

Jefferies Prime Services Quarterly

OUTLOOK 2020



CONTACTS

John Laub

Global Head of Prime Services
+1 212.284.1726
Jlaub@Jefferies.com

Barsam Lakani

Head of Prime Services Sales
+1 212.284.1783
Blakani@Jefferies.com

Leor Shapiro

Global Head of Prime Services
Capital Intelligence
+1 212.336.6267
Lshapiro@jefferies.com

Shannon Murphy

Head of Strategic Content
+1 212.336.1139
Shannon.Murphy@Jefferies.com

Lily Calcagnini

Strategic Content
+1 212.323.7596
Lcalcagnini@Jefferies.com

Jefferies

ESG or ECD?

Environmental, Social & Governance → Emissions, Climate and Decarbonization?

One of our foundational issues of focus for 2020 is the evolution of ESG as a broad thematic umbrella term to more specialized areas of focus.

1. ESG is Poised to Decentralize Into Three (or More) Subspecialties:

ESG investing has long grouped issues around environment and sustainability, social and human issues, and governance. While each of these families of issues is of critical importance, **it is clear that managers are focusing on certain aspects of these pillars.**

2. Climate and Climate Adjacent Issues Are Emerging as Top of Mind for Those Exploring This Space.

Data availability, sophistication of analytics and metrics, and the ongoing push by policy makers and investors alike for increased climate transparency will allow for a more quantifiable and investible universe.

3. ~50% of MSCI World Companies Currently Report Carbon, Waste and Water and This Number is Only Expected to Rise.

The concept of “carbon risk” is increasingly understood as an issue hitting squarely at many companies’ balance sheets and valuations, and as this reporting becomes more standardized, a growing number of managers are incorporating these data points into analyses.

4. All Eyes on Regulation. With multiple regulatory regimes working to address climate issues, it is critically important to understand pending legislative and policy shifts across jurisdictions.

Biggest cliffhangers heading into 2019:

- Will carbon reporting be standardized across companies?
- How will the election year impact climate issues in the U.S. and EU?

Our inaugural Prime monthly quoted Jimmy Iovine: **Everything we know could be wrong already.** It's no less true now than in 2017. The key is to stay focused on spotting what could be **right.**

TOP PREDICTIONS FOR 2020

Last year, we challenged ourselves to make a few predictions for the coming year. Twelve months later, we were close to spot-on. In the hopes of replicating that success, here are our bets for 2020.



Outsourcing Has Reached Peak Opportunity. As managers increasingly get smarter about allocating resources more efficiently and taking advantage of new solutions, we have noticed a considerable uptick in emerging managers leveraging an outsourced trading resource – **more than two-thirds.**

Content Becomes Its Own Core Competency. Also referenced below, but as it becomes increasingly difficult to differentiate in a crowded landscape, managers are looking to new forms of story telling to stand out and be recognized as a thought leader in their space.



Under the Microscope: Operational due diligence (ODD) has evolved and renewed focus on various emerging themes. There is a **lot of research and resources** being poured into understanding the aforementioned themes of ESG (or, ‘ECD’) and outsourced trading.

Market Structure. Ten years into an equity market rally, and in the midst of dozens of other structural shifts in the trading landscape, senior decision makers across investing, risk and trading and execution verticals are working together to understand what risks are most present in 2020....and beyond.



Globalization... and Specialization? Whether exploring new opportunities in Japan from an activist seat, diving into what may lie ahead in China and India for health care discovery and delivery or revisiting future resource consumption across various emerging markets, last year’s trend of specialization is increasingly married with regional exploration outside the U.S.

CONTENT | VIDEOS | AUDIO

A huge focus for 2019 for both the Jefferies Strategic Content team, as well as many of our clients, was how to innovate around **content, thought leadership and modes of delivery for current and potential stakeholders.** Given the average **human now has an attention span only slightly less than a goldfish,** we continue to diversify and streamline our content offerings across various mediums.

TOP CONSUMED VIDEOS AND AUDIO EPISODES IN 2019



Building Efficiencies for the Next Decade Through Outsourcing

Video



Invisible Forces Episode 3: You Are What You Buy

Podcast



Factors of the Future: Data Privacy, Trust, and Transparency

Video

SPOTLIGHT ON ASIA I

NOTES ON SECURITIES FINANCE ACROSS THE APAC AND AUSTRALIAN MARKETS

There have been a number of changes in the capital markets landscape across the Asia Pacific and Australian markets in recent years – **with a number of other shifts predicted for 2020.**

Stu Jones, our Head of Securities Finance for APAC, gives us a landscape update, and a few thoughts **on what's to come** in this arena:

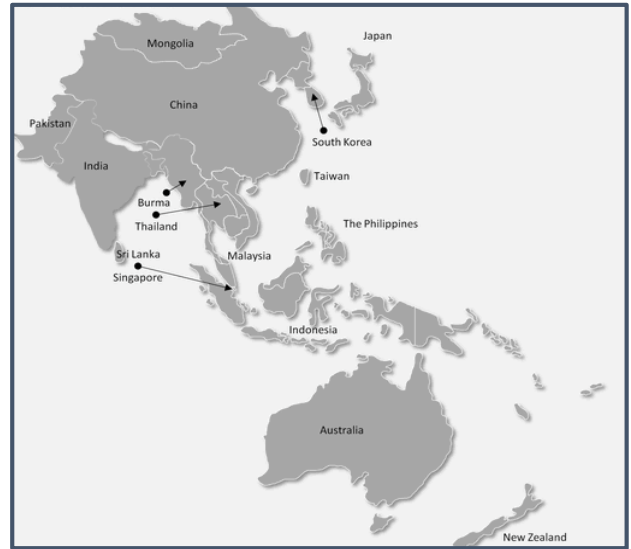
AUSTRALIA: A mature securities lending market, and the third largest in the region, with considerable focus on Resources and Financials securities, Australia is a market where nearly 70% of the market is done via swap and a significant percentage of the street short is market neutral or quantitative funds.

CHINA: With the Year of the Rat fast approaching, China is one area where eyes are **keenly focused on potential shifts in 2020. The much anticipated outcome of the recent QFII / RQFII consultation is due soon.**

- We expect to see some significant reforms off the back of that and have been actively engaged with the regulators and exchanges.
- Expect a level playing field for all QFII holders, no concept of the so called 'phase 1', 'phase 2' QFII.
- We may see the opening up of onshore borrowing activity for QFIIs for the first time, through the CSFC, which would be a significant symbolic move.
- QFIIs (qualified foreign institutions) will be able to borrow for the first time. The CSFC (China Securities Finance Corporation) is the CCP that sits in the middle of all securities lending or margin financing, but access for foreign institutions has always been restricted.

Contact: **Stuart Jones** | Stuart.jones@Jefferies.com

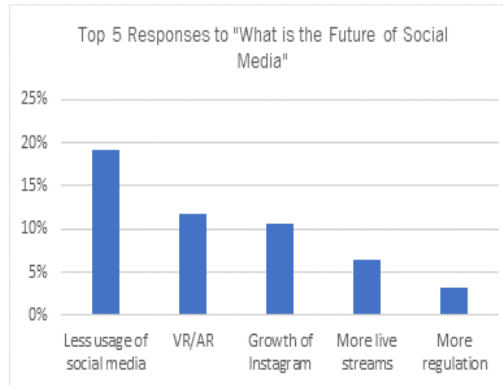
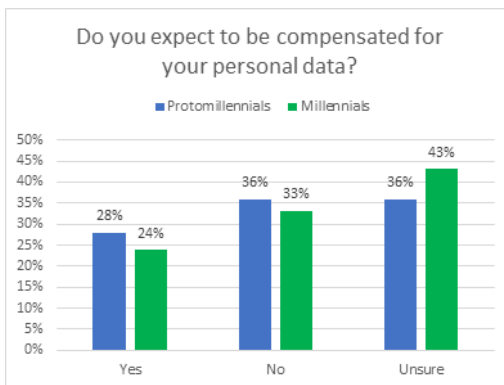
Source: Jefferies Prime Services



HONG KONG/CHINA CONNECT: A more recently opened market in 2014, from a practical perspective the short selling mechanism is not currently workable due to the eligibility requirements and relative sophistication of the way prime brokerage and prime finance organisations are structured. Whilst there is certainly appetite to continue to reform these rules, there are many more important developments that take priority: Super SPSA (the ability to link multiple underlying SPSAs to a Super account and trade using the Super SPSA), holiday trading, block trading and DLT amongst other initiatives.

INDIA: In October, India went to physically settled on their single stock futures market, which was expected to stimulate the securities borrowing and lending market. However, in practice, as single stock futures are no longer available for taking short positions, only 1-1 hedging, the product popularity has fallen away with funds.

THE FUTURE OF DATA, PRIVACY AND COMMERCIALIZATION



Given the enormous focus on issues around **data, privacy, and commercialization**, we conducted a number of surveys in 2019 to better understand what may lie ahead for this critical issue.

Access the results of these surveys here:

1. [The Future of Social Media & Content](#)
2. [Commercializing Existence](#)
3. [Data Privacy, Trust & Transparency](#)

Of note:

- A **majority of respondents across all age groups** (not just millennials and Gen Z!) **preferred to maintain the status quo** of exchanging personal information for the tools many of us have come to rely on...Google Maps for example. Few, if any respondents, let privacy concerns shift their behavior.
- About **half the polled audience already own a smart home device** (think: Alexa), and it is one of the most rapidly growing and acceptable tools for the next decade, with a **de minimus number of respondents raising any privacy concerns.**

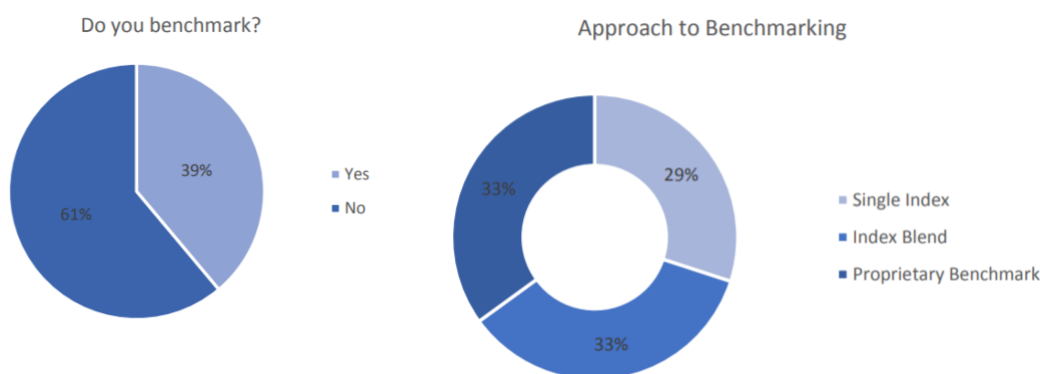
2020 AND BEYOND: PORTFOLIO CONSTRUCTION ON THE ROAD TO 2030

The **Jefferies Capital Intelligence** team conducted a deep dive on portfolio positioning for the days ahead, surveying dozens of allocators across organizational types to understand what may lie ahead for the next decade.

The resounding message: allocators are extremely heterogenous, and even within the same industry or organizational type, adhere to vastly different mandates, investment profiles and timing.

That may be self-evident, but it leads to highly varied and extremely dynamic approaches to portfolio construction and evolution. The proliferation of products over the last decade (on both the passive and less liquid ends of the spectrum), coupled with persistently low rates and new opportunities emerging in different markets have prompted a broad swathe of allocators to revisit basic portfolio assumptions.

Benchmarking In View to Build a Better Portfolio



Source: Jefferies

Momentum in Changing Benchmarking Approaches

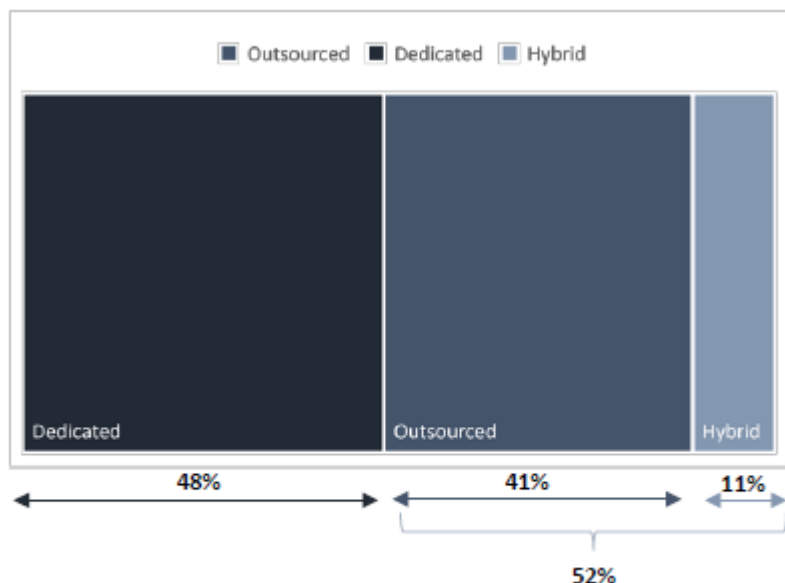
A number of allocators surveyed reported **they don't leverage any benchmarking at all to evaluate portfolios.**

For those that do – **respondents were fairly evenly split across leveraging proprietary benchmarks, a single index (often the Barclays Agg or MSCI ACWI), or a blend of multiple indices.**

More granularly, there is no consensus around approach to benchmarking across portfolios or even within certain verticals. For allocators with a fixed payout required annually (typically 5-7%), investments made that facilitate harvesting of profits or offsetting losses often center around those realities rather than trying to absolutely outperform a specific benchmark.

Lily Calcagnini | Lcalcagnini@Jefferies.com

Outsourcing Realities Have Hit a Near Majority: The Trend Has Become a Norm



When we last explored outsourcing as a trend, we noticed roughly a third of new managers were launching with an outsourced COO/CFO resource. In many cases, these firms **had no dedicated senior non-investment personnel at launch, or one person** who acted as a “counterparty relationship manager rather than a dedicated COO/CFO.

This trend continues to accelerate and has **become increasingly common to leverage an outsourced trader as an additional resource and extension of the firm.** There are considerable differences across regions, with outsourced trading more widely embraced in the U.S. than Europe, but we are increasingly hearing from managers across the globe that outsourced trading can offer more efficient operational solutions.

Jefferies



Variables that matter to allocators when defining "hedge funds"

GREED & fear believes there is another move up in oil & oil stocks, which lagged procyclical trade. Sherif highlights credit markets are wide open, as Nov HY issuance is best since '10. He thinks single B loans look compelling vs leveraged credit. This supports DeSanctis' view of owning levered stocks. Darby now modestly bearish India; Modestly Bullish Australia; Indonesia, Malaysia, upgraded Pakistan to modestly Bearish. He also upgraded Japan to Bullish.

Greed & fear - Would advise investors to own some oil stocks as a hedge since an unexpected rally in oil would have negative consequences for other sectors. Oil stocks are also a hedge on the current "value" trade running further. The constructive view on oil is partly based on the assumption that demand in emerging markets will remain strong and partly on the view that investment by conventional oil industry will remain weak precisely because of the widespread view that the fossil fuel industry is living on borrowed time. The issue raised by the sharp slowdown in US shale production growth is whether this is just a temporary phenomenon, or whether shale has reached an inflection point due to most productive areas of shale in the US have peaked.

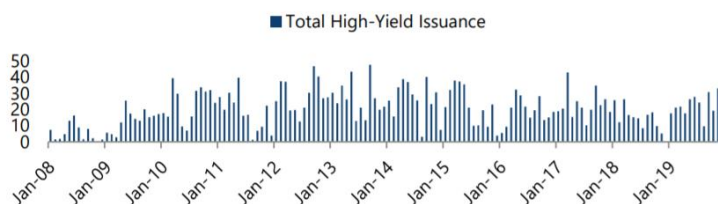
Sean Darby - Making some changes on Global Asset Allocation: As part of our year-ahead look across Asian markets two weeks ago, we made a number of changes: Upgraded Japan to Bullish, turned modestly Bearish on India, Australia upgraded to Modestly Bullish, moved to Modestly Bearish on Indonesia, Malaysia, Pakistan.

Sherif Hamid: Credit - Recently, we had a very heavy primary issuance calendar across both IG and HY; it has been the busiest November since '10. We think that single B loans look extraordinarily compelling vs the rest of the leveraged credit market at current levels.

David Owen: European Strategy: There is a large amount of cash sitting on the UK corporate sector balance sheet, which could in theory be put to work, especially given that UK investment had effectively flat-lined since the 2016 EU referendum. The so-called liquidity ratio, the ratio of cash and deposits sitting on the corporate sector balance sheet to loans is certainly much higher in the UK than in euro area economies.

Steven DeSanctis: More data points are supporting the "get cyclical" theme, with Global PMIs finding a bottom and then picking up since the summer. The Jefferies' Short Cycle Monitor (For Full report, please see [SCM](#)) has also bottomed and this suggests that end-market demand could improve over the next few quarters. In an interesting look at inventories, Jefferies research found that twice as many companies have talked about shrinking inventories than building (Please see [US Insights](#)). This sets up potentially better demand and faster growth in '20, leading to the "value" trade continuing.

High-yield issuance really strong of late; supports owning levered equities



Source: Jefferies Leverage Credit Desk

If you would like to be added to the JefMacro Weekly distribution list, you can reach out to the team [here](#).

The Jefferies Global Strategy Team recently released notes on:

- [China](#): *Frequent Factors, Better than they Appear*
- [Pakistan](#): *Bottoming Out*
- [Norway](#): *Still Living the Dream*
- [U.S.](#): *November Factor Returns, Fund Flows & Earnings Trends*
- [Europe](#): *Europe 2020 – Exiting the Slowdown*

JEF's Valuation Handbook—Revisions Getting Better, Small Trades at Nearly 21x

It does seem as if revision ratios bottomed end of Sept—earnings & sales ratios continued to get better for small, large. Of course with strong performance, absolute valuations climbed with R2 pushing 21x, Top 200 18.3x, Mid at 20.8x. Despite outperforming 3 straight months, relative valuation model for small sits in Q1 at 19th percentile. As for style, R2G's P/E is now north of 25x and sits in 94th percentile. Our style model is in 14th percentile for small.

Both earnings and sales revisions improved up and down cap: Although the US economic data has been less than perfect, things are improving and so too has been revisions. They seemed to have bottomed in September and have turned up the last two months in both small and large and earnings as well as sales. For the Russell 2000, the earnings revision hit 0.94 and this is the highest since August 2018 with the three-month moving average now at 0.80. Comm Services, Tech, and Real Estate are all above 1.0. As for sales, the ratio now stands at 0.84 and best since earlier this year thanks to the strength in Comm Services, Health Care, and Real Estate.

Steven G. DeSanctis, CFA*, Equity Strategist
(212) 284-2056
sdesanctis@jefferies.com

Eric Lockenvitz, CFA*, Equity Associate
(212) 336-7341
elockenvitz@jefferies.com

2019: JEFFERIES CAPITAL INTELLIGENCE YEAR IN CONTENT

AUDIO

Jefferies Franchise-Wide Podcast: *Invisible Forces*



Jefferies' first podcast series explored the surprising currents moving markets, driving innovation and disrupting entire business models.

Top Episodes:



Episode 1:
Mobility: The Ten Trillion Dollar Question



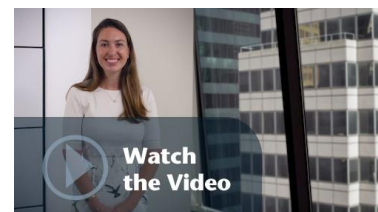
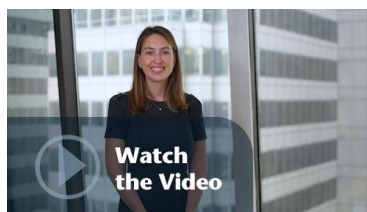
Episode 5:
Building a Boom: Brand Lessons for Creating Explosive Value



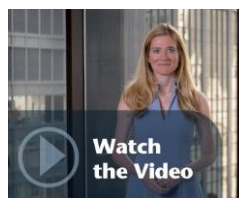
Episode 6:
What Makes Makers Tick

VIDEO

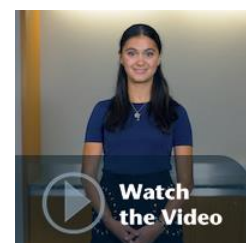
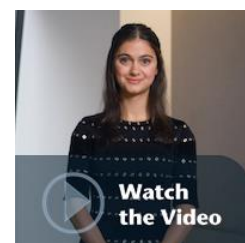
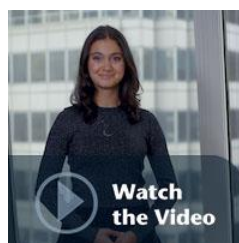
View from Capital Intelligence – Erin Shea



Clients are Asking – Shannon Murphy

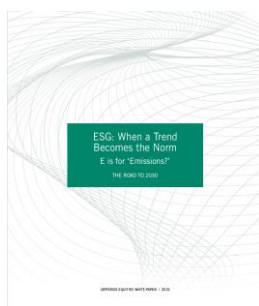


Quick Takes on Big Ideas – Lily Calcagnini

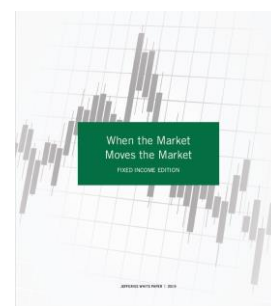


THEMATIC WHITE PAPERS

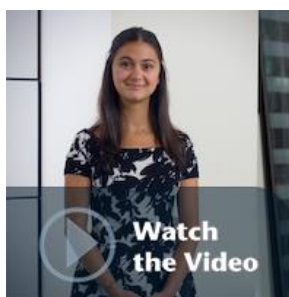
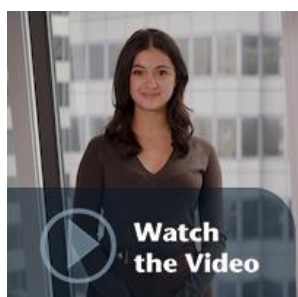
ESG Series: *Reinventing 'Value,' E is for 'Emissions'?*



Market Structure Series: *When the Market Moves the Market* Equities & Fixed Income Editions



Demographic-Cultural Series: Data Privacy and Monetization, Commercializing Existence, and Millennial Content Consumption



The Road to 2030: A Decade Defined by Data



IMPORTANT DISCLAIMER

THIS MESSAGE CONTAINS INSUFFICIENT INFORMATION TO MAKE AN INVESTMENT DECISION.

Please contact your Jefferies representative for copies of the most recent research reports on individual companies.

This is not a product of Jefferies' Research Department, and it should not be regarded as research or a research report. This material is a product of Jefferies Equity Sales and Trading department, and intended for Institutional Use. Unless otherwise specifically stated, any views or opinions expressed herein are solely those of the individual author and may differ from the views and opinions expressed by the Firm's Research Department or other departments or divisions of the Firm and its affiliates. Clients should assume that this material is not independent of the Firm's proprietary interests or the author's interests. For example: (i) Jefferies may trade for its own account or make markets in the securities referenced in this communication (and such trading may be entered into in advance of this communication); (ii) Jefferies may engage in securities transactions that are contrary to or inconsistent with this communication and may have long or short positions in such securities; and (iii) the author of this communication may have a financial interest in the referenced securities.

The information and any opinions contained herein are as of the date of this material and the Firm does not undertake any obligation to update them. All market prices, data and other information are not warranted as to the completeness or accuracy and are subject to change without notice. Past performance is not indicative of future results, and no representation or warranty, express or implied, is made regarding future performance. The Firm is not providing investment advice through this material. This material does not take into account individual client circumstances, objectives, or needs and is not intended as a recommendation to particular clients. Securities, financial instruments, products or strategies mentioned in this material may not be suitable for all investors. Jefferies does not provide tax advice. As such, any information contained in Equity Sales and Trading department communications relating to tax matters were neither written nor intended by Jefferies to be used for tax reporting purposes. Recipients should seek tax advice based on their particular circumstances from an independent tax advisor. In reaching a determination as to the appropriateness of any proposed transaction or strategy, clients should undertake a thorough independent review of the legal, regulatory, credit, accounting and economic consequences of such transaction in relation to their particular circumstances and make their own independent decisions.

OPTIONS ARE NOT SUITABLE FOR ALL INVESTORS. Please ensure that you have read and understand the current options risk disclosure document before entering into any option transaction. The options disclosure document can be accessed at the following web address:

<http://optionsclearing.com/publications/risks/riskchap1.jsp>. Please contact Peter Seccia, Head of New York Derivative Sales for additional information (212-284-2454).

© 2019 Jefferies LLC