OMBA
ADVISORY & INVESTMENTS

Omba Advisory & Investments Limited

Markets, Multiples, Monetary Policy & Momentum

Some of our thinking for a complex 2020

In this piece we touch on many topics and share some of the things we like, some of the things on our radar and a brief summary of markets.

February 2020

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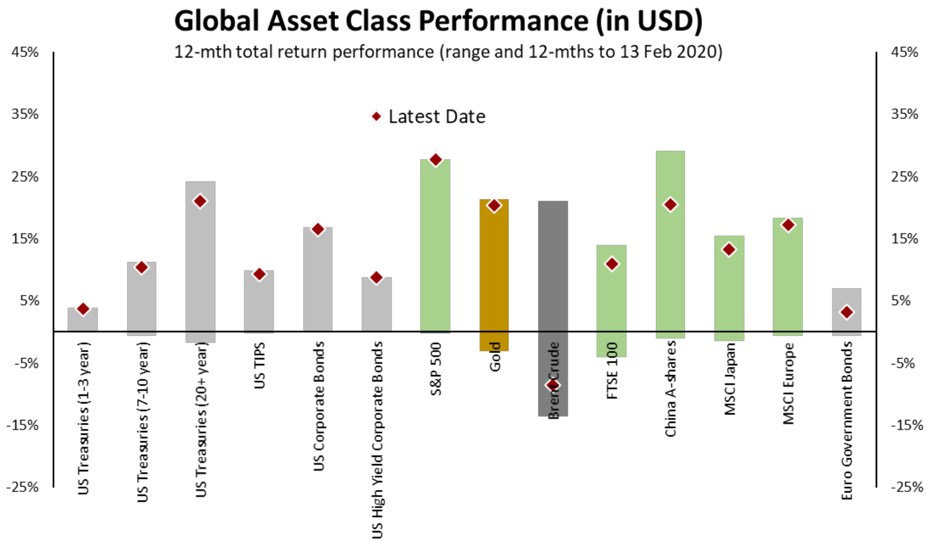
1. Overview

Markets have experienced a mixed start to 2020 after a very strong 2019 which saw all major asset classes show positive returns. Key to 2019's performance was an abrupt monetary policy change by global central banks, turning dovish after a weak fourth quarter in 2018. This reaction to the decline in market prices shows an apparent willingness to extend the current economic cycle with the sacrifice of "dry powder" with which to address an inevitable future downturn. i.e. their ability to further cut rates has been curtailed by 2019's cuts.



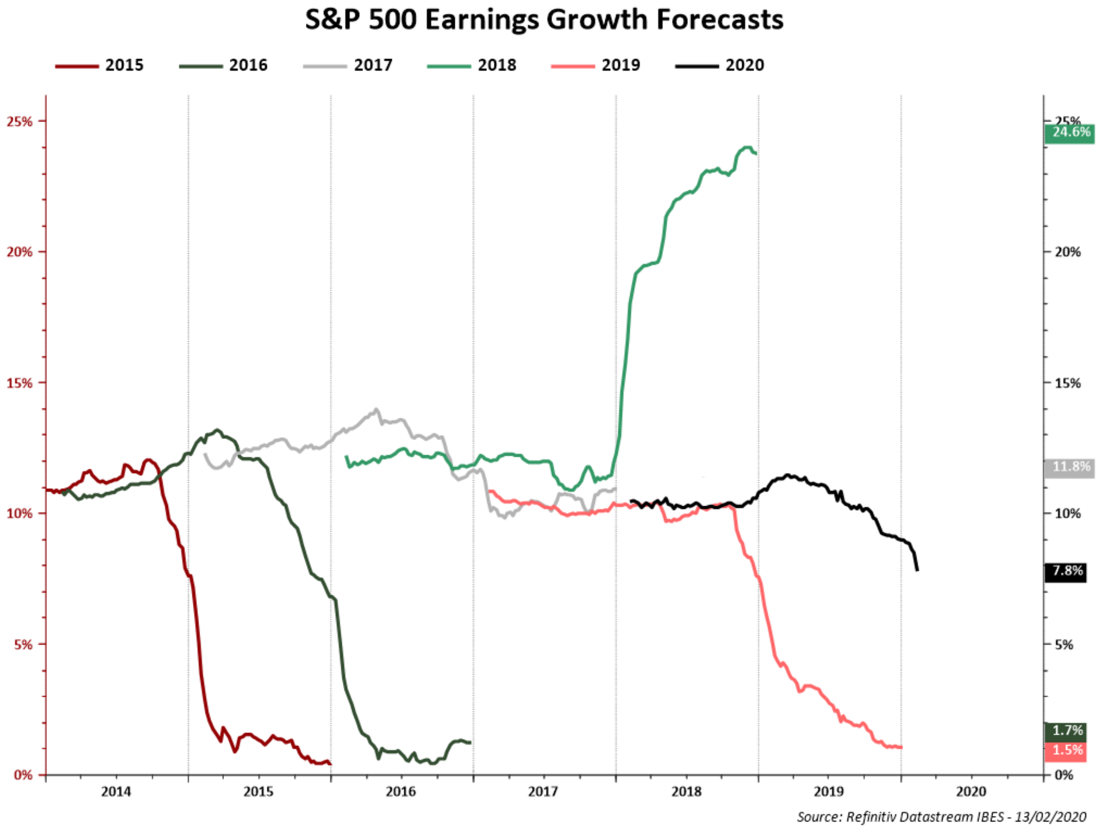
Source: Refinitiv 2020. Based on ETF data.

Throughout 2019 and into early 2020 market participants have moved into (and largely remain) in a *cautiously optimistic* stance and the prospect of an imminent recession, as cautioned by an inverted yield curve in 2019 is now no longer front of mind. Both risky assets (i.e. equity markets) and risk-off assets (i.e. gold and government bonds) have continued to perform strongly.

While we share this view of *cautious optimism*, the practical implementation of such a view is more nuanced. In this report we share some of our tactical ideas, as separated by region. The ideas include positions that we have owned, currently own or are considering owning in our discretionary portfolios.

While this stance of *cautious optimism* is dynamic and reactive to changes in market fundamentals and market sentiment, we summarise some of the key dynamics as follows:

- **Weak corporate earnings growth**. 2019 returns were largely driven by multiple expansion as earnings growth was globally relatively flat. 2020 earnings forecasts have also been revised down (from 11% to 7.8%). Some bright spots remain as shown by the recent positive earnings surprises, for example Amazon whose stock rose over 10% in response.

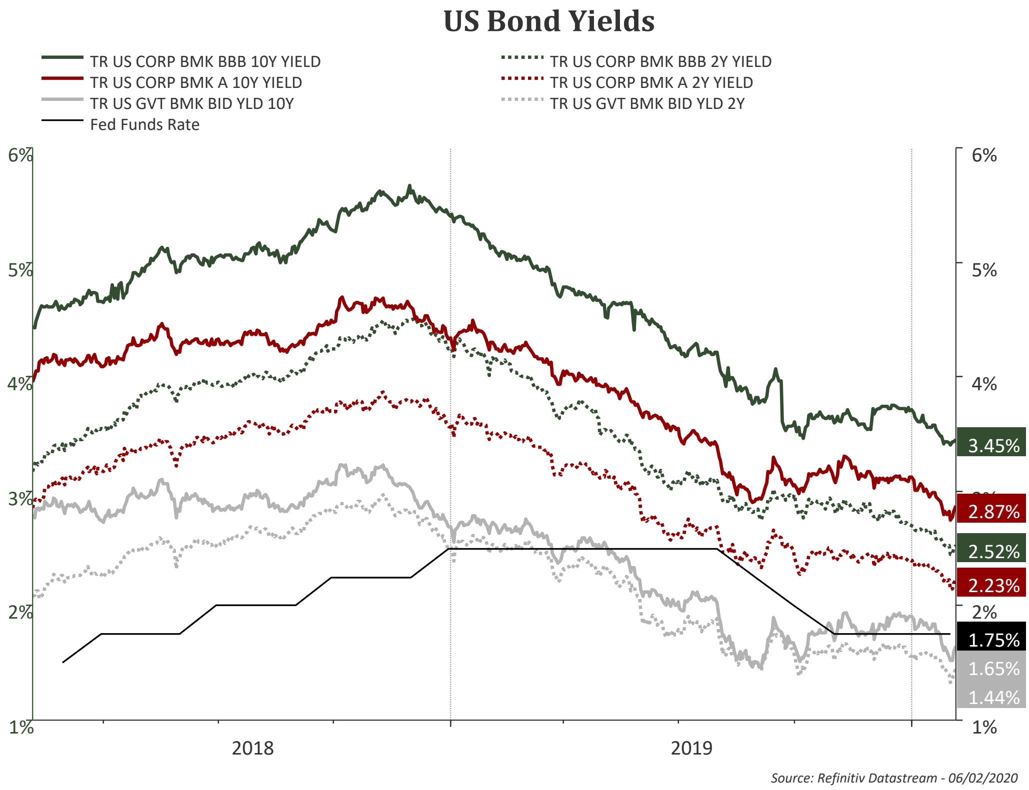


- **PMI data is showing signs of improving**. Global PMI growth accelerated for a third consecutive month in January 2020. 71% of countries saw manufacturing PMIs increase (although still not necessarily expansionary) from December 2019 to January 2020[1].
- **Politically driven uncertainty**. Politics and its unpredictability continues to drive markets. In 2019 we saw the US and China's trade conflict take centre stage. 2020 started off with the assassination of Qassim Soleimani and will end of with a presidential election in the US and the potential end of the UK-EU(27) transition period. The earlier event (assassination) not causing much of a stir in market sentiment and the latter (US election) potentially doing so as the US remains such an important cog in global affairs.
- **Coronavirus outbreak** continues to impact economies, especially in South East Asia. While it is too soon to quantify the impact on the global economy, it may be meaningful if the disruption to supply chains, travel and general economic activity in China and beyond continues.

2. Fixed Income and Alternative Investments

2.1. Fixed income – Duration & Credit Risk

As can be seen in the chart below, from a Hawkish Federal Reserve in 2018 which in the latter part of 2018 indicated they were on "autopilot" for 2019 with their hiking path, there was subsequently an about turn on monetary policy and the Fed Funds rate was cut 75bps in 2019. This was in response to weaker economic data and to pre-empt any recession - this clearly worked. What it meant for our positioning was that we decided during 2019 to extend our duration by shifting some of our 1-3 year US Treasury positioning into the 7-10 year US Treasury ETF to benefit from further long end yield compression. We captured some of this yield downdraft in 2019 but think the likelihood of rates falling further over coming quarters remains elevated as inflation remains contained and the potential for disappointment on growth and earnings might mean the Fed goes lower on Fed Funds rates.

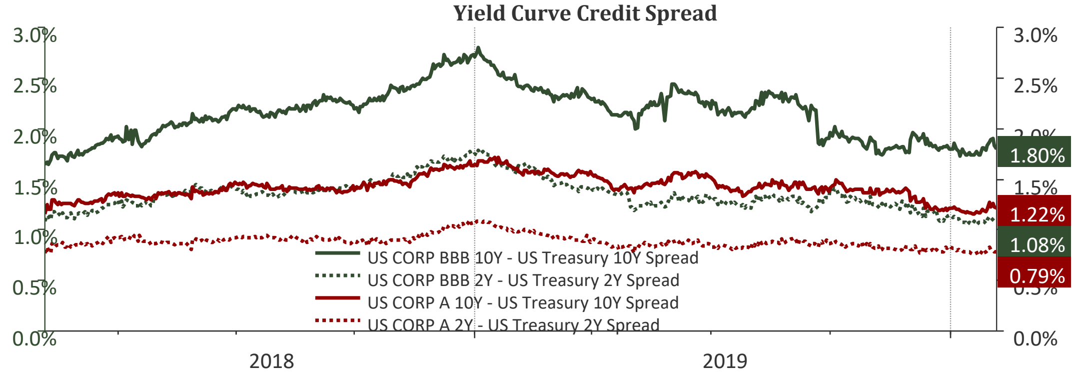


As pertains to credit risk the market is clearly not concerned about the credit issues we discussed in our Omba 2019 Outlook and credit spreads have continued to remain compressed - see chart below. This has meant that we have not taken on additional credit risk during the year and have maintained a low allocation to US High Yield Debt.

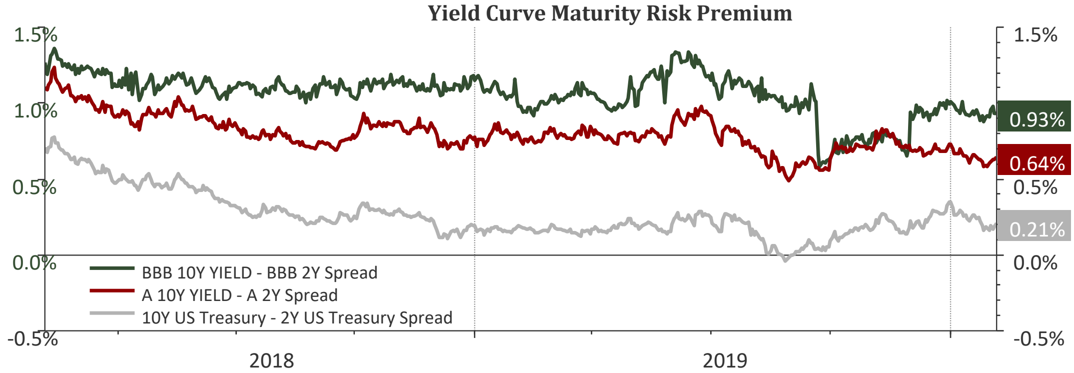
Similarly, ETFs tracking Real Estate Investment Trusts (REITs) in the United States yield very little and in our view do not pose good risk adjusted value at these levels (dividend yields around 3%) and thus, although it is something included in our universe of investments, it is not something we wish to overweight at this stage of the cycle.

US Bond Yields

Yield Curve Credit Spread



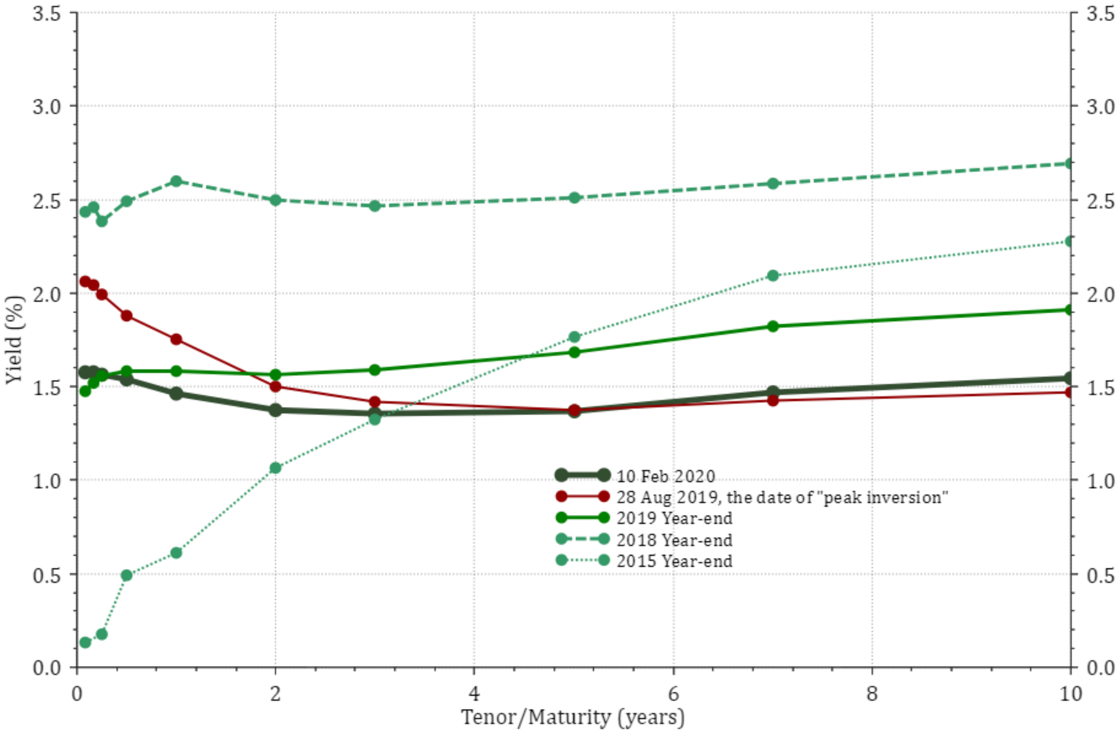
Yield Curve Maturity Risk Premium



Source: Refinitiv Datastream - 06/02/2020

Note below the changes in curve shape as the Fed have moved from 2018 Hawkish to 2019 Dovish.

The US Treasury Yield Curve over Time



Source: Refinitiv Datastream - 11/02/2020

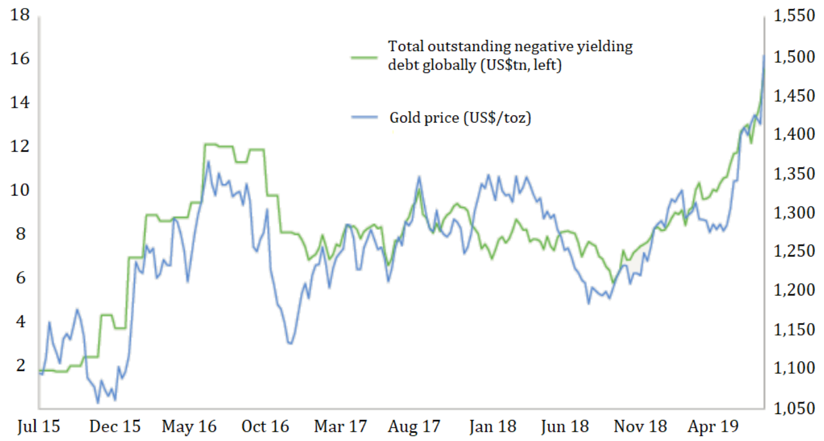
2.2. Gold

- *Gold will continue to be supported by investor inflows if we remain in an environment of low real and nominal yields with upside inflation risks;*
- *A modest gold allocation within a portfolio will decrease volatility and act as a hedge in the case of a more extended equity market correction.*

Investors hold gold in a portfolio for a variety of reasons including unexpected inflation protection, a hedge in risk-off environments and the optimisation of portfolio "efficiency" due to maximising expected returns whilst reducing overall portfolio volatility.

Gold currently trades at 7-year highs and has been on a multi-year upwards trend which started after the yellow metal found a base at just over US$1,000/toz in 2015. Since the late-2015 lows, gold prices have increased by over 50% in a move driven by a huge amount of investor interest (the spot price is shown in the chart on the right). We maintain dialogue with multiple ETF providers and they have all been quick to express the large number of enquiries pertaining to gold-based products they have received from their customers over the past year. We explore the reasons why we believe this trend could continue below.

An Extremely Strong Relationship: Gold Prices and Negative Yielding Debt



Source: Ruffer, Bloomberg

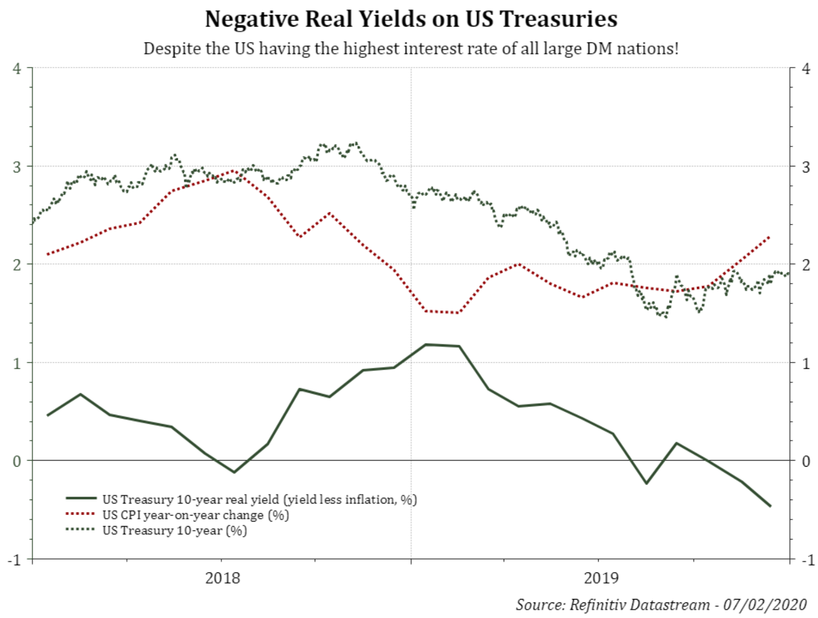
Chasing yield in a low yield world

Investors have been more comfortable owning gold, despite its inability to generate yield, as today's low yield environment makes the marginal cost of carry lower. Storage and insurance costs have typically meant that gold was only attractive as an inflation hedge over short periods of time. However, low yields have been a large contributing factor to the run-up in gold as investors add to positions as it becomes relatively cheaper to carry due to the lower opportunity cost of giving up interest on cash or bonds.

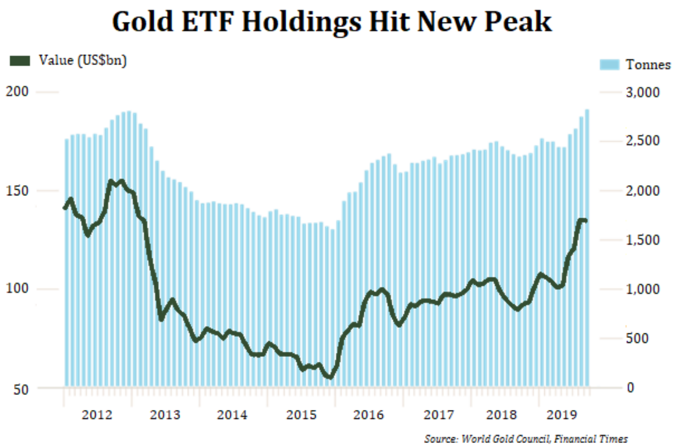
In some cases where yields become negative investors would actually be better (and safer) holding gold rather than bonds as one is often less exposed to counterparty risk. The ongoing cost of storing and insuring gold can sometimes be less than the cost associated with the negative yield on certain bonds (in Europe for example). As you can see from the chart above, the relationship between the price of gold and the amount of outstanding negative yielding debt globally is extremely strong. This measure of outstanding negative yielding debt can be a simple litmus test as to the severity of our low rate environment. This simple chart is suggestive of the fact that one can reasonably accurately predict the price of gold by forecasting trends in global debt markets (looking at things such as risk sentiment, inflation, and interest rates).

Low interest rates and the chase for yield has pushed bond prices to extremes with US$13tn of outstanding bonds now offering negative yields. Debt issued by high-quality rated governments such as Germany and Japan routinely issue bonds which actually cost investors to hold to maturity.

Yields are put under further pressure when considering the impact of inflation i.e. when one measures yield in real terms or "real yields". Even Treasury bonds issued by the US government had negative real yields during parts of 2019 – the nation which boasts the highest interest rate across all large DM economies (with a Fed Funds target range at 1.50%-1.75%). The chart on the right shows how real yields on US Treasuries have moved over the past two years.



As one can clearly see from the chart on the lower left, Gold ETF holdings have risen to a dramatic new all-time high. It is likely that gold will find continued support and inflows as long as concerns about being late cycle grow, equity and credit valuations are extended, and real yields remain low.



As we note in our 3Q 2019 publication **On The Edge**, debt in the High Yield ("HY") space is no longer *high yielding* as credit spreads compress (i.e. the yield pickup for assuming credit risk) amid a steady increase in risk-taking and debt issuance. Simultaneously, the quality of debt in the Investment Grade ("IG") space has steadily declined over the past few years as the proportion of BBB-rated debt (the lowest rung on the IG ratings ladder) makes up over 50% of all IG issuances. This increased credit risk in the system and the lower yields for assuming this credit risk is likely to support positive sentiment towards owning gold.

This gold-supportive environment could reverse if global central banks began to increase interest rates - we see the likelihood of this scenario as being low at this juncture.

3. Americas

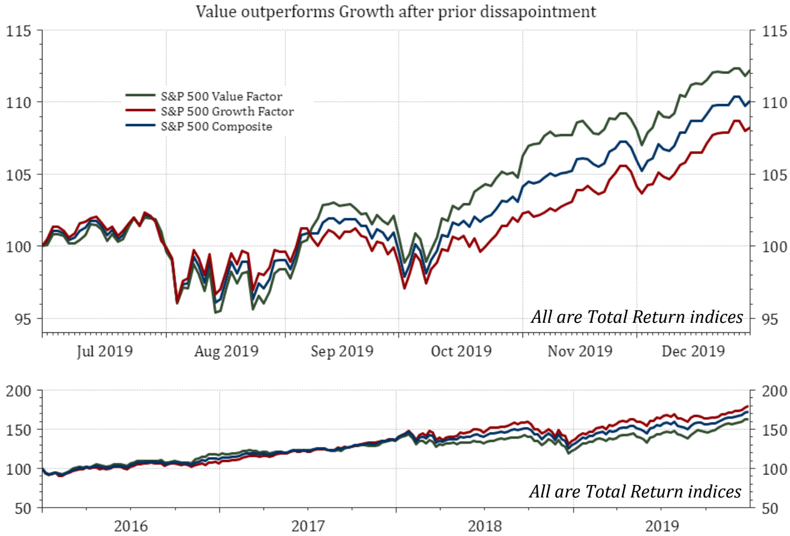
3.1. US Value Factor

- *Attractive entry point given cheap valuations on both an historic basis and relative to other Factors;*
- *The recent outperformance, due to renewed investor interest, is likely to continue in an environment which is supportive for Value Factor stocks;*
- *Corporate earnings growth is under pressure, posing downside catalysts to Growth Factor stocks.*

Our strategies benefitted from an overweight exposure to US Value Factor stocks in the latter half of 2019. The Value Factor - not to be confused with "value investing" - is one of many mutually exclusive Factor Styles that also include Growth, Momentum, Quality, Size, and Minimum Volatility. Factor Styling is a framework for isolating characteristics of equities and is a useful tool depending on where in the cycle we are and what other equity prices have done. Although value investing is generally prudent, the Value Factor can be more or less favourable to own at these different stages in the cycle. We are overweight the US Value Factor for the below reasons.

Value Factor Outperformance in 2H 2019

Value outperforms Growth after prior dissapointment



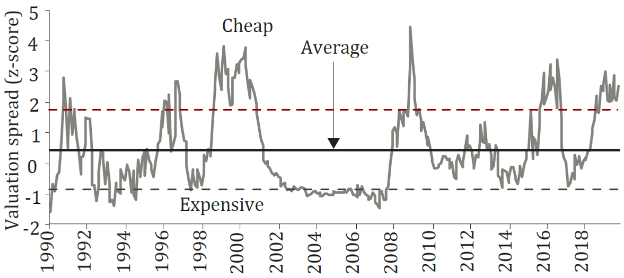
Source: Refinitiv Datastream - 05/02/2020

Evaluating "Value"

Historic underperformance to the Growth Factor benchmarks provides an opportunistic entry point. Globally, Value Factor stocks are in aggregate over two standard deviations cheaper than their historical average since 1990. This long stretch of Value lagging other factors was snapped by Value outperformance in 2H 2019. We expect this trend to continue in an environment supportive of Value stocks.

Global Value Factor Valuation Spread

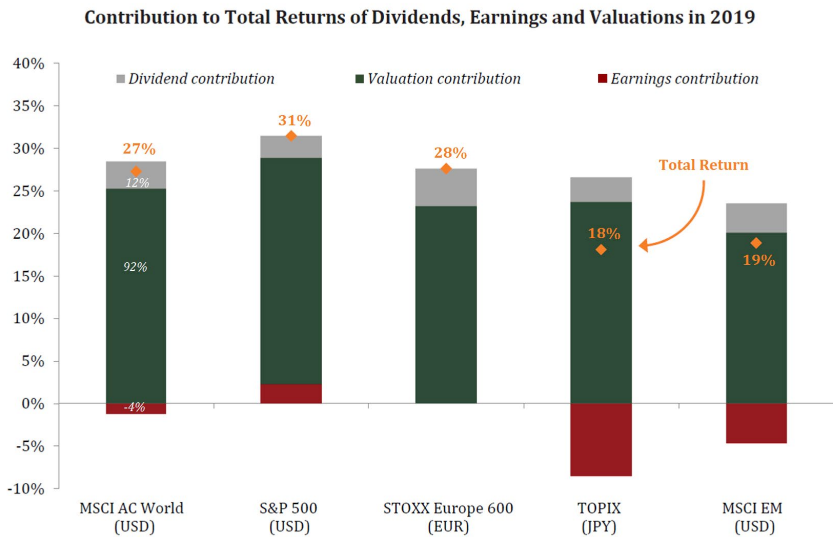
On a historic basis, the value factor is more than 2 standard deviations cheap



Source: FactSet, J.P. Morgan Asset Management; data as of December 31, 2019

The rich valuations of S&P 500 stocks (and in particular Growth Factor stocks) are supported by expectations of future *earnings growth*. The broader equity market was buoyed in 2019 by multiple expansion (more expensive valuations) in anticipation of earnings growth in 2020 and beyond. This puts earnings growth in the spotlight and leaves Growth Factor stocks exposed to risks as corporate profitability and investor expectations come to a head. We see an increased likelihood of earnings disappointment in 2020 as corporate profitability has already started to demonstrate slowing in 2019 in the face of margin pressures, wage inflation, and higher raw input costs driven in part by deglobalisation and trade issues.

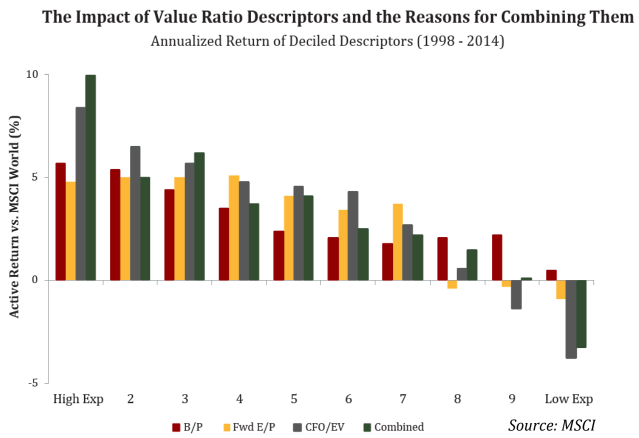
The S&P 500 was valued at a 19.4x forward P/E ratio in January 2020, compared to 17.6x three months prior and 15.0x at the start of 2019. These higher valuations occurred despite 2020 EPS growth estimates falling by over 3 percentage points since the start of 4Q 2019. EPS growth forecasts sit at +7.8% year-on-year for 2020, which may still not be enough to compensate for the 4.4-point increase in forward P/E valuations since early 2019. The chart on the right illuminates the extent to which earnings growth was lacking in 2019.



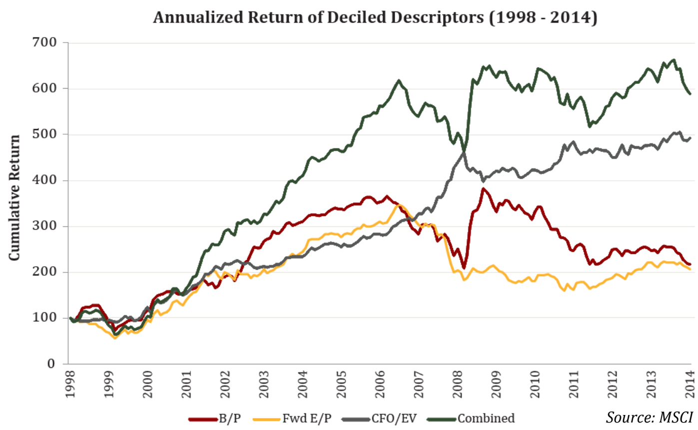
Source: Worldscope, Datastream, Goldman Sachs Global Investment Research

What is the Value Factor?

Value Factor screening is based on a variety of valuation metrics including Price-to-Earnings ("P/E"), Price-to-Book ("P/B"), and Enterprise EV over Operating Cash Flow ("EV/CFO") ratios. Every ETF provider uses a different combination of "ratio descriptors" to define what they believe best represents Value Factor stocks, which provides a variety of product options for the investor. The charts below demonstrate the importance of optimising for the best combination of descriptors in order to maximise returns. Although these charts are based on historic analysis ending in 2014, they show the importance of selecting the correct Factor optimisation method (and choosing products that reflect that assessment). This still applies today and the challenge of doing so has possibly increased given the wider variety of products available.

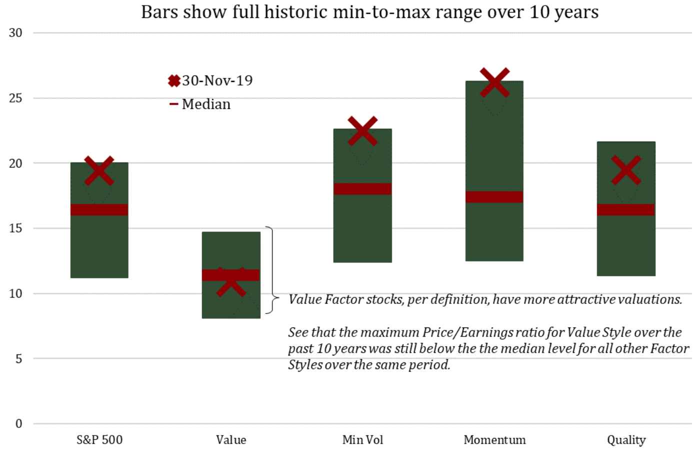


Source: MSCI



Source: MSCI

Price/Earnings Valuations for Factor Styles over 10 Years
Bars show full historic min-to-max range over 10 years



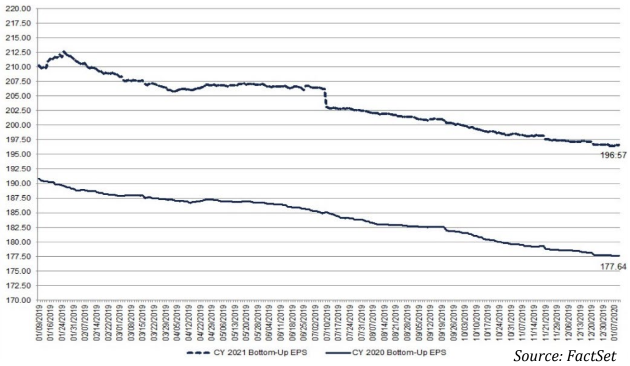
Source: Invesco, FactSet

The chart on the left shows the large degree of variation in P/E ratios across different Factor screenings of the S&P 500. As you can see, current valuations are stretched and are in the upper quartile for all Factor Styles except Value, which is disparately lower. Interestingly, for the S&P 500 universe the maximum P/E ratio recorded for Value stocks was still less than the median P/E ratio for all other factors over the past 10 years. To re-iterate, the forward P/E ratio of the S&P 500 is 19.4x, which means that investors are willing to pay $19.40 per US Dollar of earnings which is in the upper quartile over the last decade.

Value versus Growth?

The justification behind the rich valuations in Growth stocks is that future earnings growth should eventually compensate investors for the premium initially paid. This is a trade that often works very well but can leave investors vulnerable to disappointment when earnings slow. Investors need to be cautious of this given the late stage of the business cycle. Furthermore, we flirted with an "earnings recession" in the US in 2019 – defined as two consecutive quarters of negative earnings growth. US earnings growth expectations for 2020 and 2021 have been revised lower in recent months as can be seen on the chart to the right and as we showed in our introduction.

Revisions to Bottom-up EPS Estimates
S&P 500 calendar years 2020 & 2021



Source: FactSet

Why is it that Value underperformed over the past few years?

We are aware that Value has been out of favour for the past few years – seeing a particularly bad period of performance since 2009.

It is important to keep in mind that various sectors and geographies inherently have different factor characteristics and historic exposures. Typical "Value sectors" include Oil & Gas and Financial Services, whereas "Growth sectors" include Technology. Understanding how various providers weigh Factors, such as whether or not they weight sector exposures, can help explain relative Factor performances. One reason why many argue that Value stocks have underperformed since the GFC is the lower profitability of financial institutions, due to low interest rates and increasing regulation, and lower stock returns for Oil Supermajors since the collapse of the "commodity super-cycle".

We are comfortable with our Value Factor ETF selection as it is sector-neutral. This means that the underlying basket of stocks has been filtered by valuation metrics within each sector resulting in a broader, more balanced sector allocation, not a specific overweight to traditional Value sectors. Thus our portfolios still hold Technology, Financials, and Oil & Gas sectors at roughly the same proportions as the more well known market cap weighted indices but the stocks owned within each sector are skewed towards those with more attractive valuations.

		2011	2012	2013	2014	2015	2016	2017	2018	2019	Annualised Average	Mini Chart
S&P 500	Return	2%	16%	32%	14%	1%	12%	22%	-4%	31%	13%	
	Fwd P/E	13	14	17	18	17	18	20	16	20	17	
S&P 500 Value Factor	Return	0%	18%	32%	12%	-3%	17%	15%	-9%	32%	12%	
	Fwd P/E	11	12	15	15	15	17	18	12	16	15	
S&P 500 Growth Factor	Return	5%	15%	33%	15%	6%	7%	27%	0%	31%	15%	
	Fwd P/E	14	16	19	20	20	20	24	20	26	20	
S&P 500 Consumer Discretionary Sector	Return	14%	11%	26%	16%	7%	5%	13%	-8%	28%	12%	
	Fwd P/E	15	17	21	20	21	20	23	20	25	20	
S&P 500 Technology Sector	Return	2%	15%	28%	20%	6%	14%	39%	0%	50%	18%	
	Fwd P/E	13	14	17	18	18	18	22	16	25	18	
S&P 500 Financials Sector	Return	-17%	29%	36%	15%	-2%	23%	22%	-13%	32%	12%	
	Fwd P/E	11	12	14	16	14	15	16	11	13	14	
S&P 500 Energy Sector	Return	5%	5%	25%	-8%	-21%	27%	-1%	-18%	12%	2%	
	Fwd P/E	10	12	15	13	19	44	30	14	20	20	

Source: Refinitiv

The table above demonstrates the relationship between Total Return (i.e. both capital gains and dividends) and 12-month Forward P/E ratio - as of year-end for each respective year. The most important trend to notice is the steady rise in multiples – or multiple expansion – which occurs over the course of the business cycle; post-GFC in this case. This can be clearly seen by both (i) the increasing saturation in redness in "Fwd P/E" as we move right across the columns as well as (ii) by the grey bars in the Mini Chart column. Although valuations may have peaked intra-year in 2018, the large correction in 4Q 2018 effectively drove a consolidation which resulted in Forward P/E ratios finishing lower year-on-year. However, 2019 saw a quick resumption of this post-crisis trend in multiples. In terms of Value versus Growth, the top cluster represents the broader S&P 500, where as the middle cluster corresponds to two typical Growth sectors (Technology, Consumer Discretionary). The bottom cluster corresponds to two typical Value sectors (Finanicals, Energy).

To illuminate the differing degrees of multiple expansion between Factor Styles in the post-GFC economic cycle:

- the S&P 500 Value Factor Index is currently only 1 point more expensive than its own annualised average P/E ratio since 2011 (not very stretched);
- the broader S&P 500 Index is currently 3 points more expensive than its own annualised average P/E ratio since 2011;
- the S&P 500 Growth Factor Index is currently 6 point more expensive than its own annualised average P/E ratio since 2011!

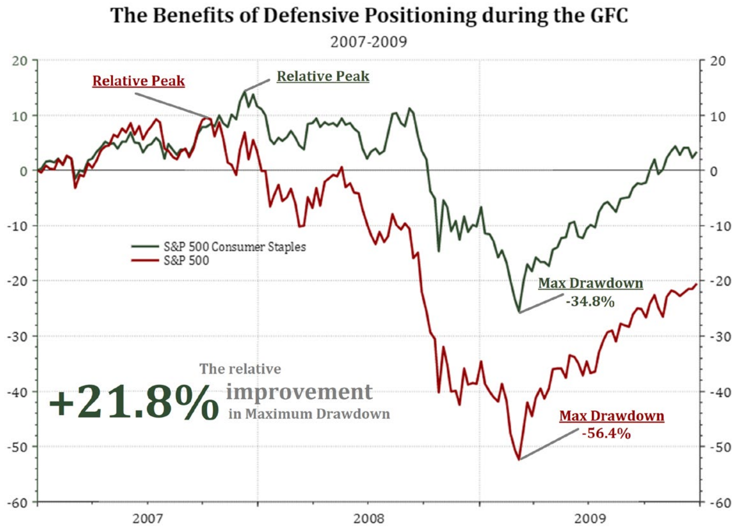
Importantly, relative to other indices the S&P 500 Value Factor Index is currently:

- 4 points cheaper than the broader S&P 500 Index (which is cheaper than normal – the annualised average discount since 2011 is 2 points);
- 10 points cheaper than the S&P 500 Growth Factor Index (which is much cheaper than normal – the annualised average discount since 2011 is only 5 points)!

3.2. US Consumer Staples Sector

- *Being a defensive sector US Consumer Staples provides better drawdown protection than the broader index and cyclical sectors;*
- *We favour reducing overall portfolio volatility at this stage of the economic cycle on a tactical basis;*
- *The sector provides exposure to large global conglomerates with diversified revenue streams;*
- *Today, the US Consumer Staples sector boasts relatively attractive valuations when compared to its own history and the historic valuation premium it usually commands over the broader S&P 500 index.*

US Consumer Staples stocks are known to be more defensive due to the fact that these companies produce items such as food, beverages and non-durable household products - items generally deemed "essential" for basic living. Given the late stage of the current business cycle, we believe it is prudent to skew part of our equity exposure towards more defensive sectors.



Source: Refinitiv – 23 Jan 2020

A Staple in hard times

The nature of the demand for consumer staple goods partly insulates the business activities of the producing companies from the cyclical nature of the business cycle. For this reason, Consumer Staple stocks have a lower beta and their "Maximum Drawdown" is less. Maximum Drawdown is a measure of peak-to-trough negative performance over a market period. As we saw from the Global Financial Crisis, when considering the Maximum Drawdown over the full 2007-2009 period, the S&P 500 Consumer Staples sector outperformed the benchmark index by over 20% (2007 through to the market low in March 2009). If a late cycle correction materialises in 2020/2021 – which could be sparked by any of the many elevated risk factors that we see today – it would be prudent be more defensively positioned. Should such a sell-off occur, we would then reallocate our equity exposure to higher risk, more pro-cyclical sectors and geographies coupled with an increase in overall equity allocation.

Valuations and other key numbers

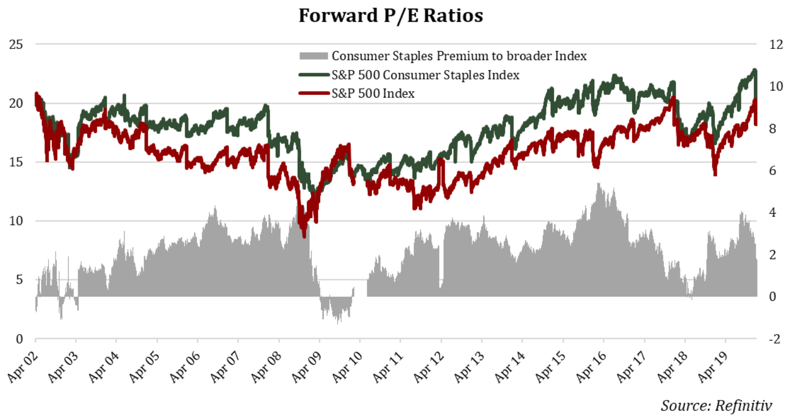
The Consumer Staples sector is "cheap" in terms of historic valuations when compared to the S&P 500, although not necessarily when compared to its own history. On the right chart one can see that the current Forward P/E premium of Consumer Staples is 1.7 points vs the long-term average of 2.2 points (21% lower than historic averages since 2002). This premium is also currently at the 32nd

	S&P 500 Consumer Staples Index	Consumer Staples Premium to S&P 500
Forward P/E Ratio	20.3x	1.7 points
Long-term Average Fwd P/E (since 2002)	17.9x	2.2 points
Difference to Long-term Average (%)	+13%	-21%
Percentile Rank (since April 2002)	84%	32%

Source: Refinitiv, as of 13 Jan 2020

percentile of its own history, meaning that it is within the lowest third of all previously observed premiums on a relative basis.

Of the 25 largest Consumer Staples companies in the world, 13 are headquartered in the US. However, the large globally diverse nature of these businesses means that even if the US specifically were to slow down the diverse nature of the earnings from these conglomerates would support the Consumer Staples sector.



Source: Refinitiv

		Weight	Revenue Exposure to the USA	Rest of World
US Beverages	CocaCola Co	19%	40%	60%
	PepsiCo	17%	62%	38%
	Monster	3%	71%	29%
	Brown-Forman	1%	47%	53%
	Considered Stocks	40%	52%	48%
US Household Products	P&G	27%	45%	55%
	Colgate	6%	28%	72%
	Estee Lauder	4%	34%	66%
	Kimberly Clark	5%	52%	48%
	Clorox	2%	87%	13%
	Church & Dwight	2%	92%	8%
	Considered Stocks	46%	46%	54%
Tobacco	Philip Morris	7%	2%	98%
	Altria	7%	100%	0%
	Considered Stocks	14%	49%	51%
All of the Above		100%	49%	51%

Source: Company Reports, Citi Research Estimates, State Street

The table on the left shows the revenue exposure of a collection of major US Consumer Staples stocks. The stocks are weighted according to the proportions held in our chosen US Consumer Staples ETF, although only 12 of the 33 held within the ETF are disclosed. Segmental revenue analysis by geography shows that, for the full weighted basket of the considered stocks, just less than half of all revenue is generated domestically. This provides comprehensive geographical diversification while also providing adequate exposure to the US itself.

Consumer Staples generally also have higher dividend yields than the broader index. **Currently the Consumer Staples sector has a dividend yield of 2.7% whereas the S&P 500 has a dividend yield of 2.2%.** Although the dividend pick-up - at 50bps - is lower than what you can historically expect, the marginal benefit is meaningful in a low yielding world where over $13 trillion[2] worth of bonds have negative yields.

Another supportive factor is the demonstrated positive real organic sales growth for US Consumer Staples stocks over the past few years. Between 2010 and 2018, real organic sales growth rose at an average annualised rate ranging from 5% for US Beverages to 1% for US Food makers. Interestingly, US Tobacco firms showed an average annualised real organic sales growth at a respectable 4% between 2010-2018 despite increasing regulatory challenges. The table on the right shows a forecasted average annualised real organic sales growth of 4% for the period 2019-2021. This compares to a 3.19% year-on-year real sales growth for the broader S&P 500[3] for the 12 months ending September 2019. Data is not yet available for full calendar year 2019 at the time of writing.

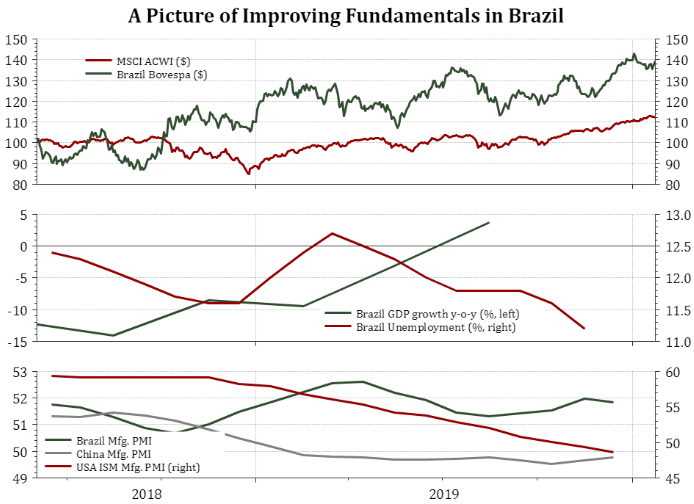
Real Organic Sales Growth (Year-on-Year)

		Weight	e2019	e2020	e2021	Estimated Average	Weighted Avg. by Sector
US Beverages	Coca-Cola	16%	5%	4%	3%	4%	5%
	PepsiCo	14%	4%	4%	4%	4%	
	Brown-Forman	1%	4%	5%	4%	4%	
	Monster	2%	12%	7%	6%	8%	
US Food	Kraft Heinz	1%	-1%	0%	1%	0%	1%
	Mondelez	7%	4%	3%	3%	3%	
	General Mills	3%	0%	1%	1%	1%	
	Hershey	2%	2%	2%	2%	2%	
	Kellogg	1%	2%	2%	2%	2%	
	McCormick	2%	3%	3%	3%	3%	
	J M Smucker	1%	0%	-2%	0%	-1%	
	Campbell	1%	0%	0%	1%	0%	
US Household Products	P&G	22%	5%	4%	3%	4%	4%
	Colgate	5%	4%	3%	3%	3%	
	Kimberly Clark	4%	4%	2%	2%	3%	
	Estee Lauder	4%	11%	9%	7%	9%	
	Clorox	2%	4%	1%	3%	3%	
	Church & Dwight	1%	4%	6%	4%	4%	
	Coty	0%	-4%	0%	0%	-1%	
US Tobacco	Philip Morris	6%	6%	5%	5%	5%	4%
	Altria	6%	1%	2%	2%	2%	
All of the Above		100%	4%	4%	3%	4%	4%

Source: Citi, Visible Alpha, State Street

3.3. Brazil

- *The early stage of Brazil's economic cycle is attractive in the context of the broader global macroeconomic picture;*
- *Strong momentum behind pro-business political reforms continue to benefit equity prices and an improving business outlook;*
- *Brazil is supported by a story of improving economic health: falling unemployment, rising GDP growth and strengthening of the government's fiscal position.*



Source: Refinitiv Datastream - 24/01/2020

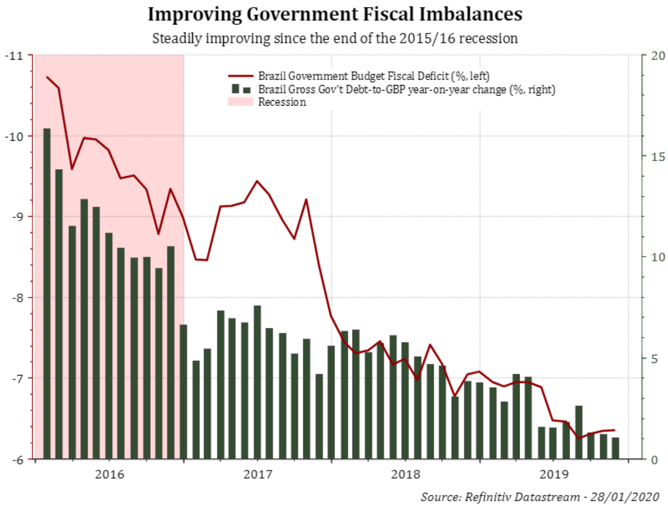
We are slightly overweight Brazil as part of a broader Latin America tactical overlay. Despite our sanguine view of the global economic climate, we feel comfortable in our exposure to specific Emerging Market geographies that could be strong beneficiaries of a pro-risk environment expected in early-to-mid 2019 ahead of the US election and while the Fed remains dovish.

Growth in Brazil is also supported by the fact that the nation is still in the early stages of its business cycle after weathering a severe economic recession in 2015/16 caused by lower commodity prices, government mismanagement of resources, and corruption. Brazil has been in a state of economic recovery (defined as time without a recession) for only 37 months (starting January 2017), whereas the US currently enjoys its longest ever stretch of economic recovery at over 127 months (starting July 2009). Considerable slack in the Brazilian labour market and modest inflation, which has only exceeded the 4.5% inflation target mid-point for brief periods since 2016, suggests that the economy is not running hot and its current economic cycle is not in its latter stages.

After a national election and government reshuffle in 2018, pro-markets President Jair Bolsonaro (dubbed "Trump of the Tropics"), has helped pass important but controversial reforms aimed at shoring up government finances. We see the early stage of Brazil's business cycle, the positive momentum in economic data, and pro-business government reforms as supportive for Brazilian equity prices. Brazil's Bovespa benchmark equity index posted strong performance in 2019, some of which was captured by Omba after we rotated out of our specific China position to capture the strong rebound which occurred in early 2019. Over 90% of the rally in China's CSI 300 equity index had occurred by February 2019. We elaborate on the various reasons why we like Brazil, as well as some risks, below.

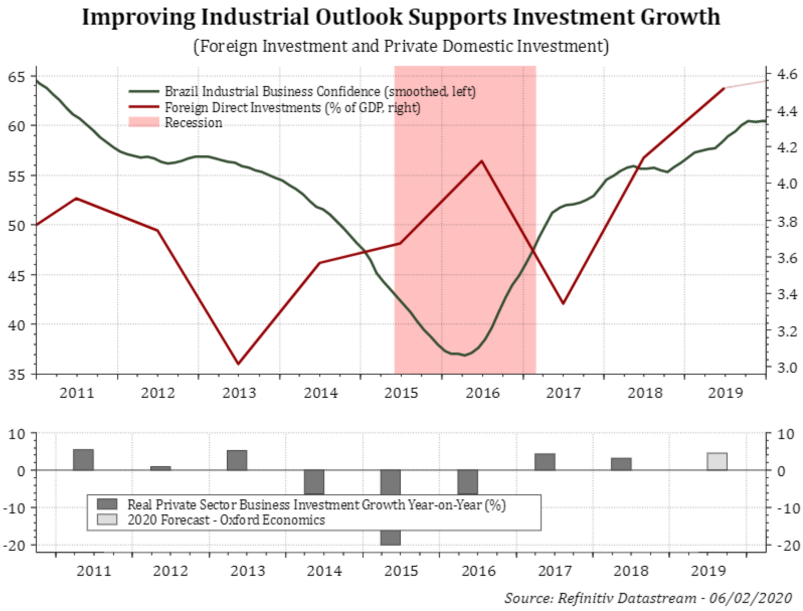
Government reforms

Market reform, and in particular improvements to the government's fiscal imbalance, are paramount to improving business confidence and private investment in the country. Such economic improvements would be highly supportive for Brazilian asset prices. Equities rallied strongly on President Bolsanaro's electoral win in 2018 on these expectations. In the past year we saw his government pass landmark (and in some minds controversial) reforms including an overhaul to the pensions system increasing the retirement age and reducing benefits to government workers. To show just how burdensome the state pension system was to government coffers: government employees were previously able to retire within their 50s and were entitled to continue to earn 70% of their final salary for the rest of their lives. Although government debt-to-GDP remains high for an EM nation at 91.6% for 2019[4] the metric has been relatively stable since mid-2019. Importantly, the rate of government debt expansion has slowed from over 17% year-on-year to around 2% year-on-year and fiscal discipline appears to be in place. We are aware that the political landscape in Brazil remains volatile as Bolsonaro suffers from falling approval ratings and continued infighting in Congress and as such are watching developments in Brazil closely.



An improving outlook

Brazil benefits from being at an earlier point in its business cycle and so could continue to grow for longer and likely has a greater capacity for expansion than many other countries. Brazil benefits further from a "low base" (or good relative starting point) following the 2015/16 recession - which saw almost a doubling of the unemployment rate and an 8 percentage point rise in the annual government budget deficit. Brazil has since seen a steady strengthening in the labour market, continued positive acceleration of GDP growth, and solid momentum in various indicators such as manufacturing PMIs. Although there are still soft spots within Brazilian industry and exports, business confidence is high across the manufacturing sector. The nation boasted one of the most optimistic Manufacturing PMI outlook survey results in the G20 during 2019[5] despite many parts of the world flirting with a manufacturing recession. Brazil also has the 5th largest population in the world at 209 million people and this further supports their economic story. We do not that lower oil prices may pose risks to the nation which generates significant income from oil exports.



3.4. US Minimum Volatility Factor

- *Minimum Volatility (or "Min Vol") is another core Factor Style which weights the exposures of stocks within an index according to the theoretical minimum variance portfolio based on Markorwitz's 1952 seminal paper;*
- *Min Vol Factor products attempt to optimise the parent index through maximising expected return relative to the lowest absolute volatility;*
- *US Min Vol portfolios, relative to the parent index, have a lower Cap bias, a lower beta bias, a lower volatility bias, and a bias towards stocks with low idiosyncratic risks.*

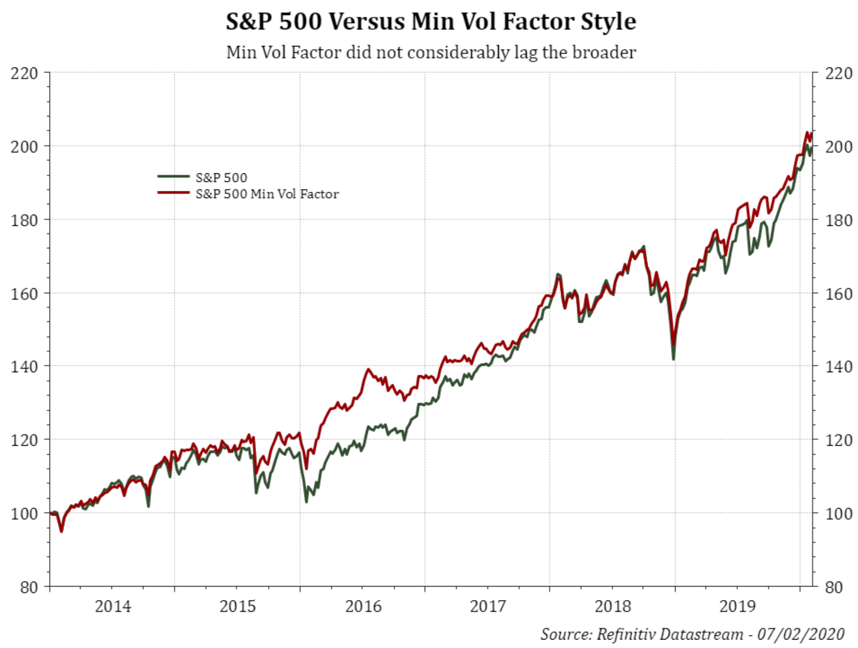
Min Vol: does exactly what it says on the tin!

On the right you can see part of an historical analysis we did when considering our US Min Vol Factor product. We examined the performance of various S&P 500 Factor products over periods of market correction since 2018, including the severe 4Q 2018 sell-off. A correction was defined as a Maximum Drawdown greater than 5% for the S&P 500. We considered data that included (i) Maximum Drawdown, (ii) the number of days it took for the product to return to the previous peak, and (iii) the Standard Deviation observed during the period (which is a measure of volatility and risk).

Period start	*29-Jan-18*	*21-Sep-18*	*01-May-19*	*25-Jul-19*	
Period end	*09-Feb-18*	*24-Dec-18*	*03-Jun-19*	*06-Aug-19*	
Maximum Drawdown Over Period					**Average**
S&P 500 Index	-9.4%	-17.9%	-6.4%	-5.2%	**-9.7%**
S&P 500 Minimum Volatility Factor	-8.3%	-15.5%	-3.9%	-3.8%	**-7.9%**
S&P 500 Value Factor	-10.4%	-20.9%	-9.0%	-6.6%	**-11.7%**
S&P 500 Hedge Fund Tracker	-8.4%	-21.3%	-9.3%	-5.3%	**-11.1%**
Recovery Time in Days (Trough to Prev. Peak)					**Average**
S&P 500	167	113	17	38	**84**
S&P 500 Minimum Volatility Factor	165	108	8	30	**78**
S&P 500 Value Factor	200	316	39	36	**148**
S&P 500 Hedge Fund Tracking Product	129	119	53	105	**102**
Standard Deviation During Period					**Average**
S&P 500	29%	19%	13%	18%	**19.7%**
S&P 500 Minimum Volatility Factor	28%	17%	12%	14%	**17.7%**
S&P 500 Value Factor	36%	19%	15%	20%	**22.5%**
S&P 500 Hedge Fund Tracking Product	30%	28%	17%	20%	**23.9%**

Source: Refinitiv

The S&P 500 Min Vol Factor product actually performed best across all four corrections across each of the three measures of risk. It demonstrated the lowest Max Drawdown, quickest time of recovery, and lowest measure of volatility (according to standard deviation). Given our sanguine outlook we are comfortable with our exposure to the US Min Vol Factor as it provides enhanced protection against market risk whilst still granting us exposure to broader S&P 500 beta.



Importantly, as can be seen from the chart on the left, the S&P 500 Min Vol Factor Style has outperformed the broader S&P 500 index over the medium-term since 2014.

4. EMEA (Europe, Middle East and Africa)

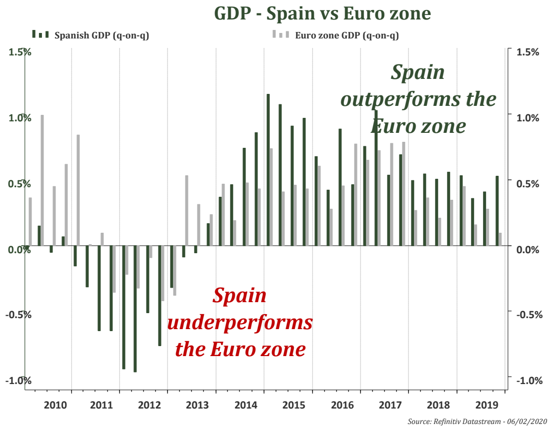
4.1. Spanish Equity

- *Political risk remains elevated with a recently installed fragile leftist coalition government;*
- *One of the fastest growing economies in Europe;*
- *Trading at historic lows versus the rest of Europe.*

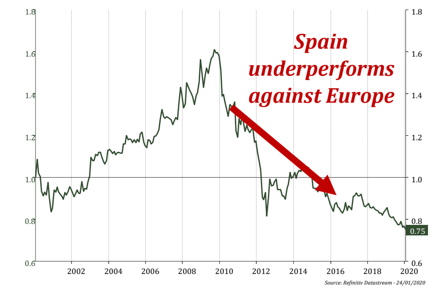
Politics

Political risk remains one of the key challenges to the success of the Spanish economy with Pedro Sánchez's Socialist party holding just 120 of the 350 parliamentary seats. To secure his election as Prime Minister, the Socialists formed a coalition with the radical left Podemos ("we can") (and together they hold just 155 seats). This is the first Spanish coalition government since 1930 and has also marked the fourth election in four years. The government's key policies are increased taxes on large corporates, more worker protection and a higher minimum wage which no doubt would weigh on investor confidence should the policies be implemented in their proposed form. Any significant reform would however likely be difficult to pass with a such a fragile and split parliament. In addition, the protests surrounding Catalonia's independence bid, which has somewhat subsided, remains far from resolved.

Economy



Despite the continued political uncertainty, the Spanish economy has largely outperformed the broader Euro zone as measured by quarter-on-quarter GDP growth. This can be seen in the chart below, where Spain grew by 0.4% in Q3 2019 (above the Euro zone at 0.2% for the same period). Other economic indicators like the unemployment rate in Spain has continued to fall from a peak of almost 27% to 13.9% (a level not experienced since 2007). Although manufacturing PMIs are contractionary, services PMIs are expansionary. Despite government debt levels (at 97.6% of GDP) remain elevated they are nowhere as concerning as those of Italy for example, at 134.8% of GDP.



Despite a relatively sound economic backdrop in Spain the equity market performance in recent years has been poor relative to the STOXX 600 Europe (in price terms). We think political uncertainty, and the time it has taken post the GFC to clean up the banking sector, has resulted in a lack of investor confidence. The IBEX 35, the benchmark stock market index of the Bolsa de Madrid, Spain's principal stock exchange, also offers a higher dividend yield of 4.3% vs 3.4% for the STOXX 600. The composition of the IBEX 35 does noticeably differ from the STOXX 600 Europe, with more financials and utilities but less healthcare and consumer staples. In the IBEX 35, the top two holdings are the global bank, Santander and a global energy and renewables company, Iberdrola. Thus, as a contrarian and "value oriented" trade, we feel comfortable holding Spain as a tactical overweight within broad Europe.

Sector	IBEX 35 ETF	STOXX 600 Europe ETF
Financials	27.65	18.42
Industrials	12.62	14.35
Utilities	19.86	4.31
Consumer Discretionary	8.36	9.87
Health Care	3.70	13.91
Communication Services	10.30	4.41
Information Technology	7.57	6.19
Consumer Staples	0.48	12.15
Materials	3.06	8.47
Energy	4.38	5.66
Real Estate	2.02	2.25

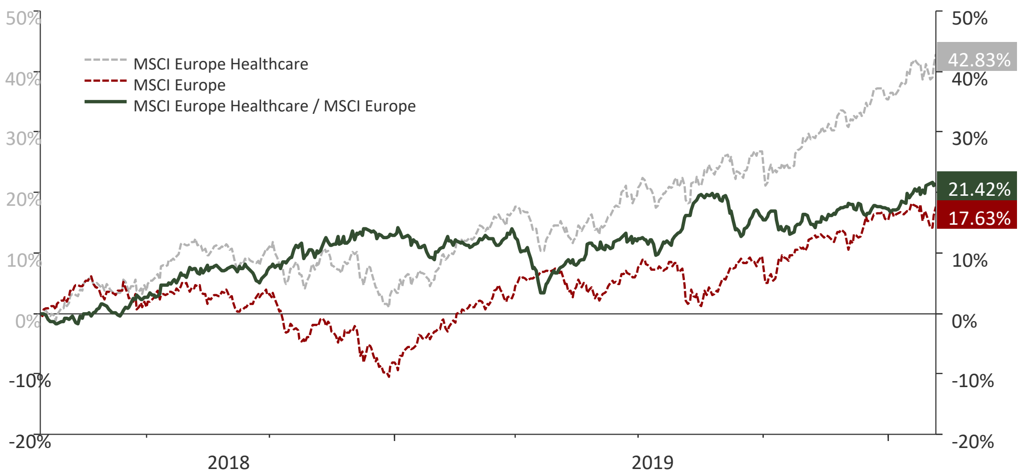
Source: Refinitiv

4.2. European Healthcare

- *A defensive sector being an essential element of consumer spending;*
- *Supportive long-term factors including an ageing population;*
- *A key risk is regulation, especially relating to drug prices.*

Important Factors

Since the inception of our tilt into European Healthcare in early 2018, it has performed strongly in absolute terms (up 40.02%) and has strongly outperformed the broader MSCI Europe (by 21.29%). Part of this outperformance is attributable to resilience shown by the sector in the Q4 2018 correction, which we view as an important aspect of the sector. Healthcare now trades at a slightly higher forward PE (of 19.7 vs 18.0 for the broader index – both driven up notably by the multiple expansion in 2019). While some of the previous drivers for this tactical position have changed (like the then poor relative performance against the broader index) many factors supportive of European Healthcare remain.



European healthcare is globally diverse and defensive sector, that unlike its US counterpart is dominated by pharmaceutical companies. Through some of its large multinationals (Roche, Novartis, AstraZeneca) the European healthcare sector currently generates about a third of its revenue from the US. The US spends far more (per capita) on pharmaceuticals than any other OECD country and more than double the OECD average. [6]

Longer term factors are supportive of strong demand for healthcare as populations age, cancer instances increase and global development of and access to medicine improves. Furthermore, there are continued advancements in the field of biotechnology.

As we're seeing with Coronavirus and have seen in the past with SARS and Ebola and others, the risk to humans from unknown diseases causing a pandemic appears to be on the rise and pharmaceutical companies would be beneficiaries of this as demand for their products could increase.

Key Risks

There are three keys risks, which may impact the sector at different points in time. The first is from government regulation and intervention. Regulation can cap or reduce spending on healthcare by governments, lead to lower revenue generation and margin compression. We watch the US election this year as a potential source of risk as most candidates appear to be taking a tough stance on big-Pharma.

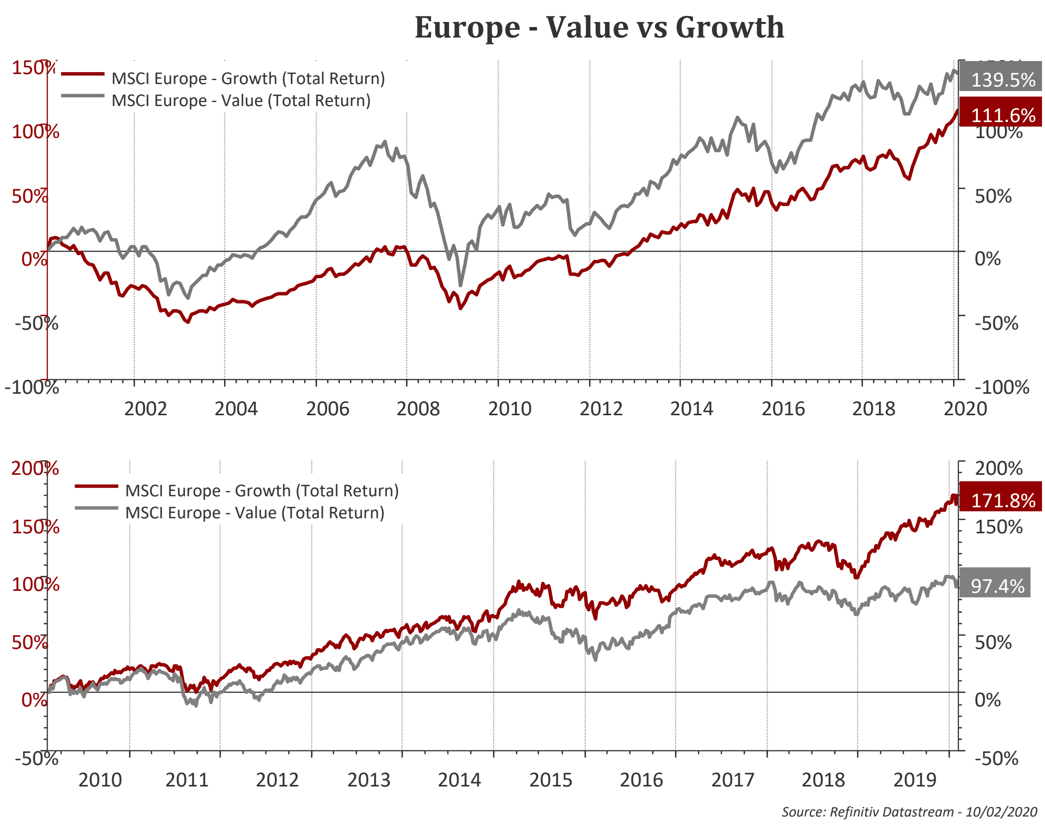
Secondly, a greater use of generic drugs (and competition among these generic drugs) may lower profits for the industry, with some price reductions ranging from 4% in Switzerland to 45% in Poland. Generics, on average across the OECD, account for approximately 52% of the volume and 25% of the value of pharma.[7]

Thirdly, competition in the healthcare sector emerging from non-traditional healthcare providers poses a risk (for example AstraZeneca's signing of a memorandum of understanding with a subsidiary of Alibaba). In the future, the technology sector may capture some of the healthcare sector revenue.

4.3. European Value Factor

- *Trading at much lower price-earnings multiples than the broader market;*
- *Recently under-performed growth and the broader market;*
- *Is well-diversified by sector and underlying companies.*

We see potential outperformance for European value - whilst its recent price performance has lagged growth (over the last 10 years) the top part of the below chart shows that value has outperformed growth over 20 years.



Fundamentals

It is also important to clarify the definition of Value as its implementation methodology can differ considerably. Specifically, the ETF that we look at uses three metrics to assess Value: Price-to-Book Value, Price-to-Forward Earnings and Enterprise Value to Cash-flow from Operations. Importantly the methodology does also remain sector neutral as compared with the broader index, which helps to isolate value and removes any bias driven by sectors. The overlap in holdings between Value and the broader index is relatively low at about 35.9%.

Sector	Value ETF	MSCI Europe ETF
Financials	17.6%	17.9%
Consumer Staples	15.2%	13.4%
Health Care	14.3%	14.4%
Industrials	13.6%	14.0%
Consumer Discretionary	8.9%	9.8%
Materials	7.0%	7.1%
Information Technology	6.5%	6.3%
Energy	6.3%	6.3%
Utilities	5.0%	4.9%
Communication Services	4.2%	4.4%
Real Estate	1.4%	1.5%

Holdings Overlap	Value ETF	MSCI Europe ETF
Value ETF	100.0%	35.9%
MSCI Europe ETF	35.9%	100.0%

Source: Refinitiv

Some other important characteristics are the dividend yield and PE ratios. The value ETF offers a higher dividend yield (of 4.59%) and notably lower PE, forward PE and Price-to-book ratios (of 12.43, 10.10 and 1.06 respectively). Linked to the recent underperformance in terms of price, the recent drawdown of Value has been higher than that of the broader index. However, due to lower valuation multiples any multiple contraction in the broader market may impact Value stocks to a far lower degree.

	Number of Holdings	Company Market Cap (EUR)	Dividend Yield	PE	Forward PE	Price-to-Book	Drawdown 1-yr
Value ETF	145	54.5 billion	4.59%	12.43	10.10	1.06	-8.02%
MSCI Europe ETF	426	73.2 billion	3.57%	16.92	14.30	1.84	-4.80%

Source: Refinitiv, MSCI

We favour the defensive nature of value, especially in relation to potential multiple contraction (particularly after 2019’s returns being largely driven by multiple expansion). Some of the recent market conditions have favoured value stocks for short periods (Q4 2019) and this may become more prevalent going forward - especially in an environment where markets have moved strongly higher but underlying earnings growth has not been particularly strong.

4.4. Sustainability (ESG) in Europe

- *Reduced exposure to a volatile oil and gas sector;*
- *Over-weight companies with better ESG ratings;*
- *Capture the trend of ESG investing.*

We think that the Environmental, Social and Governance (ESG) theme is a good way to obtain exposure to developed Europe in a differentiated manner. The European Commission, with its roadmap as set out in *The European Green Deal*, strives to make Europe the world's first climate-neutral continent by 2050. This presents a great opportunity for the continent which is otherwise struggling with lacklustre growth, negative interest rates and an ageing population. The most innovative and impactful companies are well-poised to benefit over the coming years and decades, particularly as the rest of the world adopts similar policies. There are two main approaches to realise this opportunity - it can either be accessed from a broad ESG approach, covering most of the market (with sector exclusions and customised company weightings), or from a more targeted thematic approach (for example investing in clean energy companies).

Sustainable investing continues to rapidly evolve and has only recently been able to gain meaningful momentum.

Two immediate challenges in sustainable investing are:

- The finalisation and implementation of a standardised classification system to help investors make informed investment decisions based on environmental activities. The European Parliament and the Council approved (on 18 December 2019) the creation of the world's first-ever "green list" classification system, or taxonomy, for sustainable economic activities.[8] This will however take time to implement.
- The lack of availability of robust, reliable and publicly available ESG data (which will improve transparency and comparability of investments).

Why now?

Key trends are driving growth in sustainable investing. Consumers are becoming increasingly aware of environmental damage from pollution caused by single-use plastics and the burning of fossil fuels to the melting ice caps, hotter temperatures, floods and devastating wildfires. Social and governance issues are also very topical as diversity and inclusiveness, data privacy, executive pay disputes and the principles of good corporate governance increasingly come under the spotlight. Failure to appropriately deal with these issues may have a real financial implication.

As the younger generation (who may be more environmentally aware and have stronger feelings about these topics) become more financially important, so the pressure on non-ESG friendly investments will increase. Social media has propagated some of these views and information is spreading more quickly.

Government policies are moving in tandem as society applies more pressure for policy change. In the UK for example, regulations introduced in 2019 require trustees of all schemes to understand and to include ESG factors and stewardship approaches in their investment decision-making. Trustees are at significant risk of breaching their legal and regulatory duties if they do not do so.[9]

Japan's Government Pension Investment Fund, the world's largest retirement scheme, continues to push ahead with its ESG investing, and Norway's sovereign wealth fund, the largest in the world, has been given the go ahead to divest from coal and oil companies. Two massive ETF launches took place in 2019, being the iShares ESG MSCI USA Leaders ETF (SUSL) and the Xtrackers MSCI USA ESG Leaders Equity ETF (USSG) which gathered assets of $1.8 billion and $1.7 billion respectively. Both were seeded by the

Finnish pension insurer, Ilmarinen.

How does ESG look in Europe?

As an increasing amount of literature argues the performance of ESG strategies have historically been in line with that of broader benchmarks. From a risk and valuations perspective they have also been comparable. Past performance is not a guide to future performance and market dynamics and consumer awareness have changed over the years so looking forward the results may not be as similar.

The below tables summarise some key facts for two European ESG benchmarks and two European ESG ETFs (that track the aforementioned benchmarks).

	Number of holdings	Performance 2019 (%)	Annualised Performance 5-yrs (%)	Dividend Yield (%)	P/E Ratio	Sharpe Ratio 5-yrs	Max Drawdown 7-yrs (%)
MSCI Europe	**437**	**26.05%**	**6.65%**	**3.44%**	**17.18**	**0.61**	**25.92%**
MSCI Europe ESG Enhanced Focus Index	409	26.41%	6.68%	3.41%	17.48	0.61	25.57%
MSCI Europe ESG Screened Index	411	25.99%	6.46%	3.33%	17.66	0.59	25.66%

Source: MSCI, December 2019[1]. [1]

Total CO_2 equivalent emissions[1] (in tons) to Revenue ($ million):

	CO_2 emission
MSCI Europe ETF	**149.9**
ESG Europe ETF 1	108.8
ESG Europe ETF 2	124.1

Source: Refinitiv, 2020

Percentage overlap of holdings:

	MSCI Europe ETF	ESG Europe ETF 1	ESG Europe ETF 2
MSCI Europe ETF	**100%**	**79.0%**	**87.5%**
ESG Europe ETF 1	**79.0%**	100%	85.6%
ESG Europe ETF 2	**87.5%**	85.6%	100%

Source: Refinitiv, 2020

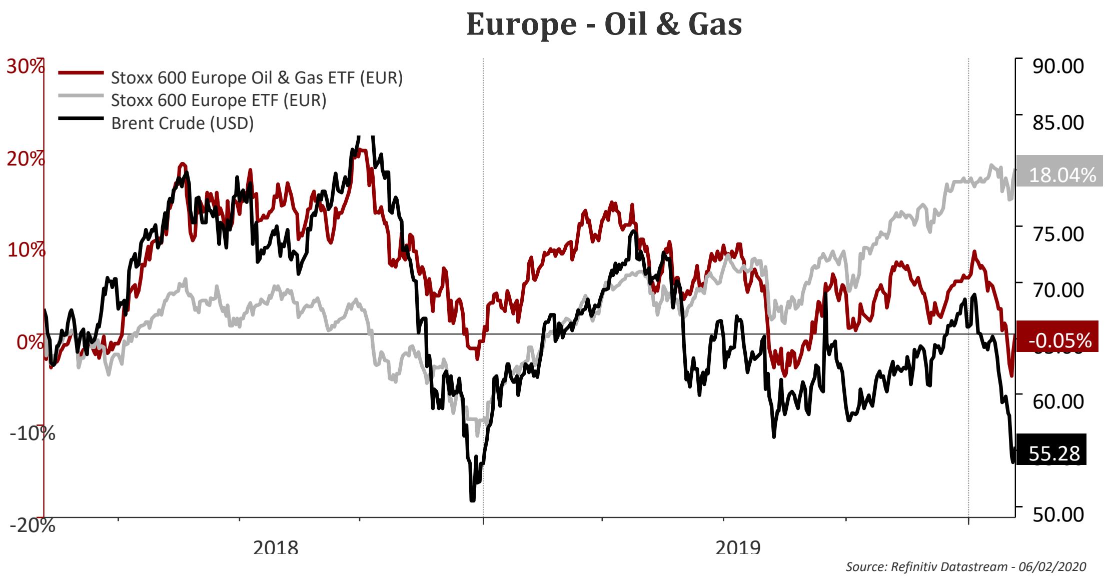
The criteria for ESG portfolios do vary considerably - companies involved in weapons, oil sands, thermal coal or tobacco are typically excluded. The next level of exclusion is often to exclude companies with worse ESG ratings, while remaining relatively sector neutral. This has the benefit of a lower expected tracking error when compared with the non-ESG equivalent index. In line with this, and depending on the exact ESG index, there is no significant deviation from the non-ESG index in relation to traditional factors (value, size, momentum and volatility). While the number of holdings is similar for the above three ESG indices, they notably only overlap by between 80.4% to 85.6%, the difference being driven by the different weightings applied to the constituents. The methodology behind the ETF is therefore of importance and something on which we spend time analysing.

[1] Including both Scope 1 (direct emissions from sources controlled by the company), and Scope 2 (indirect emissions from consumption of purchased electricity)

4.5. European Oil & Gas

- *Lower demand led by slowing global growth, trade tensions and Coronavirus outbreak;*
- *Structural slowing of demand led by climate change and renewables response;*
- *Supply side stress with volatile Middle East tensions, sanctions and OPEC cuts.*

Demand side



Although the current global expansion may be one of the longest on record, the growth rate has been one of the slowest. Slowing global growth and persistent trade tensions (even with the temporary relief of a phase one US-China trade deal) are impacting the marginal demand for oil.

The recent Coronavirus outbreak in China has contributed to the recent sharp fall in oil prices. China became the largest global energy consumer in 2011 and is the world's second-largest oil consumer behind the United States.[10] The crippling impact that quarantines have had on global transportation and Chinese industry, while temporary, are having a large impact on energy prices.

Supply side

We see four key factors impacting the supply:

- US energy production has in spiked in recent years, narrowing their energy deficit (i.e. consumption needs over energy production) to a level not seen since 1970[11];
- US sanctions on Iran and Middle East tensions (including the attacks on Saudi oil facilities);
- Renewables energy supply is expected to grow strongly, led by government funding, policy change towards greener energy and technological advancements. The International Renewable Energy Agency (IRENA) anticipates renewable energy share to reach up to 36% of the global energy mix by 2030, increasing from 18% in 2014.[12]
- In December 2019, OPEC and other producers agreed to a production cut of 1.7 million barrels a day from January 2020 to March 2020 (with Saudi pledging a further cut of 0.4 million barrels a day)[13], and has more recently considered a further cut of 0.6 million barrels a day in response to the Coronavirus outbreak.

What next?

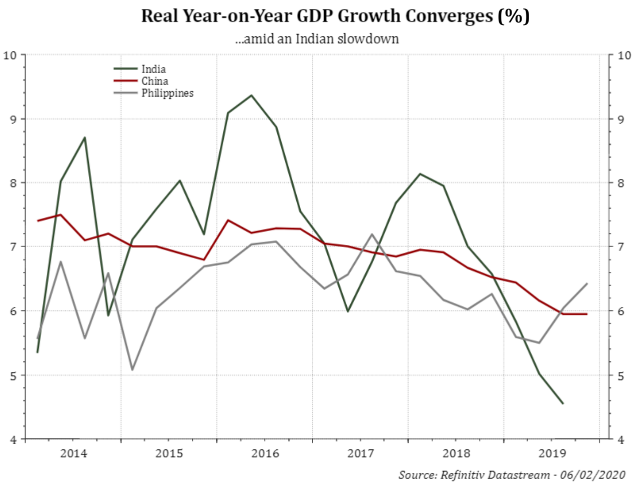
We have held a European oil and gas tactical position on two separate occasions since January 2017, however in the long term it is difficult to see energy prices (particularly oil) at sustainably high levels due to the demand and supply factors described above. Considerable pressure to transition the energy industry away from the use of fossil fuels will help to provide a price cap to energy prices. Suppliers on the other hand, together with significant level of fossil fuel dependence by many industries, will provide a price floor. On balance, and strategically, we do not see value in the oil and gas sector at current prices, and we have strategically reduced our exposure using ESG products which have specifically screened out oil companies in their process. Tactically there may be a good point to re-enter the sector for a short timeframe, but we believe that the downside risk currently outweighs upside potential.

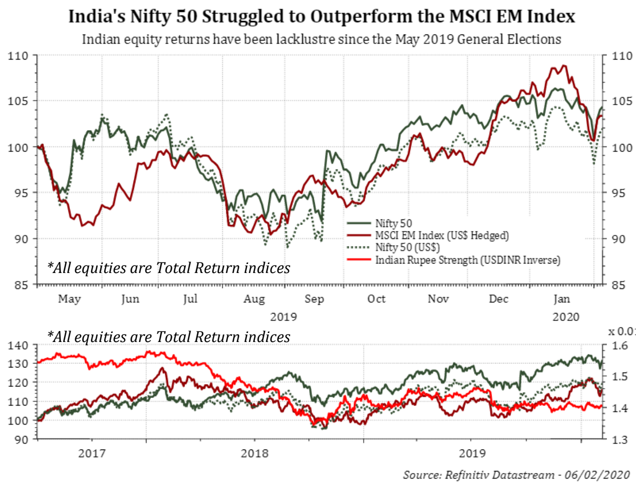
5. APAC (Asia Pacific)

5.1. India

- *Its large population, young demographic profile, stable and democratic political system, and continued path of economic and free-market reform will be supportive to India in the long-term;*
- *We have been disappointed by the performance of Indian equities since the May 2019 Modi re-election;*
- *We anticipate that the impetus for future growth and economic outperformance must come from the private sector – requiring an increase to current sluggishness in consumption (despite tepid income growth trends) and investments (recent tax cuts may be insufficient).*

India is an nation that we actively follow - especially since the 2Q 2019 publication of our **India Outlook & Analysis**[14]. Hailed as "the fastest growing large economy" as recently as last year, the world's second most populous nation has been met with general disappointment from investors as actual GDP growth has slowed and forecasts have converged with other Emerging Market nations such as China and the Philippines.





We have been disappointed by India's lacklustre performance within the broader EM equities space since the May 2019 General Elections given a lack of passthrough in much anticipated pro-business political reform and stimulus. We favoured India on hopes that Modi, having then won a second term for his Bharatiya Janata Party ("BJP"), would use his platform to build on previous reforms such as the 2016 demonetisation and 2017 tax reform (the "twin shocks"). Both policies were implemented with questionable efficacy but are ultimately expected to become long-term tailwinds for growth.

Investors had high expectations for the recent union budget amid broader economic weakness. The market is now embracing a narrative that an economic recovery must come from the private sector, with the government simply acting as an enabler.

- The announcement of no significant stimulus was disappointing, although government prudence will improve long-term fiscal stability. The government's fiscal deficit target is at 3% of GDP although it was missed by 50bps for the current fiscal year.
- The recent measures aimed at boosting rural and middle-class income are unlikely to provide a boon to the economy.
- The recent elimination of the Dividend Distribution Tax ("DDT") will have mixed results. While moderately positive for some companies, the reform may make share buybacks more attractive for other firms. However, public equity markets did not receive the news well as it may increase the tax burden for wealthy individuals and other entities.
- The government continues its divestment of state-owned enterprises. This will continue to improve corporate efficiency in India as well as provide a source of income to the government. However, some investors opine that an increased supply of equity may limit upside.

In our **India Outlook & Analysis** piece we touched on a variety of interesting topics including an analysis of various Indian asset classes, the composition of the Indian economy and some of the challenges it faces, as well as looking at the history (incl. economic history) of this great country. Despite some of the concerns we highlight above we remain optimistic about India's continued emergence as a global superpower given its large population, young demographic profile, stable and democratic political system, and continued path of economic and free-market reform. Please follow the link below to read more: https://www.ombainvestments.com/publications/india-outlook-analysis/

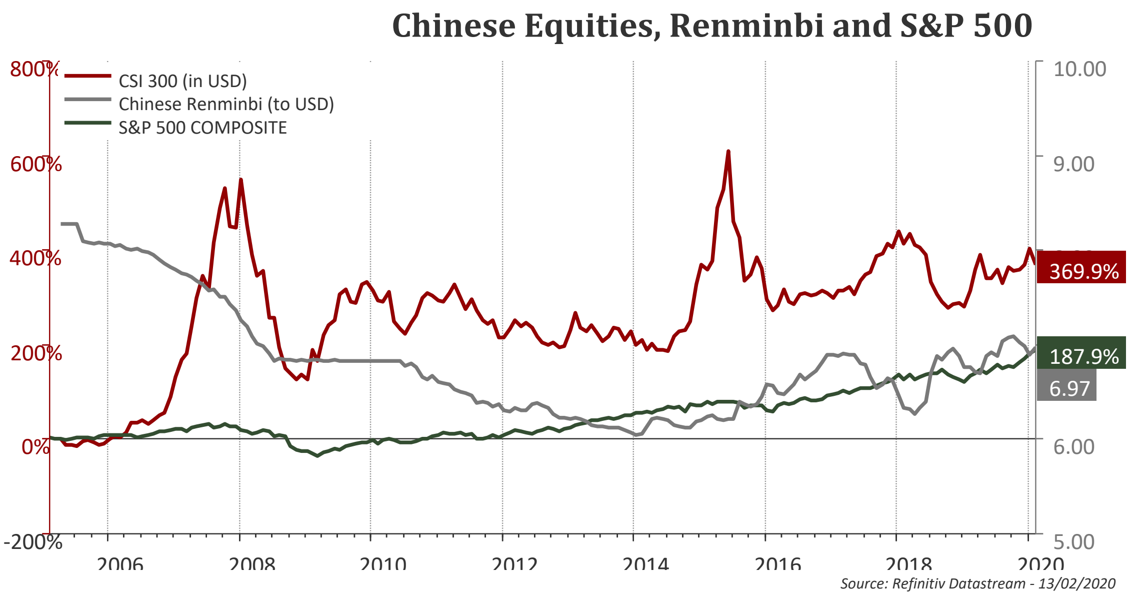
5.2. China

- *Protracted trade negotiations with the US added price volatility;*
- *GDP growth remains strong albeit slowing as the economy matures;*
- *Coronavirus (Covid-19) outbreak impacts markets and anticipated GDP growth for 2020.*

Whilst the Chinese equity market remains volatile it does offer an opportunity for investors seeking exposure to the world's second largest economy. While growth in China's GDP continues to slow, its growth rate of 6.0% is well above the global average of 2.9% and well above many developed nations. How China navigates its relationship with the US and how it manages its domestic economy (including the opening up of local industries and the managing of any over indebtedness) will be key to China's future success. In addition to its strategic long-term potential China may also offer good tactical investment opportunities especially in the wake of various challenges (such as the US-China trade tensions and the recent Coronavirus outbreak).

Last year we wrote *Investing in The People's Republic of China – An ETF Overview* which provided an overview of Chinese equity capital markets as well as an analysis of 10 key ETFs offering exposure to China. This information remains highly relevant as one seeks to understand the broader investment landscape. We have moved into and out of China in differing amounts and in favour of other regions over the last 3 years and are currently underweight but considering increasing our exposure further depending on Coronavirus impacts.

The following chart shows the performance of a China A-shares ETF (comprising onshore Chinese companies) measured in US Dollars (red line) and the Chinese Offshore Yuan (grey line). It is clear from the chart that there is significantly more volatility in Chinese equity markets than that of the S&P500 which in our view presents opportunity to over and underweight China during the cycle.



Fascinatingly, the Chinese stock market has outperformed the S&P500 significantly when one views the chart above which includes the Global Financial Crisis. We think this long term trend will continue, albeit with higher volatility for China.

A brief timeline of US China relations[15]:

3 Apr 2018: US plans for 25% tariffs on $50 bn. China retaliates.

10 Jul 2018: US plans for 10% tariffs on $200 bn.

1 Aug 2018: US increases tariffs from 10% to 25% on the $200bn.

24 Sep 2018: 10% tariff on $200 bn kicks in and plans to increase this to 25% on 1 Jan 2019.

1 Dec 2018: Trump and Xi agree 90-day truce (US postpones the 1 Jan 2019 increase on $200 bn).

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1 Mar 2019: US halts the previously planned increase (from 10% to 25%) on the $200 bn.

5 May 2019: US then plans to raise the tariffs on $200 bn of Chinese goods to 25% on 10 May 2019.

6 Jun 2019: Trump says that he will decide on whether to impose 25% tariffs on $300 bn on 15 Dec (Trump later decided against this additional tariff).

1 Aug 2019: US announces 10% tariff on $300 bn.

5 Aug 2019: US labels China as a currency manipulator.

13 Aug 2019: US postpones some of the 10% tariffs on the $300 bn goods list until 15 Dec 2019 (10% tariffs on $112 bn are still imposed on 1 Sept 2019).

23 Aug 2019: US plans to raises tariffs from 25% to 30% on the existing $250 billion worth of Chinese goods beginning on October 1, 2019, and from 10% to 15% on the remaining $300 billion worth of goods beginning on 15 December 2019. The new 15% rate will also apply to the $112 bn to be imposed from 1 Sept 2019).

1 Sep 2019: US tariffs of 15% on the $112 bn come into effect.

11 Sep 2019: US delays imposing the 25% to 30% tariff increase from 1 Oct 2019 to 15 Oct 2019.

11 Oct 2019: The proposed, and already delayed tariff increase from 25% to 30% on $250 bn of goods, are suspended due to a tentative first phase trade agreement.

13 Dec 2019: Trump tweets that a "Phase One" deal has been agreed. The penalty tariffs would be postponed indefinitely, and the 1 Sept 2019 tariffs would be halved to 7.5%. **Therefore 25% tariffs on $250 bn and 7.5% tariffs on $112 bn, still remain**.

31 Dec 2019: World Health Organisation (WHO) first alerted to what is now known to be a new type of Coronavirus (Covid-19).

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13 Jan 2020: US reverses its previous labelling of China as a currency manipulator.

15 Jan 2020: US and China sign a phase 1 trade deal.

28 Jan 2020: 5,974 cases and 132 deaths are recorded as the Coronavirus outbreaks continues. See our *Market Update* published on 4 February 2020 for more details.

6 Feb 2020: China prepares to halve the extra tariffs on US goods (that were implemented in September 2019). This will come into effect on 14 February 2020 as China seeks to cushion the impact from the Coronavirus outbreak.

6. Conclusion

2020, the start of another decade, has already been a demanding year from a markets perspective and at the time of writing we are just 6 weeks in. We see the rest of 2020 as likely to present several investment opportunities as market prices react, sometimes irrationally, to socio-economic and political events.

The Covid-19 outbreak still poses much downside risk (as many markets have at least partially recovered the initial market shock of January 2020). The extent to which economies (and not just market prices) will be impacted, especially South-East Asia, remains highly uncertain. We also look to other political events, notably the upcoming US election as an event that will require investors to react and position themselves appropriately as policies of the next administration become clearer.

The market's *cautious optimism* is expected to drive markets higher in 2020, with obvious consideration of the risks discussed in this report. Promising signs in global PMI data and low unemployment show some cause for optimism. One of the biggest influences on markets has been the US Federal Reserve with its abrupt change from hawkish to dovish in early 2019. Its ability and willingness to react remains an important consideration for increasing or decreasing risky asset exposure.

On balance, we are well positioned by retaining equity market beta but also allocating to some more defensive sub-categories within equity.

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Appendix A – Asset Returns

S&P 500 Historic Calendar Total Returns and 10yr US Bond Comparison

(light green)	2010 - 2019 (most recent 10 years)
(dark green)	1990 - 2009 (11 to 30 years ago)
(grey)	1928 - 1989 (preceeding 62 years)
X	Count of years
X %	Percentage of total years

As can be seen from this chart, nearly three quarters of the time the US market delivered positive returns over the last 92 years ... But market drawdowns are not uncommon and should be expected when equities are owned in

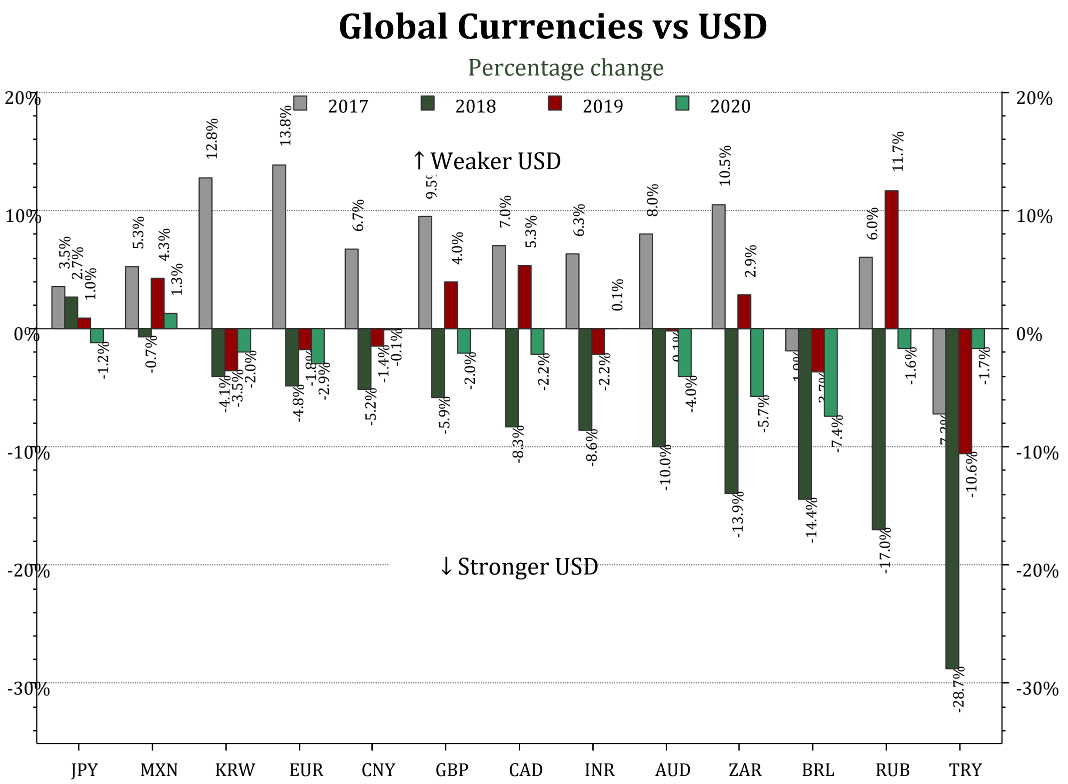
-50% to -40%	1	1%	1931
-40% to -30%	2	2%	2008, 1937
-30% to -20%	3	3%	2002, 1974, 1930
-20% to -10%	5	5%	2001, 1973, 1957, 1941, 1940
-10% to -0%	14	15%	2018, 2000, 1990, 1981, 1977, 1969, 1966, 1962, 1953, 1946, 1939, 1934, 1932, 1929
0% to 10%	15	16%	2015, 2011, 2007, 2005, 1994, 1993, 1992, 1987, 1984, 1978, 1970, 1960, 1956, 1948, 1947
10% to 20%	19	21%	2016, 2014, 2012, 2010, 2006, 2004, 1988, 1986, 1979, 1972, 1971, 1968, 1965, 1964, 1959, 1952, 1949, 1944, 1942
20% to 30%	15	16%	2017, 2009, 2003, 1999, 1998, 1996, 1983, 1982, 1976, 1967, 1963, 1961, 1951, 1943, 1938
30% to 40%	13	14%	2019, 2013, 1997, 1995, 1991, 1989, 1985, 1980, 1975, 1955, 1950, 1945, 1936
40% to 50%	4	4%	1958, 1935, 1933, 1928
50% to 60%	1	1%	1954

27% of the time <0% | 73% of the time >0%

US 10 Year Bond		
-20% to -10%	1%	18%
-10% to -0%	17%	
0% to 10%	62%	82%
10% to 20%	14%	
20% to 30%	4%	
30% to 40%	1%	

Source: New York University, Stern School of Business, 20/1/2020, http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

Currency Fluctuation



Source: Refinitiv Datastream - 13/02/2020

Equity Sector Heatmap

These are based on Thomson Reuters Global Sector Indices, total return in USD. The key point to note is that there can be significant sector dispersion, and where one year a sector is top performer, the next year it could be a bottom performer. This is why Omba places value on tactical asset allocation to sectors (and countries).

Global Basic Materials Index 37.9%		Global Basic Materials Index 65.1%	Global Cyclical Consumer Goods & Services Index 22.4%		Global Financials Index 22.7%	Global Healthcare Index 33.4%				Global Technology Index 40.9%		Global Technology Index 43.8%
Global Energy Index 34%		Global Technology Index 61.3%	Global Basic Materials Index 20.4%		Global Healthcare Index 20.4%	Global Cyclical Consumer Goods & Services Index 29.5%			Global Energy Index 27.2%	Global Basic Materials Index 29.9%		Global Industrials Index 27.9%
Global Utilities Index 28.7%		Global Cyclical Consumer Goods & Services Index 43%	Global Industrials Index 20%		Global Cyclical Consumer Goods & Services Index 16.1%	Global Industrials Index 29.1%	Global Healthcare Index 18%		Global Basic Materials Index 23.2%	Global Industrials Index 28.5%		Global Consumer Cyclicals Index 24.6%
Global Telecommunications Services Index 27.1%		Global Financials Index 40.6%	Global Non Cyclical Consumer Goods & Services Index 13.7%		Global Non Cyclical Consumer Goods & Services Index 11.7%	Global Technology Index 26.5%	Global Technology Index 14.7%		Global Technology Index 12.4%	Global Cyclical Consumer Goods & Services Index 24.4%		Global Healthcare Index 23.5%
Global Industrials Index 22.5%		Global Energy Index 34.4%	Global Energy Index 12.7%		Global Industrials Index 11.5%	Global Financials Index 21.3%	Global Utilities Index 12.2%		Global Industrials Index 10.7%	Global Financials Index 23.5%		Global Financials Index 23.3%
Global Non Cyclical Consumer Goods & Services Index 20%		Global Industrials Index 31.6%	Global Technology Index 11.8%		Global Technology Index 11.4%	Global Telecommunications Services Index 20.7%	Global Non Cyclical Consumer Goods & Services Index 7.1%		Global Financials Index 10%	Global Healthcare Index 22.9%		Global Utilities-59 Index 21.4%
Global Technology Index 10.6%		Global Non Cyclical Consumer Goods & Services Index 25.9%	Global Telecommunications Services Index 11.6%		Global Basic Materials Index 10%	Global Non Cyclical Consumer Goods & Services Index 18.5%	Global Financials Index 4.9%	Global Healthcare Index 6.9%	Global Utilities Index 8.7%	Global Non Cyclical Consumer Goods & Services Index 19.4%		Global Basic Materials Index 21%
Global Healthcare Index 5.6%		Global Healthcare Index 20.2%	Global Healthcare Index 4.8%		Global Telecommunications Services Index 5.9%	Global Energy Index 14.7%	Global Cyclical Consumer Goods & Services Index 3.6%	Global Non Cyclical Consumer Goods & Services Index 6.4%	Global Telecommunications Services Index 5.2%	Global Utilities Index 16.6%		Global Consumer Non-Cyclicals Index 19.8%
Global Cyclical Consumer Goods & Services Index 0.5%		Global Telecommunications Services Index 13.8%	Global Financials Index 4.4%	Global Healthcare Index 6.6%	Global Energy Index 2.9%	Global Utilities Index 11.2%	Global Industrials Index 3.6%	Global Technology Index 3%	Global Cyclical Consumer Goods & Services Index 3.3%	Global Telecommunications Services Index 9.3%	Global Healthcare Index 2%	Global Telecommunication Services Index 16.8%
Global Financials Index 0.1%		Global Utilities Index 11.6%	Global Utilities Index 0.9%	Global Non Cyclical Consumer Goods & Services Index 4.4%	Global Utilities Index 1.1%	Global Basic Materials Index 2.6%	Global Telecommunications Services Index 1.2%	Global Cyclical Consumer Goods & Services Index 2.9%	Global Non Cyclical Consumer Goods & Services Index 1.5%	Global Energy Index 8.6%	Global Utilities Index 0.7%	Global Energy Index 13.8%
2007	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**
	Global Healthcare Index -20.8%			Global Telecommunications Services Index -0.7%			Global Basic Materials Index -7%	Global Industrials Index -1%	Global Healthcare Index -5%		Global Technology Index -5%	
	Global Non Cyclical Consumer Goods & Services Index -27.1%			Global Energy Index -3.9%			Global Energy Index -14.1%	Global Telecommunications Services Index -2.7%			Global Non Cyclical Consumer Goods & Services Index -9.5%	
	Global Utilities Index -31.5%			Global Utilities Index -4.5%				Global Financials Index -4.2%			Global Cyclical Consumer Goods & Services Index -10%	
	Global Telecommunications Services Index -35.3%			Global Technology Index -6.1%				Global Utilities Index -9.3%			Global Telecommunications Services Index -10.3%	
	Global Cyclical Consumer Goods & Services Index -43.3%			Global Cyclical Consumer Goods & Services Index -7.6%				Global Basic Materials Index -13.7%			Global Financials Index -13.1%	
	Global Energy Index -45.4%			Global Industrials Index -12.9%				Global Energy Index -22.7%			Global Energy Index -13.8%	
	Global Industrials Index -45.7%			Global Financials Index -17.3%							Global Industrials Index -14.4%	
	Global Technology Index -46.2%			Global Basic Materials Index -20.4%							Global Basic Materials Index -16.6%	
	Global Financials Index -51.3%											
	Global Basic Materials Index -51.9%											

Source: Refinitiv, 2020.

Asset Class Heatmap

Year	Asset Class	Return
2007	EM Equity	39.8%
2007	Commodities	32.7%
2007	International Equity	11.2%
2007	Hedge Funds	10.3%
2007	US Aggregate Bonds	7.0%
2007	EM Debt	6.2%
2007	US Large Cap	5.5%
2007	International Small Cap	5.1%
2007	High Yield	3.2%
2007	Bank Loans	1.9%
2007	International Real Estate	-1.6%
2007	US Small Cap	-1.6%
2007	US Real Estate	-17.7%
2008	US Aggregate Bonds	5.2%
2008	EM Debt	-12.0%
2008	Hedge Funds	-21.4%
2008	High Yield	-26.9%
2008	Bank Loans	-28.8%
2008	US Small Cap	-33.8%
2008	US Large Cap	-37.0%
2008	US Real Estate	-39.8%
2008	International Equity	-43.4%
2008	Commodities	-46.5%
2008	International Small Cap	-46.8%
2008	International Real Estate	-51.8%
2008	EM Equity	-53.2%
2009	EM Equity	79.0%
2009	High Yield	59.4%
2009	Bank Loans	44.9%
2009	International Small Cap	44.2%
2009	International Real Estate	42.8%
2009	International Equity	31.8%
2009	EM Debt	29.8%
2009	US Real Estate	29.0%
2009	US Small Cap	27.2%
2009	US Large Cap	26.5%
2009	Commodities	13.5%
2009	Hedge Funds	11.5%
2009	US Aggregate Bonds	5.9%
2010	US Real Estate	28.5%
2010	US Small Cap	26.9%
2010	International Small Cap	21.6%
2010	EM Equity	19.2%
2010	International Real Estate	18.1%
2010	US Large Cap	15.1%
2010	High Yield	14.8%
2010	EM Debt	12.2%
2010	Bank Loans	10.0%
2010	Commodities	9.0%
2010	International Equity	7.8%
2010	US Aggregate Bonds	6.5%
2010	Hedge Funds	5.7%
2011	US Real Estate	8.9%
2011	US Aggregate Bonds	7.8%
2011	EM Debt	7.3%
2011	High Yield	3.1%
2011	US Large Cap	2.1%
2011	Bank Loans	1.8%
2011	Commodities	-1.2%
2011	US Small Cap	-4.2%
2011	Hedge Funds	-5.7%
2011	International Equity	-12.1%
2011	International Small Cap	-14.1%
2011	International Real Estate	-14.7%
2011	EM Equity	-18.2%
2012	International Real Estate	38.5%
2012	High Yield	19.6%
2012	EM Equity	18.6%
2012	International Small Cap	18.4%
2012	EM Debt	17.4%
2012	International Equity	17.3%
2012	US Real Estate	17.1%
2012	US Small Cap	16.4%
2012	US Large Cap	16.0%
2012	Bank Loans	9.4%
2012	Hedge Funds	4.8%
2012	US Aggregate Bonds	4.2%
2012	Commodities	0.1%
2013	US Small Cap	38.8%
2013	US Large Cap	32.4%
2013	International Small Cap	25.8%
2013	International Equity	22.8%
2013	Hedge Funds	9.0%
2013	International Real Estate	8.3%
2013	High Yield	7.3%
2013	Bank Loans	6.2%
2013	US Real Estate	1.3%
2013	Commodities	-1.2%
2013	US Aggregate Bonds	-2.0%
2013	EM Equity	-2.3%
2013	EM Debt	-5.3%
2014	US Real Estate	31.9%
2014	US Large Cap	13.7%
2014	EM Debt	7.4%
2014	US Aggregate Bonds	6.0%
2014	US Small Cap	4.9%
2014	International Real Estate	3.9%
2014	Hedge Funds	3.4%
2014	Bank Loans	2.1%
2014	High Yield	0.0%
2014	EM Equity	-1.8%
2014	International Small Cap	-3.2%
2014	International Equity	-4.9%
2014	Commodities	-33.1%
2015	International Small Cap	5.9%
2015	US Real Estate	4.5%
2015	US Large Cap	1.4%
2015	EM Debt	1.2%
2015	US Aggregate Bonds	0.5%
2015	Hedge Funds	-0.3%
2015	Bank Loans	-0.4%
2015	International Real Estate	-0.7%
2015	International Equity	-0.8%
2015	High Yield	-2.7%
2015	US Small Cap	-4.4%
2015	EM Equity	-14.6%
2015	Commodities	-32.9%
2016	US Small Cap	21.3%
2016	High Yield	14.3%
2016	US Large Cap	12.0%
2016	EM Equity	11.6%
2016	Commodities	11.4%
2016	EM Debt	10.2%
2016	Bank Loans	9.9%
2016	US Real Estate	6.6%
2016	International Small Cap	3.6%
2016	US Aggregate Bonds	2.6%
2016	International Real Estate	2.2%
2016	International Equity	1.0%
2016	Hedge Funds	0.5%
2017	EM Equity	37.8%
2017	International Small Cap	32.3%
2017	International Equity	25.0%
2017	International Real Estate	22.1%
2017	US Large Cap	21.8%
2017	US Small Cap	14.6%
2017	High Yield	10.4%
2017	EM Debt	10.3%
2017	Hedge Funds	7.8%
2017	Commodities	5.8%
2017	Bank Loans	4.2%
2017	US Real Estate	3.8%
2017	US Aggregate Bonds	3.5%
2018	Bank Loans	1.1%
2018	US Aggregate Bonds	0.0%
2018	Hedge Funds	-3.5%
2018	High Yield	-4.1%
2018	US Real Estate	-4.2%
2018	EM Debt	-4.3%
2018	US Large Cap	-4.4%
2018	International Real Estate	-8.7%
2018	US Small Cap	-11.0%
2018	International Equity	-13.8%
2018	Commodities	-13.8%
2018	EM Equity	-14.2%
2018	International Small Cap	-18.5%
2019	US Large Cap	31.5%
2019	US Small Cap	25.5%
2019	International Small Cap	24.5%
2019	US Real Estate	23.1%
2019	International Equity	22.0%
2019	International Real Estate	20.6%
2019	EM Equity	18.9%
2019	Commodities	17.6%
2019	EM Debt	15.0%
2019	High Yield	12.6%
2019	US Aggregate Bonds	8.7%
2019	Bank Loans	8.2%
2019	Hedge Funds	7.8%

Source: GSAM.com, 2020.

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