INDOSUEZ WEALTH MANAGEMENT

GLOBAL OUTLOOK 2021

MARKETS, INVESTMENT & STRUCTURING

MARKETING MATERIAL

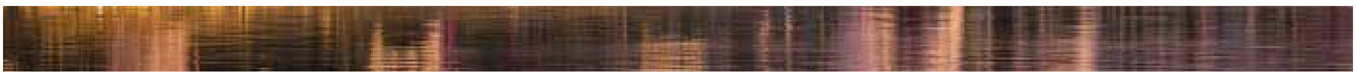
AMERICA IN A NEW DECADE

FOCUS

WILL THE UNITED STATES REMAIN A SUPERPOWER?

OUR HOUSE VIEW

US DOLLAR: SHINING GLORY OF THE PAST?



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EXECUTIVE SUMMARY

A NEW PRESIDENT, A NEW ERA, A NEW ECONOMIC MODEL?

A new president takes his place in the White House, with almost as many uncertainties as there are certainties, and in a completely new economic, health, budgetary and monetary context. But does a change of decade and a change of presidency mean a change of era and a change in economic model?

The change of tenant in the White House should mark a significant change in style. Less unpredictable, less aggressive, more respectful of customs, institutions and international bodies, Joe Biden could also be less impactful and clearly breaks with his predecessor. In itself, this change is likely to be reassuring at first glance, but even with the vaccine game-changer, we can still raise questions on the leadership capacity of the new president in the face of unprecedented economic, technological, geopolitical and environmental challenges.

CLIMATE CHANGE

On paper, it is obvious: the new administration intends to reconnect with the leadership displayed under Obama to engage the United States in energy transition and return to the framework of the Paris agreements. The “Build Back Better”[1] plan includes a significant environmental component, which contrasts with Donald Trump's infamous climate-scepticism. Nevertheless, these developments will go beyond the framework of government plans and come from changes in the behaviour of individuals, companies and investors. The new administration’s ambition is important and seems genuine but will ultimately require strong leadership when confronted with powerful lobbies. The criteria for success will not be the signing of a law or international agreement, but a clear sign CO_2 emissions are being curbed in a country where per capita energy consumption is amongst the highest in the world (behind only Gulf countries and Australia).

GEOPOLITICS

It is a common belief that Joe Biden will be more open to the rest of the world, inclined to remain in the playing field of international institutions and multilateralism, while acting in a more predictable and consensual manner, which matters in diplomatic relations. These aspects are important, and will likely reduce geopolitical risk, with less international tensions and a less confrontational style. The United States could regain its diplomatic efficiency through the revival of its soft power, thereby rekindling international empathy for the red, white and blue. Beyond style, what’s at stake is maintaining the United States as the world's superpower. On this front, doubts about Joe Biden's energy, vision and political courage have fuelled the headlines since the primaries, and Donald Trump has played on this weakness in the debates.

Beyond the political colour and style of the President, we can possibly expect both a stronger global presence than over the past four years and, at the same time, a continued diminishment of US influence in world affairs, to the benefit of regional powers such as Russia, Iran or China. It is probable that China will emerge as the leaders of this new era, reaping the benefits of their stark opposition to Obama's Pivot to Asia, which they had characterised as a wilful desire to contain their rise to power.

CAPITALISM

Capitalism and technology in the 21st century are intimately linked. They have been present in every industrial revolution, but the ongoing digital revolution appears to be creating a strategic dilemma in Washington. Digital has given birth to giants that disrupt entire sectors of the economy, generating exponential profitability and dominating positions that are difficult to reverse. Silicon Valley's line of defence rests in particular on the fact that Washington is reluctant to destabilise its digital champions so as not to risk a shift in technological leadership to China. This is the underlying challenge of the current investigation conducted by Congress into the non-competitive practices of the FAANG[2]. Finally, if the implementation of a radical approach to antitrust (dismantling of dominant positions or nationalization/regulation of natural monopolies) has little chance of seeing the light of day, it is safe to wager that these giants will learn how to adapt to more restrictive regulations and turn them into competitive advantages and heightened barriers-to-entry.

1 - Joe Biden’s Jobs and Economic Recovery Plan for Working Families.
2 - Facebook, Amazon, Apple, Netflix and Alphabet.

SOCIO-ECONOMIC ISSUES

Joe Biden's loaded programme denotes a desire to reverse a powerful trend of accelerating income and wealth inequalities, by introducing more progressive taxation and targeting higher income groups. First, however, we must debunk a Democratic myth: the working classes did not particularly benefit from the Obama years, which in part cost Hillary Clinton her victory; conversely, median real wages rose more during the Trump years. This should not be seen as a causality, but a coincidence linked to the fact that full employment in recent years had put an end to the stagnation of real wages. However, the state of wealth inequalities in the US, both under Democratic and Republican presidents, risks breaking what remains of a social pact based on the US promise of upward social mobility. The challenge of the envisaged reforms is as much to make the top 1% contribute more, as to involve the lowest rich 10% more effectively, thanks to higher salaries and better social coverage. However, the absence of a Democratic majority in the Senate greatly reduces the likelihood and potential scale of the tax reforms in Joe Biden's plan.

Beyond taxation, and after a period of heightened racial tensions, Biden intends to put forward more inclusive, targeted policies for minorities. This extends to the Federal Reserve (Fed) with the question of how best to integrate disparities in monetary policy. Beyond the moral justification and the expected effects of greater social stability, the impact on the labour-force participation rate, as well as the level of health and training on productivity justifies the implementation of such policies given their positive effects on growth and investment.

The risk however is that these initiatives will also be accompanied by an increase in the corporate tax rate, which could harm private investment, a risk that will be mitigated by a divided Congress. Our economic scenario also shows that the increased fiscal support will have positive short-term effect on growth, but will also result in a moderate rise in inflation, putting into question the sustainability of a zero-interest rate policy after 2022.

PUBLIC FINANCES

As highlighted by the Congress Budget Office, no matter who holds the office of president, the COVID-19 crisis and the resulting policy-mix will be a vector for an unprecedented rise in federal debt. The latter had a known track record of stability or moderate increase during periods of growth, and derailing during cyclical downturns. However, under Donald Trump we witnessed an exponential rise in debt (as with Ronald Reagan). Biden clearly begins his term in uncharted waters in terms of the debt / GDP ratio. The sustainability of this ratio implies the unwavering support of the Fed, which should continue to structurally monetize these debts thereby structurally weighing on the value of the dollar, yet another development which should be favorable to China.

We conclude on the means America has to meet its ambitions and more generally on the conditions of power, defined by Robert Kagan[3] as the ability to write history. Willingness is not enough for power, which also requires other tangible resources (economic, financial, military commercial power) and intangible characteristics (creativity, soft power, openness to the world, sense of responsibility). The new phase that is opening is an opportunity for the United States to reconnect with a more traditional conception of American power and rekindle its relationship with the world - halfway between idealism and realism. The danger, however, would be that the combination of a less marked leadership strategy, a stronger domestic focus and increased budgetary constraints together diminish the country's influence, from which economic benefits (the “dividends of peace”) are far from negligible.

VINCENT MANUEL
Chief Investment Officer,
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3 - Robert Kagan is an American political scientist.

Washington, United States

FOCUS

THE ECONOMIC AGENDA OF THE NEW ADMINISTRATION

A divided congress is going to make life undoubtedly more difficult for the Biden administration.

But while the Biden economic plan could have supplied a significant growth boost in the short term, it would also have caused more economic pain further down the road.

Is a political gridlock a risk to the US economic rebound and climate transition or is this limiting the risk of excessive public spending and too much inflation?

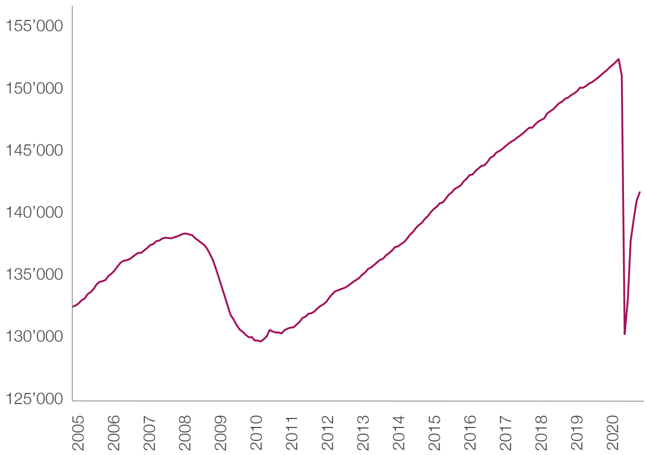
DIVIDED CONGRESS: GOOD NEWS OR BAD NEWS?

Newly elected President Joe Biden had focused his election campaign pledges on a massive 3 trillion US dollars fiscal spending package. The plan could have been a game-changer for growth, at least in the short term. However, today, with a Republican Senate to confront and American households in need of additional emergency COVID-19 aid, the timing, the size and the composition of the stimulus package will be different from his initial proposal, at least in 2021.

Regardless of the election outcome, the US economy still requires fiscal stimulus

The International Monetary Fund (IMF) recently revised US GDP forecasts for 2020 (from -8% to -4.3% in 2020) thanks to the impact government transfers had on supporting household incomes which led to a far shallower contraction in Q2 than initially feared. Retail sales have indeed recovered faster than production in the US: industrial production is below pre-crisis levels by 7% whereas retail sales are above by 4%. This can be explained in part by a redirection of expenditure from services to retail goods as the recovery in personal consumption as a whole remains below par (-3% year-on-year in Q3). The extraordinary precautionary savings buffers, while remaining exceptionally high, have decreased (the US savings ratio dropped from 34% in April to 14% in August), and unemployment remains almost double its pre-COVID-19 rate (at 7.9% compared to 3.7% in 2019) (Chart 1).

CHART 1: USA NON-FARM PAYROLL EMPLOYMENT, THOUSANDS OF PERSONS



Source: Bureau of Labor Statistics, Indosuez Wealth Management.

WHAT CAN BE EXPECTED FROM PRESIDENT BIDEN'S ECONOMIC PLAN?

Biden's "Build Back Better" plan was built around four main pillars:

- Clean energy and infrastructure;
- Education, health and caregiving;
- "Buy American" plan;
- Addressing the wealth gap.

Given that substantial fiscal stimulus seems unlikely to be voted on before year-end, fiscal priorities will be up for debate in early 2021. There will be an urgent need for additional emergency aid to combat COVID-19 in the form of another round of stimulus cheques, enhanced unemployment benefits and aid for state/local governments in January 2021.

In these more constrained circumstances, here is what we can expect will change in Biden's America.

More taxes, but later

The Biden plan is financed in part with tax increases on corporations (from 21% to 28%) and wealthy individuals by: taxing investor capital gains at normal income rates for those earning more than USD 1 million, raising the top marginal tax rate from 37% to 39.6% and lifting the cap on Social Security payroll taxes. The corporate tax hike is especially viewed as controversial for Republicans, therefore we can at the least expect to see a negotiation over the extent of the tax hike, but more likely an elimination of this proposal given the timing of such a hike in the current fragile economic recovery.

Conversely, the Biden administration has argued that affluent Americans and businesses can absorb the impact of a bigger tax burden without hurting economic growth. The current recovery has indeed been very uneven amongst income groups (see article Inequalities: a Threat for Growth and Social Stability page 9).

Going greener

Although the proposed 2 trillion Energy Revolution four year plan may indeed be delayed by the more pressing COVID-19 measures, the Biden administration is expected to attempt to re-enter the Paris Accord and enact policy towards green projects by using already existing funding. An infrastructure plan of approximately 1 trillion US dollars was already on the table under the Trump administration but was not specifically earmarked for green energy projects. Using the general consensus around an infrastructure new deal, the Biden administration should be able to focus funding on key policy agenda: cleaner vehicles, incentives for green energy, energy efficient buildings and improved transport infrastructure.

More regulation

The Biden-Harris administration is likely to move towards greater regulation on climate change, the financial sector and the technology sector. Biden was vice president during the Silicon Valley-friendly administration of President Barack Obama, but like President Donald Trump, shares a wariness towards Big Tech. According to Brookings Institution, Biden's plan would favour increased competition, antitrust enforcement, privacy and cybersecurity. The extent of his firmness, however, is to be moderated compared to a Trump scenario given: the close ties between Vice President Harris with major technology companies, the less confrontational approach of the Biden administration and the need to maintain a balanced approach so as not to encourage tech companies to delocalise and/or increase entry barriers for potential newcomers.

For banks, increased regulation is to be expected, but the sticking point will be on the introduction of a possible financial transaction tax. However, Biden would not be all bad for banks, as expansionary fiscal policies and possibly steepening interest rates, could see bank profitability flourish under Biden moving forward.

More American (plus allies)

The Biden campaign attempted to appeal to voters with measures intended to keep public spending centred on American products. A 400 billion US dollar procurement investment has been proposed over four years. This part of the Biden plan may be seen as overly abundant by fiscal (Republican) hawks, but the "Buy American" theme will remain prominent over Biden's mandate, notably with regard to Biden's position towards challenging China. Although Biden is expected to mend fences with allies, the possible relocation of US activities is a topic that is expected to continue under the Biden administration, but with delocalisation landing in the US and/or ally countries.

The overall impact on growth is expected to be mixed in the long-term

As the increases in government spending and transfer payments are much larger in dollar terms than the tax increases, the Biden fiscal package, if adopted to its full scale, would significantly boost GDP growth (Chart 2) in the short term. According to a detailed report from Moody's the Biden plan would increase the average growth rate between 2021 and 2024 compared to a no-change current policy scenario by +0.3 and 1 percentage points depending on the extent of the plan adopted in 2021.

In the long term however, multiple factors come into play. On the one hand, social measures to reduce inequalities and improve healthcare are factor positive for long-term productivity. However, the impact of public spending and increasing the minimum wage could nurture inflation resulting in faster funds rate lifts in the medium term. This in turn would erase part of the short-term growth benefits achieved by the plan. In addition, the theory of Ricardian Equivalence[4] projects that consumers will anticipate the long-term effects of these kinds of measures, limiting the effectiveness of fiscal policy on short-term consumption.

The market's positive attitude to a Biden win can at least in part be explained by their anticipation of a watered-down version of a more centrist Biden plan, where Republicans are expected to limit the extent of some socially-viable, but potentially structurally-imbalancing measures.

BÉNÉDICTE KUKLA
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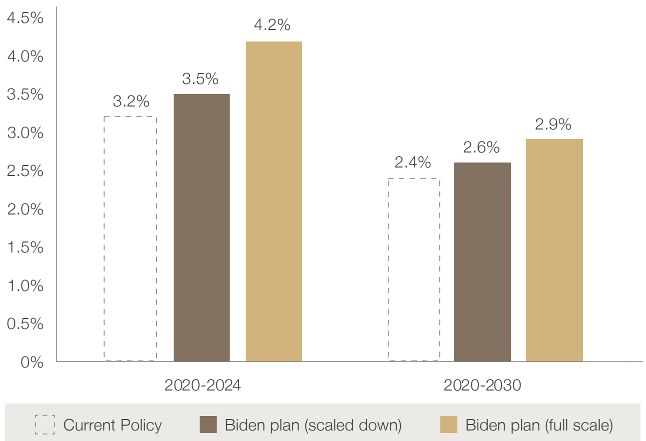
CHART 2: AVERAGE ANNUAL GDP GROWTH, %



Source: Moody's Analytics, Indosuez Wealth Management.

4 - According to this hypothesis, if the government finances extra spending through deficits today, taxpayers will anticipate that they will have to pay higher taxes in the future, which results in the short term to increased savings by taxpayers, rather than the government's desired effect of increased personal consumption.

INEQUALITIES: A THREAT FOR GROWTH AND SOCIAL STABILITY

The COVID-19 pandemic is not an “equal opportunity virus” as it disproportionately impacts the health and jobs of low-skilled workers.

High income inequalities, such as in the US, weigh on growth potential and should be an increasing concern for governments and corporates going ahead.

For decades, economists have been tackling the impact inequalities have on economic growth. Although they can have both negative and positive effects in theory, empirical evidence shows that inequalities above a certain level have an overall negative impact on long-term growth. COVID-19, like the pandemics that preceded it, will increase inequalities, in a context where inequalities, notably in the US, were already a major issue for social justice, but also for economic growth and consequently for investors.

INCOME INEQUALITIES HAVE A PROVEN, PREDOMINANTLY NEGATIVE IMPACT ON GROWTH

On a theoretical level, increases in income inequalities can have both positive and negative effects on economic growth. The dominating view in the 1950’s and 60’s was that greater inequality could actually benefit growth as prospects of higher income could act as an incentive for more effort, more risk-taking, higher labour input and more investment in one’s education. In addition, greater inequality could lead to higher growth through more investment as higher income groups tend to save and invest more. This can be linked to the trickle-down theory, made popular under the Reagan administration and supported by the Trump administration, whereby the US economy will flourish if the vaults of corporates and top earners are increased.

Nevertheless, there is an overwhelming amount of studies that warn of the negative effects of inequality on economic growth:

- On the supply side, a high level of income inequality can deteriorate an economy’s production potential, particularly in regard to human capital. Inequalities reduce professional opportunities available to the most deprived groups thereby decreasing social mobility and in turn limiting potential growth. Likewise, they also reduce investment in education and healthcare of the lowest segments. While the impact on education does not necessarily have a short-term impact on growth, it does have strong implications on human capital formation, thereby slowing long-term economic growth[5]. Finally, in a more indirect manner, inequalities can have a damaging effect on production prospects as they can also, to a certain extent, encourage populist policies and social tensions unsettling investors[6].
- On the demand side, the wealthy have a lower propensity to consume. Specifically, since their income is such that they can easily meet their needs, every dollar that goes their way is more likely to be saved than spent. Therefore, inequalities, by distributing national income away from those with higher propensity to consume, can weigh down GDP growth.
- Credit can be a means to compensate for inequalities and fuel consumption in lower income groups. However, the latter has also been proven to create imbalances, as a rise in inequality has been linked to the credit boom which led to the 2008 financial crisis in the US[7].
- All in all, although a certain degree of inequality can be helpful to enhance incentives to work, empirical study suggests that an increase in inequality weighs on growth.
- In 2015, the IMF found that if the share of the richest 20% of the population increases by 1 percentage point, GDP growth slows down by 0.08% over the next 5 years.
- A similar study from the OECD (Organisation for Economic Cooperation and Development) estimates that an increase in the Gini coefficient by 3 points, would have a negative impact on growth of 0.35% per year over 25 years (cumulating to 8.5% of GDP).

5 - Baur, Colombier & Daguet, 2015.
6 - Peterson & Schoof, 2015.
7 - Rajan, 2010 and Kumhof & Rancière, 2011.

THE STATE OF INEQUALITIES IN THE US TODAY

For nearly half a century, inequality has grown in the US virtually uninterrupted across Democratic and Republican administrations alike. The highest-earning 20% of families made more than half of all US income in 2019 (Chart 3). While the Gini coefficient has improved for the US (falling from 0.46 in 2000 to 0.43 in 2019) it remains around the worst levels seen worldwide.

The median household income (Chart 4) has however risen in the US from approximately 63 thousand US dollars in 2014 to 68 thousand in 2019.

Nevertheless, these recent improvements have been upended by the COVID-19 pandemic, which resulted in the steepest decline in employment on record (12.6 million Americans remained unemployed in the US in September 2020).

PANDEMICS RAISE DISPARITIES

A recent study observed the five major pandemics of this century - SARS (2003), H1N1 (2009), MERS (2012) Ebola (2014) and Zika (2016) – and concluded that on average the Gini measure of inequality increased persistently for five years after the event[8]. Such impacts occur due to job losses and other impediments on income. More striking is the disproportionate effects of the pandemics on lower income deciles: the employment of those with advanced degrees was scarcely affected, whereas the employment of those with basic levels of education fell drastically. This trend has been particularly salient during the current crisis in the US (Chart 5).

As the IMF put it, the COVID-19 pandemic is not an "equal opportunity virus" as it will worsen inequality in part through its disproportionate impact on low-skilled workers due to:

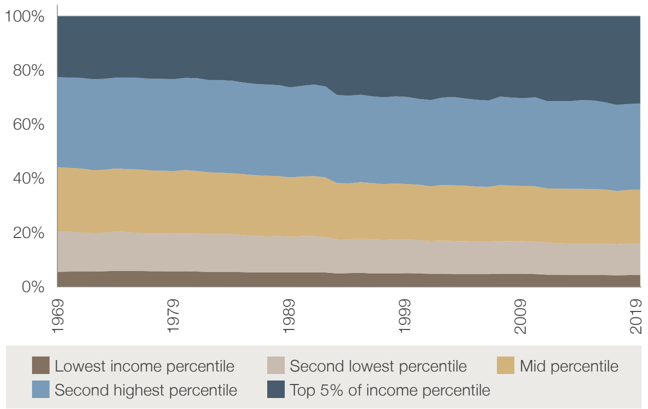
- The more limited ability of lower skilled workers to work from home than those in higher deciles;
- Lower paying occupations are more likely to have been disrupted by COVID-19 and generally suffer more during recessions;
- The adverse impacts on employment prospects for some groups of workers, particularly low-skilled workers in service sectors such as restaurants;
- Lower access to private healthcare and higher pre-existing health vulnerabilities.

These effects have been especially visible among minority groups in the US that are disproportionately employed in low-paying jobs.

Finally, as the unemployment rate surged in April and May 2020, financial markets experienced a V-shaped recovery over the same time period, that will accentuate the divergence in income and wealth effects between lower and higher income groups in 2020.

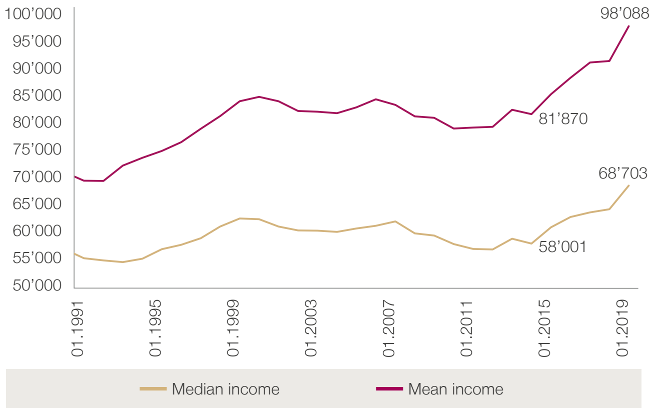
8 - Furceri, Loungani, Ostry & Pizzuto, 2020.

CHART 3: HOUSEHOLD INCOME DISTRIBUTION, %



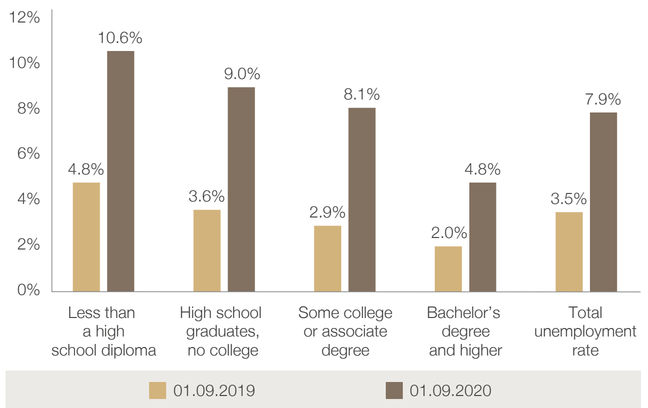
Source: US Census Bureau, Indosuez Wealth Management.

CHART 4: HOUSEHOLD MEDIAN INCOME 2019, USD



Source: US Census Bureau, Indosuez Wealth Management.

CHART 5: UNEMPLOYMENT RATE BY EDUCATIONAL ATTAINMENT, %



Source: US Bureau of Labour Statistics, Indosuez Wealth Management.

California, United States

WHAT IMPLICATIONS FOR POLICY STAKEHOLDERS AND INVESTORS?

COVID-19 crisis is now widely viewed as the greatest economic calamity since the great depression. In January IMF forecasts expected global income to grow by 3.3%; 10 months later they project a contraction of 4.7%.

The current situation justifies the magnitude of the fiscal programmes worldwide to reduce the harsh distributional consequences of COVID-19 on lower income groups by expanding social assistances systems and boosting public work programs to provide employment and avoid hysteresis.

Monetary policy also has its role to play as it can choose to focus more on employment rather than inflation. The Biden administration has also declared, in the context of its proposed economic programme, that the Fed concentrate on minority group income inequalities.

The impact of inequalities is not limited to social justice, but also extends to growth and therefore is relevant for investors. In countries with pre-existing inequalities, the long-term impact of COVID-19 on growth will be stronger.

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WILL THE UNITED STATES REMAIN A SUPERPOWER?

Will Joe Biden be able to keep the US at the centre of the global stage so as to ensure the world remains in line with America's interests? Has the US lost too much credit for this already?

Understandably, Americans prefer their government to focus on American issues, but the new President may have no other option than to realign with allies in order to limit China's influence.

In the past two to three decades, the United States has gone from dealing with existential questions on the loneliness of being the sole superpower[9] to a debate on the risk of its decline relative to China and the emergence of a "post-American world". This fear of losing its superpower status predates the Trump years and stems just as much from China's rise to power as from America's long-standing temptation to withdraw itself and self-isolate. The risk behind the reluctance to take on such a leading role is that it undermines America's power of dissuasion and creates a rift in the already increasingly disordered international order. The stakes are therefore high at the dawn of this new presidency.

A NEW DAWN FOR AMERICA?

In a country plagued by doubt after a series of military and diplomatic failures over the last decade, is the arrival of a new president and a new team at the White House likely to change the direction the United States will take in its relationship with the rest of the world?

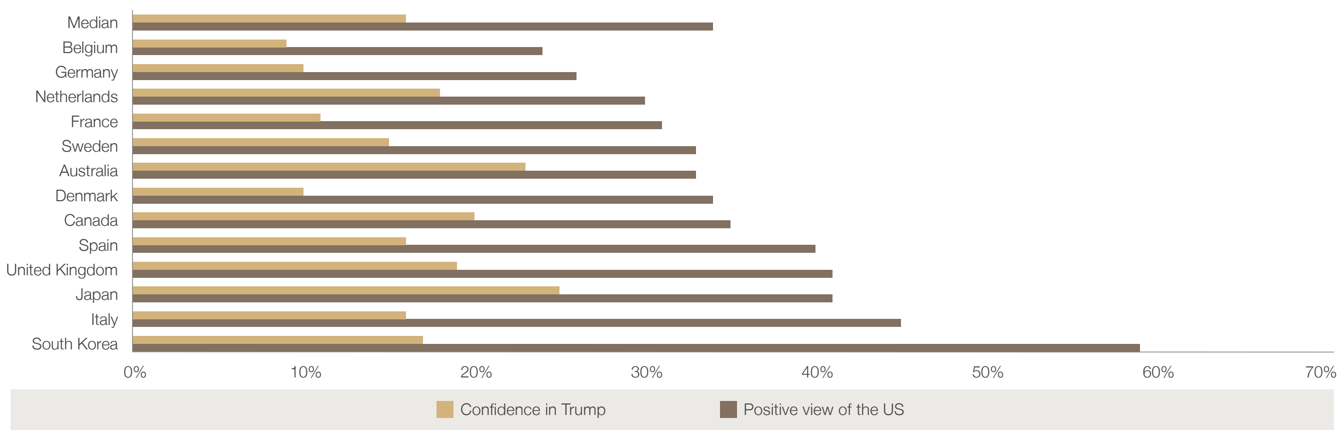
The Trump presidency represents a sharp breaking-point, calling into question the global role the United States should play and the way it interacts with other nations, as well as the extraterritorial attributes of US power, such as international institutions and the military umbrella offered to its allies.

The soft power[10] of the United States, which Barack Obama had regained after two difficult wars, has faded in the last 4 years. Admittedly, there has been a discernible loss of leadership over the years. Nevertheless, despite the way the United States is now perceived around the world, nothing is inevitable, and opinion surveys show that people are able to make a distinction between the country and its president (Chart 6).

The question is whether this trend is reversible, as the damage inflicted on international institutions is so enormous and the vacuum left for other powers has become huge. China has been able to take advantage of this opening since 2017 (the United States' withdrawal from the Trans-Pacific Partnership is one example). A change in style, or at the very least a return to a more conventional style, is expected in Washington, which should make it easier to accept the renewed role of the United States. However, beyond style and in order to reverse its loss of influence, the United States will likely have to decide, once again, to take on the role of superpower, by choosing clear strategic options, involving its partners and bearing the cost.

Being a superpower means, first and foremost, taking responsibility, having ambitions and showing resolve; this is where America seems to be most plagued by doubt, following a decade of costly conflicts with no political solution and

CHART 6: OPINION ON THE US AND THE US PRESIDENT, %



Source: PEW Research 2020 - Global attitudes Survey, CA Indosuez Wealth Management.

9 - Fareed Zakaria, is an Indian-American journalist, political scientist, and author.
10 - Joseph Samuel Nye Jr. is an American political scientist.


United States

an isolationist approach that sometimes gave way to chaos, as in Iraq. This trend towards isolationism and the normalisation of the United States' position was already a key aspect of Bill Clinton's message at the end of his second term: "we need to create the world we would like to live in when we are no longer the world's only superpower".

Today, the question of America's willingness and ambitions is likely to be where the greatest doubts now reside on Joe Biden's presidency. This uncertainty is driven by his style, which is less assertive than that of his predecessors, and by his focus on domestic policy. Much will also depend on the team he selects, as well as on the circumstances.

What happened to previous presidents could happen again: in an emergency, the United States has no other responsible choice, but to intervene, or at the very least to protect its interests. This is notably the message that one of Washington's most influential think-tanks, the Brookings Institution, conveyed to the new president. Conversely, if Joe Biden's United States were to appear to be a "weak and reluctant protector of the international order"[11], China and Russia would continue to increase their regional influence. It is therefore likely that America will be forced to take a renewed interest in the Middle East question and to reopen talks with Iran.

THE CRITERIA BEHIND POWER

Beyond its resolve, the other issue is whether the United States still has the means to achieve its global ambitions. To be a successful a superpower, a state needs to have resources, in particular:

- Military power, which allows it to act and have a global presence, as well as to ensure the credibility of its deterrence;
- Technological leadership, a key attribute of power at the centre of the rivalry with China;
- A strong currency, which guarantees sovereignty and prosperity as well as influence;
- Institutions and rules on which to establish power and ensure it endures beyond the balance of power that initially made it possible (the 1945 institutions, in short);
- Allies that it retains in the long term and that stand together against their rivals.

First, the question of military deterrence arises not only in terms of costs but also in terms of gains (the famous "peace dividends"): the creation of additional wealth, investment, trade and innovation that is possible during long periods of prosperity. From this standpoint, dedicating 3% to 4% of US GDP to maintaining a Pax Americana is likely a good investment, compared with the destruction of human and industrial capital seen during the two world wars. The United States still represents 38% of global military spending (nearly three times the Chinese military budget), while the increase in 2019 was equal to the entire military budget of Germany.

Second, the race for technological leadership is strategic and will remain one of Washington's priorities: it is what will ultimately both guarantee geostrategic supremacy and protect the sovereignty of states and their data. This issue is at the centre of the rivalry with China and this fight will not end when Donald Trump leaves office. This is where the face-off is the most intense and where the term "containment"[12], coined by George Kennan during the Cold War, seems to describe best how the United States has perceived its future relationship with China for a decade (although Barack Obama rejected this term when he launched his "pivot to Asia" initiative in 2011).

11 - Robert Kagan is an American political scientist.
12 - "China containment policy" is a political term referring to the alleged objective of US foreign policy to diminish the economic and political growth of China.

Third, the future of the dollar is key to US leadership. Often viewed as a purely economic issue, the currency issue is far from insignificant from a geopolitical standpoint. The dollar's key role makes it the leading reserve and trade currency. This allows the United States to finance its deficits and also dominate institutions such as the IMF and impose an extraterritorial concept of the law. It is therefore as much an issue of prosperity as of power. The day this equation is disrupted (see article US Dollar: Shining Glory of the Past?), the paradigm of US power will be turned upside down, making it easier for China to claim this role.

Fourth, the United States should rely more on international institutions. These will likely be held in higher regard, but to the extent that they serve the interests of the United States and protect an international order that recognises its prominent role. In the face of dispersed threats, not limited to the questions of China and terrorism, the "reluctant sheriff"[13] framework – whereby the US is forced to form flexible alliances based on geographies - will remain strong.

A NEW PACT WITH US ALLIES

Finally, the strength of the United States compared with China is that it has a powerful network of allies. In short, what matters is not the power of a nation itself, but the combined power of a bloc. "Power is not absolute; it is a human relationship"[14]. Keeping the United States in its position as maestro of this global order, shaped at the end of the Cold War, requires that it build strong partnerships, even if it does not believe in multilateralism, a concept to which the United States has never fully subscribed. Beyond reviving the purpose of the NATO project and sharing the burden, this strategy of rebuilding alliances should enable it to slow and channel the expansion of Chinese power and Russia's attempts at destabilisation.

As India becomes a more significant power and the United States' reliance on it grows, the chance of counteracting China's domination of Asia also increases. Ultimately, what will matter most to Americans will not be power in and of itself, but the guarantees of sovereignty, stability and prosperity that it provides.

To conclude, the United States likely has no option but to try to remain a superpower as long as possible. This is especially the case if it wants to avoid being subject to a different international order that would cease to ensure that its interests are protected, and its values continue to prevail. Every presidential campaign presents an opportunity to promise American voters a focus on domestic issues, but every president has had to deal with an unpredictable and unstable international reality which he has had to adapt to and attempt to manage.

The United States is likely fortunate that it still remains the leader by process of elimination, that powerful and influential countries are still ready to accept and assist it, and that certain Asian countries may continue to prefer it to China. On the whole, the United States therefore still has the means of its power; now everything rests on its resolve and the choices it makes.

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13 - Richard Haass (1997); metaphor meaning that the United States is mandated by the United Nations (like a sheriff is mandated by a judge) to restore peace by recruiting a detachment to help it.
14 - Raymond Aron, Peace and War: A Theory of International Relations, 1962.

DECARBONISING THE US, A MAJOR CHALLENGE FOR THE NEXT DECADE

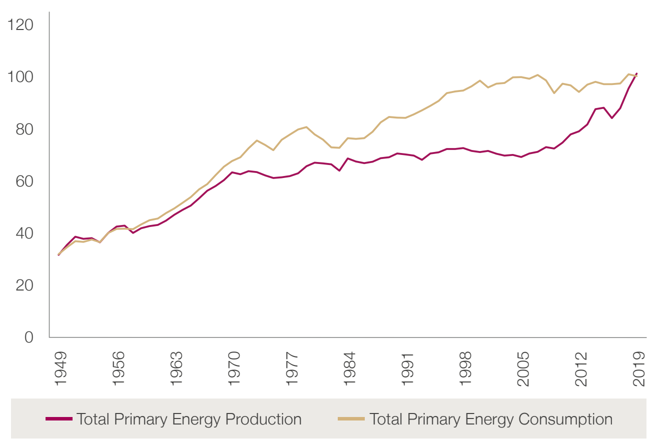
With or without the "greener" US Presidential candidate, the transition towards cleaner energy was considered indispensable in the next decade.

The US government is going to need to step up in order to complete the job a number of States, citizens and private companies have already endeavoured.

While the COVID-19 crisis undisputedly caused excess mortality and economic desolation in 2020, it brought some hopes in the possibility of a sustained transition to cleaner energy. First, on a temporary basis, CO_2 emissions have dramatically decreased in 2020 as people across the globe were locked down, planes were stuck on the tarmac and traffic jams disappeared from highways. The International Energy Agency (IEA) estimated in its 2020 World Energy Outlook that energy-related CO_2 emission decreased by 7% in 2020, or 2.4 gigatonnes (GT) in absolute terms, taking annual CO_2 emission back to where they were a decade ago. Nevertheless, we all know that this is a temporary phenomenon as the economic recovery will bring back greenhouse gas emissions to where they stood pre-COVID-19 crisis.

While climate change is a global issue, China and the United States are the largest CO_2 emitters in absolute terms while the United States (Chart 7) and Canada top the list of CO_2 emissions per capita among mature countries, behind Middle Eastern energy producers. Even before the announcement of the newly elected and "greener" President Joe Biden, the transition towards cleaner energy was already considered necessary in the next decade. Thanks to the development of shale oil, the US managed to once again become a net energy exporter in 2019, after more than 70 years as a net importer.

CHART 7: TOTAL PRIMARY ENERGY CONSUMPTION AND PRODUCTION IN THE US, QUADRILLION BTU*



* BTU: British Thermal Unit.
Source: US Energy Information Administration, Indosuez Wealth Management.

However, despite ongoing efforts to rely on nuclear electric power as well as renewable energy, US energy production is still 80% based on fossil fuels while the production of renewable energy has remained very stable in percentage of total production over the past 70 years (Chart 8).

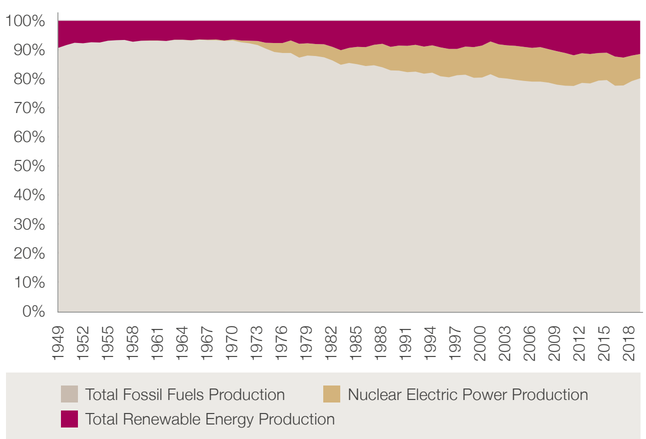
THE NEED FOR AN AMBITIOUS RENEWABLE ENERGY PLAN

The steady share of American renewable energy is due to the fact that it stems from hydroelectricity and thus comes from the large dams built in the US pre-World War II such as the Hoover Dam in 1935 or the Theodore Roosevelt Dam back in 1911. Given the limited capacity to build new dams, the US will need to run an ambitious renewable energy plan in order to reduce CO_2 emissions.

The IEA (International Energy Agency) ran a number of scenarios to assess what is required to reach zero emissions by 2050:

- Stated Policies Scenario, reflecting the current policies announced by various countries;
- Sustainable Development Scenario (SDS) including a surge in clean energy policies and investment to put the energy system on track to achieve sustainable energy objectives in full;
- Net Zero Emissions by 2050.

CHART 8: US ENERGY PRODUCTION BY TYPE, %



Source: US Energy Information Administration, Indosuez Wealth Management.

As shown in Chart 9, the already announced policies by countries across the globe lack the credibility needed to reach net zero emissions. Even if countries go beyond that and meet for example Paris Agreement targets, this will not be sufficient to avoid net positive emission by 2050. Dramatic actions will therefore be required from citizens, governments and private companies.

To achieve these scenarios, global energy demand will have to decrease and the energy mix will need to change drastically. As shown in Chart 10 renewable energies have a strong role to play in order to replace coal in particular. The US still uses coal to produce a quarter of their electricity, accounting for 90% of US coal production. The expansion of solar, wind and soon hydrogen as clean energy alternatives will be key to the energy transition and the reduction in coal demand in the US and elsewhere.

IF THE US GOVERNMENT DOES NOT ACT, OTHERS WILL

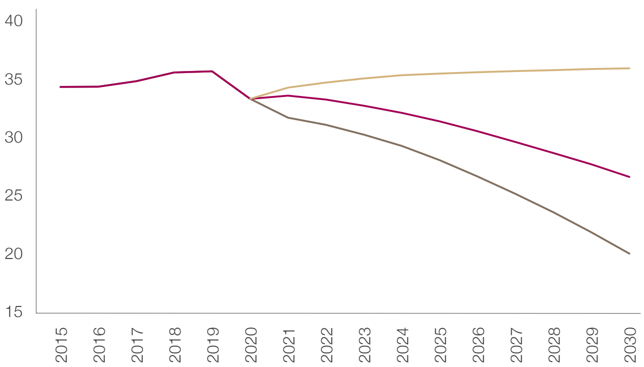
In 2016, the US, under the Obama administration, agreed with the Paris Agreement that sealed the COP21 that occurred a year before with a strong objective to minimize climate change and avoid temperature to rise by more than 2 degrees Celsius in 2050 compared to pre-industrial levels. While the Paris agreement is non-binding and does not introduce any enforcement measure, Donald Trump decided in 2017 to exit the agreement. However, with or without federal support, the US as a whole has started to tackle climate change.

States themselves have the power to issue laws and can be part of the solution. California, for example, gets more than 30% of its electricity from renewable energy, mainly from solar and wind. Under its 2018 climate law, it plans to increase this share to 60% by 2030 and to become "zero-carbon" by 2045.

FROM INDUSTRIAL GIANTS TO TECH GIANTS AND BACK?

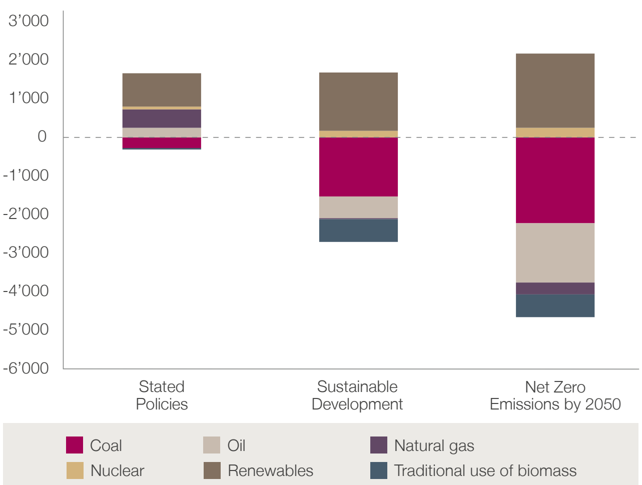
Private companies are admittedly very active too. Electric vehicles (EV) are a necessity to reduce the importance of oil consumption and Tesla, the US EV manufacturer has taken a major lead in that sector to the extent that it has been crowned the world's largest car manufacturer by market capitalisation since 2020. Decarbonisation, however, will not happen if electricity itself is produced by coal-powered electricity plants. Solar and wind are two alternative renewable energy, and could soon be supplemented by green hydrogen, a promising energy source as its only by-product is water when used to produce electricity. While hydrogen is mostly produced itself by reforming natural gas or the gasification of coal, there is high hope for the development of renewable green hydrogen coming from the electrolysis of water powered by clean energy such as wind turbine or solar panel. Again, American companies are leading the way in developing clean energy: for example, Air Products and Chemicals is building a 5 billion dollar facility in Saudi Arabia to produce green hydrogen.

CHART 9: CO_2 EMISSIONS UNDER VARIOUS SCENARIOS, GIGATONNES



Source: IEA (Energy and industrial process CO_2 emissions and reduction levers in WEO 2020 scenarios, 2015-2030), Indosuez Wealth Management.

CHART 10: CHANGE IN GLOBAL PRIMARY ENERGY DEMAND BY FUEL AND SCENARIO, 2030 RELATIVE TO 2019, MTOE*



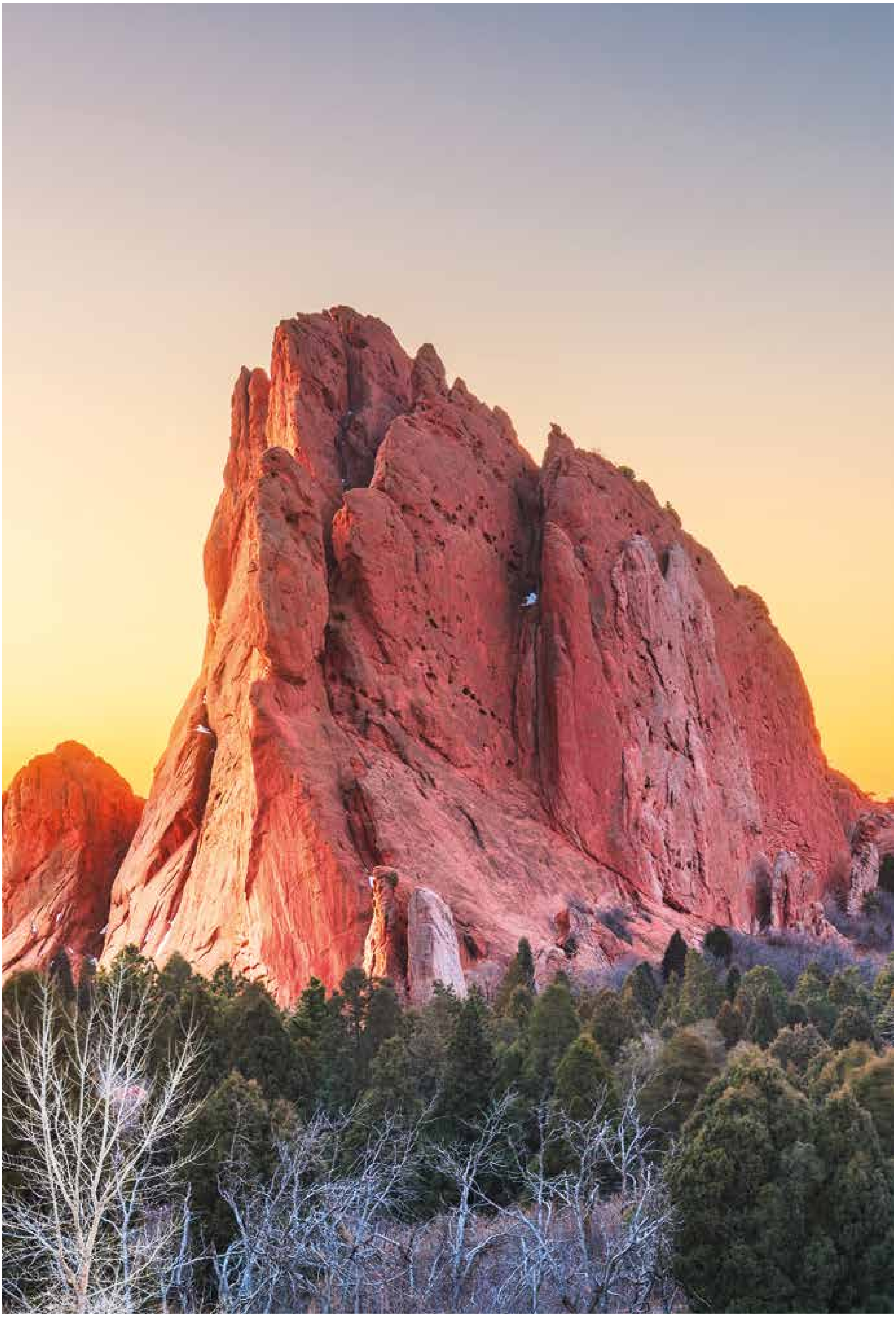
* Mtoe: Mega tonnes of oil equivalent.
Source: IEA, Indosuez Wealth Management.

Nevada, United States

Not long ago, the Dow Jones index was constituted of industrial conglomerates such as General Electric or Alcoa, but tech companies such as Apple, Microsoft and Salesforces have slowly replaced these cyclical firms. However, the green revolution may revive the industrial sector and a new champion may emerge in chemicals (hydrogen production), capital goods (fuel cells, solar panel), Industrial Goods and Services (train and plane powered by hydrogen) and Utilities (clean electricity production and distribution).

As one of the main CO_2 emitters, the US faces a steep challenge ahead to reduce their carbon footprint and help the world achieve zero emissions. While a number of states, citizens and private companies have already acted taken up the challenge, the support of the federal government will be critical in the next decade. Needless to say, the energy transition also represents a huge economic opportunity and the US will certainly not let China or the European Union become the sole clean energy world leaders.

NICOLAS MOUGEOT
Head of Global Trends and ESG Advisory,
Indosuez Wealth Management



Colorado, United States

MACRO-ECONOMIC OUTLOOK

AN UNPRECEDENTED SHOCK, MASSIVE RESPONSES AND UNANSWERED QUESTIONS

SCENARIO FOR 2020-2021

Despite a better-than-expected initial bounce in the US, GDP should remain below its pre-crisis level until early 2022.

Faced with the exceptional scope of the COVID-19 crisis, European government and federal bodies seem to have drawn the right lessons from the great financial crisis.

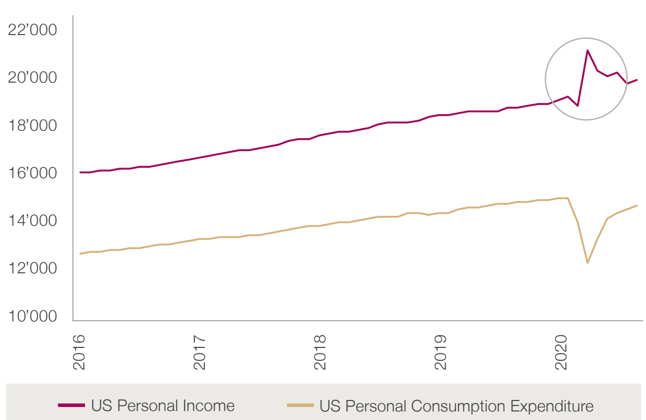
The cyclical picture for emerging market growth in 2020 is uneven, with China still the only real driver.

Just like the recession, the rebound is now widespread. Just like the recession, it is strong but uneven. It is largely mechanical and showing signs of weakening, stoking fears about its resilience once the support is dialled back. These fears are vague, but two things are crystal-clear: long-lasting low interest rates, and unequal, asynchronous global growth.

UNITED STATES: PACE OF RECOVERY TO SLOW AFTER STRONG BOUNCE IN Q3 2020

The US economy has begun to recover after a severe shock from the COVID-19 pandemic led to a historic contraction, though despite a better-than-expected initial bounce that has led us to revise our outlook slightly higher, the overall process will be a slow and gradual one, with GDP remaining below its pre-crisis level until early 2022.

CHART 11: US INCOME HAS BEEN SUPPORTED BY STIMULUS MEASURES, USD BILLIONS



Source: US Bureau of Economic Analysis, Bloomberg, CA CIB, Indosuez Wealth Management.

The worst of the crisis is behind us as Q2 contracted at a historically large 31.7%[15] rate. We expect a relatively gradual recovery as a number of businesses and consumers are likely to remain cautious and hesitant to fully return to prior spending patterns. We expect spending to slow notably from the Q3 pace. The enhanced unemployment benefits from the CARES Act[16] have expired and have only been temporarily and partially replaced by an executive order from President Donald Trump, with delayed progress on an additional fiscal stimulus bill. This should weigh on incomes going forward (Chart 11).

While we look for GDP to grow around 3.7% in 2021, this would leave the level of GDP below pre-crisis levels until 2022 in a swoosh-shaped recovery.

The policy response has been aggressive and has helped to support the recovery so far, though its impact looks to be waning. The Fed has slashed rates to the zero-low-bound (ZLB), announced open-ended asset purchases, and created a number of lending facilities to support a variety of markets. It has become clear that it will maintain an accommodative stance with rates at the ZLB for an extended period of time. We expect it will eventually shift Treasury purchases to focus on the long end of the curve, though this may not come until the end of this year or early 2021. Yield curve control remains a possibility, though it has lost traction recently and the Fed will likely only go this route if the outlook deteriorates. In terms of fiscal policy, Congress has passed four relief bills that total almost USD 3 trillion, a historic amount of fiscal stimulus that the CBO[17] estimates will cause the deficit to balloon to 16.0% of GDP in 2020.

15 - All quarter-to-quarter changes are expressed on an annualised basis as is traditional in the United States.
16 - The Coronavirus Aid, Relief, and Economic Security. The CARES Act provides fast and direct economic assistance for American workers and families, small businesses, and preserves jobs for American industries.
17 - Congressional Budget Office.

EURO AREA: ANATOMY OF AN IMPERFECT "V"

During the summer, the economy moved in two directions: one very positive, the other less so. Economic data confirm that the end of the second quarter did feature a very strong rebound in activity and confidence. On the other hand, the second wave of the epidemic dispelled any scenario of the virus quickly abating.

On the economic policy front, some reassuring certainties are emerging. With the European Recovery Plan, the zone's most indebted countries can count on large, highly concessional transfers and loans guaranteeing positive fiscal stimulus beyond the forecast horizon. With the Fed's change in strategy, any premature reversal of the monetary policy stance in advanced economies is off the table.

Yet underneath the authorities' "Band-Aids", the wounds from the crisis are becoming visible. With profits eroding and activity still quite reduced in certain sectors, we will inevitably see more and more companies go bankrupt, with higher unemployment as temporary support measures (tax relief and deferrals and short-time work) are removed.

Together, these factors back up our scenario of an incomplete recovery: end-2021 GDP will be 1% lower than its pre-crisis level. The pace of growth in 2021 (+5.4% after -7.5% in 2020) will be slower than required to close the negative output gap that has developed during the crisis (Chart 12).

The confidence scenario is critical: the use of the considerable surplus savings built up during the lockdown depends on it. There is a high risk that the spike in the unemployment rate will transform it into precautionary savings, limiting the potential increase in private consumption. As to the investment cycle resuming, a question mark persists. Capacity utilisation rates are still very low, and it is hard to imagine any expansion in capacity, given the stubborn uncertainties over demand and the expected pace of growth.

Although replacement investments are possible to support the required transformation of several activities, it is public investment that is expected to make the biggest contribution to a turnaround in capital accumulation, supported, in the Euro Area periphery, by the European Recovery Fund.

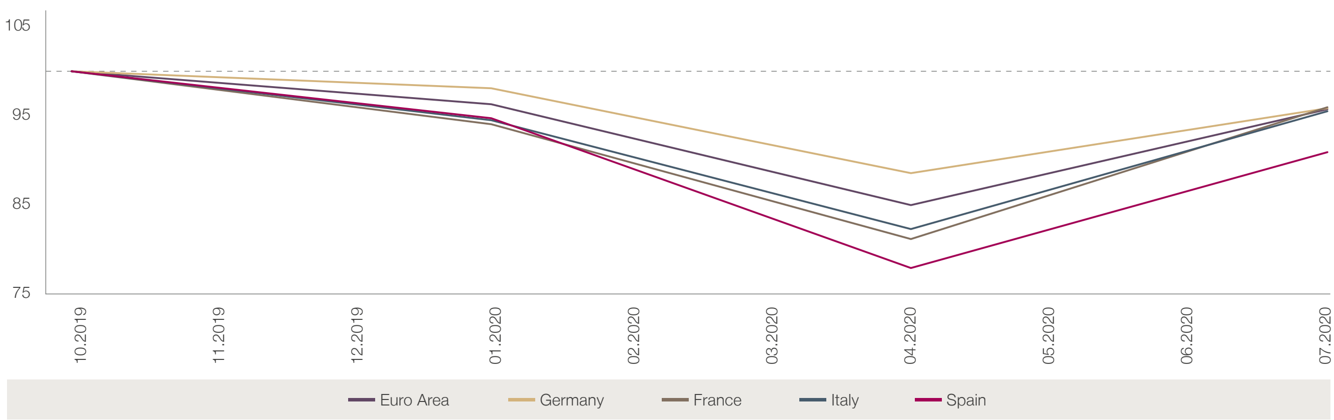
An innovative response to limit fragmentation

Faced with the exceptional scope of the COVID-19 crisis, European national, community and monetary policy authorities seem to have drawn the right lessons from the great financial crisis.

The risk of a premature withdrawal of fiscal and monetary support seems to have been dispelled over the forecast horizon, even though the negative output gap is far from closed. By easing the regulatory and supervisory framework, the unusual nature of the crisis can be managed while rejecting any consideration of moral hazard – unwarranted as it is in these circumstances. And because this is not an excessive debt-induced crisis, the disinflationary mechanisms of debt reduction should also not be encouraged, as they were in the past decade. Also, the banking sector is playing the role of shock absorber, by preventing liquidity crises from turning into solvency crises. From our viewpoint, transitioning from the principle of efficiency to the principle of resilience is a key argument for a forecast that may appear, but is not, optimistic, and for asserting that the course of the 2009 and 2012 crises is not the only possible route.

In spite of efforts to engineer a more autonomous and uniform recovery, a high risk of fragmentation persists. At the end of 2021, Germany is projected to achieve a higher GDP (+1.1%) than at end 2019; meanwhile, GDP could still be 1.4% lower in France, 3.1% lower in Italy, and 7.9% lower in Spain.

CHART 12: EURO AREA, AN INCOMPLETE AND HETEROGENEOUS RECOVERY, Q4 2019=100



Source: Eurostat, Crédit Agricole S.A., Indosuez Wealth Management.

Gravitational pull on Bund yields

Since the peak of market sensitivity to the pandemic in March/April, the 10 year German Bund yield has attempted to rise, but each time it has tended to be pulled back down to around -50 basis points – the level of the European Central Bank's (ECB) deposit policy rate. In light of the risk for an extended period of uncertainty for the coming months, we have adjusted our 10Y Bund forecasts by 10 basis points and now foresee a modest move to -40 basis points by year-end and then to -30 basis points by end-2021. This projection is based on the virus being brought under control in the months ahead, thus resulting in greater economic clarity and a sustained, albeit gradual recovery next year (Chart 13).

Learning to live with COVID-19: what this signifies for our Euro Area scenario

Although signs of a further spread of the pandemic were already visible at the time of the construction of our macroeconomic scenario in September, we made the assumption, then plausible and consensual, of a contained spread of the virus, controlled by social distancing behaviours, rapid tracking of positive cases thanks to the expansion of testing capacity and by possible localised lockdowns. In the meantime, the second wave has turned out to be more brutal than anticipated and economic slowdown has been inevitable. A stronger growth gain spawned by a more dynamic third quarter than expected will nevertheless make it possible not to stray too far from our September forecast for 2020 (-7.5%), even with a substantial drop in GDP in the fourth quarter.

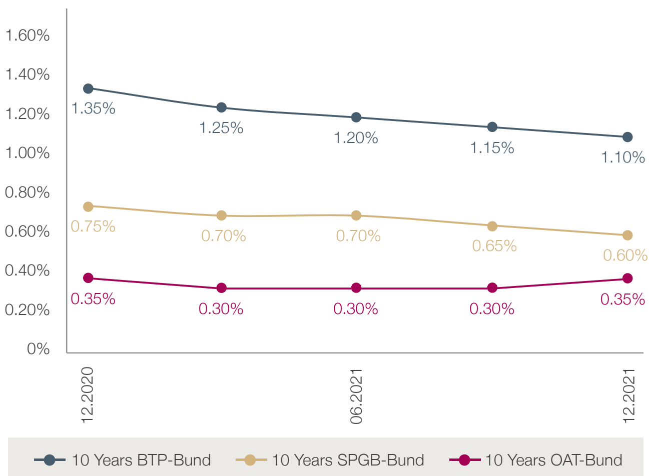
Due to more limited containment measures, we anticipate a less severe decline in activity than that observed during the first half of the year. But if containment measures are tightened or extended, the risks to our outlook for the fourth quarter are clearly on the downside.

The larger impact will nonetheless be seen on growth in 2021 (projected at +5.4% as of end of September). While better treatments, improved testing, and vaccine availability could promote normalisation of economic activity, they are unlikely to eradicate the virus quickly ot to decrease the need for social distancing and mobility restrictions in the first semester of 2021.

EMERGING COUNTRIES: TIME FOR SOME SORTING?

In the last quarter, nine months after the onset of the virus, activity began to recover in emerging countries, but the recovery was just as uneven as the decline during the height of the pandemic. The health situation in India, Brazil, Colombia, Iran and Iraq remains highly uncertain. Conversely, others such as China and Vietnam seem to have got a handle on the trajectory of the pandemic. Still, in many countries, strict control measures are being taken, verging on a return to lockdown in some cities. Against this backdrop, reopening borders is not guaranteed, nor is it in the works, which is complicating short-term trade flows and medium-term business strategy.

CHART 13: 10 Y EGB* SPREAD FORECASTS, %



* European Government Bonds.
Source: CA CIB, Indosuez Wealth Management.

The appeal of self-sufficiency

For now, in this environment, the economic advantage will be with the large countries capable of some form of self-sufficiency, and those with more diversified economies. For instance, the recession is more limited in Poland than in the Czech Republic, which is highly dependent on the German automotive cycle. As for China, the president is officially theorising the idea of a more self-sufficient model founded on a "dual circulation[18]" strategy, which doubles as a response to the intensifying battle for supremacy with the United States. Lastly, in Russia, the border closure is stimulating spending on domestic tourism, which was a very weak item in the balance of payments. As such, this could be one argument that delays reopening of the borders (Chart 14)...

Furthermore, this restricted recovery is influencing consumers, savers and investors, but not in the same way in each country, as traditional regional features are influencing behaviour. Asia saves more than Latin America (32% of GDP compared to 18%), and Russia tends to spend during a crisis, with short-termist consumers fearful of currency depreciation. For Turkey, consumption commonly rebounds after each crisis, driven by a (too) strong pick-up in lending. This rebound deepens external deficits, a source of currency risk.

The result is an uneven retail sales curve in emerging countries, which may be surprising, since that means it is unrelated to the pandemic: a quick turnaround in Turkey and Brazil, but a supply lag in China. Indeed, the trend in this supply/demand lag will be very important in the coming months because it creates different risks depending on the country, in both the short and long term. There is an inflationary risk in Turkey, even in India, but deflationary threats in the more savings-oriented Asian economies. There are also risks of investment shortfalls in the consumer-oriented economies, particularly Russia and Brazil, along with weaker growth potential.

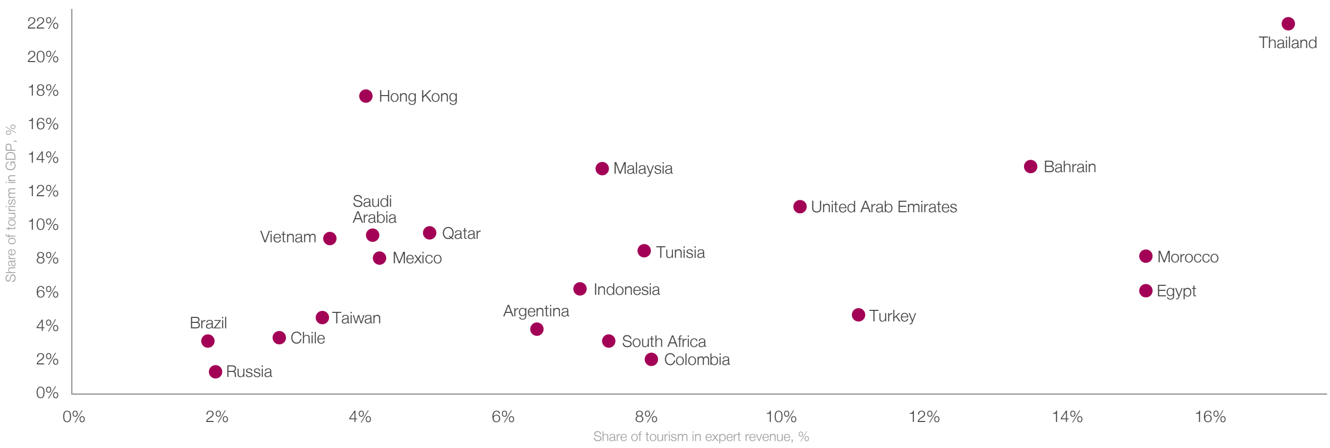
Withstanding the crisis by reinventing development models

Ultimately, the cyclical picture for 2020 is uneven, with China having been the only real driver. As for 2021 forecasts, growth will bounce lower than its long-term trend for most countries. Above all, the gap will widen between those that have the means to withstand a restricted global environment and those that do not; for them, the irreversible damage of the crisis will quickly become apparent.

This divergence is already visible in the unusual deviation from growth forecasts in 2020, with countries facing deep recession, such as India and especially Mexico, and the rare few that are still experiencing positive growth, like China, of course, but also Taiwan and Vietnam, or in a very slight recession, like Korea.

For investors, then, everything points to a country sorting approach. But what are the criteria? The most obvious – wealth – is also the most quantifiable, and includes private, government, and business wealth. But other factors will come into play soon enough, when the cards have been thoroughly reshuffled. These include crisis strategy management and the governments' skill during the exit phase from extraordinary measures; the quality of institutions, and political and social cohesion, which determines how much leeway countries have; and innovation factors specific to each country. The COVID-19 crisis is peculiar, in that it sets governments up against cyclical emergencies and structural imperatives all at once.

CHART 14: EMERGING MARKETS, SHARE OF TOURISM IN GDP AND EXPORTS, %



Source: IMF, Crédit Agricole S.A., Indosuez Wealth Management.

18 - A Chinese economic policy aimed at keeping China open to the world (the "great international circulation") while also reinforcing its own market (the "great domestic circulation").

Shenzhen, China

China: growth, but at what cost?

China will have been the only G20 country to experience positive growth in 2020. With the health crisis behind it, the Chinese authorities' strategy has been crystal-clear: restart the industrial machine by filling companies' order books, thanks to public demand, and ensuring their cash flow by stimulating bank lending. Without the drastic proclamations of 2008 and taking care to maintain fiscal and especially monetary leeway – the People's Bank of China (PBoC) had repeated several times that it would do everything to avoid the pitfall of too-low interest rates and the liquidity trap – China has focused on solutions that worked in the earlier crises.

This approach has paid off in the industrial sector, where production saw a V shaped recovery. All the lights are green on the supply side, which points to an even more optimistic growth forecast. However, on the demand side, the situation is hardly comparable, despite Xi Jinping's speeches presenting his new dual circulation plan that aims to reduce China's dependence on the outside world, particularly on certain strategic products (food and electronics) that could be affected by restrictions due to geopolitical tensions, and increase domestic demand. After seven months of contraction, retail sales registered positive growth in August but showed a slower recovery trend than in the US.

Shanghai, China

Highly robust investment and more-resilient-than-expected foreign trade should offset the low contribution of consumption and allow us to maintain our growth forecast at 3% in 2020, before accelerating to 8% in 2021.

However, rebalancing growth promises to be difficult. First, because consumers are still cautious, and will remain so until the social protection system is kinder to them (unemployment insurance in particular); and second, because the geopolitical situation and tensions around technology transfers (5G and semiconductor supply) will require massive investment plans. Xi Jinping's announcements at the United Nations and his promise to achieve carbon neutrality by 2060 will also require significant public spending. However, while China appears to be emerging from this crisis gracefully, its financial situation has suffered nonetheless.

Total debt is expected to reach 300% of GDP in 2020 and Chinese banks non-performing loans are expected to increase by the end of the year. Of course, the risks are still contained: on the one hand this debt is mainly domestic and denominated in local currency, and on the other the PBoC still has significant room for manoeuvre.

Edited as per 01.11.2020.

The economists of the Crédit Agricole S.A. Group Economic Research Department

ISABELLE JOB-BAZILLE
Chief Economist
Administrator of CA Indosuez Wealth France

TABLE 1: ECONOMIC FORECASTS FOR 2020-2021, %

	GDP, %			CONSUMER PRICES, %			CURRENT ACCOUNT, % OF GDP		
	2019	2020	2021	2019	2020	2021	2019	2020	2021
USA	**2.3**	**-4.5**	**3.7**	**1.8**	**1.2**	**1.9**	**-2.4**	**-2.2**	**-2.3**
JAPAN	**0.7**	**-5.7**	**1.6**	**0.6**	**-0.1**	**0.3**	**3.6**	**2.4**	**2.1**
EURO AREA	**1.3**	**-7.5**	**5.4**	**1.2**	**0.2**	**0.8**	**2.9**	**3.1**	**3.2**
Germany	0.6	-5.4	5.0	1.4	0.4	1.7	7.1	6.5	6.4
France	1.5	-9.1	7.1	1.3	0.5	0.5	-1.2	-1.0	-1.0
Italy	0.3	-9.7	5.6	0.7	-0.3	0.2	3.0	2.6	3.1
Spain	2.0	-12.8	4.5	0.8	-0.3	0.2	2.0	2.0	1.9
Netherlands	1.6	-4.6	4.2	2.7	1.0	1.1	9.9	10.4	10.3
OTHER DEVELOPED COUNTRIES									
United Kingdom	1.5	-9.6	6.3	1.8	0.8	1.4	-3.6	-3.9	-4.7
Canada	1.7	-5.7	4.8	1.9	0.7	1.7	-2.2	-2.1	-2.4
Australia	1.8	-6.7	6.1	1.6	1.4	1.8	0.5	-0.6	-1.8
Switzerland	0.9	-6.0	3.8	0.4	-0.4	0.6	12.2	7.2	8.8
ASIA	**5.1**	**-0.4**	**7.1**	**2.7**	**2.9**	**2.3**	**1.3**	**1.9**	**1.2**
China	6.1	3.0	8.0	2.9	2.8	1.8	1.0	1.7	1.0
India	4.9	-5.8	8.4	3.7	6.2	4.5	-0.9	1.0	-1.0
South Korea	2.0	-0.9	3.4	0.4	0.4	1.2	4.3	4.2	4.0
LATIN AMERICA	**0.5**	**-7.1**	**3.7**	**10.1**	**7.3**	**9.0**	**-2.0**	**-0.3**	**-0.3**
Brazil	1.1	-5.1	3.4	4.3	2.1	2.9	-2.8	-0.2	-0.1
Mexico	-0.1	-9.2	3.8	2.8	3.4	3.2	-0.2	-0.2	0.4
EMERGING EUROPE	**2.0**	**-4.8**	**3.8**	**6.2**	**4.9**	**4.5**	**1.5**	**0.5**	**0.0**
Russia	1.3	-5.0	3.5	4.5	3.3	3.5	3.8	1.5	1.5
Turkey	0.9	-5.0	4.5	15.5	11.0	10.0	0.0	-2.0	-2.5
Poland	4.1	-2.8	3.6	2.3	3.4	1.7	0.4	2.0	0.6
AFRICA, MIDDLE EAST	**0.4**	**-5.8**	**2.3**	**8.4**	**7.0**	**5.5**	**1.3**	**-2.9**	**-2.5**
Saudi Arabia	0.3	-6.0	3.2	-2.1	4.3	2.1	5.9	-4.0	-2.5
United Arab Emirates	1.7	-5.5	2.2	-1.9	-1.1	1.0	7.0	-0.3	1.1
Egypt	5.6	1.2	2.0	9.2	5.8	7.8	-3.6	-4.5	-4.0
Morocco	2.5	-5.1	3.5	0.3	0.5	1.1	-4.1	-7.0	-4.0
TOTAL	**2.7**	**-4.1**	**5.0**	**3.4**	**2.7**	**2.8**			
ADVANCED ECONOMIES	**1.7**	**-6.0**	**4.3**	**1.5**	**0.7**	**1.3**			
EMERGING COUNTRIES	**3.5**	**-2.6**	**5.6**	**4.9**	**4.3**	**3.9**			

Source: Crédit Agricole S.A. forecasts, Indosuez Wealth Management.

TABLE 2: INTEREST RATE FORECASTS, %

		12.2020	03.2021	06.2021	09.2021	12.2021
UNITED STATES	Fed funds	0.25	0.25	0.25	0.25	0.25
	10Y	0.80	0.90	1.00	1.10	1.20
EURO AREA	Deposit	-0.50	-0.50	-0.50	-0.50	-0.50
	10Y (Germany)	-0.40	-0.35	-0.35	-0.30	-0.30
10 YEARS SPREAD VS EUR	France	0.35	0.30	0.30	0.30	0.35
	Italy	1.35	1.25	1.20	1.15	1.10

Source: Crédit Agricole S.A. forecasts, Indosuez Wealth Management.

Forecasts as of 02.10.2020.


Washington, United States

OUR HOUSE VIEW

US DOLLAR: SHINING GLORY OF THE PAST?

The lower US interest rates has removed one of the supporting factors for the dollar and has reduced the cost of hedging US assets for asset managers.

Understandably, from a risk-reward perspective, the relative benefits of holding a trend-depreciating dollar now definitely requires deeper consideration.

Regardless of the outcome in the 2020 US Presidential elections, the US dollar is set to gradually, but surely face a reassessment of its long-enjoyed role as the world's reserve currency status. On a monthly basis international trade is less and less settled in greenbacks coupled by global Central Banks that continue to diversify their currency reserves away from the dollar and into other AAA safe haven alternatives.

REAL RATES IN NEGATIVE TERRITORY

Even if this shift is a more secular trend rather than a short-term change of paradigm, the global pandemic has served to advance this day of reckoning as the severe growth shock currently underway has forced the Federal Reserve to slash their interest rates to zero in response. Herein lies the catalyst in the fickle forex world of relative yield attraction. Whilst US equity markets roared and US real yields handsomely rewarded investors vis-a-vis their peers, buyers were happy to remain in denial about the underlying economic frailties. Now that US real yields are at record negative levels and in line with all others, relative macro considerations are now swiftly rising to the surface.

Deep concern is brewing over just how the US will be able to keep funding its runaway budget deficits now approaching 27 trillion US dollars and a 125% debt-to-GDP ratio. It must hereby be noted that the debt servicing cost by itself is nearing 700 billion US dollars a year. Amazingly, the average coupon interest rate was at a record low 1.94% (in October) which hardly discourages either political party in Washington from being frugal with expenditures. On the contrary, and even if a Republican senate were to water down Biden's massive spending plans, COVID-19 will assist the next administration in adding even more debt for job-creating infrastructure spending.

A MATTER OF CONFIDENCE

With the exception of the deep investor savings pools available to Japan, most sovereign wealth fund managers have already begun reducing their exposure to US government bonds in stages, not to mention the number one foreign holder China who is all too happy to let its still significant allocation mature and be gradually repatriated. Now that fresh treasury debt issuance is about to mushroom in the quarters ahead - who other than the Federal Reserve will be absorbing the new supply? Consequently, the rise of the US federal debt is not really a debt sustainability issue but rather a central bank credibility question and a currency confidence call.

This point contributes to explain why the FOMC appears poised to maintain rates at zero for longer, with open toleration for greater inflation overshoots. This fiscal dominance paradigm does not bode well for the world's base currency as in the past such phases saw acute depreciation. The temptation given faltering growth is to allow the dollar to drift lower to keep indispensable US savings and spending at home. Why would this time be any different?

Thus, it may well be too early to assume that the current pandemic-driven disinflation will suddenly morph into runaway inflation. However, a degree of pre-emptive portfolio inflation-proofing is gathering interest amongst long-term investors wary of the rising debt conundrum. From a risk reward perspective, the relative benefits of holding a trend-depreciating dollar unhedged in portfolios now definitely requires deeper consideration. Today, the costs associated with hedging away US portfolio currency exposure have never been cheaper, another key reason to be cautious.

New York, United States

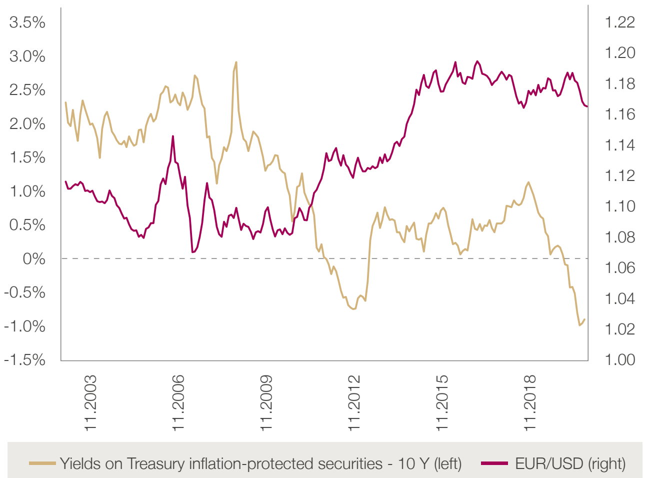
THE END OF AN ERA

In balance and going forward, we fear that the dollar's longstanding privilege is becoming fragile, perhaps spelling the beginning of the end for its pre-eminence as novel liquid safe haven alternatives emerge beyond the election and in the decade ahead.

Investors may then wonder which currencies will appreciate most against the greenback. In order of conviction and preference, gold is the ultimate call for a structural debasement of heavily-printed currencies which lost the scarcity dimension that gold retains. The issue is that gold already performed well in 2020 and though we remain positive on the precious metal, the payoff seems less appealing than it was in March 2020. The euro could benefit from an exit of the pandemic crisis and no doubt the distribution of a vaccine could help break the 1.20 resistance. However, this call also remains also dependent upon the political outlook of a region that is still struggling to agree on a recovery plan, which runs the risk of being implemented when the crisis is already well behind us… As the yen and Swiss franc have been inflated in 2020 by risk-off behaviours and seems vulnerable post COVID-19, this leaves us with emerging currencies, which would certainly benefit from an exit of the pandemic. Beyond this horizon, the Chinese currency holds not all, but many of the required attributes of a potential reserve currency and should appreciate over time, sustained by a positive real yield, a better macro momentum and a record trade balance (Chart 15).

DAVIS HALL
Head of Capital Markets, Asia
Indosuez Wealth Management

CHART 15: REAL INTEREST RATE AND USD, %



Source: Federal Reserve, Datastream, Indosuez Wealth Management.
Past performance does not guarantee future performance.

US CREDIT MARKET: CORPORATE DEFAULTS AND LEVERAGE SUSTAINABILITY

Although the extension of the Federal Reserve's corporate bond purchase programmes is currently under debate, they have clearly been a powerful tool in stabilising market conditions and reducing corporate refinancing risk.

Given the extent of the crisis, corporate "fallen angel" risk is a viable concern for investors. Selectivity is crucial in this uneven recovery pattern, notably in sectors that have been heavily impacted by the lockdown measures, but will also benefit from the sharpest recoveries going ahead.

Credit risk has fared relatively well thus far given the scale of the crisis, thanks to strong fiscal and monetary support that has limited refinancing risks. Looking ahead, corporates could either rebound or crumble after the pandemic. In this context, selectivity is crucial.

MARKETS FOSTERED BY CENTRAL BANKS

US credit markets have continued to surprise to the upside following the market sell-off earlier in March 2020, endorsing positive momentum for both investment grade and high yield credits. Both investment grade and high yield spreads have now recovered to the same level as end-February 2020 with further potential to trade tighter once the latest US fiscal stimulus plan is agreed upon.

The creation of the Fed's corporate bond purchase programmes – the Primary Market Corporate Credit Facility (PMCCF) and the Secondary Market Corporate Credit Facility (SMCCF) with a total of up to USD 750 billion - has been a powerful tool in stabilising market conditions and reducing corporates' refinancing risk. Investors have become convinced that the PMCCF will provide a backstop for issuers to maintain operations while the SMCCF will support market liquidity. The SMCCF is designed to purchase corporate bonds and loans rated IG and recent fallen angels[19] which effectively include a few high-profile corporates in the auto and airline industries.

Meanwhile, the US government stimulus actions, notably the Paycheck Protection Program (PPP) for small businesses and the pandemic unemployment benefit, have helped support the economy and US consumption. However, at the current juncture, the sharp surge in COVID-19 cases going into winter is becoming a pressing issue for the US consumer and the urgency for greater stimulus is building.

On the other side of Atlantic, the market sell-off in Europe turned a corner after the ECB's swift decision to support the credit markets on an unprecedented scale through the Pandemic Emergency Purchase Programme (PEPP).

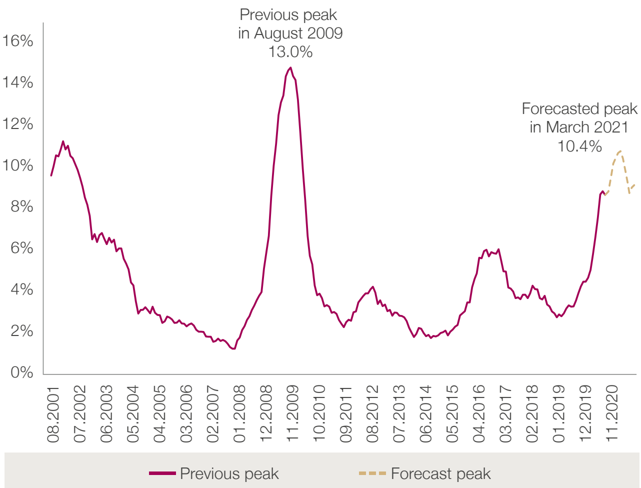
The ECB later expanded the programme by increasing the envelope of bond purchases from EUR 750 billion to EUR 1.35 trillion and extending the deadline to at least the end of June 2021 and reinvesting the maturing principal payments until the end of 2022.

Many pandemic support programs at the national level, such as the partial employment benefits and state-guaranteed loans, have greatly restored consumer confidence as well as eased corporates' liquidity pressure and default risk. Nevertheless, we are still in uncharted waters. Renewed social distancing restrictions in European cities will weigh on near-term consumer spending and delay the pace of recovery.

WILL DEFAULT AND FALLEN ANGEL RISKS GET WORSE FROM HERE?

Rating agencies have been revising their default rate forecasts downward each month given the central bank's supportive policies which coincided with the beginning of the economic recovery. That being said, default rates could trend higher from now into Q1 2021 (Chart 16). Current restrictions will likely keep economic activities well below pre-pandemic levels in the coming months.

CHART 16: US HIGH YIELD DEFAULT RATES ACTUAL AND FORECAST, 2001 TO PRESENT, %



Data as of 10.11. 2020.
Source: Moody's, Indosuez Wealth Management.

19 - Company whose credit rating falls from investment grade (Baa3/BBB- and above) to non-investment grade (Ba1/BB+ and below) due to credit deterioration.

Beyond that, the Fed's very accommodative policy and possible stimulus package will act as catalysts for economic recovery and lower default risk.

Historical averages show that only 0.9% of BBs (the less risky segment of the high yield market) defaulted over a one-year period, offering a better risk-reward profile when compared to 0.2% for BBBs (lower investment grade companies) and taking into account their current spread differential versus historical. BB default rates also compare favourably to 4.2% of Bs and 24.3% of CCC/C segment reflecting the exponential nature of risk in high yield. This also suggests that the pandemic and macroeconomic shock affected the weakest and most leveraged companies disproportionately, with a strong concentration in industries such as energy, hotel and leisure and retail.

Subsequently, over the last 15-year period, 18% of BBs have defaulted, still much lower than 30% of Bs and four times lower than 59% of CCC/C (cumulated default rates - Chart 17).

Whilst the number of fallen angels has steadily declined to 4 in September 2020 (65 in April 2020), fallen angel risk is here to stay given the record issuance from BBB companies. Encouragingly, they have shown a historic degree of rating stability with only one-third of them downgraded further within a one-year period, while two-thirds maintained the same rating or were upgraded. This trend has continued as less than 15% of fallen angels have been downgraded further within the first five months as the potential refinancing risk has not materialised. Their spread recovery has been rapid, except for those in retail, restaurants, travel and real estate sectors.

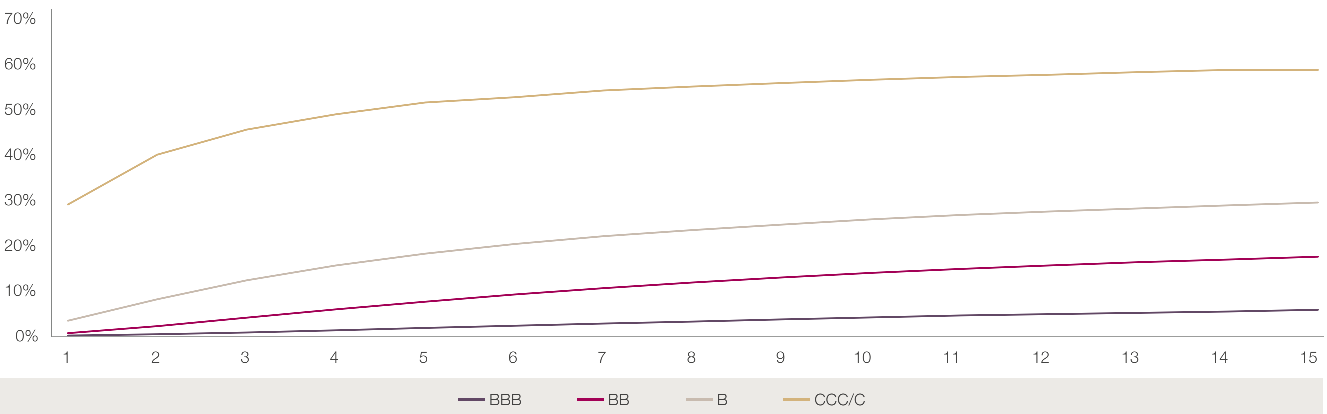
VERY SUPPORTIVE TECHNICALS TO OVERSHADOW NEAR-TERM FUNDAMENTAL CONCERNS

The credit market became an important tool for the Fed to avoid a market meltdown. As of September 2020, the Fed bought a total of USD 4.5 billion corporate bonds, an amount far below the maximum capacity of USD 750 billion. This program has been very effective in keeping the left tail risk (risk of large losses in an extreme scenario) in check. In October 2020, only 6.7% of US HY bonds were trading at distressed levels of below 80 cents a dollar, a dramatic decline from over 55% of the total in March.

As it stands, the Fed will not hike rates before 2023 further reinforcing a constructive backdrop. Investors have applauded the warning by Fed Chair Jerome Powell that the risk of overdoing stimulus is small, given that the US economic recovery is far from complete. The Fed could get creative with market tools to support investment sentiment. Thus, investors are starting to look past what might happen this year and are focusing into 2021 and beyond.

Fund flows into the US HY market are likely to stay positive on stronger BBs with a sound balance sheet. Pension and insurance funds have increased exposure to BBs amid very low interest rates. Many IG fund managers have obtained waivers to hold BBs following the wave of fallen angels back in March/April 2020.

CHART 17: GLOBAL CORPORATE AVERAGE US CUMULATIVE DEFAULT RATE TIME HORIZON BY RATING OVER A 15 YEARS HORIZON, %



Source: S&P, Indosuez Wealth Management.

POSITIVE CATALYSTS FOR 2021 ON THE US HIGH YIELD MARKET

The announcement by Pfizer and BioNTech on a 90% efficacy of a COVID-19 vaccine in its third-stage trials in November 2020 surprised the market to the upside and could deliver a tailwind for risky assets going into 2021. Although the trials are still ongoing by Pfizer and other vaccine makers, it presents a strong catalyst for the real economy which would undoubtedly be a positive for high yield sector fundamentals which generally benefit in a cyclical upturn coupled with the lower for longer rate environment.

That being said, the potential for a reduced government stimulus (in the form of a lower fiscal spending plan) in the US could have a negative impact on risky assets. The expectation of a vaccine could also lead to multiple rotation opportunities towards cyclical, travel and leisure, transportation, energy and commercial property sectors, whilst some online retailers may suffer. Residential investment should benefit from the work-from-home trend, historically low mortgage rates and a potential permanent change in the extent of time people spend at home.

The potential for a Republican Senate seems likely at the time of writing and could lead to less drastic healthcare reforms. Furthermore, a potential vaccine would benefit healthcare operators including hospitals, medical devices, eye and dental care, which should see their business and profitability normalise to pre-pandemic levels.

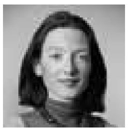
Nevertheless, uncertainties remain and investors should stay vigilant and selective within cyclicals, focusing on taking measurable credit risk with high convictions on corporates with good visibility on their recovery trajectory.

RIGOROUS SCREENING AND SELECTIVITY

Rigorous screening and selectivity are crucial in a K-shaped (or uneven) recovery pattern. Corporates could either rebound or crumble after the pandemic.

- Structural shifts in consumer behaviour, work-from-home and social restrictions have both disrupted and created opportunities;
- Hotel, gaming and leisure, retail, consumer and business services, and consumer durables in big items would remain vulnerable at risk of default in the near term from a fundamental perspective (Chart 18);
- Healthcare and telecom sectors have been the winners and should remain resilient regardless of the vaccine development;
- Auto makers with scalable production platforms and premium brands will gain market share in electrification, bolstered by strong Chinese consumption.

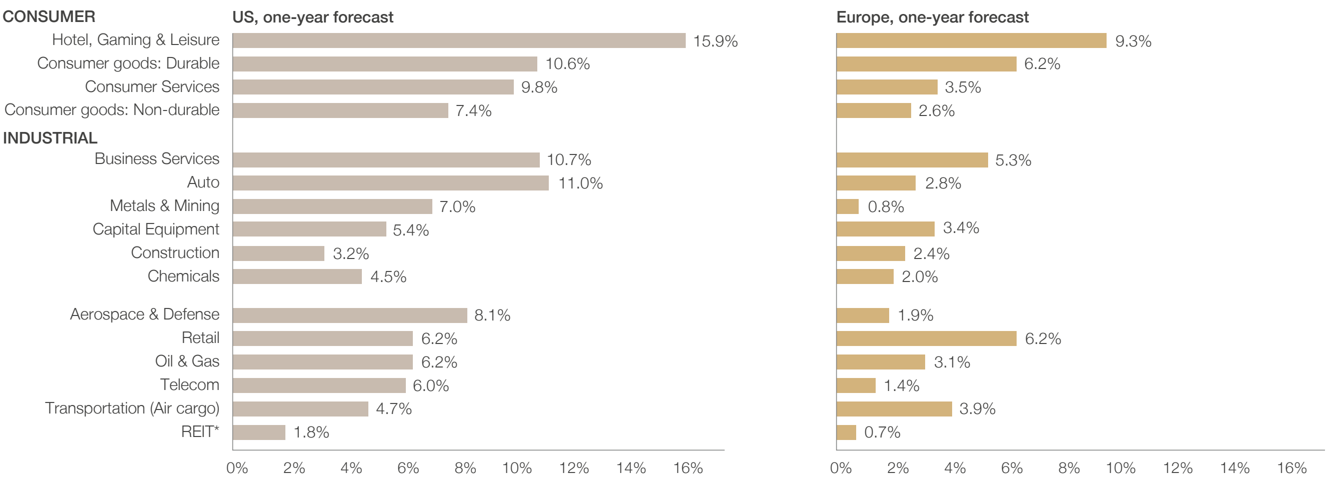
At the company level, those with low financial and operating leverage, and those having effective business and financial strategies to manage through this crisis would rebound faster because of their balance sheet strength.



SOPHIE RABRÉAUD
Head of Fixed Income Strategy and Research
Asset Management
Indosuez Wealth Management

MAGGIE CHENG
Senior Credit Analyst
Indosuez Wealth Management

CHART 18: ONE-YEAR DEFAULT RATES FORECAST BY SECTOR, %



* Real Estate Investment Trust.
Data as of 10.11. 2020.
Source: Moody's, Indosuez Wealth Management.

SPOTLIGHT ON THE US TECHNOLOGY SECTOR

Should the status of technology as the winner of equity markets in the COVID-19 context continue to prevail in 2021?

Let's discuss the structural strengths and perspectives of this key sector with our Head of US Equities.

INTERVIEW

WITH MICHEL BOURGON, HEAD OF US EQUITY PORTFOLIO MANAGEMENT

Global Outlook: The technology sector has accounted for most of the S&P 500's earnings growth for several years: are we seeing a technology supercycle, a transfer of value or does this reflect the platforms' exponential profitability?

Michel Bourgon: Year-on-year, tech company earnings rose by more than 40% while earnings per share for the S&P 500 excluding the tech sector were basically flat. The growth differential between tech stocks continues today. We are currently in the midst of the third-quarter earnings season, and while consensus expects top line revenues for the S&P 500 to fall by about 5% year-on-year, it anticipates a more than 20% increase for the five Big Tech companies (i.e. Apple, Microsoft, Amazon, Alphabet and Facebook).

Ultimately, tech companies are benefiting from both very strong sales momentum, which is consistent with the changes in our behaviour as consumers, and a high level of profitability.

Within certain segments like e-commerce (which is not included in the S&P 500 tech sector but rather in the consumer discretionary sector), we are in fact seeing a fairly disruptive transfer of value at the expense of traditional retail, a trend that has clearly been magnified since the COVID-19 crisis. However, all sectors combined, companies are allocating an ever-increasing share of their investments to IT (nearly 40% of non-residential investments in 2020) because they are essential to the pursuit of productivity.

GO: Within US tech, which areas of innovation are currently the most promising? What themes have you liked until now?

MB: Within our strategies, we have favoured three themes for several years: artificial intelligence, online activities and electronic payments.

There is no doubt that a real artificial intelligence revolution is on the horizon and could bring significant productivity gains. McKinsey estimates these gains at +0.8% to +1.4% per year until 2065.

When we talk about online activities, you might be inclined to think of e-commerce, which is and remains a major theme, but this theme also includes work-from-home, streaming, social networks...

Lastly, electronic payments continue to edge out cash transactions. Coins and bills will definitely become obsolete one day.

> Largest investments in artificial intelligence made by Big Tech companies

One last comment on these major areas of innovation: it is worth noting that they were already very dynamic before the health crisis, which only accelerated their growth.

In contrast, our strategies remain less invested in the electric car sector, which seems to have high valuations and be much more capital-intensive. As a result, visibility on cash flow generation is lower.

GO: In which sectors do you expect to see a significant risk of disruption? Can the Big Tech companies easily expand their activities into new sectors?

MB: If we take only the example of artificial intelligence, none of the Big Tech companies were originally players in this segment, yet the largest investments were made by these very players. For them, this is an ideal situation. These are highly profitable companies that have excess cash and see this as a new source of growth opportunities.

More generally, the challenge for these players (and thus for the regulators) comes down to the issue of monetising data and the ability to control an ecosystem, as demonstrated by the dispute between game publisher Epic Games and Apple over revenue sharing.

Cupertino, United States

GO: Technology is more than just FAANG but reflects the entire economy's transition to digital and the transformations all companies are undergoing. How does this trend affect other sectors?

MB: For several years, productivity gains have come mainly from technology and Big Tech is clearly not the only beneficiary: digitalization is a trend in every industry. Let's take the example of finance. The aggregate market capitalisations of Visa and MasterCard currently exceed those of the six largest US banks. The two payment leaders have only 38'000 employees versus more than a million for the top six US banks.

The recent COVID-19 crisis has shaken things up. Two worlds are facing off. On one side, some change-averse companies simply want to resume their pre-lockdown activities as if nothing had happened. On the other side are companies that see these changes as a tremendous opportunity to improve their productivity. Surveys show that more than a third of companies are now looking to reduce their office space. This type of decision could be viewed as a simple strategic choice, but companies that do not opt for this new work structure will surely face significant challenges relative to competitors with lower cost structures. Note that the major beneficiaries of work-from-home and e-commerce continued to grow even after the lockdown ended. In contrast, office and commercial real estate-related stocks remain under pressure. According to real estate expert Jones Lang LaSalle, the office occupancy rate is 86% in the United States overall. In its specific analysis of Charlotte (where the headquarters of the six largest US banks are located), the office occupancy rate officially stands at 90% but, in reality, fewer than 20% of employees are currently onsite.

GO: Let's get back to the platform model. In what way is it changing how we understand their profitability?

MB: We can define the platform model as the creation of a marketplace or an ecosystem that has a number of characteristics, such as:

- Exponential profitability once breakeven has been reached and a competitive edge has been established;
- Quasi-monopolistic market shares (winner takes all);
- High barriers to entry due to investments due to important upfront investments;
- A cost model based more on fixed investments than on recurring costs (and in particular much more limited payroll costs);
- The ability to create an ecosystem characterised by a value-sharing system that works largely in their favour in order to make a product available on their platform.

For investors, understanding these models means being able to analyse, over time, the cycle of creating and extracting value from a platform, which we see clearly in the past trajectory of the results of an actor like Amazon, even though its profitability comes mainly from the cloud (Amazon Web Services).

San Francisco, United States

GO: Has US tech changed its business model in the last decade and how does this affect the way we value these companies?

MB: In finance, we value an asset by discounting future earnings. This method is used for all types of assets: real estate, bonds and equities. For equities, future earnings are often highly uncertain. However, when most of a company's business is based on a subscription model, visibility on its future earnings increases and this generally leads to a significant rerating. These equities are often called bond proxies because the earnings generated are "predictable" and interest rate levels are key to their valuation.

The number of companies adopting this model is growing (and not just in the tech sector). This trend is particularly strong in software. Let's take the most well-known example, Microsoft: less than 10% of its revenues were recurring in 2000 versus more than 60% today. With such a change, is it still appropriate to compare historical price/earnings with current price/earnings?

Less than 10% of Microsoft revenues were recurring in 2000 versus more than 60% today

GO: Let's talk about the candidates' positions on and agendas for technology: what are the take-aways and should we be concerned about increased political pressure on competition issues?

MB: We should note that only four years ago, when Donald Trump was elected, most investors had identified the technology sector as the potential big loser. Tech stocks were often helmed by progressive, globally minded liberals, some of whom were environmentalists. They had funded the Democratic campaign and did not support Trump's agenda. Investors feared Trump would seek to penalise a sector that was viewed as too powerful and hostile to his agenda. In the end, it has emerged victorious from the last four years, and not just because of the tax cuts. In short, this could be confirmation that the secular trends the tech stocks have capitalised on are stronger than short-term political noise.

On the regulatory side, we note that IT is one of the least regulated sectors, much less so than the manufacturing, healthcare and banking sectors. The reason is simple: these activities are more recent. Regulation is clearly a constraint that could be tightened, and one that entails additional costs and thus puts pressure on margins. But regulation also has the paradoxical effect of creating barriers to entry. Could a student alone in their room create the next big social network if they have to monitor everything that happens on their platform and comply with personal data regulations? Probably not.

Lastly, if regulators wanted to force companies to split up their businesses, this would not necessarily pose a systematic risk for shareholders. For example, eBay was able to dispose of PayPal without destroying value — quite the contrary.

To summarise, the two main threats would be higher taxes and limits on their ability to diversify, but the risk of a serious attack on tech leaders seems highly unlikely, particularly in light of the underlying issues between the United States and China.

GO: In fact, technology is at the centre of the Chinese-American rivalry: is US leadership threatened here, in particular if political pressure on the sector were to intensify?

MB: China and the United States both aspire to be the dominant world power in the coming years, and this will not be possible if they do not dominate the IT sector. US tech actors keep making this argument to the political authorities to highlight the risk of a world potentially dominated by Chinese tech actors. The underlying issue is clearly the confidentiality of the data of individuals, companies and governments. This issue goes beyond the economic framework and is a geostrategic question that likely protects US actors from the strong temptation to regulate. To summarise, for investors, the theory of the strategic dimension of technology is only reinforced by this rivalry and the scale of the investments in this sector.

GO: The technology sector is also regularly criticised for its environmental impact. Can you address this point and tell us how you incorporate it?

MB: Data centres are, in fact, widely criticised in the media for consuming large amounts of energy, and data usage has skyrocketed in recent years. However, that statement should probably be qualified because we need to remember that the data centre sector has become a green bond issuer; it is also an area where technical progress has been made and energy efficiency and power generation pursued. It is possible that data centres will be carbon neutral before we have clean cars. So bear in mind that the technology sector is not limited to Big Tech but also includes many innovators in the environmental and healthcare fields. This is of course an important investment pillar.

MICHEL BOURGON
Head of US Equity Portfolio Management
Indosuez Wealth Management

Shanghai, China

PRIVATE EQUITY: THE NEW FACE OF US CAPITALISM

Since 2009, there is now more capital raised from private equity and venture capital funds than from traditional public stock markets.

US private equity is firmly established at the crossroads of the financing, operational and digital transformation of US corporates: the heart of modern US capitalism.

US capitalism has faced over the last 25 years an unprecedented shift in its corporate model of financing and transmission with the secular emergence of private markets, and especially private equity. This transformation, often unknown, is however by its magnitude a fundamental factor in the evolution of long-term investors' asset allocations in the US.

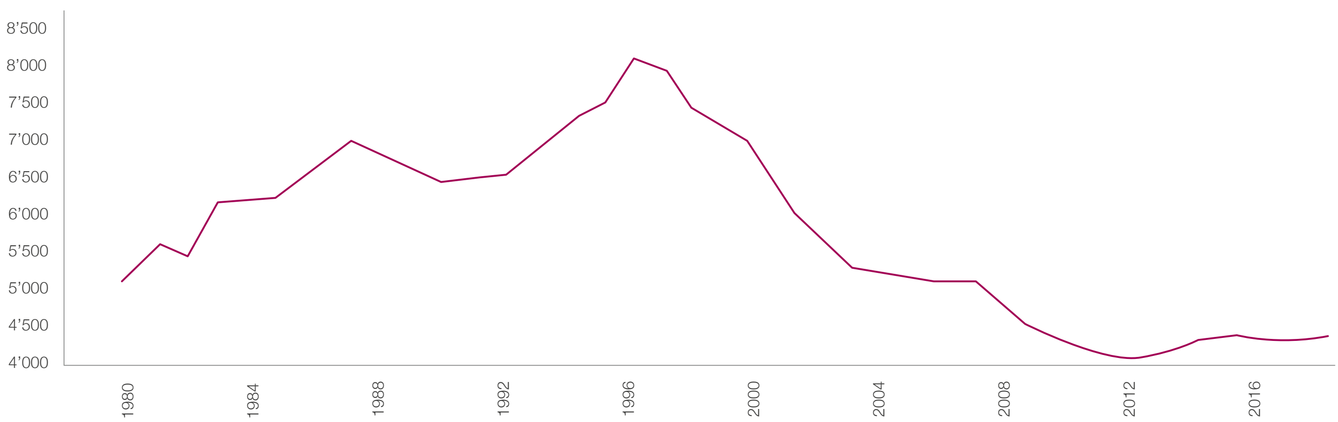
Actually, the number of US public companies dropped from its historic peak in 1997 of 7'300 to less than 3'700 in 2019. It is in the segment of small and medium-sized corporates that such evolution is the most marked, since almost 90% of those companies have simply been made private and delisted (Chart 19). Over the same period, we estimate that the number of US companies backed by private equity or venture capital funds increased from less than 1'000 to more than 8'000. Since 2009, there is now more capital raised from private equity and venture capital funds than from traditional public stock markets. In 2017, companies raised nearly 3 trillion US dollars on the private markets compared to just 1.5 trillion on public markets[20].

THE MAIN VEHICLE FOR RAISING CAPITAL

This massive transfer of funding and assets between public and private markets is also measured in the asset allocations of the more sophisticated investors as US pension funds and endowments, whose allocation in private equity has now reached 17.2%[21] versus less than 1% at the end of the last century.

US private equity assets have been multiplied by 9 in less than 25 years[22] to reach now nearly 2 trillion US dollars. This secular growth has allowed the emergence of US based investment giants with global footprints, such as KKR, Blackstone, Carlyle or Bain Capital, which are de facto controlling a part of the US economy and its entrepreneurship resources. It is no surprise that their regulatory, fiscal and societal status has now been under growing public scrutiny and debated in US congress as well as during the last presidential campaign[23].

CHART 19: NUMBER OF US COMPANIES LISTED ON THE STOCK EXCHANGE



Source: Globaleconomy.com, Indosuez Wealth Management.

20 - MorganStanley, 2020.
21 - Prequin, Alternatives Report 2020.
22 - Pitchbook, 2020.
23 - House of representatives, Session 11-19, "America for Sale: A examination of the practices of Private Equity".

Chicago, United States

It is clear that private equity has quite simply "pre-empted" a large part of the US mid-sized, growing corporates and in particular of its underlying value creation potential. What ties Google, Facebook or Uber is the decisive role that Private Equity has played in their start-up and funding. More than 90% of IPOs and half of public to private delisting now concern US corporates initially backed or controlled by Private Equity and venture capital funds.

THE ADVANTAGES OF PRIVATE EQUITY

There are several reasons that may explain this profound change. The pressure of quarterly results and the regulatory and operational burden of a stock public listing have forced a large number of entrepreneurs to keep their businesses private for longer and this by relying on alternative sources of financing provided by funds from private equity, and this at each stage of their development. This phenomenon is particularly visible in American technology companies whose listing only occurs after 12 years on average compared to 8 years previously[24].

By implementing operational transformation strategies, optimising capital employed and pursuing long investment horizons, US private equity funds have been able to deploy investments that have provided investors with returns higher by a factor of 1.2 on average versus the S&P 500 over the past 20 years[25].

Finally, both banking disintermediation since the 2008 downturn (with the emergence of private debt funds whose outstanding amounts have tripled) and the development of the secondary market (which has now reached 80 billion US dollars in 2019 compared to less than 20 billion US dollars 10 years ago[26]), have offered US private equity funds alternative sources of funding as well as increasing liquidity to their investors.

This ecosystem, which combines sources of equity and alternative financing, increased liquidity and critical size allowing Private Equity to offer US capitalism a new face while freeing itself from traditional capital markets and building up a virtuous circle of autonomy increasingly attracting new talents.

US private equity, by its size and the dissemination of its model, has been firmly established at the crossroads of the financing, operational and digital transformation of US corporates. A reality that long-term investors can no longer ignore when building up their asset allocation.

OLIVIER CARCY
Global Head of Asset Management
Indosuez Wealth Management

24 - MorganStanley, 2020.
25 - Source Prequin and Indosuez, PME Index.
26 - Alpinvest, 2020 Secondaries Report.

Utah, United States

INVESTMENT SCENARIO

The key question for investors in this chaotic health context and at the dawn of a new American presidency is whether this new framework is likely to be a game changer with regards to the outlook for the major asset classes.

The first reaction might be to ask some questions about the international framework: Will this decade be less contentious and easier to understand? Will geopolitical and trade tensions cool and make it easier for investors to plan ahead? In this regard, we believe the framework that is taking shape generally remains favourable to emerging investments. An accommodative Federal Reserve, a weaker dollar and a less aggressive presidency on the trade tensions front are likely to facilitate the flow of capital back into the region. Asian countries will also benefit from a meaningful recovery in China's growth which, to a fairly large extent, determines growth in the rest of Asia. In fact, the Asia-Pacific region accounts for nearly 50% of China's foreign trade. Within Asia, China is emerging even more clearly as the winner of this health ordeal and as the primary beneficiary of a change in tone at the White House, although we should not overstate Joe Biden's goodwill towards China; the change in style is likely to be more significant than the change in substance.

The second question might concern the implications of growth outlooks for investors. Worldwide, the growth rebound expected in 2021 mainly reflects a significant base effect (in comparison with a year that was devastated by the spring 2020 lockdown) but should not obscure the uncertainties that weigh on this recovery and the weaknesses compounded by this pandemic. The recovery is therefore more gradual in countries where the pandemic is still very active, like Europe, and more rapid in Asia, and in China more specifically.

The third question might concern the policy-mix that is being developed against the backdrop of a severe recession and an uncertain recovery in all major economies, which we described in our previous Global Outlook (second-half 2020). This mix represents a break from the past, since an expansionary fiscal policy is now being added to a quasi-structurally accommodative monetary policy. The Fed has revised its target inflation policy and now forecasts three years with no rate hikes even if inflation exceeds 2%.

The US election only reinforces this trend: while the fiscal stimulus plan proposed by Biden will likely not pass the Senate intact, the economic and social emergencies arising from the pandemic are expected to give rise to new fiscal measures.

This environment should keep short-term interest rates rooted at very low levels for a long time and would therefore be quite positive for assets that are risky, but will have modest returns:

- Companies will continue to benefit from measures that support their turnover and will be able to continue to access funding for some of their part-time unemployment, which supports results and limits the rise in bankruptcies;
- This is becoming clear from the third-quarter earnings season. A very high percentage of companies reported results that beat market expectations, although these results remain below their pre-COVID-19 levels;
- The central banks will continue to provide liquidity and compress bond risk premiums by increasing their balance sheets and expanding them to include corporate bonds, enabling companies to refinance;
- However, bear in mind that corporate default rates will continue to rise in 2021 in several sectors, even if the distribution of a vaccine could improve the risk outlook; this context is therefore both a reason for high-yield investors to be cautious and a source of new opportunities for the discounted debt segment;
- Low rates have the effect of automatically pushing asset prices higher, while prompting investors from the bond world to seek yield in riskier assets;
- This investment framework is also likely to continue to be positive for assets supported by the easy availability of cheap credit, and in particular residential real estate.

Los Angeles, United States

Nevertheless, an important risk factor must be taken into account: the risk of changes to the corporate tax system and their impact on the markets. In his economic plan, Biden has proposed raising the corporate tax rate by 7 points, thus wiping out some of Donald Trump's tax reform. These measures have little chance of seeing the light of day, at least to that extent; a more general increase in the minimum wage seems more plausible. This could dent companies' profitability and cap the valuation of US equities, whose strong profitability growth in recent years has mostly been driven by a favourable fiscal policy and an accommodative monetary framework.

Another risk would be if this economic policy were to prompt a greater-than-expected yield steepening. A moderate rise in long term yields like that of September/October 2020 is not enough to make the market stumble but could instead cause a sector redistribution. In contrast, if the strength of the recovery and the wage trend (once the unemployment rate has returned to a low level) were to lead to an even moderate rise in inflation, it is conceivable that investors would massively sell out of long-term bonds. However, there are two reasons to adopt a more nuanced view of this risk. First, it will likely take two years for the unemployment rate to return to its 2019 level, which could eliminate the risk of wage inflation; second, the challenge to Biden's stimulus plan by a red Senate reduces the likelihood that inflationary growth will accelerate. It is nevertheless possible that a middle-of-the-road stimulus plan would be enough to rekindle the early fall 2020 sector rotation into cyclical stocks. The question of regulating the growth/inflation relationship will likely be more pertinent in 2-3 years and could raise once again the question of the Federal Reserve's control of the yield curve.

Investors also have reasons to question the sustainability of sovereign debt in the longer term, in particular in relation to Biden's plan. This plan, should it be implemented, would continue to cause the United States' debt ratio to climb, and would force the Federal Reserve to continue to monetise the US Treasury's debt, which would exert moderate, but structural downward pressure on the dollar. In the longer term, its role as primary reserve currency could be challenged by other currencies such as the euro or the renminbi.

At the end of a year that has been good for tech stocks — the companies associated with the "stay at home/work from home" theme — is there reason to believe this trend will continue? Will the new president of the United States in fact bring about some sort of rebalancing between the physical economy and the virtual economy? In this regard, we believe that the antitrust threat to tech stocks has likely been overstated, and that the health context is only intensifying a very powerful structural trend of creative destruction[27].

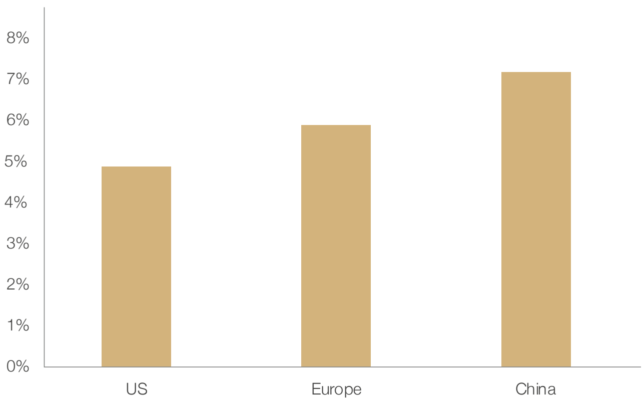
These phases of creative destruction during a lower-growth phase help accelerate the transformation of capitalism, and private equity can capitalise on the situation. The need for many groups to change their model and dispose of assets, and for others to adopt a longer-term investment outlook with a productive shareholder/director dialogue is likely to favour this asset class, which is popular among institutional investors and increasingly among high net worth individuals.

27 - Joseph Schumpeter (1942) describes creative destruction as the "process of industrial mutation that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one".

To conclude, this environment seems positive for long-term investors able to transcend short-term ups and downs and base their asset allocation both on a realistic outlook for more modest long-term returns and on the prospect of growth that is focused on secular transformation themes. The emerging middle class, the environmental transition, health and demographic developments, and the digital revolution will therefore remain key themes in which to invest at the global level, with perhaps a less pronounced bias towards the United States and a stronger exposure on emerging markets (Charts 20 and 21).

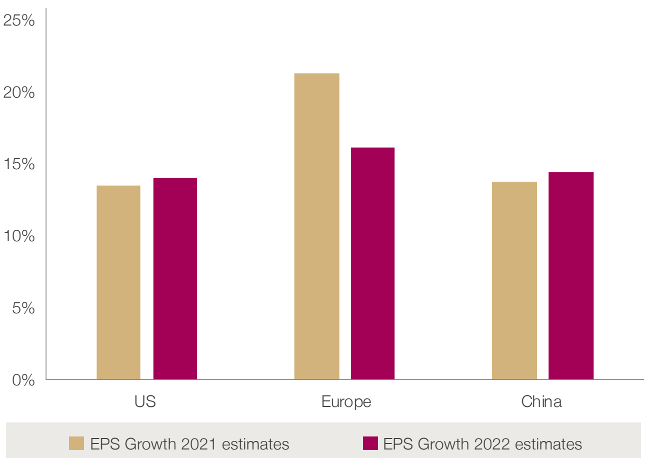
VINCENT MANUEL
Chief Investment Officer,
Indosuez Wealth Management

CHART 20: EARNINGS YIELD 2021 ESTIMATES, %



Source: FactSet, Indosuez Wealth Management.
Past performance does not guarantee future performance.

CHART 21: EPS GROWTH, %



Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.


New York, United States

PERFORMANCE TABLES

TABLE 3: ANNUAL FIXED INCOME PERFORMANCE, LOCAL CURRENCY, %

CORPORATE BONDS	2016	2017	2018	2019	01.01 to 03.12.2020
Governments Bonds Emerging Markets	6.29%	12.49%	-10.62%	1.88%	-0.48%
US Government Bonds	1.11%	1.10%	1.41%	5.22%	5.75%
Euro Government Bonds	1.86%	0.39%	0.40%	3.16%	2.07%
Corporate EUR High yield	8.14%	4.82%	-3.37%	9.55%	0.97%
Corporate USD High yield	15.31%	6.32%	-1.48%	14.65%	2.93%
Corporate Emerging Markets	7.61%	2.84%	-6.89%	9.11%	1.95%

TABLE 4: ANNUAL FOREIGN EXCHANGE RATES PERFORMANCE, SPOT, %

CURRENCIES	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	01.01 to 03.12.2020
EUR/CHF	-15.70%	-2.71%	-0.74%	1.63%	-1.99%	-9.54%	-1.48%	9.16%	-3.82%	-3.55%	-0.14%
GBP/USD	-3.45%	-0.44%	4.58%	1.86%	-5.92%	-5.40%	-16.26%	9.51%	-5.62%	3.94%	0.50%
USD/CHF	-9.66%	0.31%	-2.42%	-2.46%	11.36%	0.78%	1.69%	-4.39%	0.80%	-1.58%	-5.97%
EUR/USD	-6.54%	-3.16%	1.79%	4.17%	-11.97%	-10.22%	-3.18%	14.15%	-4.48%	-2.22%	6.37%
USD/JPY	-12.80%	-5.19%	12.79%	21.39%	13.74%	0.37%	-2.71%	-3.65%	-2.66%	-0.98%	-3.96%

TABLE 5: ANNUAL COMMODITY PERFORMANCE, LOCAL CURRENCY, %

COMMODITIES	2016	2017	2018	2019	01.01 to 03.12.2020
Steel Rebar (CNY/Mt)	60.46%	42.69%	-8.19%	-1.91%	10.48%
Gold (USD/Oz)	8.14%	13.53%	-1.56%	18.31%	17.11%
Crude Oil WTI (USD/Bbl)	45.03%	12.47%	-24.84%	34.46%	-25.75%
Silver (USD/Oz)	15.84%	7.23%	-9.36%	15.32%	25.74%
Copper (USD/Mt)	17.65%	30.92%	-17.69%	3.50%	22.77%
Natural Gas (USD/MMBtu)	59.35%	-20.70%	-0.44%	-25.54%	31.66%

TABLE 6: ANNUAL EQUITY INDEX PERFORMANCE, PRICE INDEX, LOCAL CURRENCY, %

2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	01.01 to 03.12.2020
20.89%	0.00%	19.42%	51.46%	51.66%	9.93%	27.92%	38.71%	-6.24%	36.07%	21.08%
16.99%	-5.55%	18.01%	29.60%	11.39%	6.79%	16.44%	34.35%	-9.27%	28.88%	14.87%
16.36%	-7.62%	17.71%	24.09%	8.08%	5.58%	14.43%	21.78%	-10.44%	25.19%	12.10%
12.78%	-11.34%	15.15%	17.37%	4.35%	-0.73%	9.54%	20.96%	-12.48%	23.16%	9.53%
12.07%	-18.94%	14.37%	14.43%	2.92%	-2.74%	8.57%	20.83%	-13.24%	15.42%	8.11%
9.55%	-19.16%	13.40%	0.61%	2.23%	-4.93%	5.32%	20.11%	-16.31%	15.37%	1.95%
9.00%	-20.41%	13.18%	-5.03%	-2.71%	-11.31%	2.87%	19.69%	-16.57%	15.21%	-6.37%
8.63%	-21.92%	7.55%	-7.65%	-4.62%	-16.96%	-1.20%	19.42%	-17.80%	13.71%	-15.19%
-0.97%	-22.57%	5.84%	-8.05%	-14.78%	-22.37%	-1.85%	7.68%	-18.71%	12.10%	-16.92%
-12.51%	-25.01%	5.43%	-15.72%	-17.55%	-32.92%	-11.28%	7.63%	-25.31%	11.20%	-24.71%

BEST PERFORMING

WORST PERFORMING

FTSE 100 | Topix | MSCI World | MSCI EMEA | MSCI Emerging Markets

Stoxx Europe 600 | S&P 500 | Shanghai SE Composite | MSCI Latam | MSCI Asia Ex Japan

Source: Bloomberg, Indosuez Wealth Management.
Past performance does not guarantee future performance.

World

GLOBAL PRESENCE

OUR STORY

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The banks of the Indosuez Wealth Management Group are preparing for the replacement or restructuring of interbank interest rates, such as the LIBOR, EURIBOR and EONIA, the fixing terms of which will be strengthened significantly, as decided by the financial market authorities and banking agents. At the European level, the European Central Bank began publishing the €STR (Euro Short Term Rate) in October 2019, which will sit alongside the EONIA until December 2021 and will replace it in January 2022. Concerning the EURIBOR, the European Money Markets Institute confirmed in November 2019 that the transition phase for the Hybrid EURIBOR has been completed, paving the way for full restructuring between now and December 2021. Each IBOR interest rate (e.g. the LIBOR US Dollar) will also be overhauled between now and the end of 2021. Accordingly, the Swiss National Bank announced in June 2019 the introduction of its own policy interest rate in Swiss francs, calculated based on the SARON (Swiss Average Rate Overnight) with the goal of creating forward rates that will also be calculated based on the SARON.
The Indosuez Wealth Management Group is following all of these reforms very closely and has a specific framework to cover all related legal, commercial, and operational impacts. For now, you are not required to do anything in relation to your financing operations or investments indexed to the benchmark rates concerned by these changes. You will receive further information once a better picture surrounding the details of the replacements are known. Please feel free to contact your account manager if you have any questions.

GLOSSARY

Backwardation: Refers to a situation where a futures contract's price is below the spot price of the underlying. The opposite situation is referred to as Contango.

Barbell: An investment strategy that exploits two opposing ends of a spectrum, such as going long both the short-and long-end of a bond market.

Basis point (bps): 1 basis point = 0.01%.

Below par bond: A bond trading at a price inferior to the bond's face value, i.e. below 100.

Bottom-up: Analyses, or investment strategies, which focus on individual corporate accounts and specifics, as opposed to top-down analysis which focuses on macro-economic aggregates.

Brent: A type of sweet crude oil, often used as a benchmark for the price of crude oil in Europe.

Bund: German sovereign 10-year bond.

Call: Refers to a call option on a financial instrument, i.e. the right to buy at a given price.

CFTC (Commodity Futures Trading Commission): An independent US federal agency with regulatory oversight over the US commodity futures and options markets.

COMEX (Commodity Exchange): COMEX merged with NYMEX in the US in 1994 and became the division responsible for futures and options trading in metals.

Contango: Refers to a situation where the price of a futures contract is higher than the spot price of the underlying asset. The opposite situation is referred to as Backwardation.

CPI (Consumer Price Index): The CPI estimates the general price level faced by a typical household based on an average consumption basket of goods and services. The CPI tends to be the most commonly used measure of price inflation.

Duration: Reflects the sensitivity of a bond or bond fund to changes in interest rates, expressed in years. The longer the duration of a bond, the more its price is sensitive to any changes in interest rates.

EBIT (Earnings Before Interest and Taxes): Refers to earnings generated before any financial interest and taxes are taken into account. It takes earnings and subtracts operating expenses and thus also corresponds to "operating earnings".

EBITDA (Earnings Before Interests, Taxes, Depreciation and Amortisation): EBITDA takes net income and adds interest, taxes, depreciation and amortisation expenses back to it. It is used to measure a company's operating profitability before non-operating expenses and non-cash charges.

ECB: The European Central Bank, which governs the euro and euro-member countries' monetary policy.

Economic Surprises Index: Measures the degree of variation in macro-economic data published versus forecasters' expectations.

EPS: Earnings per Share.

ESG: Environmental, Social and Governance.

ESMA: European Securities and Markets Authority.

Fed: The US Federal Reserve, i.e. the central bank of the United States.

FOMC (Federal Open Market Committee): The US Federal Reserve's monetary policy body.

Futures: Exchange-traded financial instruments allowing to trade the future price of an underlying asset.

G10 (Group of Ten): One of five groups, including also the Groups of 7, 8, 20 and 24, which seek to promote debate and cooperation among countries with similar (economic) interests. G10 members are: Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the UK and the US with Switzerland being the 11th member.

GDP (Gross Domestic Product): GDP measures a country's yearly production of goods and services by operators residing within the national territory.

GHG: Greenhouse gases.

Gulf Cooperation Council (GCC): A grouping designed to favour regional cooperation between Oman, Saudi Arabia, Kuwait, Bahrain, United Arab Emirates and Qatar.

High yield: A category of bonds, also called "junk" which ratings are lower than "investment grade" rated bonds (hence all ratings below BBB- in Standard & Poor's parlance). The lower the rating, the higher the yield, normally, as repayment risk is higher.

Hybrid securities: Securities that combine both bond (payment of a coupon) and share (no or very long maturity date) characteristics. A coupon might not be paid, as with a dividend.

iBoxx investment grade/high yield indices: Benchmarks measuring the yield of investment grade/high yield corporate bonds, based on multi-source and real-time prices.

IMF: The International Monetary Fund.

Investment Grade: A "high quality" bond category rated between AAA and BBB- according to rating agency Standard & Poor's.

LIBOR (London Interbank Offered Rate): The average interbank interest rate at which a selection of banks agree to lend on the London financial market. LIBOR will cease to exist in 2020.

LME (London Metal Exchange): The UK exchange for commodities such as copper, lead, and zinc.

Loonie: A popular name for the Canadian dollar which comes from the word "loon", the bird represented on the Canadian one dollar coin.

LVT: Loan-to-Value ratio; a ratio that expresses the size of a loan with respect to the asset purchased. This ratio is commonly used regarding mortgages, and financial regulators often cap this ratio in order to protect both lenders and borrowers against sudden and sharp drops in house prices.

Mark-to-market: Assessing assets at the prevailing market price.

OECD: Organisation for Economic Co-operation and Development.

OPEC: Organisation of Petroleum Exporting Countries; 14 members.

OPEC+: OPEC plus 10 additional countries, notably Russia, Mexico, and Kazakhstan.

Policy-mix: The economic strategy adopted by a state depending on the economic environment and its objectives, mainly consisting of a combination of monetary and fiscal policy.

PMI: Purchasing Managers' Index.

Put: An options contract that gives the owner the right, but not the obligation, to sell a certain amount of the underlying asset at a set price within a specific time period. The buyer of a put option believes that the underlying stock price will fall below the option price before expiration date. The value of a put option increases as that of the underlying asset falls, and vice versa.

Quantitative Easing (QE): A monetary policy tool by which the central bank acquires assets such as bonds, in order to inject liquidity into the economy.

Renminbi: Translating literally from Chinese as "currency of the people", this is the official name of China's currency (except in Hong Kong and Macao). It is also frequently referred to as the yuan.

Russell 2000 Index: A benchmark measuring the performance of the US small cap segment. It includes the 2000 smallest companies in the Russell 2000 Index.

SEC (Securities and Exchange Commission): The SEC is an independent federal agency with responsibility for the orderly functioning of US securities markets.

Spread (or credit spread): A spread is the difference between two assets, typically between interest rates, such as those of corporate bonds over a government bond.

SRI: Sustainable and Responsible Investments.

Subordinated debt: Debt is said to be subordinated when its repayment is conditional upon unsubordinated debt being repaid first. In return for the additional risk accepted, subordinated debt tends to provide higher yields.

Swap: A swap is a financial instrument, often over the counter, that enables two financial flows to be exchanged. The main underlyings used to define swaps are interest rates, currencies, equities, credit risk and commodities. For example, it enables an amount depending on a variable rate to be exchanged against a fixed rate on a set date. Swaps may be used to take speculative positions or hedge against financial risks.

USMCA: The United States-Mexico-Canada Agreement, signed by the political leaders of the three countries on 30 September, 2018, replacing NAFTA (created in 1994).

VIX: The index of implied volatility in the S&P 500 Index. It measures market operators' expectations of 30-day volatility, based on index options.

Wedge: A wedge occurs in trading technical analysis when trend lines drawn above and below a price chart converge into a arrow shape.

WTI (West Texas Intermediate): Along with Brent crude, the WTI is a benchmark for crude oil prices. WTI crude is produced in America and is a blend of several sweet crude oils.

WTO: The World Trade Organisation.

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