FIS GROUP

January 2020

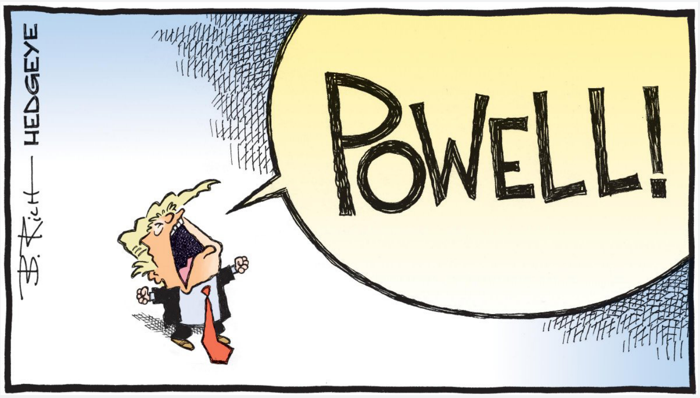
MARKET OUTLOOK Q1 2020

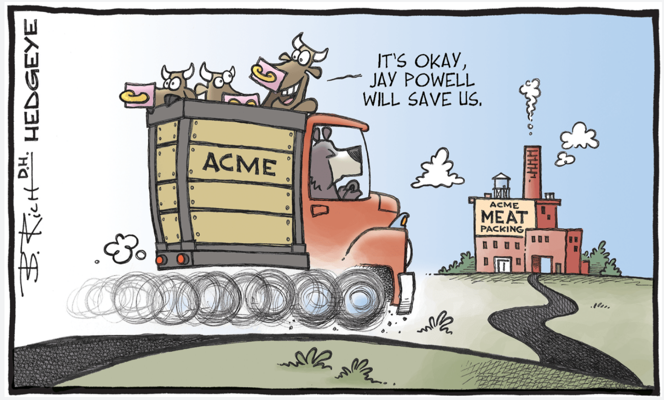
Saved by Jerome: A Second Wind for the Late Cycle Rally

TINA BYLES WILLIAMS
CIO & CEO

THOMAS QUINN, CFA
DEPUTY CIO

RECAP OF 2019 FOR FINANCIAL MARKETS IN PICTURES





During the second half of 2019, the late cycle bull market for financial risk assets sprinted to the finish line despite lackluster global growth. Global markets ended the year on a bullish note, with the U.S. S&P 500 climbing to another record close.

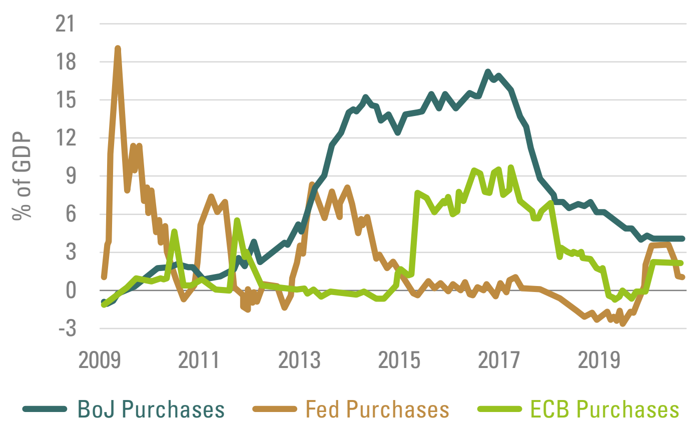
TABLE 1 | Key Market Returns

	4Q 2019		2019	2018	2019	2018
	US $	Local	US $		Local	
MSCI AC World Index - Net Return (ACWI)	8.95	7.73	26.60	-9.41	26.24	-7.69
MSCI AC World Index ex USA - Net Return (ACWI ex US)	8.92	6.18	21.51	-14.20	20.75	-10.65
S&P 500 - Total Return (U.S.)	9.07	9.07	31.49	-4.38	31.49	-4.38
MSCI Canada - Net Return (Canada)	4.89	2.73	27.50	-17.20	21.05	-9.74
MSCI Europe - Net Return (Europe)	8.84	4.49	23.77	-14.86	23.75	-10.59
MSCI United Kingdom - Net Return (U.K.)	9.95	2.28	21.05	-14.15	16.37	-8.82
MSCI Japan - Net Return (Japan)	7.64	8.24	19.61	-12.88	18.48	-15.15
MSCI EMF Asia - Net Return (Emerging Asia)	12.51	10.81	19.24	-15.45	19.08	-13.12
S&P GSCI Brent Crude Total Return (Crude Oil)	13.49		34.09	-20.49		
Trade-Weighted Dollar	-2.61		0.04	7.91		

Source: FIS Professional Estimates and FactSet

For much of 2019, market volatility was driven by recession fears prompted by the yield curve's inversion in the spring/early summer; dramatic volte-faces on the Sino-U.S. strategic rivalry, and uncertainty over Brexit. In July, Chairman Powell reversed course and in total cut the Fed Funds rate by 25 basis points three times. From August through the balance of the year, global equity markets made handsome gains, with the U.S., eurozone and Asia all generating total returns of around 8%. (See Table One). These gains have been propelled by further monetary easing and the synchronous resumption of central bank asset purchases in the U.S. and the eurozone, (see CHART 1).

CHART 1 | In 2020, the Fed, ECB and BoJ will all be conducting QE simultaneously

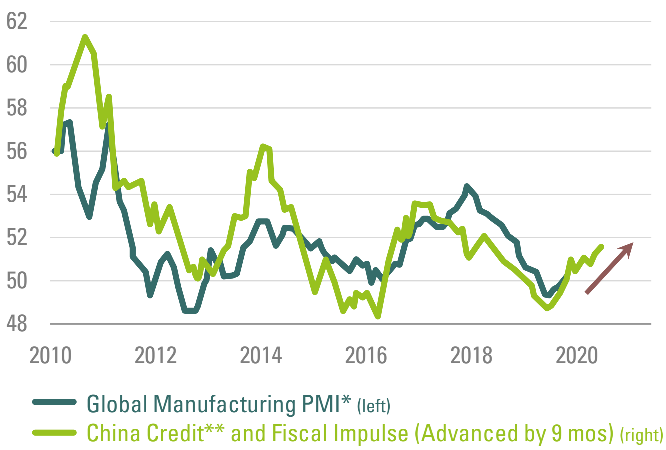


Fed: US$60bn/m until Apr, then US$10-20bn/m; ECB: €20bn/m; BoJ avg ¥1.7trn/m

Source: Gavekal Data/Macrobond

Moreover, two key sectors that have dragged down industrial production—electronics and autos—have bottomed, and manufacturing activity is picking up (see CHART 2).

CHART 2 | Industrial Production is Accelerating



Source: BCA Research

**J.P. Morgan, Markit*

***Cumulative aggregate financing excluding equity financing*

In most (but not all) respects, the cyclical rally in global equities was consistent with the late cycle rally we forecast last January when optimism was in scarce supply. Last year we stated that:

> "In 2019, global leading indicators herald a soft spot for the first half of 2019. In the U.S., where leading indicators dipped in November but are still consistent with above-trend growth, we expect growth to slow to around 2% to 2.5% in 2019, as the fiscal policy impetus from the 2017 tax law diminishes. (Notably, if it makes it to July 2019, the current U.S. economic expansion will have been the longest on record). Recession risk in the U.S. remains low for now, but if this changes it would likely trigger another leg down in equities, setting the scene for what would ultimately be one of the best buying opportunities in years.
>
> Further rises in interest rates combined with a slowdown in global trade and Chinese growth remains a headwind for non-U.S. economies and earnings. However, these slowing growth trends in the rest of the world (RoW) which began in 2018 and are likely to bottom out in the second half of 2019, while U.S. growth is set to roll over. Emerging Markets will become more attractive when the U.S. dollar, which has traded sideways recently, softens, and Chinese reflation stems the decline in credit and industrial production."

During the holiday season, investors received a double dose of good cheer, with British voters delivering the Tories a huge majority enabling the UK's swift exit from the EU; and U.S. and Chinese negotiators finally announcing a trade deal that will roll back tariffs. Risk assets, sterling and the euro rallied on the election news, but were more cautious about the trade deal, whose initial details were scarce. Even so, there is now a good chance that the two major uncertainties weighing on markets for the past two years will be much reduced. With major central banks all printing money simultaneously for the first time since the financial crisis, and fiscal policy easing at the same time, there are good reasons to believe the rally will be sustained into 2020.

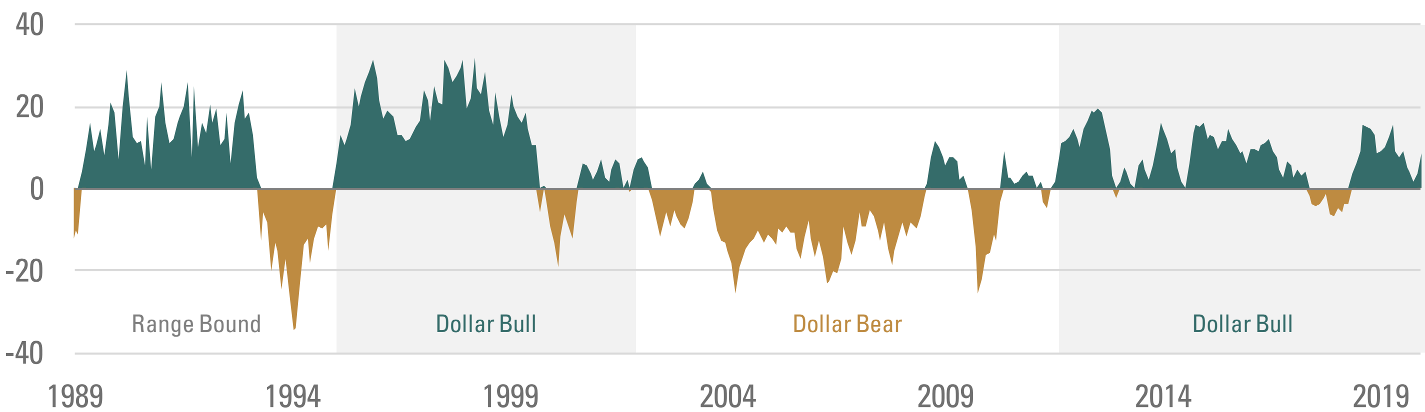
Moving forward into 2020, the two main questions that we receive from clients are:

1. whether the broad rally in risk assets can continue, and
2. whether the outperformance of U.S. assets versus the rest of the world will persist.

With respect to the first question, we expect that the global equity rally can go on, because for the first time in over a decade all the world's major economic blocs are easing monetary policy, and fiscal policy settings are neutral to positive across the board. This does not mean that the continuation of a risk-on rally will not face policy or geopolitical speed bumps. The "phase one" U.S.-China trade deal gives both sides incentives to avoid the economic damage from further tariff escalation. However, the agreement falls far short of achieving the U.S. goal of forcing China to change its state-led economic system. The proposed deal defers, indefinitely, levies on around US$160bn of Chinese imports that were threatened for December 15, and cuts in half—to 7.5%—the tariff imposed on September 1 on US$120bn of Chinese goods. But it does not touch the 25% tariff on US$250bn of other Chinese shipments to the U.S., and leaves open the possibility that tariffs could be hiked again (under a "snap-back" provision) if the U.S. judges that China has failed to meet its commitments. Importantly, it will do nothing to stop further escalation of the two countries' technology war. In sum, the macroeconomic uncertainty created by U.S.-China tensions have diminished, but will probably return over the long-term. More recently, the early January killing of the most prominent commander of Iran's Revolutionary Guards by a U.S. missile attack—and the 3% spike in the oil price it triggered—is a sharp reminder that geopolitical risks have not gone away. Nevertheless, the fundamental picture remains favorable.

The second question is the subject of an in-depth research paper which we plan to distribute shortly. Our January 2019 forecast that ex-U.S. equities would outperform U.S. equities in the second half of the year proved to be premature, as only toward the final quarter did non-U.S. markets begin to gain relative ground. The relative performance of U.S. equities in 2019 capstones their decade long outperformance since the GFC (see CHART 3).

CHART 3 | Relative Equity Performance: U.S. vs Rest of World
% Year-Over-Year



Source: FIS Professional Estimates and FactSet

Over the last 10 years, U.S. equities have outperformed developed and emerging market equities (except for a brief interlude in 2017) by an annualized 10%. (See CHART 3). The chart demonstrates that the performance leadership between U.S. and non-U.S. equities changes on roughly ten-year cycles; that in turn, correlate with 10-year trends in the performance of the U.S. dollar. Our forthcoming research paper, Will U.S. Equities Continue to Trounce Non-U.S. Equities, posits that several of the cyclical and secular factors that have propelled U.S. equities' performance leadership will become increasingly challenged.

TABLES 4 and 5 starting on PAGE 6 delineate our portfolio positioning on a country and sector basis. Most notably, we have initiated an overweight to emerging markets, our first in a few years, as we believe that an abating slowdown in global growth and likely USD softening could buoy EM risk assets over the coming quarters. Within EM, we maintain our long-held Russia overweight, where despite the huge outperformance of Russian equities over the past two years, the market remains nearly as inexpensive relative to its own history or broad EM, at an even higher dividend, with further increases in the dividend expected to come in 2020-21. We are also overweight Korea and India, as our tactical models cite attractive market dispersion characteristics in both markets as well as (relatively) good quality and valuation, respectively. Our largest underweight is to Saudi Arabia, which looks both expensive and risky to us. Within developed markets, we are overweight the UK and Australia, as our tactical models give us strong near-term signals, and use neutral tactical views and soft fundamental views on Japan, Canada, and Germany to fund higher conviction calls elsewhere. We have also positioned our portfolios more pro-cyclically with overweights to European industrials and financials, and generally underweight most other sectors. We also continue to hold our now three-year-old portfolio of European defense manufacturers and contractors (a play on heightened geopolitical uncertainty as we transition to a multipolar world), which has outperformed the MSCI EAFE index by over 21% since inception. Finally, as a ballast against resurging geopolitical uncertainty as well as falling real yields, and a depreciating U.S. dollar, we maintain a modest exposure to global gold mining companies. Since the inception of the gold miners trade in mid-August, we have generated 2.3% in excess return relative to the weighted average of these securities' relevant country indices (50% Canada/50% Australia).

TABLES 2 and 3 on PAGES 4-5 is our own report card of our tactical calls in 2019. Of the markets where we made significant calls throughout the year, we got 5 correct, 2 incorrect, and 2 with mixed results. Our positioning in Core Europe, which accounts for the largest single geographic exposure where we made active calls in 2019, was one of our big winners, while our losers were in much smaller Korea and Thailand, so we assign ourselves a B+ for the year. In core Europe, our overweight to Switzerland and the sector positioning that came with it yielded over 7.5% excess while our basket of European defense stocks had its best year yet delivering nearly 13% excess returns. In the latter half of the year we took a healthy position in a basket of non-U.S. gold miners, which led to overweights in Australia and Canada, and that trade was highly accretive relative to both those local markets and global markets at large. Within EM, our long-term overweight in Russia paid off very handsomely yielding a healthy 32.5% excess return.

TABLE 2 | 2019 Scorecard for Developed Markets

Regions / Countries	What was said…	Results
Developed Markets	**Neutral.** During all of 2019 we remained neutral to developed markets vis a vis emerging markets.	**N/A.** Developed markets outperformed EM markets by over 8% during 2019.
United States	**Neutral.** While we saw a robust U.S economy, we did not envision it strengthening and also saw several risks to equities including stretched valuations and an overly hawkish Fed.	**N/A.** The U.S was the best performing major developed market.
Core Europe	**Neutral with an Overweight to Switzerland.** "While valuations are tame, we believe economic and geopolitical headwinds will keep EPS growth modest. Within Europe we have taken a more conservative posture with regards to sector, country and factor exposure."	**Correct.** Switzerland outperformed Europe by over 7.5%.
Japan	**From neutral in 1H to an underweight in 2H.** Our positioning within Japan focused on corporate efficiency and shareholder friendly practices reflected by the Nikkei 400 index. In Q3, we said " Earnings and economic outlook in Japan are unattractive and we expect further underperformance as the market could re-rate based on lower earnings. Within Japan we remain biased towards stocks with rising ROEs and improving governance."	**Mostly Incorrect.** Japanese Equities outperformed Global equities by apx. 2% in the 2nd half. Our focus on higher quality stocks was correct with the Nikkei 400 outperforming MSCI Japan for the year. By 25 Bps.
U.K	**Neutral.** Brexit uncertainty was all we needed to avoid making a call on the U.K.	**N/A.** The U.K underperformed all other major markets except for Japan.
Australia	**From neutral in 1Q to an overweight the rest of the year.** Starting in Q2 we were bullish on Australian equities. This was due to our tactical models signaling short-term outperformance but also from Chinese reflationary policies which Australia typically benefits from. **In the 4th quarter we added junior gold miners to our Australian equity exposure.**	**Mixed.** In the last 3 quarters of the year Australia underperformed EAFE by 0.70% and the ACWI by 3.5%. Junior Goldmining stocks outperformed Australian stocks by over 12% in the 4th Q and Global Equities by 7.6%
Canada	**Neutral.** We had no clear signals on the Canadian market. During the 4th quarter, we added junior gold miners to the Canadian equity exposure, saying " We have shifted part of this exposure into gold mining mid and large caps as a hedge on global market tail risk."	**Correct.** Canada performed on par with the overall DM universe. Junior Gold Miners outperformed the Canadian index by 11.6% in the 4th Q.

● Correct ● Mostly Correct ● Mixed ● Mostly Incorrect ● Incorrect

2019 Scorecard for Emerging Markets on next page.

TABLE 3 | 2019 Scorecard for Emerging Markets

Regions / Countries	What was said...	Results
Emerging Markets	**Neutral.** During all of 2019 we remained neutral to developed markets vis a vis emerging markets.	**N/A.** Developed markets outperformed EM markets by over 8% during 2019.
EM (Asia)		
China	**Neutral.** We did not take a view on China overall relative to other EM countries, however we took a position in the A-share market in Q2, saying "We took a position in the A-share market mid-quarter on an intra-China basis (selling down broad Chinese beta), on expectations that this retail driven market will continue the momentum rally." We exited the position later that quarter when momentum turned negative.	**Mostly Correct.** A-Shares outperformed the MSCI China index by 40 Bps in the 2nd quarter. China outperfmed the broad EM market by roughly 5% for the year.
Korea	**Q2 overweight.** In the Q2 outlook we mentioned Korea as a long-term strategic overweight with the Chinese consumer spending as the catalyst. We quickly reverted to a neutral the next quarter after we saw a deterioration in the earnings outlook.	**Incorrect.** Korean equities underperformed by 1.8% in Q2.
India	**Neutral/Overweight/Neutral/Underweight.** We moved off our strategic overweight in India for most of the year, seeing too much uncertainty in the short-term to maintain a tactical view despite our long-term outlook.	**Correct.** We were neutral in Q1 and Q3. When we went overweight India in Q2, it performed in line with the benchmark, but heavily underperformed in Q4 when we were underweight.
Thailand	**Overweight.** A call initiated in 2018, Thaliand was a strategic overweight for all of 2019. Continued inflows of foreign investment, a stable domestic capital base, and it's defensive nature amid uncertainty across EM led to the bullish view.	**Incorrect.** Thailand gave back gains in 2019, falling almost 10% relative to the EM index.
EM (Europe)		
Russia	**Overweight.** Russia has been one of our longest and conviction calls, and we continued our bullish stance in 2019 based on defensively cheap valuations, radically high dividends, and steady improvements in corporate governance.	**Correct.** Russia was the best performing major market in EM, with a 32.5% excess return.
EM (EMEA)		
South Africa	**Neutral.** We had no clear signals on South African equities.	**N/A.** South African underperformed by 7.5%.
EM (LatAm)		
Brazil	**Neutral in 1H to an overweight in 2H.** In Q3 we moved to an overweight stance on the thesis that the ongoing earnings recovery and progress towards pension reforms would drive equity demand.	**Correct.** Brazil outperformed in the 2nd half of 2019 by over 1.5%.

● Correct ● Mostly Correct ● Mixed ● Mostly Incorrect ● Incorrect

TABLE 4 | Global / Country Positioning

Region / Countries	-		N		+	
Developed Markets		●				We have moved to underweight developed markets, largely on the back of underweights in Japan and Canada, favoring an overweight to emerging markets where we see an abating slowdown in global growth and likely USD softening as both favoring greater EM exposure.
United States			●			**Neutral.** While we expect a softening of the USD, we continue to believe US equities could benefit from a further melt-up in risk appetite in a market of low rates and high liquidity from the Fed.
Core Europe		●				**Slight underweight.** Within Europe we are overweight Spain as our quantitative models point to strong signals on valuation and stock dispersion while also favoring financials and industrials. We continue to maintain our now multi-year position in European defense companies, which is a key component of that industrial overweight. But we have eliminated our overweight in Switzerland and get most of the balance of the underweight from Germany.
Japan		●				**Underweight.** Our tactical models point to a neutral call, but we have trimmed some Japanese exposure to fund higher conviction positions elsewhere.
U.K.				●		**Overweight.** Our tactical models point to strong signals on valuation and stock dispersion while we also feel that diminished Brexit uncertainty should provide greater support for UK equities in the near-term.
Australia				●		**Overweight.** Our tactical models continue to point to near-term outperformance based on a high degree of dispersion among Australian stocks and we will stay in this trade for now (though it certainly did not work last quarter). Much of our exposure to this overweight has come from gold mining stocks, which has paid off handsomely thus far, to which we have now added further exposure to silver mining stocks.
Canada		●				**Underweight.** Our tactical models are neutral on Canada, but as with Japan we have used this area to fund higher conviction overweights elsewhere in the portfolio.
Emerging Markets				●		We have moved to overweight emerging markets on the view that an abating slowdown in global growth and likely USD softening could buoy EM risk assets over the coming quarters. Furthermore a truce in the U.S.-Sino trade war could reduce pressure on the RMB, which in turn could reduce pressure on other EM currencies, in Asia in particular.
Emerging Markets Asia						
China			●			**Neutral.** Amid ongoing reforms both structural and economic, we remain neutral to the risks and opportunities broadly, but bullish the opportunities for active and especially highly specialized stock pickers to best navigate these uncertain waters.
Korea				●		**Overweight.** Our tactical models favor Korea citing strong quality and stock dispersion as potentially driving a short-term rebound in the market (relatively).
Taiwan			●			**Neutral.** Taiwanese equities appear to have been a beneficiary of the U.S.-Sino trade war in 2019. Much of 2019's outperformance emanated from multiple expansion and we are conscious of the risks of mean reversion, but lack a clearer short-term signal to drive a higher conviction call on the market.
India				●		**Overweight.** Our tactical models point to a very high conviction overweight towards Indian equities supported by attractive valuations and dispersion.
Thailand		●				**Underweight.** We have cut our 18+ month overweight to Thailand to favor higher conviction and more cyclical/growth oriented calls across EM.
Emerging Markets Europe						
Russia				●		**Overweight.** Russia continues to outperform based on defensively cheap valuations, radically high dividends, and steady improvements in corporate governance (albeit from a low base). Moreover, despite a 51% rally (in USD terms) in 2019, it remains nearly as cheap relative to its own history or broad EM valuations.
Emerging Markets EMEA						
South Africa			●			**Neutral.** While we have low expectations for South Africa, we also are cognizant of the coiled spring in local positioning within the market as "SA Inc." remains deeply underowned and is now looking towards the ANC conference in June for further political direction.
Saudi Arabia		●				**Underweight.** High valuations amid deep economic and geopolitical uncertainty, together with the overhang from the recent Aramco IPO, point to a high conviction underweight in Saudi Arabia.

TABLE 4 | Global / Country Positioning (cont'd)

Region / Countries	-		N		+	
Emerging Markets Latin America						
Brazil			●			**Neutral.** With relatively low inflation and the potential for further rate cuts, Brazilian earnings may have further room to surprise on the upside, while there is also a lot of hope for further economic reforms priced into the market and we are cautious to expect too much from a Brazilian congress with a long history of styming any change that potentially threatens entrenched voter interests.
Mexico			●			**Neutral.** The Mexican market remains attractively priced, but with little likelihood of a catalyst for improving sentiment.

TABLE 5 | Sector Positioning

Sector / Style / Capitalization	-		N		+	
Early Cyclicals Consumer Discretionary, Financials			EM	DM		We added an overweight to European financials which are relatively cheap and should benefit from yield curve steepening and asset purchases. Meanwhile we are neutral to DM consumer discretionary stocks. Within EM, our country calls have led us to a broadly neutral position in both sectors.
Late Cyclicals Energy, Industrials, Materials, Technology, Communication Services		DM	EM			We are overweight European industrials, expressing both a broad view on expectations of a bottoming in the manufacturing slowdown as well as our long-term exposure to European defense stocks. We have also maintained our high accretive trade in gold miners, adding some further exposure to silver miners, but we are otherwise underweight broad DM energy, materials, IT, and communication services. Within EM, our sector views give way to higher conviction country calls.
Counter Cyclicals Consumer Staples, Health Care, Utilities		DM	EM			We cut our tactical overweights in these counter cyclical sectors, including our Swiss overweight, to take a more cyclically oriented view. Within EM, our sector views give way to higher conviction country calls.
Value vs. Growth			DM EM			The late 2019 reversal of value over growth portends a potential buckling of the near decade long outperformance of growth over value, but the liquidity fueled cycle could also yield more of the same long-term trend favoring growth stocks. But we feel that growth's leadership is becoming increasingly precarious as the pressures on profit margins for growth companies face rising risks in the face of decreasing globalization and increasing regulation, and are opportunistically trimming some of our long-held growth exposures.
Non-U.S. Defense					DM EM	For the past three years we have been bullish on non-US defense, as a play on waning U.S. hegemony worldwide and rising geopolitical uncertainty. To date, the trade has been highly accretive, outperforming Europe by over 20% amid improving earnings such that today the P/E of the same basket of stocks is lower than at the inception of our hold period. We now have expanded that view to encompass other non-US based defense stocks outside of Europe, including in Japan, Turkey, and opportunistically where such companies are traded and have sufficient liquidity.
Non-US Precious Metals Miners			EM	DM		In the early Fall of 2019 we took a position in a basket of non-US gold miners, both to capture what appears to be a favorable point in the cycle for such companies generally, as well as to gain some partial exposure to gold prices, amid heightened geopolitical uncertainty. We maintain this position as both dynamics continue to look favorable for this sector and recently added some exposure to silver miners as well.

● Developed Markets ● Emerging Markets

Important Disclosures:

This report is neither an offer to sell nor a solicitation to invest in any product offered by FIS Group, Inc. and should not be considered as investment advice. This report was prepared for clients and prospective clients of FIS Group and is intended to be used solely by such clients and prospects for educational and illustrative purposes. The information contained herein is proprietary to FIS Group and may not be duplicated or used for any purpose other than the educational purpose for which it has been provided. Any unauthorized use, duplication or disclosure of this report is strictly prohibited.

This report is based on information believed to be correct, but is subject to revision. Although the information provided herein has been obtained from sources which FIS Group believes to be reliable, FIS Group does not guarantee its accuracy, and such information may be incomplete or condensed. Additional information is available from FIS Group upon request.

All performance and other projections are historical and do not guarantee future performance. No assurance can be given that any particular investment objective or strategy will be achieved at a given time and actual investment results may vary over any given time.