INTRODUCTION
RISEING UNCERTAINTIES AFTER A STRONG H1

Earlier this year, in our Global Investment Outlook, we expressed concerns on the investment landscape for the next decade, and highlighted the keys to successfully navigate it. We emphasised one in particular: the ability to quickly add or reduce risk, when volatility generates opportunity.

Putting it immediately into practice, we started 2019 with a positive stance. After the capitulation of December 2018, we quickly reversed our previously defensive positioning. For instance, we almost halved our allocation to government bonds, and significantly increased exposure to equities.

Markets so far proved us right, with one of the strongest rallies in the history of financial markets, for the first half of the year. As a result, our recommended Cautious, Moderate and Aggressive allocations gained respectively 7.4%, 9% and 10.6% in US dollars during H1 2019. As a matter of fact, these numbers are comparable to most of our international competitors over the period. But we strongly outperformed our respective categories last year, in much tougher markets, by limiting losses. This is precisely what we believe Wealth Management is about: making a difference in difficult times by protecting your assets, and being simply in-line with markets when they are well oriented, to build a superior long-term performance.

We are always transparent: we currently have more questions than certainties. This is why we are gradually moving our positioning to a more defensive bias, again. We have taken partial profits on equities, and more recently on gold, keeping the proceeds in cash. Cash is now our largest overweight, providing reasonable yield and priceless flexibility.

Our positioning is however not radical, and not disproportionately diverging from our long-term strategic allocation, which had been rebuilt, which we trust for the long-term. Monetary support is indeed a powerful force and expensive valuations do not normalize spontaneously; in fact, they create vulnerability. We closely monitor the potential catalysts for a risk-off episode, their potential consequences, and even under which conditions it could constitute the next opportunity for your portfolios.

This publication is a revamp of our Global Investment Outlook for 2019, and very simply presents our updated investment views after 6 months.
OUR KEY CONVICTIONS AT A GLANCE

EXHIBIT 1: CURRENT ABSOLUTE TACTICAL POSTIONING (ABS.) AND RELATIVE TO STRATEGIC ASSET ALLOCATION

<table>
<thead>
<tr>
<th>ASSET CLASS</th>
<th>SUB-ASSET CLASS</th>
<th>CAUTIOUS ABS.</th>
<th>CAUTIOUS REL.</th>
<th>MODERATE TAA</th>
<th>MODERATE REL.</th>
<th>AGGRESSIVE TAA</th>
<th>AGGRESSIVE REL.</th>
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</thead>
<tbody>
<tr>
<td>Cash</td>
<td>USD Cash</td>
<td>19.6%</td>
<td>4.6%</td>
<td>15.0%</td>
<td>5.0%</td>
<td>10.6%</td>
<td>5.6%</td>
</tr>
<tr>
<td>Fixed Income</td>
<td>DM Government</td>
<td>19.8%</td>
<td>(1.5%)</td>
<td>11.3%</td>
<td>(1.5%)</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td></td>
<td>DM Investment Grade</td>
<td>24.4%</td>
<td>1.4%</td>
<td>15.7%</td>
<td>0.2%</td>
<td>8.7%</td>
<td>0.2%</td>
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<tr>
<td></td>
<td>DM High Yield</td>
<td>0.0%</td>
<td>0.0%</td>
<td>2.9%</td>
<td>(0.7%)</td>
<td>3.9%</td>
<td>(0.7%)</td>
</tr>
<tr>
<td></td>
<td>EM Government</td>
<td>6.6%</td>
<td>0.3%</td>
<td>10.2%</td>
<td>2.3%</td>
<td>13.2%</td>
<td>3.5%</td>
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<td>Fixed Income Total</td>
<td></td>
<td>50.8%</td>
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<td>40.1%</td>
<td>0.3%</td>
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<td>2.9%</td>
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<td>(0.9%)</td>
<td>25.8%</td>
<td>(0.4%)</td>
<td>37.6%</td>
<td>(2.6%)</td>
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<tr>
<td></td>
<td>EM</td>
<td>3.9%</td>
<td>(0.1%)</td>
<td>8.7%</td>
<td>(0.2%)</td>
<td>14.5%</td>
<td>(0.3%)</td>
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<tr>
<td>Equities Total</td>
<td></td>
<td>19.2%</td>
<td>(1.0%)</td>
<td>34.6%</td>
<td>(0.6%)</td>
<td>52.2%</td>
<td>(2.9%)</td>
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<td>Alternatives</td>
<td>Gold</td>
<td>4.0%</td>
<td>0.0%</td>
<td>3.5%</td>
<td>0.0%</td>
<td>3.0%</td>
<td>0.0%</td>
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<tr>
<td></td>
<td>Hedge Funds</td>
<td>6.4%</td>
<td>(0.1%)</td>
<td>6.9%</td>
<td>(0.1%)</td>
<td>8.5%</td>
<td>0.0%</td>
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<td></td>
<td>Real Estate</td>
<td>0.0%</td>
<td>(3.6%)</td>
<td>0.0%</td>
<td>(4.6%)</td>
<td>0.0%</td>
<td>(5.6%)</td>
</tr>
<tr>
<td>Alternatives Total</td>
<td></td>
<td>10.4%</td>
<td>(3.7%)</td>
<td>10.4%</td>
<td>(4.7%)</td>
<td>11.5%</td>
<td>(5.6%)</td>
</tr>
</tbody>
</table>

ASSET ALLOCATION AND PORTFOLIO CONSTRUCTION

> Our positioning is increasingly defensive after a strong H1
> Overweight cash, slight overweight fixed income and slight underweight equity
> We may consider adjusting risk in a contrarian way

EQUITY CONVICTIONS

> Developed Markets: neutral in all regions, focus on stock-picking
> Emerging Markets: we are overweight India for the long term, took profits on KSA
> Sectors: we favour Technology and Consumer Discretionary

FIXED-INCOME CONVICTIONS

> Emerging Markets debt is still our preferred segment
> Within Developed Markets we favour duration risk over credit risk. US is our preferred sovereign bond
> Within Emerging Markets, we selectively overweight some local currency bonds

COMMODITIES

> We keep on expecting Brent prices to average USD 65 in 2019
> We cut our overweight Gold to neutral after the 10% gain so far

REAL ESTATE

> Late cycle concerns: very low level of yields with little room for rental growth
> We are cautious on the asset class, opportunities are specific
The second half of the year has begun with greater optimism now that US-China trade talks are ‘back on track’, following the bilateral meeting between Presidents Trump and Xi at the G20 summit in Osaka. This should be a welcome relief for financial markets which have oscillated since talks were halted in May, as there will now be a suspension of further tariff increases on USD 300bn of Chinese imports ‘for the time being’ as well as any retaliatory action from China, and some relaxation of the restrictions placed on Chinese telecoms firm Huawei.

However, a lot of work remains to be done and the implications are not wholly straightforward. For one thing the existing tariffs have not been removed so the Chinese and US economies will continue to feel the combined weight of those, with other countries also suffering from disruption to global supply chains and attendant business uncertainty. Also the apparent ‘truce’ may still prove to be short lived as fundamental differences have not gone away, with both the US and China becoming more entrenched in their positions. The US is demanding fundamental changes to Chinese industrial practices, in effect challenging its sovereignty to provide subsidies to state owned enterprises, and over opening up its domestic market to US goods. China on the other hand looks set to resist this. And even though trade talks with the China are resuming, it looks as if tensions are going to increase elsewhere as the US is now planning USD 4bn of tariffs on European products as retaliation for European aircraft subsidies.

Furthermore, with a more positive trade outlook potentially likely to boost economic sentiment and lift markets, it might also cast doubt on the likelihood of Fed interest rate cuts later this month. The Fed’s hint about lowering interest rates at its June meeting was in part dependent on whether ‘uncertainties’ would continue to weigh on the economic outlook. With that outlook presumably lifting as a result of the decision to resume trade talks, it may not be necessary to cut rates, especially not as soon as this month which the markets have discounted. This could add further to tensions that are brewing in currency markets between the US and the Eurozone, especially if the ECB proceeds with its own monetary easing in coming months.

The ECB certainly appears to be laying the groundwork for a further rate cut and the adoption of more quantitative easing, and other global central banks are also becoming more dovish. The Reserve Bank of Australia cut interest rates to a historic low of 1.0% already this month, and a number of emerging market central banks have also trimmed rates. Even the Bank of England appears to be softening its language in the face of what looks likely to be another uncomfortable Brexit deadline in October.

EXHIBIT 2: EMIRATES NBD RESEARCH GROWTH AND INFLATION FORECASTS FOR 2019, MAJOR ECONOMIES

<table>
<thead>
<tr>
<th>2019 FORECASTS</th>
<th>REAL GDP GROWTH %</th>
<th>INFLATION (CPI) %</th>
</tr>
</thead>
<tbody>
<tr>
<td>USA</td>
<td>2.5</td>
<td>2.3</td>
</tr>
<tr>
<td>Eurozone</td>
<td>1.5</td>
<td>1.5</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1.5</td>
<td>2.1</td>
</tr>
<tr>
<td>Japan</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>China</td>
<td>6.3</td>
<td>2.3</td>
</tr>
<tr>
<td>India</td>
<td>7.0</td>
<td>3.5</td>
</tr>
</tbody>
</table>
Survey data over the last quarter has pointed to an acceleration in growth in both the UAE and Saudi non-oil sectors this year. In Saudi Arabia, the strength of point of sales data, pick up in private sector credit growth and an improving fiscal position supports our view that the non-oil economy is likely to grow at a faster rate in 2019 than it has over the last three years. However, the extension of the OPEC+ production cuts through Q1 2020 means that the oil sector is likely to expand at a slower rate this year compared with 2018, especially as Saudi Arabia has borne the brunt of the production cuts within OPEC by maintaining oil output well below its target level of 10.3mn b/d. As a result, we expect headline growth to slow to 2.0% this year from 2.2% in 2018.

In the UAE, the PMI data indicates that non-oil growth was the strongest in more than four years in Q2 2019. However, the growth in output and new work has come on the back of price discounting and margin compression, and has consequently not translated into job growth as businesses focus on keeping costs down. In a country where the majority of the population is foreign, private sector job growth is key to overall population growth. The absence of employment and wage growth, is weighing on household consumption and contributing to deflationary pressures in the economy. This is most apparent in the continuing decline in real estate prices, where soft demand has been compounded by increased supply. However, there is evidence of pricing pressure in the retail and hospitality sectors as well, both as a result of relatively soft demand and increasing capacity.

The government has recently begun issuing longer-term visas for expatriates, and also moved forward with removing caps on foreign ownership of onshore businesses across a number of economic sectors, although the final decision on how much foreign ownership will be permitted will lie with each emirate. These measures are likely to make investment in the UAE more attractive over the medium term. For this year however, we have revised down our growth forecast to 2.0% from 3.1% previously, to take into account the weaker 2018 GDP data and continued softness in the job market. We expect growth to accelerate to 2.6% in 2020 as Expo 2020, easier monetary policy and weaker dollar should support a rebound in tourism and retail spending.

EXHIBIT 3: RISING BUSINESS ACTIVITY IN THE UAE IS NOT TRANSLATING INTO MORE JOBS

Source: IHS Markit, Emirates NBD Research.
ASSET ALLOCATION
A LOOK BACK AT H1 2019

The first half of 2019 has ended with the strongest rally in a decade across most asset classes, with benchmarks achieving average long-term annual returns in just 6 months (exhibit 4).

The start of the year saw the beginning of an impressive rally, initially fueled by undervaluation versus fundamentals and then boosted by what has come to be known as the Fed’s dovish pivot in January. Also, a very strong US labor market report alleviated investor fears of an accelerating slowdown phase. Against this backdrop, we tactically rebalanced our portfolio allocations to take profit on government bonds and increase equity exposure across risk profiles.

Risk-on sentiment persisted in the following months, buoyed by the 90-day trade truce agreed to by President Trump and President Xi in December 2018. In early February, we further reduced exposure to cash and government bonds to tactically add to EM debt. Simultaneously, negative macro news flow was continuing to build, with the World Bank, OECD and IMF revising down global growth forecasts for the year, while China and Europe downgrading the domestic outlook. In the latter part of the month we partially took profit on DM equities as they were approaching our year-end fair values.

In March, the US caught up with the slowdown phase gripping the rest of the world. The US yield curve inverted and economic surprise indices fell in negative territory.

In April, risk assets continued to rise on the expectation that a deal between the US and China was done. But the unabated fall in global manufacturing confidence was telling a different story and the gap between the industrial and the resilient consumer sector continued to widen.

The month of May saw a sharp pullback in asset markets as President Trump shocked markets by tweeting that he would impose new tariffs on Chinese imports. Immediately, this prompted us to reassess our EM equity overweight exposure right after the tweet, which was subsequently cut to neutral. The flight to quality was extreme, with investors starting to discount more than two policy cuts by the Fed in 2019.

June saw central banks again in the spotlight. At the FOMC meeting, Fed Chair Powell lowered the bar further for rate cuts in the short term, with a growing number of officials favouring imminent looser policy. Mario Draghi made a dovish turn too. Gold surged to a 6-year high and 10-year government yields tumbled to all-time lows in most G-10 countries. Risk assets rallied into the G20 meeting, which saw a renewed trade truce come to life.

EXHIBIT 4: MAJOR ASSET CLASSES NET USD RETURNS IN H1 2019

Following the outsize performances of the first half, it is important to assess whether there are positive catalysts ahead capable of lifting markets further. We do not find compelling evidence of strong upside in any asset class, considering the macro outlook or valuations.

There should be a window of opportunity for non-US assets to outperform into the July 31 FOMC meeting, where Fed officials are expected to deliver at least one rate cut, given the intersection with the trade truce agreed to at the G20 meeting. In this respect, EM assets, hard-currency credit and equities look appealing and can be further boosted by a temporary loss of momentum in the dollar, more dovish EM central banks and hopes for a less-dark-than-initially-thought outlook for trade tariffs.

Regardless, valuations are not particularly supportive. The balance of factors between what must go right for markets to continue to rise, and what might go wrong for volatility to persist, seems to be strongly skewed towards the latter. While a high-single digit rally in equities from current levels would require almost all the stars to be aligned, the stalling of the rally just needs the current state of affairs to continue.

Although a trade truce has been announced, the fallout from current tariffs and the uncertainty about future developments remain. Valuations of equities and credit are not cheap, and the rate of growth of the global economy is slipping below trend. There is a risk that corporate earnings will soon be negatively impacted, forcing investors to reprice equities and credit accordingly.

We maintain a prudent allocation with an overweight in cash. We just took partial profits on Gold, after 9% performance, and kept it neutral. We are slightly underweight in equities. Duration is crowded and doesn’t pay much, hence the overweight in dollar cash against government bonds, reinforced by the inverted US yield curve. We favour Emerging Markets debt as a fixed-income region. EM hard-currency debt still offers an appealing yield pick-up with less sensitivity than equities to the global cycle.

Investors are advised to allocate at least a benchmark-weight share of the portfolio to absolute return strategies, which tend to outperform traditional asset classes in the late stages of the economic cycle, marked by a higher-volatility regime. Since we still do not see a recession occurring on our forecast horizon, we are not in a fully defensive mode. The risk of a Fed-driven generalised multiple expansion also exists, even if we don’t expect it. On the other side, we may consider a material market weakness as an opportunity to add risk to the portfolio, assuming that valuations show some fundamental upside potential again.
EQUITY
A LOOK BACK AT H1 2019

The first half of 2019 saw double digit returns across all major markets and global sectors, after a roller coaster ride. For H1, net total returns in US dollars for US, European and Emerging Markets were 18.5%, 16.9% and 10.6% respectively. In the GCC, the KSA market rallied 20% and then gave up some gains, once the 1st tranche of the MSCI EM inclusion was implemented, in late May. In the UAE, the Dubai and Abu Dhabi indices returned 8.2% and 6.0% respectively. The GCC banking sector led at +18%, even with the prospect of lower rates. Mergers and high level of dividends remained supportive, helping sustain a rally which started in late 2017. Real estate performance in the region lagged, with just +4% gains for the sector in H1.

The record global H1 performance played out in three distinct phases. The first phase was a rally in the first quarter, with a favourable starting point of undervalued markets, propelled by the Fed's dovish turn and by robust corporate earnings. This was followed by a selloff in May as the US-China trade dispute re-escalated, weighing on growth and margin prospects, with a strong drag on Emerging Markets and trade exposed sectors such as semi-conductors, also affected by the Huawei story. Technology retained its year-to-date lead, but defensive sectors came back in favour. Finally, June was very strong for equities, with an increasingly dovish Fed and hopes of progress on the trade war front. Emerging Markets however didn't reach their previous year high of April. Share buy-backs were also supportive, with a record pace in the US and acceleration in Japan.

HOW DID OUR EQUITY STRATEGIES FARE IN H1?

Within Developed Markets, our regional preferences were to be neutral the US, slightly underweight Europe and slightly overweight Japan. Our regional allocation performance was in line with the global DM Index in H1. Our style and sector recommendations fared well. The tech sector returned +27%, including +23% and +25% for Robotics and Artificial Intelligence ETFs. Our selection of high quality, sustainable business models outperformed in H1.

Within Emerging markets, our regional preferences were an overweight of Asia versus Latin America and EMEA, which delivered a slight outperformance compared to a global EM Index. We took the opportunity of the pre-election uncertainty to add a slight overweight to India.

Pertaining to our region, we advised a reduction in exposure to KSA Equities, close to the MSCI inclusion implementation after having been constantly overweight since late 2017.

EXHIBIT 6: THE H1 EQUITY RALLY HAD 3 PHASES

1. A global rally from undervalued levels; a dovish Fed; hopes on trade resolution
2. Global sell off in May. Yield curve inverts, Trade disputes escalate. EM drop most
3. Rally in June, led by the US, as Fed talks of rate cut; G20 brings hope

The 2018 backdrop:
A dismal December. Fears of higher rates & escalation of trade tariffs

The 2019 backdrop:
The 2019 backdrop:
The 2019 backdrop:

EQUITY OUTLOOK AND POSITIONING

The key drivers for the future direction of equity markets will be earnings, with the imminent start of the Q2 season and the impact of Central Bank action on valuations. We have slightly increased our year-end fair values for the US, Eurozone and China, adjusting P/E to the lower rates context. Developed Markets have reached or exceeded our fair values, while Emerging Markets show a modest upside potential. Their valuations are less stretched, earnings growth is supportive and the combination of potential relief on trade and a Fed weakened US dollar could support them in absolute and relative terms.

Within Developed Markets, we don’t have regional preferences between the US, Europe and Japan and recommend positioning close to their weight in the MSCI Index.

It’s difficult to overweight the US because of valuations, which appears reasonable only by comparison to bonds and can only be justified by stronger earnings growth. Our own (unchanged) assumption is for a +5% earnings growth in 2019. We will closely watch Q2 earnings: according to Factset, consensus is expecting a year-on-year decline of -2.6% which we believe will be beaten by 3 to 4%. Our neutrality on the US is based on it being a formidable pool for stock-picking, as well as a lack of alternatives within developed markets. We are no longer overweight Japan, as the second phase of the consumption tax, to be implemented in October, is a threat. We are neutral on Europe, which has rallied well above our expectations.

Within Emerging Markets, India is our only overweight position, funded with an underweight in Latin America. Within India, we favour domestically oriented businesses within the Industrial (exposed to infrastructure spending) and Consumer sectors. India is at the onset of a multi-year earnings growth cycle, hence, the high valuation multiple is justified. We expect continued near term volatility, with financial sector defaults in focus and headwind from higher oil prices. Regarding China, valuation appears extremely reasonable with a 12.2x forward price earnings ratio (MSCI China), but equity markets will be highly dependent on the developments on the stand-off with the US.

As for the GCC, geopolitical tensions have not impacted performance materially, but are affecting trading volumes and thus liquidity, which could deteriorate further should the situation escalate. Current oil prices provides support for government spending. UAE valuations are low, though stretched in the KSA. Banks and logistics are our preferred sectors.

In terms of global sectors, we expect the Technology market to continue, with selectivity. We also recommend a slight overweight in the Consumer Discretionary and Healthcare sectors, the latter for its defensive characteristics, and in high dividend payers within the Energy sector. We are neutral financials and industrials. We are overweight Staples and Utilities.

<table>
<thead>
<tr>
<th>REGION</th>
<th>US</th>
<th>EUROZONE</th>
<th>JAPAN</th>
<th>UK</th>
<th>EM</th>
<th>CHINA</th>
<th>INDIA</th>
<th>GCC</th>
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<tr>
<td>INDEX</td>
<td>S&amp;P 500</td>
<td>EUROSTOXX</td>
<td>NIKKEI</td>
<td>FTSE</td>
<td>MSCI EM</td>
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<td>16.0%</td>
<td>5.0%</td>
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<td>Price/Earnings</td>
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<td>13.5</td>
<td>15.0</td>
<td>12.5</td>
<td>12.0</td>
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<td>85</td>
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<td>4.7%</td>
<td>3.0%</td>
<td>2.4%</td>
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<td>14.5%</td>
<td>16.1%</td>
<td>16.9%</td>
<td>21.8%</td>
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<tr>
<td>Index Level from Fair Value</td>
<td>(1.4%)</td>
<td>(4.4%)</td>
<td>5.4%</td>
<td>1.0%</td>
<td>4.2%</td>
<td>7.1%</td>
<td>4.6%</td>
<td>(3.3%)</td>
</tr>
</tbody>
</table>

Bond markets have been extremely positive in the first half of the year, surpassing in six months most of our projected performances for the end of the year. The rally was remarkable in both its magnitude and its breadth, with all segments of fixed income delivering 5% to 10% during the first half of this year. Such an unanimity can, of course, be attributed to a single dominant factor, driving all financial markets higher so far in 2019: the Federal Reserve. As our illustration shows, it started with a verbal change of tone in January, signalling “patience” replacing the idea that short-term rates were “far from neutral”. It was then reinforced in March as the FOMC member’s projections removed any hike in 2019. As the US-China tensions escalated in May, it became openly dovish and the markets priced in with certainty several imminent cuts in rates. Short-term references were the first to react, with 12m LIBOR substantially falling to as low as 2.18%. Long-term rates dramatically fell in sympathy, also pressured by the late cycle context. Coincidentally, the riskiest segments benefitted from the hunt for yield as well as from a general “risk-on” orientation and saw their spreads compressing to extremely tight levels. Strong technical factors from previously defensively positioned investors contributed amplifying the move.

Understanding the mechanics of the rally is one thing. However, our fundamental framework has to question the levels that we have reached, and some of them seem difficult to justify. In the sovereign world, negative yields in Eurozone now affect some maturities up to 20 years. Greece is borrowing money at 2%, lower than before the crisis at almost on par with the US. In the corporate world, especially in high yield, spreads don’t reflect any of the considerable geopolitical or even cyclical risks which are dominating headlines.

HOW DID OUR FIXED INCOME STRATEGIES FARE IN H1?
At the asset class level, our preference towards Corporate Credit and Emerging Market debt versus Developed Market government bonds did well. Our caution towards DM High Yield was detrimental to performance but compensated by our conviction towards Emerging Market debt, which offered a similar performance in hard currency. Our positive stance towards GCC also did well. Finally, we didn’t materially participate in the rally of negative yielding bonds in Japan and Europe, as it would not make sense from a USD denominated Wealth Management perspective.

EXHIBIT 9: H1-2019 FIXED INCOME RETURNS (USD)


EXHIBIT 8: DRAMATIC SHIFT IN FEDERAL RESERVE EXPECTED POLICY

Looking forward, the key question is obviously if the spectacular returns of H1 can be sustained, or if they are at risk. Notably, the beginning of a global monetary easing cycle should support prices, especially on the safest segments. In parallel, risks to the global economy are significant, from the geopolitical tensions to the natural roll-over of an abnormally long business cycle, which is already observable in manufacturing indicators. According to the National Bureau of Economic Research, the average duration of the 11 business cycles the US has gone through since 1945 is 58 months. The current one is 120 months old. In addition, the desperate attempts from Central Banks to generate inflation in the last decade have dramatically inflated valuations, making it difficult to assess fair-values. The best example is the astonishing USD 13tn of negative yielding debt in the world.

As for the US, we now expect the US yield curve to “bull flatten”, as long-term yields will continue adjusting to the low inflation context, in synchronisation with the Fed cutting rates. This trend will also be a step towards some convergence between yields from the US and other developed economies. Pricing, solvency and liquidity risks are the additional factors which shape the following preferences.

Within Developed Markets, we favour duration risk over credit risk. This is consistent with the late cycle context as well as with our “bull flattening” scenario, which does not advocate deteriorating credit quality to achieve higher yields. The US is our preferred developed sovereign issuer, and in the corporate space, we favour investment-grade issuers over high-yield. From a sectoral point of view, we adopt a defensive preference to stomach any stress episode: sovereigns, utilities, consumer staples, healthcare, and selected financials.

Emerging Markets are our unchanged long-standing conviction, with an overweight in local currency denominated bonds. We find compelling market opportunities within Asian credit markets. Higher on the risk-curve, Brazil, Mexico and Turkey provide returns proportionated to the underlying risk. GCC debt is generally adequately valued with limited upside potential. High yielding sovereigns which are constituents in major indices offer reasonable value. There are also some individual opportunities relying on deep bottom-up analysis, i.e. more alpha than beta.

### EXHIBIT 10: FIXED INCOME YEAR-END FAIR VALUES

<table>
<thead>
<tr>
<th>BONDS</th>
<th>CURRENT YIELD</th>
<th>CURRENT SPREAD</th>
<th>YIELD/SPREAD INITIAL ESTIMATES 2019</th>
<th>REVISED ESTIMATES</th>
</tr>
</thead>
<tbody>
<tr>
<td>US 10Y Treasury Bond</td>
<td>2.10%</td>
<td>0</td>
<td>2.75%</td>
<td>2.00%</td>
</tr>
<tr>
<td>Global Investment Grade</td>
<td>2.34%</td>
<td>106</td>
<td>110bps-125bps</td>
<td>90bps-110bps</td>
</tr>
<tr>
<td>Global High Yield</td>
<td>5.87%</td>
<td>417</td>
<td>425bps-450bps</td>
<td>400bps-425bps</td>
</tr>
<tr>
<td>Emerging Markets Debt (USD)</td>
<td>4.86%</td>
<td>281</td>
<td>275bps-300bps</td>
<td>250bps-275bps</td>
</tr>
<tr>
<td>GCC</td>
<td>3.52%</td>
<td>155</td>
<td>175bps-200bps</td>
<td>150bps-175bps</td>
</tr>
</tbody>
</table>

Source: Bloomberg, CIO Office 10 July 2019.
OPEC has agreed to extend its production cuts into the first quarter of 2020 and will get support from non-OPEC countries, such as Russia, in restraining output. Cutting production has helped to draw down on excess inventories but variables beyond the control of OPEC+ will exert significant force on the trajectory for oil prices in the next 12 months.

The strategy from OPEC+ (OPEC members plus partners like Russia, Kazakhstan, Mexico among others) since 2016 has been to forgo a market share battle with alternative producers like the US shale patch and instead focus on draining excess inventories and pushing prices closer to fiscal breakeven levels, particularly for OPEC members from the GCC. Given the rather broad objectives, the cuts have so far had a measure of success, coming close to 80% of average fiscal breakeven prices for GCC producers so far in 2019.

While the OPEC+ cuts have helped in contributing to tighter oil markets, factors outside of OPEC control have had a significant impact as well. In the first five months of 2019 OPEC countries that are party to cuts have actually produced more oil compared with the same period of 2018. Most of the decline in total OPEC production this year has been down to lower volumes from Venezuela and Iran, both of which are under US sanctions. With no apparent sanctions relief on the horizon both countries will remain the primary contributors to lower OPEC production for the rest of the year and into Q1 2020.

But even with several countries under sanctions, the scale of cuts that OPEC+ will extend into next year won’t be enough on their own to tip markets back into deficit. Even if every member achieved 100% compliance with the cuts, headline balances will still result in a surplus of nearly 1.5mn b/d in Q1 while our own forecasts—which assumes over-compliance by members like Saudi Arabia and severe under-compliance by others—results in a surplus of closer to 1.9mn b/d. Production from countries outside the OPEC+ grouping is forecast to expand by 2.5mn b/d in Q1 YoY thanks to persistently strong growth from the US but helped next year by additions to supply in Brazil and Norway.

With a strong non-OPEC supply growth profile, enormous uncertainty over demand in a global economy facing trade disruptions and OPEC itself keeping considerable spare capacity on the sidelines, oil prices face a significant challenge to break out of their current range and move closer to GCC fiscal requirements.

OIL OUTLOOK

EXHIBIT 11: OIL SUPPLY GROWN

Source: Emirates NBD Research, IEA.
REAL ESTATE OUTLOOK

Real estate has had a strong first half of the year with global REITs rebounding from a poor January to produce a total return of 15.1% in the first half of the year.

Despite these healthy numbers, we are now very late into the current real estate cycle. Since 2009, there has been consistently strong demand for real estate, principally from investors seeking stable and steady yields in a low interest rate environment, with the tangibility of the underlying adding comfort. At current prices however, yields have reached historic lows in almost all major markets, with little room for further significant monetary support. As a result, rental growth is the last potential driver of property returns, but it is certainly capped by the global late cycle context. In short, investing into real estate today involves paying peak prices but receiving diminishing returns.

Real estate is a varied asset class though and the outlook is far from uniform across individual sectors. Retail properties across most developed markets are under acute pressure from the structural shift away from traditional channels to online shopping. The rise of e-commerce has affected retail sales with a concurrent impact on rents and prices. However, retail’s loss has been industrial’s gain and the sector has been a key beneficiary of the structural digital shift, through increased demand for industrial and warehouse space is required for storage and logistics. In response, businesses have sought to reform their supply chain and embrace this new paradigm but have faced a consistent shortage of suitable properties. This supply-demand imbalance has led to robust rental and price growth and industrial has been the best performing sector across almost all jurisdictions for a number of years. The outlook for office properties is also uncertain at present due to weak business sentiment impacting occupier demand and rents. There are also rising risks from flexible workspace providers who are gradually disrupting the traditional commercial letting market.

Given the elevated prices and largely sluggish outlook for mainstream real estate, there has been growing popularity amongst investors for non-traditional or alternative properties. These have either defensive or counter-cyclical income characteristics which largely negate any concerns about where we are in the current real estate cycle.

We are cautious on the asset class. We however continue to favour REITs over direct real estate. Competition for the best real estate remains intense and prices remain stubbornly high. Meanwhile, REIT prices, which are more forward looking than their direct counterparts, reflect the potential corrections to come and are trading at a discount to their current portfolio values. Although discounts have closed recently (and indeed have been a key driver of returns so far this year), REITs still offer better value compared to direct investment and are a much more efficient way to gain exposure to real estate.

EXHIBIT 12: GLOBAL REAL ESTATE YIELD COMPARISON BY PROPERTY TYPE 1990 - 2018

GLOBAL TECHNOLOGY
CURRENT AND EMERGING TRENDS
IN THE TECHNOLOGY SPACE

In 2019, internet usage reached 56% of the world’s population and by 2020, it’s estimated that for every person on earth, 1.7 MB of data will be created every second. The Information Technology (+27% in H1) and the Communication Services (+15% in H1) sectors have been major contributors to the global rally in equities. Amazon turns 25 this July. Once an online book store, it has revolutionised the retail industry and has a market capitalisation close to USD 1tn. If you had invested USD 100 in its IPO, it would be worth about USD 120,000 today.

In our Year Ahead publication we focused on the exponential rate at which technology is developing and how it presents both investment opportunities and pitfalls. We continue the theme, with a focus on current and emerging trends, especially around interconnectivity.

INNOVATION AND AGILITY HAVE BECOME VERY ESSENTIAL COMPETITIVE INGREDIENTS FOR COMPANIES IN ALL INDUSTRIES

Companies continue to invest in their digital transformation journey as emerging technologies provide significant cost reductions with powerful tools and services. The development of artificial intelligence (AI) and the Internet of Things (IoT) requires more public cloud resources. According to IDC, spending on public cloud services and infrastructure is expected to reach USD 210bn in 2019 (+23.8% YoY) and USD 370bn in 2022 (CAGR 22.5% 2017-2022). Amazon, Microsoft, Alibaba, IBM and Google are the leaders in the cloud space; Amazon and Microsoft together make up 59% of the cloud services market in 2018.

THE SWITCH HAS BEEN FLIPPED – 5G NETWORKS ARE ON

After a decade in the making, the fifth generation of wireless networks have finally become a reality. The network will go beyond connecting people to deliver exciting prospects such as the Smart Cities, Industrial IoT, Augmented and Virtual Reality, autonomous transportation, to name a few. The focus for 5G encompasses telecom carriers with infrastructure capacity, chipmakers and next-gen 5G capable smartphones. Growth investors could consider high-growth semiconductor makers and payment companies that will likely benefit from the rise of high-speed wireless networks and IoT. Whereas, income-seeking investors could evaluate the attractive dividends offered by major telecom carriers. With respect to the competitive spectrum, top players in the market are Samsung Electronics, Qualcomm Technologies, Huawei Technologies, NEC Corporation, Nokia, ZTE Corporation, Cisco Systems, CommScope, Ericsson and Equinix.

EXHIBIT 13: DOWNLOAD DURATION FOR A 2 HOUR MOVIE

<table>
<thead>
<tr>
<th>3G</th>
<th>4G</th>
<th>5G</th>
</tr>
</thead>
<tbody>
<tr>
<td>26 Hours</td>
<td>6 Minutes</td>
<td>3.6 Seconds</td>
</tr>
</tbody>
</table>

Source: GSMA, March 2019.
RE-ESTABLISHING THE CRYPTO CONVERSATION AND BLOCKCHAIN USE FOR SUSTAINABILITY

Blockchain is used in almost every industry globally with an expected CAGR of 81% 2018-2023 (Statista, June 2019). According to IDC, the financial sector is expected to account for 38% of spending on these technologies in 2019. Governments around the world are using enterprise blockchain applications with diverse objectives such as preventing corruption in public sector finance (Italy), streamlining land registries (Netherlands) and managing customs controls (South Korea). Blockchain today is probably at a stage similar to that of the “walled gardens” of the Internet.

Companies are investing in their own blockchain, crypto projects; MasterCard filed more than 30 patents in the field. We recommend positioning in companies that are actively investing in, developing or have products that are expected to benefit from this disruptive innovation. Financial transaction processors such as Visa, Paypal and MasterCard; digital payment leaders in the emerging world such as Alibaba and Tencent with its WeChat platform.

Facebook’s cryptocurrency Libra will be backed by traditional assets in fiat currencies, and will potentially target the two billion people who do not have access to bank accounts. It may not be just another new entrant, and could help increase adoption in what is currently a confusing universe. As of now, over USD 260bn of value is spread over 2235 coins or digital assets. Bitcoin retains a 55% lead in the cryptocurrency market (Coinmarketcap.com). Clarity and stability look like necessary conditions to consider that one day digital coins could replace fiat currencies. Being backed by more traditional assets could make it easier on both fronts as well as for regulators.

Blockchain is being increasingly used with sustainability projects. A good example is food. Retailers are planning to use ledger technology to track the overall supply chain and to help improve the safety and transparency of food sourcing. It might prove particularly relevant for specific categories such as organic, non-GMO or baby products. JD recently partnered with Walmart, IBM and Tsinghua University to launch the Blockchain Food Safety Alliance to enhance food tracing. Carrefour has launched similar initiatives to track meat, milk and fruit from farm to stores.

EXHIBIT 14: BLOCKCHAIN MARKET SHARE BY TOP USE CASE: 2019E

VIDEO GAMING: A NEW CYCLE IS AROUND THE CORNER
Next generation consoles are expected to be launched in 2020, always with more powerful specifications. Developers are now racing towards the development of new titles, increasing the hype by including popular Hollywood actors in their games such as Keanu Reeves in CD Projekt’s CyberPunk 2077 and Norman Reedus in Hideo Kojima’s Death Stranding. Battle Royale games continue to sustain growth and popularity with EA’s recent successful release of Apex Legends. Prize pools in eSports are setting new records, as Epic Games recently announced a USD 30mn prize money for this July’s Fortnite World Cup (the largest prize pool for an eSports event). We recommend to be positioned in companies exposed to mobile gaming, VR/AR and next-gen console software/hardware.

DIGITAL HEALTHCARE
Terms such as Internet of Medical Things, large-scale data initiatives and telemedicine are increasingly used when referring to healthcare companies. Patient wearables, digital health tracking apps and virtual assistants are turning mainstream, with ever growing penetration. The segment is hot for private equity with almost USD 14.6bn invested in the field. Within listed markets, we recommend to get exposure to biometrics related mobile apps, insurance, and connected devices to perform diagnostics such as electrocardiogram. In the second half of 2019, a number of IPOs are expected, as startups seek public funding; notable names include Livingo, Health Catalyst and Change Healthcare.

THE EMERGING BATTLE – CYBERSECURITY & IOT
A recent survey of 1200 companies conducted by IDC shows that 46% reported a digital security breach in 2018, up from 26% in 2017. AI and machine learning help accelerate incident detection and response. However, the rise of Internet of Things (IoT) devices within enterprises significantly increases cyber vulnerability. According to Symantec, IoT attacks multiplied 7 times in 2018. Cybersecurity Ventures predicts that an attack is currently occurring every 14 seconds, and that global damages could reach over USD 11bn in 2019.

EXHIBIT 15: FASTEST GROWING EMERGING TECHNOLOGIES

Source: IDC, 1 April 2019.
DIGITAL WAVE IN THE GCC
ARTIFICIAL INTELLIGENCE, A PERFECT OPPORTUNITY FOR OUR REGION

Historically dominated by the oil and gas industry, the economies of KSA and UAE are continuously accelerating their path to diversification. Fortunately, it happens at a pivotal moment when Artificial Intelligence (AI) is taking the world by storm.

Mass Internet adoption in the GCC took off around the mid-2000s. KSA and the UAE have some of the highest levels of internet, smartphone and social media penetrations globally, which explains why in 2017 Amazon acquired “Souq”, the leading e-commerce platform, and why Uber followed a similar approach with Careem in 2019. Both acquirers benefitted from the Saudi Public Investment Fund’s support. According to a study by PwC, AI could add as much as USD 96bn and 135bn to the UAE and KSA’s respective economies.

Here, we focus on some sectors that would particularly benefit from this phenomenon.

THE FINANCIAL SERVICES SECTOR

The financial services sector cumulates c. 50% of the KSA and UAE market cap. Naturally, GCC banks have been amongst the earliest adopters of new technologies. This is illustrated by the number of occurrences the word “digital” is found in their annual reports, which multiplied 14 folds between 2013 and 2017 – and is still growing. Banks far ahead in their digital transformation journeys include National Commercial Bank in the KSA; Abu Dhabi Commercial Bank, First Abu Dhabi Bank and Emirates NBD in the UAE, to name a few.

Overall, 35% of bank clients currently use internet or mobile banking to access banking solutions in the GCC. The ratio is higher for the UAE at 60%.

There are numerous initiatives in the field, leading to a sharp increase in digital client base, such as NCB tripling its penetration in KSA over 3 years, but also improving its operational efficiency through the use of robotics and process automation, and more importantly innovative solutions and products. Emirates NBD for example has integrated digital technologies to its offer for long, with the launch of Emirates NBD Lab in 2016. Its fully digital bank, Liv has introduced an AI-powered chatbot to interact with clients, Olivia, in 2019. The bank is overall going through an ambitious digital transformation journey with AI at the heart of both operational excellence and client experience.

The Insurance sector has also been quick to adopt AI. In line with UAE Vision 2021, I-Insured, the retail unit of the largest insurance group in the MENA region, launched an AI based ‘SafeDriver’ app in May 2018. The app aims to reduce traffic casualties, offering incentives and premiums based on how safe drivers are on the road.

EXHIBIT 16: USE OF MOBILE WALLETS IN 2019

Source: Hootsuite; Global Digital Yearbook 2019.
RETAIL SECTOR

E-commerce is at the core of retailers’ strategies globally, and our region is no exception. According to a Bain and Company report, the UAE is the most advanced e-commerce market in the region, with a penetration rate of 4.2%, with KSA closely behind at 3.8%. Currently, KSA is home to public companies in the electronics and retail sectors such as Al Jarir and Extra. In the UAE, the regional leaders in the retail ecommerce space remain mainly private such as Majid Al Futtaim with its Carrefour online services or Al Tayer Group’s Ounass and Nisnass.

HEALTHCARE SECTOR

AI’s potential to improve healthcare overall is profound, ranging from diagnosis to treatments. There is a growing potential for AI to disrupt the healthcare sector in the region, with the rise in spend prompting AI to step-in and reduce costs. Cancer and obesity remain concerns in KSA and the UAE. The Dubai Health Authority recently collaborated with a start-up company to install health scanners in public places across the city, allowing individuals to insert their Emirates ID to register and guide them through an assessment of various health measures, which would be uploaded to the cloud and accessed by doctors to review upon permission. Amongst the GCC healthcare companies adopting AI is NMC Health.

ENERGY SECTOR

Energy is a source of funding to diversify beyond... Energy. It is also a field where KSA and the UAE are using AI to improve efficiency, maximise returns but also ensure sustainability. McKinsey estimates that such efforts could potentially add USD 173bn of value to the oil and gas sector globally, of which a significant part to our region, as a leader in the field.

Saudi Aramco is among the companies embracing AI, converting an office complex in Dhahran to a Fourth Industrial Revolution (FIR) Center, where it implements technological and digital innovation. The AI Hub is focused on developing advanced analytics and machine learning solutions in hydrocarbon-related applications, as well as predicting the performance of the company's assets. Virtual Reality is also used to develop, prototype and train.

AI could help consumers by letting them reduce unnecessary costs. For example in the UAE, the electricity and water authorities plan to deploy 1mn smart meters by 2020, that will collect data to predict consumption patterns. Sharing this data with consumers would allow them to understand and thus optimise their energy consumption. In July 2018, Saudi Electric Company announced that it would install 2.5mn similar devices by 2021.

EXHIBIT 17: DIGITAL PENETRATION IN 2019

TRANSPORT SECTOR

AI can improve monitoring fleets of delivery trucks, enhance traffic control and optimise parking management as well. Mobility is indeed one of the most impacted fields of federalisation in general, and artificial intelligence in particular, and our region is at the forefront of this transformation.

In 2018, the Dubai Future Foundation published an Autonomous Transportation Strategy that aims to automate one in four trips in Dubai by 2030, with cost savings of AED 22bn. In Dubai, the Road and Transport Authority (RTA) is planning to transform some Dubai taxis into driverless cars, and recently signed an agreement with the Dubai Police to develop driverless patrol vehicles.

In the logistics sector, Aramex’s Shop and Ship has taken advantage of the annual 25% growth in ecommerce in the UAE. The company is investing heavily in AI, exploring technologies such as geo-location and AI-powered resource optimisation to improve the efficiency of deliveries. DP World is also among the companies that have made it clear that their future is heavily dependent on AI.

ESSENTIAL FOR SUCCESS

Overall, AI appears to be essential to the success of both KSA and the UAE economies in the upcoming decades. Despite still being at an embryonic stage, both countries have understood its potential not only from a diversification perspective, but also to materially boost economic growth. Our region will derive considerable benefits from adopting the trend early on. From an investment point of view, AI opens a door to another world for companies seeking market share and promising returns, and thus considerable potential opportunities for investors.

EXHIBIT 18: GDP PER CAPITAL AND INTERNET USAGE

ASIAN MARKETS UPDATE
SOMETHING’S BREWING IN JAPAN

Thirty years of the Heisei period came to an end on April 30th, with the new Reiwa period starting on May 1st. The Heisei period saw the Nikkei falling from its historical peak as Japan’s economic bubble collapsed and the economy entered almost 20 years of deflation and stagnation. JGB yields fell as deflationary mindsets became entrenched and economic growth stagnated. However, under Abenomics in the last 6 years, the economy has started to grow, and the financial markets have sharply recovered.

PRIVATE EQUITY (PE) FUNDS AND ACTIVIST SHAREHOLDERS ARE KNOCKING ON THE DOORS

Japan has more global activists and PE on the ground now than anywhere else outside the US. The crème de la crème of the investing community undoubtedly see value there.

KKR’ Henry Kravis in April 2018 described Japan as their “highest priority” and the best opportunity globally if “you look at value to price of stock and the cost of capital”. KKR has been in Japan since 2003 and has done only 6 deals since then. Carlyle's CEO, Kewsong Lee, in June 2018 described Japan as a country with "tremendous opportunity", and in Q2 2019 launched another Y200bn Japanese buyout fund. In October 2018 Apollo described Japan as a country with "real promise" where "there is still so much to do".

SHARE BUYBACKS ARE ON A ROLL

Whilst the PE funds entered in mid-2018, they haven’t deployed much capital yet – access is not as easy as elsewhere especially for private companies. As for listed markets however, share buybacks have started to explode along with activists’ pressure such as Third Point with Sony.

Corporate Japan returned 62% of net profits to shareholders in FY03/19 compared to 48% in FY03/18. Dividends for Topix-500 companies rose approximately 10% for the same period.

Even after all these buybacks and dividend hikes, 55% of Topix’s non-financials are net cash positive – no debt at all – compared to 20% or less in the West. The proportion of net-cash companies is much higher for small caps – which is good for activists because they are potentially easier to influence.

Japanese buybacks are different, and their impact on share prices is usually longer than elsewhere. One possible explanation is because cash on Japanese balance sheets is generally valued at nothing – simply lying idle in an environment of negative interest rates. Buybacks create shareholder value out of nothing, and are not funded by borrowing, another difference compared to US companies.

EXHIBIT 19: TOTAL VALUE OF SHARE BUYBACKS, IN JPY TRILLIONS

Source: Bloomberg.

Besides this, approximately 50% of Topix stocks still trade below tangible book, a simple measure of intrinsic value. Companies have too much cash, real estate and investments in other companies’ from cross holding structures.

We are Neutral Japan from a country allocation perspective. The current weight of Japan in the MSCI World is close to 8%. Many global investors don’t even own any exposure to Japan.

Valuation is reasonable in absolute, and attractive relative to history and to some other developed markets. We however tactically expect some volatility ahead, potentially around trade tensions and the implementation of the consumption tax hike.
DOMESTIC FUNDAMENTALS

Japan is in a desperate quest for inflation for long. Household consumption has shown signs of life and the next stage is to see wages increase. A falling unemployment rate towards the 2.0% level should help strengthen upward pressure on wages.

Meanwhile, private investments should also continue to pick up as businesses offset labor shortages with increased capital. Business capex plans remain strong, signaling capex growth should continue. Japan remains a key player in robotics and artificial intelligence. Public investments are also significant, to strengthen existing infrastructure, combined with the preparation for the Olympic Games.

Despite being the world’s third largest economies, Japan is still under-represented in many portfolios. It is easy to understand why its considerable debt is mostly owned by domestic investors, but something is happening in its equity markets, and we keep on monitoring its opportunities.

TRADE TENSIONS

There will be noise and thus volatility around US/Japan trade. We tend to think that Japan should be relatively resilient. There could be perhaps an Agriculture-for-Automotive deal. Japan could easily cut agricultural tariffs in exchange for less stringent auto tariffs, and the country is barely able to produce enough food for itself, especially as approximately 70% of Japanese farmers are 65 years old or above. This could be a way to please US farmers, who historically favor the Republican camp in elections.

UPCOMING CONSUMPTION TAX HIKE IN OCTOBER 2019

Economic growth will likely accelerate ahead of the consumption tax hike in October 2019, as consumers and businesses frontload spending and investments. This is probably anticipated already based on the initial tax implementation. The subsequent slowdown could be temporary as preparations for the Tokyo Olympics should gather momentum, and as parallel fiscal support could be implemented. Assuming that the tax is really implemented, we might see opportunities to add down the road.
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