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VanEck ViewPoint™

Global economic perspectives

December 2019

Market summary

Equities continued their strong 2019 into the fourth quarter. Gold, which had led the charge into the third quarter as investors sought protection from recessionary fears, retreated in the fourth quarter. Those fears investors had abated, as it looked like a global recession would be avoided driving demand in equities.

It's looking too like there will be more certainty for investors as we enter 2020, especially in the UK with Boris Johnson winning a landslide election which should ensure a Brexit resolution. The trade war between China and the US also inched closer to some sort of resolution too, with a first-step trade agreement being made in December. It is worthwhile noting, however, this time last year we were also writing that it would be likely the trade war would be resolved soon, and here we are a year later. During the past quarter President Trump surprised the market by slapping tariffs on Brazil and Argentina, so it is likely trade policy could still impact markets into 2020.

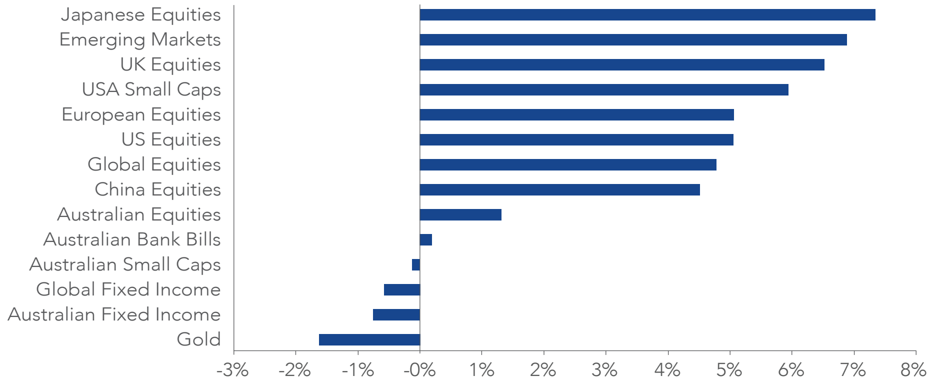
President Trump also has to contend with an impeachment and the 2020 election, however it's looking like the US will avoid recession, but we expect him to keep pressure on the US Federal Reserve to keep rates low. This is likely to keep the US dollar lower, which intron will benefit emerging economies.

During the quarter the US Federal Reserve kept rates on hold as job numbers printed positive. While in Australia the Reserve Bank lowered rates to an historic low of 0.75%. Governor Phillip Lowe has indicated that the bank is prepared to drop rates to 0.25% to stimulate the economy. So far, it appears all the rate cut has done is stimulate housing prices Australia. Treasurer Josh Frydenberg has made it clear there is no new fiscal intervention on the cards for now.

Elsewhere in the developed world rates remain on hold, mostly at historic lows. There appears to be little central banks can do if economies falter. These remain uncharted waters and as central banks continue to point to a sustained period of lower interest rates, it will be interesting to see what quantitative easing measures may be on the horizon, if at all. For central bankers their preference will be "if at all."

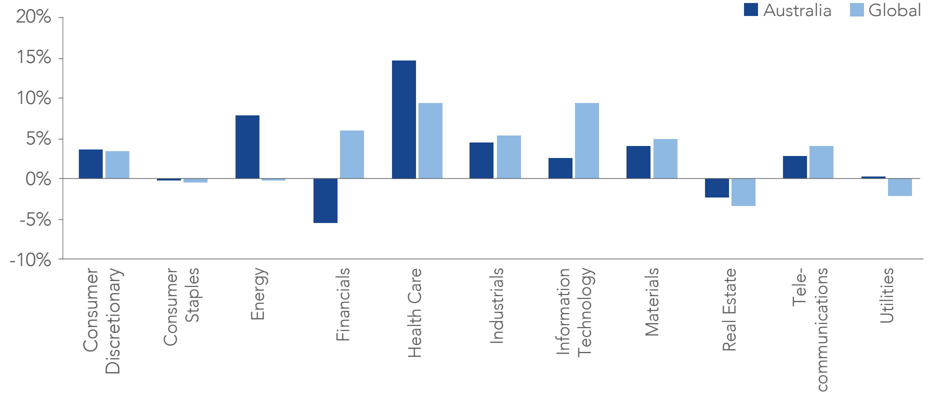
Fears have abated as it looks like a global recession will be avoided.

Chart 1: Index returns in December 2019 quarter



Source: Bloomberg, 1 October 2019 to 14 December 2019, returns in Australian Dollars. International Equities is MSCI World ex Australia Index, Australian Equities is S&P/ASX 200 Accumulation Index, Australian Fixed Income is Bloomberg AusBond Composite 0+ yrs Index, Global Fixed Income is Bloomberg Global Aggregate Bond Hedged AUD Index, Australian Bank Bills is Bloomberg AusBond Bank Bill Index, Emerging Markets is MSCI Emerging Markets Index, Gold is Gold Spot US$/oz, Australian Small Caps is S&P/ASX Small Ordinaries Index, US Small Caps is Russell 2000 Index, US Equities is S&P 500 Index, UK Equities is FTSE 100 Index, Japanese Equities is Nikkei 225 Index, European Equities is MSCI Europe Index, Chine equities is CSI300 Index.

Chart 2: Global and Australian equity sectors December 2019 quarter performance



Source: Bloomberg, 1 October 2019 to 13 December 2019, returns in Australian Dollars. Consumer discretionary is MSCI World Consumer Discretionary Index / S&P/ASX 200 Consumer Discretionary Index, Financials is MSCI World Financials Index / S&P/ASX 200 Financials Index, Materials is MSCI World Materials Index / S&P/ASX 200 Materials Index, Healthcare is MSCI World Heath care Index / S&P/ASX 200 Heath care Index, Utilities is MSCI World Utilities Index / S&P/ASX 200 Utilities Index, Property is MSCI World REIT Index / S&P/ASX 200 AREIT Index, Consumer staples is MSCI World Consumer Staples Index / S&P/ASX 200 Consumer Staples Index, Information technology is MSCI World Information Technology Index / S&P/ASX 200 Information Technology Index, Energy is MSCI World Energy Index / S&P/ASX 200 Energy Index, Industrials is MSCI World Industrials Index / S&P/ASX 200 Industrials Index, Communications is MSCI World Telecommunications Index / S&P/ASX 200 Telecommunications Index.

On the merry-go-round

Another quarter has elapsed and little change has occurred in our outlook or the issues facing markets.

If you squint, the data is improved:

- manufacturing outlook remains poor but seems to have stopped getting worse;
- US data had a decent bounce compared to the falling expectations a couple of months ago – but even that has largely run its course.

More importantly for markets, trade war sentiment swung from pessimistic to optimistic over the quarter. But, given there has been a "phase one" agreement and little or no underlying progress for more phases, a cynic might view this as a move to fade. We are still yet to escape trading by tweet!

This time a year ago, markets were about to rebound from a major fall, driven by an about face from the Fed. This year, the Fed seems to be on the sidelines, notwithstanding the recent bailout of short term liquidity. The latest Federal Open Market Committee (FOMC) meeting confirms the Fed would like to dodge any action during the upcoming Presidential election year.

As an aside, the repo market bailout generated a lot of excitement, including claims of QE4 "not QE". But "quantitative easing" implies flooding markets with liquidity beyond what's required to drive cash rates to zero. Adding sufficient liquidity to offset rates squeezing above an already non-zero target is not QE. Broader discussion of repo market fragility and shadow banking can wait for another day, as we don't think we've heard the last of that.

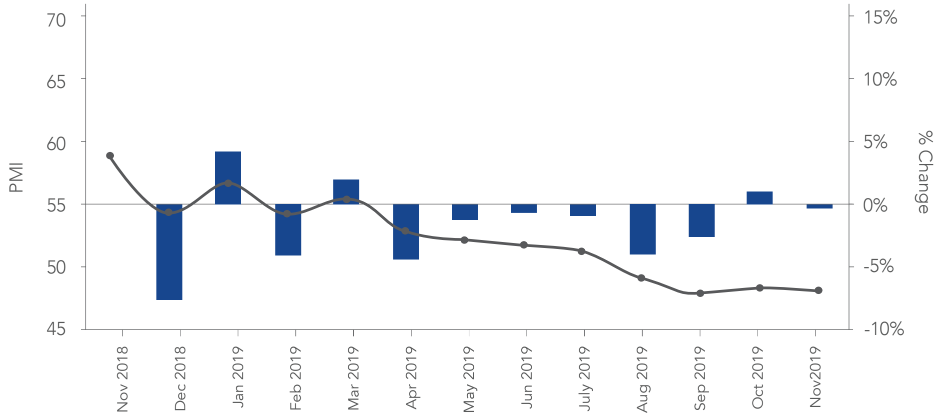
Also, this time a year ago, the trade war was going to be quick and "easy to win." Now it's clear that it will be an ongoing series of, often escalating, skirmishes, punctuated by face saving "deals" and "phases".

In particular, 2020 looks messy on trade: heading into the 2020 US election, the Chinese may calculate President Trump needs a deal more than they do (and/or may prefer to see the election result before making any conclusive deal); President Trump is likely to get increasingly erratic on policy, particularly if polling is tight.

US markets however don't seem to be pricing any policy risk, with volatility measures around their lows and equity valuations at near cycle highs. This looks problematic.

Chart 3: Manufacturing remains underwhelming

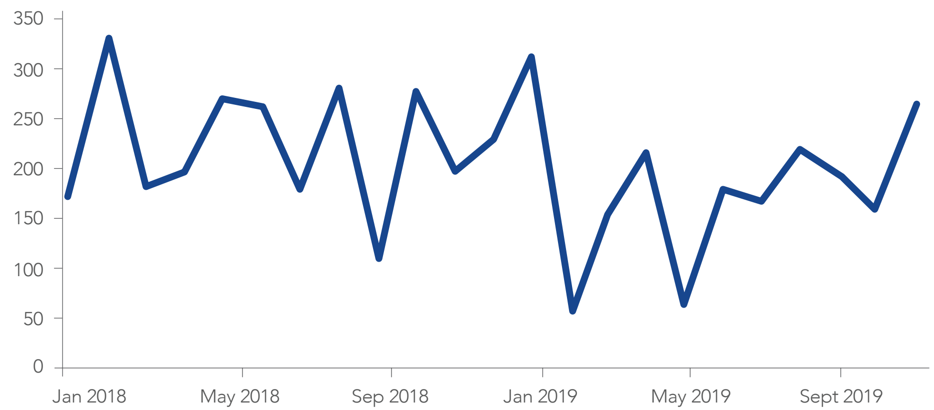
Purchasing Managers' Index (PMI) in the United States from November 2018 to November 2019



Source: Institute for Supply Management (ISM). PMI above 50 is considered expansionary.

Chart 4: US Jobs growth soared in November

Employment report: Payrolls. Monthly change, seasonally adjusted, in thousands



Source: US Bureau of Labour Statistics.

US equities not to lead

In equity markets, there still seem better options than the US as we muddle through the slowdown.

The US is late in its cycle, with little labour market slack left. Indeed, were the economy to rebound, the current gradual pick-up of wages would likely accelerate and emerge as a problem.

Other countries look much more likely to provide additional stimulus. There is a groundswell of opinion among policy makers that monetary policy has run its course. It is increasingly impotent and/or is creating more distortions than benefits. It is a shame they're a decade too late. The Japanification of the world economy has already been achieved!

Australia too is no longer immune to this monetary policy dilemma.

We expect, globally, lower rates for longer. On the other hand, fiscal drums have been beating ever louder.

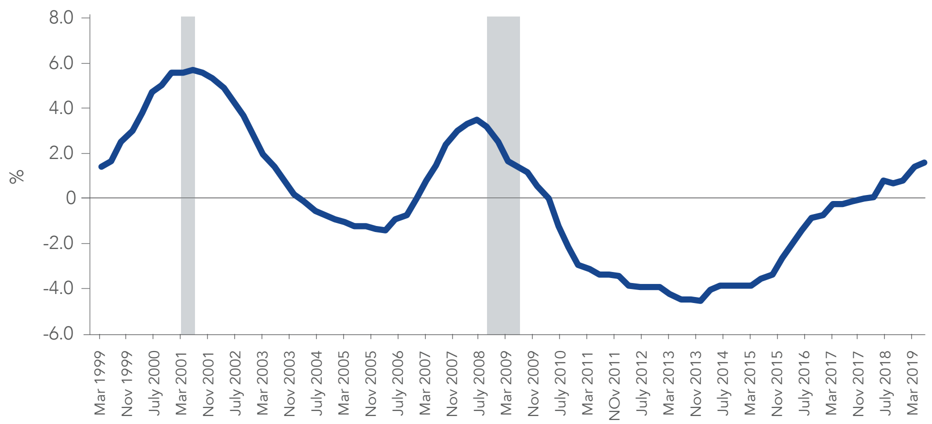
In Europe, Christine Lagarde, in her first public outing as the new European Central Bank (ECB) chief, called long and loud for fiscal stimulus.

On the other side of the world, Japan is aiming to implement a big stimulus package, admittedly, to offset a slowdown triggered partly by a consumption tax hike!

As always, the trick with Japanese announcements is to distinguish actual new stimulus from re-announcements and loan incentives, which may or may not be drawn. A rough guess is the new stimulus will amount to around one per cent of GDP injection next year, a hefty package.

Chart 5: US corporate debt continues to rise

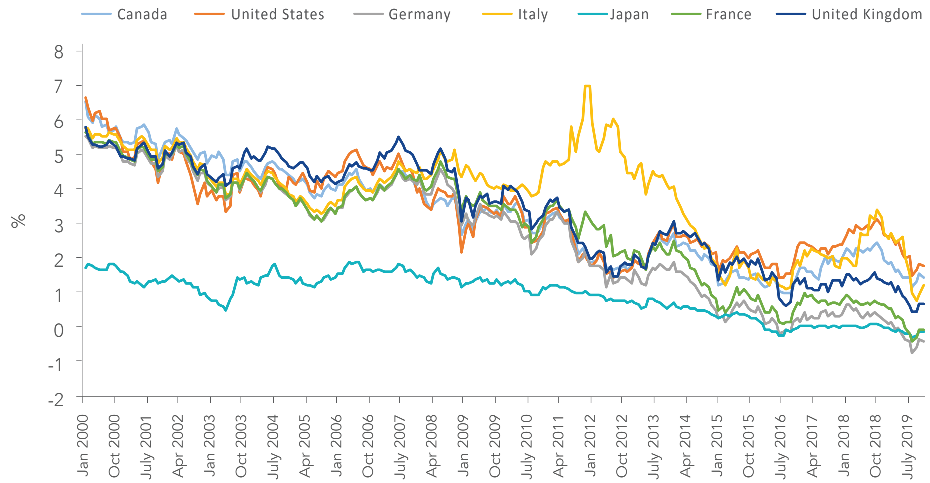
US Corporate Debt Service Ratio (deviation from mean)



Source: Thompson Reuters. Shaded area indicates recession.

Chart 6: Lower rates for longer

10-year yields (%) of G7 nations



Source: Bloomberg.

China to the rescue

Likewise, China seems determined to keep their economy ticking over through 2020 with both fiscal and monetary stimulus in the pipeline. One of our key messages at the start of year was "Don't fight the PBOC (People's Bank of China)." China was addressing its debt bubble in a very balanced and attentive way then, and as we predicted, this drip stimulus approach has been effective. China's economy continues to move forward, even though its manufacturing sector may be languishing. We think Chinese policies will be adequate support for global growth particularly beyond the US.

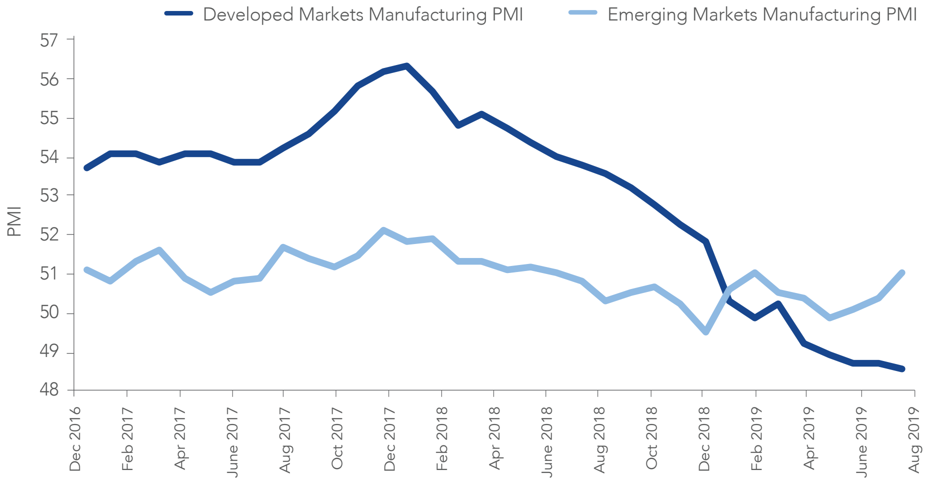
In the US, in the near term, ideology and the election cycle will intervene to stymie US fiscal intervention. In the medium term, the scale of tax cuts already implemented mean "the cupboard is bare." Normally as the economy nears full employment the budget moves toward and sometimes into surplus. Not this time. At near-full employment, the budget is still in huge deficit. In any downturn, it would blow out as revenue falls and social security payments balloon.

All of this suggests the superior US growth performance of recent years is unlikely.

However, if China experiences a growth surprise, unlikely while managing a debt bubble, we think global financial markets and commodity markets could jump higher. On the other hand, financial markets may turn negative if the US Federal Reserve turns hawkish – but that seems unlikely in an election year. Another potential downside depends on whether central banks in Europe are still considered a credible counterweight to slower growth. We think investors should consider a hedge in their portfolios in the event that central bank confidence weakens dramatically.

China seems determined to keep their economy ticking over through 2020 with both fiscal and monetary stimulus in the pipeline.

Chart 7: China and Emerging Markets drive global growth
Purchasing Managers' Index (PMI) in emerging markets and developed markets
November 2016 to November 2019



Source: Bloomberg. PMI above 50 is considered expansionary.

Beyond the US

Equity markets have been driven by momentum, rather than valuation. So winners keep winning and losers keep getting cheaper.

In global terms, this has seen the US market push further and further ahead. To be fair, it hasn't been all momentum, US tech company earnings have outgrown other sectors globally and Trump tax cuts boosted after tax returns.

Debt market and balance sheet risks seem to be not factored into US pricing. The US corporate sector has been on a debt funded buy back spree with low interest rates, strong equity gains and little compelling capital expenditure opportunities.

As a result of this there has been an accumulation of debt on corporate balance sheets. Reminiscent of 2007, this build-up in corporate leverage has been unaccompanied by any meaningful downgrade in corporate credit rating.

Further, the biggest chunk of corporate debt expansion has been in the BBB bucket – a notch away from sub investment grade. Should a chunk of this be downgraded there will be many forced sellers that is those investors who can only hold investment grade.

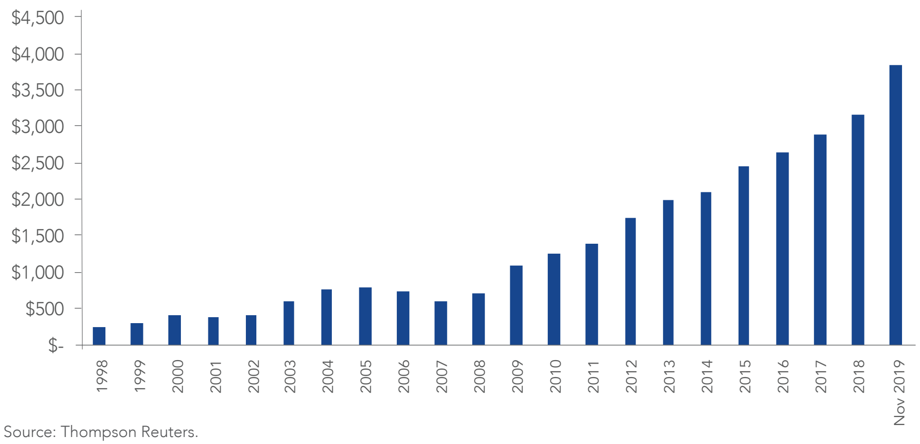
These dumped securities may well overwhelm the much less liquid high yield market, which has already been underperforming.

So, in line with macro growth and corporate dynamics explained above, the divergence must be nearing an end. The good news appears priced across US markets whereas Japan and emerging markets are at the other end of the scale

Japan looks a good relative bet either on this optimistic scenario, due to export rebound and low valuation; or on a pessimistic scenario, due to yen flight to quality, fiscal offset and low valuation.

Chart 8: The expansion of BBB credit

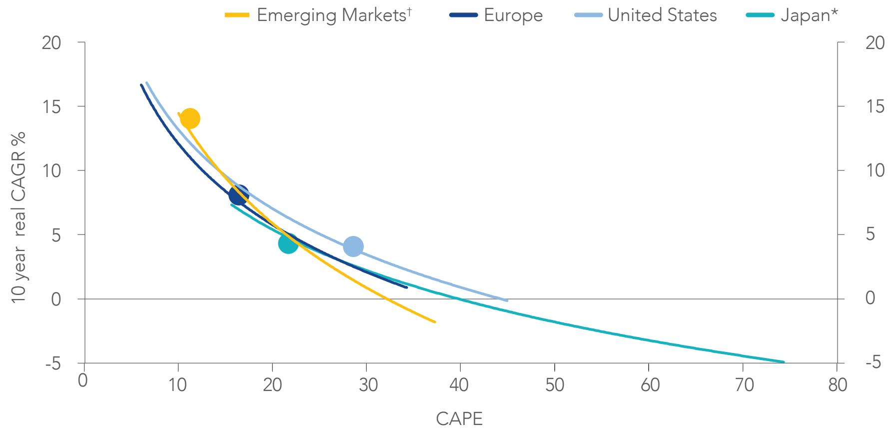
BBB corporate debt issued (US dollars, millions)



Source: Thompson Reuters.

Chart 9: The good news appears to be priced in

Cycle Adjusted Price Earnings (CAPE) & subsequent return



Source: MSCI Bloomberg, MSCI indices, US$ terms. EPS and price index deflated bY US CPI to calculate CAPE. Total return is in US$, deflated bY US CPI. Data from 1980. * Japan returns are in Yen terms. † Data from 1998. MSCI EPS series linked to IBES trailing EPS. Dots show current CAPE.

Out of the shadows

Emerging markets may outperform in an optimistic scenario, especially in a scenario where the trade war resolves, leading the US dollar into a gradual, benign decline.

Interest rates are low in most emerging markets. Russia, India and Mexico have been cutting rates and in Brazil, its central bank cut its rates to a record low in September. These low interest rates have driven demand for equities, however emerging markets (EM) equities have trailed the returns of developed market (DM) equities in 2019. EM valuations look compelling relative to DM and on an absolute basis.

Pockets of emerging markets appear more compelling than others. The Chinese growth story has been well publicised. If the trade war gets resolved its likely to benefit China equities, however for some time now China's leaders have not been expecting a rapid resolution to the trade war and it has been using fiscal and monetary levers to manage its consumer-led economy. The impact has been significant growth in China's "new economy."

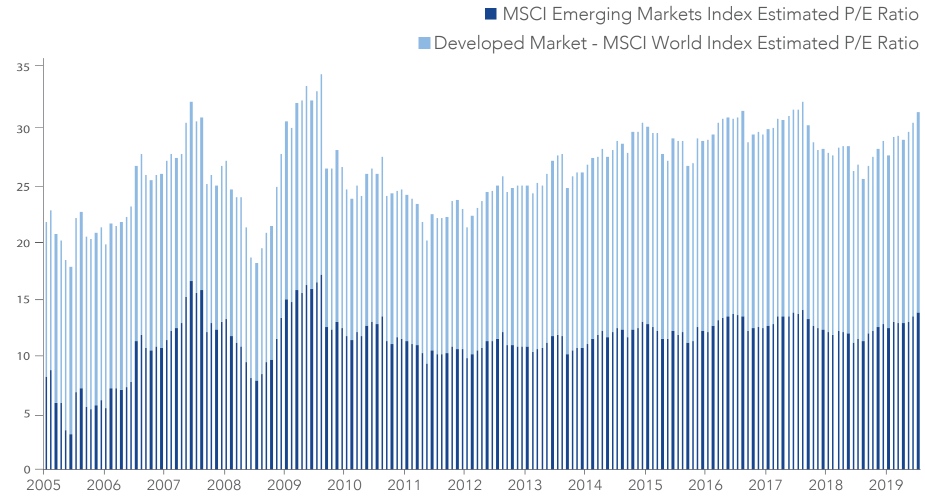
Of the four sectors that represent the "new economy", information technology has been the most impacted by the trade war (the other new economy sectors are healthcare, consumer staples and consumer discretionary). However, state investments in the sector is accelerating. A good example is the 'China Integrated Industry Investment Fund', backed by the state and operated by the Ministry of Industry and Information Technology and the Ministry of Finance. The fund recently announced the completion of its second capital raising round, towards its goal of CNY 200 billion (U$29 billion). The fund, which focuses on industries where China is reliant on imports such as chips and advanced manufacturing components, has already made investments in more than nine listed firms, as reported by the South China Morning Post.

Overall, China's domestic spending on research and development grew from US$9 billion in 2000 to US$293 billion last year, now the second highest total R&D spending in the world behind only the United States. The trade war could make China's technology sector stronger.

And we expect China's growth to be a driver in overall emerging markets growth in 2020.

Chart 10: Compelling valuations

Price to Equity (P/E) ratio DM compare to EM



Source: Bloomberg.

Chart 11: China's "new economy" outperforming

2019 YTD index performance

Source: Morningstar. Past performance is not a reliable indicator of future performance.

Navigating the gold mine

The gold price remains elevated above US$1,450 as it enters its fourth month of correction after reaching a six-year high of US$1,557 in early September. It is difficult to see much market movement in the near term as the Fed's rate outlook appears to be on hold, Brexit was postponed until the UK election, and global trade stagnates. Geopolitical risks continue to escalate with persistent protests in Hong Kong and Latin America. Brazen terrorist attacks have also gripped West Africa, while conflicts continue in the Middle East.

Political unrest has yet to have a significant impact on global financial markets despite its increasing breadth and frequency. We believe late-cycle financial risks will increase. With no end in sight to the spread of geopolitical turmoil, we believe gold might see significant gains in the new year.

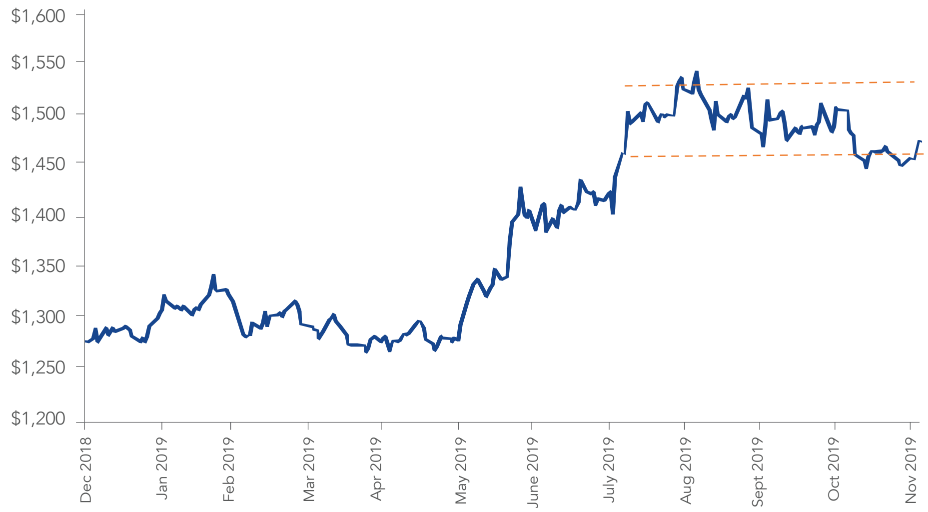
Based on S&P Global Markets' estimates for 2019 exploration spending, Australia spent more in exploration than Canada and the US this year. Gold remains the leading metal with US$4.29 billion allocated towards exploration — down 12% from last year despite the jump in the gold price. As well, this is actually the first year that mine-site, or "brownfields", budgets have accounted for the largest share of exploration spending, with past spending results typically dominated by new, or "greenfields", exploration.

We believe this reflects the current strategy of many producers to focus on getting more from their existing assets to create value organically, rather than building in new areas. While this strategy works quite well, we think it has its limits and that companies will eventually need to increase their greenfields efforts or engage in mergers and acquisitions (M&A).

M&A activity has increased recently and we expect to increase in 2020.

Chart 12: Gold range traded in the second half of 2019

LBMA PM Gold Price, $US per ounce



Source: Bloomberg.

Australia

The Australian economy is at a critical juncture. Private sector growth is negligible, with government spending providing the bulk of what little growth there is. Indeed, GDP per capita has stalled. Unfortunately policy seems unlikely to provide much help in the near term.

The Morrison Government has delivered its tax cuts, with no visible impact on consumer spending. With a deep political attachment to maintaining a surplus, the Federal Government has painted itself into a fiscal corner.

The RBA has fired the monetary bazooka, cutting the cash rate three times in rapid succession. Thus far, the result has been simply to reflate the housing price bubble, with little or no impact on the broader economy, except perhaps to undermine confidence in the outlook.

The implication is that monetary policy in Australia may already have reached a point where asset market/balance sheet distortions and adverse confidence effects outweigh growth benefits. RBA Governor Phil Lowe has studied these effects over the years may well be reluctant to push further. Unfortunately for him, the RBA has only one tool.

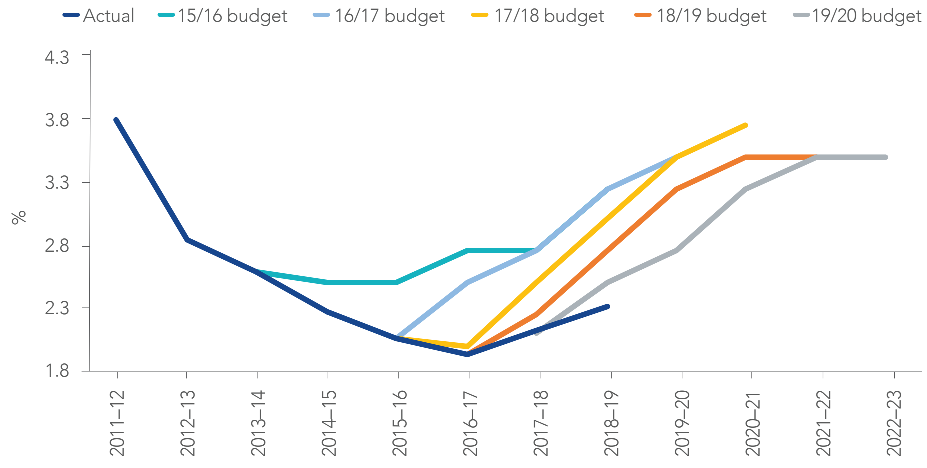
Of course, housing and asset prices is one of the two main channels through which monetary policy normally works. So the RBA will wait and see, and hope, that there is an eventual spill over to broader consumer spending.

At this stage, though, it looks likely they will be disappointed. Years of weakness in wages growth has left households stretched and nervous.

There has been much discussion of the breakdown of the Phillips Curve – that is, the relationship between labour market slack and wages growth. But the problem seems to be definitional: the relationship with the unemployment rate looks broken, but plotted against underemployment (as measured by the ABS) the relationship look intact, and depressing.

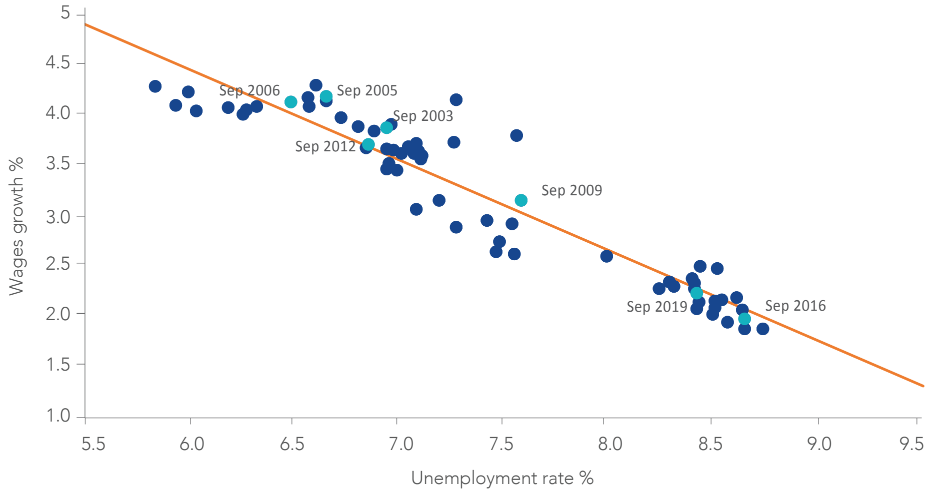
To generate any meaningful pick-up in wages in the next two years, underemployment would have to fall faster than during the mining boom. While faster wages growth would help underpin the economy, it would undermine corporate profits. The Morrison Government seems ideologically intent on further undermining the power of employees, not boosting it.

Chart 13: Wages growth unlikely to match government expectations
Annual Wage growth predictions in the budget



Source: ABS, RBA.

Chart 14: The 'unbroken' Phillips Curve:
Wages growth and underemployment 2003–2009



Source: ABS.

Range of VanEck Vectors Exchange Traded Funds (ETFs) on ASX

ETF Name	ASX code	Index	Management costs (% p.a.)
Australian Broad Based			
Australian Equal Weight ETF	MVW	MVIS Australia Equal Weight Index	0.35%
Australian Sector			
Australian Banks ETF	MVB	MVIS Australia Banks Index	0.28%
Australian Property ETF	MVA	MVIS Australia A-REITs Index	0.35%
Australian Resources ETF	MVR	MVIS Australia Resources Index	0.35%
Australian Small and Mid Companies			
Small Companies Masters ETF	MVS	MVIS Small-Cap Dividend Payers Index	0.49%
S&P/ASX MidCap ETF	MVE	S&P/ASX MidCap 50 Index	0.45%
Sustainable Investing			
MSCI International Sustainable Equity ETF	ESGI	MSCI World ex Australia ex Fossil Fuel Select SRI and Low Carbon Capped Index	0.55%
MSCI Australian Sustainable Equity ETF	GRNV	MSCI Australia IMI Select SRI Screened Index	0.35%
International			
ChinaAMC CSI 300 ETF	CETF	CSI 300 Index	0.60%
China New Economy ETF	CNEW	CSI MarketGrader China New Economy Index	0.95%
MSCI Multifactor Emerging Markets Equity ETF	EMKT	MSCI Emerging Markets Diversified Multiple-Factor Index (AUD)	0.69%
Morningstar Wide Moat ETF	MOAT	Morningstar Wide Moat Focus Index™	0.49%
MSCI World ex Australia Quality ETF	QUAL	MSCI World ex Australia Quality Index	0.40%
MSCI World ex Australia Quality (Hedged) ETF	QHAL	MSCI World ex Australia Quality 100% Hedged to AUD Index	0.43%
Global Sector			
FTSE Global Infrastructure (Hedged) ETF	IFRA	FTSE Developed Core Infrastructure 50/50 Hedged into AUD Index	0.52%
FTSE International Property (Hedged) ETF	REIT	FTSE EPRA Nareit Developed ex Australia Rental Index AUD Hedged	0.43%
Gold Miners ETF	GDX	NYSE Arca Gold Miners Index	0.53%
Australian Fixed Income			
Australian Corporate Bond Plus ETF	PLUS	Markit iBoxx AUD Corporates Yield Plus Index	0.32%
Australian Floating Rate ETF	FLOT	Bloomberg AusBond Credit FRN 0+Yr Index	0.22%
Australian Subordinated Debt ETF	SUBD	iBoxx AUD Investment Grade Subordinated Debt Index	0.29%

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