

**SARASIN**  
& PARTNERS

# Sarasin Global Strategy and Outlook

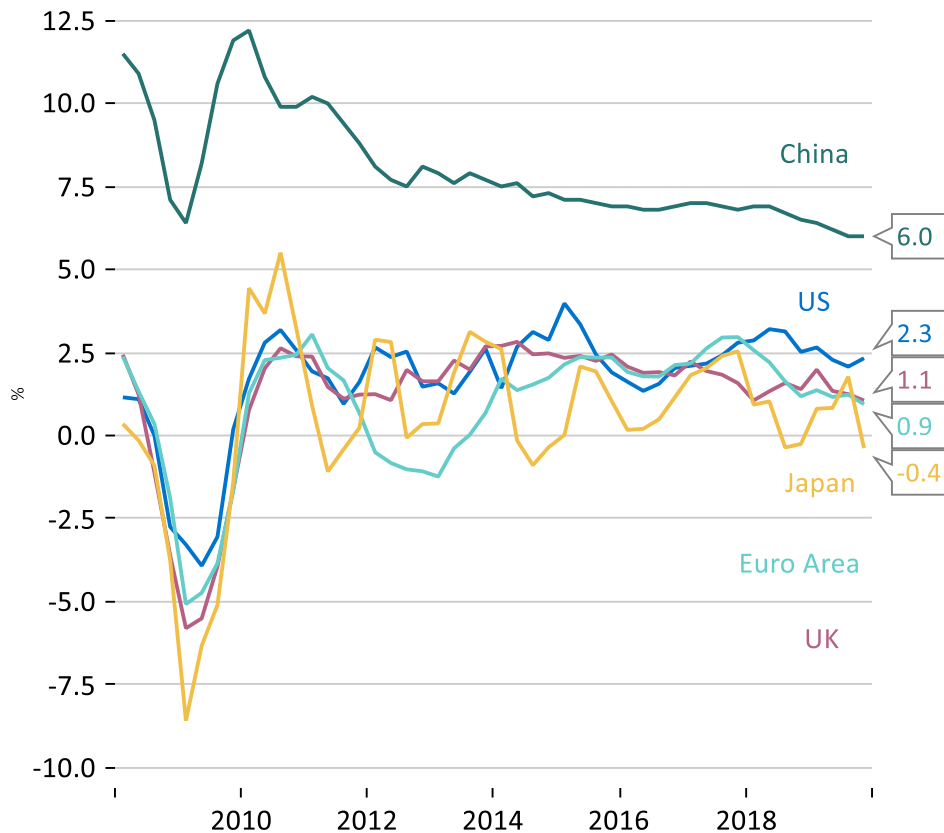
Guy Monson



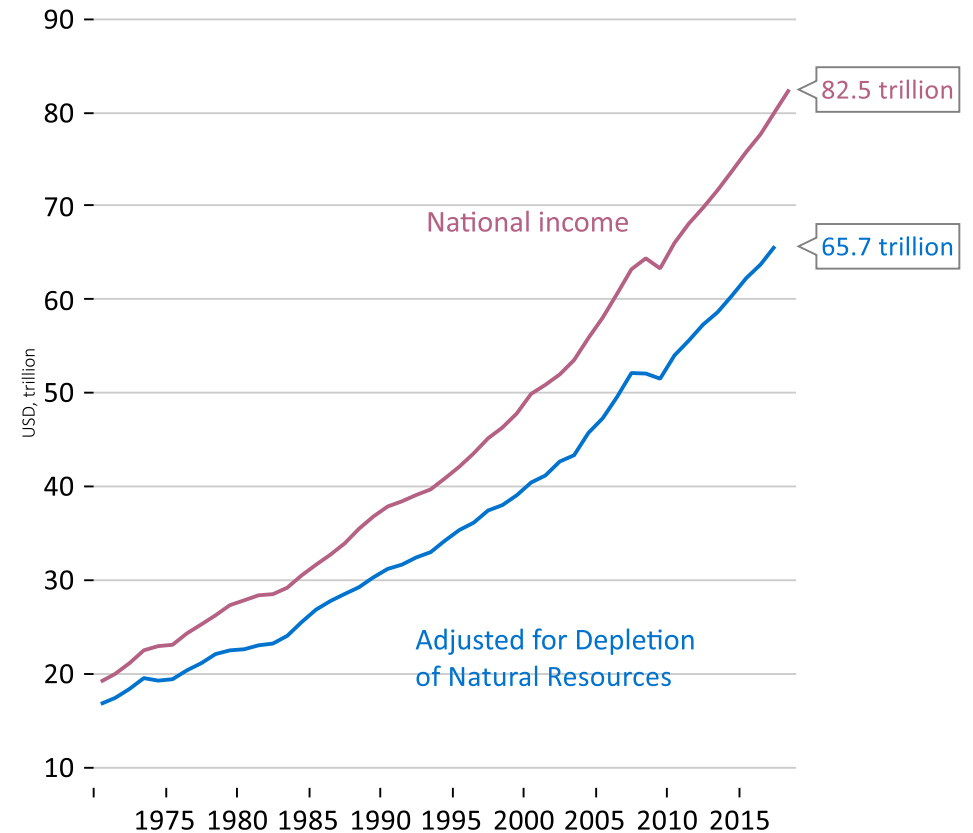
# Market & economic outlook: Global growth has slowed in every major region even before taking a haircut for climate change and resource depletion



GDP, annual growth (yoy %)



World Growth adjusted for Natural Capital Depletion



“There are now tentative signs that global growth may be stabilizing”  
Gita Gopinath IMF Chief Economist Jan 20<sup>th</sup> 2020

**World Bank Adjusted Net National Income** – Natural capital depletion accounts for: carbon dioxide damage, depletion of fossil energy resources, air pollution damage, net forest depletion, and depletion of metals and minerals.

Source: Macrobond, World Bank August 2019

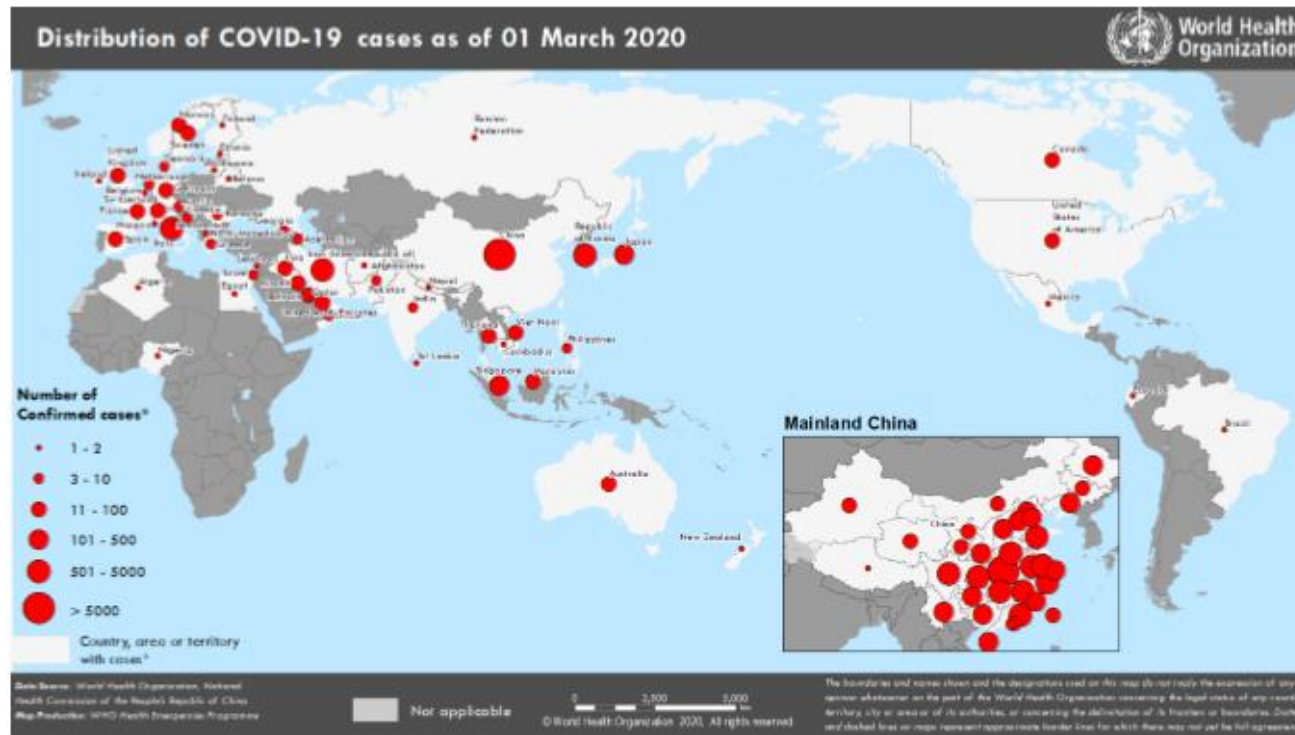
# Economic Risk 1: Coronavirus – a challenge to global growth?

Novel Coronavirus (nCoV19) outbreak is most similar to SARS



## nCoV19 outbreak

Figure 1. Countries, territories or areas with reported confirmed cases of COVID-19, 01 March 2020



- WHO declares the new coronavirus outbreak a Public Health Emergency of International Concern – 30/1/2020
- WHO RISK ASSESSMENT: China Very High, Regional Level Very High, Global Level Very High
- A majority of patients with COVID-19 are adults. Among 44 672 patients in China with confirmed infection, 2.1% were below the age of 20. The most commonly reported symptoms included fever, dry cough, and shortness of breath, and most patients (80%) experienced mild illness. Approximately 14% experienced severe disease and 5% were critically ill. Early reports suggest that illness severity is associated with age (>60 years old)

\*The situation report includes information provided by national authorities as of 10 AM Central European Time

Source: WHO March 2020 (Updated weekly)

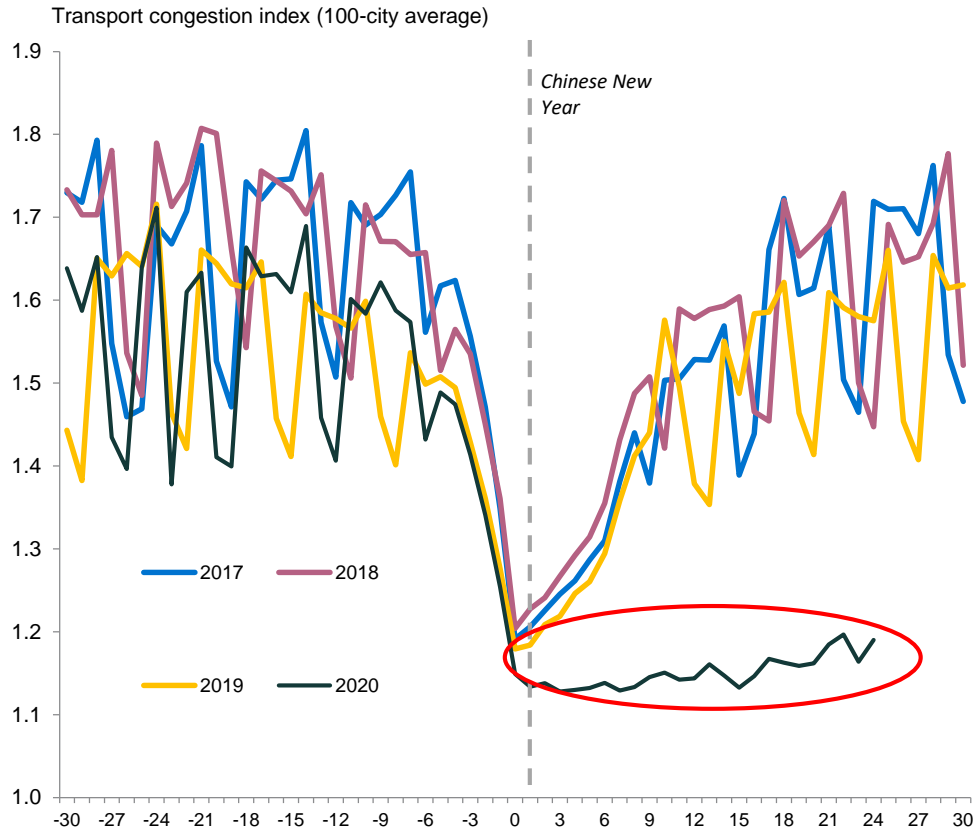
# China activity: difficult to track, but well below previous years. Note risk of altered consumer behaviour longer-term



## Transport congestion



## Summary of resumption activity



Source: Macrobond

## Summary of Activity Resumption in China

Figure 18: Summary of activity resumption by sector

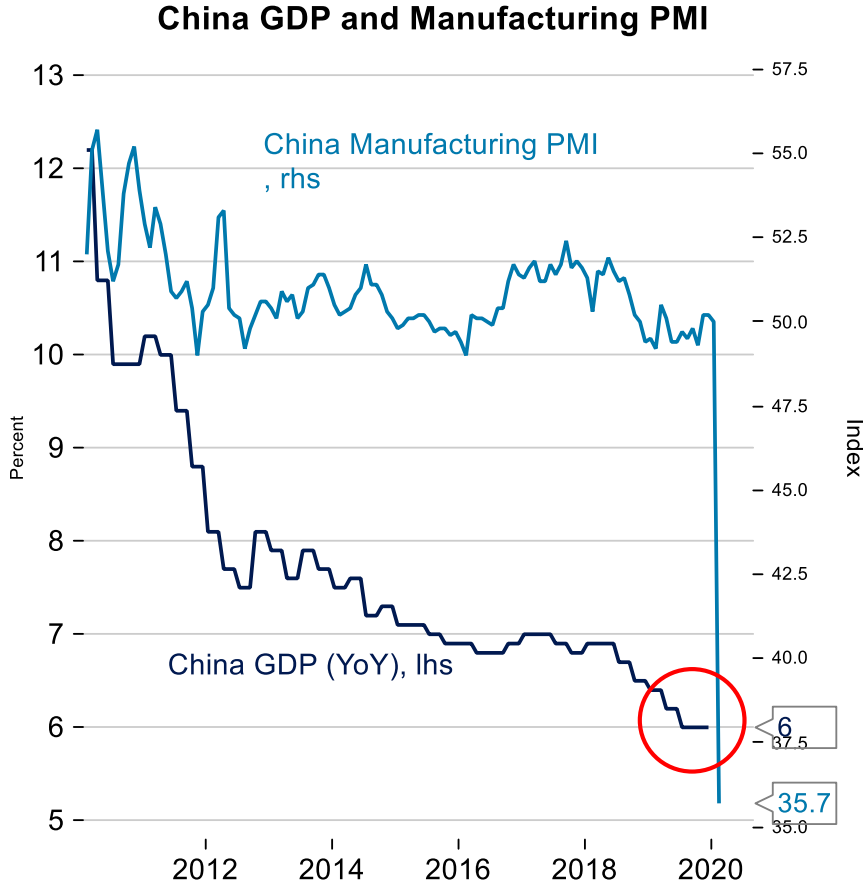
|   | Activity resumption ratio (%)  | Source         |
|---|--|----------------|
| Central SOEs' subsidiaries with production mandates | 81.6% (Feb 12, for companies without local restraints)                         | SASAC          |
| Major grain production & processing enterprise      | 94.6% (Feb 10)   | NDRC           |
| Coal mines  | 57.8% (Feb 10)   | NDRC           |
| Auto production                                     | 32.2% (Feb 12)   | CAAM           |
| Auto dealer   | Overall 8.6% (Feb 14, o/w employee 20.3%, sales 4.9%, aftersales service 6.4%) | CADA           |
| Carload freight                                     | 23% of Nov 2019 level (Feb 16)   | G7 & Chemanman |
| Steel sector (production)                           | 56.5% (Feb 16); expect to reach 76% by end-Feb                                 | Mysteel        |
| Food delivery and express delivery                  | 62% (Feb 13)   | Media report   |

Source: NDRC, SASAC, CAAM, CADA, G7&Chemanman, Myseel, media report, UBS estimates

# Quantifying the impact is very difficult at this stage, with both temporary AND permanent loss in activity

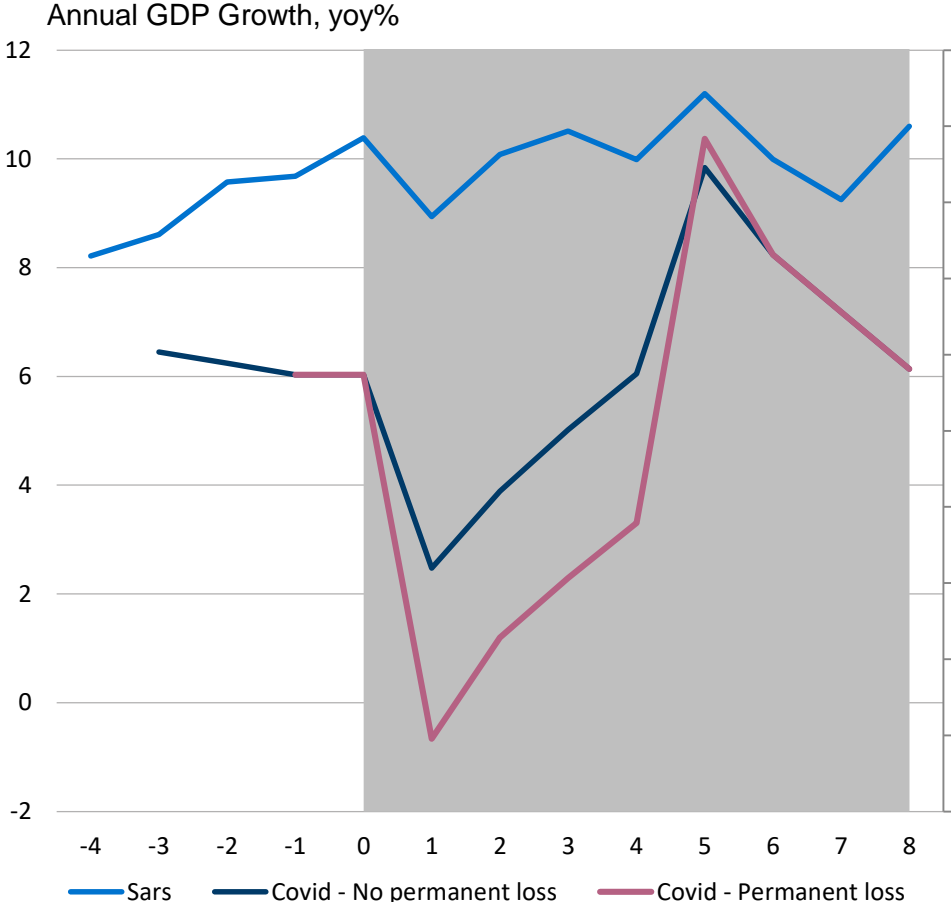
 The Chinese PMI indicates economy will shrink in Q1 2020

 GDP trajectory: COV-19 vs SARS



Source: Macrobond

Source: Macrobond



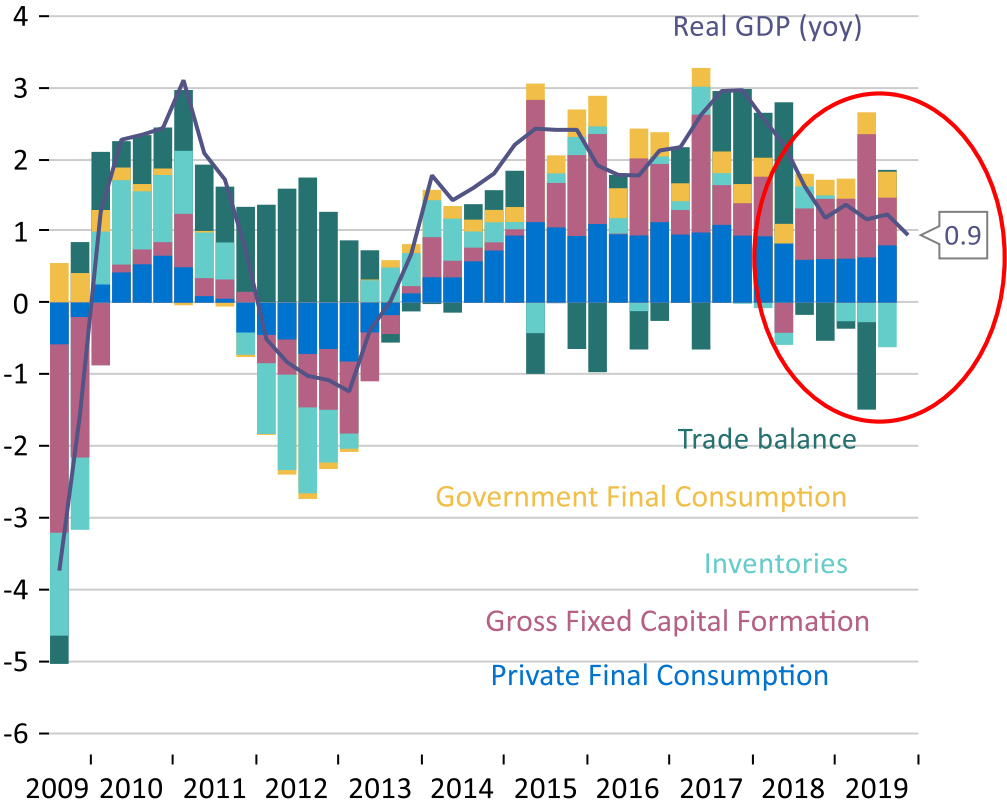
Note: T0 in Sars is Q1 2003, and in Covid Q4 2019, and the number of quarters before and after shock. The no permanent loss scenario assumes GDP level returns to its previous trend with significant catch-up in Q2, Q3 and Q4 resulting in 2020 growth of 4% lower than our previous forecast of 5.8%. In the permanent loss scenario, we assume 2.5% loss in 2020 GDP with a sharp fall in Q1 and a similar rebound in subsequent quarters. This results in 2020 growth of merely 1 1/2%.

# Euro area weakness particularly pronounced in exports and industrial production...



## Euro area GDP decomposition

GDP Growth decomposition (yoy%)

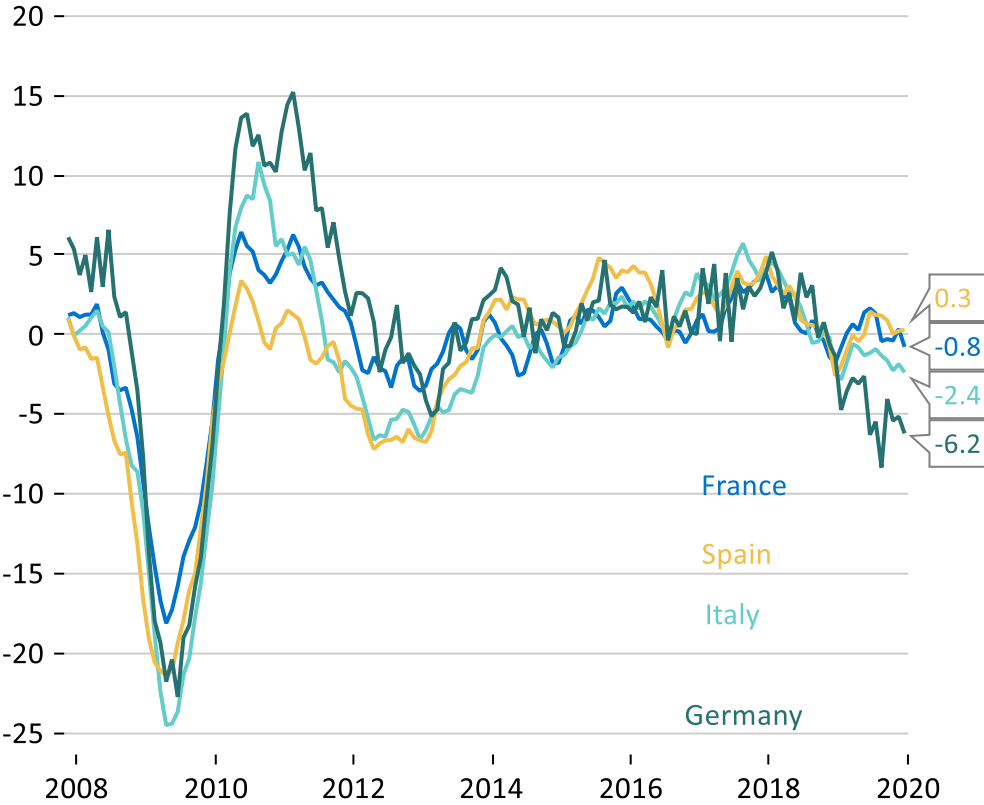


Source: Macrobond



## Euro area industrial production

European Industrial Production



Source: Macrobond

# And with core inflation well below 2%, *central banks can still ease* but their toolkit is largely exhausted...

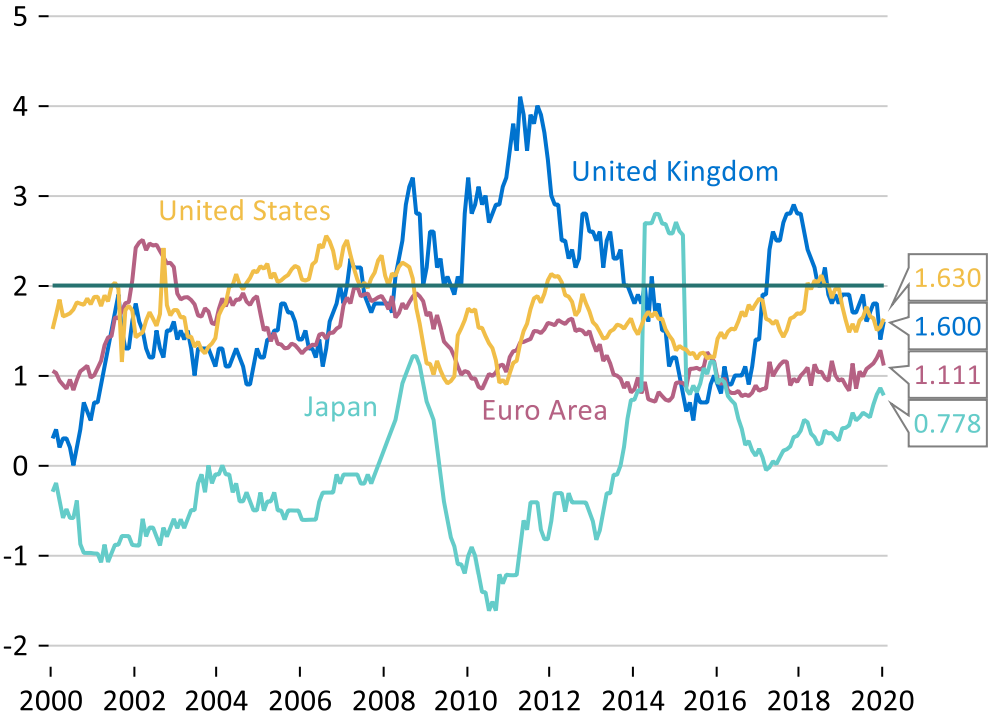


## Core inflation rates stubbornly below 2%



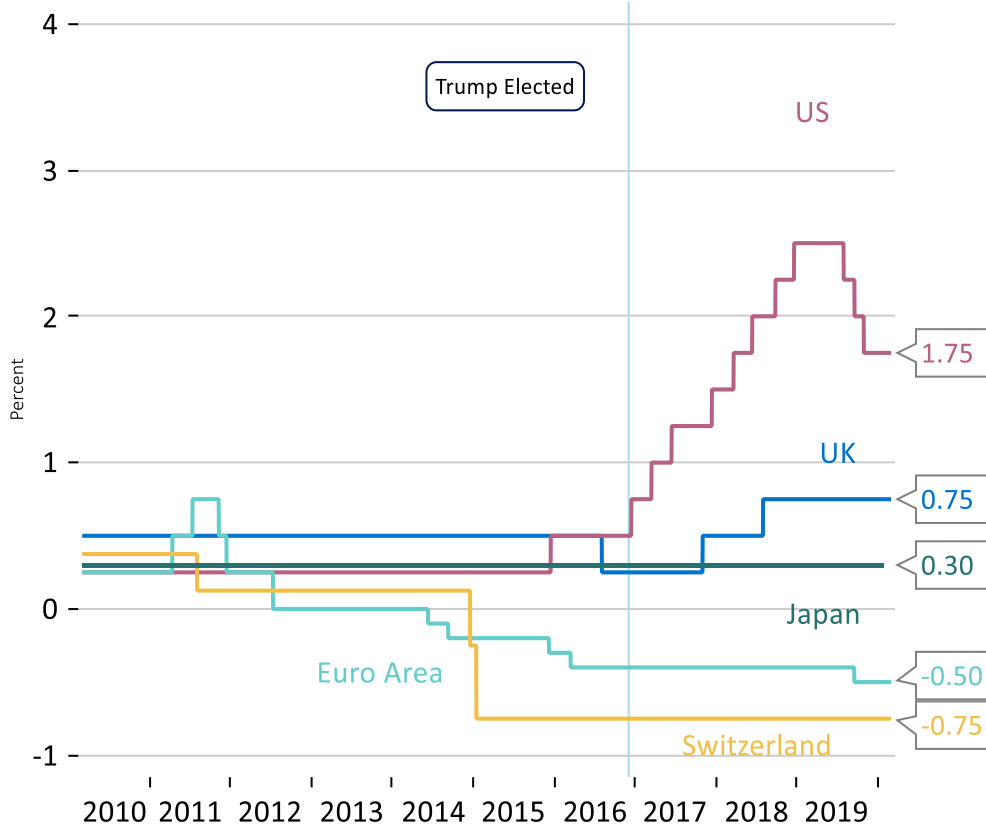
## Little room for lower rates

Core Inflation Rates (Excluding Food & Energy)  
Below Central Bank 2% Targets



Source: Macrobond, 2020

Global Interest Rates



Source: Macrobond, 2020

# Expect a co-ordinated central bank response as US bond yields hit record lows...



## Central Bank statements on Covid-19



February 28, 2020

### Statement from Federal Reserve Chair Jerome H. Powell

“The fundamentals of the U.S. economy remain strong. However, the coronavirus poses evolving risks to economic activity. The Federal Reserve is closely monitoring developments and their implications for the economic outlook. We will use our tools and act as appropriate to support the economy.”



March 2, 2020 **Bank of Japan**

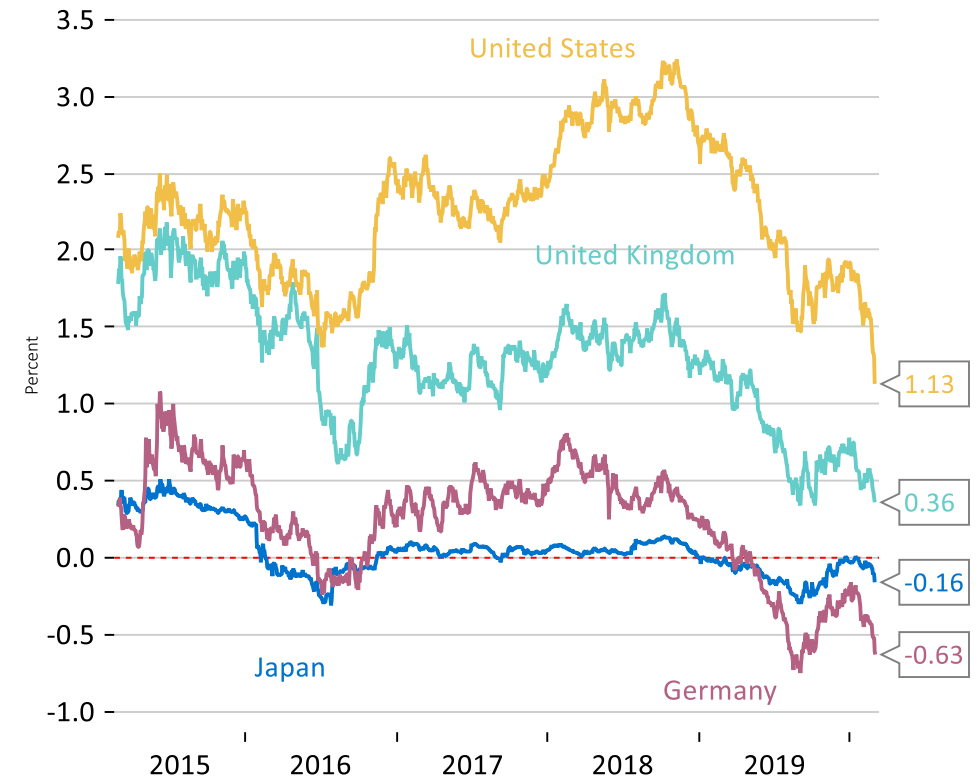
The Bank of Japan will closely monitor future developments, and will strive to provide ample liquidity and ensure stability in financial markets through appropriate market operations and asset purchases.

Source: Macrobond, 2020



## Japanese and European yields decline again

### Government Benchmarks 10 Year Yield



Source: Macrobond, 2020

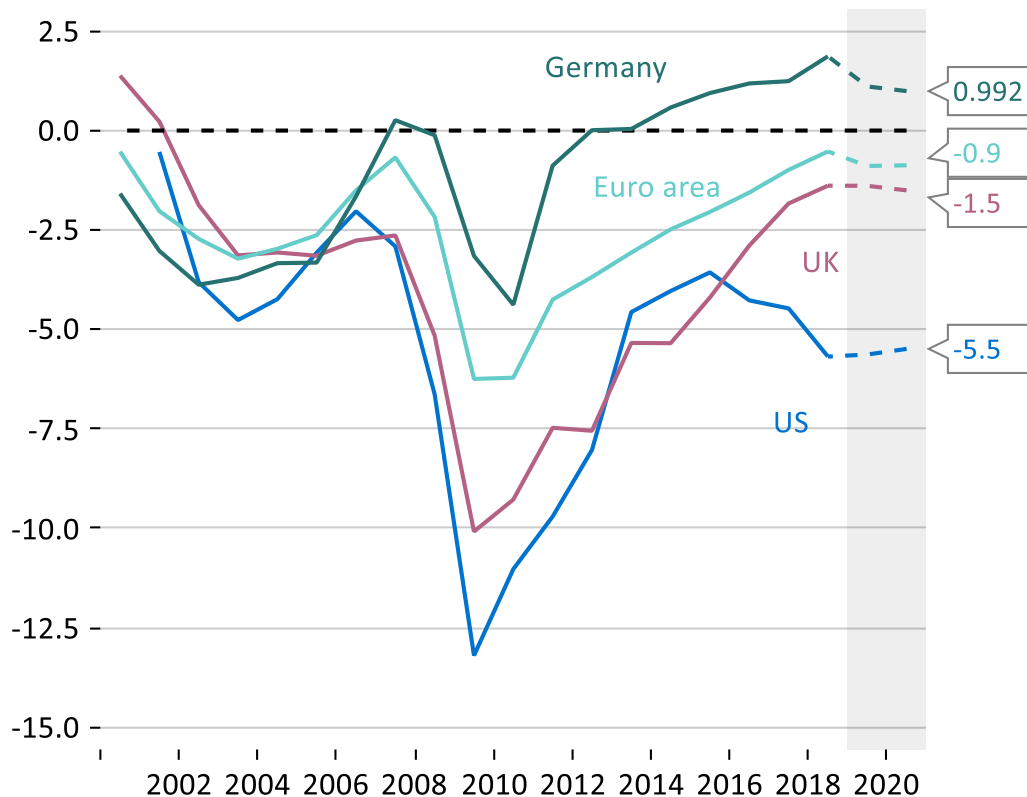


# While there is growing pressure across all markets for further government spending...



## Fiscal policy - Following Trump's lead...

### Government budget, % share of GDP



Source: Macrobond, 2020



“This could turn out to have been a very expensive election, indeed. Up to £20 billion a year of extra investment spending has been pledged by the Tories, £55 billion by Labour “  
IFS 9/11/2019



“Over the next 10 year **US budget deficits** are projected to average 4.7% of GDP (compared to 2.9% of GDP on average for the last 50 years).”  
Congressional Budget Office 2019

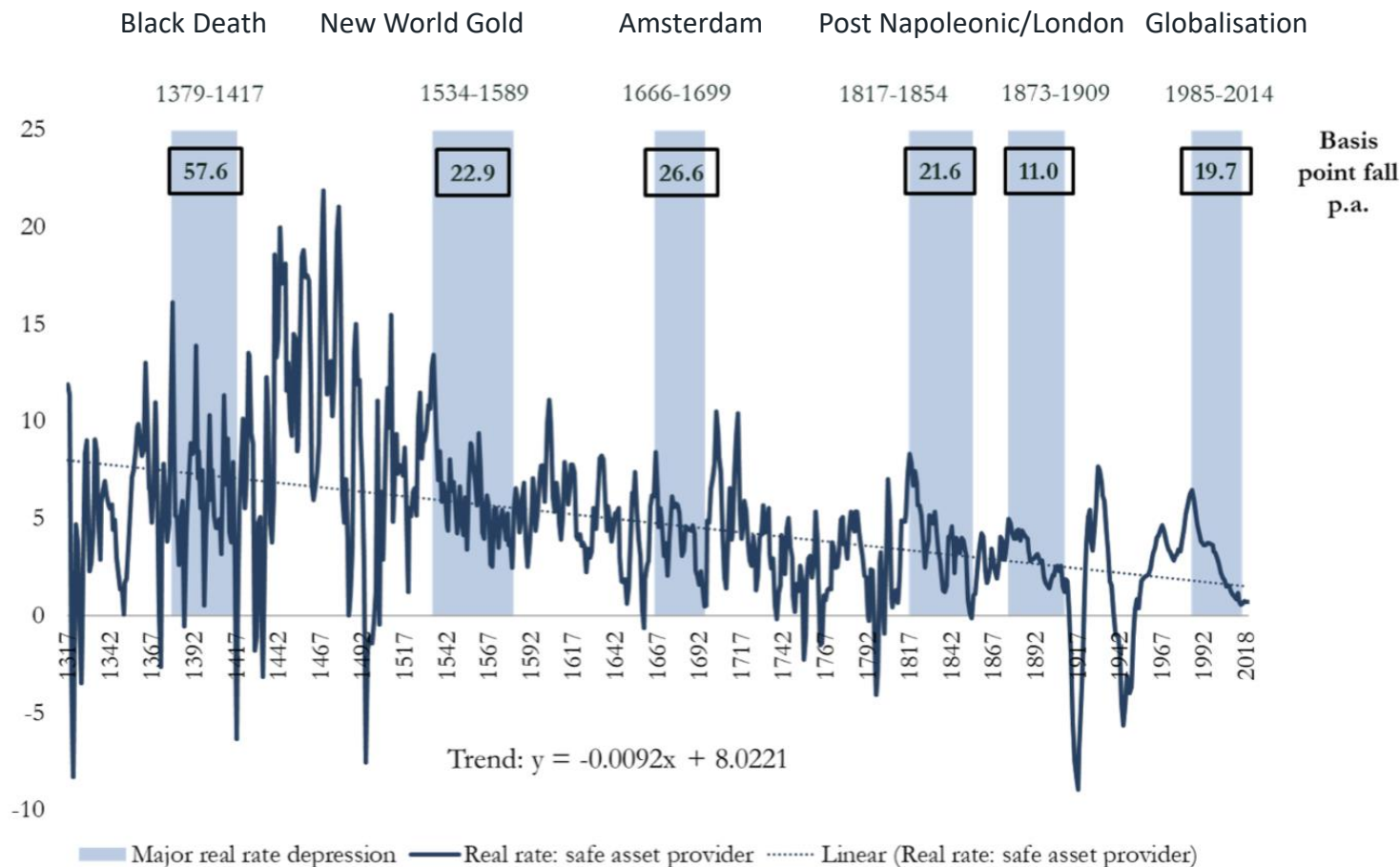


“Fiscal measures intended to support the economy are certainly very welcome, particularly under present circumstances  
Christine Lagarde  
Feb 26 2020

# Periods of persistent decline in sovereign real yields are historically the norm...



Real borrowing rates 1317-2018 (shaded blocks show periods of rates consistent rate depression)



## Data Series

Long-term sovereign real rates over a span of 707 years, relying on a collection of evidence from 14th century European municipal and imperial registers, over Habsburg, British, Dutch, crown documents.

Source: Eight centuries of global real interest rates, R-G, and the 'suprasecular' decline, 1311-2018 Paul Schmelzing – Bank of England 2020

# 01

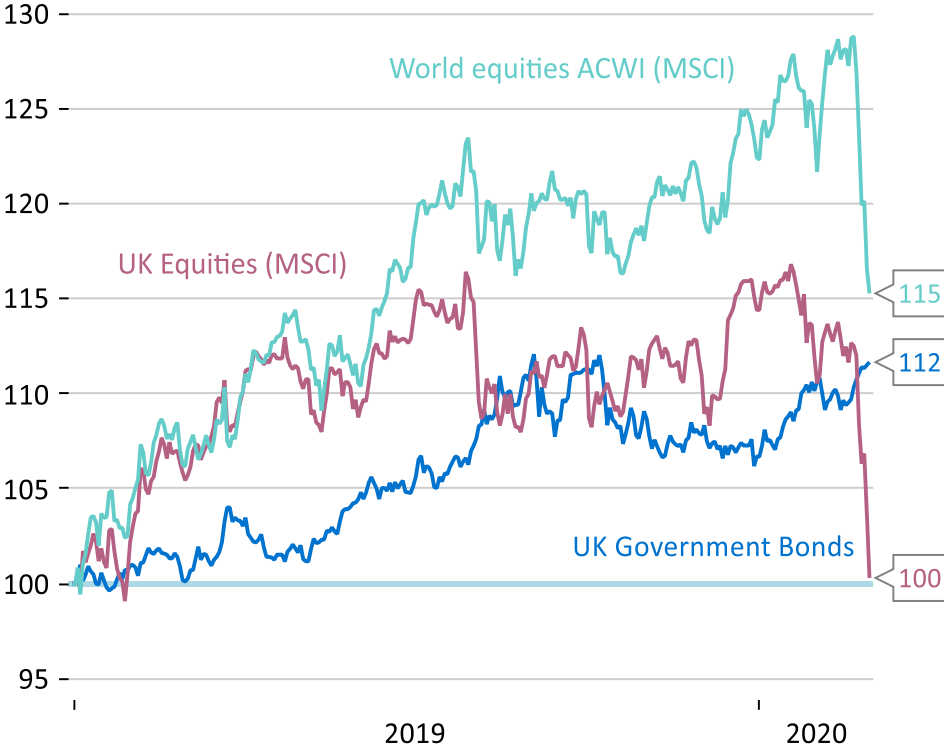
## Asset markets & growth opportunities

# After a vintage 2019 for equities, this year has seen new highs with little increase in volatility...

 Global Asset markets correct at unprecedented rates

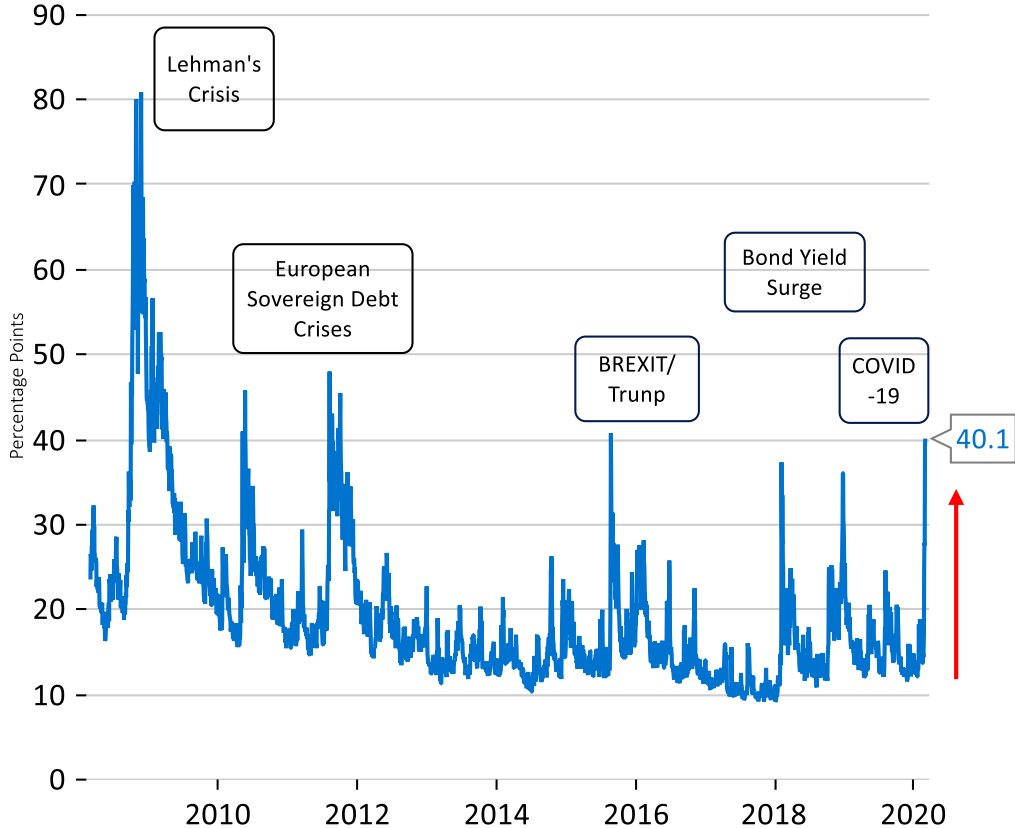
 Equity volatility still close to all time lows in 2019

**Global Asset Returns**  
GBP (1/1/2019 = 100)



Source: Macrobond, 2020

US Equity Volatility (VIX)



Source: Macrobond, 2020

# Global equities ex-US offer value while bond-equity yield gaps are now close to all time highs

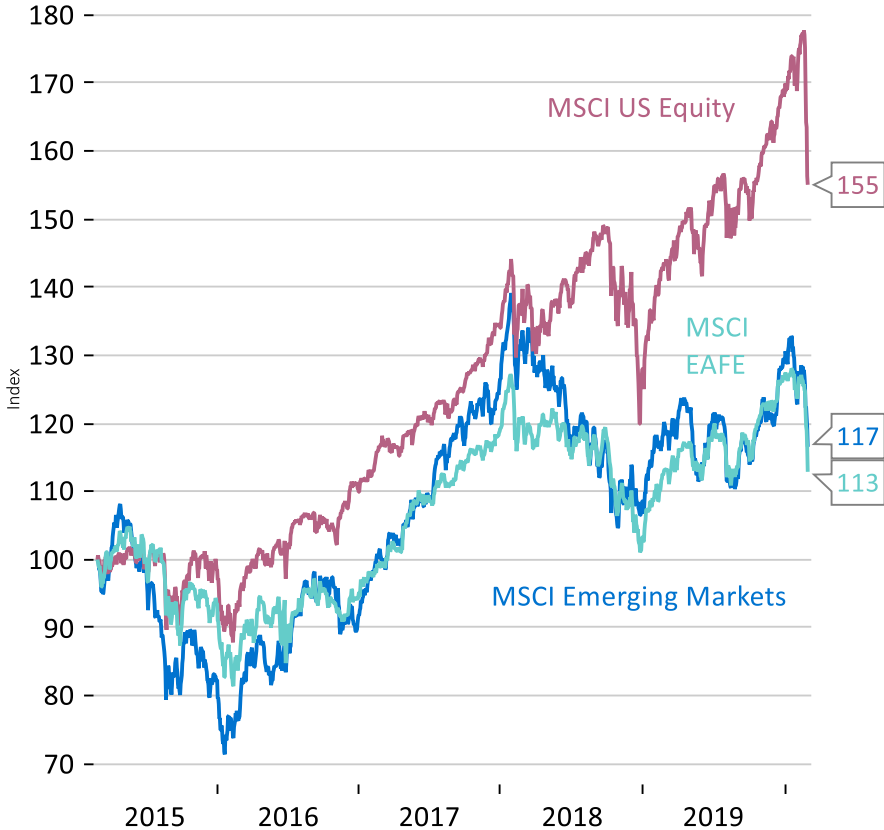


## US equity regional outperformance



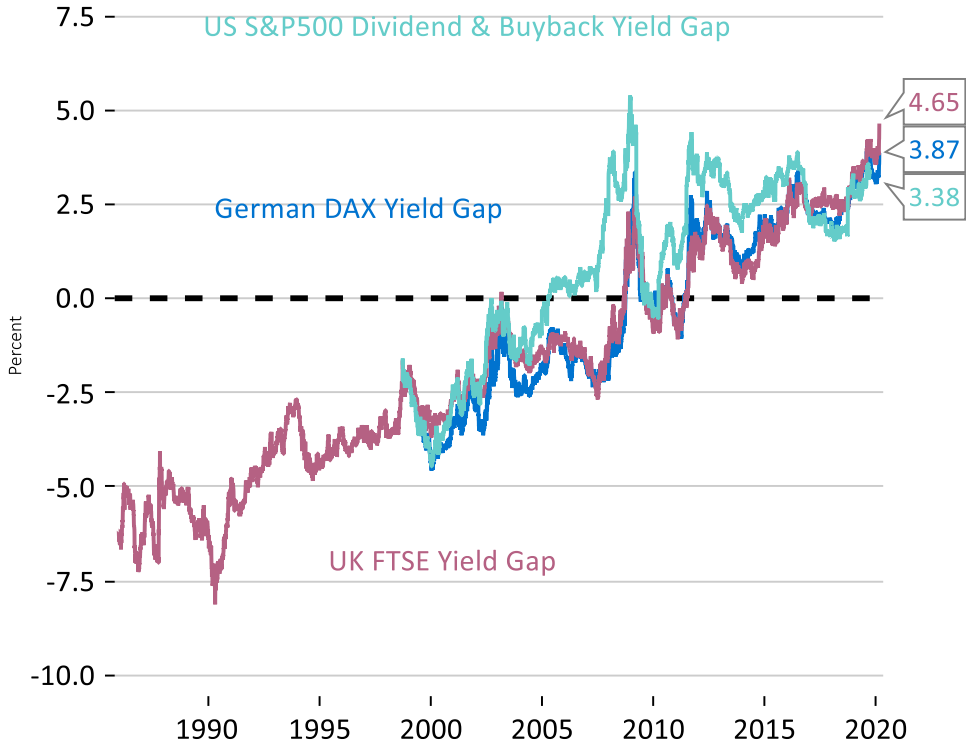
## Dividend Bond Yield Gap close to all time highs

### World Equity Indices MSCI



Source: Macrobond, 2020

### Equity Dividend and 10 Year Bond Yields



Source: Macrobond, 2020

# Remarkable stability among major currencies



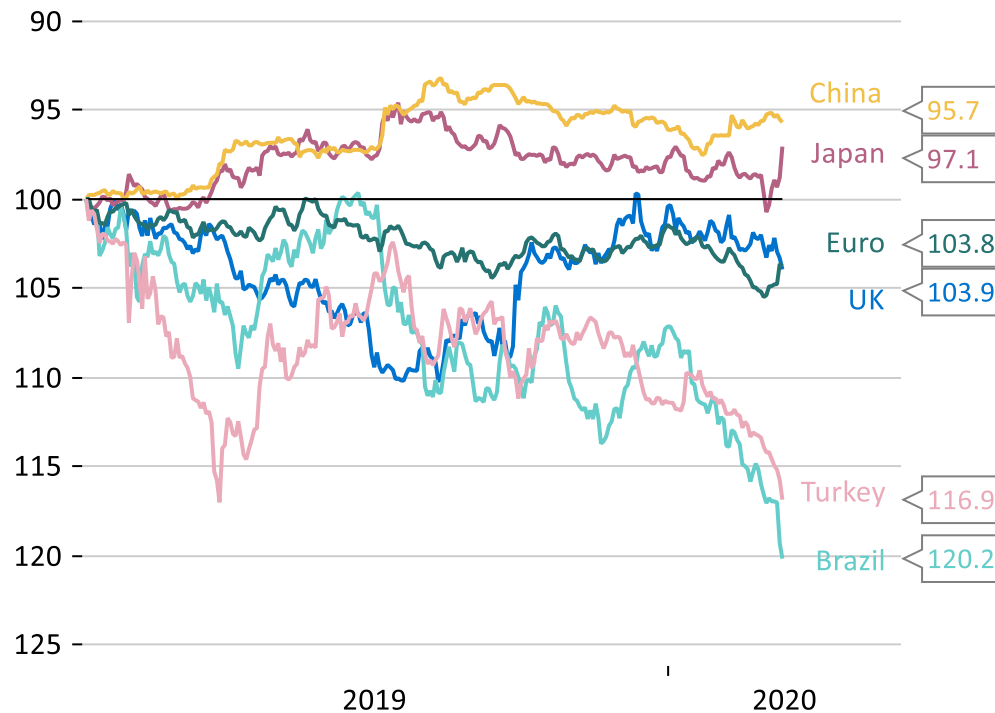
Only struggling EM currencies have fallen



Renminbi and Euro supported by trade surpluses

## Currencies per US Dollar

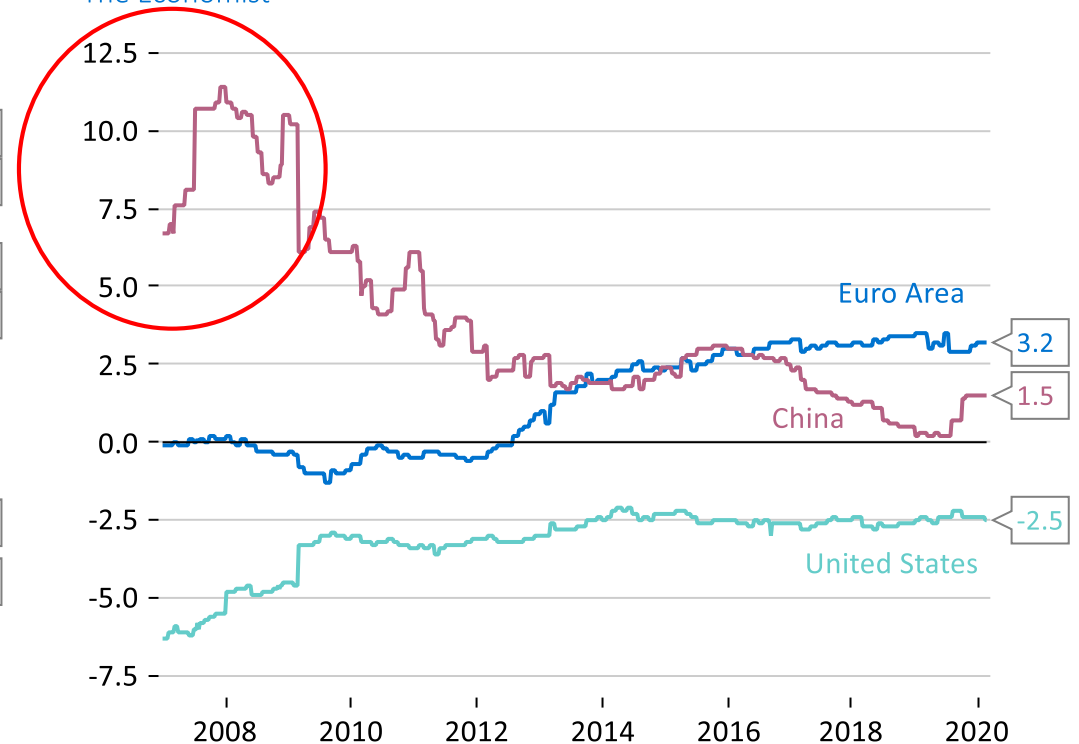
Last 12 Months (Rebased)



Source: Macrobond

## Current Account Balance % GDP

The Economist



Source: Macrobond

Source: Macrobond

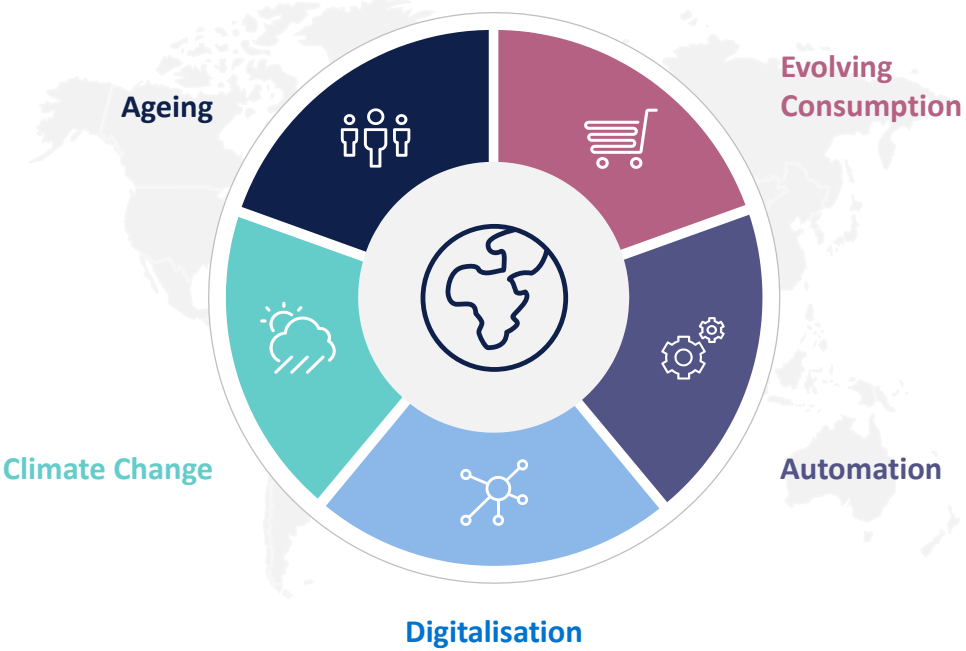
Source: Macrobond

# Thematic & Stewardship

Securing tomorrow

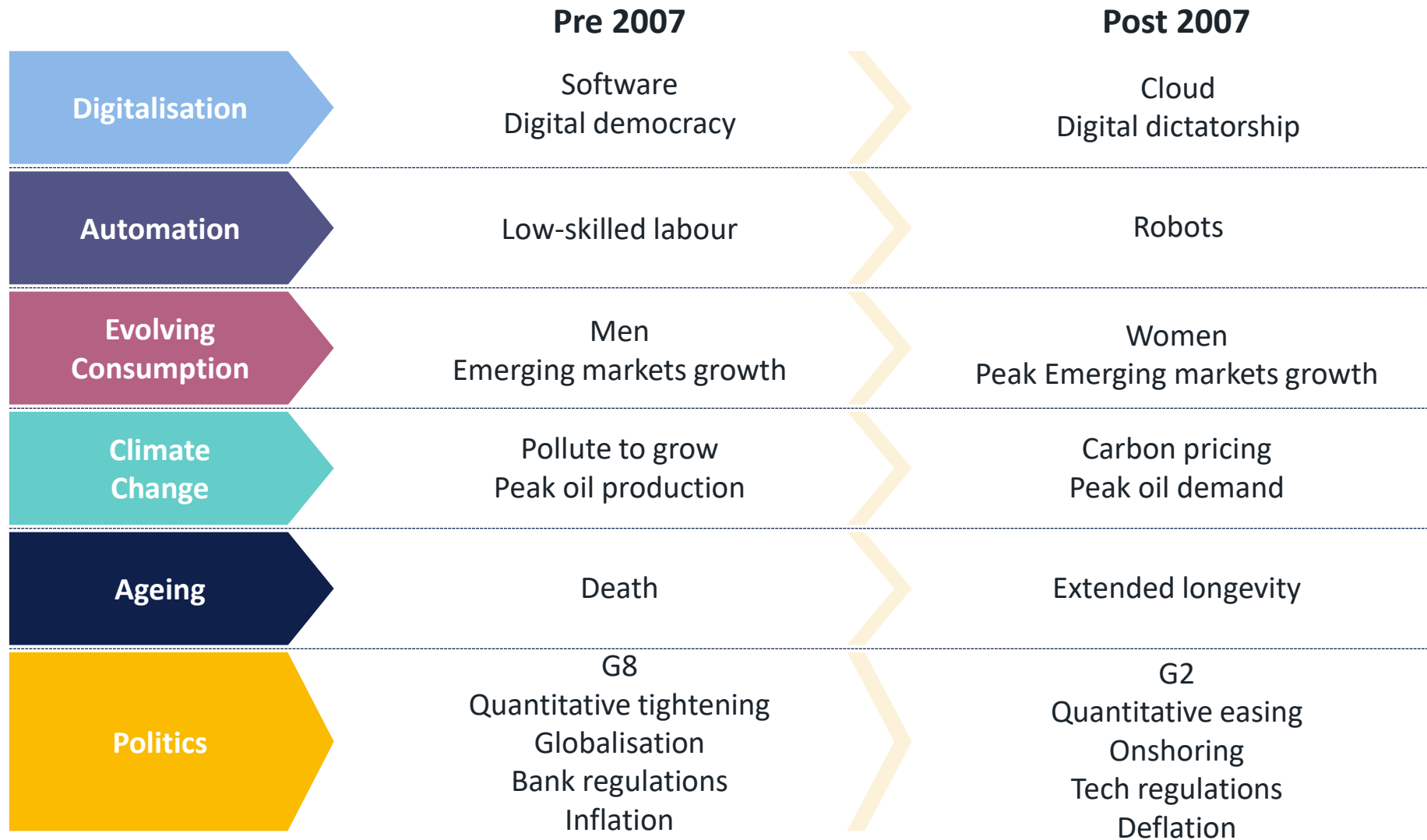
Thematic = Cash flows

Stewardship = Capital protection



|  |   |   |   |  |
|--|---|---|---|--|
| CLIMATE CHANGE<br>    | CIRCULAR ECONOMY<br>   | LAND<br>                   | AIR<br>                      | WATER<br>             |
| SUPPLIERS<br>         | EMPLOYEES<br>          | CUSTOMERS<br>              | BRIBERY & CORRUPTION<br>     | COHESIVE SOCIETY<br>  |
| BOARD STRUCTURE<br> | OWNERSHIP RIGHTS<br> | REPORTING & CONTROLS<br> | EXECUTIVE REMUNERATION<br> | BUSINESS ETHICS<br> |

# New thematic trends are rapidly replacing the old...



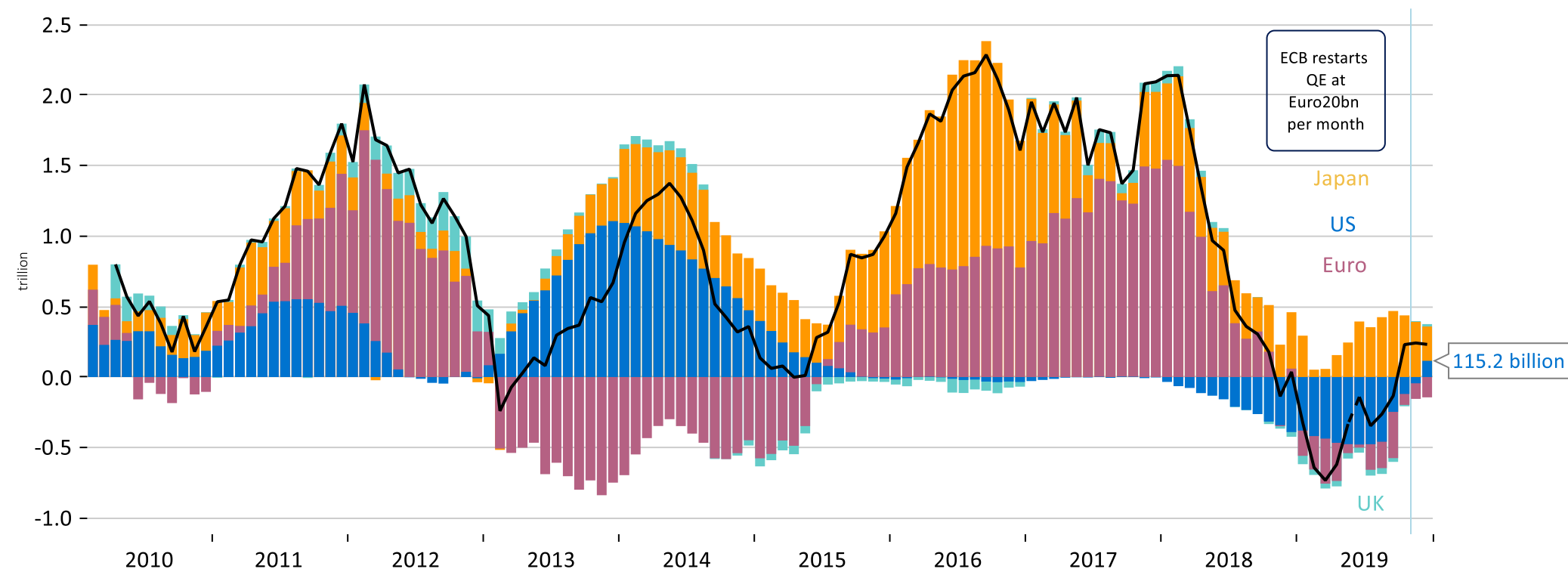
Source: Bank J. Safra Sarasin Ltd – Note 2007: The Iphone, Cloud Computing (AWS) and the Stern Review



# Risk 1: How much have asset prices been inflated by central banks...?

Central bank asset purchases turn positive supporting global asset prices

Central Bank Asset Purchases  
USD trillion, 12 month rolling sum



Source: Macrobond, 2020

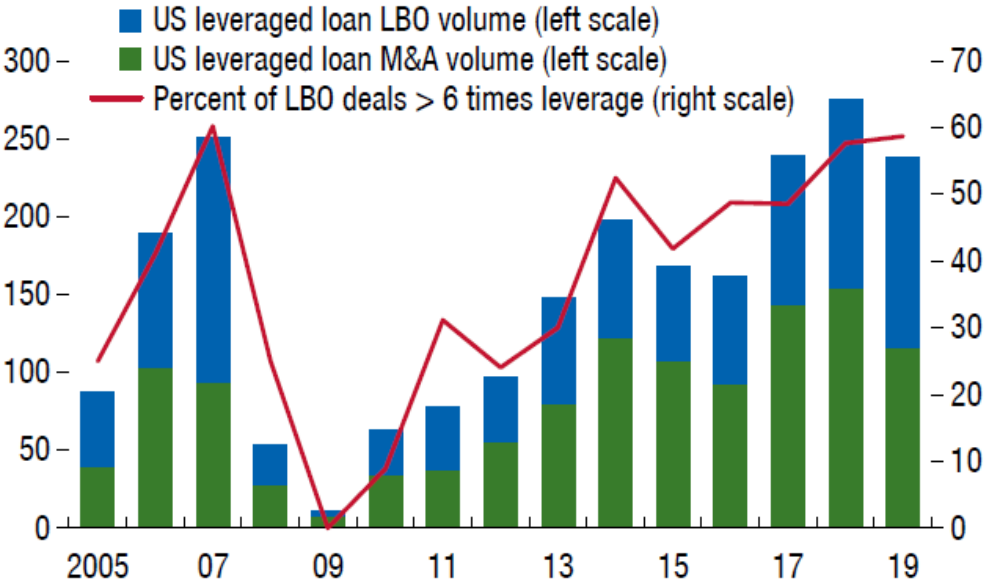
# Risk 2: Credit quality - Corporate and EM credit markets could be vulnerable to a COVID-19 led credit crunch

## Significant increase leveraged loan volumes in the US

## Emerging Market State Owned Enterprises

In the United States, the volume of M&A and leveraged buyout (LBO) transactions funded by US leveraged loans remains high ...

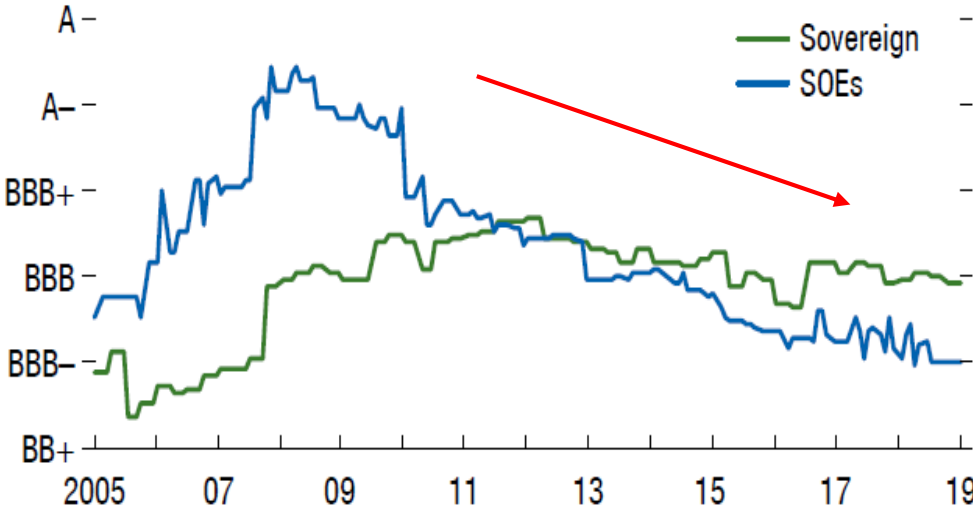
5. US Leveraged Loan M&A and LBO Volume (Billions of US dollars; percent)



Source IMF Stability Report Oct 2019

SOE credit ratings have deteriorated since 2007 and are now lower, on average, than the sovereign ratings.

3. Average Ratings of Major SOEs and their Sovereigns



Source: IMF Stability Report Oct 2019

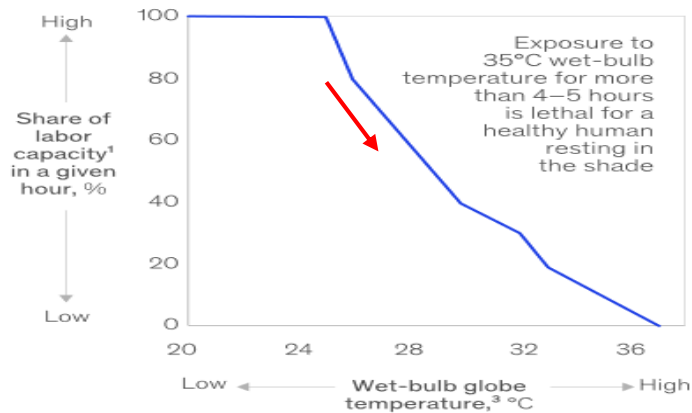
# Risk 3. Climate - How climate hazards can become economic risks...



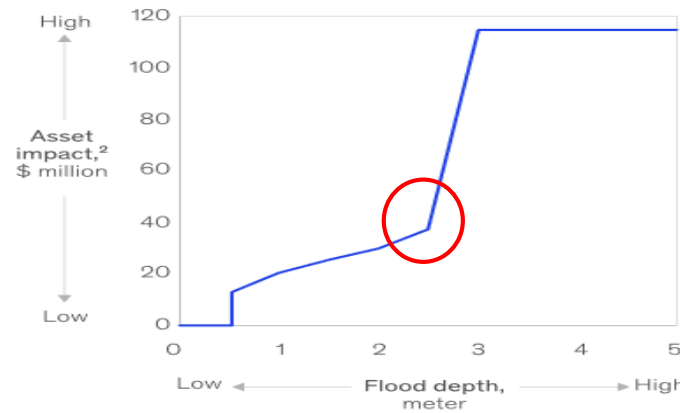
Many of the impacts are non-linear and could have unexpectedly large economic consequences

Direct effects of climate change can become nonlinear when thresholds are crossed.

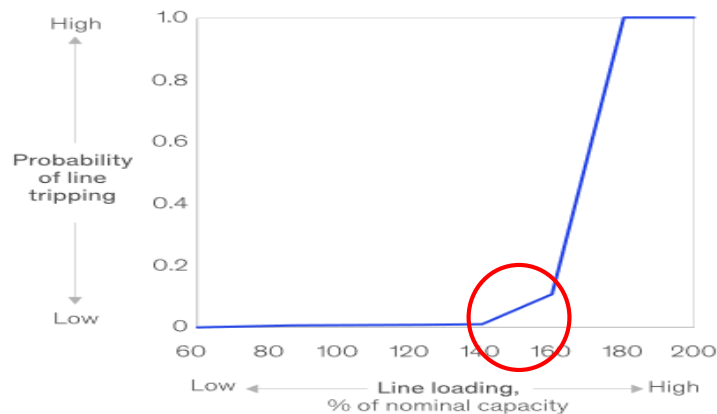
Impact of heat on outdoor labor



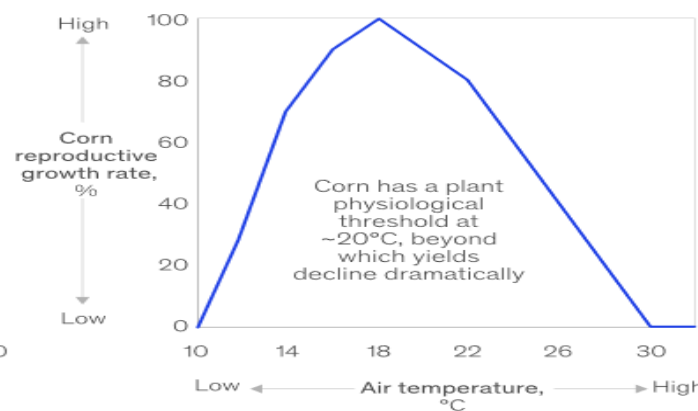
Floodwater impacts on a UK train station (example)



Effects of line overloading in an electrical grid<sup>4</sup>



Temperature impact on corn-crop yield



## Climate Risks & Economic Impact

- **Workability** : Will India get too hot to work?
- **Food systems** : Will the world's breadbaskets become less?
- **Physical assets**: Will mortgages and markets stay afloat in Florida?
- **Infrastructure services**: Will infrastructure bend or break under climate stress?

Source: McKinsey Climate Risk & Response 2020

# 03

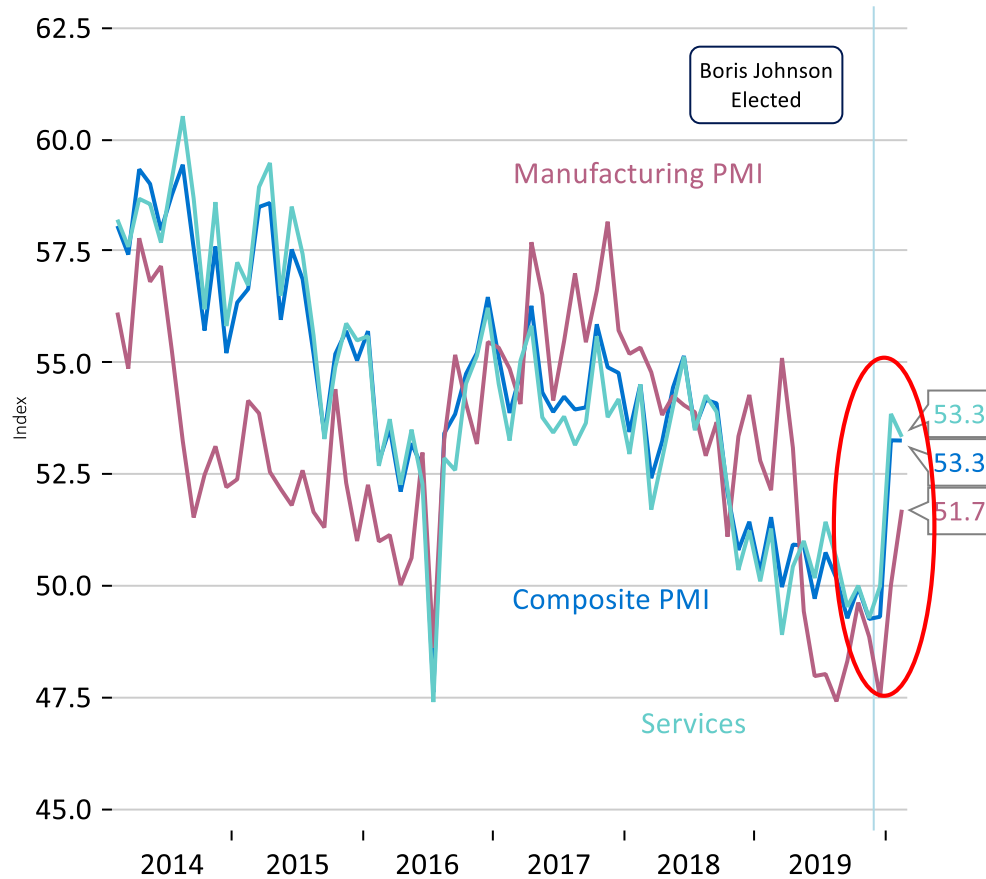
## UK and Brexit update



# UK - A strong rebound in sentiment post election with larger stimulus likely under Chancellor Rishi Sunak...



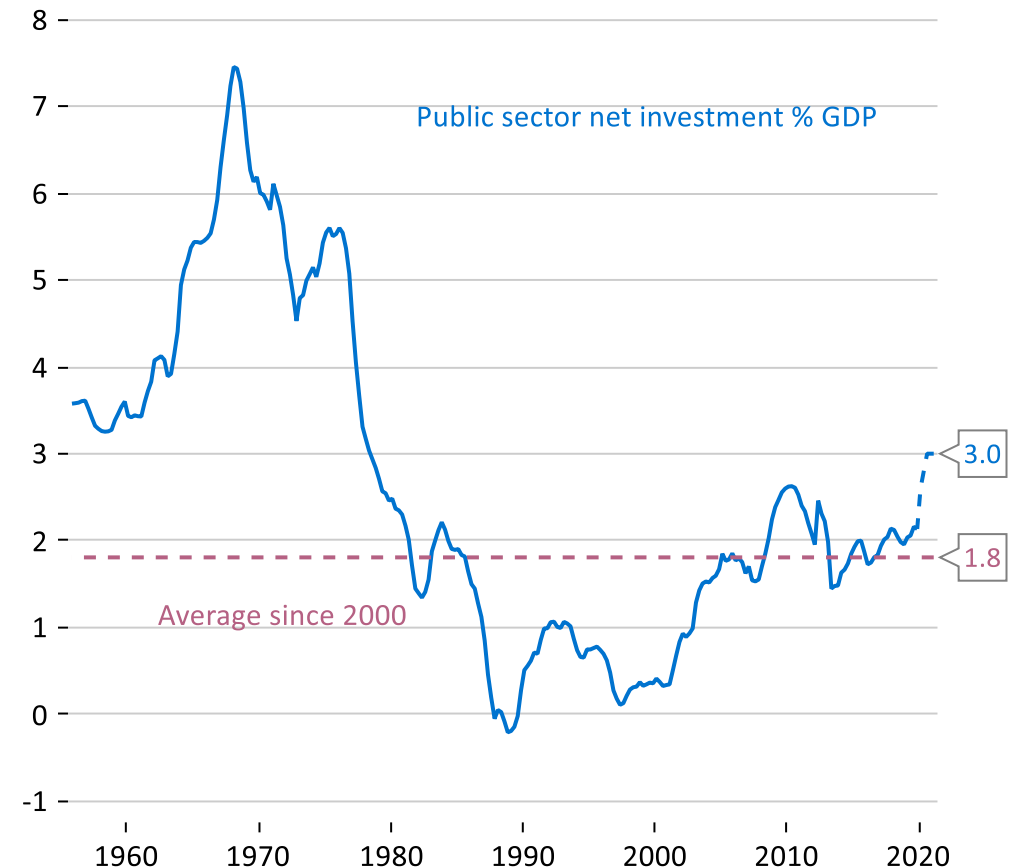
## UK Purchasing Manager surveys



Source: Macrobond



## UK Net investment - Current target 3%



Source: Macrobond



# EU27 and UK trade talks - *Fisheries, Finance & Freedom to Diverge...*



## EU Mandate for Michel Barnier

“The EU wishes to establish an ambitious, wide-ranging and balanced **economic partnership** with the UK. The mandate stresses that the future partnership should be underpinned by robust commitments to ensure a **level playing field** for open and fair competition, given the EU and the UK's geographic proximity and economic interdependence.

On **fisheries**, the mandate outlines that the future partnership should uphold the existing reciprocal access to waters as well as stable quota shares. The agreement on fisheries should be established by 1 July 2020”



Source: EU Commission 25 Feb 2020



## UK Opening Position

“It is a vision of a relationship based on friendly cooperation between **sovereign equals**, with both parties respecting one another's legal autonomy and right to manage their own resources as they see fit.

Whatever happens, the Government will not negotiate any arrangement in which the UK does not have control of its own laws and political life. That means that we will **not agree to any obligations for our laws to be aligned with the EU's**, or for the EU's institutions, including the **Court of Justice**, to have any jurisdiction in the UK...if it is not possible to negotiate a satisfactory outcome, then the trading relationship with the EU will rest on the 2019 Withdrawal Agreement and will look similar to Australia's”



Source: The Future relationship with the EU Feb 27 – UK Government

# Neutralising the risk budget

Risks to the downside increasing with Q1 Global GDP likely negative



## Global strategy update

|                     |   |
|---------------------|---|
| <b>Bonds</b>        | <b>Modest underweight</b> – global growth still fragile and inflation subdued <ul style="list-style-type: none"> <li>• Central banks remain supportive – UK gilt weightings moved to neutral</li> <li>• Corporate spreads tight with rising recession risk - underweight</li> <li>• Caution on High Yield as corporate leverage climbs and liquidity issues emerge</li> </ul>     |
| <b>Equities</b>     | <b>Neutral</b> – Global growth baseline has shifted lower – earnings risks rising <ul style="list-style-type: none"> <li>• Central bankers remain dovish and US presidential cycle supportive</li> <li>• Global dividend strategies attractive where supported by sustainable thematic trends</li> <li>• Portfolio protection strategies attractive if volatility ebbs</li> </ul> |
| <b>Alternatives</b> | <b>Neutral</b> – but note liquidity/rate risks in leveraged/opaque assets <ul style="list-style-type: none"> <li>• Clear preference for uncorrelated assets and gold</li> </ul>   |
| <b>Cash</b>         | <b>Modest Overweight</b> <ul style="list-style-type: none"> <li>• Despite trade uncertainty foreign investor flows back to the UK should support sterling</li> </ul>  |
| <b>Risks</b>        | <b>Current:</b> Virus impact - global linkages underestimated, inflated asset prices after QE/low rate era, excessive corporate leverage, UK/EU 2020 trade negotiations.<br><b>Longer-term:</b> China’s growth experiences long-term damage from Virus, Climate risks/Extended Producer Responsibility (EPR), Populism & US election  |

# Important information

---

**If you are a private investor, you should not act or rely on this document but should contact your professional adviser**

For your protection, telephone calls may be recorded. This document has been issued by Sarasin & Partners LLP which is a limited liability partnership registered in England and Wales with registered number OC329859 and is authorised and regulated by the UK Financial Conduct Authority and passported under MiFID to provide investment services in the Republic of Ireland.

It has been prepared solely for information purposes and is not a solicitation, or an offer to buy or sell any security. The information on which the document is based has been obtained from sources that we believe to be reliable, and in good faith, but we have not independently verified such information and no representation or warranty, express or implied, is made as to their accuracy. All expressions of opinion are subject to change without notice.

**Please note that the prices of shares and the income from them can fall as well as rise and you may not get back the amount originally invested.** This can be as a result of market movements and also of variations in the exchange rates between currencies. **Past performance is not a guide to future returns and may not be repeated.**

Neither Sarasin & Partners LLP nor any other member of Bank J. Safra Sarasin Ltd. accepts any liability or responsibility whatsoever for any consequential loss of any kind arising out of the use of this document or any part of its contents. The use of this document should not be regarded as a substitute for the exercise by the recipient of his or her own judgment. Sarasin & Partners LLP and/or any person connected with it may act upon or make use of the material referred to herein and/or any of the information upon which it is based, prior to publication of this document. Where printed by Sarasin & Partners, this document has been printed on FSC certified sustainably sourced or 100% recycled paper.

© 2020 Sarasin & Partners LLP – all rights reserved



# SARASIN &PARTNERS

Juxon House  
100 St Paul's Churchyard  
London  
EC4M 8BU

T: +44 (0) 20 7038 7000  
[www.sarasinandpartners.com](http://www.sarasinandpartners.com)

