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ENTEXT Economic Strategy & Analysis

Weekly Insight | June 27th 2019

ECB Enters Monetary Twilight Zone, China Insurance Rebound…

'The Fed is now back to 'data dependent' mode but ***the existential angst among the PhDs seeking the neutral rate like some mythical monetary G-spot will continue.*** *I've highlighted the risks to capex next year from housing to tech led industrial restructuring (GM etc.) and a negative 'shale shock' – as much as capex data, the chart below on labour market lead indicators bears close watching…the loss of confidence among asset management CIOs extends to CFOs.'* Weekly Insight, 18th December 2018

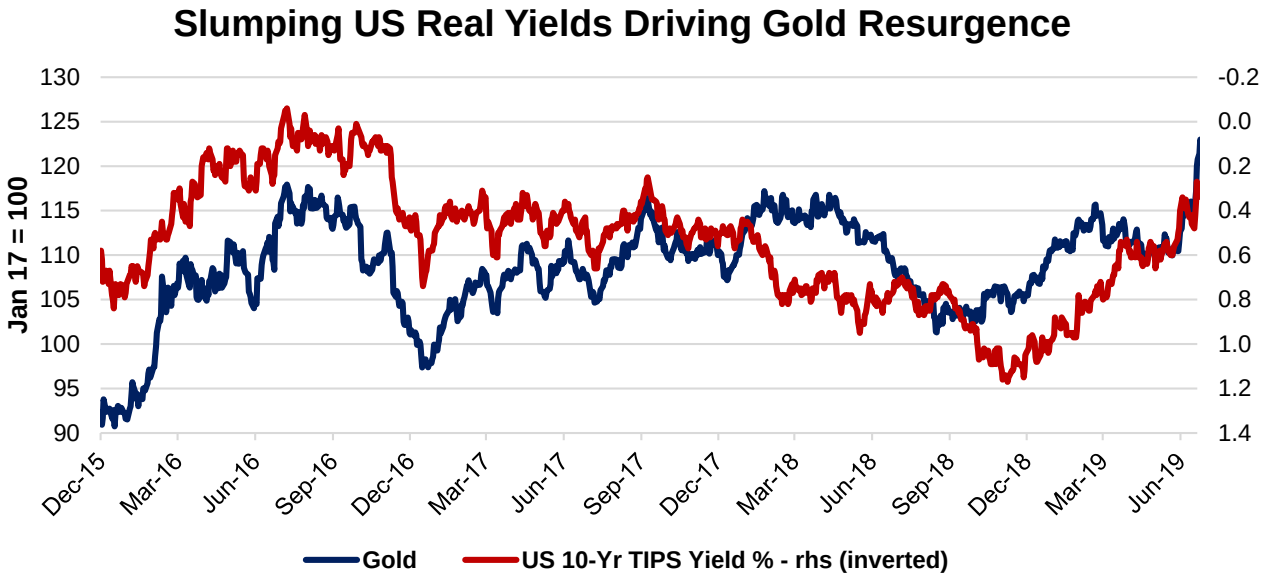
'It was striking that Jay Powell ***commented recently that 'In our thinking, inflation expectations are now the most important driver of actual inflation.' He was basically admitting that the elaborate forward-looking econometric models of slack and output gaps have little predictive power*** *(and indeed the inflation forecasting record of central banks has been dismal since the crisis). Of course, inflation expectations are unobservable directly – market measures via TIPS and inflation swaps generally correlate hugely with gyrations in energy prices.'.* Weekly Insight, 1st April 2019

'In the Federal Open Market Committee meeting that concluded on Wednesday, I advocated for a 50bps cut to 1.75% to 2% and a commitment not to raise rates again until core inflation reaches our 2% target on a sustained basis. I ***believe an aggressive policy action such as this is required to re-anchor inflation expectations at our target****…'* Minneapolis Fed President Neel Kashkari

- The German finance ministry announced this week that it expects the debt/GDP ratio to fall sub 59% this year and to no more than 51% by 2023, exacerbating a structural shortage of ultra-safe German Bunds. There are only about $1.7trn of German government debt securities versus over $16trn in Treasuries while ECB QE has further reduced the 'free float' available to investors via QE since 2013. **Germany remains politically obsessed with paying down debt (as well as running a record external surplus) ahead of demographic decline**, even though Japan has shown that with high private savings there is no need to do so.
- It's ironic that BoJ bond buying policy was designed to keep 10-yr JGB yields anchored at around zero i.e. keep them down but is currently holding them up, with yields in Germany and Switzerland having plunged far deeper into negative territory (the latter now negative all the way out to 30 years, and many speculating that Germany will follow). Indeed, some of the most spectacular returns across markets since last autumn have come from ultra-long duration Eurozone sovereign debt, with several 30-yr bonds generating a ~40% return.
- Even the Italian 10-yr has converged with Treasuries, despite endless coalition wrangling, the weakest economy in Europe and ominous long-term solvency dynamics, if nominal growth doesn't accelerate. You could ascribe that to investors capitulating on the long debated but now consensus 'Japanification' trajectory, as well as front running the next round of ECB QE, but it has sent the reach for yield into ever more dangerously distorting territory. The CIO of insurer AXA France recently described the '*beginning of a tsunami'* for Eurozone insurers away from negative yielding sovereign bonds into alternative investments including lending directly to companies and buying packages of CLOs and mortgages to get positive returns, mirroring the Japanese precedent.
- The ECB having undermined the core business model of the banking system risks doing the same to insurers trying to liability match in this bizarre fixed income environment. We're at a point in the economic/monetary cycles when liquidity risks (not least in ETFs invested in markets such as senior secured loans) are surging. At a time when the average yield of the entire global bond market is 1.7% and over $13tn of debt is trading with negative yields, the **shift into esoteric securities has clearly**

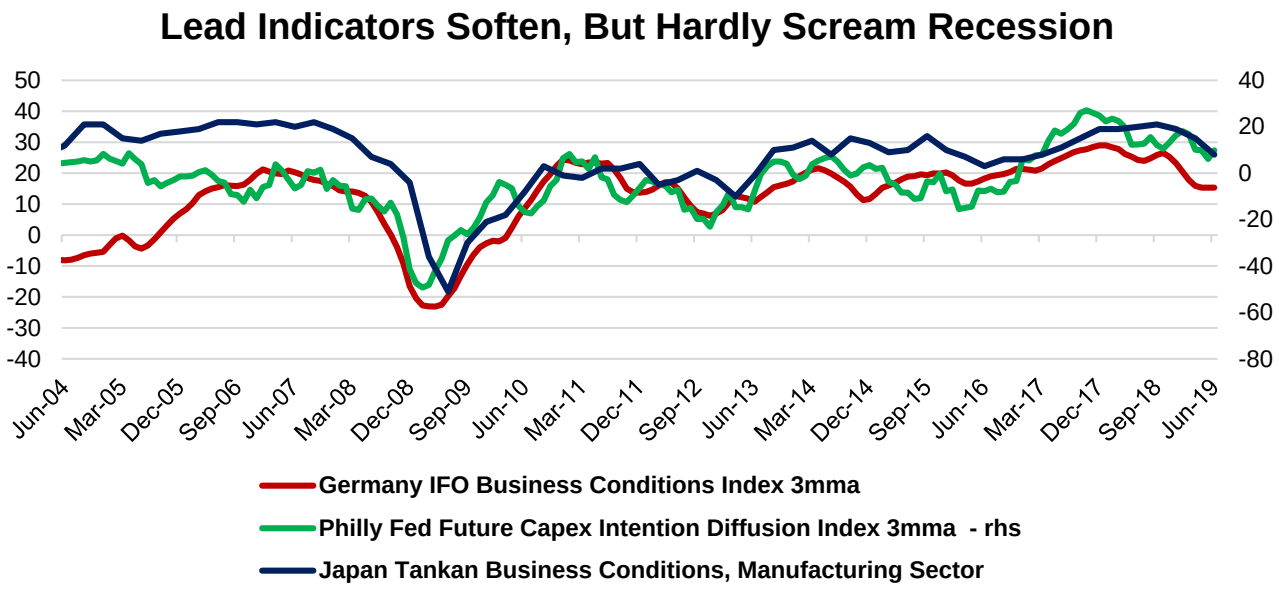
extended even in UCITS daily priced style funds to near-untradeable slices of private debt. Swiss manager GAM has still not managed to sell some of the bonds in the $11bn absolute return fund it had to shut last summer amid panic redemptions.

- The Natixis/H2O debacle which has seen the outflow of almost 20% of AUM in a matter of days (full disclosure: never a client, but on trial a couple of years back) on exposure to "non-rated private bonds" connected to a controversial German entrepreneur is likely to be followed by similar events as credit fund returns are scrutinised. As BOE governor Mark Carney stated this week: '*These funds are built on a lie, which is that you can have daily liquidity…for assets that fundamentally aren't liquid…'.* After historic bond inflows YTD and the growth in unhedged credit buying (notably from Japanese insurers), **'return enhancement' strategies could morph into a systemic risk if bond market distortions continue to grow.**



Source: Entext

- It seems a very long time ago when the consensus was convinced that QE would create an inflation surge, **but the unspoken reality is that ultra-low rates sustained indefinitely are largely a deflationary force** (for instance, forcing a higher household savings level to compensate for lower returns or suppressing bank credit growth by crushing net interest margins). A recent BoJ research paper comes close to accepting this, noting that: '*The reversal interest rate is the rate at which accommodative monetary policy reverses and becomes contractionary for lending. The reversal interest rate creeps up over time, making steep but short rate cuts preferable to "low for long" interest rate environments.'* Japanese (and Eurozone) commercial bankers would undoubtedly agree…as noted before, the fact the BoJ is even pursuing the same 2% inflation target as the Fed is ludicrous, given a population shrinking by almost 450k annually of which over-85s approaching 5%.
- I've long maintained that the entire neutral rate/output gap/DGSE econometric modelling framework of central banks had been exposed as largely pseudo-scientific gibberish, **taking us closer to the point where they become explicitly** politicised. Last week the FOMC again lowered their estimate of the long-run Fed funds rate and we've seen a stunning U-Turn over a relatively short period – the **Fed has changed its view of the 'neutral' Fed funds rate from above 4% to 2.5% today.**
- As covered back in the April note, market inflation expectations are now driving Fed/ECB policy above else, which is a pretty damning indictment of the whole monetary targeting framework. Meanwhile, the RBA governor noted that there's no exchange-rate channel for monetary stimulus if everyone is easing at the same time (and with the collapse in Australian 2-yr yields ahead of anticipated rate cuts to prop up the housing market, the AUD has lagged the wider rally versus the USD over the past month.



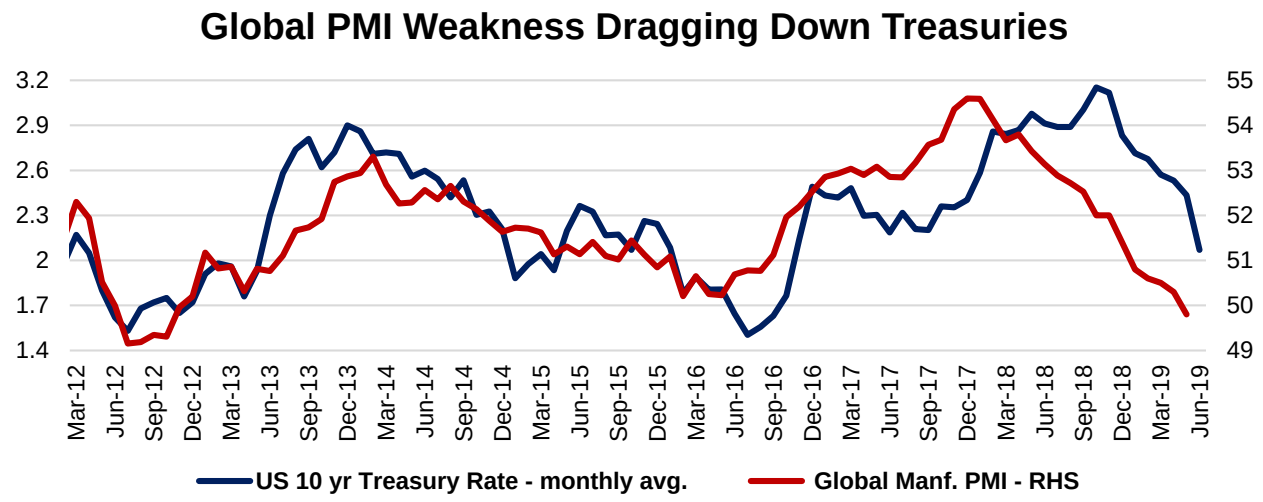
Source: Entext

- The jaw dropping moves in long-duration yields generate endless ex post rationalisations, but sometimes you simply can't take the numbers on your Bloomberg screen at face value. For instance, I noted back in the 10th June weekly that: '…*one factor is the recent surge in IEA estimated US inventories (by 24m barrels in a few weeks), is so huge that it implies that US production is running at something like 13m bpd i.e. 500-600k bpd above most independent estimates (despite falling rig counts and capex). There is a growing view that survey-based elements of the data are simply erroneous, and we will see estimated inventories fall sharply as 'payback'. That's particularly likely as an unusually large amount of refinery capacity offline in Q2 for maintenance draws in crude again by end quarter and US exports reaccelerate.'* The $10 surge in WTI since has been more about a dramatic reversal in that inventory 'glut' as Iranian provocations...**market narratives change faster than ever given the amplifying role of CTA and various quant trend following strategies**. As covered recently, bonds have become an epic momentum trade and volatility is likely to spike higher this summer…

- For the moment, the ECB has apparently been 'out-doved' by the Fed's U-Turn (pushing the €/$ to a 3-mth high, helped by an improvement in the surprise index versus the US) and **this year has again underlined that nothing matters more to global risk assets than shifts in US monetary policy**. I covered the prospect of an 'insurance cut' in the June 19th note, but it looks impossible from here for the Fed to catch up let alone get ahead of the rate futures market, unless the incoming data weakens dramatically and/or we get a further trade shock.

- Kashkari (of 2008 TARP fame) quoted above was advocating a 'one and done' approach which would leave rates well above market implied levels through year end and into next - the market has discounted three Fed rate cuts in H2 when there are four meetings and is likely to be disappointed, assuming some form of trade détente is achieved i.e. no tariff escalation. The USD reversal and falling real yields have driven goldbugs (and their crypto equivalent, further energised by misinterpretation of Facebook's plans) into renewed frenzy, helped by geopolitical tail risks in the Gulf. Gold has now become a consensus long with CFTC positioning up 5x since April and looks extended near term.

- **The consensus view seems to be that market expectations running ahead of the Fed doesn't matter, because every easing cycle since the 1980s has ended up with rates lower than the previous one**. Indeed, it's a mathematical necessity since in a dematerializing, digital led economy more debt per unit of output will need to get created to drive inflation to the elusive policy target and that is only serviceable at ever decreasing interest levels.

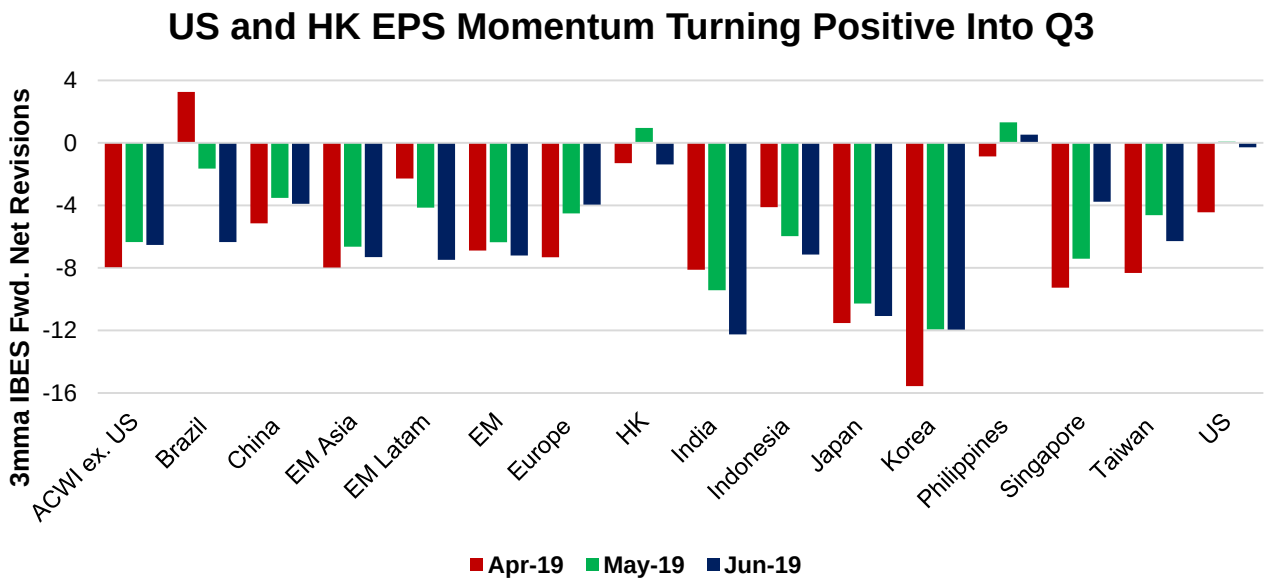


Source: JPM, FED

- While the current growth panic looks overblown (and aside from the trade aspect echoes several preceding ones), what could the Fed do in an eventual recession? In recently published research, the SF Fed finds that a negative fed funds rate of -0.75% would have contributed to better recovery from the 2008 recession. **The Fed can the ease policy by the 'typical' 5% or so during the next downturn only by employing QE on an even more aggressive basis.** The research examined "what would have happened" to the path of inflation if rates had been cut to -0.75% during the Great Recession. The two primary takeaways are that inflation would have been closer to target for longer, and the Fed funds rate would have lifted off faster and moved higher.

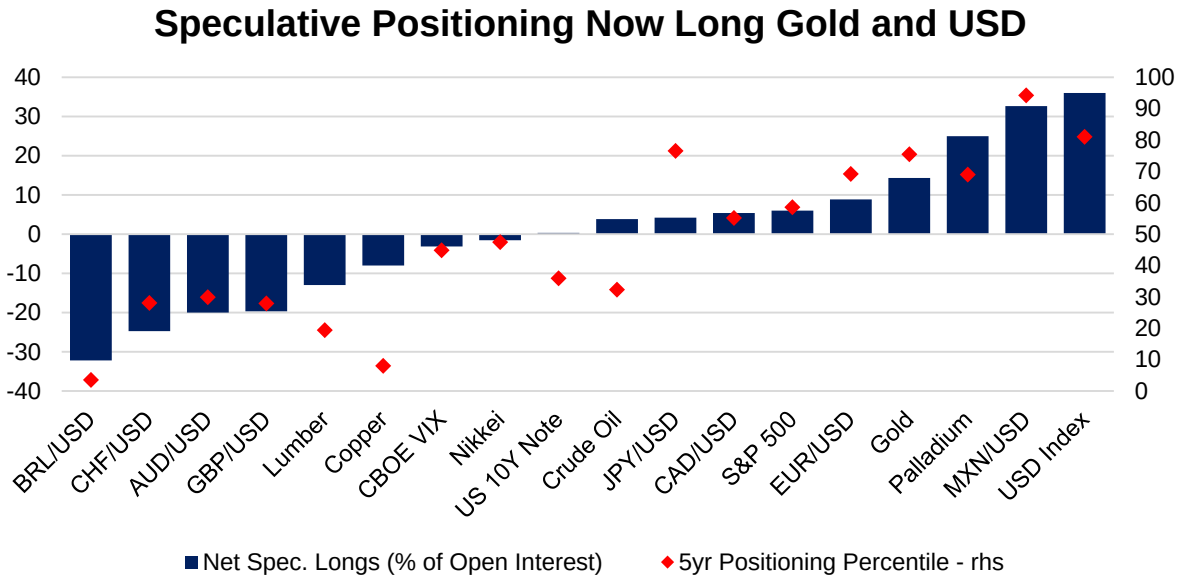
- The generally accepted notion that QE purchases equivalent to 1.5% of GDP is roughly equivalent to a 0.25% reduction in the Fed funds rate. This research paper from the Peterson Institute for International Economics summarizes the future options. **To achieve the (theoretical) additional 1.75% reduction in fed funds beyond the zero bound, the Fed would need to undertake QE equivalent to roughly 10.5% of US GDP**, call it about $2trn which would not expand the Fed's balance sheet as a % of GDP much beyond the 2014 peak….so that's ok then.

- As for earnings, **net upgrade momentum has turned positive in HK and the US as at end May and is improving sharply in China while India remains a laggard** as the fallout from an ongoing shadow bank liquidity crunch continues. MSCI World has had three corrections of note since the 2016 Brexit referendum - Feb 2018 (10.9%), Q4 2018 (18.6%) and May 2019 (6.5%) and each one of these corrections end with a more dovish tone from the Fed. As long as corporate cash flows don't contract dramatically, the multiple that investors are prepared to pay for equity cash flows are being inflated by another cycle of synchronised central bank easing. Equities still remain relatively cheap versus fixed income, **so a lower discount rate driving multiple expansion remains a key support, particularly if global earnings momentum and the global macro surprise indices stabilise this summer**.



Source: IBES, Entext

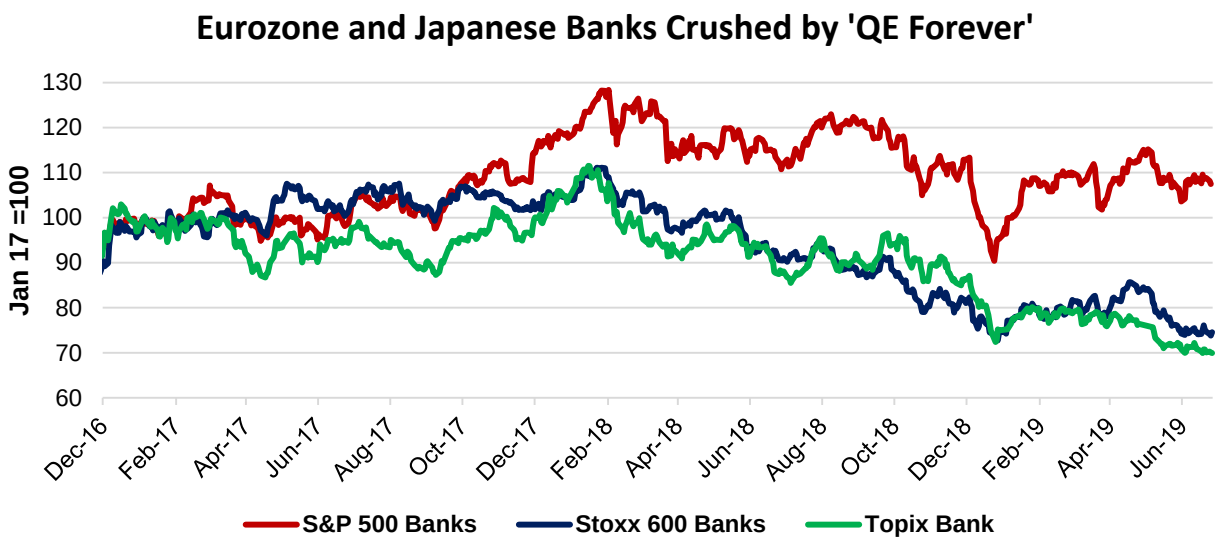
- **Positioning also looks supportive**, with the latest BoAML survey reflecting a remarkable spike in risk aversion, with one of largest monthly drops ever in equity allocation (largely to Japan and EM). Forward returns historically after drops of magnitude were broadly weak, as they correlate with plunging consensus expectations for global growth/earnings – of course, the binary trade war outcome adds a unique factor this time. One thing is clear - **the Fed having ratcheted up pressure on GEM last year has now given the asset class breathing space** – China is likely to follow India, Russia and the Philippines with lower rates along with other stimulus measures as pre-emptive recession insurance policy. As FX volatility eases, even the most stressed EMs like S. Africa and Turkey should be able to cut policy rates by the autumn, reducing growth tail risks.



Source: Entext, CFTC

ECB Has to Insulate Eurozone Banks From Further Easing Measures

- With the deposit rate already sitting at -40bps, what exactly does a cut to -50bps do for inflation pressures? Not a lot but Draghi also made clear that further QE is also on the table (boxing in his successor). **The ECB is likely close to the effective lower bound - the level where easing rates is no longer useful and can become counter-productive and incremental stimulus will need to come from elsewhere, and the most logical tool is QE.** It could even be targeted toward weaker economies, or something to make it less German-centric to make it more popular/effective.
- Draghi specifically stated that limits to what the ECB can buy were self-imposed and President Macron's effusive praise for Draghi last week (and mockery of Bundesbank president and potential Draghi replacement Jens Weidmann) make the enthusiasm of the political elite for more free money clear. **The limits on how much the ECB can own of any member state's outstanding debt will probably be eased or simply dropped**, a prospect beginning to be reflected in the shrinking Italian sovereign premium over Bunds.
- **Eurozone banks have proved a persistent value trap (like autos, also facing huge structural issues in terms of overcapacity and declining earnings power) - investors** seem to discounting current bank ROEs being unsustainably high. IB sector analysts generally attribute ROE pressure to ultra-low net interest margins because of the monetary backdrop (particularly in Europe and Japan) and higher post-crisis capital requirements. Post crisis regulatory reform forced DM banks to increase capital levels by about 5ppts since 2010 (Tier1 plus CET1), driven by higher absolute ratio requirements and tougher rules on how risk-weights are calculated.
- However, many investors I meet with a longer term outlook are focused on the risk that downward pressure on profitability will increase from the draining of incumbent bank 'moats' via trusted brands, principally as a result of technological change and that's a risk I've covered at length in recent years, generally seeing the sector as a value trap/tactical trading opportunity and best to focus exposure to the banks who are adapting technology to become 'systems integrators' such as DBS, BBVA, JPM and ING etc. With Italian banks holding over €400bn in BTPs, a shrinking spread to Bunds on less constrained ECB bond buying should offer the Eurozone sector support this summer while any further ECB easing measures **will have to take into account the adverse impact on bank margins via say a tiered deposit system,** a prospect I covered back in the 1st April note. Having long been rightly sceptical of the value proposition, **I've added the Eurostoxx banking index (SX7E) testing decade lows this week as a tactical long -** there's a price even for value traps…



Source: Entext

- Meanwhile, to follow up on last week's note, an FT opinion piece from Facebook co-founder Chris Hughes outlined his **concerns that the proposed digital currency could hand over much of the control of monetary policy from central banks to Facebook and its partners**, alongside the possibility that Libra could see many consumers in EM trading out of their local currencies and threatening "*the ability of EM governments to control their monetary supply, the local means of exchange, and, in some cases, their ability to impose capital controls*". While that's still several years away as a practical issue, he's right that the role of central banks and legacy interbank payments networks like SWIFT are now facing existential threats if the ambitions of the tech giants aren't tamed.
- Ironically, Facebook's rather hubristic announcement last week (which may be seen in hindsight as the tech equivalent of China's 2025 plan) probably makes big tech disruption of incumbent banks harder, as regulators and central banks now 'circle the wagons'. I noted last week that the BIS, the 'central banker's central bank' would quickly respond to Libra and it has now stated in its just published annual review (which includes the useful graphic below of its thinking on tech disruption paths) that big tech groups such as Facebook could "*rapidly establish a dominant position*" in global finance and pose a potential threat to competition, financial stability and social welfare, while regulators worldwide may need to revamp rules to deal with the structural changes threatened by companies that control key digital platforms. I suspect we're headed toward explicit property rights on consumer data and the imposition of a similar regulatory framework to incumbent banks as regards money laundering risks, reserving etc.
- Farsighted central banks (notably the PBoC, which has set up a Digital Currency Research Institute and has been experimenting with blockchain payments for a couple of years) will embrace the prospect of a frictionless, almost free and instantaneous monetary transmission mechanism. Last autumn, a PBoC expert advocated for the launch of a government-endorsed RMB-backed stablecoin, despite the country's ever tighter restrictions on cryptocurrencies. I wouldn't be surprised if long awaited RMB internationalization comes partly in the form of a tethered digital currency spread by tech giants like Tencent and Alibaba, across Asia initially. As covered previously, **a shift to central bank issued digital currencies would eventually allow a very different form of QE as 'helicopter money' paid directly into household accounts** rather than trying to create a portfolio channel effect via suppressing bond yields.

Turkey as Much as Trade Truce Key for H2 EM Risk Appetite…

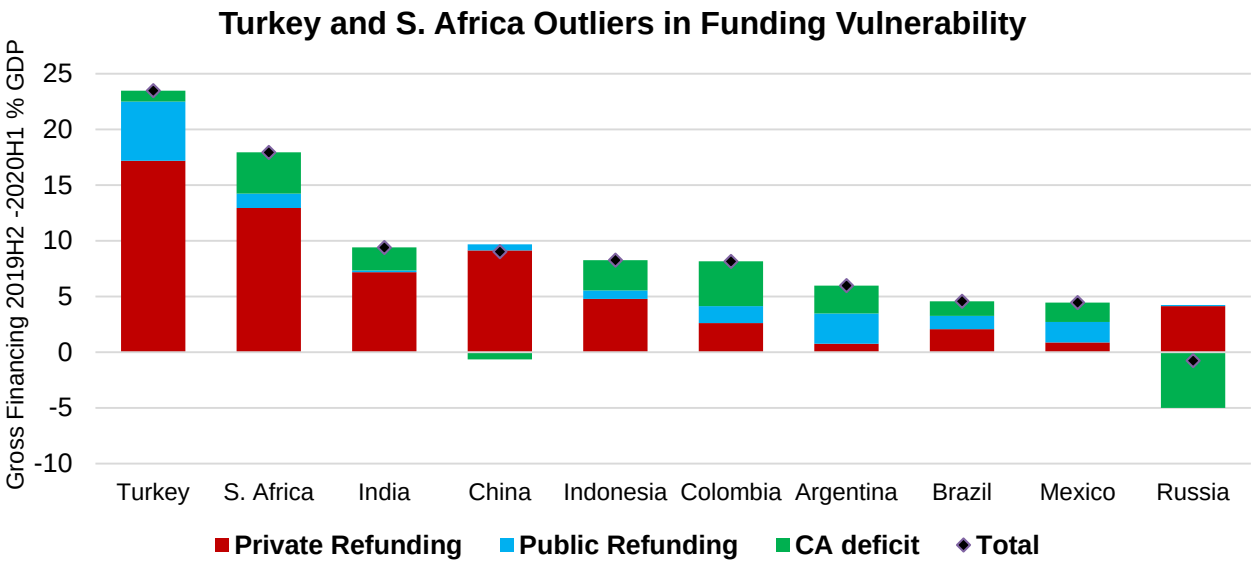
'The overwhelming number of counterintelligence cases in our country now involve Chinese nationals. ***The Chinese spy services are literally threatening Chinese families. If your son or daughter does not come back [from the US] and come back with intellectual property, the family will be put in jeopardy.*** *This is a revenue source that the universities become addicted to. All those students are paying 100 cents on the dollar tuition.'"* Democratic Senator Mark Warner, speaking at a Council for Foreign Relations event last week

"As far as I'm concerned, the ***most important reason behind high inflation is high interest. If you don't bring down high interest rates, then high inflation will not come down****..."* Turkish President Erdogan

- The **best outcome we can expect from the G20 is that the US and China will recommence formal negotiations over the summer** and while existing tariffs are unlikely to be reversed, perhaps some relaxation of the Huawei embargo (an issue which has seen intense lobbying by US tech companies). The alternative scenario would be an RMB adjustment toward 7.5 versus the USD to offset the impact of full tariffs on US exports, which would create a deflationary impulse. In many ways, Trump is losing control of the China phobic paranoia he created - Senator Warner's comments above reflect the febrile atmosphere in Congress, with everything from industrial scale organ harvesting in Inner Mongolian gulags to mainland students being co-opted as spies entering the mainstream consciousness - even Chinese biotech is now getting dragged into the confrontation.
- However aside from China, the **imminent US decision on sanctioning Turkey as a NATO member buying weapons from Russia will be critical for EM risk appetite** through the summer. Mild

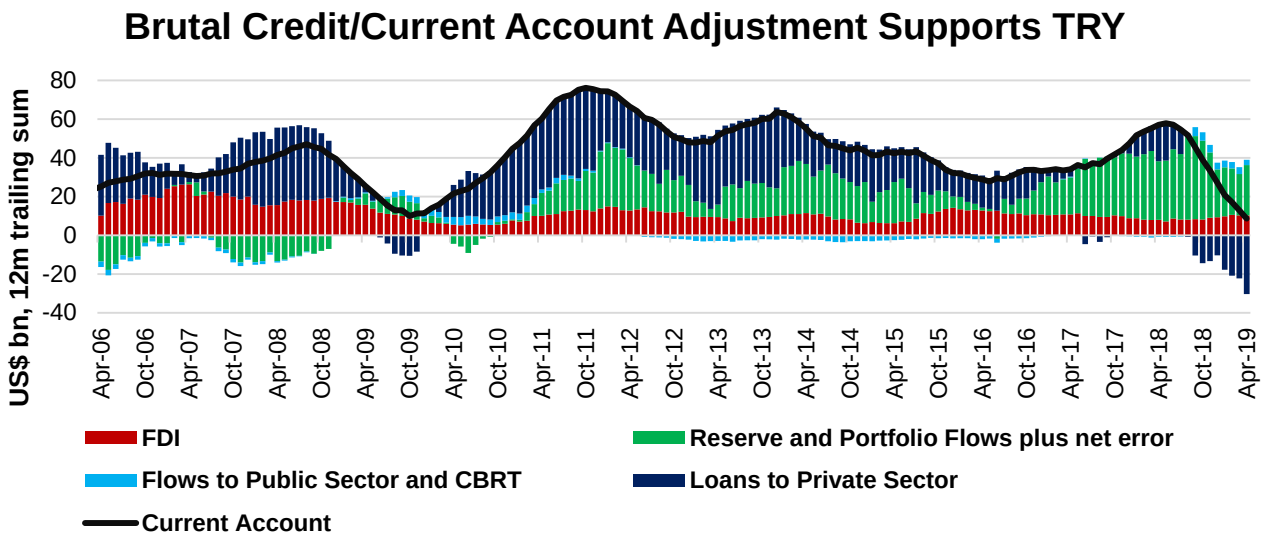
sanctions targeted on the military will be a relief, but broader economic ones, risk tipping the county into a default crisis with contagion into Spanish banks etc. Erdogan after the Istanbul election humiliation now leave economics to the experts and restore foreign investor confidence? Turkey is a small part of the global economy (peaking at about $850bn in GDP, heading toward the early $600s), but its 2017 credit and import boom was so disproportionately large that its reversal since mid-2018 has **had a material impact on its main trading partners, notably China and Germany via depressing new export orders etc**.

- For instance, the country has been the single biggest contributor to the decline in German export orders over the past year. It is now facing a classic balance sheet recession - **GDP is down 3% from the peak, and the 10% drop typical for capital inflow "sudden stops" looks likely**. The key is to resist the urge for more credit to delay the inevitable adjustment, and after a state bank funded spike in credit growth in Q1, the temptation seems to have been resisted since.



Source: Entext, World Bank, IIF

- Bank lending in Q2 through mid-June is down by TRY 13bn versus a jump of TRY 75bn in same period in Q1. The biggest driver of TRY weakness in recent years were repeated, out-sized credit expansions, which boosted growth at the expense of a sustainable balance of payments – **the more GDP and credit now fall, the faster the TRY will stabilize as the current account deficit is forcibly closed and even moves into surplus.** Near term, the Erdogan response to the decisive rerun Istanbul election result (i.e. does he clear out his government/central bank of incompetent cronies and appoint credible technocrats) and his G20 meeting with Trump to try to avoid/minimize threatened sanctions on the Russian missile delivery will be key.



Source: CBRT, Sign reversed for Current Account ((+) – Deficit, (-) – Surplus)

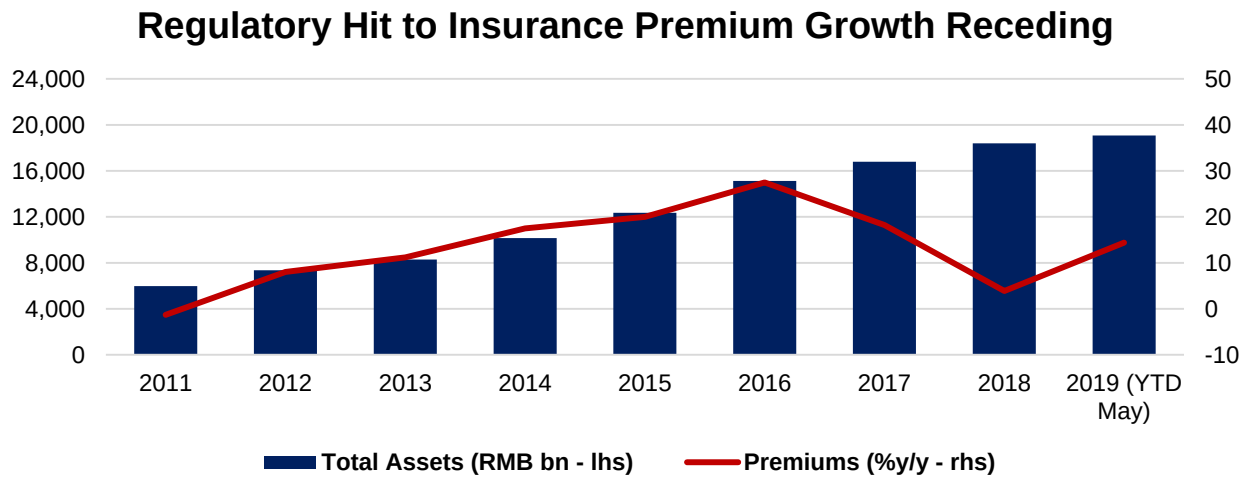
- **The country has to find financing equivalent to almost 25% of GDP over the next 12mths** focused on its banking system as the current account mean reverts, or more than twice Indian or Chinese requirements. Real money outflows YTD have exceeded those in Q2/3 last year during the wider EM FX panic. To restore strong growth in time for the 2023 Presidential elections, it needs not only sustained easier Fed policy but **far more orthodox, investor friendly policy mix to attract carry inflows.**
- The TRY is down 105 versus the dollar YTD but didn't approach its lows last summer at 7.2 to the USD even when Erdogan briefly took foreign investors hostage via capital controls in March and has been gently rallying in recent weeks to a current level of 5.8. Erdogan is a political survivor and if he now tilts to pragmatism (and manages to convince Trump to do the same), in a yield starved world the lira could lead a wider EM FX summer rally.

China Insurers Key Demographic/Consumer Exposure as Premium Growth Rebounds

*'Wu Xiaohui was shopping in New York. for buildings. "**He didn't really care — he'd point out the window and say: that one!" recalls a real estate executive who met Mr Wu, then chairman of China's Anbang Insurance. The acquisition strategy — to the extent there was one — appeared to be "the bigger, the better",** the executive recalled. Among the baubles Mr Wu snapped up was the fabled Waldorf-Astoria Hotel…Anbang paid $1.95bn for it in late 2014 — the biggest ever sum for a US hotel. These days Wu is in jail in China, sentenced to 18 years for fraud and embezzlement. Anbang, meanwhile, is under the control of the Chinese government and looking to unload US properties worth billions of dollars.'* Recent FT analysis the disappearance of Chinese buyers from NY real estate

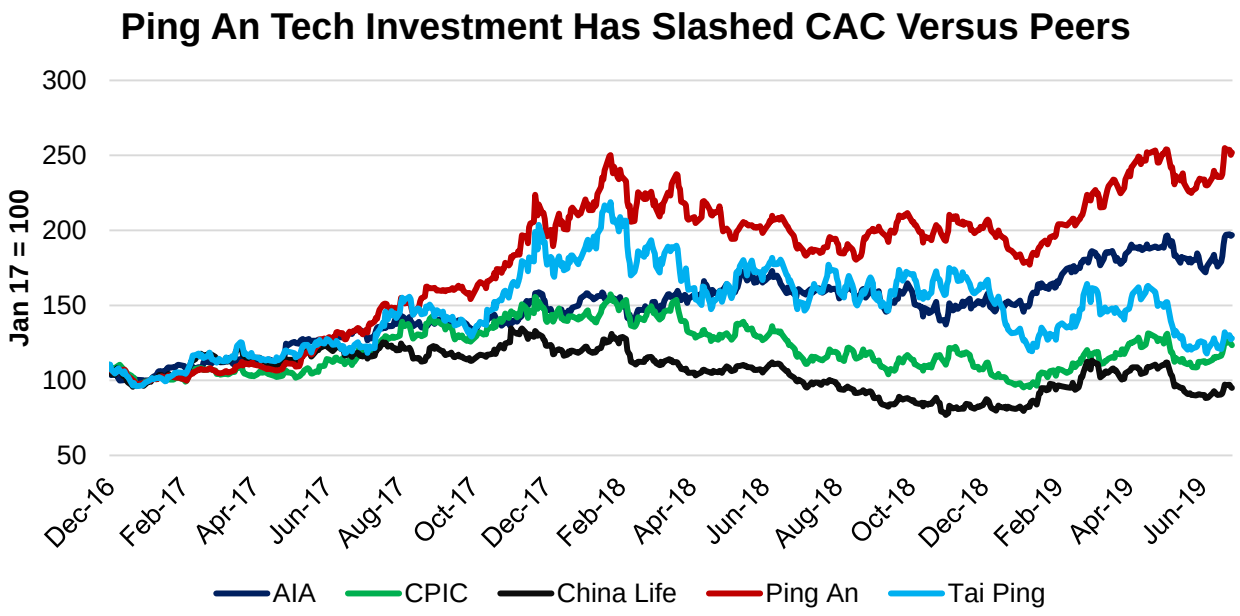
- Every sector in China has its cautionary tale of swashbuckling entrepreneurial hubris and (CCP) nemesis. Anbang before the 2016 regulatory crackdown scaled up with astonishing speed by offering guaranteed returns of 6% or more on wealth management style products, adding leverage and cutting margins to deliver them. Regulators imposed rules barring insurers from selling products with maturities of less than one year and instructing them to phase out those with maturities of less than three years to prevent risky duration mismatches. Solvency rules are now closer to international norms - capital requirements now vary in line with how quickly policies turn over and how premiums are invested.
- Firms that rely excessively on short duration policies or invest heavily in equities must hold a much bigger capital cushion. As elsewhere, the slide in bond yields has inevitably hit investment returns, but offsetting this is an improving competitive landscape and a rebound in premium growth. On most

industry estimates (including those of Swiss Re), China will be the biggest insurance market in the world by the early-mid 2030s, even as trend premium growth settles in the 7-10% range.



Source: Entext

- The pension funding deficit covered by central government is likely to reach over $150bn annually by next year. Deeper capital markets (including ultimately access by foreign mutual funds with local distribution partners) supported by pension savings inflows are a key part of the wider reform agenda. Current contribution rates for state/SOE pensions are far too low; private pensions and employer annuities (i.e. the addressable market for the insurers) are just over a quarter of total assets with the basic pension/national social security fund comprising the balance - the public pension system's 43% replacement rate (ratio of annual benefits to final salary) implies a significant cash flow deficit will open up that could amount to over $1.5trn within a decade. Insurers will be a key part of the underfunding solution – they have faced falling government bond yields as a headwind as well as regulatory changes slowing premium growth but remain a key China exposure as deficit in social provision from healthcare to pensions is funded directly by individuals.
- In China, the pension shortfall versus future liabilities amounts to as much as 40% of GDP on an NPV basis - the private share of total pension assets (currently sub 30%) will become dominant. Beijing already has the fallout from local government deleveraging and SOE restructuring to absorb which will see **central government debt/GDP double to 70-80% over the next 3-5 years from the currently reported 37% – bailing out the pension system as well simply isn't realistic**. I've covered China's fast evolving social credit system previously, which merges private and public databases on a scale unimaginable elsewhere in an attempt to use technology to bridge a chronic trust deficit.
- Ping An has become a leader in facial recognition technology to verify identity and more recently to help assess risk when lending through their consumer finance company; loan approval times have dropped from five days on average to two hours; the company looks for what they categorize as 'micro expressions' that can offer clues as to whether the applicant is telling the truth, an AI era update of the polygraph test. For larger amounts an applicant has to complete a list of questions in a 10 – 15-minute video where they also analyze facial expressions during the answers; **Ping An claims to have made over $72bn in loans with the help of this facial recognition technology.**



Source: Entext

- **China's insurance premiums per capita stood at about $320 last year and just 3.7% of GDP**, relatively low versus regional per capital income peers like Thailand. After a series of regulatory changes, Chinese insurance premium income was falling at a 3.9% y/y pace at end 2018 but has since reaccelerated strongly to show **14% growth in first four months of 2019**. Total assets stood at 19.4trn RMB at the end of April and as covered before demographic trend and public sector underfunding/fiscal deficits imply a sustained private pension/healthcare provision tailwind.
- **Ping An remains one of the most impressive fintech plays** globally, **on a par with say JPM in banking** – the group invests about one percent of revenue in R&D in fintech/healthtech and employs over 23,000 IT specialists. Having invested $7bn in R&D in the past decade, it now plans to more than double that over the next.it is slashing customer acquisition and servicing costs by using mobile apps and WeChat etc to reduce its over 1.5m employees, most of whom are in customer admin and sales, while hugely expanding its IT capacity, including extensive VC investment. The threat to the legacy insurers from the tech giants is clear with Alibaba now entering the health insurance market (and Ant extending its asset management ambitions beyond money market funds via a joint venture with ETF giant Vanguard).

- The restrictions on wealth management product issuance (bank WMPs were offering yields of about 5.4% a year ago versus an average guaranteed rate offered by universal insurance products 30-70 bps lower) has **seen retail investors return to insurers. By the end of next year the new regulatory framework will require bank WMPs to be marked to market each day** (like a traditional mutual fund), to underline the fact to retail investors that returns aren't guaranteed. Banks are scrambling to set up wealth management arms in response, but this will reduce their competitiveness relative to already-compliant yield products from fund companies and insurers.
- Also by end 2020, further liberalisation of the interest rate regime should boost savings-based life insurance products; the current two-track rate system will likely end to help channel risky shadow lending activity back onto bank balance sheets. Even with foreign firms likely to grow their share from the current low 5% base as the market opens, **investors seem too bearish on life insurer growth prospects, with the key stocks on sub 1x price to embedded value multiples**. Eventually, HK and mainland investors will start valuing these companies on the basis of embedded value rather than earnings multiples and yields i.e. the adjusted NAV (adjusted by marking assets and liabilities to market

and deducting unrealized gains and deferred acquisition costs) and the present value of the future post-tax profits from existing policies (i.e. in-force value), a calculation obviously hostage to assumed discount, investment return and mortality rates etc.

- China Life has the highest pension market exposure while China Life, CPIC and Ping An in that order already have significant premium income exposure to the private pensions market (combined employer annuity and individual) and would be the biggest beneficiaries in terms of a sustained embedded value uplift from what looks like an inevitable policy led shift to pension self-funding. While higher plan returns from asset diversification/later retirement would mitigate the level of pension investment, the scale of the uplift needed in private pension inflows looks dramatic over the next decade.
- **I've been a long-time bull on Ping An which has paid off** given superior relative margin trends, balance sheet strength and perceived management quality, but the divergence with CPIC and China Life which are trading pretty much flat since early 2017 now looks extreme and has scope to mean revert by year end if the premium uptrend is sustained. **To compete with Ping An, other 'second mover' insurers are likely to partner with the social media/messaging platforms** to distribute simple pension/term assurance products, as well as capturing a surge in employer annuity flows. I**nsurers remain an attractive long-term demographic transition bet,** particularly those that can adapt technology to cut customer acquisition costs and drive higher margins.

Current Macro Trades and Thematic Stock Baskets

Open Positions	Instrument	Initiation	Performance (%)
Long AUDNZD	Long AUDNZD Forward June	29/03/2019	0.1
Long Copper	HG1 Jul19 Future	29/03/2019	4.9
Short US 10-year Note	US 10 Year T-Note Future	29/03/2019	2.7
Long China Internet Stocks	KraneShares CSI China Internet (KWEB)	06/06/2019	7.1
Long European Banks	Stoxx 600 Banks Index (SX7E)	06/26/2019	1.1
Closed Positions	**Instrument**	**Closed Date**	**Performance (%)**
Short MXNUSD	Bloomberg MXNUSD Spot	31/05/2019	2.3

Basket Theme	Constituents	Initiation	Performance (%)
5G Infrastructure	Accelink, Cisco, Finisar, Juniper Networks, Nokia, Qualcomm, Zhongji Innolight	02/01/2019	10.9
Global Oil E&P (Reserve Underinvestment)	iShares SPOG ETF	02/01/2019	8.5
Autonomous Vehicles	Denso Corp., Koito, Nexteer, Renesas, GM, Sony, Baidu	02/01/2019	1.0
Auto Electrification	LG Chem, BYD, Samsung SDI, Toyota, Ganfeng Lithium, Hanon	02/01/2019	6.0
Embedded Intelligence (sensors/MEMS)	Broadcom, Murata, NXPI, Nidec, Sony, Synaptics	02/01/2019	6.2
Services/Ecommerce Automation	Cognex, Delta Elec., Innovance, Keyence, Omron, Rockwell, THK	02/01/2019	17.3
Esports/Social Gaming	Netease, Capcom, Electronic Arts, Nintendo, Tencent, Ubisoft, Square Enix	02/01/2019	13.1
Artificial Intelligence Software/Semis	AMD, Alibaba, Baidu, Google, Hikvision, Iflytek, Nvidia	02/01/2019	16.0
Cybersecurity	Akamai Tech., Check Point Software, Cyberark, Fortinet, Palo Alto Networks, Proofpoint, Trend Micro	02/01/2019	22.5
China Education	Wisdom Education, Tianli Education, New Oriental, New Higher Education Group, YuHua, Maple Leaf Educational Systems	22/01/2019	31.3

Source: Entext – equal weighted baskets

Summary Asset Views

	Investment View Vs. Benchmark MSCI Weight/SAA Benchmark (6-12mths +)	Rationale
Equities		
US	Bearish/Neutral	Structural PER premium to Japan/Europe driven by high tech weighting but extended. EPS growth slowing to 5-6% this year with strong USD/sustained tariff war downside; regional banks, industrials, housing and energy favoured
Europe	Bullish/Neutral	EU-US tradeconflict delayed to autumn but auto tariffs remain a risk - banks at 0.6x book look cheap but value trap until tiered ECB reserves/cost cutting consolidation allowed. Energy, deep cyclicals, industrials ex autos preferred
UK	Neutral/Bullish	Global funds very underweight and will be buyers if 'long goodbye' soft Brexit scenario, o/w energy, financials u/w telecom, consumer
Japan	Bullish	ROE/buyback uptrend intact despite China headwinds - o/w deep cyclicals, real estate, global niche dominant tech exposure themes
Asia Pacific	Bullish	Earnings momentum still broadly negative, favour N. Asia over India/Asean - o/w cheap consumer plays e.g. Macau casinos - insurers, education and select internet names now attractive LT
GEM Equities	Neutral/Bullish	Brazil stalling on receding pension reform hopes, India liquidity/ funding risks a drag, North Asia still preferred despite trace escalation
Fixed Income		
Government	Bearish	10-yr testing 2.4% on risk off flows far too low to be 'clearing price' for $1trn deficits, negative real term premium unsutainable absent growth shock, Fed rate cut expectation looks anomalous
Investment Grade	Neutral/Bearish	IG spreads should be widening this late in cycle, supported by (unhedged?) Japanese inflows - avoid high leverage 'blue chip' names with rising business model terminal valuation risks (e.g. Kraft-Heinz)
High Yield	Neutral/Bearish	US credit quality metrics deteriorating, HY spreads widened over 200bps in Q4 amid ETF outflows before sharp YTD rally - at fair value and uncompelling
EM debt	Bullish	After dramatic Q1 rally, valuations broadly reflect credit risks, Turkey and Argentina dampening wider sentiment, underweight LC debt in twin deficit markets on FX pressure
Commodities		
Energy	Neutral	Closed bullish stance on tightened Iran sanctions as Brent at $75 looks extended; upside risks to $80+ into 2020 on underinvestment/shale growth slowdown - add exposure on weakness
Industrial Metals	Neutral	Upgraded from u/w in Q4 -sustained rebound needs China FAI trends to improve, fundamentals support zinc, copper
Precious Metals	Neutral	Falling real yields support gold, palladium selloff overdue as premium to platinum had become extreme given weak global auto sales
FX		
USD	Neutral	DXY reached late 90s target from Dec 17 - yield differentials uncompelling on hedged basis, needs global risk off impetus to break new highs
GBP	Neutral	Closed multi-year bearish stance in January 2014, - broad 1.27-1.33 range until clarity on customs union and/or second referendum
JPY	Neutral/Bullish	Fair value on real yield, PPP basis about 110 versus USD, household panic selling of EM carry trades drove recent 'flash crash'
Europe	Neutral/Bearish	Early 2018 1.15 target broken vs USD, needs relative macro surprise data to improve iversus US, ECB TLTRO extension helps
GEM	Neutral/Bullish	BRL/TRY weakness resuming on political risks - China momentum and oil stabilisation key for sustained carry inflow rebound - weak inflation likely to allow easing cycle in H2, MXN long positioning extended

Absolute return investors may wish to treat Bullish recommendations as longs and Bearish recommendations as shorts. Meanwhile those with a benchmark may wish to treat our recommendations as tilts against their own strategic benchmark, and according to any single asset class limits they may have.

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