Private Bank

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US Stimulus, UK Fear and Asia's Post-Covid Ascent

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Summary

- **Congressional approval of a new Covid relief bill appears more likely. The package is likely to include direct stimulus checks between $600 and $700 to most households and supplement weekly state unemployment insurance payments to workers who lost jobs this year by $300. The $900 billion fiscal support package provides a good start for the New Year, while vaccines will deliver the most effective stimulus.**
- **The appearance of new Covid virus variants is expected. Over time, as in the UK, mutations accumulate and lead to new variants as the virus adapts to the human immune system. The latest clinical advice is that it is highly unlikely that the UK mutation would fail to respond to a vaccine. That said, risks of further mutations remain.**
- **China is a beacon for both post-Covid impact and recovery. China's surprisingly strong and immediate export recovery was not something we expected in setting our regional and global growth estimates for 2021. As an investment opportunity, China and Asia are far more important than investors currently appreciate.**

Essential US Stimulus Appears More Likely

Congressional approval of a new Covid relief bill appears more likely. The major dispute between Democrats and Republicans was related to Federal Reserve's lending powers. The agreement, still forming as we write, means that four Federal Reserve credit lending facilities created by the CARES Act will end and the Fed will be prohibited from starting similar facilities in the future without congressional approval. The four impacted programs are the primary market corporate credit facility, the secondary market corporate credit facility, the Main Street lending program and the municipal credit facility. Under the compromise agreement, the Fed will retain flexibility over restarting the Term Asset-Backed Securities Loan Facility (TALF).

Republicans had feared that the incoming Biden administration would be able to interpret the CARES Act in a way to prolong special lending authority and possibly use it to fund other priorities. In particular, the GOP worried that progressives could use aspects of the Federal Reserve Act to address climate change or supplement state and local budget shortfalls.

From a financial perspective, the deal repurposes $429 billion in unspent CARES Act funding for $900 billion in coronavirus relief. The package is likely to include direct stimulus checks between $600 and $700 to most households and supplement weekly state unemployment insurance payments to workers who lost jobs this year by $300. Critically, it would include funding for vaccine distribution, aid for healthcare providers, and schools.

The bill renews critical expiring federal benefits at a time when the nation is seeing surging infections, hospitalizations and deaths. Federal inaction would have left tens of millions of unemployed Americans without an income and millions of households facing eviction.

If the $900 billion were actually spent during the first half 2021, the stimulus would amount to more than 8% of annualized GDP, protecting and reinvigorating the US economy at a critical time. This is proportionately smaller than the $2.25 trillion allocated during 2Q 2020, but appropriately so, in our view.

Taken together, US will have spent less than the $4.5 trillion we argued would represent "overwhelming force" back in March (please see "Catching the COVID-19 Knife: What It Will Take"). It would also not offset direct revenue losses for states and municipalities suffering from the pandemic. However, much of the US economy has strengthened and adapted to coping with the virus, with a far better labor market recovery than any anticipated. State and local governments will be indirect beneficiaries of the boost that the broader economy will get from renewed stimulus.

In our view, there were some strong arguments that the taxpayer capital behind some of the Fed's emergency programs could have been used more effectively to support the economy directly. The Fed was barely able to implement its lending program for small and mid-sized companies. However, the desire to limit these lending and financial market support programs with an arbitrary year-end date does risk mis-judging the virus. Similarly, if there are significant setbacks on the path to mass vaccinations, Congress may have to act again. Overall, however, a $900 billion fiscal support package for the start of the new year, while vaccines deliver the *most effective stimulus* to come, fits with our bullish view of the US and global economy over the coming year. It is likely to provide a sufficient fiscal bridge to a health-care led solution to the pandemic by mid-year and adds upside risk to our near-term view of the US economy.

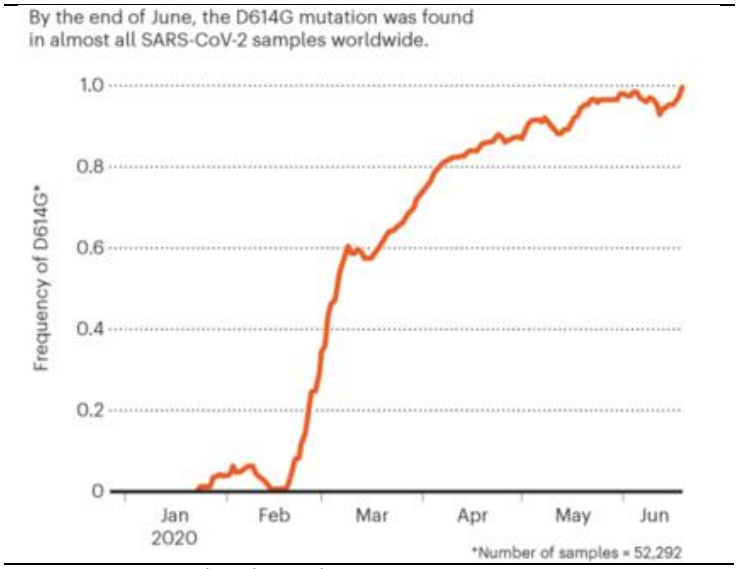
New UK Virus Fears and Realities

Fears associated with a new Covid-19 variant spread globally as the UK announced more severe restrictions in an attempt to slow the rampant spread of the disease in and around London. The identification of the mutation was made possible by close monitoring of the virus' genetic code. There three predominant concerns. The first is that the new disease variant will spread more easily, causing more people to become ill in less time. The second is that the vaccine being rolled out would be less effective or ineffective against this new Covid variant. The third is that the current vaccine is so narrowly focused that the virus will mutate more quickly than expected, reducing the window of time in which this vaccine can broadly achieve herd immunity.

The appearance of new Covid virus variants is expected. Over time, mutations accumulate and lead to new variants as the virus adapts to the human immune system. In fact, from January 2020 to June 2020, the D614G Covid mutation became the predominant global strain of the virus **(see Figure 1)**.

The vaccine presently being used against the coronavirus produces antibodies against several regions of the virus' spike protein. Matt Hancock, the UK Secretary of State for Health and Social Care, noted in Commons that there is no evidence to suggest the Covid-19 vaccines will not work against the new variant of coronavirus. He said, "I must stress at this point that there is currently nothing to suggest that this variant is more likely to cause serious disease and the latest clinical advice is that it's highly unlikely that this mutation would fail to respond to a vaccine." (Northern Echo, 12/14/2020)

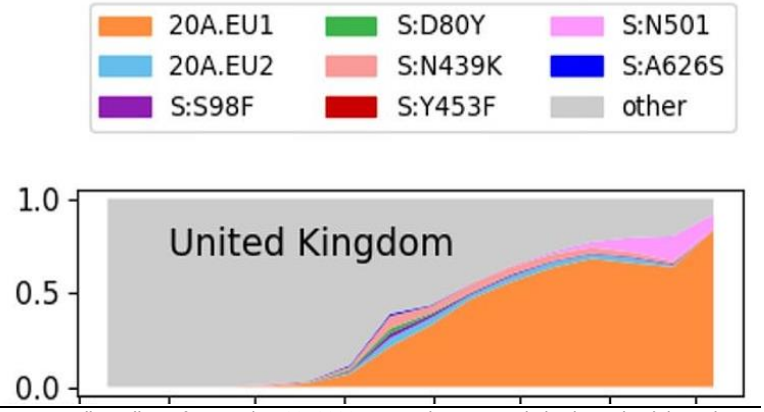
Figure 1: Global Spread of the D614G mutation



Source: Nature Journal as of December 20, 2020.

Major concerns remain about the rate of transmission, however. Chris Whitty, the UK's Chief Medical Officer said that "the variant (VUI – 202012/01) does spread more quickly than previous strains" (Daily Mail as of December 19th). And the spread of the new UK variant (S:N501) is accelerating relative to the dominant strain (20A.EU1) that arrived in the UK from Spain in the summer. **(see Figure 2)**.

Figure 2: Timeline from May to December 2020 of several type of Covid mutations



Source: Daily Mail as of December 20, 2020. Note: The new strain is shown in pink, and the timeline runs from May to December 2020.

Numerous scientists, including Professor Whitty, have said there is 'no evidence' that the mutation, also identified in Wales, Scotland, Denmark and Australia, will have any impact on vaccines, nor is it more deadly. Thus, to the extent that these data remain consistent, we do not see the increasing prevalence of the S:N501 as a major impediment to economic recovery in 2021.

With this all said, there is a risk that a more significant variant of the novel coronavirus will appear and be less treatable with the present vaccine. According to Prof. Jacob Moran-Gilad, a medical specialist in clinical microbiology and public health from Ben-Gurion University's School of Public Health, "The British are currently the world leaders in their rate of genetic sequencing for COVID-19 patient samples. That's why they're the ones that find these things. It is very likely that what we are seeing in Britain is just the tip of the iceberg. There are most likely a lot of mutations we don't yet know about because most of the world doesn't consistently survey and track the mutation." (Jerusalem Post, 12/20/2020)

As China's Economy Heals, Broader Asia to Benefit

China is the largest buyer of many of the world's production commodities and represents a vast, growing domestic market. As the world's second largest economy, China's success will directly impact the overall health of the global economy. Similarly, how China and the US interact while China develops technologically will likely be the single-most critical geopolitical story of the 21st century. Yet, as an investment opportunity, China and Asia are far more important than investors currently appreciate.

China's "Different" Response to the Pandemic

In January, the city of Wuhan in China's Hubei Province became the first epicenter of what is now known as the COVID-19 pandemic. Since then, we've observed China as a beacon for both impact and recovery. For example, China's surprisingly strong and immediate export recovery was *not* something we expected in setting our regional and global growth estimates (see our August 2020 Quadrant).

Of course, China's dramatically different approach to controlling the pandemic made the duration of the shock it felt quite different from other economies (please see our October 19, 2020 Strategy Bulletin, "East vs West: A Contrast in Covid Costs and Economic Outcomes). The nature of China's domestic economy and the role it plays within the world means the comparisons to other regions are quite complex. Yet in both China and the world at large, supply and demand both contracted very sharply and briefly, with just a short lag in between.

The spread of the virus outside China, the public's adaptations to living with the pandemic, and the advent of vaccines, now suggests the potential for *diverging fortunes* in regional economies in the coming few years. Accordingly, our near-term view of Asia in 2021 as a region is increasingly positive. This is partly because of China's strong trade linkages throughout the region, and the COVID-driven shift from services toward goods consumption that is reigniting Chinese export growth to the west **(see Figures 3-4)**.

Figure 3: US Consumer Goods vs Services Spending (Annualized)

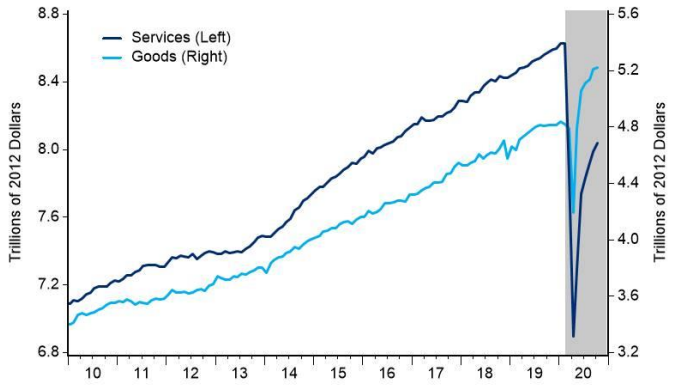
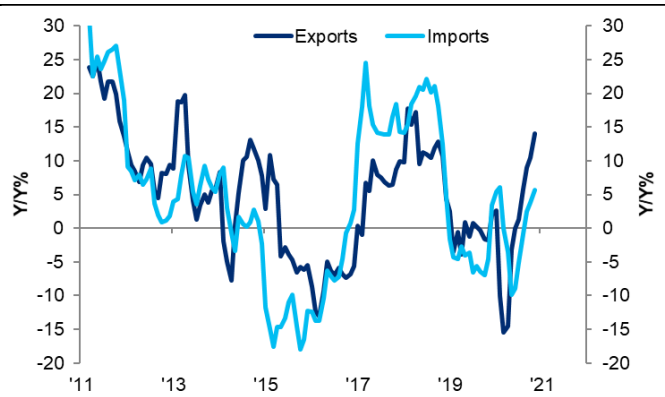


Figure 4: China's Exports and Imports Y/Y%



Note: Shaded regions are recessions. Source: BEA, Haver Analytics as of December 18, 2020.

Asian Growth Prospects Brighten

As highlighted in our Outlook for both 2021 and 2020, Asia is also the region with the greatest long-term development prospects, gaining share of the world economy for the past 40 years, and at an accelerating pace **(see Figure 5)**. EM Asia's share of the world's population would already imply a much larger share of the world economy **(see Figure 6)**. However, the wars and policy failures of earlier periods left the region poor compared to the west, prior to the beginning of its epic recovery.

As we described in Outlook 2021, China and India were the largest national economies of the world for most of the past 500 years, with a relative decline in the 19th though-mid 20th centuries. Unlike other EM regions, Asia has long built up the domestic resources to power its development, with the world's highest national savings rates powering the fastest growth rate of capital investment spending per worker **(see Figure 7)**.

Figure 5: Emerging Asia's Share of the World Economy (%)

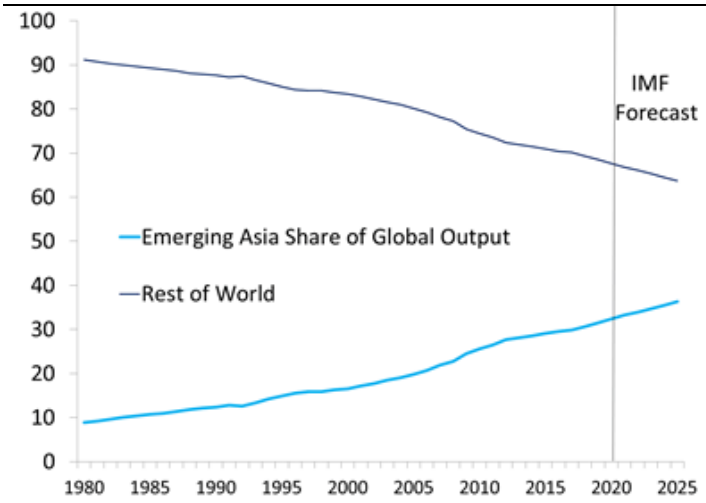
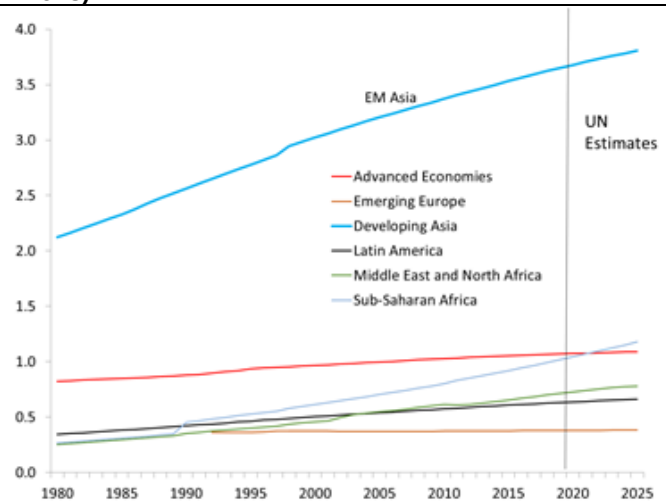
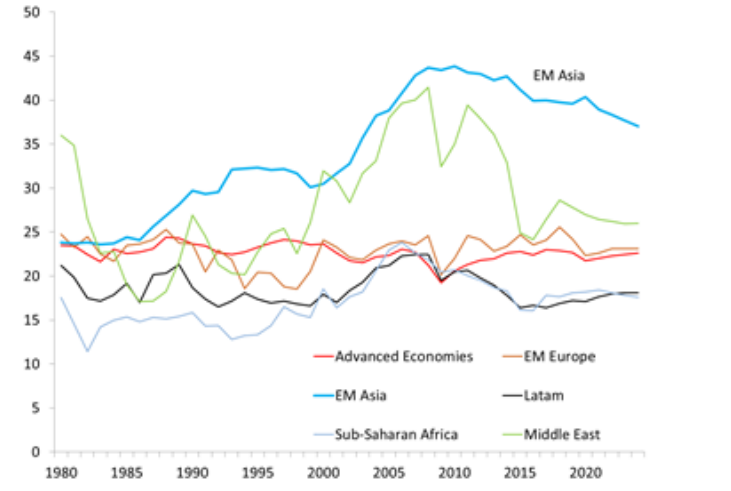


Figure 6: Emerging Asia and other Regional Populations (Billions)



Source: Haver Analytics as of December 18, 2020. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be guarantees of future events

Figure 7: National Savings Rates by Region %



Source: Haver Analytics as of December 18, 2020.

COVID Cyclicals in Asia Are Likely to Rebound

The tech-driven equity markets of China, Taiwan and South Korea are more likely to see their relative strength wane in a post-Covid world. They have outperformed in the region through most of 2020 thanks to surging demand for "stay at home" related solutions globally. Their industry composition and effective pandemic management has helped them gain global market share in tech and many other exports. China, for instance, has seen its exports jumped to 21% in November from a year ago. A main contributor has been the tech related products.

China's domestic economy also continues to recover, which would be meaningful to lift demand for exporters in the region. China's credit expansion has amounted 34% of GDP in 2020, the highest since 2010. This points to nominal GDP growth of nearly 12% six months out into the future **(see Figure 8)**. With roughly 2% inflation, real growth is likely to reach 10% in 1H 2021. Assuming a moderation in 2H, China is likely to grow by 8% in 2021, above our latest estimate of 6%. To the benefit of the region, this is likely to lift China's import growth, which has lagged exports markedly so far in the recovery **(see Figure 9)**. These dynamics are likely to strongly contribute to regional growth in 2021.

Figure 8: China Credit impulse points to 8% real GDP growth in 2021

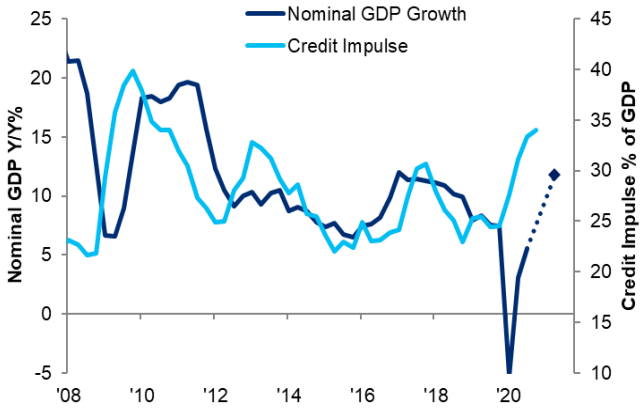


Figure 9: China's imports are likely to follow exports and boost regional growth

Source: Haver Analytics as of December 18, 2020. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be guarantees of future events

Further Value in Asian "Leave Your Home" Shares

The improving prospects of vaccine rollout in Asia is likely to give rise to the economies with most dependence on tourism and services industries in 2021, which have been laggards throughout the year. This would mainly point to Southeast Asia, among which, Thailand, Hong Kong, Malaysia and Singapore have the largest exposure to tourism **(see Figure 10)**.

Equities of these markets are still trading below historical average valuations, even after a rapid rally of over 10% since Nov 6. Tourism activities in those countries have just started to pick up from close-to-zero levels since 3Q20 **(see Figure 11)**. Mass vaccinations should lift cross-border tourism in the coming year, with broader regional tourism recovering sharply in 2022.

Figure 10: Tourism revenues as % of GDP: Asia

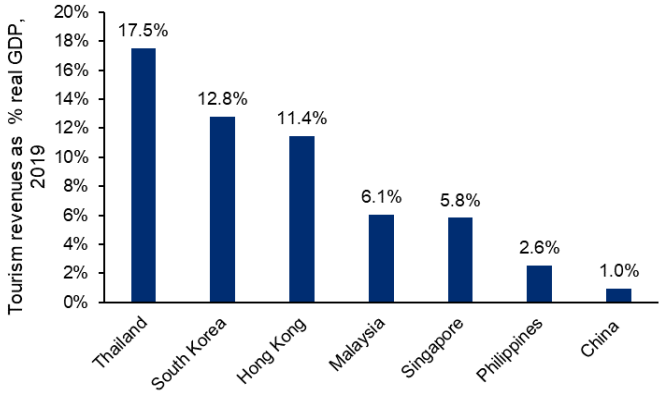
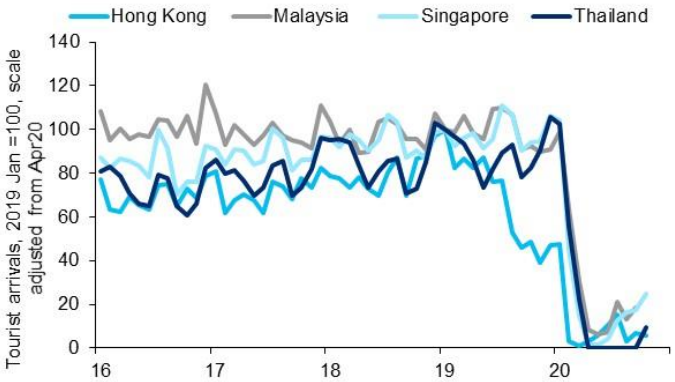


Figure 11: Tourist arrivals in Asia have plenty room to improve



Source: Factset, Haver Analytics as of December 16, 2020.

Chinese Vaccine Makers to Assist Emerging Market Recovery

We expect economic growth in emerging Asia (ex-China) to surge from a moderate decline in 2020 to an above-trend rate of 7%-8% in 2021. China's swift recovery from the COVID shock within 2020 will be a key driver. While there are doubts in western countries, the availability of lower cost, regionally-developed vaccines rolled out starting early in 2021 should also boost regional growth.

The announcement of a high efficacy rate for a vaccine made by Sinopharm has notably improved prospects of mass vaccinations in emerging markets. The Sinopharm vaccine has yielded 86% effectiveness in preventing COVID-19 infection in in phase three trials in the United Arab Emirates (UAE) on Dec 9. The UAE and Bahrain have approved the vaccine's widespread usage domestically. Indonesia and Pakistan have also agreed to be early adopters.

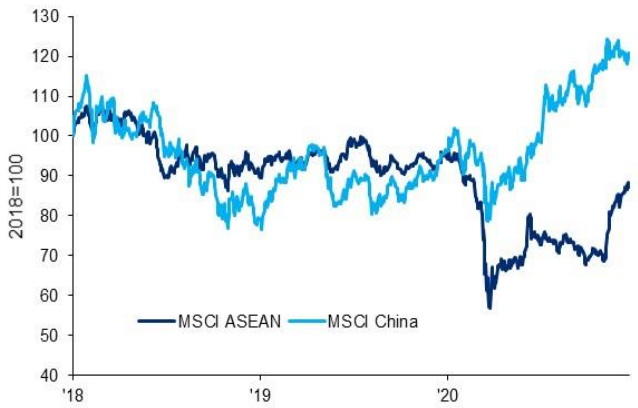
There are other vaccine front runners in China include Sinovac and CanSino Biological, with published efficacy rates due in coming weeks. Developed markets in Asia including Hong Kong and Singapore have contracted with both Sinovac and western vaccine producers including Pfizer. Brazil also added the prospective Sinovac vaccine to its national immunization plan.

The ease of delivery and less stringent storage requirements of Chinese vaccines are especially suited for lower income countries in Asia and globally. The Sinopharm vaccine, for example, only requires refrigeration at 2-8 degrees Celsius for storage, similar to the AstraZeneca vaccine. Sinopharm is expected to produce 1.3 billion doses next year, a capacity comparable to that of leading producers in developed markets.

With the rollout of vaccines, we expect trade recovery in Asia to broaden towards non-tech products, and benefit other parts of EM Asia. The Asian export growth we anticipate is consistent with over 30% growth for corporate earnings in Southeast Asia in 2021 **(see Figure 12)**. GDP for EM Asia excluding China, Taiwan and Korea is now projected to grow by 7.5%-8.5%% in 2021, rebounding from a decline of 6.5% in 2020. As **Figure 13** shows, South East Asia's equity markets looked far more like Latin America's than China's in 2020, and offer both a recovery opportunity and long-term growth.

Figure 12: EM Asia exports vs Southeast Asia earnings growth

Figure 13: China vs ASEAN equity market performance



Source: Haver Analytics, MSCI indices as of December 18, 2020. Note: MSCI ASEAN is index which tracks performance of equity markets within the Association of Southeast Asian Nations. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be guarantees of future events

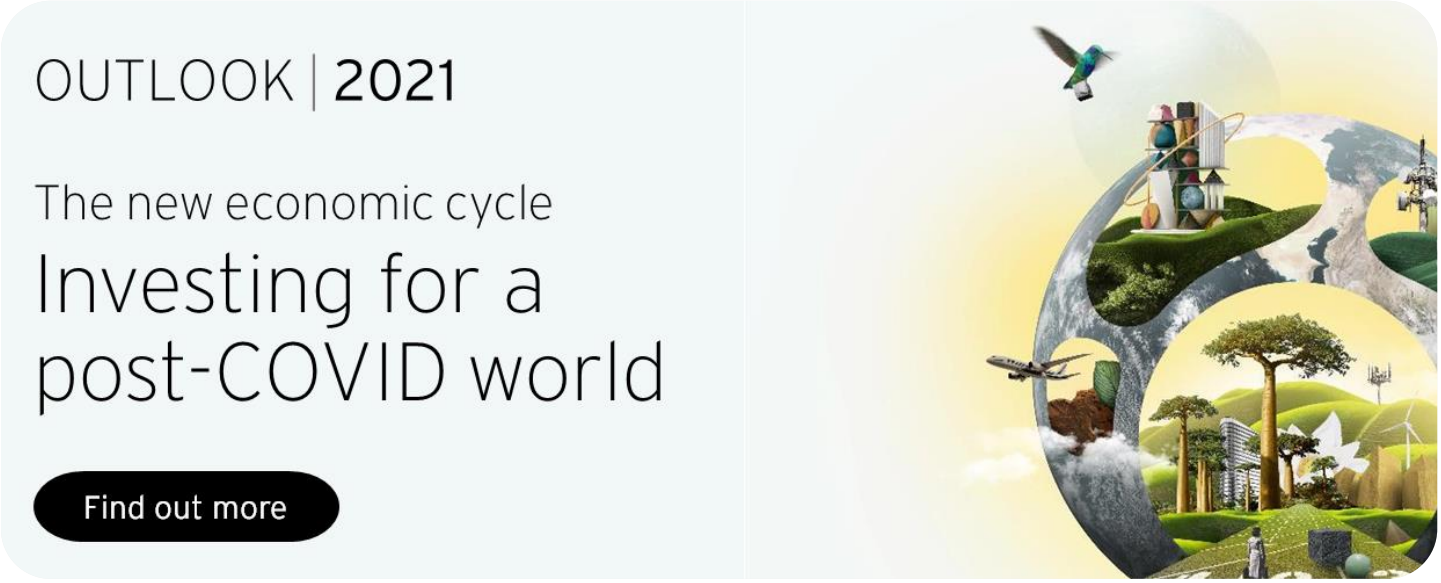
Better Diversification AND Exposure to Future Growth

As we've long discussed in Outlook 2020, regional diversification is the closest thing to a "free lunch" in mitigating idiosyncratic local country risks. A global pandemic - the first in more than 100 years – is an unlikely, but wise time for investors to remember this. Even after the sharp rally of 2020, we continue to hold a modest overweight in China's equity and credit markets for appropriate global investors.

As we discussed in last week's Bulletin (Why Global Investors Should Follow the Vaccine, Not Politics), US investors do face regulatory risks when investing directly in certain Chinese equities, particularly any that might be tied in some way to China's military. The US Congress may also follow through with threats to delist Chinese entities on US exchanges unless China makes concessions on relevant accounting issues. US investors, however, will be far from the sole determinant of China's local equity market performance.

As we note, it is Southeast Asia that is likely to drive regional outperformance in 2021. Adding exposure to Asia apart from China may seem difficult for many investors, but with our continued overweights to both China and Japan now, adding a simplified, broader Asia exposure is easier for many investor portfolios, and won't exclude the stronger elements of the post-COVID recovery.

With the US dollar having dropped significantly in the second half 2020 with room for more depreciation in the coming few years, so many investors wonder how to gain from this revaluation. External currency appreciation in Emerging Asia's assets is clearly one of these opportunities. So many investors have failed to diversify globally, taking needless idiosyncratic local risks in their portfolios. Now we see tactical opportunities aligning with that structural case.



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