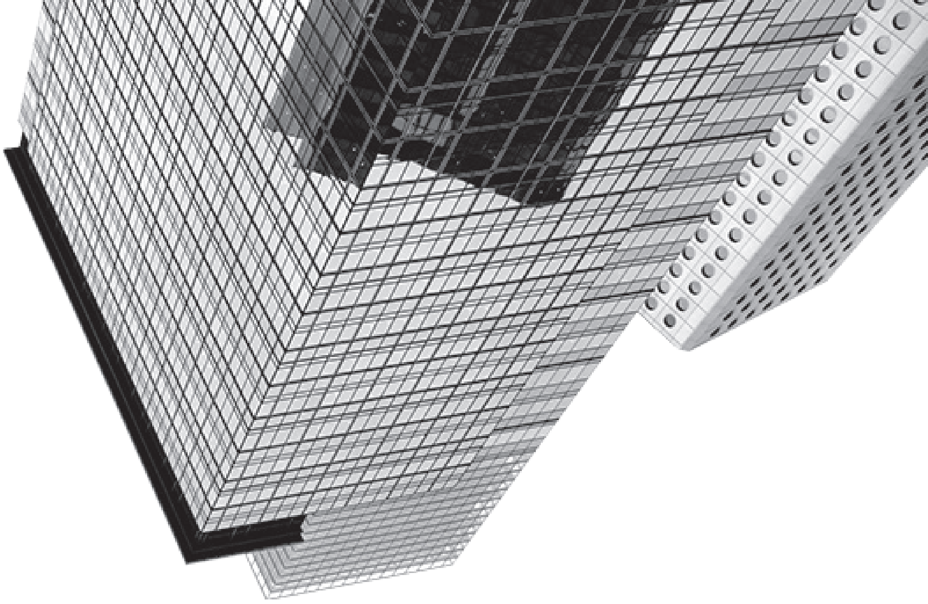

KGI

Global Wealth Management

2021 Outlook

中華開發金控
CHINA DEVELOPMENT FINANCIAL

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Conclusion

The sun will rise again

Highlight

Global economic will not return to trend growth in 2021. Economic performance will hinge on: pandemic, government reactions and vaccine development. A better understanding of the virus, financial relief and vaccine development will prevent substantial stock market corrections. We prefer cyclical value stocks, like commodity and industrial names, for their close correlation to economic performance. We also recommend non-US (EU, emerging Asia) markets, as (1) economic reset may not be as favorable to tech stocks; (2) emerging markets could ride US dollar weakness and rising commodity prices; and (3) non-US markets offer better valuations.

2021 economic recovery intact; we recommend cyclical value stocks and non-US markets

- Global economic output may return to the pre-pandemic level in 2021, but near-term growth is unlikely to realign with the old trajectory. Economic performance will hinge on the pandemic, government reactions and vaccine development.
- The EU and US could step up restrictions to counter rising infections in winter, and that could disrupt the recovery. A better understanding of the virus, financial relief and vaccine development will prevent substantial stock market corrections. Mass vaccination should take place in 2H20. The duration of vaccine protection is critical.
- The global economy will see a V-shaped recovery once the pandemic ends for good.
- The Fed will be more tolerant to inflation following the proposal of the average inflation concept in August. Preemptive rate cuts seem less likely. The Fed's new approach to making monetary policies will have a more profound impact on the market in the later stage of economic expansion.
- We prefer cyclical value stocks, like commodity and industrial names, for their close correlation to economic performance. We also recommend non-US (EU, emerging Asia) markets, as: (1) the economic reset may not be as favorable to tech stocks; (2) emerging markets could ride US dollar weakness and rising commodity prices; and (3) non-US markets offer better valuations.

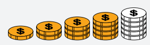
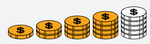
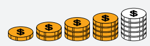
Market overview

Solid recovery in 2021; value stocks and non-US stock markets to outperform

Asset	Comment	Allocation
Fixed income		
US Treasuries	Economic recovery and Treasury issuance to lift yields, but Fed's bond purchase will hinder yield upward speed	− +
Investment-grade bonds	Credit spreads have limited convergence due to economic recovery; beware of a rising risk-free rate	− +
High-yield bonds	Interest coverage ratio of non-financial sector yet to worsen significantly; high-yield bonds remain attractive	− +
Emerging market bonds	Rising EM currencies to help narrow credit spread, which still has downside	− +
Equity markets		
US	2021 focus on corporate earnings improvement, narrowing of supply-demand gap, and balanced allocation of cyclical and growth stocks	− +
Europe	2021 fiscal policy launched to boost economic recovery; upbeat on export-oriented & services, & consumption sector's recuperative ability	− +
Japan	On global economic recovery, we favor Japan's cyclicals, high-end semi process players & automation sector in 2021	− +
China	A-shares to begin new bull market; all sectors to perform well	− +
Taiwan	Digital economy & economic re-opening will support Taiex long-term bullishness in 2021F	− +
Emerging Asia	Corporate earnings growth & US dollar weakness in 2021 are favorable to emerging Asia, which is strongly connected to global economic cycle	− +
Emerging EMEA	In 2021, many EMEA countries are fraught with political uncertainties; investment to focus on value-based & defensive stocks	− +
Latin America	In 2021, emerging Latin America to bottom out on low base; raw materials & consumption sectors favored to rally	− +

Market overview

Solid recovery in 2021; value stocks and non-US stock markets to outperform

Asset	Comment	Allocation
Commodities		
Energy	Neutral on energy as oil prices have recently rebounded amid rising geopolitical tensions in the Middle East & extended output cuts by OPEC+ until March	–  +
Metals	Diminishing policy uncertainty & rising real interest rates spell doom days ahead for gold	–  +
FX markets		
US dollar	US dollar to depreciate in 2021F amid slow midterm global recovery, policy redirection, & alarming current account & fiscal deficit levels	–  +
Euro	Improving risk appetite & soft US dollar favors euro outlook in 2021F	–  +
Japanese yen	Neutral on yen in 2021 in light of improving real interest rate vs. positive global outlook & dissipating uncertainties	–  +
Renminbi	Renminbi bullish in 2021F on edge over economic growth, interest spread, & potential mitigation of Sino–US tensions	–  +

Market performance (as of 12/10)

US, Japan and EM Asia stocks outperform, sovereign and IG bode well in 2020

		Local currency					NT dollars				
		Past 1 month	Past 3 months	YTD 2020	2019	2018	Past 1 month	Past 3 months	YTD 2020	2019	2018
Fixed income	US Treasuries										
	US Treasury bond index	0.38%	–0.99%	7.66%	6.86%	0.90%	–0.80%	–4.94%	1.22%	4.91%	3.67%
	Investment-grade bonds										
	Bloomberg global investment grade bond index	1.92%	2.68%	9.09%	11.51%	–3.57%	0.72%	–1.41%	2.56%	9.48%	–0.92%
	High–yield bonds										
	Bloomberg US High–Yield Bond Index	1.69%	4.68%	6.15%	14.32%	–2.08%	0.49%	0.51%	–0.21%	12.23%	0.60%
	Bloomberg Europe High–Yield Bond Index	2.37%	4.14%	2.26%	11.33%	–3.82%	3.42%	3.41%	4.43%	7.19%	–5.36%
	Bloomberg Asia High–Yield Bond Index	2.25%	1.36%	4.54%	13.79%	–3.21%	1.05%	–2.67%	–1.71%	11.71%	–0.55%
	Emerging market bonds										
	Bloomberg Emerging Market Composite Bond Index	2.04%	2.77%	7.18%	13.14%	–1.89%	0.84%	–1.32%	0.77%	11.07%	0.80%
Equity markets	Developed markets										
	S&P 500	3.45%	8.06%	13.68%	28.88%	–6.24%	2.23%	3.75%	6.88%	26.52%	–3.66%
	STOXX 600	3.65%	6.83%	–5.04%	23.16%	–13.24%	4.71%	6.08%	–3.01%	18.58%	–14.62%
	Nikkei 225	7.96%	16.44%	13.36%	18.20%	–12.08%	7.88%	13.87%	11.06%	17.05%	–7.08%
	Emerging markets										
	MSCI Emerging Markets Index	5.32%	15.67%	12.67%	15.42%	–16.63%	4.09%	11.06%	5.92%	13.31%	–14.34%
	MSCI Emerging Markets Asia Index	4.59%	16.03%	22.42%	16.63%	–17.29%	4.09%	11.06%	5.92%	13.31%	–14.34%
	MSCI Emerging Markets EMEA Index	5.94%	12.06%	–11.15%	11.20%	–18.73%	3.37%	11.41%	15.10%	14.50%	–15.02%
	MSCI Emerging Markets Latin America Index	12.16%	17.68%	–19.15%	13.71%	–9.27%	4.70%	7.60%	–16.47%	9.17%	–16.50%
Commodities	Commodities										
	S&P GSCI Energy Index	10.49%	12.72%	–49.57%	26.98%	–18.75%	9.19%	8.23%	–52.59%	24.66%	–16.52%
	S&P GSCI Industrial Metal Index	9.47%	13.87%	16.02%	0.44%	–19.63%	8.18%	9.33%	9.07%	–1.39%	–17.42%
	S&P GSCI Agriculture Index	1.15%	12.31%	3.42%	–2.42%	–9.85%	–0.04%	7.84%	–2.77%	–4.20%	–7.38%
FX markets	FX markets	Versus US dollar					Versus NT dollar				
	US dollar	—	—	—	—	—	–1.17%	–3.98%	–5.99%	–1.83%	2.74%
	Euro	2.23%	3.42%	8.63%	–1.92%	–4.22%	1.03%	–0.70%	2.13%	–3.72%	–1.59%
	Yen	1.11%	1.85%	4.21%	0.87%	2.86%	–0.07%	–2.21%	–2.03%	–0.97%	5.69%
	Renminbi	1.32%	4.43%	6.39%	–1.22%	–5.38%	0.13%	0.27%	0.02%	–3.02%	–2.78%
	Australian dollar	2.28%	2.49%	6.43%	–0.25%	–9.71%	1.08%	–1.59%	0.06%	–2.07%	–7.23%
	New Zealand dollar	3.04%	5.09%	4.68%	–0.25%	–5.00%	1.83%	0.90%	–1.58%	–2.07%	–2.39%
	South African rand	2.84%	11.03%	–6.14%	2.14%	–13.51%	1.63%	6.61%	–11.76%	0.27%	–11.13%

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Asset allocation

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Asset allocation

Solid economic recovery in 2021; cyclical value stocks and non-US stock markets to outperform

Equity markets	Conservative 50%	Neutral 60%	Aggressive 70%
US	15%	15%	15%
Europe	15%	20%	20%
Japan	5%	5%	10%
Emerging markets	10%	10%	15%
China A–shares	5%	10%	10%

Fixed income	Conservative 50%	Neutral 40%	Aggressive 30%
US treasuries	10%	5%	5%
Investment–grade corporate bonds	10%	10%	5%
High–yield bonds	15%	10%	10%
Emerging market bonds	15%	15%	10%

Economy to return to pre–pandemic level in 2021F

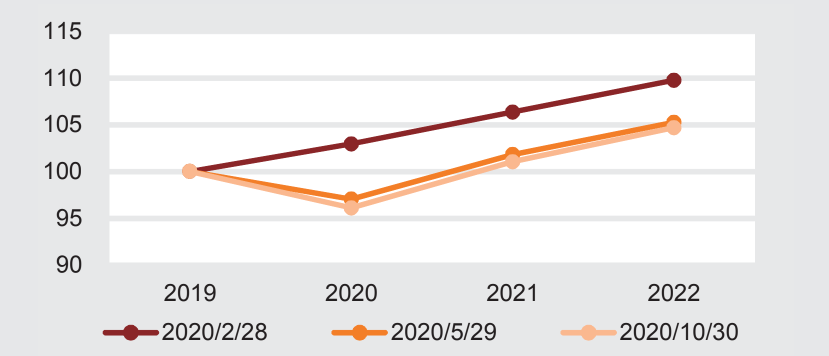
But unlikely to realign with old trajectory

Global economic recovery to continue; pandemic and vaccine development are the key

- The global economy has been disrupted by the pandemic in 2020. Many countries saw economic results trough in April before rebounding on the launches of monetary easing policies and financial relief plans by major economies. Consensus on 2021 global economic growth has also climbed from a low of 3.1% to 5.2%.
- While economic recovery loses pace slightly on the reinstatement of lockdowns in the EU and US, we still expect global economic output to return to the pre–pandemic level in 2021. That said, near–term growth is unlikely to realign with the old (pre–pandemic) trajectory. Recovery pace will depend on the pandemic, government reactions and vaccine development.

Global economic outlook improves, but unlikely to catch up with old trajectory near term

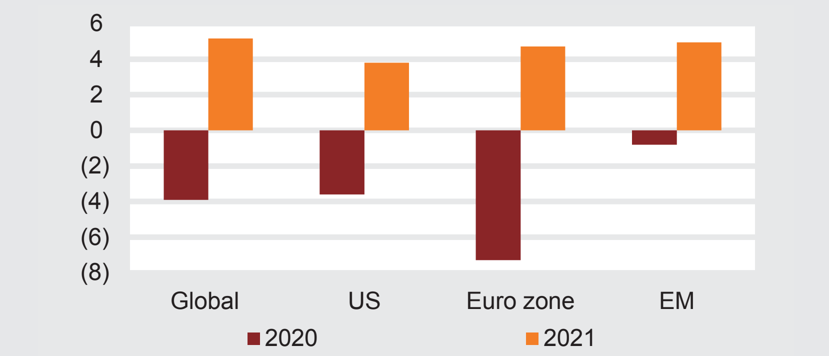
Projected global GDP growth (2019=100), percent



Source: Bloomberg; CDF

Economic growth in EU and US is weaker than in emerging Asia given the pandemic

Consensus GDP growth forecast, percent



Source: Bloomberg; CDF

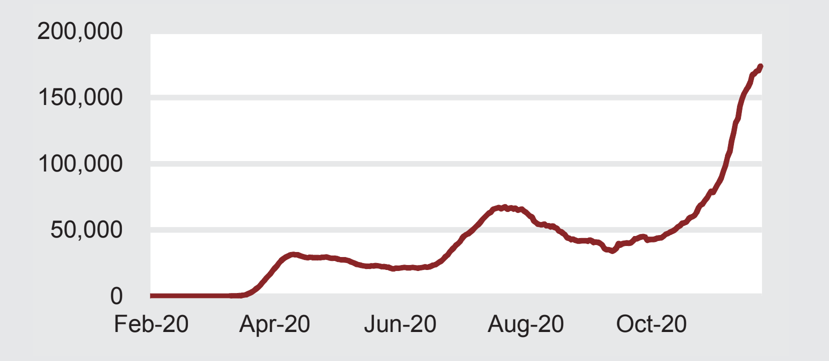
Pandemic making a comeback
This winter is going to be very cold

EU and US to re-impose restrictions in winter to counter a resurging pandemic, but the measures won't be as tight as in 1H20

- As winter approaches, new COVID-19 infections in the US and EU have reached new highs. Lockdowns have been reinstated in some regions. We believe the economic impact of the pandemic will stem from: (1) government control measures; (2) consumers changing economic behavior for self-protection; and (3) companies halting investment in light of uncertainties.
- However, the current pandemic should be more manageable than the first wave, as: (1) governments have rolled out aggressive fiscal stimuli; (2) medical resources are more sufficient; and (3) vaccine development is making progress. The comeback of the pandemic won't alter the course of economic recovery, but rather just slow it down.

New infections are twice as many as the previous peak

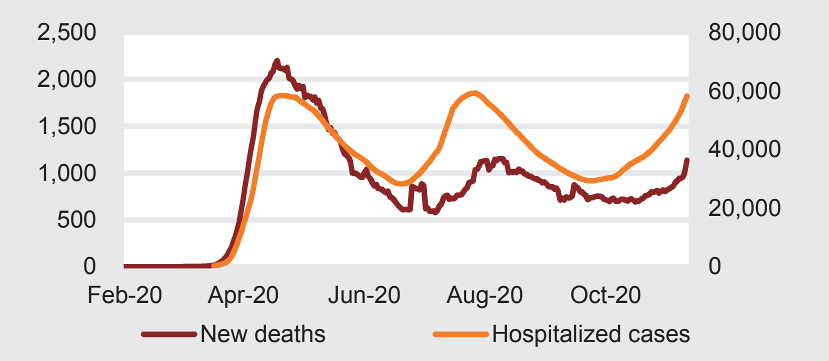
Daily new infections in the US, case



Source: The Covid Tracking Project; CDF

Availability of medical resources is being put to the test again

Daily new deaths in the US, case (LHS); number of hospitalized patients, person (RHS)



Source: The Covid Tracking Project; CDF

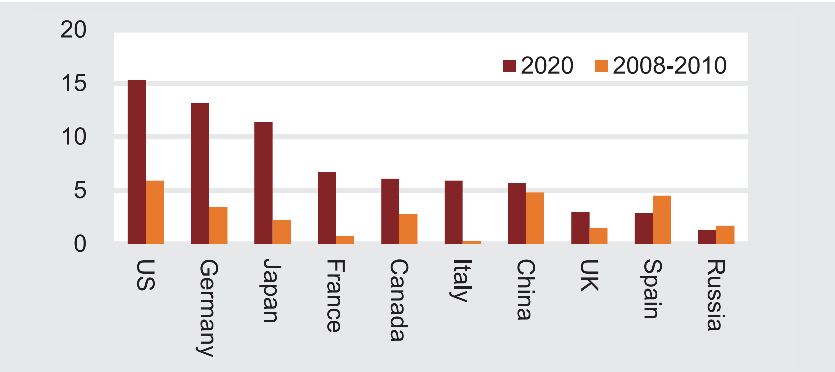
A recession unlike before

Government relief saved the vulnerable private sector; pandemic is only an external disruption

- The economic decline caused by the pandemic is very different from previous recessions. Normally, an economic recession arises from long-term imbalances within the economic system, be it about debt, asset prices or trade balances. Such an imbalance requires major reform to rectify, which is often painful and lengthy. However, the imbalances facing developed economies at the moment, especially the US, are not grave enough to trigger a recession.
- The pandemic is a short-term disruptive event, and the aggressive stimuli introduced by governments and central banks have markedly reduced the possibility of a flaccid economy when the pandemic is over. Compared to the 2008 financial crisis, the number of bankruptcies filed during the pandemic has not picked up significantly. The ratio of loan delinquencies over 60 days in the US is even lower than the same time last year, suggesting the private sector has not been devastated by the pandemic.

Government aid on an unprecedented scale has helped prevent a crisis from happening

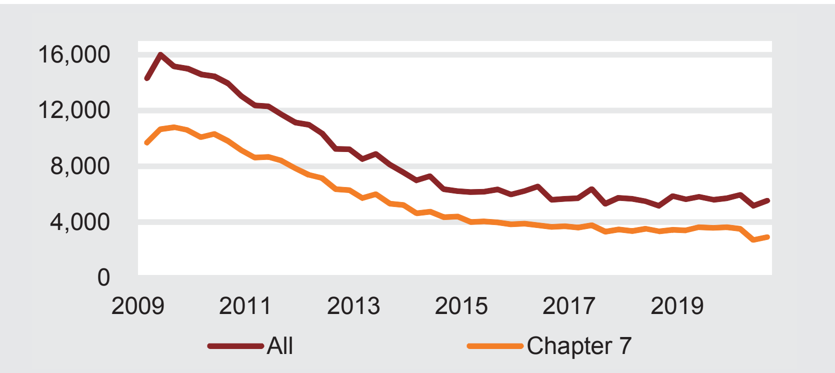
Fiscal stimuli as a percent of GDP, percent



Source: BCA Research; KGI Research compiled

Bankruptcy filings in the US have not increased during the pandemic

Number of bankruptcy protection filings in the US, case



Source: Bloomberg; CDF

Effective, safe vaccines are not too far off

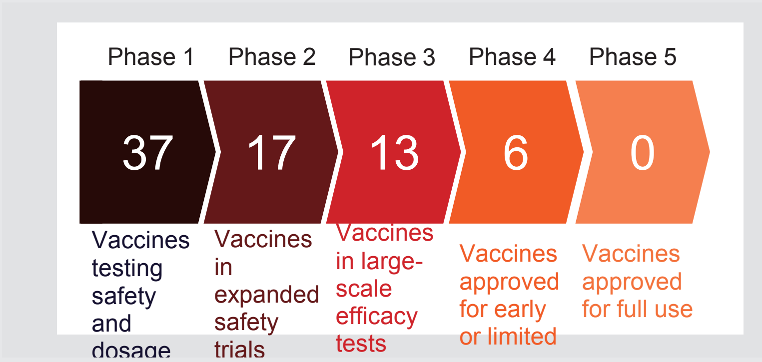
But mass vaccination is a mammoth challenge

Vaccine development faster than expected, but mass vaccination remains afar

- Six candidate vaccines were at the final stage of clinical trials as of November 23. Most experts now expect the US to get 25mn people vaccinated by end–May 2021. According to Nature, if the protection period is less than 40 weeks, the virus could still have seasonal outbreaks in the future, but if the protection can be extended to 100 weeks, the pandemic will come to an end.
- Producing vaccines for billions of people across the world is a mammoth challenge. Some in the EU and US are skeptical about the vaccines. In the US, only 51% of the population is willing to be vaccinated immediately. The other 49% mainly cited safety concerns. Vaccination takes time, and we estimate major countries won't get mass vaccination done before 2H20. Only after that can economic activities resume as before.

Six candidate vaccines are at final stage of clinical trials

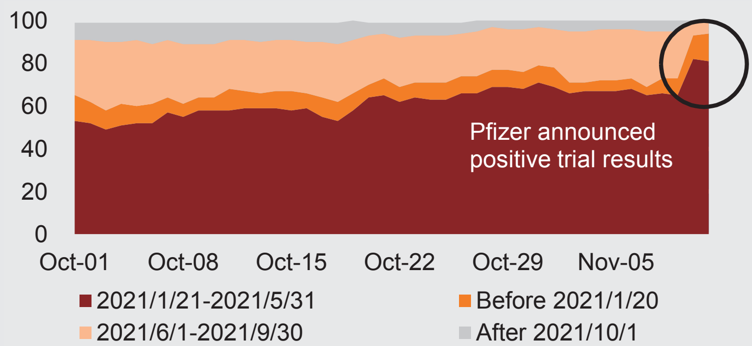
Potential vaccines tracked by The New York Times



Source: NY Times; KGI Research

Most experts expect the US to begin mass vaccination by June

Projected time of 25mn vaccinations in the US, percent



Source: Good Judgement; KGI Research

A v–shaped turnaround?

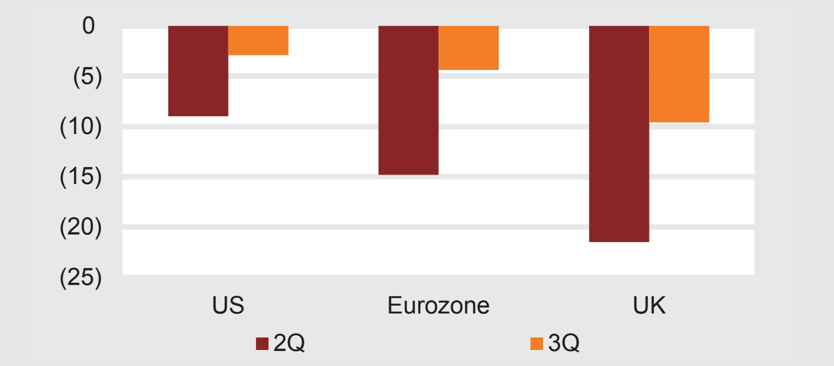
Lessons learned in the summer

A V–shaped recovery is not out of reach as the foundation of global economic growth has not been destroyed by the pandemic

- Two front–running vaccines have boasted over 90% effectiveness, surpassing market expectations. If the vaccines can keep the pandemic under control, or even eradicate it, the global economy should witness a solid V–shaped recovery in 2H21. When the US and EU governments lifted restrictions on an ameliorating pandemic in the summer, the economy immediately rebounded.
- It is definitely possible that global economic output could realign with the pre–pandemic growth trajectory. Output growth is determined by: (1) labor; (2) capital; and (3) overall productivity. Labor loss due to the pandemic has been minimal, and business investment has not really decelerated. The pervasive use of new technologies could potentially enhance productivity. As such, we remain upbeat about global economic growth over the long run.

US and EU economic growth rebounded substantially in 3Q20 as control measures eased

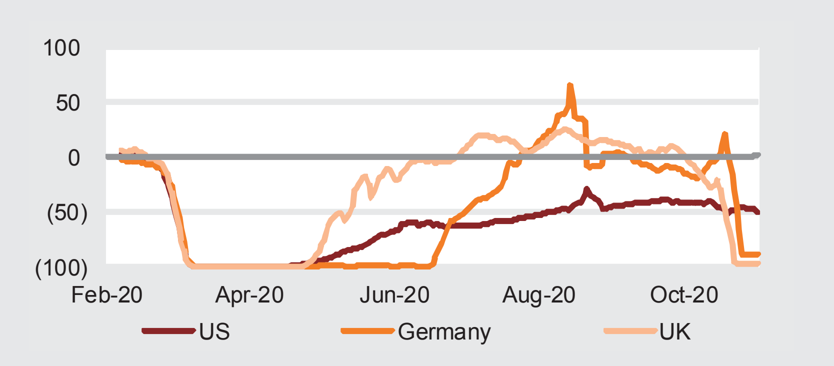
GDP YoY, percent



Source: Bloomberg; CDF

Restaurant occupancy rates in Europe after restrictions were removed were even higher than before the pandemic

OpenTable restaurant occupancy rate, percent



Source: Bloomberg; CDF

Monetary policy direction

Fed to be more tolerant of inflation

Fed to be more tolerant of inflation; real employment rate below sustainable level will not justify a rate hike

- Given the pandemic, the Fed has rolled out rate cuts and other measures to boost market liquidity. In August 2020, the Fed announced a major structural change to its monetary policy (please refer to the Fed's "Statement on Long-term Goal and Monetary Policy Strategy"), which we believe will raise the bar for interest rate hikes.
- In the past, the Fed aimed to achieve a 2% inflation target to keep prices stable, and for employment, the Fed aspired to narrow the gap between the real employment rate and the non-accelerating inflation rate of unemployment (NAIRU).
- After August 2020, the Fed has switched its focus to achieve an average of 2% inflation in a given period, and for employment, the primary target is to reduce the shortfalls of real employment in relation to NAIRU.

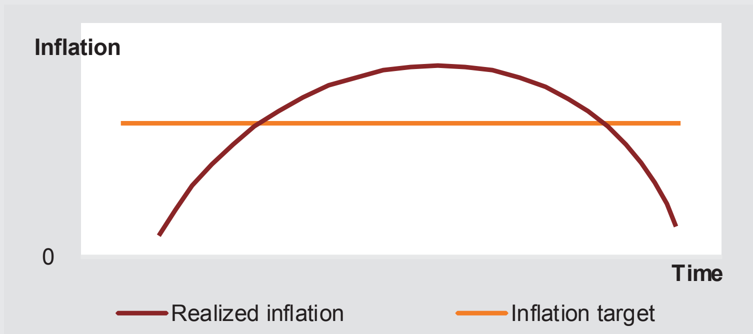
The target now is to achieve 2% inflation on average in a given period

CPI

Source: BCA Research; KGI Research compiled

Inflation could constantly remain above 2% within the given period

Inflation



Source: BCA Research; KGI Research compiled

Should we see rising rate hike expectations as a significant market risk?

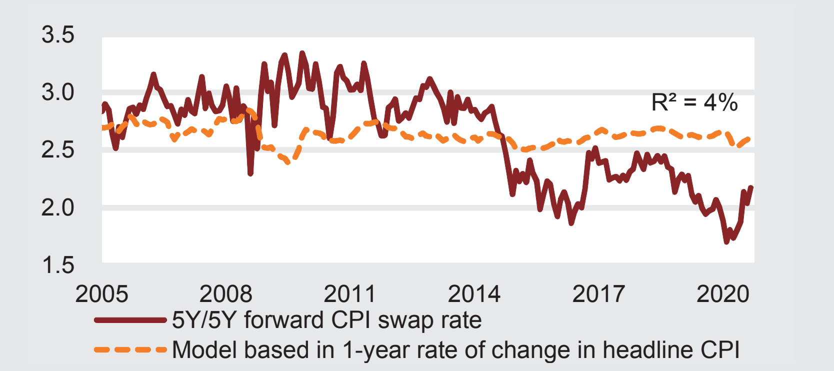
Don’t jump the gun yet

Rising rate hike expectations are not a risk, but rather a sign of a solid economic recovery ahead

- The current dot plot of the Fed suggests that the chance of the US central bank raising interest rates before 2023 is close to zero, and this has been a widely accepted assumption in the market. However, given a positive outlook for the global economy in 2021, some expect the Fed may turn to rate hikes in 2023. The difference this time, is that the government is so indebted that the Fed will have stronger political incentives to keep interest rates low in order to keep the government’s financial pressure under control.
- We think the market will be unaffected by the upcoming rate hike when it begins, as the impact of monetary tightening is more pronounced at the later stage of an economic expansionary cycle. In fact, when the Fed began to raise interest rates, it was when the economy had been in a solid uptrend, so we actually saw stock markets pick up in the beginning of a rate hike cycle.

A temporary uptick of real inflation is not enough to push up long-term inflation expectations

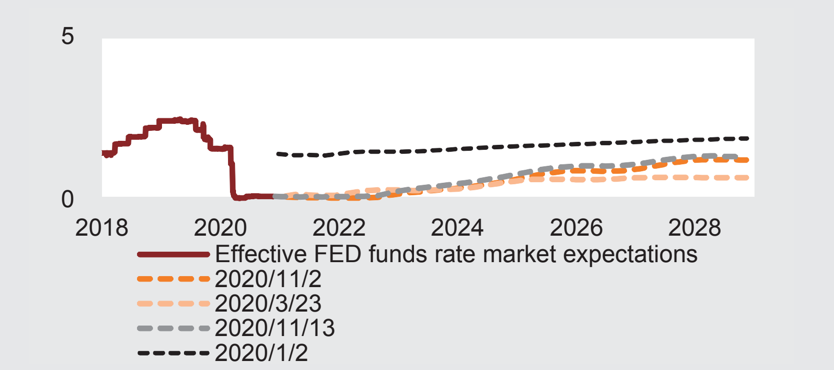
5Y/5Y forward inflation swap and regression model, percent



Source: Bloomberg; CDF

Expectations for Fed rate hikes after 2022 are rising

Effective Fed funds rate and market expectations, percent



Source: Bloomberg; CDF

Low interest rates a share price catalyst

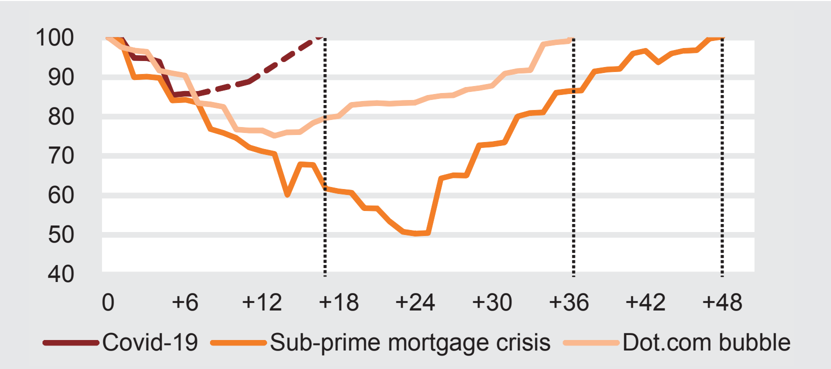
But unusually resilient corporate earnings are the primary driver

It's different this time — Stock markets and corporate earnings have been extremely resilient

- Aggressive stimuli by central banks and governments have largely buffered the pandemic impact, allowing corporate earnings to return to pre–pandemic levels in an estimated 17 months, far faster than the 36 months after the dot–com bubble burst and 48 month after the sub–prime mortgage crisis.
- Global stock markets have bounced to new highs, with seemingly overstretched valuations. However, we note that the high PE is the result of low interest rates. Monetary easing policies have kept government bond yields low, leaving stock market yields relatively more attractive to investors.

Corporate earnings declines have been milder during the current economic recession, so subsequent recovery could be swifter

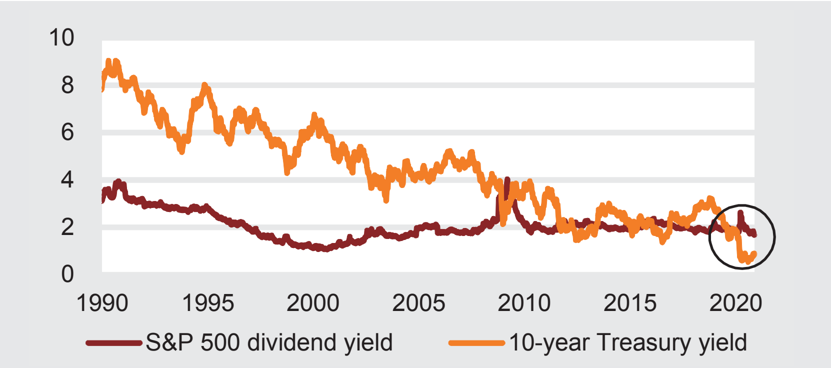
Number of months (x–axis); S&P 500 EPS (pre–pandemic = 100), percent (y–axis)



Source: Bloomberg; CDF

Stock yields are higher than bond yields, so stock markets are still attractive

S&P 500 dividend yield & 10–year Treasury yield, percent



Source: Bloomberg; CDF

But economic resumption bodes poorly for tech sector

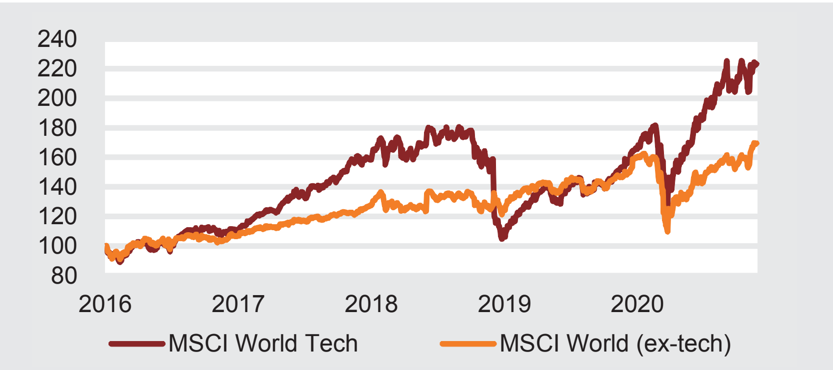
You can't always stay on top

Policy easing helps shore up tech stocks, but economic recovery will lure investors to non-tech sectors

- Interest rates have plummeted since the pandemic as central banks started aggressive liquidity injection. The tech sector has stood out as a beneficiary of the latest rate cuts, in that: (1) tech names are by nature growth stocks; and (2) the risk premium has not picked up yet. The reasonable price of a growth stock is to a large part determined by the current value of its discounted long-term dividends, so when the discount rate goes down alongside the risk-free interest rate, the price of a growth stock will naturally rise higher than that of a value stock.
- Market funds have gathered to the tech sector during the pandemic as the other industries have been damaged severely. However, as the recovery outlook becomes clear, investors may switch to other sectors. The extremely loose monetary environment is unlikely to change anytime soon, so while we believe the valuations of tech names are high, it's premature to call them bubbles.

Tech stocks have been unstoppable during the pandemic

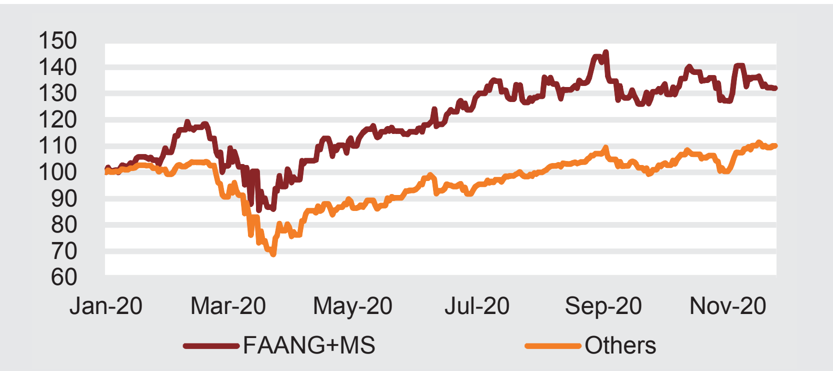
Return rate (January 1, 2016 = 100), percent



Source: Bloomberg; CDF

Large-cap names have been leading the pack

Return rate (January 1, 2020 = 100), percent



Source: Bloomberg; CDF

US dollar fundamentals have worsened

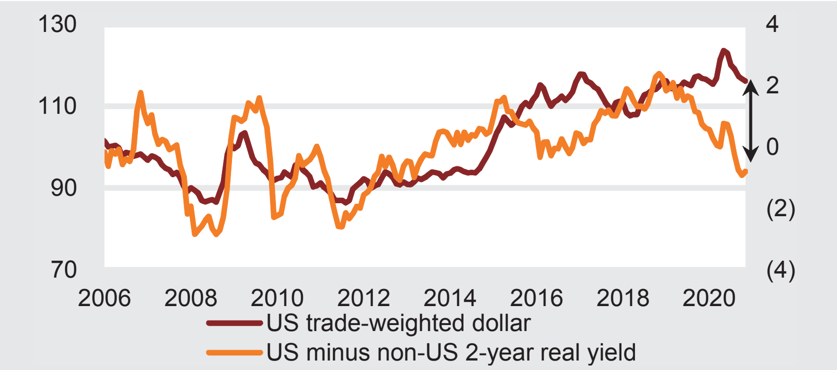
Multiple negatives arose at the same time

Conditions are right for US dollar weakness; vaccine development also a contributor

- The last swing factor for next year's market outlook is the US dollar. Notably, the US dollar has retreated 10% from its recent peak since March. The strength of the US dollar is determined by: (1) the economic growth gap between the US and other regions; (2) the interest spread between the US and other regions; and (3) global economic performance. The US dollar tends to gain value when the global economy is weak, and vice versa. The economic growth gap and interest spread have not been in the dollar's favor since the pandemic began, and as vaccine development turned out faster than expected, we believe a global economic recovery will only create more downside for the US dollar.
- The decline in nominal US Treasury yields has been far more significant than other major economies. As the US has rolled out more aggressive relief plans, its deficits are mounting, and inflation expectations are also relatively higher. As such, we think the US dollar will face more pressure from a declining real interest rate.

Current interest spread changes bode ill for the US dollar

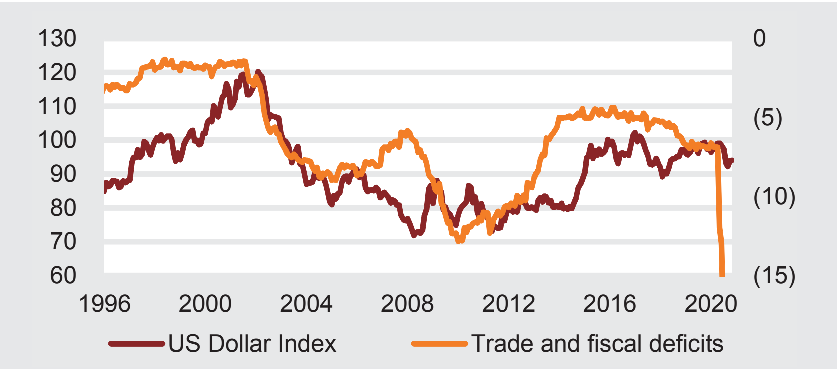
National polling result, percent



Source: Bloomberg; CDF

Mounting double deficits also work against a strong US dollar

VIX futures, point



Source: Bloomberg; CDF

US stock markets have outperformed the world

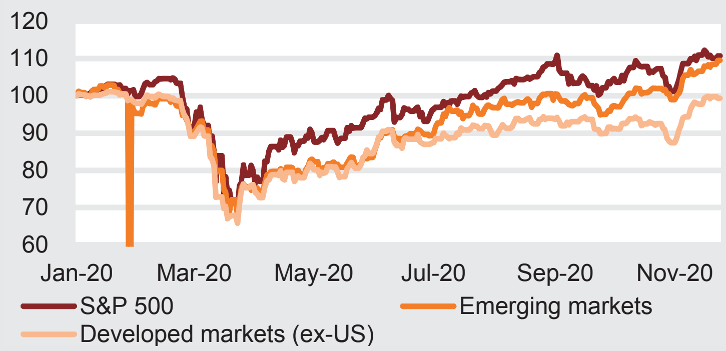
But it's not sustainable

Outperformance of US stocks will end soon as economy recovers; tech will lose its status as a standout sector

- US stock markets have outperformed other bourses by a significant margin during the pandemic as: (1) their weighting of the tech sector is the highest, and tech firms have been less affected by the pandemic (some sub–sectors are actually among the beneficiaries); and (2) hedging demand arose on growing geopolitical tensions. As such, the valuations of US non–tech stocks are also higher than peers in other markets.
- Geopolitical tensions have abated following Biden's election win, so the premium of US stocks will gradually narrow. Also, like we said, some investors will move away from the tech sector as the economy regains strength. In fact, the outperformance of the tech sector has become few and far between in the past two months. US stock markets usually move in tandem with the US dollar, so their dominance will soon come to an end.

US stock markets have outperformed other bourses during the pandemic

Return rate (January 1, 2020 = 100), percent



Source: Bloomberg; CDF

US market outperformance was mainly due to its higher weightings of tech and healthcare sectors

Sectoral weightings in MSCI indices, percent

Sector weights	US	Excluding US	Europe	Japan	EM
Technology	28.8	8.9	7.7	12.7	18.5
Health care	14.1	13.1	16.3	11.7	4.3
Financials	9.4	16.8	14.0	8.6	17.2
Communication	10.7	5.2	4.0	10.3	12.7
Consumer discretionary	12.2	11.1	10.6	17.6	20.2
Industrial	8.1	14.8	14.3	20.6	4.4
Consumer staples	6.7	11.3	14.8	8.0	6.1
Energy	1.9	3.6	3.8	0.6	5.4
Utilities	2.9	4.0	5.0	1.5	2.0
Real estate	2.8	2.9	1.4	3.5	2.4
Materials	2.5	8.3	8.1	4.9	6.9

Source: Bloomberg; CDF

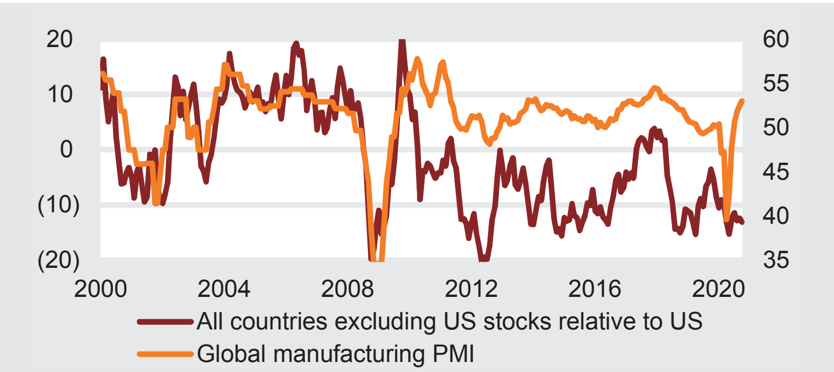
Rotations ahead

We recommend non-US markets and cyclical value stocks

- Global economic recovery is unlikely to change course in 2021. Given positive vaccine development the Biden administration potentially soon rolling out its second-wave relief plans, amid continued monetary policies, we believe the Goldilocks economy, featuring low interest rates and high growth, will persist for a while.
- Against this backdrop, we recommend cyclical value stocks, which are closely correlated to the economy, including commodity and industrial names. Region-wise, we prefer non-US markets (EU and emerging Asia) to the US, as: (1) economic resumption is not in favor of the tech sector; (2) a weak US dollar and rising commodity prices bode well for emerging markets; and (3) non-US markets offer more attractive valuations.
- Investors should keep in mind that the real economy cannot fully recover before mass vaccination is realized, and if markets correct before a full recovery, it's actually a good entry point.

US stock markets tend to move in tandem with the US dollar

Performance of MSCI World (ex-US) in relation to US markets YoY, percent (LHS); global manufacturing PMI, point (RHS)



Source: Bloomberg; CDF

The valuation of value stocks in relation to growth stocks is at a new low since 2000

Valuation ratio of MSCI World value stocks to growth stocks, x

Source: Bloomberg; CDF

2

Economic outlook

Economic outlook
United States

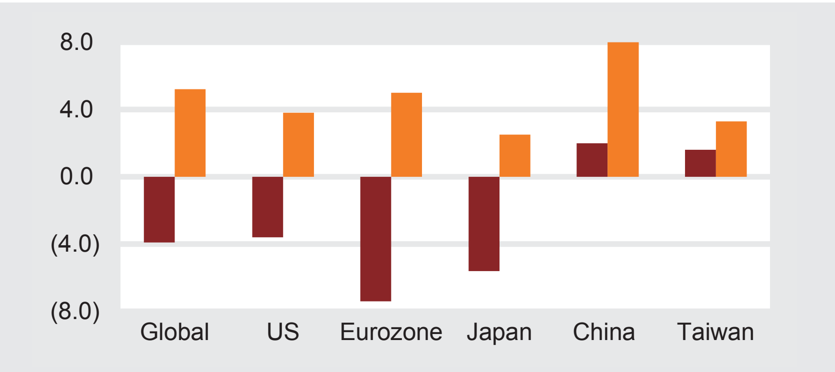
Neutral

To recover in 2021F as political and economic dynamics are back on track

- The market forecasts global and US economies will grow solidly in 2021, with respective growth of 5.2% and 3.8%. US non–farm payrolls growth will slow to the norm, with expansion of around 300k a month, or even below, from the surge seen in 2H20. Inflation will surpass 2% briefly in 2Q21F and fall afterwards due to the comparison base factor, with a full–year reading capped at 2% YoY. The housing market will log solid expansion on low interest rates. On the fiscal spending front, since the GOP will still control the Senate, any stimulus package is unlikely to be huge and taxes cannot be increased (versus a Democrat run Senate). Overall, 2020 and 2021 look set for a deep fiscal deficit.
- The market largely believes president–elect Biden's policies are more predictable than Trump's. While some of his cabinet nominees are China hawks, a Biden administration will likely adopt an overall moderate stance toward foreign affairs. The chances of provoking trade conflicts with other major economies are relatively slim. The US trade deficit will remain high.

Major economies a mixed bag in 2021F

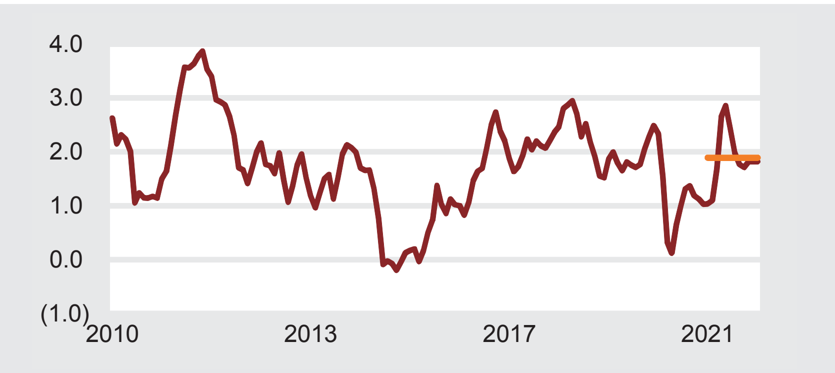
Economic growth, percent



Source: Bloomberg; CDF

Inflation over 2% briefly in 2Q21F and down afterwards

Price rise YoY, percent



Source: Bloomberg; CDF

Economic outlook

Eurozone

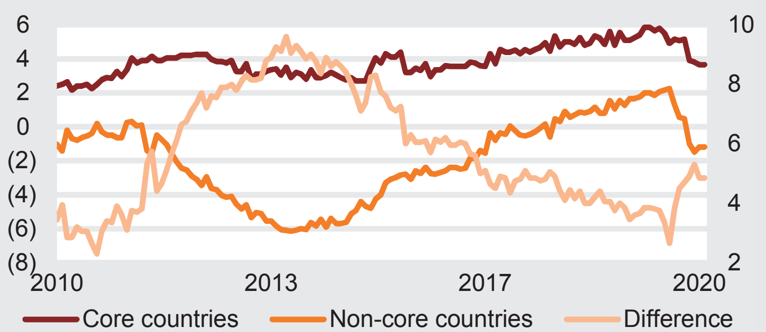
Neutral

Lukewarm, despite recovery; more stimuli across all member states

- Major member states have been disrupted by the resurgence of the pandemic recently, dragging down economic indices. The pandemic has not hurt employment in Europe much, but it has eased inflation. The ECB and the EU are pretty much on the same page with regard to stimulus policies. Countries in the eurozone also hold similar stances on monetary policy. These two aspects are key to whether the eurozone can launch measures fast enough to emerge from the current recession. We predict the ECB will keep its benchmark interest rates at the historical trough and further expand its bond-purchase program at the end of 2020. Fiscal stimulus packages will be introduced following the second round of COVID-19 lockdowns. The market expects the eurozone economy to stabilize markedly in 2021F after bottoming in 2020, with GDP growing from a negative 7.6% to 5.2%. The automotive industry, a key industry in the region, has recovered but it is unclear whether the recovery is sustainable. The trade surplus remains high at present. The impact of the strong euro on the trade surplus will likely be muted.

Eurozone members hold similar views on monetary policies

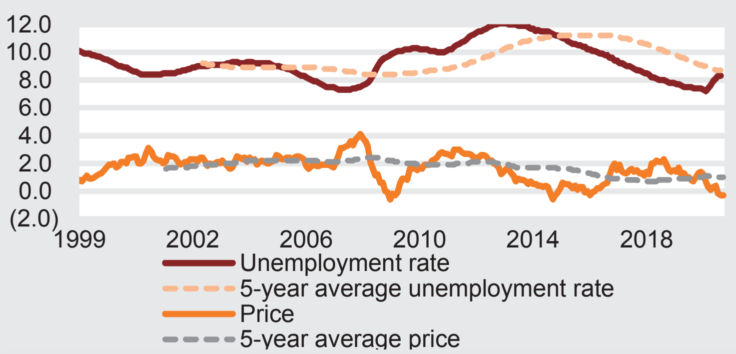
Tyler rationale-based interest rate for European core and non-core countries, percent (LHS); difference, percent (RHS)



Source: Bloomberg; CDF

Current recession hasn't hurt employment much, but has dragged down inflation markedly

Unemployment rate and price rise YoY, percent



Source: Bloomberg; CDF

Economic outlook

China

Neutral

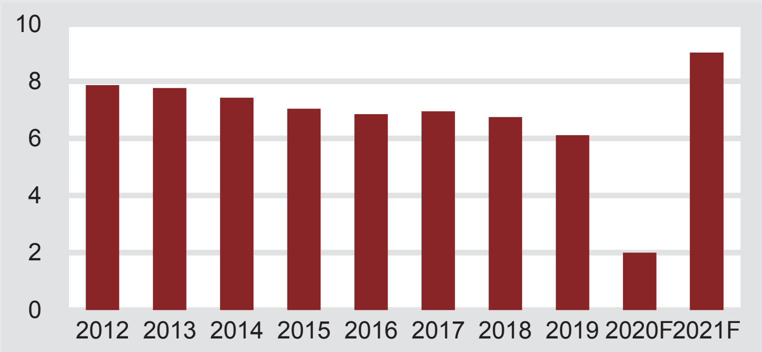
2021F economic growth to accelerate; corporate sales volume & price to rise in tandem

- Due to the pandemic, China's GDP will grow about 2% in 2020F, but 4Q20F will return to the pre-pandemic level of about 6% growth in a quarter. Due to recovery of the global economy, the continuous rebound of domestic demand, the low level of overall inventory, and the low base, GDP will grow about 9% YoY in 2021F, and double-digit growth will be recorded in 1H20F. While economic growth is recovering, PPI and CPI will also bottom, driving corporate earnings up. Central bank monetary policy is expected to become more neutral, interest rate pivot will remain stable, and the interest rate differential between China and the US is expected to narrow slightly, which will ease pressure for renminbi appreciation as the global economy recovers.

- In 2021F, the manufacturing and service sectors will contribute the most to economic growth. In terms of spending, consumption contribution to GDP will grow the most YoY in 2021F. 2021 will be the beginning of China's 14th Five-Year Plan, and as there is less pressure to maintain growth, policy will put more stress on structural adjustment and increase reforms of land, household registration, energy, state-owned enterprises, and government functions, and increase investment in information technology, high-end manufacturing, education, medical care, and the construction of city clusters, in order to lay a solid foundation for the achievement of the 14th Five-Year Plan.

2021F GDP to grow about 9%

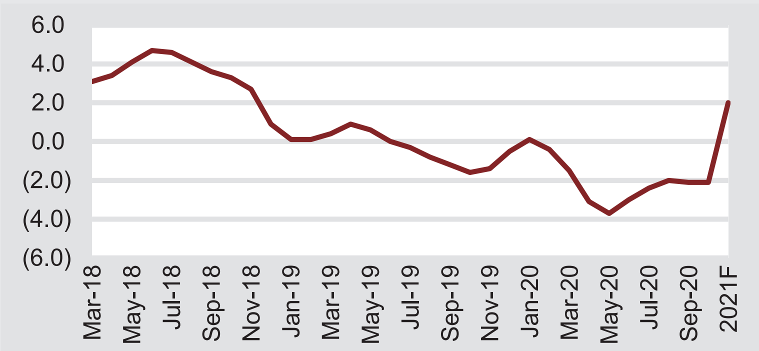
GDP YoY, percent



Source: Wind; CDF

PPI to kick off uptrend & boost volume & price of corporate sales

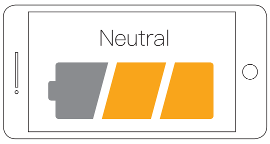
PPI YoY, percent



Source: Wind; CDF

Economic outlook

Japan

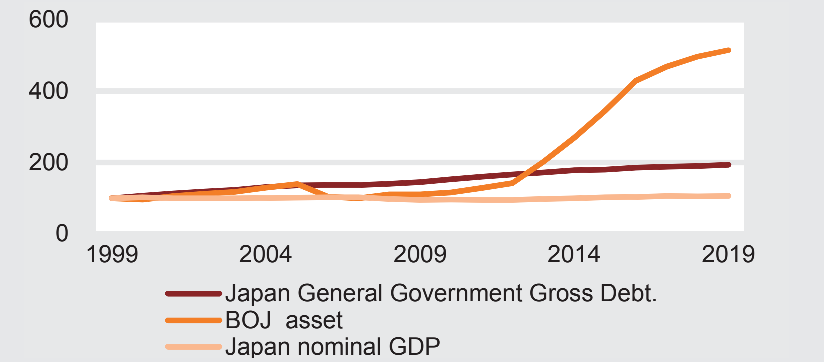


Stable near-term; low growth long-term now the norm

- The Japanese economy is recovering nicely. Leading and coincident indicators have both risen. Money supply and loan growth remain above the long-term trend. With overseas economies recovering, exports and industrial output are rising. The Tokyo 2020 Olympic Games, postponed to 2021, will also bring about tourism-related income. However, we don't expect economic recovery in 2021 to make up for the loss incurred in the 2020 recession. Inflation will remain low, making its target of 2% out of reach.
- Over the long term, room for Japanese economic growth will be limited due to a stagnant working population. Its aggressive fiscal policy and accommodative monetary policy have swelled general government gross debt and BOJ assets to 1.9x and 5.1x their respective sizes of twenty years ago, while nominal GDP grew just 6%, evidenced by the muted effect of government stimuli.

Japan's long-term GDP, debt and BOJ asset size

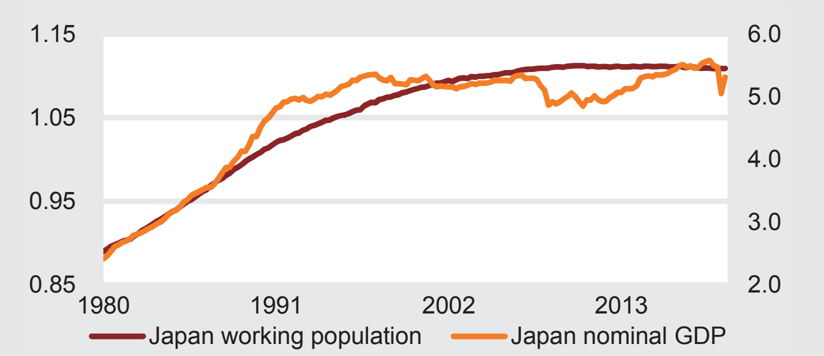
Standardized points using December 31, 1999 as 100



Source: Bloomberg; CDF

Maintaining Japan's economic growth is hard amid falling population

Japan's working population, 100mn (LHS); nominal GDP, ¥100tn (RHS)



Source: Bloomberg; CDF

Emerging markets (EMs)

Positive

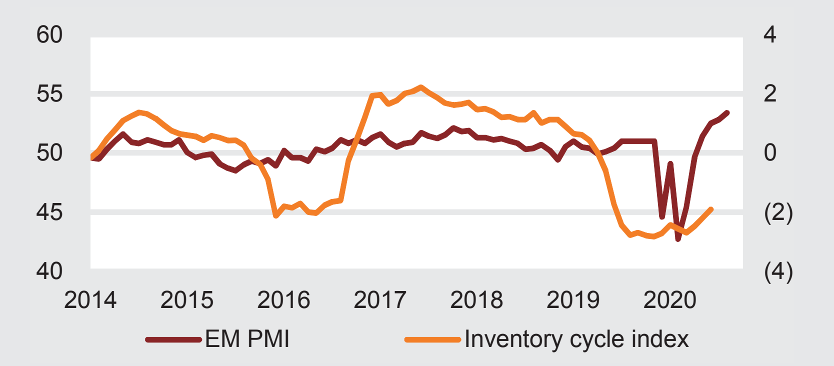
High growth in Asian EM on COVID–19 containment and manufacturing expansion, lifting global economy

- The global manufacturing inventory cycle troughed at end–2019 and stayed at the bottom until 1H20 on the significant recession caused by COVID–19 lockdowns. The economic reopening in 2H20 has brought about economic recovery for EM and allowed the global manufacturing inventory cycle to start expansion. The expansionary period of an inventory cycle has been around 22 months over the past 30 years. Therefore, EM economies will benefit from inventory expansion and will continue to grow in 2021F.

- The global economy has been in a deep recession since early 2020, but will likely resume growth in 2021F on vaccines and containment of the pandemic. The IMF estimates that global economic growth in 2021 will make up for the recession in 2020, driven primarily by 6% growth in EM. Thanks to better control of the pandemic and global manufacturing expansion, Asian EM economies will likely grow an impressive 8% next year and become the major source of growth for global EM.

EM economies will recover as inventory cycle has troughed

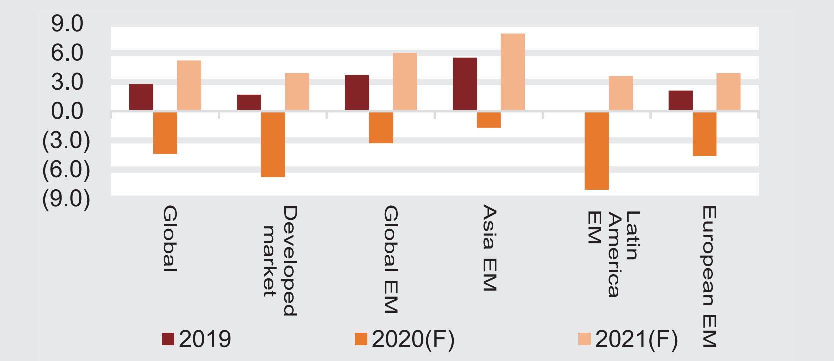
EM manufacturing PMI, percent (LHS); inventory cycle indicator, points (RHS)



Source: Bloomberg; CDF

IMF forecasts high Asian EM growth will drive global economic recovery in 2021

Economic growth, percent



Source: Bloomberg; CDF

3

Fixed income

中華開發金控
CHINA DEVELOPMENT FINANCIAL

US Treasuries

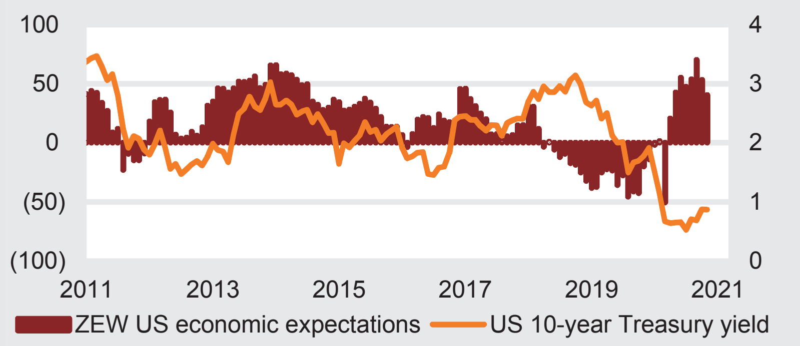
Rating | Neutral

Economic recovery and Treasury issuance to lift yields, but Fed's bond purchase will hinder yield upward speed

- The US economy started recovering in 3Q20 when restrictions on economic activity were lifted. While most economic data have picked up markedly as a result, medium– and long–term Treasury yields have not risen along with the economic recovery. This is because of rising uncertainty during the presidential election, the third wave of coronavirus infections and the stall of the relief bill. Despite a slight decline in the economy expected for the short term, the overall outlook remains in the expansionary territory. We predict economic growth will gather pace and Treasury yields will pick up in 2021 as the pandemic will be contained with widespread vaccinations.
- It will take multiple years for the labor market to return to full employment, as the economy has slumped on the pandemic. Inflation won't reach the policy target in the near term. The Fed has vowed to hold interest rates unchanged unless the average inflation hits 2.0%. We don't expect a rate hike until after 2023. As such, two–to–three–year Treasury yields will remain low during 2021 but ten–year yields will tick up, reflecting economic recovery, steepening the yield curve.

Economic recovery will eventually boost Treasury yields

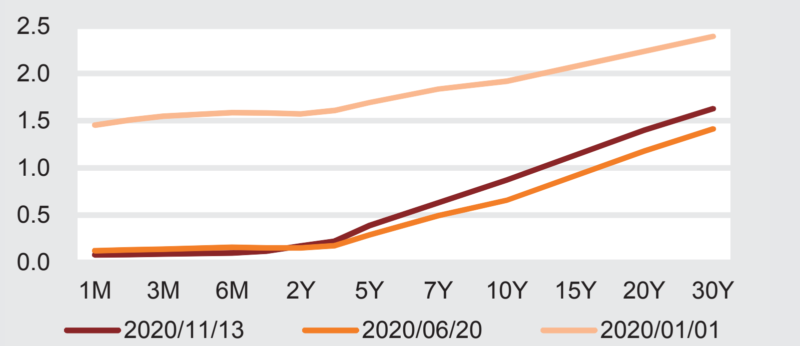
ZEW US economic expectation index, points (LHS); US 10–year Treasury yield, percent (RHS)



Source: Bloomberg; CDF

Steepening yield curve a focus of 2020 Treasury market

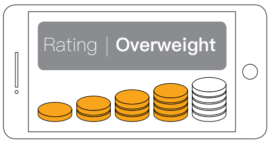
Yield curve, points



Source: Bloomberg; CDF

Fixed income

Investment-grade corporate bonds



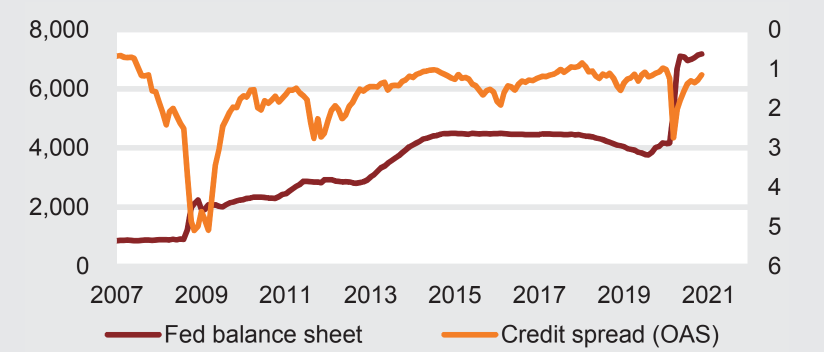
Razor thin credit spreads, low yields & rising risk-free interest rates to depress returns

- The pandemic-induced economic recession has prompted the Fed to cut the federal funds rate to zero and purchase Treasuries and investment-grade corporate bonds. The purchasing have rapidly increased its balance sheet by US$3tn and narrowed credit spreads for such corporate bonds at a fast clip. Now that the Fed is slowing the purchasing, the narrowing is easing. We predict the global economy will be recovering in 2021 and the Fed will continue its US$120bn bond-purchase-a-month program to maintain the negative risk-free real interest rate. Funds will also continue to flow into the corporate bond market in pursuit of positive returns. Under such circumstances, the credit spreads of investment-grade corporate bonds will narrow further.

- Currently, the credit spread of investment-grade corporate bonds stands at just 115bps, lower than the 2018-19 average of 117bps and at the low end of its historical band, thus having little room to significantly shrink further. Since the modified duration of investment-grade corporate bonds is high, rising risk-free interest rates in 2021 will drag down their returns.

Fed's bond purchasing to depress credit spreads for investment-grade corporate bonds

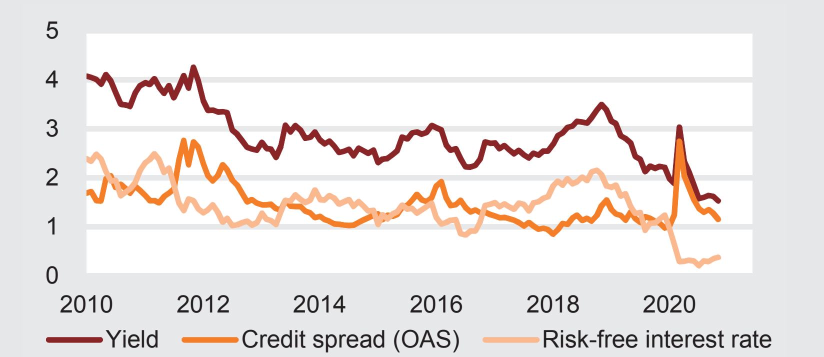
Fed assets, US$bn (LHS); investment-grade corporate bond spread, percent (RHS)



Source: Bloomberg; CDF

Investment-grade corporate bond credit spread razor thin, narrowing overall yields

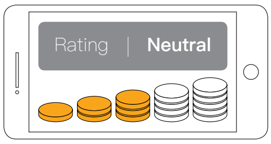
Bloomberg investment-grade bond yield, credit spread, and risk-free interest rate, percent



Source: Bloomberg; CDF

Fixed income

High-yield bonds

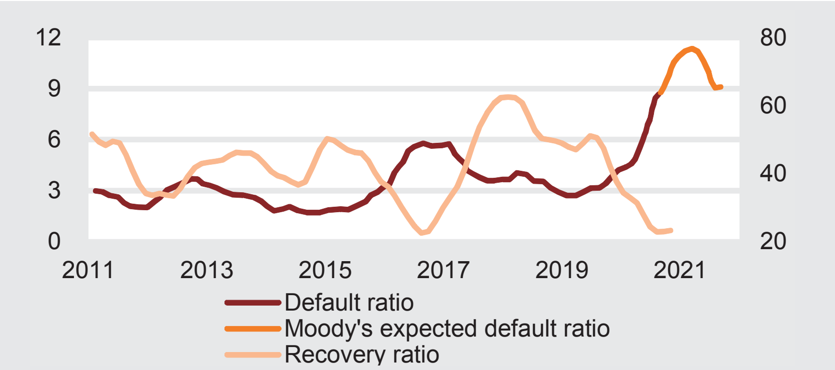


Worth investing on high yields as US economy is recovering

- Although the economy has bottomed out, default risk for certain sectors remains high as the pandemic is not fully contained. Moody's forecasts their default ratio will peak at 11.2% in 2Q21 and the recovery ratio will be just 20–25% due to high corporate leverage. Changes in high–yield bonds' credit spread typically lead the default ratio by around one year. The credit spread will continue to narrow amid the recovering economy and the Fed's bond purchase program. However, since the credit spread is excessively low at present, even in a range of –200bps to –400bps if adjusted by the default ratio and the recovery ratio, high–yield bonds are not suitable for long–term asset allocation.
- The credit spread of high–yield bonds now stands at around 447bps, just 62bps above its 2018–19 average of 385bps. We recommend high–yield bond trading in accordance with market risk appetite because the overall yield is near 5%, albeit with overly low default–adjusted credit spreads.

High–yield bonds have high default ratio and low recovery ratio

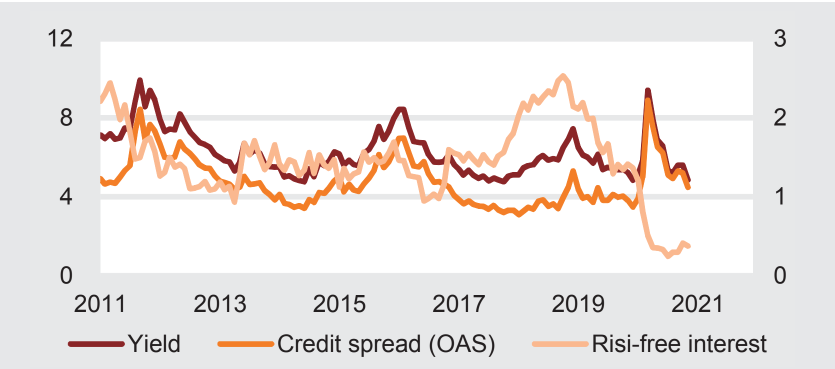
High–yield bond's default ratio and Moody's expected default ratio, percent (LHS); recovery ratio, percent (RHS)



Source: Bloomberg; CDF

Unfit for long–term allocation due to low adjusted credit spread

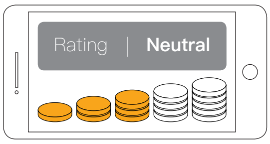
Bloomberg high–yield bond yield and credit spread, percent (LHS); risk–free interest rate, percent (RHS)



Source: Bloomberg; CDF

Fixed income

EM bonds

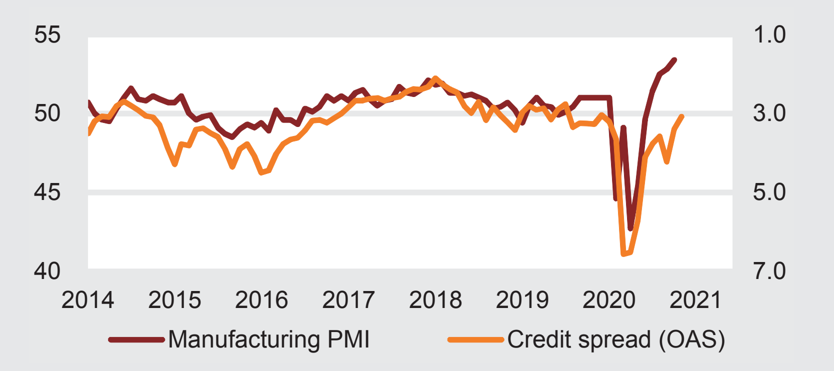


To perform better on high economic growth & more room for credit spread narrowing

- The EM is enjoying stronger currencies and an economic growth trend, thanks to global economic recovery and an accommodative monetary policy worldwide. The IMF forecasts EM economic growth will pick up from –3.3% in 2020 to 6% in 2021, with Asian EM recovering most strongly on a manufacturing upcycle as the pandemic is well controlled in the region. China, India and the ASEAN will grow a respective 8.2%, 8.8% and 6.2%, bringing the overall Asian EM growth to around 8.0%. The EM manufacturing sector's expansion will lead to a narrower credit spread for corporate bonds in the EM.
- Currently, the EM bond's credit spread is around 308bps, just 17bps above its 2018–19 average of 291bps. Although the spread is low, global funds will continue to buy EM bonds, driven by the stronger EM currencies amid the recovering economy, for positive returns and forex gains.

EM manufacturing expansion to narrow EM bond credit spread

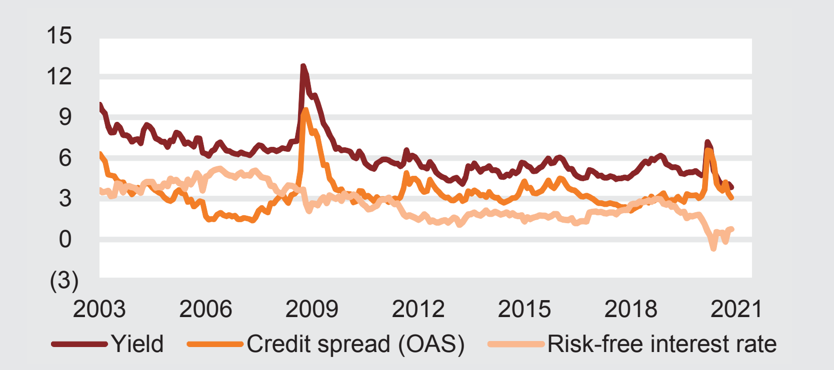
EM manufacturing PMI, percent (LHS); EM bond credit spread (inversed), percent (RHS)



Source: Bloomberg; CDF

Global funds will continue to buy EM bonds despite low credit spread

EM bond yield, credit spread and risk–free interest rate, percent



Source: Bloomberg; CDF

4

Equity markets

中華開發金控
CHINA DEVELOPMENT FINANCIAL

Equity markets

US

Rating | Overweight

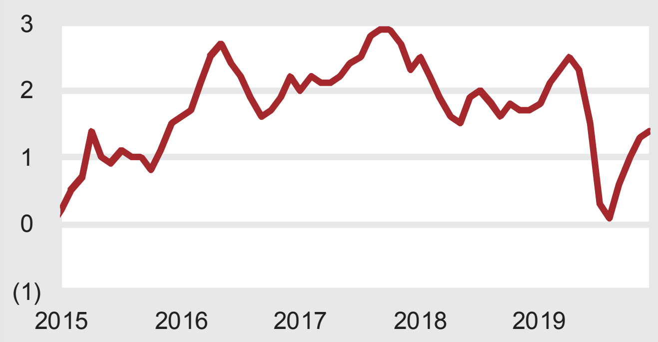
2021 focus on corporate earnings improvement, narrowing of supply–demand gap, and balanced allocation of cyclical and growth stocks

- The ISM Manufacturing PMI rose to 59.3 from 55.4 in October. Non–farm payrolls increased by 638,000 in October, beating expectations for a monthly gain of 580,000, and the unemployment rate fell to 6.9% from 7.9%. October CPI rose 1.2% YoY and core CPI rose 1.6% YoY, slower than the expected 1.3% and 1.7%, respectively. The manufacturing sector recovered steadily, as MoM growth of durable goods orders rose to 1.9% in September, up from 0.4%. According to Refinitiv, the estimated growth rate of corporate earnings in 2021 is 22.6% YoY as of 11/06/2020, down from 25.7% YoY in the previous month.

- Looking ahead to 2021, political transition risks still exist, high–valued stocks face correction pressure for reevaluation, and corporate profit improvement is the main factor supporting U.S. stocks; the overall market, amid economic recovery, low interest rate environment and corporate profit optimistic expectations, should see rotation opportunities for recovery–themed and low–valuation stocks. Over long–term we remain optimistic about online economy, electric vehicles and alternative energy and other new economy stocks for their solid growth prospects. Amid capital rotation, we recommend balanced allocation of cyclical and growth stocks, and investors should continue to pay attention to the U.S.–China relationship and changes in US treasury yields.

US inflation stabilizing post–COVID–19

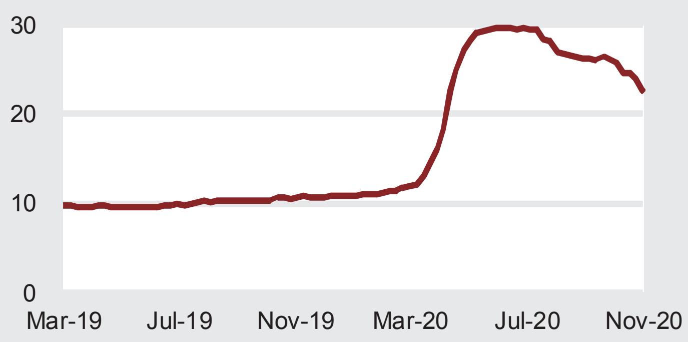
US CPI YoY, percent



Source: Bloomberg; CDF

2021F US earnings growth revised down slightly

2021F US S&P500 corporate earnings growth, percent



Source: Refinitiv; CDF

Equity markets

Europe

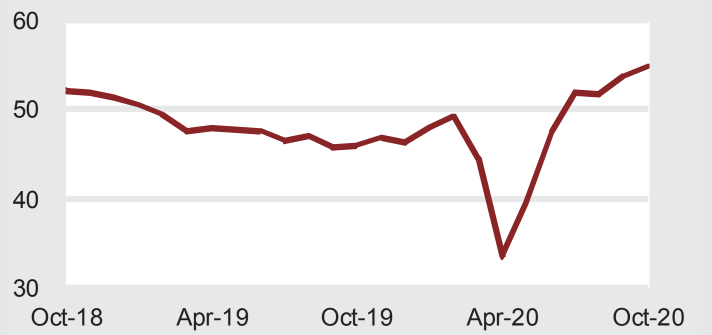
Rating | Neutral

2021 fiscal policy launched to boost economic recovery; upbeat on export-oriented & services, & consumption sector's recuperative ability

- The Eurozone's Markit Manufacturing PMI rose to 54.8 from 53.7 in October, while the Services PMI fell to 46.9 from 48.0; October's preliminary CPI was down 0.3% YoY, same as expected and the previous value, showing contraction for three consecutive months; October's consumer confidence decline worsened to –15.5 from –13.9, and some economic data were down again under the impact of the pandemic. According to EPFR capital flows, as of 2020/11/04, there were outflows of US$$2b from Europe in the past week and US$$9.92bn in the past three months. According to Refinitiv, as of 2020/11/06, the estimated growth rate of corporate earnings in 2021 is 37.4% YoY, down from 39.9% YoY in the previous month.
- The easing of the pandemic and the normalization of the global economy in 2021 are expected to make trade with Europe and the US friendlier. It is estimated that export-oriented industries such as manufacturing, semiconductor, and healthcare, as well as face-to-face service sectors that have been harder hit by pandemic and have bigger room for rebound, such as aviation, tourism, luxury goods sales, catering, and other consumer sectors, will benefit the most. For stock-picking purposes, one can go with a balanced portfolio consisting of both growth and cyclical stocks and reinforce it with the stability offered by ESG. One should also pay attention to the impact of Brexit on politico-economic landscape.

Eurozone mfg. PMI above watershed

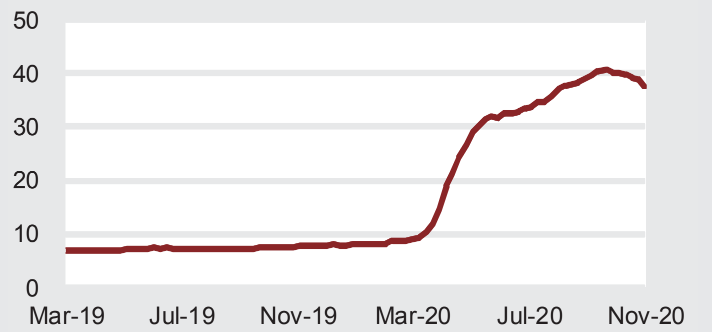
Eurozone mfg. PMI, point



Source: Bloomberg; CDF

2021F eurozone earnings growth revised down slightly

2021F eurozone corporate earnings growth, percent



Source: Refinitiv; CDF

Equity markets

Japan

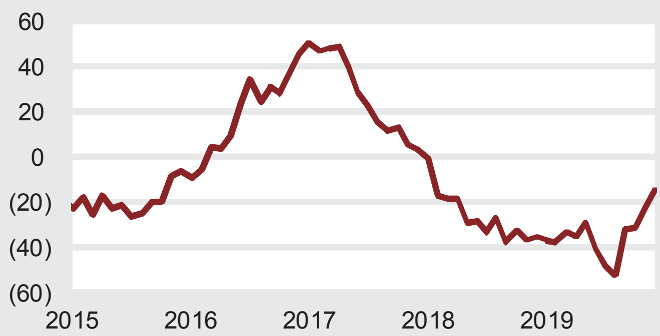
Rating | Neutral

On global economic recovery, we favor Japan's cyclicals, high–end semi process players & automation sector in 2021

- Japan's manufacturing PMI was 48.7 in October, up from 47.7, while the service sector PMI was 47.7, up from 46.9; October's preliminary machine tool orders were down 5.9% YoY, up from the previous value of down 15.0% YoY; September's retail sales were down 8.7% YoY, down from the previous value of down 1.9% YoY; domestic demand remained weak. According to EPFR's Flow of Funds, as of 10/30/2020, there was an outflow of US$2.03 billion in the past week and an inflow of US$6.19 billion in the past three months. According to Refinitiv, as of 2020/11/05, the estimated growth rate of corporate earnings in 2021 is 43.4% YoY, slightly revised up from 43.1% YoY in the previous month.
- Although Japan's economic structure is weak and the pace of recovery is slow, the its pandemic control is more successful than other mature countries. It is expected that the pandemic situation in Japan will improve in 2021, and the manufacturing industry will benefit from the recovery of the global economy. Thus, production capacity utilization rate will be gradually restored, and the capital expenditure cycle will be restarted. In addition, Japan is highly dependent on the tourism industry, and the demand elasticity of related service industries is high; the valuation of Japanese stocks is relatively low among mature markets, and cyclical industries such as automobiles, electronic components, steel, etc. have valuation recovery opportunities. Over long–term, we remain positive on high–end semiconductor processes, industrial automation and e–commerce sectors.

Japan's machine tools orders up continuously

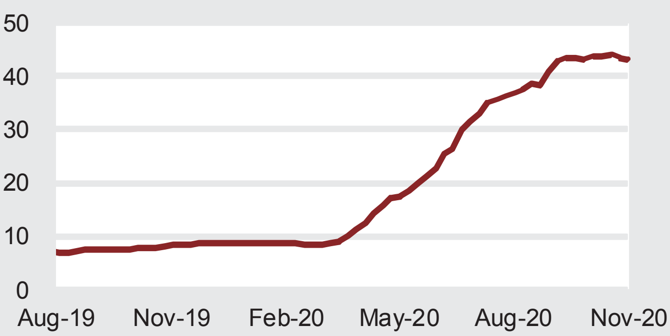
Japan's machine tools orders growth, percent



Source: Bloomberg; CDF

2021F Japan's earnings growth revised up slightly

2021F Japan's corporate earnings growth, percent



Source: Refinitiv; CDF

Equity markets
China

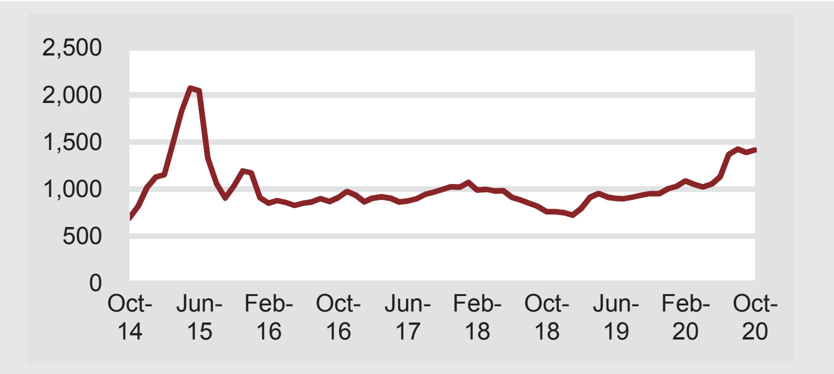
Rating | Neutral

A–shares to begin new bull market; all sectors to perform well

- In 2020, A–shares were able to withstand the pandemic and gained ground. A–shares will perform better in 2021F due to the following factors: (1) the economic boom will strengthen, corporate sales will rise in volume and price, and fundamentals of A–shares will improve significantly; (2) enthusiasm of foreign investors to buy A–shares will continue to grow as financial liberalization accelerates, the renminbi strengthens, and the economy recovers; (3) reform of the capital market will eliminate corporate fraud, large capital manipulation, large shareholder money grabbing, and other cheating behavior to boost overall A–share valuation; and (4) China's household wealth allocation is shifting from real estate to equity assets at an accelerating pace. The SCI and SZSE 300 indexes will increase by 25% and 30% respectively in 2021F.
- In 2021F, A–shares will rise across the board, and most sectors will see significant increases. In contrast, electronics, communications, automobiles, home appliances, tourism, aviation, non–ferrous metals, finance, automation, and new–energy sectors will perform the best.

A–share margin loan balance to see rapid rise

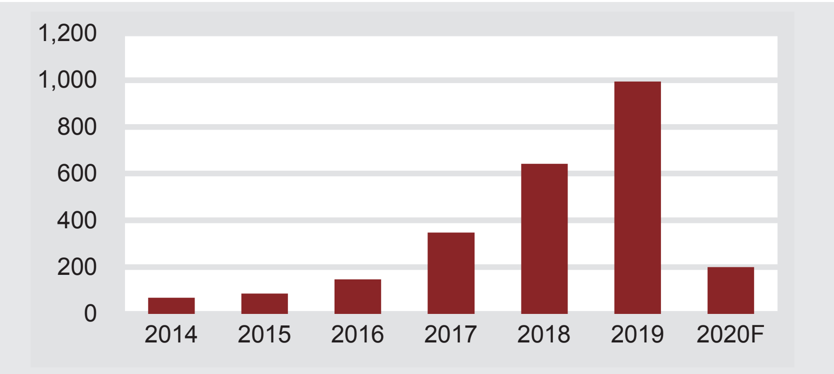
Margin loan balance, Rmb bn



Source: Wind; CDF

Inflow of overseas capital to quicken

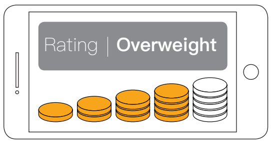
Net fund inflows to Stock Connect, Rmb bn



Source: Wind; CDF

Equity markets

Hong Kong

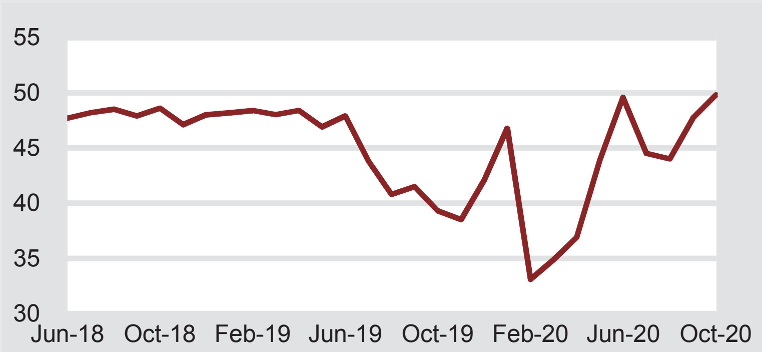


Heng Seng to challenge historic peak

- In 2020, due to political, economic, and pandemic factors, the Hang Seng Index (HSI) lagged behind major global markets, dragged down by local Hong Kong stocks
- However, in 2021F, market confidence in the HSI will improve and the index will challenge its historical high, mainly due to the following factors: (1) global economic recovery, especially the significant acceleration of China's economic growth, will be beneficial to the Hong Kong economy and also profit recovery of Chinese companies in the Hong Kong stock market; (2) the gradual stabilization of the Hong Kong society, which is conducive to the return of capital to Hong Kong stocks; (3) global market sentiment will improve, and the low valuations of Hong Kong stocks are expected to be a major advantage among global stock markets; (4) the AH premium index is currently high, and a rise in A–shares will lead to a rise in Hong Kong stocks.

HK economy to get slowly back on feet; 2021F to see accelerated recovery

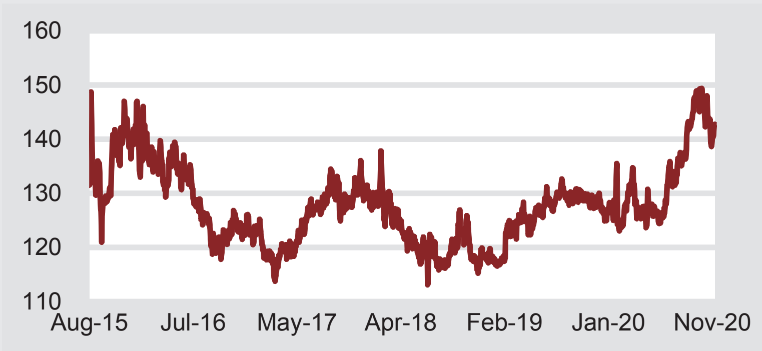
Manufacturing PMI, point



Source: Wind; CDF

AH premium index is high

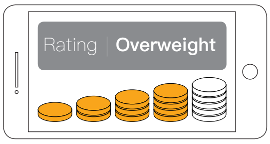
Premium index, point



Source: Wind; CDF

Equity markets

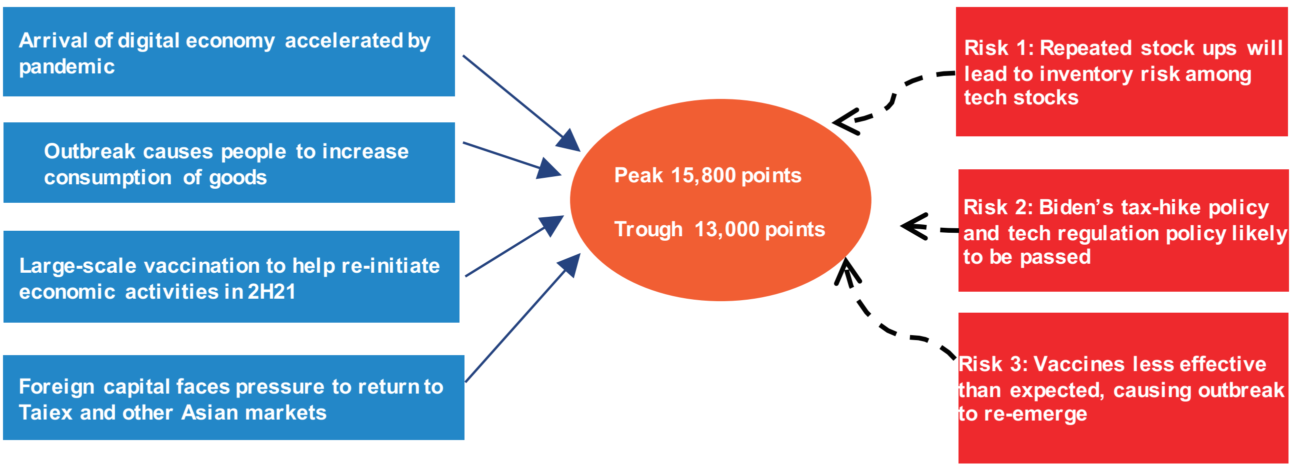
Taiwan



Digital economy & economic re-opening will support Taiex long-term bullishness in 2021F

- The COVID-19 pandemic has brought forward the onset of the digital economy and has become a permanent trend, supporting the continuation of the strong profitability of new economy stocks. The possibility that vaccines will be gradually administered in 2H21 will help the global economy to restart. By then, the old-economy stock hit hard by the pandemic will slowly begin to recover to pre-outbreak performance. The overlapping effect of the new economy extending momentum and old economy bottoming out will keep the upward cycle of corporate profits in Taiwan stocks since 2Q20 alive, thus supporting Taiwan stocks to maintain their bullish pattern. We forecast a reasonable high of 15,800 points (2.1x P/B or 19.4x PE) for 2021.

- Although the good news seems to outweigh the bad news in 2021 in the financial market, there are three potential risks to watch out for: (1) the risk of inventory correction in the technology sector due to overbooking; (2) The risk that Biden's policies of tax increase and technology industry regulation will unexpectedly get green light; (3) the impact of the re-emergence of the pandemic and the return of the economic blockade due to the lower than expected vaccine effectiveness.



Source: CDF

Taiwan

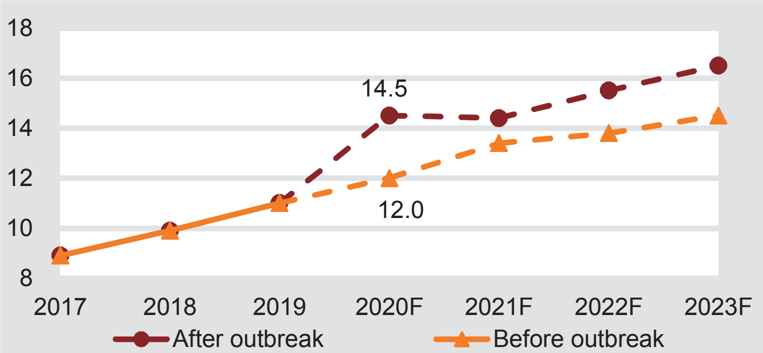
Rating | Overweight

Arrival of digital economy accelerated by pandemic; long–term structural trend established

- Although the COVID–19 pandemic has severely impacted global business activities, it has accelerated the early arrival of digital economy such as e–commerce, work–at–home, and e–learning, which has led to strong demand for e–commerce, NBs, Chromebook, and gaming NBs. At the same time, the pandemic has set off the change in people's consumption habits (i.e., reducing service–oriented consumption and increasing consumption of goods), which has benefited export–oriented economies such as Taiwan and Korea.
- In the US, the percentage of retail sales that come from online channels will reach 14.5% in 2020, compared to 12.0% estimated before the pandemic, and the percentage of online spending will increase by 1 percentage point per year in the future, accelerating the rate of overall penetration compared to the pre–pandemic period.
- The pandemic has changed the way we lead our lives. The annual growth rate of goods–based consumer spending has turned positive from –13% at the time the pandemic hit, to +8% at present, and has surpassed the pre–pandemic level; the annual growth rate of services–based consumer spending has receded from 17% at the time the pandemic hit, to 5% at present.

Arrival of digital economy accelerated by pandemic; a long–term structural trend has been established

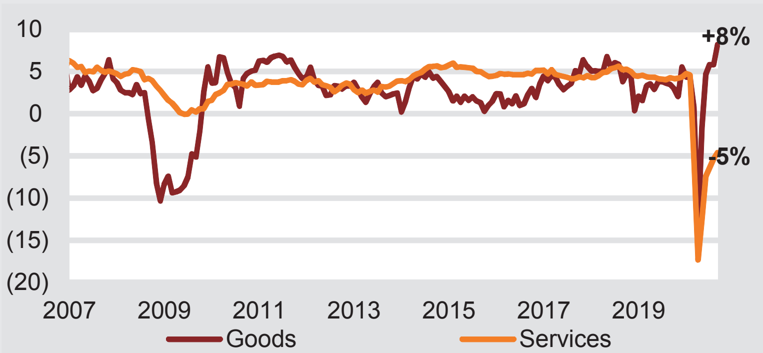
US retail market's ecommerce penetration rate, percent



Source: eMarketer; CDF

Outbreak pushes people to increase consumption of goods, good for export–oriented economies

YoY growth of US consumption of services and goods, percent



Source: Bloomberg; CDF

Equity markets

Taiwan

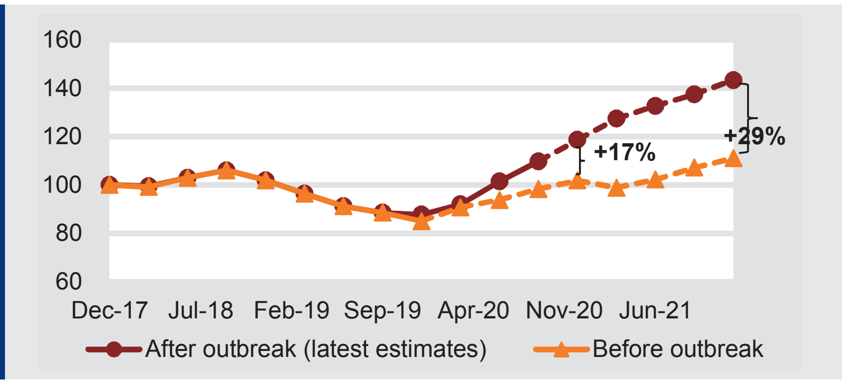
Rating | Overweight

New & old economies grow in tandem, supporting rotation rally of tech & non–tech in 2021F

- The rise of the digital economy has led to a 17% and 29% upward revision of 2020 and 2021 earnings estimates for technology stocks, respectively, compared to what they were before the pandemic. Looking ahead, in addition to the continuation of the digital economy trend, the advent of the 5G upgrade will support the profit momentum of technology stocks, preventing it from falling. While technology stocks are expected to grow their profits by 35% in 2020 compared to the previous year, we expect their profits to grow by another 20% in 2021.
- COVID–19 has severely impacted global business activity, resulting in a dramatic 24% downward revision of 2020 earnings estimates for cyclical stocks such as oil refining and textile raw materials compared to pre–pandemic levels. Looking forward, with the possibility of a large number of vaccines being administered in 2H21, it will help restart global economic activity, which will in turn support improved bank lending, as well as a real recovery in demand for oil refining, garment raw materials, and automobiles, we estimate that cyclical non–tech stocks will see profit growth of more than 50% in 2021, avoiding the repeat of a 30% earnings decline in 2020.

Rise in digital economy boosts tech stocks' earnings outlook to improve significantly

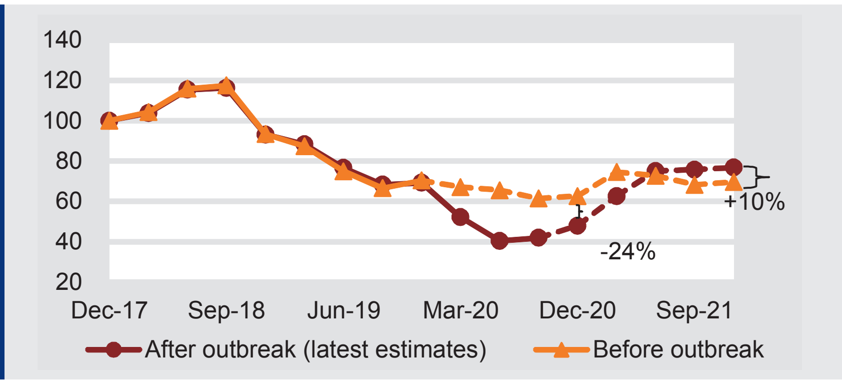
Tech earnings (trailing 12M), NT$bn (end–2017 =100)



Source: CDF estimates

Cyclical non–tech hit by pandemic but earnings will strongly recover in 2021F

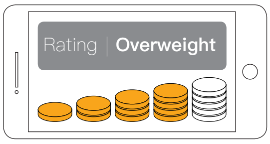
Non–tech earnings (trailing 12M), NT$bn (end–2017=100)



Source: CDF estimates

Equity markets

Emerging Asia

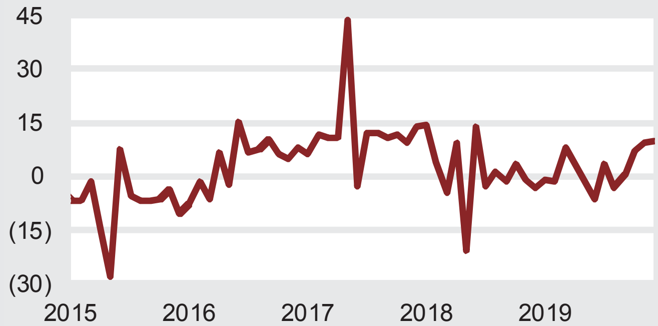


Corporate earnings growth & US dollar weakness in 2021 are favorable to emerging Asia, which is strongly connected to global economic cycle

- China's October Caixin manufacturing PMI rose to 53.6 from 53.0, while the official manufacturing PMI fell slightly to 51.4 from 51.5; October exports rose 11.4% YoY, higher than expected; imports rose 4.7% YoY, lower than expected. ASEAN's October manufacturing PMI rose from 48.6, up from 48.3. India's manufacturing PMI rose to 58.9, up from 56.8. According to Refinitiv, as of November 2020, the estimated growth rate of corporate earnings in 2021 was 24.9% YoY, same as 24.9% in the previous month.
- In 2021, China's corporate capital spending and consumer demand will continue to recover, the 14th Five-Year Plan will be launched, domestic demand, innovation and openness will be the policy directions, and the dual-cycle development pattern will accelerate structural upgrading, with such new infrastructure projects in 5G, AI, data center, and other realms set to be injected with more capital. For regional investment purposes, we focus on China, Korea and Southeast Asia, where high-valuation stocks have room for corrected, while rotation opportunities exist for low-valuation stocks that are cyclical in nature, such as commodities, and tourism sector, which stands to benefit from the emergence of vaccines Consumer and export industries benefiting from the improved global economy are expected to grow at a higher rate, with the new economy remaining the main investment axis. Long-term trends in the electric vehicle, home economics, e-commerce, food delivery, and mobile games industries are intact and earnings growth of these sectors will remain solid.

China's exports resume double-digit growth

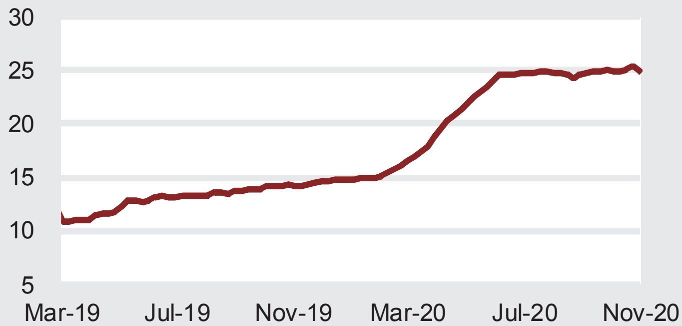
China's US$-denominated export growth YoY, percent



Source: Bloomberg; CDF

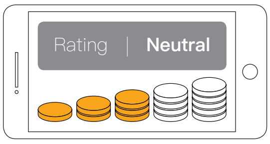
2021F emerging Asia corporate earnings growth flat

2021F emerging Asia corporate earnings growth, percent



Source: Refinitiv; CDF

Emerging Europe, Africa & the Middle East

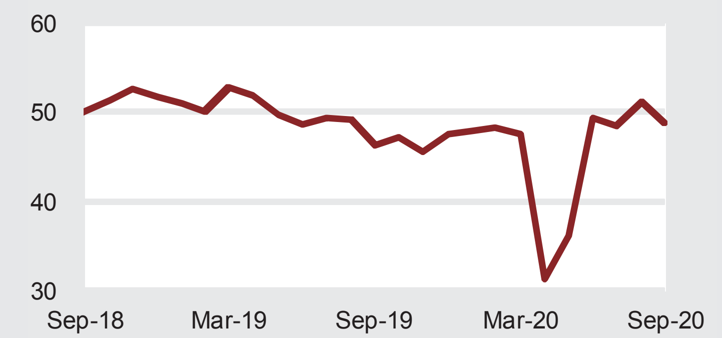


In 2021, many EMEA countries are fraught with political uncertainties; investment to focus on value-based & defensive stocks

- Russia's October manufacturing PMI fell from 48.9 to 46.9, falling below watershed for the second consecutive month; October CPI rose 4.0% YoY, same as expected. Turkey's October Markit Manufacturing PMI increased to 53.9 from 52.8, and October CPI increased slightly to 11.89% from 11.75% YoY. In South Africa, the Absa Manufacturing PMI increased from 58.5 to 60.9 in October, and manufacturing production declined 2.6% YoY in October, with a weaker overall outlook. According to Refinitiv, as of 2020/11/06, the estimated growth rate of corporate earnings in 2021 is 44.6% YoY, up from 42.8% YoY in the previous month.
- Demand for vaccines will pick up in 2021, but there are still political issues to be resolved in many countries in Europe, Africa and the Middle East, such as geopolitical risks in Russia, slow structural reforms in South Africa, fiscal austerity in Saudi Arabia, and low oil prices. Overall, the EMEA as a whole is bullish on value and defensive stocks, such as Russia's high yielding banks, nickel and oil companies, and South Africa's general retail and healthcare stocks. Keep an eye on Biden's diplomatic relationship with Russia and oil price changes to see if the push for alternative energy reduces shale oil supply, while valuations of oil producing countries like Russia have room to recover.

Russia's mfg. PMI indicates further contraction

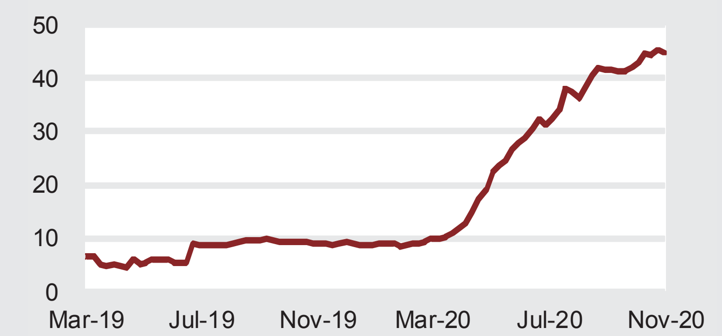
Russia's mfg. PMI, point



Source: Bloomberg; CDF

2021F EMEA corporate earnings growth rebounds

2021F emerging EMEA corporate earnings growth, percent



Source: Refinitiv; CDF

Equity markets

Emerging Latin America

Rating | Overweight

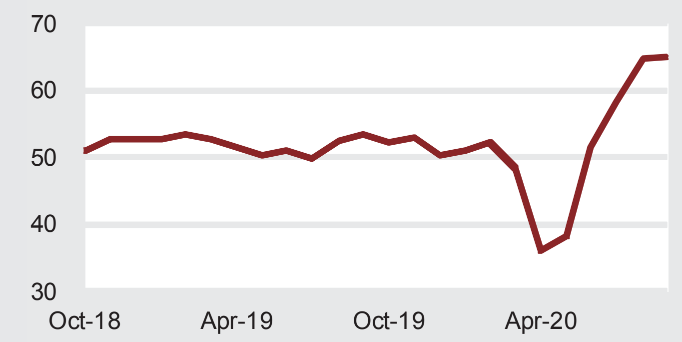
In 2021, emerging Latin America to bottom out on low base; raw materials & consumption sectors favored to rally

- Brazil's manufacturing PMI rose to 66.7 from 64.9 and services PMI to 52.3 from 50.4 in October; CPI rose 3.92% in October, beating expectations of a 3.90% annual increase; October trade balance was US$5.47 billion, missing expectations of US$6.10bn; September industrial production rose 3.4%, beating expectations of a 2.5% annual increase. Mexico's manufacturing PMI rose to 43.6 from 42.1 in October, while CPI rose 4.09% in October, below the previous value of 4.01%, as Brazil's recovery accelerated. According to Refinitiv, as of 2020/11/06, the estimated growth rate of corporate earnings in 2021 is 163.1% YoY, up from 129.4% YoY in the previous month.

- Emerging Latin America is likely to lag behind in access to vaccines in 2021, with raw materials benefiting from resilient demand in a recovering global economy, and the highly face-to-face service sector is recovering slowly. After rampant pandemics and halved profits, in 2021, Latin American equities will focus on low comparison base period, post-disaster reconstruction and Brazilian tax reform issues. Among the industries, we are optimistic about the export-oriented raw material companies such as iron ore and other raw materials, and the low-base essential consumption and supermarket sub-sectors, which are expected to have more room for rebounding under the economic recovery. Medium to long-term investment trend in ecommerce and electronic payment sectors is intact.

Mfg. and industry push Brazil's mfg. PMI to new high

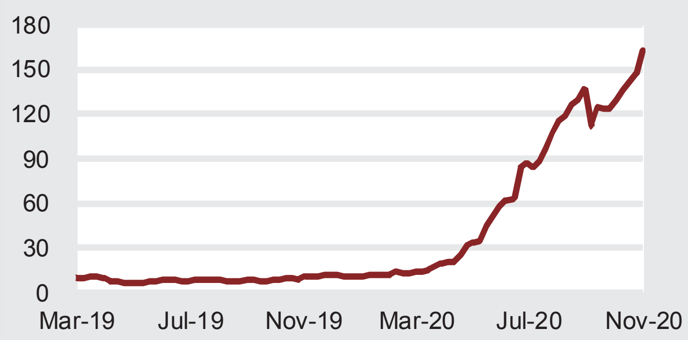
Brazil's mfg. PMI, point



Source: Bloomberg; CDF

2021F Latin America to see earnings growth rebound on low comparison base

2021F emerging Latin America corporate earnings growth, percent

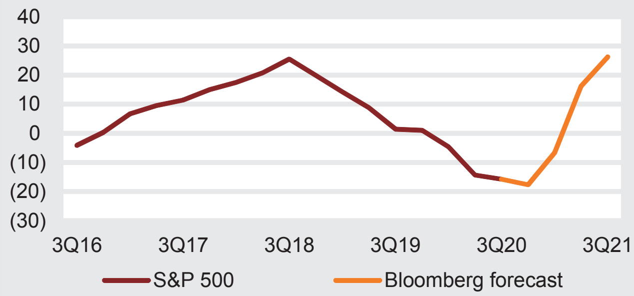


Source: Refinitiv; CDF

Appendix 1: Major markets' EPS growth

US (S&P 500 Index)

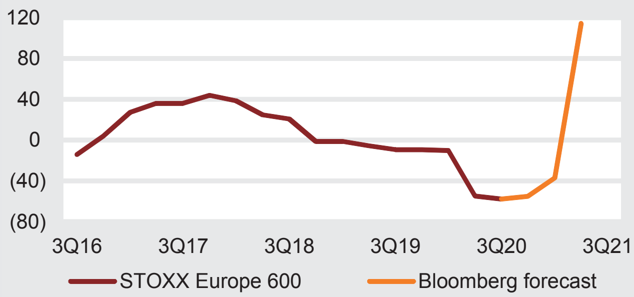
EPS growth YoY, percent



Source ：Bloomberg；CDF

Europe (STOXX Europe 600 Index)

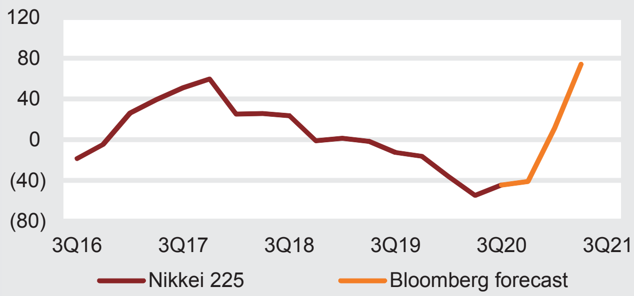
EPS growth YoY, percent



Source ：Bloomberg；CDF

Japan (Nikkei 225 Index)

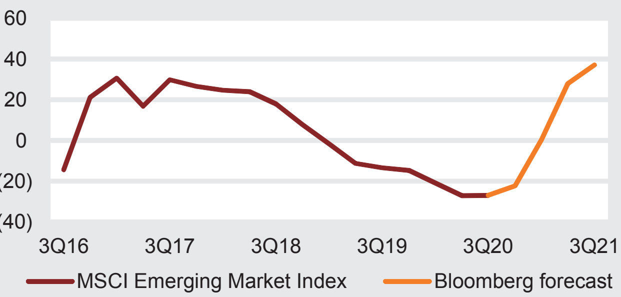
EPS growth YoY, percent



Source ：Bloomberg；CDF

Emerging markets (MSCI Emerging Market Index)

EPS growth YoY, percent

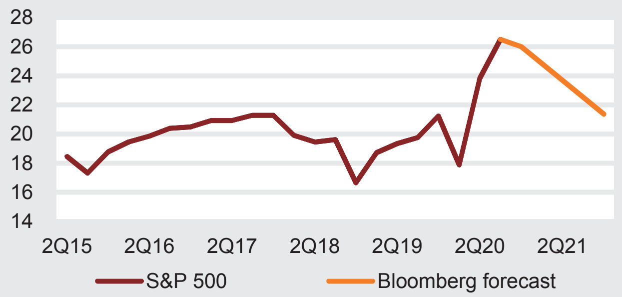


Source ：Bloomberg；CDF

Appendix 2: Major markets’ PE

US (S&P 500 Index)

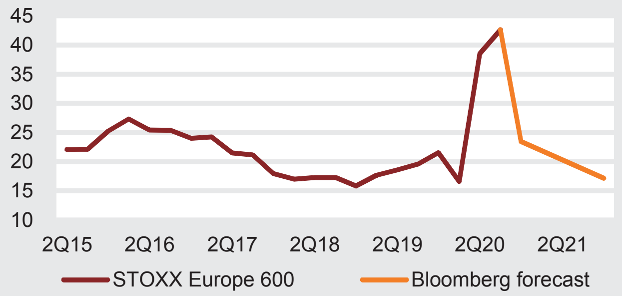
PE, x



Source ：Bloomberg；CDF

Europe (STOXX Europe 600 Index)

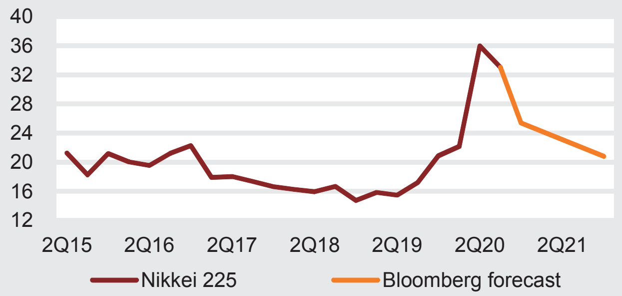
PE, x



Source ：Bloomberg；CDF

Japan (Nikkei 225 Index)

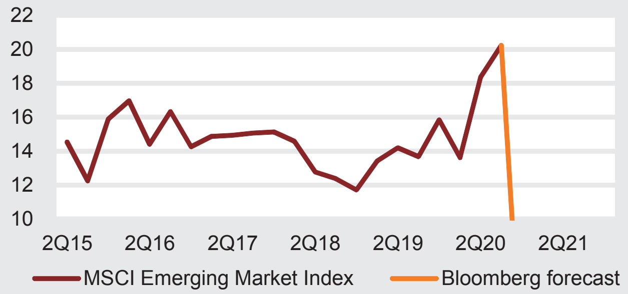
PE, x



Source ：Bloomberg；CDF

Emerging markets (MSCI Emerging Market Index)

PE, x



Source ：Bloomberg；CDF

5 Commodities

中華開發金控
CHINA DEVELOPMENT FINANCIAL

Energy

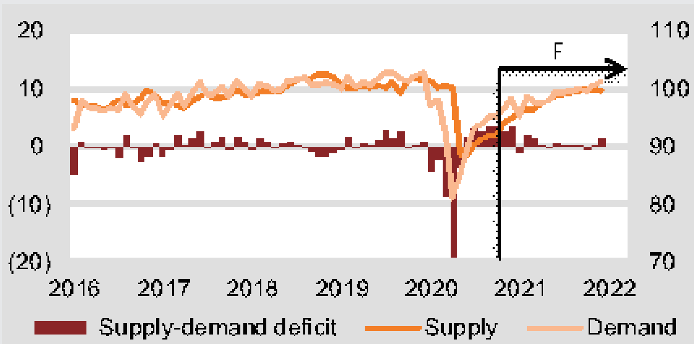
Rating | Overweight

◢ **demand slightly outstripping supply, pushing up oil prices ; potential upside on post–pandemic recovery & US shale gas extraction policy**

- In 2021, as world economic recovery will be led by EMs in Asia, a region representing considerable oil consumption where GDP is projected to grow 8% YoY, crude oil demand is expected to increase 6.34% YoY to 98.79mn barrels per day (bpd). But as US shale gas output is projected to decline 2.59% YoY to 11.1mn bpd due to subdued investment, aggregate crude output is estimated to rise just 4.17% to 98.38mn bpd. The severe supply glut of 6.2mn bpd in 1H20 due to COVID–19 has been addressed, with 2H20 recording shortage of 3.11mn bpd. In 2021, demand is expected to exceed supply by 0.41mn bpd as production resumes.
- Oil prices are expected to rise 15% in 2021, with demand slightly outstripping supply. The top factors dictating the price trend will be the enforcement of OPEC 2.0 alliance's output–cut pact, US shale policy, and post–COVID–19 consumption. President elect Biden's restrictive–leaning stance on shale extraction and positive vaccine trial efficacy results could offer upside to the rally.

2021F crude demand to slightly outstrip supply

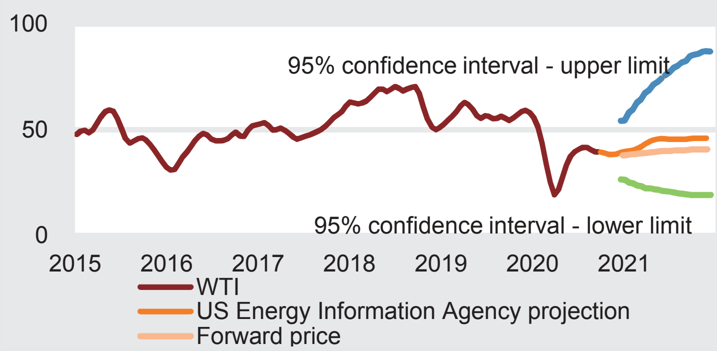
Global crude supply deficit, mn bpd (LHS); global crude output & demand, mn bpd (RHS)



Source: Bloomberg; CDF

US shale policy & post–pandemic recovery could boost crude upside

WTI, US$/barrel



Source: Bloomberg; CDF

Metals

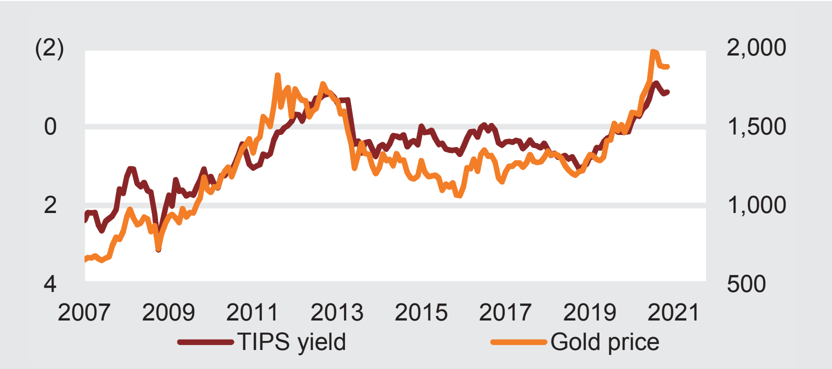
Rating | Neutral

Diminishing policy uncertainty & rising real interest rates will gradually depress gold prices

- Gold price volatility could be dictated by a multitude of factors. Implications of demand for gold as a financial market instrument are far more profound than that of real–world demand for the commodity. As a non–interest–bearing asset, gold is pursued by funds seeking reallocation from other assets to hedge against risky positions or to transition away from a low–risk portfolio with dwindling returns. Fluctuations of gold exchange currencies should be attributed to currency trend rather than associated with the value of gold. In 2021F, policy uncertainty levels will flatten as the US experiences a transfer of power post–election. With vaccination programs in the pipeline, COVID–19 will be better contained, reducing the need for hedging. As such, the real interest rate trend will be the principal factor driving gold prices.
- In 2021, world GDP is projected to grow at least 5% YoY. Central banks will likely maintain a dovish stance on interest rate policy before inflation and job numbers fully recover, though QE operations could taper off going into 2H21, propping up real interest rates and dampening gold.

Real interest rates to be principal gold price factor

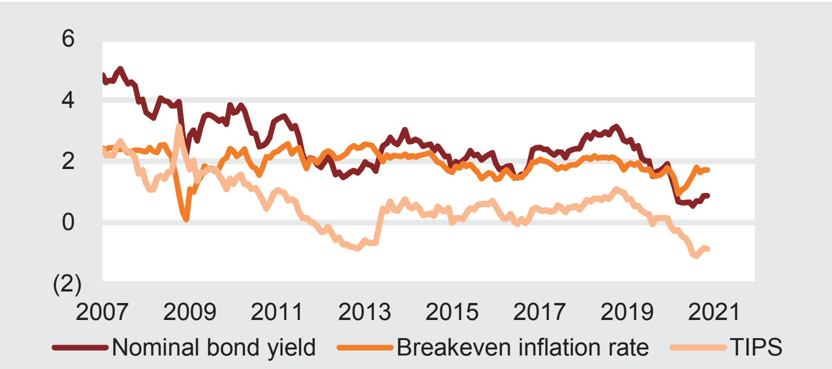
TIPS, percent (LHS, inverted); gold price, USD/ounce (RHS)



Source: Bloomberg; CDF

Recovery & moderate loosening to lift real interest rates

Nominal bond yield, breakeven inflation rate, TIPS, percent



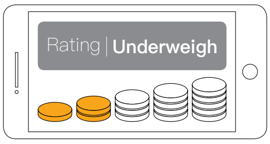
Source: Bloomberg; CDF

6
FX markets

中華開發金控
CHINA DEVELOPMENT FINANCIAL

FX markets

US dollar

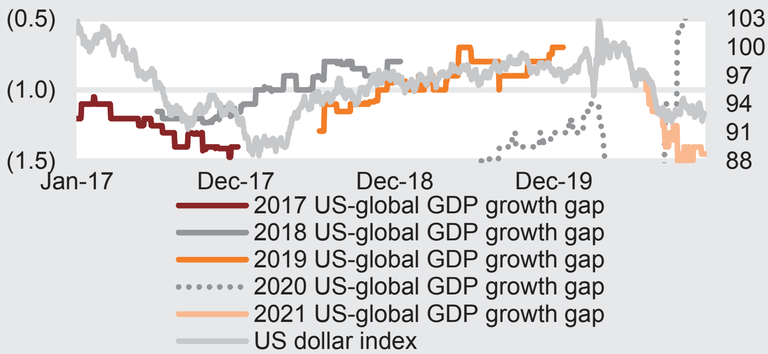


US dollar to depreciate in 2021F amid slow midterm global recovery, policy redirection, & alarming current account & fiscal deficit levels

- We expect the US Dollar Index to weaken in 2021 due to an anemic economic recovery and mounting deficits.
- The market anticipates economic rebound across major economies and globally in 2021, and expects the US to trail the rest of the world on recovery, which usually signals a weakening dollar. US current account and fiscal deficits are being raised through the roof for 2020–21. Meanwhile, the Fed has taken the initiative to uphold its mandate of policy loosening. From a long-term perspective, the US dollar tends to get a boost when Republicans are in charge, and soften during Democratic control, as a result of fundamental ideological differences on issues like taxation and regulatory policies. The Fed's 2021 Board of Governors are mostly centrists and will likely be an extension of their predecessors. While it remains clear the Fed won't attempt rate hikes next year, based on assessment of macroeconomics, hiring, and inflation, the Fed will introduce tapering to the the balance sheet expansion program in 2H21F. Overall, the dollar will endure pressure in 2021F, with some prospect of stabilizing in 2H21F.

Economic underperformance dovetails with soft US dollar

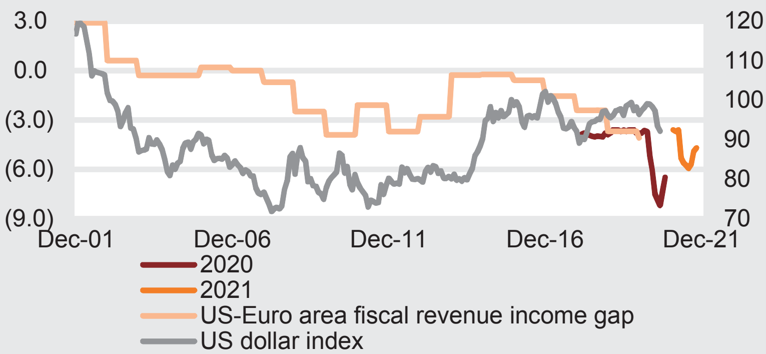
US–global GDP growth gap, ppt (LHS); US Dollar Index (RHS)



Source: Bloomberg; CDF

Alarming levels of US fiscal deficit to weigh on currency

US/EU fiscal deficit/GDP weighting gap, ppt (LHS); US Dollar Index (RHS)



Source: Bloomberg; CDF

FX markets

Euro

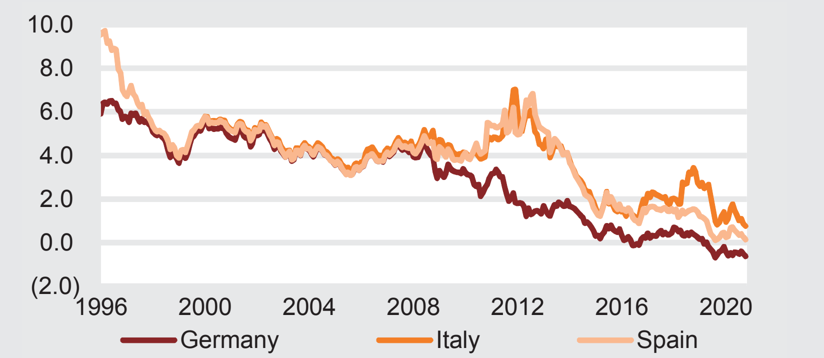
Rating | Overweight

Improving risk appetite & soft US dollar favors euro outlook in 2021F

- The exchange trend is looking up for the euro in 2021, mainly because of bullish sentiment and involuntary appreciation. We are also monitoring regional interstate fiscal collaborations and synergies. The eurozone isn't going to be amazing economically in 2021F, so there is still plenty the ECB and its affiliates must do fiscally and monetarily, and this is also a moment that will test the foundation of interstate fiscal collaboration. Treasury yields of vulnerable member states have hit rock bottom levels, their spread over core member states' yields appears well established at this point, with minimal yield and spread downside.
- Against the midterm backdrop of better risk appetite worldwide, the euro's improvement on real interest rate, and a weak US dollar, the euro will continue to experience involuntary appreciation momentum. After all, euro accounts for nearly 60% of the US Dollar Index and is the most relevant currency to the US dollar. For these reasons, the euro may record some mild gains over the next year.

Eurozone sovereign yields troughing, peripheral–core yield spread established

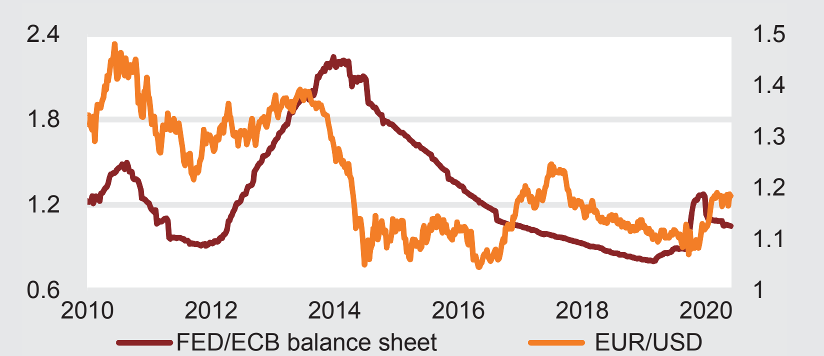
Italian, Spanish & German government 10Y bond yield spread, percent



Source: Bloomberg; CDF

Huge upside unlikely for euro due to paralleled easing by US & EU

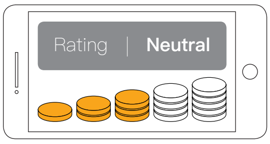
FED/ECB balance sheet comparison, x (LHS); EUR/USD (RHS)



Source: Bloomberg; CDF

FX markets

Japanese yen

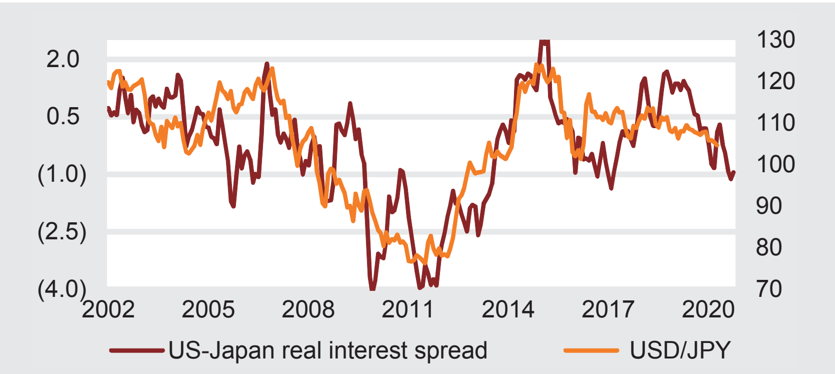


Neutral on yen in 2021 in light of improving real interest rate vs. positive global outlook & dissipating uncertainties

- We expect the Japanese yen to consolidate in the coming year. Safe–haven demand for the yen will be less intense in 2021F due to a positive recovery outlook worldwide and a higher weighting of overseas assets in the portfolio of state–run pension funds. Also, the BOJ may continue monetary easing and intervene to stop the yen from rising too high, like it always has when the yen exceeds 100–105 to US$1.
- Despite the yen's low nominal interest rate and low inflation, the real interest rate against the US dollar has improved lately due to significant rate cuts and recovering US inflation. The postponement of the Tokyo Olympics 2020 to 2H21 due to COVID–19 may generate some demand for the yen. All told, we expect the Japanese yen to consolidate within a range in 2021, rather than developing a unilateral trend.

Yen FX performance boosted by improving real interest spread over US dollar

US–JPY real interest spread, ppt (LHS); USD/JPY (RHS)



Source: Bloomberg; CDF

Demand for yen wanes on positive recovery outlook and as hedging demand returns to normal

VIX, point (LHS); GDP growth projection, percent (RHS)

Source: Bloomberg; CDF

FX markets

Renminbi

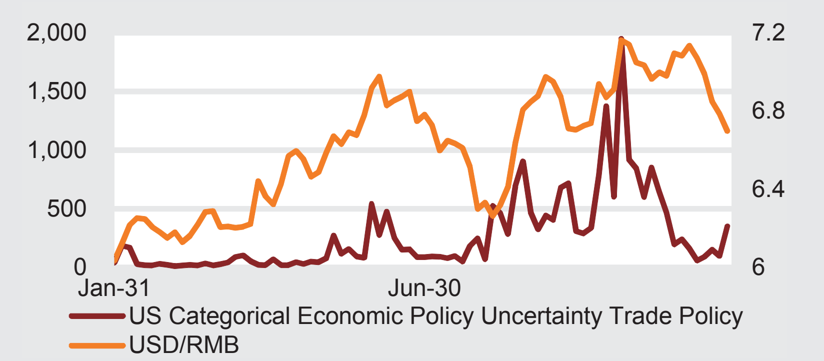
Rating | Overweight

Renminbi bullish in 2021F on edge over economic growth, interest spread, & potential mitigation of Sino–US tensions

- We expect the renminbi to rise next year given China's relatively solid growth outlook, as GDP growth is projected to accelerate from 2% in 2020 to 8% in 2021. In contrast, growth achieved in Japan and western economies over the past two years ultimately turned out to be modest as they managed to recover from contractions. On the monetary policy front, not only does the renminbi offer more attractive returns, the PBoC has also taken a more disciplined approach to easing compared to the Fed, which has been evidenced in the extent of recent expansion of the China–US interest spread and central bank balance sheet. All of the above bode well for renminbi performance.
- It's generally believed that a Biden presidency will ensure a consistent and predictable foreign policy, leading China and the US toward a more diplomatic relationship. China's recently improved and relatively solid current account and fiscal data also favors the performance of its currency.

Less radical relationship between US & China to favor renminbi

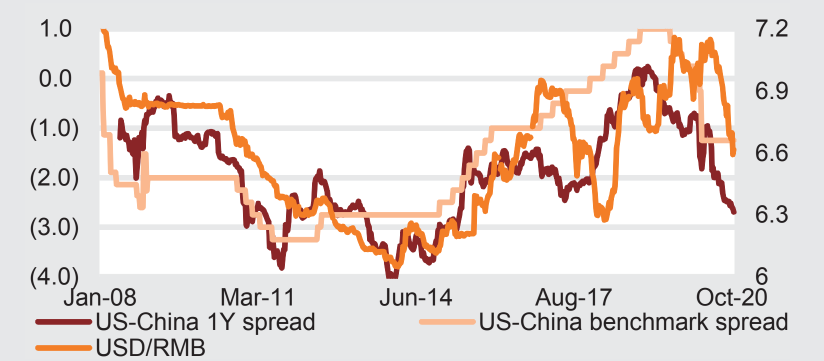
US Categorical Economic Policy Uncertainty Trade Policy, point (LHS); USD/RMB (RHS)



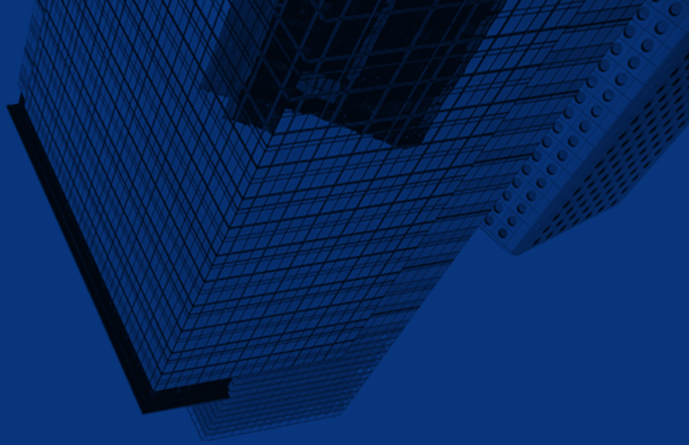
Source: Bloomberg; CDF

Renminbi return relatively attractive

Interest rate spread, percent (LHS); USD/RMB (RHS)



Source: Bloomberg; CDF



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