oz. Sell above US$1,300

Negative drivers

Gold in real terms: In real terms, the price of gold (calculated as the current nominal price divided by the US Implicit Price Deflator-Domestic as a proxy for the global deflator) fell to US$1,329 (from US$1,358 last month). In real terms, gold continues to trade well above its 20-year average of US$919. Given the global deflator (now at 1.12307), for the gold price to stay near its historical average in real terms, the nominal price (or equilibrium price) must remain near US$1,032.

Gold to Silver (Preference for store of value over productive assets). This ratio rose to 84.93x (from 82.2x last month) and still remains well above its 20-year average of 64.1x, suggesting that gold is expensive (at least relative to silver). For this ratio to reach its long-term average, assuming that silver is better priced than gold (which is highly probable), then the gold price should go to US$1,127/oz.

Gold to Oil: This ratio up-ticked during the month to 26.77x (from 26.05x last month), still well above its 20-year average of 15.3x. Considering our fundamental long-term target for oil of US$50 pb (our central target for the long term) and that the utility of oil relative to that of gold will remain unchanged, the price of gold must approach US$765 for this ratio to remain near its LT average.

Speculative positioning: CFTC 100oz Active Future non-commercial contracts: Long contracts declined to 319k (from 341k last month). Short contracts up-ticked to 66k (from 59k). Thus, the net position fell to 253k contracts during the month (from +282k the previous month).

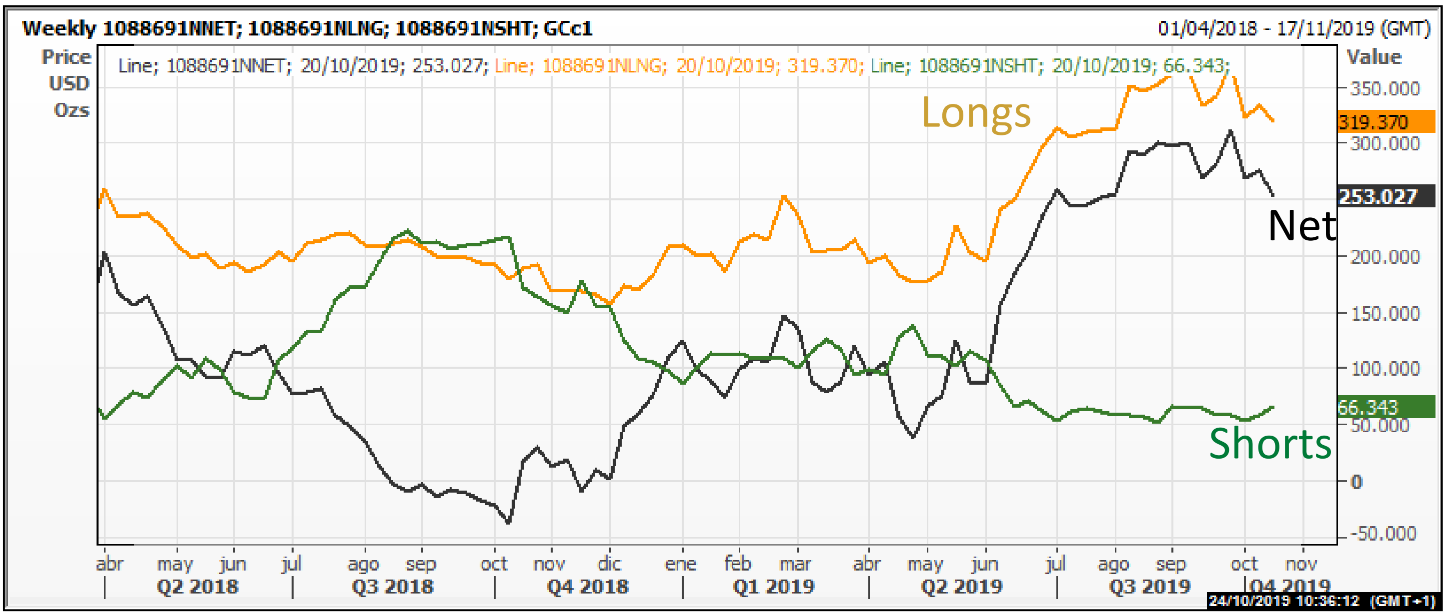
Demonetization in India. Demonetization forced millions of households to use formal banking services for the first time, helping to integrate them into the formal economy. The move will help mobilize billions of dollars in savings that were residing in unproductive physical assets such as gold.

Positive drivers

Gold to the S&P500: This ratio down-ticked to 0.50x (from 0.51x last month) but is still well below its LT average of 0.60x. Given our target price for the S&P of US$2,900, the price of gold must approach US$1,740 for this ratio to remain near its LT average.

Negative yields still make gold attractive: The disadvantage of gold compared to fixed-income instruments (gold does not offer a coupon) is now neutralized with negative yields in a large number of global bonds (>US$13trn of face value is yielding negative rates).

Relative share of gold: The total value of gold in the world is circa US$6.9tn, a fairly small share (3.2%) of the total global cash market (212tn). The daily volume traded on the LBMA and other gold marketplaces is around US$173bn (just 0.08% of the total in the financial markets).



EXCHANGE RATES

Flow analysis & Fundamental targets

According to JPM' last IMM Fx Positioning Update, political risks around the world have been important contributors to sentiment drags globally in 2019 and have thus buoyed traditional safe currencies in the last six months at the expense of high-beta currencies and GBP. There is considerable scope for short unwinds if sufficient progress is made to materially reduce risks from either Brexit or the trade war. The most recent data shows GBP shorts not drastically far off from peak levels. A three-year beta of GBP/USD to IMM positioning suggests ~6% upside if positioning is reduced to neutral from last week's positioning level to around 1.34.

EUR-USD: Fundamental year-end 2019 target at 1.10

Global positioning in the US dollar up-ticked last month (to US$15.100bn from US$11.5bn), with a 3-year z-score at levels growing to 0.37 (vs. 0.09 the previous month). The benefactors of the rotation out of USD were the EM currencies (specially the BRL and RUB), EUR and JPY. Net longs in USD continue being far lower than the US$35bn seen in the last year, and shows a 3Y Z-Score of just 0.37, meaning that there is no stress in positioning. The sharp decline in Z-score in EM positioning (0.64 vs 1.73 last month) suggests that these currencies are no longer overbought, although indicates fears about the risk of global recession. All said, global positioning still suggests that investors think the US economy will perform well, as will emerging market economies in the coming months. Our **fundamental (long-term) discussion** still reflects our structural bullish view on USD against EUR. Our year-end target remains unchanged at 1.10. Our **technical analysis** within the Investment Committee now indicates a sideways 1-month view, with the EUR-USD now facing key support at 1.087, with resistance at 1.125.

USD-JPY: Target 112; **EUR-JPY**: Target 123.2

In our view, several aspects suggest that JPY should not appreciate versus USD: (1) Although the Fed hints that it will ease off on cutting its balance sheet, the truth is that it continues to do so, albeit at a lower rate, while the BoJ will probably continue to expand its balance sheet and the money supply, making USD more attractive (or JPY less appealing). (2) We downplay the tapering option after the BoJ reiterated that it intends to stick to its ultra-loose monetary policy, at least until it hits the 2% inflation target (unachievable in the short term) ; (3) Real yields are lower in JGBs, and with the 10Y JGB controlled at 0% there is little prospect that Japanese real yields will rise.

GBP-USD: Target 1.32; **EUR-GBP**: Target 0.83

USD-CHF: Target 0.98; **EUR-CHF:** Target 1.07

USD-MXN: Target 20; **EUR-MXN:** Target 22

USD-BRL: Target 4.00; **EUR-BRL:** Target 4.40

USD-ARS: Target 70

USD-INR: Target 72

CNY: Target 6.90

RUB: NEGATIVE

AUD: NEUTRAL

CAD: NEGATIVE

Positive
Neutral-Positive
Neutral-Negative
Negative

Currency	Mkt Value of Net positions in the currency (Bn $)	Change vs last month (Bn $)	1-yr Max (Bn $)	1-yr Min (Bn $)	1-yr Avg (Bn $)	Current Z-score 3-yr
USD vs All	15,10	-2,27	34,3	10,6	23,4	**0,37**
USD vs G10	17,88	-2,00	38,9	0,0	24,9	**0,46**
EM	2,78	0,27	4,7	-0,2	2,1	**0,64**
EUR	-7,10	1,26	1,6	-14,8	-6,2	**-0,77**
JPY	-2,09	-3,59	4,0	-12,8	-5,1	**0,66**
GBP	-4,22	2,09	-0,3	-7,8	-4,9	**-0,34**
CHF	-1,43	-0,09	-0,4	-6,0	-2,6	**0,54**
BRL	-1,15	-0,33	0,2	-1,2	-0,4	**-2,23**
MXN	2,95	0,57	3,9	0,0	1,9	**1,08**
RUB	0,98	0,02	1,4	-0,2	0,7	**0,86**
AUD	-3,02	0,19	-1,9	-5,2	-3,8	**-0,84**
CAD	2,55	2,20	2,6	-5,0	-1,0	**1,00**

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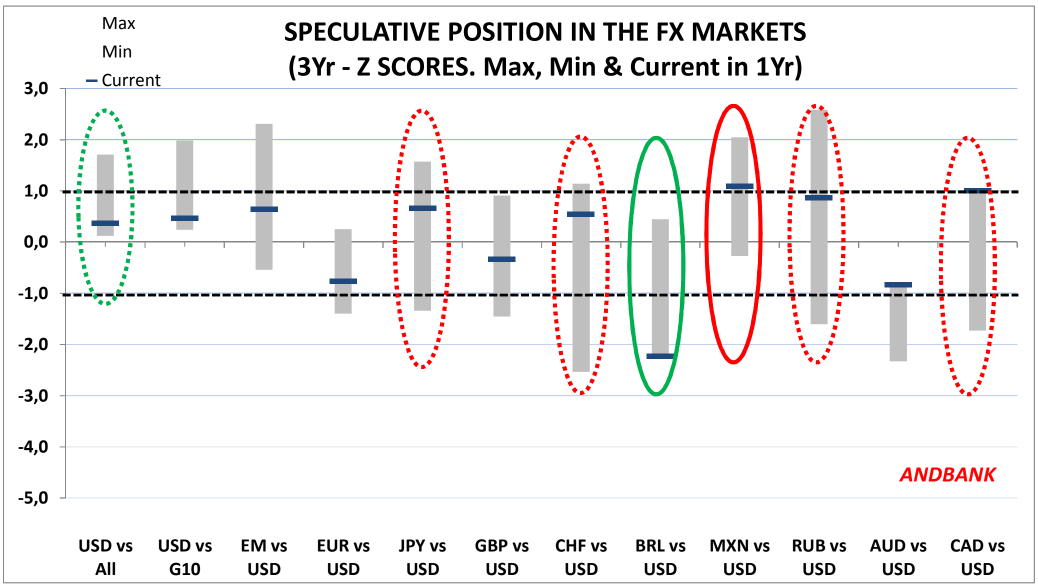

The currencies we technically favor are circled in green

SUMMARY TABLE OF EXPECTED RETURNS

Asset Class	Indices	Performance Last month	Performance YTD	Current Price	Fundamental Central Point 2019	Expected Performance 2019
Equity	USA - S&P 500	2,0%	21,1%	3.037	2.900	-4,5%
	Europe - Stoxx Europe 600	1,3%	18,0%	398	387	-2,9%
	Euro Zone - Euro Stoxx	1,7%	18,9%	391	379	-2,8%
	SPAIN - IBEX 35	1,7%	10,1%	9.400	9.423	0,2%
	MEXICO - MXSE IPC	2,0%	5,3%	43.851	43.988	0,3%
	BRAZIL - BOVESPA	2,7%	22,4%	107.556	103.017	-4,2%
	JAPAN - NIKKEI 225	5,0%	14,8%	22.974	22.250	-3,2%
	CHINA - SHANGHAI COMPOSITE	1,2%	18,5%	2.939	3.176	8,1%
	CHINA - SHENZEN COMPOSITE	2,1%	29,6%	1.629	1.757	7,9%
	INDIA - SENSEX	3,6%	10,4%	40.045	40.023	-0,1%
	VIETNAM - VN Index	0,4%	11,6%	1.000	1.028	2,7%
	MSCI EM ASIA (in USD)	4,3%	8,4%	526	548	4,2%
Fixed Income Core countries	US Treasury 10 year Govie	-1,2%	9,0%	1,83	1,85	0,2%
	UK 10 year Gilt	-1,8%	5,5%	0,71	0,80	-0,6%
	German 10 year BUND	-1,8%	5,0%	-0,36	-0,30	-0,5%
	Japanese 10 year Govie	-0,9%	0,9%	-0,12	0,00	-1,0%
Fixed Income Peripheral	Spain - 10yr Gov bond	-1,1%	10,3%	0,27	0,50	-1,8%
	Italy - 10yr Gov bond	-2,0%	15,4%	1,07	1,00	0,7%
	Portugal - 10yr Gov bond	-0,5%	13,3%	0,21	0,60	-3,1%
	Ireland - 10yr Gov bond	-0,7%	7,6%	0,04	0,00	0,3%
	Greece - 10yr Gov bond	0,8%	28,3%	1,21	1,70	-3,7%
Fixed Income Credit	Credit EUR IG-Itraxx Europe	0,1%	1,6%	52,20	65	-0,6%
	Credit EUR HY-Itraxx Xover	0,4%	6,7%	221,88	270	-1,3%
	Credit USD IG - CDX IG	0,3%	1,5%	54,44	50	0,5%
	Credit USD HY - CDX HY	0,9%	7,0%	332,53	389	-0,9%
Fixed Income EM Europe (Loc)	Turkey - 10yr Gov bond	4,0%	38,0%	12,75	14,00	2,7%
	Russia - 10yr Gov bond	5,5%	25,5%	6,39	6,75	3,5%
Fixed Income Asia (Local curncy)	Indonesia - 10yr Gov bond	2,7%	13,6%	7,00	6,00	15,0%
	India - 10yr Gov bond	0,7%	11,6%	6,67	5,75	14,0%
	Philippines - 10yr Gov bond	1,3%	25,5%	4,57	3,60	12,3%
	China - 10yr Gov bond	-0,9%	1,6%	3,27	3,25	3,4%
	Malaysia - 10yr Gov bond	-0,7%	8,4%	3,44	2,75	9,0%
	Thailand - 10yr Gov bond	-0,7%	8,6%	1,54	1,00	5,9%
	Singapore - 10yr Gov bond	-0,1%	3,8%	1,75	1,20	6,2%
	South Korea - 10yr Gov bond	-2,5%	3,1%	1,70	1,50	3,3%
	Taiwan - 10yr Gov bond	0,3%	2,1%	0,68	0,70	0,5%
Fixed Income Latam	Mexico - 10yr Govie (Loc)	0,7%	21,4%	6,84	6,85	6,8%
	Mexico - 10yr Govie (USD)	0,8%	16,2%	3,39	3,35	3,7%
	Brazil - 10yr Govie (Loc)	5,0%	29,4%	6,48	7,00	2,3%
	Brazil - 10yr Govie (USD)	0,6%	14,5%	4,21	3,85	7,1%
Commodities	Oil (WTI)	2,7%	22,3%	55,5	50,00	-10,0%
	GOLD	1,0%	16,0%	1.487,4	1.200	-19,3%
Fx	EURUSD (price of 1 EUR)	1,9%	-3,1%	1,111	1,100	-1,0%
	GBPUSD (price of 1 GBP)	4,7%	0,8%	1,29	1,32	2,6%
	EURGBP (price of 1 EUR)	-2,6%	-3,9%	0,86	0,83	-3,5%
	USDCHF (price of 1 USD)	-0,4%	1,3%	0,99	0,98	-1,7%
	EURCHF (price of 1 EUR)	1,6%	-1,9%	1,10	1,07	-2,7%
	USDJPY (price of 1 USD)	0,7%	-0,6%	108,87	112,00	2,9%
	EURJPY (price of 1 EUR)	2,7%	-3,8%	120,98	123,20	1,8%
	USDMXN (price of 1 USD)	-3,1%	-2,7%	19,12	20,00	4,6%
	EURMXN (price of 1 EUR)	-1,2%	-5,8%	21,22	22,00	3,7%
	USDBRL (price of 1 USD)	-3,8%	3,0%	4,00	4,00	0,1%
	EURBRL (price of 1 EUR)	-1,9%	-0,2%	4,44	4,40	-0,9%
	USDARS (price of 1 USD)	2,9%	57,5%	59,27	70,00	18,1%
	USDINR (price of 1 USD)	0,3%	1,9%	70,88	72,00	1,6%
	CNY (price of 1 USD)	-1,2%	2,8%	7,07	6,90	-2,3%

** For Fixed Income instruments, the expected performance refers to a 12 month period*

UPWARD REVISION   DOWNWARD REVISION

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Together
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