Julius Bär

# INVESTMENT GUIDE

## 2020 Outlook

MARKETING MATERIAL

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Please find important legal information at the end of this document.

Julius Bär

# EDITORIAL

Dear reader,

While there are few absolute investment truths, history shows that it usually pays to be fully invested. Our secular outlook provides valuable guidance in this respect, identifying key macroeconomic and capital market trends together with risk factors. Among the long-term drivers, we have identified that: monetary policy will give way to fiscal policy, social concerns will outweigh narrow shareholder interests and the lure of China will prove even stronger.

In the more immediate future – welcome to the roaring 2020s. Although we do not expect the new year to start with an economic fanfare, the manufacturing recession should continue to fade, with the consumer standing strong. We also expect economic fundamentals to support financial markets, especially riskier assets.

In this edition of the Investment Guide you can find our conviction themes for the first quarter of 2020.

Your dedicated Julius Baer representative will be pleased to furnish you with additional information.

We wish you a successful 2020 and thank you for your continued trust in Julius Baer.

Yours faithfully,

**Nicolas de Skowronski**
Head Wealth Management Solutions
Member of the Executive Board

**Yves Bonzon**
Chief Investment Officer
Member of the Executive Board

# CONTENTS

5
A LOOK BACK AT 2019

10
THOUGHTS FROM OUR CIO

13
THE MACRO PICTURE

17
POLITICS

20
DEALING WITH LOW RATES

23
(R)EVOLUTION

27
FURTHER INFORMATION

30
IMPORTANT LEGAL INFORMATION

# A LOOK BACK AT 2019

# MARKET REVIEW

After 2018 ended with an upset, 2019 was shaped mainly by the disruptive US-China trade negotiations and central banks coming to the rescue. Let's take a look at how markets performed.

## EQUITY REGIONS

| | 2015 | 2016 | 2017 | 2018 | 2019 | 5Y annualised |
|---|---|---|---|---|---|---|
| Emerging markets | -14.92% | 11.18% | 37.28% | -14.50% | 18.39% | 5.61% |
| Switzerland | 1.18% | -3.42% | 17.47% | -8.03% | 29.98% | 6.53% |
| Eurozone | 8.23% | 2.58% | 10.24% | -10.57% | 26.05% | 6.65% |
| USA | 0.69% | 10.89% | 21.19% | -5.04% | 30.88% | 10.95% |
| Japan | 9.93% | -0.74% | 19.75% | -15.15% | 18.48% | 5.61% |
| UK | -2.21% | 19.16% | 11.71% | -8.82% | 16.37% | 6.67% |

THE BEST: The current bull market has been driven by US equities and the big US-based information technology and internet stocks, which are boosting overall growth rates to above-average levels. We do not expect a leadership change before the end of the bull market.

THE WORST: UK equities lagged well behind other regions and were impacted by the persisting political uncertainties. Relative earnings growth dynamics look weak and due to their defensive nature, UK equities tend to underperform when global purchasing managers' indices (PMIs) rise.

## EQUITY STYLES

| | 2015 | 2016 | 2017 | 2018 | 2019 | 5Y annualised |
|---|---|---|---|---|---|---|
| Quality | 3.71% | 4.55% | 25.96% | -5.50% | 36.08% | 11.92% |
| Value | -4.82% | 12.33% | 17.10% | -10.78% | 21.75% | 6.34% |
| Growth | 3.11% | 2.80% | 28.01% | -6.74% | 33.68% | 11.09% |
| Large cap | -0.96% | 7.51% | 22.21% | -7.75% | 27.73% | 8.93% |
| Small cap | -0.31% | 12.71% | 22.66% | -13.86% | 26.18% | 8.42% |
| Cyclicals | -0.13% | 10.58% | 27.54% | -9.83% | 31.54% | 10.81% |
| Defensives | -0.64% | 4.07% | 14.94% | -4.94% | 21.69% | 6.58% |
| High dividend | -3.20% | 9.29% | 18.14% | -7.56% | 23.15% | 7.31% |

THE BEST: Quality stocks gained over 36% in 2019, and they continue to offer structural growth opportunities and first-class balance sheets, which are attractive characteristics in times of negative interest rates and low macro growth.

THE WORST: What a successful year it has been for equities overall. With an impressive performance of +21.69%, defensive stocks were the 'worst' performers in 2019. Many defensive sectors are structurally challenged by general pricing pressure, online competition, local brands or new consumer trends, like health and wellness.

# EQUITY SECTORS

| | 2015 | 2016 | 2017 | 2018 | 2019 | 5Y annualised |
|---|---|---|---|---|---|---|
| Information technology | 4.76% | 11.45% | 38.23% | -2.60% | 47.55% | 18.33% |
| Materials | -15.26% | 22.46% | 28.94% | -16.92% | 23.35% | 6.51% |
| Oil & gas | -22.80% | 26.56% | 4.97% | -15.84% | 11.45% | -0.77% |
| Industrials | -2.06% | 12.88% | 25.23% | -14.54% | 27.77% | 8.62% |
| Communications | 2.54% | 5.66% | 5.82% | -10.02% | 27.39% | 5.61% |
| Healthcare | 6.60% | -6.81% | 19.80% | 2.52% | 23.24% | 8.50% |
| Financials | -3.37% | 12.47% | 22.73% | -16.97% | 25.51% | 6.81% |
| Consumer cyclical | 5.48% | 3.14% | 23.69% | -5.51% | 26.57% | 9.99% |
| Consumer defensive | 6.36% | 1.63% | 17.04% | -10.10% | 22.80% | 6.91% |
| Real Estate | 0.23% | 2.82% | 14.64% | -6.36% | 22.96% | 6.35% |
| Utilities | -6.61% | 5.96% | 13.66% | 1.97% | 22.53% | 7.04% |

THE BEST: Information technology stocks are the leaders of the current bull market and by far the best performers in 2019 – earning 20% more than the second-best performing sector, industrials. Earnings growth in the sector remains strong and valuations undemanding.

THE WORST: As the only sector with a negative annual performance over the last five years, oil & gas equities were the worst performing sector of 2019 – but they still earnt more than 11%. The sector remains exposed to commodity prices, but we generally believe it offers a hedge against rising geopolitical risks.

# FIXED INCOME

| | 2015 | 2016 | 2017 | 2018 | 2019 | 5Y annualised |
|---|---|---|---|---|---|---|
| **Developed markets:** | | | | | | |
| Government bonds | -3.29% | 1.65% | 7.29% | -0.38% | 5.59% | 2.10% |
| TIPS | -4.97% | 3.91% | 8.67% | -4.11% | 8.04% | 2.14% |
| High quality IG | -6.44% | -0.82% | 11.59% | -3.54% | 6.33% | 1.21% |
| Low quality IG | -5.91% | 3.63% | 11.94% | -3.90% | 12.52% | 3.37% |
| High yield | -2.72% | 14.27% | 10.43% | -4.06% | 12.56% | 5.80% |
| **Emerging markets:** | | | | | | |
| EM hard currency | -0.18% | 9.00% | 9.61% | -3.02% | 12.13% | 5.34% |
| EM local currency | -10.38% | 5.86% | 14.27% | -3.40% | 9.47% | 2.77% |

TIPS = Treasury Inflation Protected Securities; IG = investment grade; EM = emerging markets

THE BEST: High-yield bonds were the best performing segment in 2019 and we expect to see continued money inflows into this segment. This is being driven by the low interest rates and the omnipresent hunt for yield given the lack of alternatives.

THE WORST: The global government bond market remains under some pressure as the consequences of more fiscal support are being questioned. We believe that investors are not compensated for the risk of holding longer dated government debt.

# COMMODITIES

| | 2015 | 2016 | 2017 | 2018 | 2019 | 5Y annualised |
|---|---|---|---|---|---|---|
| Brent Crude Oil | -34.97% | 52.41% | 17.69% | -19.55% | 22.68% | 2.86% |
| Natural Gas | -19.11% | 59.35% | -20.70% | -0.44% | -25.54% | -5.40% |
| Gold | -10.46% | 8.63% | 13.68% | -2.14% | 18.87% | 5.16% |
| Silver | -11.51% | 15.84% | 7.23% | -9.36% | 15.32% | 2.81% |
| Platinum | -26.24% | 1.11% | 3.62% | -14.80% | 22.05% | -4.28% |
| Aluminum | -17.90% | 12.52% | 33.31% | -19.28% | -1.84% | -0.49% |
| Copper | -24.44% | 17.35% | 31.73% | -20.28% | 6.31% | -0.20% |
| Iron Ore | -32.20% | 81.11% | -25.15% | 10.76% | 28.58% | 5.53% |

THE BEST: Higher steel prices and the improved market mood have lifted iron ore prices. However, we believe that sufficient supplies from Australia and Brazil, the world's largest exporters, are likely to push prices down again over the course of 2020.

THE WORST: As the only commodity deep in the red, natural gas was the clear loser in 2019, returning -25%. Nevertheless, the winter heating season is gaining traction and nervousness is spreading in natural gas markets. Furthermore, natural gas is the growth niche within fossil fuels, with demand in emerging economies growing robustly.

**Source:** Bloomberg L.P., Julius Baer Investment Publishing
Please see the appendix (Further information, p. 28) for more details on indices used. Annual performance numbers in USD except for equity regions, which are calculated in local currency.
Past performance is not a reliable indicator of future results. Performance returns take into account all ongoing charges but not transaction fees. The value of your investment may fall as well as rise meaning that you may not get back your initial investment.

# SCORING OUR CALLS

In Q4 2019 we stayed invested in equities, took measured credit risk, invested responsibly and suggested tweaking exposures rather than selling – all while considering political uncertainties.

## MORE UPSIDE AHEAD

| TOPIC | Q4 RETURN |
|---|---|
| Brazilian stocks | 19.1% |
| Information technology stocks | 17.0% |
| Stock picking strategies | 14.6% |
| Value stocks | 10.4% |
| Chinese stocks | 10.3% |
| Crossover bonds | -0.1% |

## RESPONSIBLE INVESTMENT MATTERS

| TOPIC | Q4 RETURN |
|---|---|
| Sustainable investing | 5.0% |
| Impact investing | -1.8% |

## STORE OF VALUE

| TOPIC | Q4 RETURN |
|---|---|
| Low correlation strategies | 0.4% |

## NAVIGATING FINANCIAL MARKETS

| TOPIC | Q4 RETURN |
|---|---|
| Safe-haven strategies | 1.2% |
| Flexible strategies | 0.4% |

**Source:** Julius Baer Investment Publishing
Performance between 2 October 2019 and 31 December 2019
The performance of our calls was evaluated on the basis of the performance of an underlying benchmark index which we feel best fitted the call. More information on these benchmark indices are shown in the appendix (Further information, p. 29). Past performance is not a reliable indicator of future results. Performance returns take into account all ongoing charges but not transaction fees. The value of your investment may fall as well as rise meaning that you may not get back your initial investment.

# THOUGHTS FROM OUR CIO

## SECULAR OUTLOOK 2020–2029

Every year, senior experts from our asset management and research departments gather to reassess secular economic, financial and social trends around the world. The identification of these structural forces is not only helpful to formulate our Strategic Asset Allocation (SAA), but it is also useful for shorter-term investment decisions. In particular, it tells us in which direction the 'gravity' in the system is pulling asset prices, helping to better distinguish noise from information.

The timing of this edition is particularly interesting, as the decade 2010-2019 draws to a close and we present, for the first time, the trends and asset class leadership that we believe will characterise the next decade.

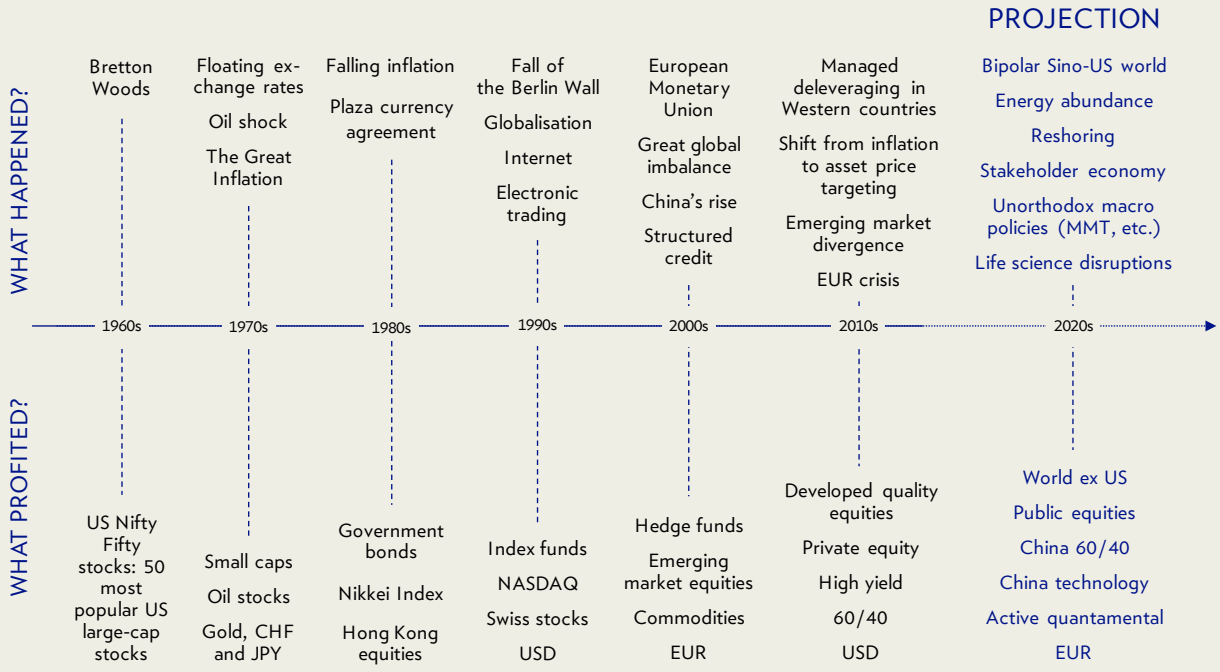
# THOUGHTS FROM OUR CIO

## Secular Outlook 2020-2029

## CHANGE IN LEADERSHIP

The rise and fall of asset classes from one decade to the next should not come as a surprise. Humans, however, tend to extrapolate the recent past, believing recent trends will go on for much longer, and only realising that asset class leadership has changed once new trends are well underway. Thus, shortly after the Asian crisis at the end of the 1990s, the future seemed bright and certain for tech and less so for Asia. No one could predict the dot.com implosion at the time, nor the bull market in emerging economies in the later part of the decade. In the same vein, come 2010, it was difficult to foresee the return of American technology stocks after their disastrous performance in the 2000s. This pattern has been evident in the last six decades, with the asset leaders of one cycle becoming laggards in the next one.

However, one should not expect an overnight shift to a completely different investment environment. These structural shifts are a process, not an event, and at the time of writing the current regime, characterised by the US technology-led bull market and the associated US dollar secular bull, is still in force.



## SECULAR TRENDS – OVERVIEW

**MACROECONOMIC TRENDS**

- Bipolar Sino-US World
- Energy abundance
- Reshoring
- Stakeholder economy
- Unorthodox macro policies
- Life science disruptions

**CAPITAL MARKET TRENDS**

- Late-stage US dollar bull market
- China becoming a core asset class
- Rise of political triggers and decline of market signals
- Public equities challenge median private equity returns

**KEY RISK FACTORS**

- Dormant systemic risk
- Rise in cyber risk
- Global political risk
- China-US decoupling

**Source:** Julius Baer Investment Management

## SECULAR TRENDS IN FOCUS

We have selected three secular trends, which we would like to highlight below.

### BIPOLAR SINO-US WORLD

The trade war is a symptom of a broader, long-lasting confrontation between the current world leader, the US, and its aspiring challenger, China. Apart from ongoing trade tensions, attempts have been made to restrict financial market access to Chinese companies in the US while Chinese technology companies have been banned from doing business with US corporations. The Chinese Belt and Road initiative is ploughing ahead, highlighting China's ambitions and the extent of global Chinese influence. This 21st century Cold War over economic, technological and military supremacy will usher in a new, dual world order, with separate economic and financial cycles and technological ecosystems, reviving the benefits of international diversification.

### UNORTHODOX MACRO POLICIES

Working in isolation, monetary policy in the West has reached its limits. The current policy mix has failed to reflate the developed world and has reached a point, especially in Europe, where it might do more harm than good. At the same time, major developed economies have ample room for fiscal stimulus, with record low government bond yields, mostly balanced budgets, and quite importantly, a huge private sector saving surplus. The discourse is thus now moving towards the use of a new policy template, more reliant on fiscal stimulus, using tools such as Modern Monetary Theory (MMT) or direct liquidity injections by central banks, in the form of a tax credit to all citizens, for example. After negative interest rates, we might hence experience negative taxes. This should lay the ground for very gradual reflation in developed economies.

### CHINA BECOMING A CORE ASSET CLASS

The BRICS concept has become obsolete. With the exception of China and India, emerging countries' growth is not much stronger than developed countries' growth nowadays. At the same time, China is heavily investing into R&D as well as rebalancing its economy from manufacturing towards services, and from exports towards a domestic, consumer-led economy. Chinese capital markets are still relatively closed to foreign investors, but – subject to Beijing respecting property rights – represent a major enlargement of investors' opportunity set. De-synchronised from the US cycle, Chinese assets, already exhibiting low correlation to international markets, will become an increasingly valuable source of global diversification and are thus on a path towards core asset class status.

# THE MACRO PICTURE

## The world economy should pass its cyclical low in 2020

The manufacturing recession is fading and consumers are continuing to spend. After the world economy was fuelled with cheap money in 2019, the economic cycle should last well into 2020. There are, however, plenty of factors to take into account when considering how to position your portfolio for the year. Christian Gattiker, Head of Research, and Mark Matthews, Head of Research Asia, tell us about their expectations in 2020 and what investors should bear in mind for the year ahead.

# EXPERT TALK

## There is plenty to consider when looking ahead in 2020 – geopolitics, low interest rates and monetary and fiscal policy decisions will all have an influence on economic growth.

### WHAT DEVELOPMENTS DO YOU THINK WE'LL SEE IN THE WORLD ECONOMY THIS YEAR?

*Christian:* Assuming that there are no exogenous shocks, we expect that the world economic cycle will reach a bottom in the first half of this year. There are a number of reasons for this. The stabilisation of leading indicators suggests that the manufacturing recession is fading. Although manufacturing is still contracting, a stabilisation in the US and the eurozone suggest that the worst could now be over. Furthermore, the economy should also be supported by the monetary support from central banks, improving economic sentiment, the fact that consumers are continuing to spend and resilient corporate earnings.

### SO YOU THINK THE ECONOMY'S LOW WILL BE IN THE FIRST HALF OF THE YEAR, BUT WHY ISN'T YOUR OUTLOOK EVEN MORE OPTIMISTIC?

*Christian:* Monetary easing by major central banks in 2019 should help to extend the global economic expansion into 2020, but further easing from here is limited. We would be more optimistic if we expected significant government spending, and while we do see the potential for fiscal spending to support the economy, especially in Europe, overall we expect policymakers will be hesitant.

Christian Gattiker
Head of Research

Mark Matthews
Head of Research Asia

"ACCELERATING ECONOMIC MOMENTUM IN 2020 SHOULD DRIVE BOND YIELDS UP FROM RECORD-LOW LEVELS, WHICH SHOULD CREATE A VERY STRONG BACKDROP FOR GLOBAL EQUITIES."

Christian Gattiker, Head of Research

### WHAT ARE THE PROSPECTS FOR THE CHINESE ECONOMY IN YOUR VIEW?

*Mark:* Over the past two decades, the Chinese economy has grown by 9.0% per year. Having gone from being smaller than France to the second largest economy in the world, China has to start slowing down. We expect its GDP to grow by an annual average rate of 4.9% over the coming decade. But this doesn't make China a less appealing place to invest. We foresee it moving aggressively up the ladder in terms of value-added over the next decade with the help of technology, particularly Artificial Intelligence.

### AND HOW ATTRACTIVE IS CHINA'S STOCK MARKET AT THE MOMENT?

*Mark:* The Chinese stock market has always been cheaper than India's in price/earnings terms, with the exception of two months in 2015. Today's 45% discount, however, is much wider than the ten year average of 28%. In the past, such large gaps between the two were followed by good performance in China. So although it did very well in 2019, we think the Chinese market can still go higher in 2020. Taking a longer-term view, the Shanghai Composite should look a lot more like the S&P 500 than the Dow Jones industrial average in five years' time. By then, the largest sector should be technology, and it should offer many more high-quality companies with structural growth stories than it does today.

### YOU ARE CURRENTLY POSITIVE ON EMERGING MARKETS AS A WHOLE – IS THIS LARGELY DUE TO YOUR POSITIVE VIEW ON CHINA, OR ARE THERE OTHER COUNTRIES WITHIN EMERGING MARKETS THAT ARE CURRENTLY ATTRACTIVE?

*Christian:* Yes, that's right, we are positive on emerging markets at the moment as the relative valuations are attractive and we believe that earnings growth momentum should accelerate from low base levels. The emerging market index is dominated by Asia and we believe this region should perform well, especially China, but we also like Brazil. Leading indicators suggest that the growth of Brazil's economy should accelerate further in the coming months and the Brazilian equity market should provide superior earnings growth. Then there are the historically low yields and the implementation of the government's reforms, which should also both support Brazilian equities.

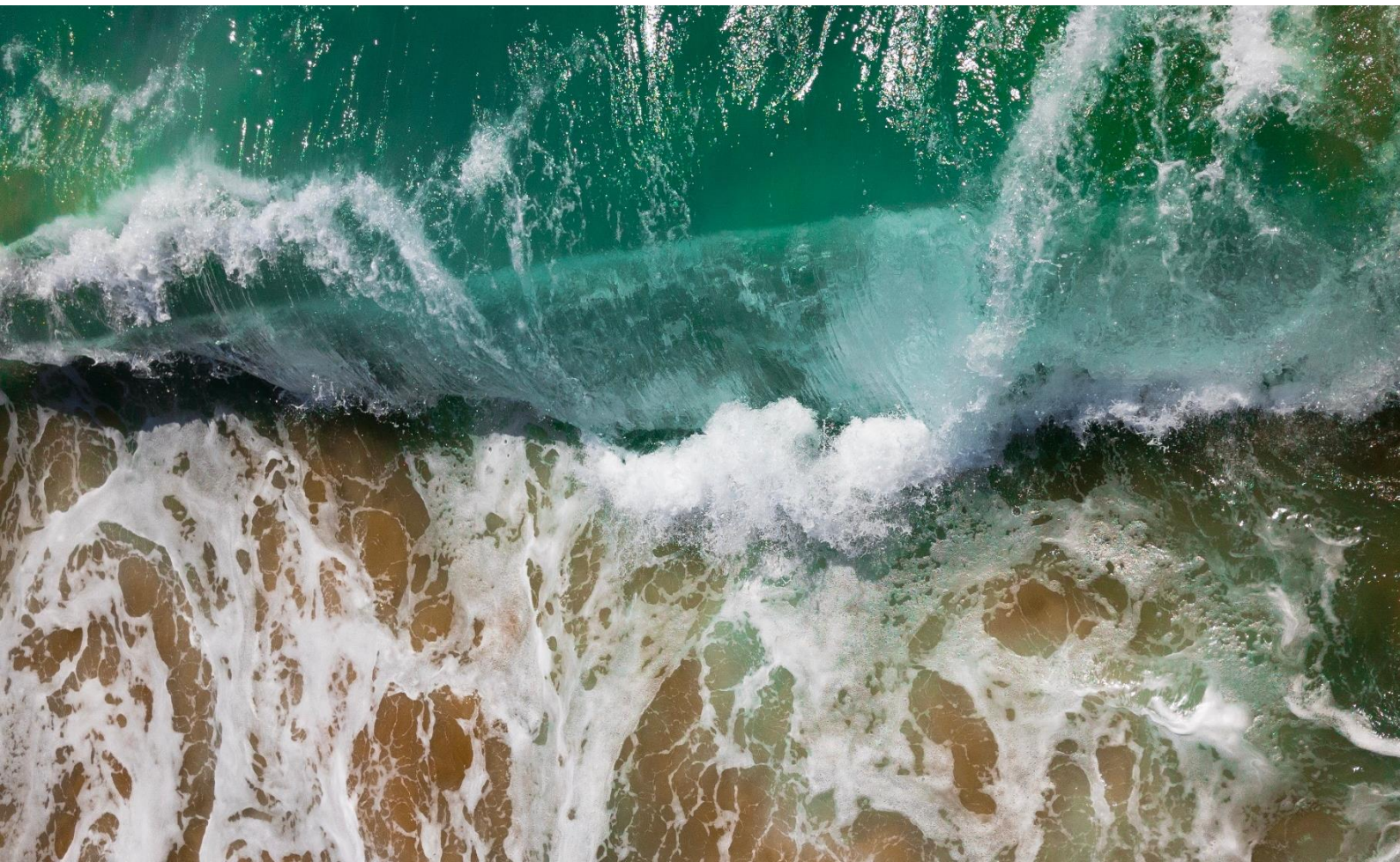
## SO WHERE DO YOU SEE OPPORTUNITIES FOR INVESTORS IN 2020?

*Christian:* Accelerating economic momentum in 2020 should drive bond yields up from record-low levels, which should create a very strong backdrop for global equities. In particular, cyclicals and beaten-down value stocks should prosper. Among cyclicals, we prefer the industrials and materials sectors, as well as the oil & gas sector. Also, current valuations are undemanding both relative to other asset classes as well as on a historical basis. We also believe that high-quality growth stocks will remain attractive and that they will continue to dominate beyond a short-term economic upturn. As a result, we recommend that investors stay invested in high-quality information technology and communication stocks.

## INTERESTED?

Please contact your Julius Baer representative for further information on products that best suit your needs.

**Source:** Julius Baer Investment Publishing



# POLITICS

## US elections drive the cycle

The US Presidential elections will trump all other headlines in 2020. In the run-up to the elections, the odds for a de-escalation in the US-China trade conflict and partial, face-saving trade deals are likely to rise. But other political hotspots will get air-time too, just think of the UK and the Middle East. Rest assured, markets will be impacted by unpredictable politics at times. Indeed, it is cumbersome to trade politics. Still, for those who actively wish to invest in political uncertainty, we suggest exposure towards multi asset class solutions, able to exploit volatility. Or, consider healthcare stocks: the sector regularly comes under scrutiny during US election campaigns – unwarranted we think.

# US ELECTIONS DRIVE THE CYCLE

It's difficult to trade politics. Investors are well advised to remain on their toes in order to adjust quickly to often unpredictable political decisions. Or, look at the past.

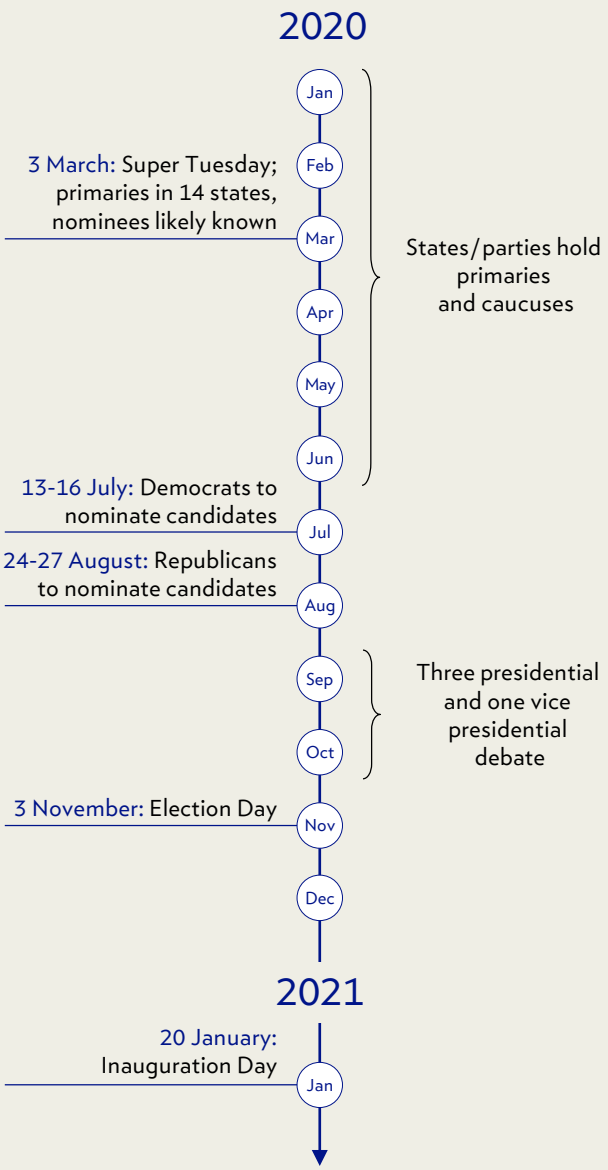
## STATE OF PLAY

The US elections are likely to trump all other headlines in terms of politics in 2020. But other political hotspots will get some air-time too, just think about the UK and the Middle East. And don't write off the growing number of anti-government protests that have rocked nations across the globe, fired by anger over issues including corruption, inequality and a yearning for democratic choice. It is unlikely that such protests will abate in 2020. On the contrary, peak globalisation, separatist movements, regional issues and a spoonful of populism have laid the ground for further unrest in many parts of the world.

## US ELECTIONS

Although we won't know who the next President of the US will be until 3 November this year, the election campaign will overshadow most of the political discussions in 2020. So, who would be the preferred 'POTUS' from an investor's point of view?

## US ELECTION ROADMAP




**Source:** Julius Baer Investment Publishing

In a recent note by our Technical Analysis team, they state that investors should wish for the incumbent party, the Republicans, with Donald Trump, to be re-elected. Their reasoning for this is simple: while the S&P 500 index made 12.3% on average in years when the incumbent party won the Presidential election, it lost 2% in years when the ruling party changed.

President Donald Trump is likely to try to provide some good reasons to re-elect him. One of the most likely scenarios is that he will try to secure a trade deal with China, which he could then promote as a success story in the run-up to the election. Therefore, we believe that the odds of a de-escalation and partially face-saving trade deal are rising over the coming months, which would be positive for financial markets overall and also in the overarching interests of both nations.

## HEALTHCARE

Fiercely debated during every US election campaign is the critical subject of healthcare costs – and this time will be no different. However, during previous US presidential election campaigns, healthcare stock price weakness often represented a buying opportunity. Since 1996, global healthcare stocks have actually outperformed the broad market by an average of about 4% during the 12 months ahead of election day. So, although we expect US political and litigation risks around drugs to rise, we feel comforted by the fact that the focus of the debate will be mainly on drug pricing, which makes up only about 12% of healthcare spending in the US.

We therefore reiterate our 'Overweight' rating for the sector, especially at today's attractive valuations. We particularly like life science companies, which are generally unaffected by the numerous political proposals.

## BREXIT

The drama around Brexit continues to unfold. However, after the sweeping victory of the Tories in the general election in December, it looks like the UK will formally break apart from the European Union this year, likely at the end of January. Nevertheless, many uncertainties regarding future trade relationships with the UK's main trading partners remain. From an investor's point of view this must be seen as an opportunity too.

While our equity strategists have an 'Underweight' rating on the UK equity market, we do believe that there is value in the currency, at least in the longer term. The British pound is undervalued against most of its peers, largely due to political factors. Once the 'mist' surrounding Brexit has cleared, we believe the currency is ripe for a rally, not least because of the efficient handling of capital in the UK corporate sector.

## INTERESTED?

Please contact your Julius Baer representative for further information on products that best suit your needs.

**Source:** Julius Baer Investment Publishing

# DEALING WITH LOW RATES

## Alternatives to return-free bonds

The expected growth pick-up this year is unlikely to unleash inflation and higher policy rates. Although it is being discussed, there is still a lack of concrete and effective fiscal stimulus (particularly in Europe), and we therefore expect the current low-interest rate environment to prevail.

In the search for yield, we look across the gamut of the fixed income world for attractive opportunities. Furthermore, high-dividend value equities can also be considered in a portfolio context.

# DEALING WITH LOW RATES

In the search for yield, we do not indiscriminately favour higher yielding securities – rather, we aim to identify the sweet spots across the risk-return spectrum.

## SEARCH FOR YIELD (BUT NOT AT ANY PRICE)

Generations of pupils are taught that investors want to be compensated with a positive expected return on an investment to offset the risk of a loss on the principal, the corrosive effect of inflation and their decision to postpone consumption in favour of the investment. However, in September 2019 nearly USD 17 trillion of bonds – a volume just shy of the annual output of the US economy – were being offered at negative yields. All this as financial repression (please see the next page) continued to keep much of the developed world in its grip and as a consequence, interest rates low.

Hence, where should you look for yield in the prevailing environment? Certainly, not where central banks have distorted yield levels in a material way via their asset purchase programs. Rather, given our overall constructive outlook for 2020, we still prefer taking measured credit risk (while avoiding structurally weak sectors) with limited duration. Thus, this brings low-investment-grade as well as high-yield bonds of better quality into play.

In emerging markets, we have a preference for Asian credits due to solid growth prospects and because many local firms pay attractive yields, while being less leveraged than their developed market counterparts.

We also favour unconstrained fixed-income strategies. They are not tied to any benchmark; thus capital can be allocated to those markets deemed most attractive.

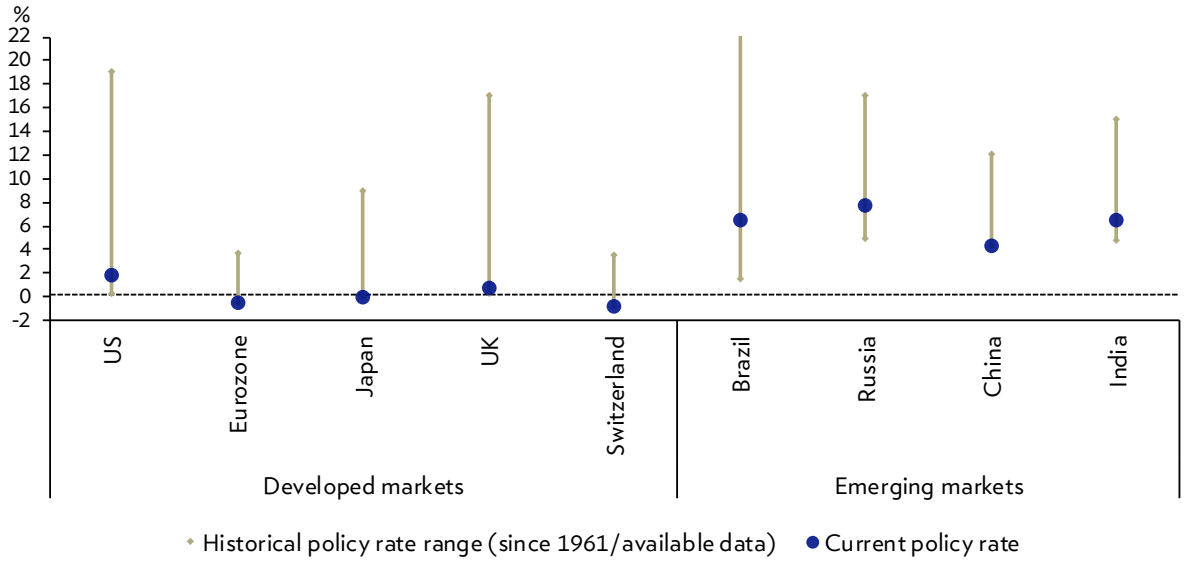
Investors with a higher risk tolerance can consider subordinated bank bonds (contingent convertibles) issued by solid banks, that have both fixed income and equity features. In addition, value stocks with robust and rising dividends are attractive, especially compared with highly speculative bond issues.

## INTERESTED?

Please contact your Julius Baer representative for further information on products that best suit your needs.

**Source:** Julius Baer Investment Publishing

## POLICY RATES ARE AT OR NEAR THEIR HISTORICAL LOWS




6 January 2020, 13:44 CET
**Source:** Thomson Reuters Datastream, Julius Baer Investment Publishing

## FINANCIAL REPRESSION & LOW INTEREST RATES

Financial repression describes a variety of policies and means (regulation and interventions) through which market forces are distorted, often leading to governments effectively transferring wealth from the investing public to the public sector. Today, financial repression can be observed in much of the developed world where household wealth is eroded by historically low or even negative interest rates and extensive bond buying programmes by central banks. As a consequence, in many countries around the world, cash-like investments no longer compensate investors for inflation. In other words, savers are left with negative real interest rates.

Thus, while these policies of financial repression started as emergency measures to combat the great financial crisis, they have become deeply ingrained in our financial system as growth remains anaemic, inflation dormant and all the while public debt is soaring.

We note a growing public unease about financial repression and outright scepticism about its effectiveness. Thus, the voices demanding more fiscal stimulus are getting louder. In fact, effective government stimulus measures and increased deregulation would also reduce the need for artificially low policy rates and bond yields, as well as for government bond purchases by central banks.

**Source:** Julius Baer Investment Publishing

# (R)EVOLUTION

## Invest in innovators and disruptors

Innovators can capitalise on incremental changes. Disruptors can change the face of entire industries, and quickly. Those which succeed will provide incredible growth stories and become household names. Those that don't, will vanish. Today's technology enables revolutionary ideas to spread quickly, which pushes whole industries to adapt to new standards and foster constant change. However, it is also worth bearing in mind that today's disruptors may become tomorrow's prey.

# INNOVATORS AND DISRUPTORS

The pace of change is now greater than ever before. Philipp Lienhardt, Julius Baer's Head of Equities, tells us more on how to identify innovative and disruptive companies.

### FIRST OF ALL, WHY IS INNOVATION SO IMPORTANT FOR A COMPANY?

*Philipp:* We think that innovation is really the path to success. In a competitive marketplace, companies with the best products and services, at the lowest possible prices, have the highest chances of success. Innovation plays a crucial role in this equation.

### DOES THIS ONLY APPLY TO CERTAIN INDUSTRIES OR IS INNOVATION A GENERAL PREREQUISITE FOR SUCCESS?

*Philipp:* The phenomenon of innovation can be observed across more and more industries. It is not limited to those industries that are most often associated with innovation, such as information technology or biotechnology. Companies in all industries need to continuously reinvent themselves in order to stay abreast of changing consumer demands, regulatory requirements or technological advancements.

### WHAT ARE THE KEY FACTORS THAT MAKE A COMPANY INNOVATIVE?

*Philipp:* We have identified five general characteristics of innovative companies. They are usually gaining market share, they achieve above average profit margins and act as price makers rather than price takers. In addition, they often grow their market by identifying unmet needs and have the most efficient production process amongst their peers. However, not every innovative company exhibits all these characteristics as the relative importance of each can depend on the type of industry.

"I DO BELIEVE IN THE HORSE. THE AUTOMOBILE IS NO MORE THAN A TRANSITORY PHENOMENON."

Attributed to Kaiser Wilhelm II, German Emperor, around 1900

## HOW DOES INNOVATION LEAD TO DISRUPTION?

*Philipp:* Highly innovative companies can change the face of entire industries – they become disruptors that can achieve incredible growth rates which far outpace the respective industry and the broader economy. Competitors then need to fundamentally revamp their business model and product or service portfolio. Otherwise they will become obsolete and eventually disappear from the market place. Investors should always keep in mind that what starts off as an innovation can over time become highly disruptive and create new investment opportunities.

## TALKING ABOUT OPPORTUNITIES, HOW CAN INVESTORS PARTICIPATE? CAN YOU GIVE US SOME CONCRETE EXAMPLES?

*Philipp:* Investing in highly innovative and disruptive companies is not always straightforward as they are often privately held or in a niche that is simply too small for investors. My colleagues and I have therefore identified six topics for our clients which are not only interesting but also investable. We see attractive opportunities within renewable energy, digital media, liquid biopsies, travel booking platforms, robotics and automation as well as electronic payment systems.

## INTERESTED?

Please contact your Julius Baer representative for further information on products that best suit your needs.

**Source:** Julius Baer Investment Publishing

# OUR SIX INNOVATION AND DISRUPTION TOPICS

## RENEWABLE ENERGY

Thanks to the impressive cost collapse, wind and solar energy have become mainstream. They are now cost competitive with fossil power generation and form the dominant source of new power generation. With regard to regions, Europe is showing the strongest momentum in the transition from fossil to renewable energy.

## DIGITAL MEDIA

The media and advertising landscape has been reshaped dramatically since the breakthrough of the internet. The increasing time spent online has led to a shift of advertising budgets from traditional to online channels.

## LIQUID BIOPSIES

A liquid biopsy is the sampling and analysis of non-solid biological tissue, primarily blood. In comparison to traditional medicine, it offers a more convenient, cheaper and less intrusive method of cancer screening and monitoring.

## TRAVEL BOOKING PLATFORMS

The main online booking platforms have a significant and growing market share in the global travel market and are threatening the existence of traditional travel agencies. Meanwhile new companies with disruptive business models are also moving into the market.

## ROBOTICS AND AUTOMATION

The next generation of robotics and automation systems has the potential to fundamentally change the dynamics of economies, both in the manufacturing and the service sector. This is triggered by complex software which is constantly evolving and replacing ever more complex human tasks.

## ELECTRONIC PAYMENT SYSTEMS

New players are entering the market and are disrupting established payment networks. However, success in the payment industry is driven by global ubiquity in acceptance and clients still prefer to connect their accounts with established credit card providers.

**Source:** Julius Baer Equity Research

# FURTHER INFORMATION

# FURTHER INFORMATION

Please find below further information on benchmarks and indices used in the review section of this Investment Guide.

## MARKET REVIEW

### EQUITY REGIONS

| REGION | INDEX | REGION | INDEX |
|---|---|---|---|
| **Emerging markets** | MSCI Emerging Markets Net Total Return USD Index | **USA** | MSCI USA Net Total Return USD Index |
| **Switzerland** | MSCI Switzerland Net Return CHF Index | **Japan** | MSCI Japan Net Return JPY Index |
| **Eurozone** | MSCI Europe Net Total Return EUR Index | **UK** | MSCI United Kingdom Net Return GBP Index |

### EQUITY STYLES

| STYLE | INDEX | STYLE | INDEX |
|---|---|---|---|
| **Quality** | MSCI World Quality Net Total Return USD Index | **Cyclicals** | MSCI World Cyclical sectors Total Return USD |
| **Value** | MSCI World Value Net Total Return USD Index | **Defensives** | MSCI World Defensive Sectors Total Return USD |
| **Growth** | MSCI World Growth Net Total Return USD Index | **Small caps** | MSCI World Small Cap Net Total Return USD Index |
| **High dividends** | MSCI World High Dividend Yield Net Total Return Index | **Large caps** | MSCI World Large Cap Net Total Return USD Index |

### EQUITY SECTORS

| SECTOR | INDEX | SECTOR | INDEX |
|---|---|---|---|
| **IT** | MSCI World Information Technology Net Total Return USD Index | **Financials** | MSCI World Financials Net Total Return USD Index |
| **Materials** | MSCI World Materials Net Total Return USD Index | **Consumer cyclical** | MSCI World Consumer Discretionary Net Total Return USD Index |
| **Oil & gas** | MSCI World Energy Net Total Return USD Index | **Consumer defensive** | MSCI World Consumer Staples Net Total Return USD Index |
| **Industrials** | MSCI World Industrials Net Total Return USD Index | **Real Estate** | MSCI World Real Estate Net Total Return USD Index |
| **Communications** | MSCI World Communication Services Net Total Return USD Index | **Utilities** | MSCI World Utilities Net Total Return USD Index |
| **Healthcare** | MSCI World Health Care Net Total Return USD Index | | |

## FIXED INCOME

| SEGMENT | INDEX | SEGMENT | INDEX |
|---|---|---|---|
| **DM government bonds** | Bloomberg Barclays Global Agg Treasuries Total Return Index Value Unhedged USD | **DM High yield** | Bloomberg Barclays Global High Yield Total Return Index Value Unhedged USD |
| **DM TIPS** | Bloomberg Barclays Global Inflation-Linked Total Return Index Value Unhedged USD | **EM hard currency** | Bloomberg Barclays EM Hard Currency Aggregate TR Index Value Unhedged USD |
| **DM high quality IG** | Bloomberg Barclays Global Agg Aa Total Return Index Value Unhedged USD | **EM local currency** | Bloomberg Barclays EM Local Currency Government TR Index Unhedged USD |
| **DM low quality IG** | Bloomberg Barclays Global Agg Baa Total Return Index Value Unhedged USD | | |

DM: developed markets, EM: emerging markets, IG: investment grade

## COMMODITIES

| COMMODITY | FUTURE | COMMODITY | FUTURE |
|---|---|---|---|
| **Brent Crude Oil** | Generic 1st Crude Oil, Brent | **Platinum** | Generic 1st Platinum |
| **Natural Gas** | Generic 1st Natural Gas | **Aluminium** | Generic 1st Primary Aluminium |
| **Gold** | Generic 1st Gold | **Copper** | Generic 1st Copper |
| **Silver** | Generic 1st Silver | **Iron Ore** | Generic 1st Iron Ore |

# SCORING OUR CALLS

| TOPIC | BENCHMARK INDEX USED | TOPIC | BENCHMARK INDEX USED |
|---|---|---|---|
| **IT stocks** | MSCI World Information Technology Net Total Return USD Index | **Sustainable investing** | S&P Global Infrastructure Net Total Return USD Hedged Index |
| **Value stocks** | MSCI World Value Net Total Return USD Index | **Impact investing** | Bloomberg Barclays MSCI Global Green Bond Total Return Value Hedged EUR Index |
| **Chinese stocks** | MSCI China A Onshore Net Total Return USD Index | **Low correlation strategies** | Hedge Fund Research HFRX Event Driven USD Index |
| **Brazilian stocks** | MSCI Brazil 10/40 Net Total Return USD Index | **Flexible strategies** | Credit Suisse Global Macro USD Index |
| **Stock picking strategies** | MSCI World Quality Net Total Return USD Index | **Safe haven strategies** | XAUUSD Spot Exchange Rate – price of 1 XAU in USD |
| **Crossover bonds** | Bloomberg Barclays US Aggregate Total Return Value Unhedged USD Index | | |

# IMPORTANT LEGAL INFORMATION

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