



BREAKINGVIEWS

Predictions 2020

Turning up the heat

A pivotal year for profit, politics and the planet



Sponsored by



BREAKINGVIEWS

Predictions 2020

Turning up the heat

A pivotal year for profit, politics and the planet



Sponsored by



CONTENTS

Introduction 1

Fired up 5

Hotter inflation is the best surprise to hope for..... 5

Jay Powell has golden chance to avow independence..... 7

Green laggards face war on multiple fronts..... 9

Wall Street finally gets some capital satisfaction 10

Look out for Narendra Modi's big economic surprise 12

Jack Dorsey adds third job as anti-Facebook hero 14

Rainmakers 17

Asia Pacific is primed for its next 11-digit LBO..... 17

The hottest new car model is a Daimler-BMW deal 18

M&A bankers will turn climate risk into clients 20

BlackRock is Wall Street's object of fantasy M&A 22

Deutsche, Commerz get 30-year reunification bonus 24

An ever-drier world will unleash investment flood 26

Flaming out 29

Investors will rue their Hong Kong risk appetite..... 29

Buyout barons' debt machine will blow a gasket 31

Wealth managers will inflate superprime bubble 33

French lottery IPO may be as good as Macron gets 34

Disney will lose its magic touch 36

Playing with fire 39

American election to test Wall Street's nerves.....	39
South Africa heads for year of living dangerously	42
Italy and Germany will unite on EU tech taxes	43
Investors warming to Putin's Russia will go cold.....	45
Johnson's big win unlocks Brexit black box	46
Taiwan will widen U.S.-China schism in 2020.....	49
A Canadian breakup is back on the table	51

Sparks flying..... 55

Wanted: bold activist to take on Masayoshi Son	55
Tencent is next in Western cross-hairs	57
Argentina debt do-over is even chancier than usual	59
ECB feuding will have a new front in coming year.....	60
Margrethe Vestager will open tech's walled garden.....	63

Alternative energy 65

Tokyo brings home the Olympic gold in 2020	65
Gaming's strongest opponent will be regulation	66
Peak subscription economy approaches in 2020	68
Underdog will take home Japan's casino jackpot.....	70
A health craze for 2020: Chinese medicine	71
HR nous will make or break tech-driven ambitions.....	73

About us.....76

Acknowledgements.....77

INTRODUCTION

The world needs to make some burning decisions in 2020. That's why this year's Breakingviews Predictions book is entitled "Turning up the heat: a pivotal year for profit, politics and the planet." If that sounds like overreach, paired with a cliché, so be it. Humanity is at something of a crossroads.

Start with politics. The pro-democracy protests in Hong Kong continue and may prompt the People's Republic of China to act. UK Prime Minister Boris Johnson, fresh from a stunning election victory, will push ahead with Brexit, even if it means the dissolution of Great Britain. Meanwhile, American voters will return to the ballot box in November to either send to the White House one of the many Democrats still running for president or, assuming he survives impeachment, reelect President Donald Trump. The choices made in each instance will have ramifications for years, perhaps a generation.



Swedish environmental activist Greta Thunberg watches as U.S. President Donald Trump enters the United Nations to speak with reporters in a still image from video taken in New York, Sept. 23, 2019. REUTERS/Andrew Hofstetter

Next, as our cover photograph of fires raging in the Amazon suggests, comes global warming. This is supposed to be the year when the almost-200 governments which signed the 2015 Paris accord make good on commitments to curb greenhouse-gas emissions. It does not look promising, based on the disappointing outcome of a United Nations climate-change confab in December. Failure to act risks sparking more of the devastating wildfires that have raged recently across Brazil, California and Australia. These, along with more floods and droughts like those seen from India to Nebraska to Iran, will have an immense impact on economic activity in the short- and long-term.

Despite all this doom and gloom, we begin our book with some positive predictions. On climate, for example, the rising need to act will spur shareholders to take bolder stances with some of the major greenhouse-gas emitters – and their supply chains. And what would scream Federal Reserve independence from climate-change-denying Trump more than for Chairman Jay Powell to take the central bank into the Network for Greening the Financial System? There's an opportunity here for bankers, too: The M&A adviser who adds climate issues to her repertoire will find receptive clients.

Green deals won't be the only ones being struck, though. Expect a rare 11-digit leveraged buyout to be unveiled in Asia in 2020 – even as fears grow elsewhere about private-equity financing. There may even be another big merger contemplated between carmakers, with BMW-Daimler as our top pick. The 30th anniversary of German reunification brings some welcome relief to struggling Commerzbank and Deutsche Bank in the form of fees from helping eastern German entrepreneurs prepare for retirement.

And, as always, we indulge in a bit of fantasy corporate finance: Blackstone boss Steve Schwarzman will reunite his firm with BlackRock – unless Goldman Sachs Chief Executive David Solomon beats him to it.

Elsewhere, look for Indian Prime Minister Narendra Modi to pull a rabbit out of his hat to bolster the economy. Watch as Twitter and Square CEO Jack Dorsey becomes the anti-Facebook hero. And we even imagine how welcome a return of inflation would be – in modest amounts, of course.

There will also be fiery trouble ahead. The continuing tensions in Hong Kong are likely to burn investors. Bankers to the ultra-wealthy are in danger of stoking a superprime bubble. Russia and South Africa will both disappoint markets. And serial defaulter Argentina is heading back for another round of bond restructuring that could scorch the sovereign-debt market.

We also make space for some lighter-hearted observations. A mix of new standards, sustainability and short-term stimulus will help Tokyo benefit from hosting the Olympic Games. The most important job for companies to fill will be the one that fills jobs. And beware the peak of the subscription economy.

Predicting the future is a risky business - and we often get singed for sticking our necks out. Last year we asserted that Japan would be the stealth threat to the global economy in 2019. Unless well-cloaked, we were wrong. And the market debuts of Lyft and Uber did not affect Tesla's scarcity value at all.

But when we prognosticate correctly, the stakes are high. Voters did indeed give Mauricio Macri the boot as Argentina's president. And we laid out why write-downs were in the immediate future for SoftBank's Vision Fund: The colossal failure of WeWork to launch an IPO became Exhibit A. For 2020, we're doubling down on that one and pushing for an activist to take on SoftBank boss Masayoshi Son.

Whether or not we succeed on that call and others, our main goal is to provide thought-provoking financial analysis of the biggest topics in global finance, business, technology, markets and economics. Continuing to do so is one prediction we can guarantee.

Antony Currie

Associate Editor, Reuters Breakingviews
Jan. 6, 2020

OUR DATA COMES
DOWN TO TWO
SIMPLE THINGS.

WHAT WE DO WITH IT.
AND WHAT YOU
ACHIEVE WITH IT.

We are Refinitiv – trusted and relied on by over 400,000 professionals in more than 190 countries.

We provide the data, technologies, and expertise our customers and partners need to drive their business forward.

And we're particularly proud to offer the most transparent ESG data set available, with over 400 individual metrics.

So you can drill down to gain deeper insights into your funds – and make sustainable investment decisions with confidence.

refinitiv.com

REFINITIVTM

DATA IS JUST
THE BEGINNING



FIRED UP

Hotter inflation is the best surprise to hope for

By Richard Beales

The death in December of Paul Volcker, former chairman of the U.S. Federal Reserve and famed inflation-fighter, is a reminder that galloping price increases used to be a problem. In recent years, though, inflation has largely gone missing. Its return in 2020 would be an unexpected bright spot.

Not, of course, the kind of inflation Volcker countered with tough monetary policy in the early 1980s, when annual price increases topped 10% in America. Or the debilitating 50% annual rate in Argentina as of October. But there's a lot to be said for modest price gains.

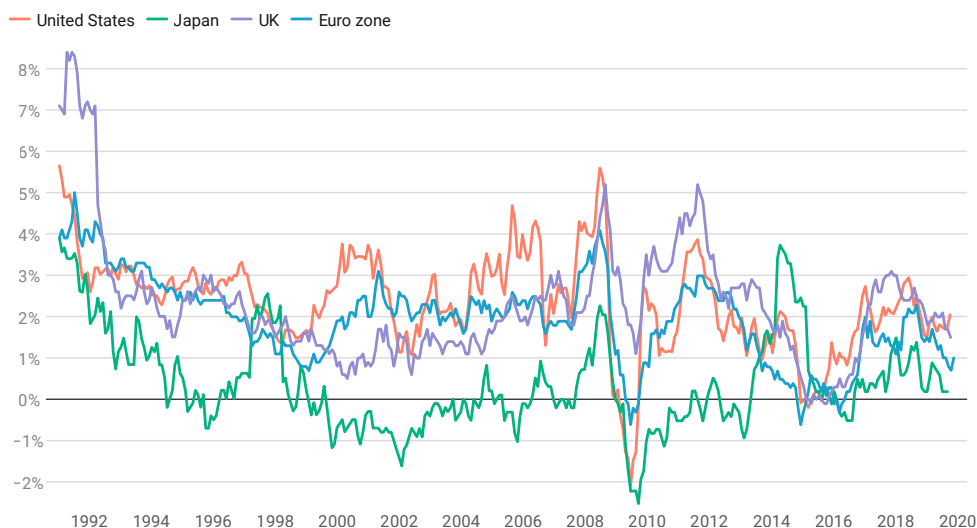


Confetti falls in Times Square just after midnight during New Year celebrations in New York, Jan. 1, 2018.
REUTERS/Darren Ornitz

The failure of U.S. price pressures to gain much momentum, starting with wages, is a head-scratcher given the tight labor market evinced by an unemployment rate of a mere 3.5% in November. The country's consumer price index rose 2.1% in the year to November. That metric clears the central bank's 2% symmetrical target but doesn't make up for long periods of much weaker inflation since the financial crisis.

Volcker's legacy

Consumer price inflation in major economies



Vincent Flasseur | Breakingviews – Predictions 2020

Source: Refinitiv Datastream

In turn, this contributes to low interest rates, which in the past decade or so have changed the financial world. Central bankers like New York Fed President John Williams like to talk about “r-star,” the real interest rate that’s natural for a healthy economy. Economists think the theoretical r-star has become lower than it used to be thanks to aging populations, lower productivity growth and other factors. Add weak inflation, and the nominal interest rate matching r-star is also low.

That's why the Fed's target rate is far lower than the historical average, in the 1.5%-1.75% range. In Europe and Japan, key policy rates are less than zero. That's a huge challenge for pension funds, some targeting long-term 7%-plus annual returns on their often-underfunded portfolios, insurance companies seeking safe investments, and risk-averse savers. It's also problematic for banks trying to lend profitably.

It's hard to find hints of a resurgence in inflation. True, the impact of President Donald Trump's tariffs could push prices up. But globally the International Monetary Fund, for example, is more worried about the reverse – even if BlackRock, the giant asset manager, thinks inflation risks are underappreciated. Maybe the best hope for a resurgence of manageable inflation is that the consensus is largely dismissing the possibility. Otherwise, there'll be more painful adjustments to a new, low-interest rate future.

First published Jan. 2, 2020

Jay Powell has golden chance to avow independence

By Rob Cox

Federal Reserve Chairman Jay Powell is channeling Groucho Marx when it comes to climate change. The U.S. central banker seems to be following the comedian's quip that he would "refuse to join any club that would have me as a member." But there are good reasons for Powell to see sense and nudge the Fed into the Network for Greening the Financial System in 2020.

Founded two years ago, this 50-plus global group of central banks and other regulators wants to focus the financial sector's mind on environmental and climate risks and encourage the industry to support the switch to a greener economy. Trying to keep the planet from frying is a noble cause and even hydrocarbon-dependent countries, like United Arab Emirates and Canada, have sent emissaries to figure out how global warming will impact banking supervision and macro-financial policy.

Fed Governor Lael Brainard said in November the U.S. central bank was in discussions about how it might participate in the network. But there is no good official reason why it hasn't already signed up. Some at the Fed worry that tackling climate change is a diversion from its mandate of maximizing employment and ensuring price stability. And Powell told Congress in April that climate risks don't "fit neatly" into his financial stability duties. Neatness hasn't, however, prevented the Fed from past diversions.



Federal Reserve Board Chairman Jerome Powell testifies before a Joint Economic Committee hearing on “The Economic Outlook” on Capitol Hill in Washington, Nov. 13, 2019. REUTERS/James Lawler Duggan

That leaves an impression the true motive for aloofness is a reluctance to tangle with President Donald Trump, who is pulling the United States out of the 2015 Paris climate accord. If this is the reason, Powell is doing a disservice to America’s financial institutions, which are among the world’s largest. It deprives them of some of the best practices agreed to by the body’s members, while cutting them out of their formulation altogether.

Joining the network would have the added benefit of broadcasting the Fed’s independence from political interference. Powell has cut rates even though the U.S. economy is relatively healthy and yet still gets bashed by Trump. Taking the central bank into a multilateral dialogue on an issue that Trump once called a “hoax” might defuse criticism that the central bank has been too malleable on interest rates. Brickbats will fly anyway. Better to do the right thing come what may.

First published Dec. 18, 2019

Green laggards face war on multiple fronts

By George Hay and Antony Currie

Climate-change slowcoaches are heading for a smash. Fossil-fuel producers, steel companies, carmakers and other big greenhouse-gas emitters have so far faced only limited pressure from their owners for action on climate risk. That'll change in 2020.

Despite increasingly frantic calls from scientists to limit global warming to 1.5 degrees Celsius, companies and investors have had grounds to hang back. An International Energy Agency business-as-usual scenario has oil demand still growing during the 2030s. Even engaged governments have only set very long-term carbon emissions goals.

That narrative is shifting. Shareholders have until now mostly needled companies like BP, Glencore and Royal Dutch Shell for extra detail on global-warming risks. They're getting pushier. Climate Action 100+, a group of 370 investors with \$35 trillion in assets, will soon place more stringent demands on individual companies, including going after directors and supply chains. Activist hedge fund TCI, run by Christopher Hohn, is already doing it.



A firefighter attempts to protect the Colo Heights Public School from the Gaspers Mountain fire near Colo Heights, southwest of Sydney, Nov. 19, 2019. AAP Image/Dean Lewins/via REUTERS

Meanwhile, the pension and insurance funds that hand out mandates to asset managers are slowly mobilising the trillions of dollars they have in passive investments with BlackRock and Vanguard, which have been chastised by think tank InfluenceMap for underwhelming shareholder engagement. The United Nations' new Net-Zero Asset Owner Alliance includes big hitters like Allianz and CalPERS. Hiro Mizuno, chief investment officer of Japan's \$1.5 trillion Government Pension Investment Fund, is already awarding work based on environmental, social and governance concerns. Last year BlackRock's passive foreign equities mandate for GPIF nearly halved.

Crucially, climate risk will increasingly feature in shorter-term analyses of company valuations. A U.N.-supported research project backed by Principles for Responsible Investment estimated that the world's 10 biggest oil companies, including Exxon Mobil and Total, would lose a third of their value if markets repriced their shares now to anticipate tough policy pushbacks, such as carbon pricing by 2025.

That's starting to create the kind of noise that wakes up more traditional shareholder activists and short sellers. The prospect of some governments using the fifth anniversary of the 2015 Paris climate accord to add some teeth to their green commitments will push more than a few laggards towards the ditch.

First published Dec. 18, 2019

Wall Street finally gets some capital satisfaction

By Anna Szymanski

It's tough to pity the likes of JPMorgan, Bank of America and Goldman Sachs. But Wall Street giants with more than \$700 billion in assets have barely benefited from the regulatory rollbacks bestowed on smaller peers and other industries by President Donald Trump's administration and the Federal Reserve. But the central bank will finally give them some satisfaction in the next few months.

Sadly for the them, they won't suddenly be allowed to cut their overall capital levels. Instead, they'll get some relief from tweaks to the short-term lending market known as repo.

This usually arcane part of the business hit the headlines in September when repo rates jumped more than fourfold to around 10%. It wasn't even sparked by an actual crisis. Large banks exacerbated the spike, though, by not exchanging reserves – basically a form of cash – for treasuries. Postcrisis rules were a big part of the reason why.



The Federal Reserve Bank of New York, Oct. 4, 2019. REUTERS/Carlo Allegri

Technically, treasuries are treated the same as cash for many capital requirements for lenders, like the liquidity coverage ratio. But Fed Vice Chair Randy Quarles has said that many banks feel regulatory pressure to favor reserves. Ultimately, the two aren't interchangeable: A client wanting to borrow \$1 billion when the repo market is closed isn't going to accept U.S. government bonds.

The Fed is likely to alleviate this by creating a permanent standing facility, presumably run by Lorie Logan, head of the New York Fed's market operations. Banks could get cash from the Fed in exchange for high-quality assets like treasuries almost any time on a business day. That ought to persuade their repo desks to hold more treasuries, rather than hoarding reserves, and thus make a bit more money. It could also allow banks to reduce the amount of reserves they hold to satisfy their so-called living-will liquidation plans; the eight largest players currently have nearly \$800 billion set aside as a precaution and could cut that drastically, the New York Fed reckons.

The facility would need some deft handling, from determining both the firms and assets allowed, to setting the right borrowing rate: too high, and it creates a stigma; too low and the Fed ends up running the entire market.

Those ought to be manageable. Granted, it wouldn't be quite the regulatory relief the banks have been hoping for. But it would be welcome nonetheless.

First published Dec. 9, 2019

Look out for Narendra Modi's big economic surprise

By Una Galani

The good days are coming: India's Prime Minister Narendra Modi needs to jump-start the economy to keep that 2014 campaign promise. Months into a second term, GDP growth of 4.5% is about half the pace ideal for its 1.3 billion people. Modi surprised markets in good ways, and bad, before. Here's how he might do so again.

A crisis of confidence is crippling the private sector, which is hobbled by \$200 billion of bad debt, and isn't investing as demand weakens and businesses adjust to new rules on everything from sales tax to insolvency. If India Inc is now acutely aware of the costs of corruption, the pendulum of fear has swung too far. Industrialists once willing to back large infrastructure projects are now risk-averse.

One big problem is unpredictable policymaking that has seen companies abruptly stripped of key licences or whacked with costly new contractual terms. Prashant Ruia, whose Essar Group lost its steel asset through a new bankruptcy regime to ArcelorMittal, told the audience at Breakingviews' Predictions event in Mumbai on Dec. 6 that fixing regulatory risk is key to revival.

Another sentiment lift can come from privatising businesses like Air India, an indebted globetrotting reminder of India's inefficiencies. Modi's earlier attempt failed. Getting it right this time would send a message that New Delhi is serious about reform. Outlining a roadmap to other selloffs would help too, Sunil Mehta, non-executive chairman of Punjab National Bank said at Mumbai Predictions.



Prime Minister of India Narendra Modi addresses the 74th session of the United Nations General Assembly at U.N. headquarters in New York, Sept. 27, 2019. REUTERS/Brendan Mcdermid

To kick start consumption, meanwhile, direct transfers of cash into people's bank accounts or a big spending plan on roads can't be ruled out. The government could risk the ire of the bond market to raise the funds by relaxing the fiscal deficit beyond a target of 3.3% by March 2020 to over 4%.

A more radical option is to devalue the rupee, says Shankar Sharma, co-founder of securities firm First Global. By making Indian goods more competitive, it would boost net exports. Most of the 200-strong audience predicted in a Breakingviews poll that India may choose a combination of these measures to kick start the recovery.

Modi's past economic surprises haven't all worked out: Demonetisation, the shock 2016 withdrawal of bank notes, dealt a massive shock and probably contributed to the current slowdown. Investors should brace themselves for the year ahead.

First published Dec. 9, 2019

Jack Dorsey adds third job as anti-Facebook hero

By Gina Chon

Jack Dorsey will add another line to his resume in 2020. The Twitter boss banned political ads and did more than Mark Zuckerberg to prevent the silencing of Hong Kong protesters. Dorsey, who also runs payments firm Square, fared surprisingly well in Washington hearings, too. His style will turn him into the anti-Facebook hero.

Dorsey is an unlikely political darling. He comes across as awkward and soft-spoken. But he has also been more up-front with U.S. lawmakers than his social-media rivals about toxic content and his platform's confusing terms of use. It's a contrast with both Zuckerberg's tin-eared talking points and the technical wonkiness of Sundar Pichai, who now runs Alphabet as well as its biggest business, Google.



Twitter CEO Jack Dorsey testifies before the House Energy and Commerce Committee hearing on Twitter's algorithms and content monitoring on Capitol Hill in Washington, Sept. 5, 2018. REUTERS/Chris Wattie

Twitter has also been more decisive than rivals about resolving controversies, including political ads. While Facebook and Google's YouTube are tying themselves in knots over restrictions, Dorsey in October announced Twitter was simply banning political ads altogether. While President Donald Trump's campaign manager criticized the decision, it hasn't sparked much blowback from other Republicans and it drew applause from Democrats.

That move followed another politically popular decision on Hong Kong. In August, Twitter decided to stop running ads from state-controlled media entities, including Beijing-backed outlets. Facebook, which generated about \$5 billion in revenue from Chinese advertisers in 2018 according to Pivotal Research, has run Xinhua ads about this year's protests in Hong Kong, while YouTube hosted similar China Global Television Network shows.

Square, meanwhile, has been building its cryptocurrency capabilities without drawing political backlash, whereas Facebook has put its Libra digital-currency project on hold after a global regulatory outcry.

Political pressure on social networks will increase as the November 2020 presidential election approaches. Dorsey may find he has earned a third important job as a thorn in the side of his larger, more compromised rivals.

That's if he's even around: After a trip to Africa in November he tweeted that he would spend three to six months living there in 2020. There are opportunities for Square in African markets, but Dorsey's absence could hurt Twitter if it gets caught in an election firestorm. That said, a move to another continent is one way to get a breather from an interminable, and probably nasty, campaign.

First published Dec. 20, 2019



People attend a “Fridays for Future” protest, claiming for urgent measures to combat climate change, in Berlin, July 19, 2019.
REUTERS/Fabrizio Bensch

RAINMAKERS

Asia Pacific is primed for its next 11-digit LBO

By Alec Macfarlane

It is shaping up to be a big year for buyouts in Asia. There's over \$250 billion of capital committed to private equity in the region, according to research outfit Preqin. KKR plans to raise a fund that would be bigger than its flagship U.S. one. Cheap debt is also available from Japan to Australia, making a mega-deal all the more likely.

Jumbo Asian LBOs are rare. Bain led the biggest one a couple of years ago, an \$18 billion acquisition of Toshiba's memory-chip business. The region's only other 11-digit buyout, according to Dealogic data, was Singapore's Global Logistics Properties. With so many companies controlled by tycoons, governments or entrenched boards, it has been a tougher part of the world for private equity to crack.



A man checks his phone at Lujiazui financial district in Pudong, Shanghai, March 14, 2019. REUTERS/Aly Song

Overall conditions are improving for buyout barons, however. Interest rates keep falling. Banks are generally willing to lend more. Debt markets in Europe and the United States, often offering looser covenants, are opening to Asian deals. Ageing owners without clear succession plans are warming to private equity. And conglomerates such as Panasonic have been increasingly willing to sell off big businesses.

There are also plenty of listed companies with solid cash flows and modest borrowing which fit the buyout profile. A rough-and-ready screen for ones with a market capitalisation of over \$10 billion, at least \$1 billion in EBITDA and net debt equal to no more than that measure of earnings churned out some tantalising theoretical prospects. Among them are Japanese chocolatier Meiji and advertising giant Dentsu. Chinese appliance maker Haier's publicly listed units could also be a target if a mooted take-private of the parent company fails.

At the decidedly larger end of the spectrum, there is Woolworths and 7-Eleven operator Seven & I. The Australian supermarket chain would cost upwards of \$40 billion, including a takeover premium.

Using \$20 billion of debt, or a robust 6.5 times the EBITDA forecast by analysts for its next financial year, would mean scrounging up another \$20 billion. That would take at least four buyout shops and additional co-investors, such as sovereign wealth funds, to write the full equity cheque. It'd be a stretch, for sure, but given the amount of money sloshing around Asia Pacific, even that kind of deal has entered the realm of the possible.

First published Dec. 23, 2019

The hottest new car model is a Daimler-BMW deal

By Christopher Thompson

Daimler and BMW should quit fumbling around the backseat. Faced with slumping global demand for their pricey cars, merging would reap synergies worth more than the 13 billion euros in annual savings they're currently targeting. As Peugeot and Fiat Chrysler Automobiles consummate their marriage in 2020, the German heavyweights will model one of their own.

Analysts forecast almost no sales growth over the next two years for cars. And luxury brands' winning streak – premium car demand has grown above global demand each year since 2009, according to Jefferies – is coming to an end due to a Chinese slowdown. Even in the Middle Kingdom, upmarket vehicle sales hit 11% of the total, in line with the global proportion.



A person wipes a BMW car on display at the LA Auto Show in Los Angeles, Nov. 20, 2019.
REUTERS/Lucy Nicholson

Ola Kaellenius and Oliver Zipse, bosses of Daimler and BMW, respectively, are feeling the strain. Together with incoming European Union fines for dirty fleets, Daimler, worth 53 billion euros in mid-December, plans to save 1 billion euros in staffing costs by 2022 and accelerate its transition to electric vehicles. BMW, worth 48 billion euros, is seeking 12 billion euros in total savings by then to offset higher technology spending.

The Fiat-Peugeot deal suggests an alternative. The Germans already cooperate in mobility services and autonomous vehicles. And there are additional financial benefits. The Italo-French combo is seeking to save about 2.4% in combined operating costs. Applying the same proportion to Daimler-BMW would result in savings worth 38 billion euros – assuming a 28% tax rate and 9 billion euros in restructuring costs – to shareholders today. But given their greater overlap in products and geographies they could probably achieve synergies worth twice that much.

BMW's controlling Quandt family has a strong independent streak and might not take kindly to having significant Chinese carmakers as shareholders. Together, Geely and BAIC Motor own a combined 15% of Daimler, although that could rise to 20%. Again, they can look to Fiat, where the Angelli family will emerge as the largest shareholder in the group.

Assuming a nil-premium merger, Stefan Quandt and his sister, Susanne Klatten, would hold nearly 17% of “BMDaimler”. The Chinese would be diluted to around 12%.

True, German unions would howl at the prospect of potential job losses. But given the financial and industrial logic in a stagnant market, the Fiat-Peugeot playbook will be scrutinised heavily in Stuttgart and Munich, where Daimler and BMW are respectively based, in the year ahead.

First published Dec. 18, 2019

M&A bankers will turn climate risk into clients

By Antony Currie and Christopher Thompson

The looming \$46 billion merger of France’s Peugeot and Fiat Chrysler Automobiles may go down as one of the first major corporate tie-ups driven by climate risk. Yet the novelty will quickly wear off as chief executives wake up to the financial impact of global warming. That gives climate-conscious advisers an edge.

Investment bankers spent little time on green issues in 2019 – or before. Lazard boss Ken Jacobs has said environmental, social and governance concerns may play a role in deals, but reckons they are “not a factor yet.” He’s mostly right. Of the 39 transactions worth over \$10 billion announced up to Dec. 10, only Fiat-Peugeot counts. The Italian-American carmaker could avoid a potential \$2 billion in European emissions fines in part by teaming up with its French rival, Jefferies reckons, and ease industry problems like overcapacity and low margins.

Others may follow suit. Carbon-intensive sectors like steel, cement and airlines are grappling with the prospect of higher prices or even a tax on carbon, incentivizing a shift to cleaner energy. Royal Dutch Shell in 2019 bid for Dutch renewables utility Eneco, which instead agreed a 4.1 billion euro sale to a consortium led by banking-to-energy conglomerate Mitsubishi Corp. Chevron, ConocoPhillips and even climate laggard Exxon Mobil may similarly need to buy their way to a greener future.

Avoiding bad deals is equally important, even if climate due diligence virtually never happens, as one veteran banker told Breakingviews. Drought in the Colorado River basin could drain up to a fifth of defense group Raytheon’s revenue, yet received no mention in its \$120 billion merger with United Technologies. BB&T’s \$28 billion acquisition of rival U.S. lender SunTrust ignored potential flooding in Florida and the southeast United States. As



The area around houses is seen flooded due to Hurricane Dorian in St. Augustine, Florida, Sept. 4, 2019. REUTERS/Maria Alejandra Cardona

such risks materialize, climate-conscious advisers can more convincingly pitch their services to CEOs.

Green bankers are admittedly a rare breed. Former UBS investment-banking boss Jeff McDermott set up Greentech Capital Advisors to work on clean energy a decade ago, and in December agreed to sell to Nomura. Erstwhile Lazard dealmaker Tony O'Sullivan and Baker McKenzie climate lawyer Martijn Wilder recently founded Pollination. As climate concerns rise up the corporate agenda in 2020, more Fiat-style mega-deals are possible. That'll give Lazard's Jacobs and other fast-moving rivals more ways to rake in fees.

First published Dec. 19, 2019

BlackRock is Wall Street's object of fantasy M&A

By John Foley and Rob Cox

Steve Schwarzman has one big regret. In 1994 the Blackstone boss sold a stake in some funds that later became BlackRock, the \$7 trillion asset manager run by Larry Fink. Schwarzman describes the sale as “a heroic mistake.” It’s not too late to fix it.

Yet he might not be alone in coveting the investment manager. The stability of BlackRock’s earnings has won it the respect from investors that its Wall Street peers, such as Goldman Sachs, covet. It fetches 16 times the next 12 months’ forecast earnings, according to Refinitiv, compared to 9 times for the investment bank and money manager helmed by David Solomon.



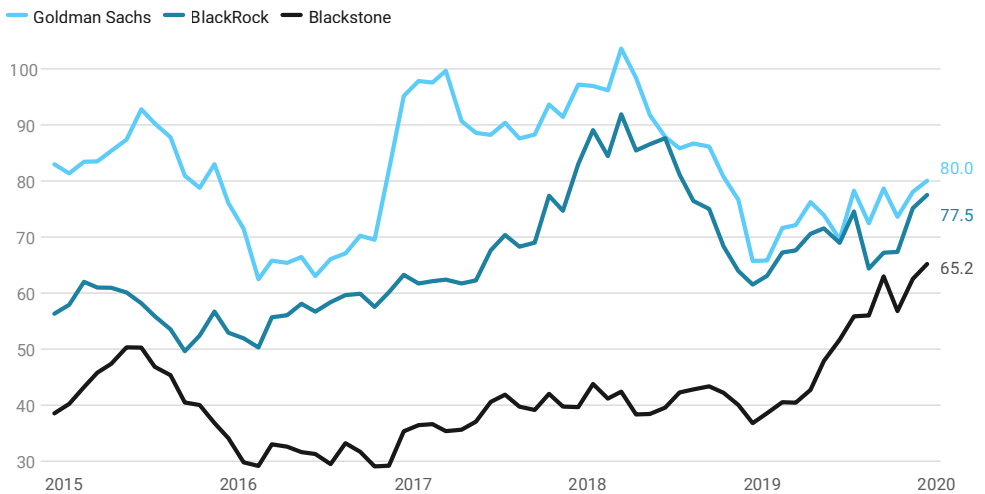
A sign for BlackRock hangs above its building in New York, July 16, 2018. REUTERS/Lucas Jackson

Today, BlackRock serves opposite ends of the market from Blackstone and Goldman. Fink's company houses two-thirds of its assets in exchange-traded and passively managed index funds. Blackstone's \$545 billion of private equity, real estate and other investments, managed for wealthy clients and institutions, are active. Ditto most of the \$1.5 trillion Goldman oversees.

Yet all are hungrily eyeing the middle. BlackRock's fees from easy-to-trade products are under pressure amid tough competition, so Fink is growing alternative investments like private equity. Blackstone is eyeing more retail money – so it's perhaps no wonder Schwarzman says he often pictures the two together. As for Goldman, it's somewhere in between but looking to grow at both ends, having entered consumer financial services with its Marcus electronic bank and Apple credit card.

Rolling stones

Goldman Sachs, BlackRock, and Blackstone's market capitalizations since 2015, in \$ billions



Note: Data to Dec. 12, 2019

Vincent Flasseur | Breakingviews – Predictions 2020

Source: Refinitiv Datastream

Valuation has always been the obstacle, though needn't be for much longer. Blackstone's shares had risen around 85% in 2019 by mid-December, helped by a restructuring that let passive funds like BlackRock's buy shares. The \$66 billion buyout firm even trades at a higher multiple of 2020 earnings, after a decade of trading at a discount. Goldman is only a couple of billion dollars larger than BlackRock, which was worth \$78 billion in mid-December. Mathematically, a merger of equals is doable.

Fink has little reason to contemplate such a deal for now. But at 67, and an oft-cited contender to lead the Treasury under a Democratic president, succession is a live topic. One of the candidates to replace him, Mark Wiseman, was fired in December for having a relationship with a subordinate. Fink shouldn't be surprised to see a pitchbook with his company's name on it do the rounds on Wall Street in the year ahead.

First published Dec. 23, 2019

Deutsche, Commerz get 30-year reunification bonus

By Liam Proud

Germany's big lenders suffer from high costs in an overbanked market offering customers abundant access to credit. But Commerzbank and Deutsche Bank will get a small but welcome boost from an unlikely source in 2020: the generation of entrepreneurs who founded businesses after reunification in 1990.

October 2020 will mark 30 years since the Soviet-backed German Democratic Republic rejoined the Federal Republic of Germany as a single country. It was a rough transition for workers at former state-owned companies in the East: they had to compete on the open market with more competitive rivals, and a stronger currency made their products more expensive than previously.

Amid the chaos, however, entrepreneurship soared. Historian Michael Fritsch calculates that the self-employment rate in the East was just 1.8% in 1989, but had almost tripled to over 5% two years later. By the end of the decade it was almost 10%.

Success stories include tech-services firm Comparex, founded in Leipzig in 1990 and now part of Switzerland's \$3 billion SoftwareONE. There's also sparkling wine maker Rotkaeppchen-Mumm Sektkellereien, previously a state-owned group bought out by management in 1993, whose revenue was 1 billion euros in 2018. Many of the companies founded or taken private in the 1990s are part of what Germans call the *Mittelstand*, or small- and medium-sized companies.



West German citizens sit on the top of the Berlin wall near the former Allied Checkpoint Charlie after the opening of the East German border was announced in this Nov. 9, 1989 file photo. REUTERS/Fabrizio Bensch

So what does that have to do with Commerz and Deutsche? It's all about age: An entrepreneur who was, say, 40 in 1990 would now be 70 and thinking about retirement. A 2017 Commerzbank study found that 39% of Mittelstand companies with at least 2.5 million euros of annual revenue expected a change of management within five years.

Corporate financiers are hoping that many heirs would rather sell or merge the family business than take over, for example, a slow-growing manufacturer at the end of an economic cycle. That would mean deals, and therefore fees for bankers.

It might not be a lifesaver for the lenders: just under one-tenth of the companies Commerzbank surveyed had over 100 million euros of annual sales. Still, interest rates are falling and Germany's economy is slowing, hurting banks' bottom lines. In 2020, they'll be grateful for any help they can get.

First published Jan. 3, 2020

An ever-drier world will unleash investment flood

By Antony Currie

The global water crisis is getting worse. By 2030 humans will be using 56% more than is sustainable, according to new research out later in January from the World Resources Institute, a climate think tank. Luckily, investors and companies are investigating some solutions.

The WRI reckons it'll cost \$1 trillion a year to fix the problem, almost half of which is required to boost water supply, with the rest going towards managing demand. Buyout shop KKR is hoping to do its part, announcing in December that it would invest alongside specialist fund XPV Water Partners to develop wastewater-treatment solutions.

It'll be hard to solve the crisis without addressing farming, since the industry accounts for around 70% of global water use and the same proportion of the WRI-calculated sustainability gap.

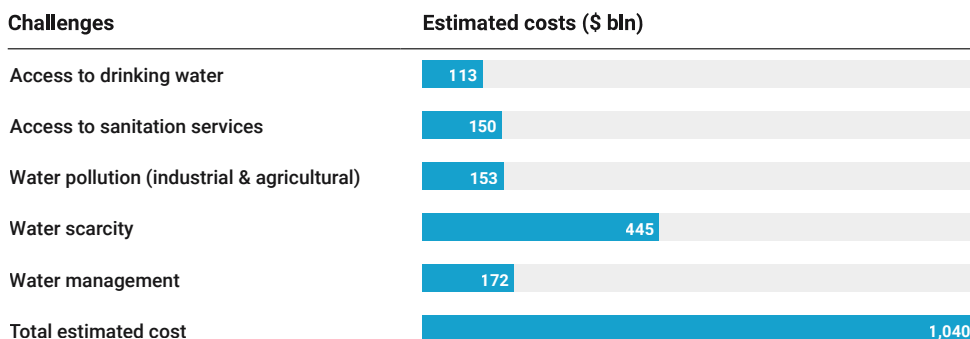


Clouds gather but produce no rain in drought-stricken Graaff-Reinet, South Africa, Nov. 14, 2019. REUTERS/Mike Hutchings

Encouragingly, a fix would soak up only 38% of total investment. Trouble is, it can take three or more years for water and other sustainability projects to pay off for farmers, points out Continuum Ag, an agriculture consulting firm set up by Iowa farmers. Yet many eke out a living from season to season. The companies who buy farmers' goods therefore need to help.

Water's \$1 trillion challenge

The annual cost of sustainable use



Vincent Flasseur | Breakingviews – Predictions 2020

Source: World Resources Institute

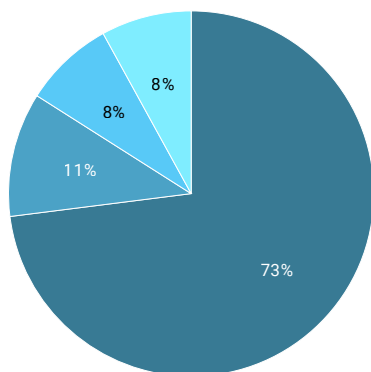
Some are already doing so, like brewer Anheuser-Busch InBev and Mars. The confectioner recently helped Pakistani smallholder farmers cut water use by a third over three years, while increasing their income by a similar amount. On a larger scale, such projects lend themselves to green-bond financing, as PepsiCo showed with a \$1 billion deal in October. Some of the proceeds will go towards smarter water use, including for farmers.

Shareholders, meanwhile, are targeting slower-moving companies. A coalition managing \$6.5 trillion is haranguing fast-food providers like McDonald's to force their suppliers to up their game. That pressure will increase in 2020. A number of discussions are underway involving investors, companies and a couple of governments, with goals ranging from setting science-based targets to corralling big water users to publicly set more ambitious targets.

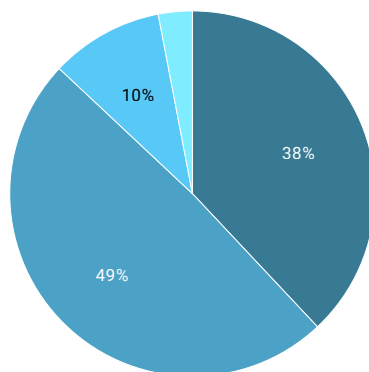
Others, meanwhile, see a big investing opportunity. UBS Global Wealth Management, with \$2.5 trillion in assets, has identified water scarcity as one of its top longer-term investment themes. That came after some three-quarters of the 3,400 high-net-worth

Where water is most scarce, and where investment is needed

■ Agricultural ■ Industrial ■ Domestic ■ Supply



Share of the global water scarcity gap*



Share of the cost to close the water gap

* Volume of the global water scarcity gap each sector would deliver if optimal sector water efficiency were achieved. Optimal sector efficiency is determined by the top 20th percentile of sectors in terms of water use intensity.

Vincent Flasseur | Breakingviews – Predictions 2020

Source: World Resources Institute

clients it recently surveyed tagged clean water and sanitation as the most pressing issue facing the world.

Ignoring water risks can drain earnings. Salt and potash supplier K+S lost 11% of quarterly revenue from lost production as last year's German drought prevented it from shipping out its wastewater. Meanwhile, investing in solutions can return several times the principal, the United Nations, among others, has calculated. More big players are starting to notice. There's a flood of money looking to flow into action, and the WRI's startling new data should help unleash that. But it's a race against time.

First published Jan. 6, 2020

FLAMING OUT

Investors will rue their Hong Kong risk appetite

By Jeffrey Goldfarb

There is relative optimism about Hong Kong reflected in its stock market. That's hard to reconcile with past and present realities. It also doesn't bode well for the future.

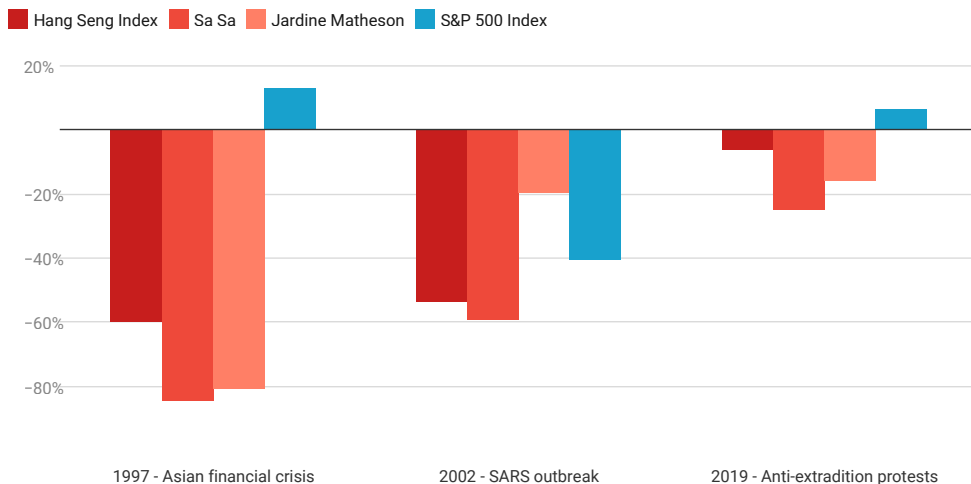
The city's benchmark indicator of equities has lagged the S&P 500 Index since violent anti-government protests started in June. Nevertheless, the slide has been less severe than during the Asian financial crisis some two decades ago or the deadly SARS breakout that followed. As of mid-December, the Hang Seng Index was down less than 7% from its July apex. That's modest when compared with peak-to-trough falls of more than 50% during each of the previous two calamities.



Anti-government protesters protect themselves with umbrellas among tear gas during a demonstration in Hong Kong, Sept. 15, 2019. REUTERS/Jorge Silva/File

Hong Kong resistance

Stock market reactions to three different crises



Note: Peak-to-trough prices through each event. 2019 data to Dec. 12.

Vincent Flasseur | Breakingviews – Predictions 2020

Source: Refinitiv Datastream

The main Hong Kong index includes more mainland companies than it used to, with such notable additions as Chinese tech titan Tencent. However, more locally skewed indices and stocks – including subway operator MTR, cosmetics retailer Sa Sa International and conglomerate Jardine Matheson – have held up comparatively well through more than six months of turbulence that drove the city into recession.

Clashes are likely to persist. Even under an optimistic scenario laid out by political risk consultancy Control Risks, any de-escalation would be temporary and underlying tensions “would not fully revert to pre-crisis levels.” That’s a bad omen for tourism, shopping and property prices.

The former British colony’s fortunes are also tied to China’s economy, which has been roiled by the volatile trade war being waged between Washington and Beijing. Progress in the negotiations has been slow, and any significant breakthrough looks distant. Under a newly passed law, the United States will now decide each year whether Hong Kong is “sufficiently autonomous” to qualify for special treatment on trade matters.

Any downward turn for buoyant U.S. stocks also would weigh on Hong Kong equities. The cyclically adjusted price-to-earnings ratio developed by economist Robert Shiller, which smooths out the profit for S&P 500 constituents over a decade, has been running at over 30 times. The level was breached only twice before, ahead of the 1929 crash and the dot-com bubble bursting. Likewise, the MSCI Hong Kong Index in late November was trading at a higher multiple of expected earnings than its long-term trend line, according to UBS. Investors will come to rue their risk appetite.

First published Dec. 19, 2019

Buyout barons' debt machine will blow a gasket

By Neil Unmack and Anna Szymanski

Private equity looks set for a tricky ride in 2020. And it will be thanks to ructions in the \$1 trillion market for bonds backed by the leveraged loans that finance many deals struck by Henry Kravis's KKR and David Rubenstein's Carlyle, for example. A weaker economy will make investors wary of buying these so-called CLOs and force vehicles to curb lending. That means higher borrowing costs, and probably fewer takeovers – though some industries and regions, such as Asia, will buck the trend.

Collateralised loan obligations, to give them their full name, Hoover up over 70% of the loans buyout shops often use to finance their deals. They slice and dice these loans into tranches offering higher returns for riskier cuts. The U.S. CLO market has more than doubled since 2012 to over \$650 billion. JPMorgan reckons the amount of outstanding CLOs should top \$1 trillion next year. But this securitisation bonanza is starting to sputter.

It's all about the arbitrage – or lack thereof. CLOs work when cash flows from the underlying loans exceed payments to the CLO noteholders, leaving annual returns of 15% or more for the lowest-ranking tranches, and fees for managers. But fears of a U.S. recession and general economic skittishness have made investors demand higher returns for some CLO debt. If yields rise much higher, the CLO new-issue machine is likely to grind to a halt.

Downgrades could also be a problem. The rating models that govern CLOs allow them to account for loans at face value. But the moment a CLO holds more than a certain percentage of assets rated CCC, typically 7.5%, managers have to value them with current market prices, which are usually far below par. If enough companies are downgraded, and the CLOs' assets sufficiently devalued, income from loans is diverted to repay senior bondholders, cutting off lower-ranking investors.



Businessman Henry Kravis arrives for a meeting at the Trump Tower in New York, Jan. 12, 2017.
REUTERS/Mike Segar

The situation already looks quite fragile. A combination of high company debt and a stagnating global economy mean the share of loans in U.S. CLOs rated B-minus, one level above CCC, is nearly 20%, twice the level before the 2008 crisis, according to Standard & Poor's. UBS analysts expect the average U.S. CLO CCC exposure to reach 11% in 2020.

The effect could be doubly bad. Investors in lower-ranking CLO tranches will take steep losses, sapping appetite for new deals. Meanwhile, existing CLOs will be less able to lend to lower-rated companies, driving up borrowing costs. That raises the risk of the dealmaking debt machine blowing a gasket.

First published Dec. 19, 2019

Wealth managers will inflate superprime bubble

By Lisa Jucca

The world's biggest banks are stirring up a new lending frenzy. More than a decade has passed since loans to subprime homebuyers went bad. Now UBS and other private banks are cranking up credit to uber-rich clients. This superprime bubble will bring higher returns and risks, too.

A global transparency push forced the wealth management industry to kick the lucrative habit of hiding clients' assets from tax authorities. Now rock-bottom interest rates are making it harder to deliver positive returns. That's putting pressure on fees and squeezing profit margins.

In an attempt to boost revenue, wealth managers are extending more loans to successful entrepreneurs and their offspring. Total lending revenue at top private banks grew 8% annually in the two years to mid-2019, according to Tricumen, a consultancy.

UBS's private bank had extended \$176 billion to wealthy clients at the end of September. That's equal to 7% of the \$2.5 trillion in assets it looks after. New global wealth



CEO Sergio Ermotti of Swiss bank UBS gestures as he attends the company's annual shareholder meeting in Basel, Switzerland, May 2, 2019. REUTERS/Arnd Wiegmann

management co-head Iqbal Khan, who previously cranked up lending at rival Credit Suisse, looks set to go further. Some executives reckon private banks could comfortably extend credit worth up to 15% of the assets they manage.

Lending to people who are already rich appears relatively low-risk. So-called Lombard loans, which are secured against a portfolio of securities lodged with the private bank, are typically the safest. Gross margins on such loans tend to be less than 100 basis points, says consultancy Capco. Banks can charge twice as much for fancier collateral such as real estate or shares in unlisted companies, and even more for credit backed by art, yachts or wine. However, private bankers will sometimes reduce rates to win a bigger mandate – or lock in an investment-banking client.

Even though wealthy borrowers can generally repay the loan, accidents do happen. When Steinhoff International revealed a massive accounting fraud in 2017, the likes of Bank of America and Citigroup suffered losses on 1.6 billion euros of loans secured against shares owned by Christo Wiese, the South African retailer's former chairman.

Such lending is safer than risking big fines by helping money launderers or tax dodgers. And by rights it ought not to have the potential to blow up the entire financial system like the subprime crisis did. Such comparisons, though, can breed a false sense of security, and complacency. That means this bubble has further to inflate – and will leave a mess when it pops.

First published Dec. 30, 2019

French lottery IPO may be as good as Macron gets

By Christopher Thompson

There are some benefits to having a former investment banker as president. Shares in La Française des Jeux rose by up to 18% on their debut after the government-controlled national lottery made its stock market debut in a listing championed by Emmanuel Macron, the ex-Rothschild banker who now occupies the Elysee Palace. But resurgent protests and a national strike will make it harder for him to flog other state assets in the coming year.

The biggest French retail stock offering since the global financial crisis was a success for around 500,000 domestic punters who saw their cut-price shares jump by almost a fifth. The state and its advisers, however, will face charges of underpricing the country's showpiece privatisation by leaving around 600 million euros of value on the table.

In truth, the FDJ soufflé may yet deflate. A market capitalisation of around 4.3 billion euros means the company trades at a heady 22 times expected earnings for next year. That's a hefty premium to Greek peer Greek Organisation of Football Prognostics, which is valued on a multiple of 15 despite higher expected sales growth, according to Refinitiv data.



France's President Emmanuel Macron gestures as he arrives at 10 Downing Street in London, Dec. 3, 2019. Daniel Leal-Olivas/Pool via REUTERS

The successful initial public offering should whet investors' appetite for the sale of other French assets, much as the British government offloaded telecom and gas holdings in the 1980s. Top of the list is the government's 51% stake in Aeroports de Paris, which Macron wants to use to start an innovation fund. Shares in the 18 billion euro manager of the Charles de Gaulle and Orly airports have crept back up after suffering a selloff in May, when France's constitutional court approved plans for opposition politicians to ballot for a referendum on the idea.

Yet hostility to privatisations has hardly gone away. Parisian bankers speak of the "social issues" overshadowing a sale of ADP, including a national strike planned for December. One of the likely beneficiaries of a selloff is Vinci, the French infrastructure company which

already owns 8% of ADP and would probably buy more. The operator of French highway toll booths is a frequent target of “gilets jaunes” protestors.

The ADP ballot is well short of the threshold needed to force a national vote on the issue. And Macron can point to a fruitful lottery IPO. But French bankers hoping their former colleague will push more lucrative business their way may be disappointed.

First published Nov. 21, 2019

Disney will lose its magic touch

By Jennifer Saba

Walt Disney Chief Executive Bob Iger rarely puts a foot wrong. In his 14 years in charge he has bought properties like Star Wars and the Avengers, and while he paid a high price



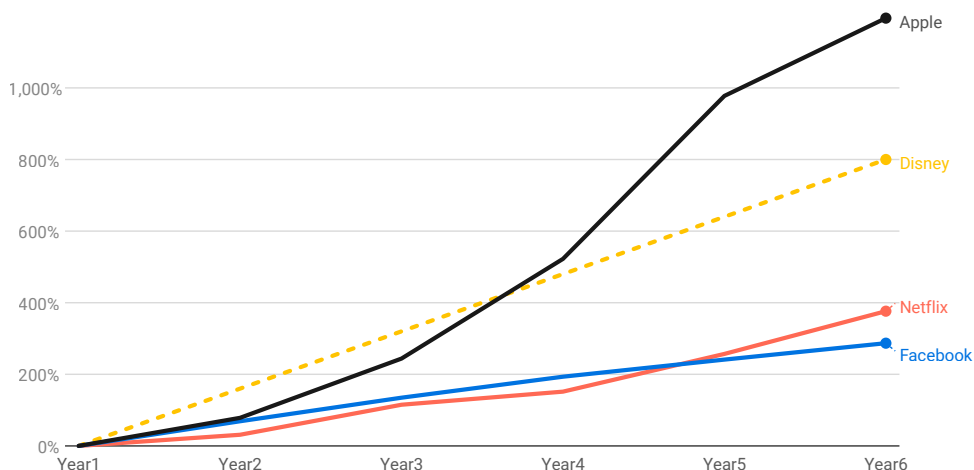
Cast member Daisy Ridley poses at the premiere for the film “Star Wars: The Rise of Skywalker” in Los Angeles, Dec. 16, 2019. REUTERS/Mario Anzuoni

in the auction of assets from Twenty-First Century Fox, at least he won. Expectations are therefore high for his next magic trick: creating a video-streaming product to rival Netflix. This feat may be beyond him.

An eye-popping 10 million people signed up for Disney+ on its first day out of the gate in November, a number that added \$18 billion to Disney's market capitalization within hours of disclosing it. Disney's stock was in mid-December trading at 26 times 2020 forecast earnings, according to Refinitiv, having overtaken Apple and Google owner Alphabet's multiple during 2019. Iger wants up to 90 million subscribers by September 2024 – by which time he says he will no longer be chief executive.

Mouse tracks

How Walt Disney's growth plans for its Disney+ streaming service compare with past growth of Netflix, Apple's iPhone and Facebook's monthly active users



Jennifer Saba & Vincent Flasseur | Breakingviews – Predictions 2020

Source: Company reports

Is that growth feasible? It's pretty much what Netflix did, times two. Reed Hastings' streaming pioneer went from just under 10 million subscribers in 2008, which included by-mail DVD rental, to 44.3 million five years later. Apply that same rate of growth to Disney and it would be just halfway towards Iger's upper target. And that's already faster than Facebook's growth in monthly active users between 2009 and 2014 for a product which, unlike Disney+ and Netflix, is free to use.

Granted, Disney has advantages its rivals didn't, like name recognition and splashy content including Yoda and animated works from Pixar. And it's cheap at \$6.99 a month, about half the price of Netflix. That too, though, is a problem. Disney effectively hopes to grow at twice the speed of Netflix in its early days, but at half the revenue per user that Hastings' service gets today. A slew of rival offerings from companies like Comcast's NBC Universal and AT&T-owned HBO will make it tough to raise prices.

That suggests Disney investors are already living in Fantasia. Netflix, with an enterprise value of \$136 billion in mid-December, is valued at around \$860 per user. Take half that rate and apply it to 90 million subscribers, and Disney's digital service ought to be worth around \$40 billion five years from now. Yet the company's market capitalization has increased roughly \$50 billion since details of Disney+ started to emerge in April. The return to earth promises to be anything but magical.

First published Dec. 19, 2019

PLAYING WITH FIRE

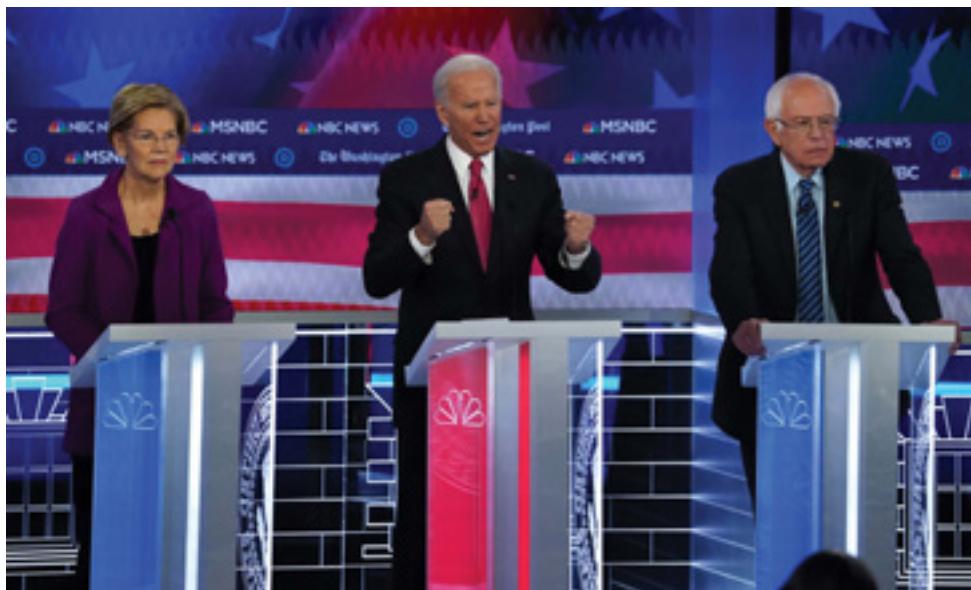
American election to test Wall Street's nerves

By John Foley

The following imaginary conversation between two Wall Street bankers was overheard in the changing room of Park Avenue's elite Racquet and Tennis Club.

Jordan: So, the head of our family office is starting to get a bit antsy about 2020. I know 2016 was uncomfortable, but this time is something else. It's all tax the rich and shut down Wall Street. I feel like the market rally's running out of steam, and Democrats are just out to punish anyone who's made it. What are you hearing from your people?

Patrick: You worry too much. Donald Trump's a shoo-in. Sure, he's the least popular president to run for re-election in history and only third to be impeached. But the economy, or I should say the consumer, is doing great. Housing starts are on a roll



Democratic U.S. presidential candidate and former Vice President Joe Biden speaks as Senator Elizabeth Warren and Senator Bernie Sanders listen during the fifth 2020 campaign debate at the Tyler Perry Studios in Atlanta, Georgia, U.S., Nov. 20, 2019. REUTERS/Brendan McDermid

and impeachment is DOA in the Senate. Oh, and it's hard to dislodge a president after just one term if the economy is fine. Remember that Jimmy Carter had kicked off a recession, and George Bush Sr. raised taxes.

Jordan: Right. All the same, you've got to be a bit nervous about what happens if the Republicans win, and he keeps on down this trade-war road. Last year our guys were forecasting global GDP growth of 3.6%, and now it's more like 3%. In real money that's about \$400 billion down the drain - with hardly any actual tariffs. And the budget deficit is going up during the best of times. That's totally contrary to what we learned in Econ 101 at Harvard.

Patrick: Relax, everyone knows he'll strike a deal with the Chinese. If they don't fold before the election, they'll give in afterwards when they realize Trump's got another four years to turn the heat up. Plus, worst-case scenario is that growth takes a hit. That's when Jay Powell and the Federal Reserve will step in. They've got it covered. Bigly.

Jordan: Ok, but just bear with me. What if he loses. I just looked this morning and Elizabeth Warren and Bernie Sanders were right up there for the Democratic nomination. I mean, my teenage kids love Bernie, but this idea that capitalism is broken is bad news for markets, for dealmaking, and, you know, for people like us.

Patrick: Yeah, I hear you. Do you really think Bernie or Warren has a chance, though? Even if Trump flames out, I'm banking on the three B's - Biden, Buttigieg and Bloomberg. Joe Biden's an old hand - ok, maybe too old - who's not going to rock the boat. Pete Buttigieg is a Harvard man and former McKinsey guy. As for Mike, well, I am still a bit sore about the way he dropped his membership here. But really, there's no better man for the job.

Jordan: Don't get me wrong - I love Mike as much as anyone - notwithstanding that whole brouhaha when he quit the club. Lots of Republicans I know would flip for him. But he's nowhere in the race right now.

Patrick: Maybe. Don't bet against an establishment billionaire though. He's already spent more on TV ads in swing states than any candidate ever. And if Biden can't go the distance, or things go down to the wire when the Dems pick their candidate at the convention in Milwaukee, he's got a definite shot.

Jordan: How so?

Patrick: Think of it this way. It's a super-crowded field. Usually we know by Super Tuesday in March who's leading the pack, but that might not happen this time because the party's so divided. If it's all still up for grabs by the time the convention happens in July it's all

down to those 760-odd so-called superdelegates – you know, the party elites and so on. They changed the rules so they don't vote in the first round this time unless there's an obvious winner already. If there isn't, they wade in and we go to a brokered convention.

Jordan: Oh yeah, a brokered convention. Remind me?

Patrick: Basically, that's where anything could happen. It's a bunch of horse trading where people can switch their support and there's another vote for the nomination. Everyone always predicts there'll be one and it never happens, but this time could be different. If the delegates want someone closer to the center, that's when Bloomberg could emerge as the dark horse. Or Amy Klobuchar or Buttigieg – someone centrist, maybe from the Midwest, who can win those states Hillary Clinton lost.

Jordan: Hmm. And if he doesn't? What's the plan if Warren or Sanders come out on top? I tell you, Bernie makes me nervous. He's angrier than my wife was the day I got her that Peloton.

Patrick: Come on, dude. Being POTUS isn't like being the candidate. Even Liz and Bernie, when they realize how much of the economy relies on finance, they'll change their tune. And either way, they can't do squat if the Senate remains divided. You can also bet that Jamie Dimon and a bunch of other moderate corner-office guys will be working to get them onside. The best thing about having an inexperienced POTUS is you can help mold their views.

Jordan: I guess. I feel like I heard that somewhere before. Anyway, I've got to split.

Patrick: See you at Buffy's thing this weekend in Bridgehampton.

First published Dec. 30, 2019

South Africa heads for year of living dangerously

By Ed Cropley

President Cyril Ramaphosa is running out of time to salvage South Africa. A flatlining economy and soaring debt-servicing costs are squeezing public spending. The obvious option is to shrink bloated state firms like power utility Eskom. That will provoke trade union protests and strikes, which may dent the economy. A failure to press ahead will be worse in the long run.

South African government bond yields are relatively stable, at around 8.4% for 10-year debt, but Pretoria's debt pile is growing. The government expects it to hit 80% of GDP in 2023 from the current 69%, including borrowing by Eskom. That will push up debt-servicing costs. In 2020, South Africa will spend more on interest payments than healthcare for the first time in the post-apartheid era.

Ramaphosa's fiscal wiggle room would be bigger if he could turn around troubled state-owned companies. His first test is South African Airways. True, the debts of the perennially loss-making airline are only \$1.5 billion, less than 1% of total public debt. They also pale



South African President Cyril Ramaphosa speaks during a news conference in Pretoria, South Africa, Oct. 3, 2019.
REUTERS/Siphiwe Sibeko

against Eskom's \$30 billion debt pile. But unlike Eskom, which supplies 90% of South Africa's power, SAA can go bust without taking down the \$360 billion economy.

Unions have opposed cuts to the airline's 5,000-strong workforce. Yielding ground would weaken Ramaphosa for the more important fight over Eskom, which is teetering on the brink of bankruptcy and struggling to keep the lights on. The government is willing to take a chunk of the utility's debt onto its books. But it also wants to split the company into three to improve efficiency, possibly as a stepping stone to privatisation. Eskom bosses also reckon they need to axe 16,000 jobs, a third of the workforce. That would trigger sustained and violent protest.

Blackouts due to sabotage or strikes would hurt the economy. But caving in to unions would carry even greater long-term costs. Without a profitable Eskom to invest in a stable power supply, billions of dollars in investment pledges will lapse and the economy will further atrophy. Ramaphosa's leadership of striking mine workers in the 1980s played a central role in collapsing the apartheid economy and ending white-minority rule. His battle with unions in 2020 will decide the country's next chapter.

First published Nov. 29, 2019

Italy and Germany will unite on EU tech taxes

By Lisa Jucca

Ursula von der Leyen is starting on the defensive. Despite her ambition to overhaul the European Union, the new European Commission president is unlikely to persuade Italy and Germany to set aside their differences on common banking rules any time soon. A plan to tax technology giants offers a better chance for the traditional EU rivals to find some common ground.

Among her long list of promises, the former German defence minister has pledged to complete the euro zone's half-baked monetary union. To enable lenders to operate freely across the 19-nation currency bloc, member states first need to agree to common deposit insurance, as well as a fund to handle the cost of bank failures.

Rome and Berlin are in opposite corners. German leaders want Italy to reduce financial risks, including its \$2.5 trillion public debt, before signing up to measures that could see euro zone taxpayers share the cost of a future crisis.

Meanwhile Italian officials object to Berlin-backed suggestions that euro zone sovereign bonds should carry different levels of risk when calculating bank capital requirements.

Stripping Italy's public debt of its current risk-free status would hit domestic lenders, which are large holders of the securities. That might accelerate an Italian debt blowup.

Messy politics in both countries will hamper any compromise in 2020. Italian Prime Minister Giuseppe Conte's coalition is fragile and under constant attack from eurosceptic leader Matteo Salvini, the likely winner of any election. Meanwhile, German Finance Minister Olaf Scholz, who championed a recent plan to create a common deposit backstop, has become less influential after losing out in a recent vote to lead his Social Democratic Party.

It thus makes sense for von der Leyen to change tack. A more promising idea is a plan to impose a 3% levy on the revenue of global tech companies such as Facebook and Amazon. That would help redress an imbalance which the commission says allows digital players to pay an effective 10% corporate tax rate, against 23% for brick-and-mortar rivals. The project needs to overcome opposition from small low-tax states like Ireland – and faces fierce criticism from President Donald Trump.

But France, Italy and Germany all like the idea. While banking union remains elusive, the tech tax could unite the euro zone's biggest adversaries.

First published Dec. 19, 2019



European Commission President Ursula von der Leyen speaks during an extraordinary session to present a Green Deal plan, at the European Parliament in Brussels, Dec. 11, 2019. REUTERS/Francois Lenoir

Investors warming to Putin's Russia will go cold

By Dasha Afanasieva

A thaw is coming early this Russian winter. Inbound retail and technology investments are hints of improvement in the business climate, and fresh sanctions fears have eased off. But these bright spots won't save the G20 country from economic stagnation in 2020.

The owner of U.S. retailer TJ Maxx acquired 25% of Russian low-cost clothing retailer Familia for \$225 million in November, the first big Western investment since Washington and Brussels imposed sanctions over Russia's annexation of Crimea in 2014. New York-traded search engine Yandex may float its ride-sharing business, part-owned by Uber Technologies, in 2020, Reuters reported. Bank VTB Capital expects Russian companies to raise more than \$10 billion through equity listings over the next year – a big improvement on \$484 million raised in 2018, according to Refinitiv data.



Russian President Vladimir Putin speaks during an investment forum in Moscow, Nov. 20, 2019. Alexander Zemlianichenko/Pool via REUTERS

Yet investors should be wary. For one thing, existing sanctions are not going away. And Russia's economy is still stuck in a rut with growth forecast below 2% in the coming years after a 2.3% expansion in 2018. President Vladimir Putin's plans to spend billions of dollars enhancing business conditions, infrastructure, healthcare and ecology have been slow to take off. They also merit healthy scepticism. Business conditions are hardly friendly when – as one example – Michael Calvey, the American head of one of the country's biggest buyout funds, is under house arrest over a dispute relating to a portfolio company.

Russia is protected from much scrutiny by chaos elsewhere. With military action in Ukraine and Syria, Putin has perfected a foreign policy along those lines, and the same goes for business. U.S. lawmakers are too busy with the Democrats' efforts to impeach President Donald Trump and their election in November 2020 to enact major new sanctions – a worry for Russian businesses as recently as last summer. Washington's trade fights with China and the European Union also serve as distractions that are welcome in Moscow.

Investors can find chunky yields in Russia, particularly if they are happy to own stakes in companies that are tools of Putin's government. Gazprom, for instance, brought shareholders a total return of around 75% in the year to mid-December partly thanks to a new bumper dividend policy. Some may find that worth the risk. But if they are warming to Russia more generally, they are likely to feel chills again.

First published Jan. 2, 2020

Johnson's big win unlocks Brexit black box

By Peter Thal Larsen

Britain will soon know what Boris Johnson's pledge to "get Brexit done" actually means. The UK Conservative Party secured a large parliamentary majority in Dec. 12's general election. That will allow Britain to quit the European Union three and a half years after voters narrowly opted to leave. The prime minister's policy ambitions, however, remain a black box.

The result is an overwhelming vindication of Johnson's decision to campaign on a single repetitive promise. His government's hefty majority will ensure Britain leaves the EU at the end of January. It should also make it easier for Johnson to secure a trade deal with the remaining 27 countries by the end of 2020, a tight deadline he says he will not extend.

That's because Johnson will no longer be captive to the eurosceptics in his party, who dream of turning Britain into a lightly-regulated capitalist nirvana. If the prime minister opts for a closer alignment with the EU, it will be hard to stop him.

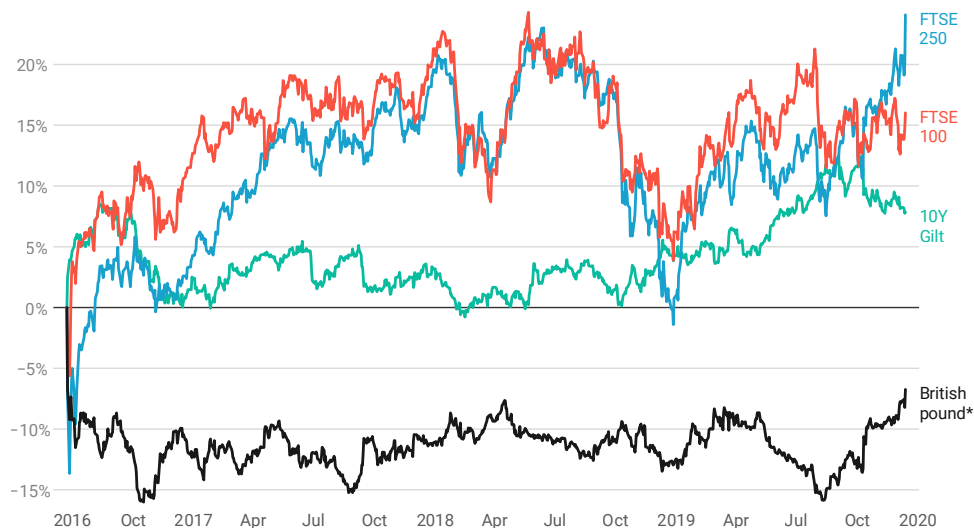


Britain's Prime Minister Boris Johnson speaks during a final general election campaign event in London, Dec. 11, 2019.
REUTERS/Hannah McKay

Markets reflect the hope that Johnson will have the authority to push through a softer version of Brexit. The pound was up almost 2% against the U.S dollar. Soaring stocks will deliver a short-term feel-good factor. Foreign investors who fretted about Labour Party leader Jeremy Corbyn's hard-left agenda will decide that their money is once again secure in Britain.

Yet what Johnson plans to do with post-Brexit Britain is a mystery. His decision to campaign to leave was famously motivated by personal ambition. His election campaign was largely free of policy ideas, beyond vague promises to hire more nurses and police, and a pledge to prop up ailing companies.

UK financial markets since the Brexit vote



Note: Data to Dec. 13, 2019. *Trade-weighted index

Vincent Flasseur | Breakingviews – Predictions 2020

Source: Refinitiv Datastream

He will also face high expectations, particularly among former Labour voters in the north of England. Leaving the EU will still inflict long-term economic damage and any blame will fall squarely on Johnson and his government. Meanwhile, a strong election performance by the Scottish Nationalist Party will revive pressure for a new independence referendum north of the border. Johnson will get Brexit done. It's still not clear that voters will be glad he did.

First published Dec. 12, 2019

Taiwan will widen U.S.-China schism in 2020

By Robyn Mak

Keep a close eye on Taiwan in 2020. Its significance is set to grow amid shifting supply chains. Anti-Beijing sentiment also has been gaining traction in the United States. Both dynamics herald deeper ties between Taipei and Washington, bolstering the case for a controversial bilateral trade deal.

The \$560 billion economy is an unlikely beneficiary from U.S.-China tension. While other Asian export powerhouses grapple with slowing demand, Taiwan recently nudged up its GDP growth forecast for 2020, to 2.7%. Rising domestic investment should help, boosted by local manufacturers moving operations back home from mainland China.



A military honour guard holds a Taiwanese national flag as he attends a flag-raising ceremony in Taipei, Taiwan, March 16, 2018. REUTERS/Tyrone Siu

Moreover, American companies are buying more from Taiwan. In the first half of 2019, for example, U.S. tariffs diverted over \$4 billion of office machinery and communications equipment orders to the island, according to a UN report. Microsoft and Alphabet's Google are also stepping up investments there.

Against this backdrop is growing American antagonism towards the People's Republic, which considers self-governed Taiwan a renegade province. President Donald Trump signed a veto-proof bill effectively supporting anti-government protesters in Hong Kong. Soon after, the U.S. House of Representatives roundly passed a bill that condemns the crackdown on Chinese Muslims in Xinjiang.

Taiwan is next on the legislative agenda. The Taiwan Allies International Protection and Enhancement Initiative Act calls for the United States to reduce engagement with countries whose actions have undermined Taiwan. Under President Tsai Ing-wen, who faces an election in January, and her independence-leaning Democratic Progressive Party, eight countries have broken diplomatic relations with Taiwan in favour of Beijing. The U.S. proposal also calls for bilateral trade talks.

That will provoke Chinese President Xi Jinping and could even derail already-fragile U.S.-China negotiations. But there is a strategic rationale for a trade agreement with Taiwan.

American giants such as Apple and Qualcomm rely on Taiwanese components. Manufacturing export orders from the United States reached some \$150 billion in 2018. And while companies including TSMC are leading the charge for next-generation semiconductors, China is catching up quickly. A deal may help Tsai defend the industry, and ultimately reduce her economy's dependence on the mainland. But it also means Taiwan is destined to be a flashpoint.

First published Dec. 18, 2019

A Canadian breakup is back on the table

By Rob Cox

Something disturbing happened Saturday on the platform of the Place-des-Arts metro stop in Montreal. As a woman of South Asian descent was boarding a train with a Domino's box in her arms, a man slammed it from her hands, sending the pizza melting onto the subway floor. She called after the man, who had bleached yellow hair. He flipped her the bird, scrambling toward the exit. Her face registered astonishment, then fear. "I'm sorry, but do you know that man?" No, she replied, shaking. "Never seen him before."

The incident was surely racially motivated, at least in part. It was shocking not just for its randomness, but for having occurred in Canada, a country which has led even other liberal democracies in its openness to the world and to immigrants and refugees. On the same day, Canada's best-known hockey commentator, Don Cherry, suggested that new arrivals should spend a few dollars buying the red poppies worn to commemorate Remembrance Day. Two days later, Cherry was sacked as a host of "Hockey Night in Canada."



Pro-oil counter-protesters respond to a climate strike march at the Alberta legislature in Edmonton, Alberta, Canada, Oct. 18, 2019. REUTERS/Amber Bracken

A couple of anecdotes don't define an entire nation, of course. But it's hard not to see a reflection of the current divided state of Canada.

It's a larger debate that could one day threaten the country's cohesion. Taking control of immigration is one of the demands coming from supporters of "Wexit" – the withdrawal of western provinces, in particular energy-rich Alberta and breadbasket Saskatchewan. The far bigger beef, however, is economic. In part, that relates to the federal government's approach to global warming under Prime Minister Justin Trudeau, who is leading a minority government for a second term. It's a disagreement that democratic countries will increasingly need to tackle, often in tandem with migration.

Canada has seen divisions like this before. A move for Quebec's independence was only narrowly defeated in a referendum in 1995. And the question has cropped up in Alberta periodically since the region became a province in 1905, usually in connection with energy policy and taxation. During local boy Stephen Harper's decade as prime minister, Albertan separatism was muted. It has come back under Trudeau. A third of Albertans think the province would be better off separate, according to an Ipsos poll released last week, up from 25% scarcely more than a year earlier.

The main issue is Canada's approach to energy, or more specifically the tar sands of Alberta, which the provincial government says represent the third-largest oil reserves in the world, after Venezuela and Saudi Arabia. The sands employ 140,000 people and generated royalties of C\$2.6 billion in the 2017 to 2018 year. What's less good about them, however, is their high cost of extraction, which combined with the expense of transport arguably makes tar sands the world's least efficient large-scale energy resource.

That's before what economists call the externalities. To extract bitumen from the sands, processors effectively melt the earth with boiling water and chemicals, creating toxic residues. The National Resources Defense Council argues: "From extraction to waste storage, every step of the tar sands oil production process wreaks havoc."

Consequently, the province produces 62 tonnes of carbon dioxide equivalent per person, according to 2019 World Population Review statistics cited by Canada's Global News. That compares to roughly 17 tonnes per Saudi Arabian subject or 16 tonnes per American citizen. By that measure, an independent Alberta might be the world's biggest polluter per person.

That's not deterring Peter Downing, who heads Wexit Canada, which he hopes to turn into a political party. Downing, perhaps Canada's answer to Brexiteer Nigel Farage, says the group should gain political support beyond Alberta, in Saskatchewan, Manitoba and parts of British Columbia. He says the party "is basically going to be the Bloc Quebecois of the

west but it does a little more damage.” While the francophone Quebec still commands 26% backing for separation according to the Ipsos poll, rising support for Wexit other than in Alberta is really only noticeable in Saskatchewan, at 27%, up from 18% a year ago. Manitoba and BC just aren’t into it, for now.

Conscious of the rift in his province, Alberta Premier Jason Kenney last week created a “fair deal panel” to study ways to reclaim powers from Ottawa. These could include taking Alberta out of the Canada Pension Plan, creating a provincial police force, and fighting back against the Trudeau government, including its regulation of the energy sector and foot-dragging on the construction of the Trans Mountain pipeline expansion.

Kenney says he is a federalist. Keeping Western anger at Ottawa and the so-called “Laurentian elites” of Toronto and Montreal from boiling over – while also not alienating the country’s two most populous provinces, Ontario and Quebec – won’t be easy, though.

Downing’s response to Kenney’s panel on the VoteWexit Facebook page, which has 265,000 followers, suggests the difficulty that lies ahead: “Trudeau is set to DESTROY Alberta. Kenney is set to STUDY and STALL for the next 6-months. Only separation SOLVES the problem.”

Ultimately, the debate comes down to where Canadians see their economic future. When resource extraction is deemed the enemy of a warming planet, how will the industry and the country prosper? A government that wants to cut out fossil fuels will have to find economic answers that ease the transition – maybe reversing the majority view in Alberta and Saskatchewan, per Ipsos, that the provinces don’t get their fair share from the Confederation.

For a nation of just 38 million people occupying the world’s second-largest land mass after Russia, maintaining a vibrant economy in a warmer future in which the oceans encroach on coastal land almost certainly means encouraging immigration. That’s already a source of division, illustrated by the Montreal metro incident, but it could become much bigger.

It may sound far-fetched to suggest newish countries like Canada, or its southern neighbor, could break into smaller sovereign pieces. But the consequences of climate change will present existential challenges that could easily drive even friendly neighbors apart. Keep an eye on Alberta.

First published Nov. 12, 2019



Smoke from nearby bushfires obscure the view of the iconic Opera House in Sydney, Dec. 19, 2019. By mid-December, the fires raging for weeks along Australia's east coast had ravaged 3 million acres (1.2 million hectares) of land, killed 8 people and destroyed more than 700 homes. Residents of Sydney have been warned to stay indoors, supplies of breathing masks are running low and economic costs to the city are running as high as A\$50 million (\$34 million), according to SGS Economics, while health costs alone could run to hundreds of millions of dollars. REUTERS/Stephen Coates

SPARKS FLYING

Wanted: bold activist to take on Masayoshi Son

By Liam Proud

Masayoshi Son's SoftBank Group is worth significantly less than the sum of its parts. For an activist investor with plenty of cash and the stomach for a fight, it could be the trade of a lifetime.

Son's \$82 billion tech-to-telecom conglomerate ticks the boxes for pushy shareholders like Dan Loeb's Third Point Management or Paul Singer's Elliott Management. There's poor governance: Son is both chief executive and chairman and makes investments in cash-burning companies like WeWork partly based on his ability to "feel the force". Performance is weak too. SoftBank shares have returned minus 15% over the past six months, including dividends.



Japan's SoftBank Group Chief Executive Masayoshi Son attends a news conference in Tokyo, Nov. 5, 2018. REUTERS/Kim Kyung-Hoon

Son of the parts

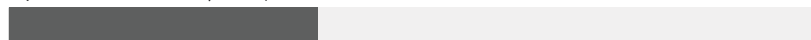
SOFTBANK ASSET VALUES: \$257 BLN (**ALIBABA** + **SOFTBANK CORP** + **ARM** + **SPRINT** + **VISION FUND & OTHERS**)



POTENTIAL BREAK-UP VALUE: \$215 BLN (ASSET VALUE MINUS NET DEBT)



EQUITY VALUE ON DEC. 09, 2019: \$82 BLN



ACTIVIST POTENTIAL UPSIDE: \$133 BLN (+161%)



Note: Alibaba, SoftBank Corp and Sprint values based on Dec. 9 market prices. Arm is based on its 2016 pre-acquisition value. "Vision Fund and others" and net debt based on SoftBank's own figures. SoftBank Group's equity value based on Dec. 9, 2019 closing price.

Liam Proud & Vincent Flasseur | Breakingviews – Predictions 2020

The result is that Son's company trades at a huge discount to its theoretical asset value. It owns Alibaba shares worth \$136 billion. Chipmaker Arm's value is probably \$22 billion, using the price before Son bought it in 2016. Listed stakes in SoftBank's eponymous Japanese telecom unit and U.S. operator Sprint are worth \$19 billion and \$43 billion, respectively. Finally, SoftBank touts \$36 billion of mostly private holdings, including its share in the Saudi-backed Vision Fund. Add everything up, deduct debt, and SoftBank's equity should be worth \$215 billion – 161% more than its current market value.

An activist-led breakup would help close the gap. SoftBank could start by handing Arm, Sprint and the Alibaba stake to shareholders. The latter could admittedly be tricky. As Yahoo discovered, it's hard to realise the value of shares in the Chinese e-commerce giant without triggering a massive tax bill. Still, the potential rewards outweigh the costs.

Son's 22% stake, based on information on the company's website, is a big obstacle to forcing change. Major corporate decisions at SoftBank require the support of two-thirds of shareholders. If, say, three-quarters of them turn up to vote, Son only needs the support of investors representing 3% of the company to veto a motion. To overcome that hurdle an activist would either need to acquire a huge stake or rely on widespread support from fellow shareholders.

A protagonist would not be short of potential allies, though. Investors including Capital Group and Tiger Global Management privately criticised SoftBank's Vision Fund losses and governance, the Wall Street Journal reported. In 2020, an activist could tap into that dissatisfaction to make a killing.

First published Dec. 10, 2019

Tencent is next in Western cross-hairs

By Pete Sweeney

China's Tencent is set for unwanted attention overseas. Its WeChat app, with over 1 billion users, is indispensable to life and business in the People's Republic, and plays an important role in Beijing's campaign to monitor and influence Chinese people abroad.



Tencent Chairman and Chief Executive Officer Pony Ma Huateng attends a news conference in Hong Kong, March 17, 2016.
REUTERS/Bobby Yip

The debate over containing it will test Western commitment to free information flow.

The Hong Kong-listed company looks ripe for a session on the griddle. ByteDance, owner of the TikTok video app, is already under investigation in the United States. But if TikTok is a risk, WeChat is too. It is obligated by its government to share user data, plus censor conversations and news. It has flown under the radar because it has few non-Chinese users. This is unlikely to last.

The app is already under fire in Australia, which has around half a million residents born in China. Politicians there are nervous about Chinese meddling in their political system. The Labor Party recently alleged misleading articles describing their policies on immigration and gay rights were disseminated over WeChat – similar to how Facebook was criticised after the U.S. presidential election.

The \$461 billion company is the largest constituent of the Hang Seng Composite index, and the second-largest member of the MSCI China Index. While China remains its main market, revenue in other countries from advertising and payments could be at risk. It may be forced to divest stakes in U.S. game studios, including a 40% piece of Epic Games. HSBC estimates to be worth \$6 billion, or be unable to co-produce films, as it did with “Wonder Woman” and “Venom”.

But WeChat could also present a challenge that previous targets of U.S. ire, like telecom-equipment maker Huawei Technologies, did not: how to block the flow of data. Authorities could tell Tencent to stop transmitting anything back to China, or to store data locally. The most extreme measure would be to block WeChat outright, the way Beijing blocks Facebook.

WeChat is media, not message. But any of the above moves would grease the slippery slope Western societies are already easing on to. With an election around the corner, 40% of Americans believe the government should restrict false information online, per Pew Research Center polling. As Europeans and North Americans harden physical borders, the idea of them creating their own versions of the Great Firewall seems less far-fetched.

First published Dec. 20, 2019

Argentina debt do-over is even chancier than usual

By Anna Szymanski

Sovereign debt's bad boy is back. Argentina, the eight-time defaulter, is on the hook for around \$100 billion of hard currency debt held in private hands, just part of its hefty borrowings. The International Monetary Fund may complicate new President Alberto Fernandez's plans for a quick debt fix, with wonky new bond features making the outcome even chancier than usual.

The dwindling liquid cash reported by the country's treasury won't even cover next year's roughly \$10 billion in private-lender interest, let alone principal. The Fernandez administration, which took office on Dec. 10, has signaled it prefers a so-called reprofiling to anything more drastic. That normally means maturities would be pushed out a few years, but interest rates and principal amounts due would be unchanged.



Argentina's President Alberto Fernandez holds the symbolic leader's staff, next to Vice President Cristina Fernandez de Kirchner, after he was sworn in as Argentina's next president, in Buenos Aires, Dec. 10, 2019. REUTERS/Agustin Marcarian

The IMF may nix this. The fund gave Argentina a \$57 billion credit facility in 2018. No rejig of government debt will happen without its agreement. And its debt-sustainability analysis is unlikely to deem this a simple liquidity issue, especially factoring in the debtor's history.

So a harsher restructuring is more likely. Citigroup has suggested that private lenders ought to be the biggest losers, with some interest payments cut by about 65% and maturities kicked out by around 10 years. Markets are also gloomy. Argentina's benchmark U.S. dollar bond maturing in 2028 was trading at around 40 cents on the dollar in early December.

Further drama might come from a seemingly boring source: new legal language. Argentina added so-called single-limb collective-action clauses to recently issued debt. These force owners of specific bonds to accept a deal approved in a vote by 75% of holders of all issued bonds, making it harder for a small group of creditors to hold out, as Elliott Management and a few others famously did last time around. But a related clause says a deal must be "uniformly applicable" to all parties, and this can be interpreted in many ways.

Finally, the so-called *pari passu* clause – the boogeyman of Argentina's last restructuring, a provision traditionally understood to give different bonds equal legal ranking – could even become an issue again, with new clarifying language apt to be tested in U.S. courts. The only certainty is that the outcome of the country's likely debt do-over will, once again, change the wider sovereign debt landscape.

First published Jan. 3, 2020

ECB feuding will have a new front in coming year

By Swaha Pattanaik

Christine Lagarde has given a masterclass in diplomacy since taking the helm of the European Central Bank in November. But even her considerable peace-making skills will be challenged in the coming year. Disagreements will erupt in 2020 between rate setters who are fed up of ultra-loose policies and those who are convinced that the euro zone economy needs more help.

The discord will be over a big ECB strategy review that will, among other things, look at how the central bank's treasured price stability mandate is defined. Unlike, say, Britain, where this definition is spelt out by politicians as an inflation rate of 2% with some margin of error, the ECB can set – and move – its own goalposts. Since 2003, the central bank has interpreted price stability as meaning inflation that is close to but below 2%. Before then, it simply aimed for less than 2%.



European Central Bank President Christine Lagarde arrives to testify before the European Parliament's Economic and Monetary Affairs Committee in Brussels, Dec. 2, 2019. REUTERS/Francois Lenoir

The review that led to the change didn't cause much in the way of ructions. But this time will be different. How the mandate is defined will determine how loose monetary policy will be in the future. Those who oppose sub-zero rates or asset purchases may therefore back definitions that would strengthen their case.

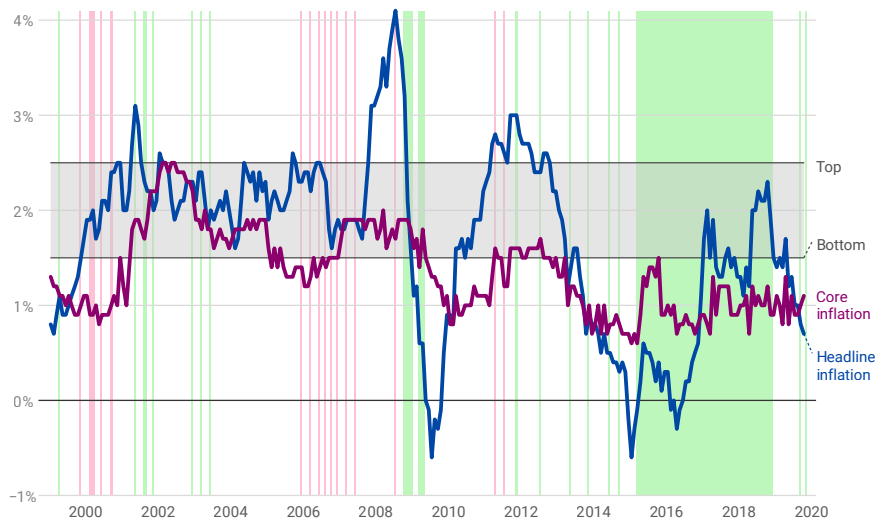
For example, Austrian central bank chief Robert Holzmann has expressed a preference for a lower inflation target, of 1.5%. That would make it harder to justify the ultra-easy monetary policy. So would a switch to an alternative measure of price pressures that includes owner-occupied housing costs, since the inflation rate that is being targeted would be higher. Or the ECB could focus on actual price levels, rather than the annual rate of change. In this case, a protracted period of weak inflation would require monetary policy to remain looser until the undershoot was eliminated. Focusing purely on core inflation, which excludes volatile food and energy costs, would also militate for easier policy.

Christine Lagarde's choices

Alternative ways to define the European Central Bank's price stability mandate

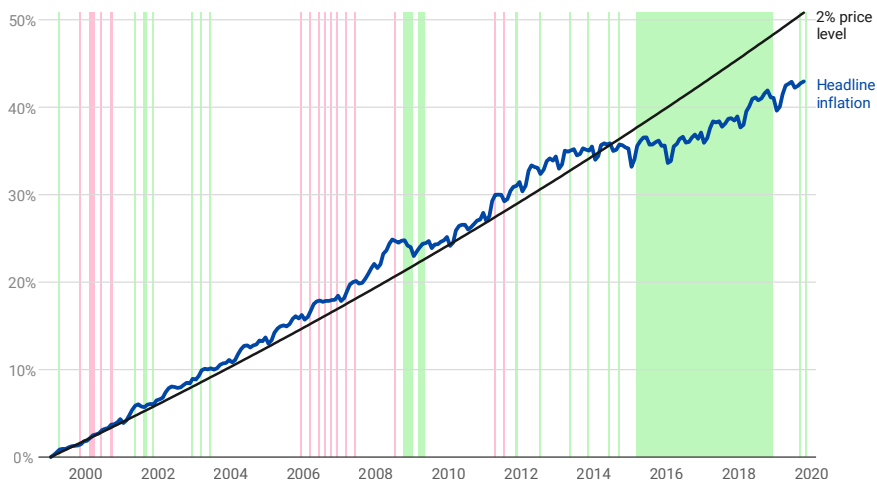
1. Inflation band 2. Core inflation

Easing (rate cut or asset purchase) | Tightening (rate increase)



3. Price level targeting

Easing (rate cut or asset purchase) | Tightening (rate increase)



A major change could destabilise the euro zone. A shift towards tighter monetary policy could cause investors to sell the debt of weaker countries, like Italy. But a looser framework could infuriate savers in northern Europe. With so much at stake, the battle is likely to be bitter and played out in public.

First published Dec. 11, 2019

Margrethe Vestager will open tech's walled garden

By Liam Proud

European Competition Commissioner Margrethe Vestager will in 2020 swap her sledgehammer for a scalpel. A new, more surgical approach to antitrust regulation could finally make it easier for Alphabet-owned Google and Facebook's rivals to compete with these behemoths.

The Dane has yet to really earn her reputation as Big Tech's slayer-in-chief, despite slapping 8 billion euros worth of fines on Google. Facebook got off with a 110 million euro charge for providing misleading information about its WhatsApp acquisition. Amazon.com has been largely unscathed, while Vestager's tilt at Apple was mostly about taxes.

She certainly hasn't dented their share prices. These four companies' combined market capitalisation has increased around 150% to \$3.5 trillion in the five years since Vestager's term started. Google still processes almost all web searches in Europe. It and Facebook suck up about three-quarters of digital ad spending in the bloc's five largest economies, eMarketer calculates. Apple's App Store and Google Play control the discovery and distribution of mobile applications.

Such dominance is sustained by so-called network effects, or self-perpetuating advantages that make it hard for others to compete. A budding Instagram competitor would struggle to get off the ground, since early adopters of a newbie could no longer interact with friends who stayed on the Facebook-owned site. It's the same for online marketplaces such as Amazon, or app stores. Meanwhile, Google's search algorithms get better the more they are used. Dominance begets ever greater dominance.



European Commissioner Margrethe Vestager of Denmark adjusts an earphone during her hearing before the European Parliament in Brussels, Oct. 8, 2019. REUTERS/Francois Lenoir

Vestager, now starting her second term in the job, could break the loop by introducing what antitrust wonks call interoperability – basically, shared technical standards that apply across competing services. As with email, users of different social networks could seamlessly interact and move their data around. Rival digital-marketing companies could slot advertisements on to Google’s web pages, allowing them to undercut the search giant’s ad prices. Entrepreneurs could build rival app stores which work on Apple’s phones.

True, hammering out details will be tricky. But the mobile-phone sector shows that industry-wide technical standards are possible. Similarly, British banks now build their IT systems so that customers’ accounts interact with third-party apps. Forcing Big Tech to do something similar might feel less satisfying than a huge fine. But it would give Vestager a better chance of breaking their stranglehold.

First published Dec. 20, 2019

ALTERNATIVE ENERGY

Tokyo brings home the Olympic gold in 2020

By Sharon Lam

Tokyo will top the sporting podium in 2020. Host cities for the summer Olympics are often saddled with large debts, and cases of mismanagement have stretched from Montreal to Rio de Janeiro. Yet Japan is setting new standards in sponsorship and sustainability. Add on a boost from short-term stimulus, and the Land of the Rising Sun is set to bring home host gold.

The games come with outsize economic costs. Los Angeles ended up turning a profit in its 1984 event, a rare feat in recent times. Brazil extended a \$850 million emergency state loan to Rio in 2016, and others have grappled with post-competition maintenance costs for abandoned facilities.



Speed skating gold medalists Miho Takagi, Ayaka Kikuchi, Ayano Sato and Nana Takagi of Japan on the podium at the Winter Olympic Games in Pyeongchang, South Korea, Feb. 22, 2018. REUTERS/Eric Gaillard

True, Team Japan hasn't been perfect. Tsunekazu Takeda, former president of the country's Olympic committee, stepped down in March on allegations of suspected corruption, putting governance front and centre. And the cost of hosting had also swelled to \$12.6 billion as of December 2018, according to Reuters, up from an original estimate of under \$7 billion. Still, most countries aren't in it to pocket a financial profit.

Tokyo is leading the race elsewhere, racking up more than \$3 billion in domestic sponsorships, three times more than any previous summer games. And the city is sending a timely message about the environment: Medals have been made entirely from the parts of 6.2 million used mobile phones, and electricity during the games will also come from renewable sources, according to organisers aiming for a carbon-neutral competition.

Robots, ferrying people to their seats and carrying food and luggage, will also showcase Japan's technological prowess. In July, International Olympic Committee President Thomas Bach noted that Tokyo was better prepared than any city he has seen before. So, the city is on track to score a big win.

An influx of games-related tourism infrastructure spending will also give Japan a much-needed boost, even if it proves short-lived. The world's third-largest economy has stalled, growing at an annualised 0.2% in the third quarter and prompting Prime Minister Shinzo Abe to call for stimulus measures to maintain the country's economic competitiveness beyond the Olympics. In the games at least, it's going for gold.

First published Dec. 24, 2019

Gaming's strongest opponent will be regulation

By Oliver Taslic and Robert Cyran

The \$130 billion video game industry looks set to be a major battleground in 2020. Microsoft and Sony will release their first new consoles in years. Alphabet's Google has just released Stadia, its cloud-based platform – and along with Apple wants to be the Netflix of online play. Meanwhile developers like Activision Blizzard have a strong hand. But the way the industry is growing will attract increasing regulatory scrutiny.

Amazon and other behemoths have either launched or are planning subscription packages offering monthly access to a slew of games, in the hope that a mix of exclusive content and a wide selection persuades players to pay up. People tend to play a few games

a lot, though, rather than a wide range of games a few times. Popular ones like Fortnite have become places to hang out online with friends. The gaming comes second. This acts as a coalescing force around a few titles and gives the developers of popular games, like China's Tencent, Activision and privately held Epic Games, a strong hand.

While these players duke it out for market share, though, their strongest opponent is limbering up. An important source of developers' revenue are so-called loot boxes – digital packages of random items that can be purchased using real money. They give players the chance to win desirable digital items, and gaming companies a stream of high-margin income. In Electronic Arts' Ultimate Team mode, for example, gamers open randomised "packs" in the hope of acquiring rare sports players. It accounted for 28% of the company's net revenue in the most recent financial year.



A female gamer uses an Xbox One game controller to play Need for Speed, at the world's largest computer games fair, Gamescom, in Cologne, Germany, Aug. 23, 2017. REUTERS/Wolfgang Rattay

But success brings scrutiny. Critics argue there's a correlation between loot-box use and gambling addiction. Worse, children can easily access games featuring loot boxes, since many of them are approved for youngsters and age verification is typically weak.

Microsoft, Sony and Nintendo, which dominate the console market, will from 2020 make it mandatory for developers to show the probability of winning certain types of items from loot boxes. Apple introduced that two years ago, yet loot boxes remain in many high-grossing games in its App Store. Developers will be hoping that self-regulation is enough. But the bigger gaming gets, the sharper the scrutiny will become.

First published Dec. 23, 2019

Peak subscription economy approaches in 2020

By Peter Thal Larsen

Don't subscribe now! At least not to the idea of the subscription economy. It's not just streaming TV services chasing steadily paying customers. Wine sellers, food delivery outfits and even Swedish furniture giant Ikea want them, too. Buyers can only spend and consume so much, though.

Online video is the fiercest battleground. About 10 million people signed up for Disney+ within 24 hours of its November debut, lured by "Star Wars" and other classic movies. Apple has rolled out its own service; HBO will soon join the fray. They're all taking on Netflix, which has amassed 158 million users worldwide since pioneering unlimited viewing access for a regular fee.

The business model has exploded. Razors, meal kits, pet food and clothes are all available by subscription. Peloton Interactive bicyclists pay \$39 a month for virtual spin classes. Revolut customers can spend 13 pounds a month for the online bank's shiny metal card. Carmakers and supermarkets are experimenting with subscriptions.

The logic is clear. Regular payments are more predictable than one-off sales. That helps companies plan their spending and gets rewarded by investors. Salesforce.com, a huge purveyor of software as a cloud-based service, is valued at around \$140 billion, more than 7 times expected revenue for the year to January.

Newcomers may struggle to repeat such success. Customers are expensive to recruit and difficult to keep. Half of subscribers to e-commerce services cancel within six months, according to a 2018 study by McKinsey. Delivery of physical products doesn't benefit from the same economies of scale as software. Meanwhile, Netflix and its rivals probably are not charging enough to cover their vast investments; Disney+ is charging just \$7 a month. When prices inevitably rise, subscribers may be forced to choose.



The Netflix logo is shown in this illustration photograph in Encinitas, California, Oct. 14, 2014. REUTERS/Mike Blake/File Photo

The best subscription services may therefore be those with extra benefits. Take Amazon. More than half of U.S. households pay \$13 a month for Prime, which includes faster shipping and access to movies and music, UBS analysts reckon. The real benefit, though, is that users spend a lot more on Amazon. Only companies that can unlock similar advantages will stay atop peak subscription. For the rest, the summit will prove unattainable.

First published Dec. 23, 2019

Underdog will take home Japan's casino jackpot

By Katrina Hamlin

Betting group Genting is not the bookies' favourite as it competes for a coveted casino licence in Japan. The Malaysian outfit lacks the scale or the glitz of rivals in Las Vegas and Macau but it has an ace up its sleeve to enter the hotly anticipated new market in 2020.

The prize is tantalising. The Japanese enjoy a flutter: Pachinko parlours rake in around \$30 billion each year. Now the country, eyeing a gaming-economic uplift, will introduce three casino resorts to open a new market. The initial opportunity is worth a potential \$10 billion, according to Bernstein estimates.



Students practice on a blackjack table at Japan Casino School in Tokyo, Aug. 4, 2018. REUTERS/Toru Hanai

The biggest names in the business are readying their bids. Sheldon Adelson's Las Vegas Sands seems like a shoo-in, and rival MGM Resorts International boasts both deep pockets and extensive experience. With three spots up for grabs, an Asian operator could get lucky too.

Though their Chinese heritage could be a disadvantage given sometimes tense relations between Tokyo and Beijing, Macau's homegrown operators, Galaxy Entertainment and Melco International Development, will be worthy competitors.

Genting boss Tan Sri Lim Kok Thay is vying for a chance in Osaka or Yokohama, and plans, through a Singapore unit, to raise \$3.2 billion for expansion. The group has experience in smaller markets, including its native Malaysia and the Philippines, and a new project under development in Las Vegas lends some street cred. The Malaysian group will also wow wary rookie regulators with the success of its resort in Singapore. Japan studied Asia's strictest gambling jurisdiction to prepare their own regime.

Officials in Tokyo have expressed admiration for the robust rule book in the city-state where locals must pay to merely enter the gaming floor. That's because ordinary folk are fretting over unsavoury side-effects on society: two-thirds of respondents in an October poll said they oppose gambling resorts, according to the Japan Times.

That makes the underdog a more palatable winner too. Genting Singapore's share price hovers at around 17 times its 2019 earnings, consistently below those of rival bidders in recent years. If the Malaysians play their cards right in Japan, they might hit the jackpot in multiple ways.

First published Jan. 3, 2020

A health craze for 2020: Chinese medicine

By Robyn Mak

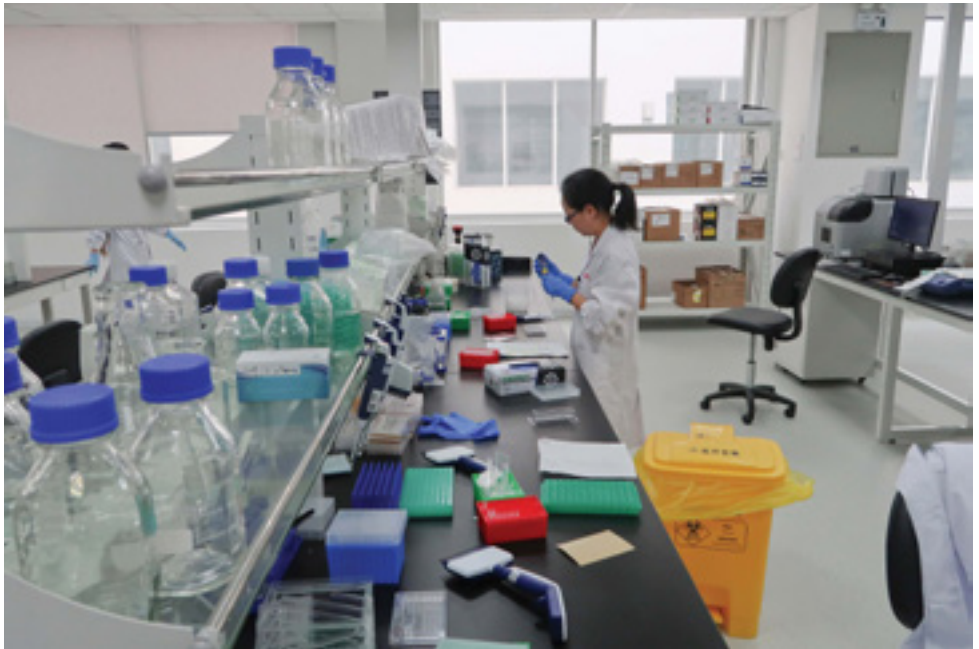
Move over, connected exercise bikes. There's a new, more serious healthcare fad for investors: Chinese drugs. U.S. regulators in November approved the first-ever cancer therapy from the People's Republic. For global pharmaceutical companies, a made-in-China blockbuster drug may be within reach.

The world's most populous country is aging quickly. Despite overwhelming demand for treatments against cancer, diabetes, and cardiovascular disease, Chinese drugmakers have produced few innovative medicines so far. But there's a new breed of biotechnology

upstarts inspired by friendly policies, government research incentives, and the prospect of grabbing a slice of the world's second-largest drugs market, at \$137 billion in 2018 according to healthcare analytics group IQVIA.

Leading the charge is BeiGene. The Beijing-based company, valued at \$12 billion as of early December, focuses on oncology treatments. China now accounts for more than a fifth of new cancer cases, according to the International Agency for Research on Cancer. And BeiGene's co-founders, John Oyler and Xiaodong Wang, have global ambitions. In November its lymphoma treatment won an accelerated approval from the U.S. Food and Drug Administration – a first for a Chinese company.

More such breakthroughs are probably on the way. One reason is the country's 2017 entry into the International Council for Harmonisation, which sets standards for developing new drugs. For China, a key benefit of adopting ICH guidelines is that other members of the coalition, including American and European regulators, will more readily accept local clinical trial results. BeiGene's landmark U.S. approval was also the first to be based partly on data from Chinese patients.



A scientist works at Zai Lab's drug development facility in Shanghai, Oct. 18, 2017. REUTERS/Adam Jourdan

China's cancer burden

Share of global annual cancer cases and deaths

■ China ■ United States ■ India ■ Japan ■ Russia ■ Germany ■ Brazil ■ Others

NUMBER OF NEW CASES



NUMBER OF DEATHS



Robyn Mak & Vincent Flasseur | Breakingviews – Predictions 2020

Source: International Agency for Research on Cancer

Big Pharma is noticing. Just weeks before the United States approved BeiGene's cancer drug, biotechnology giant Amgen splashed out \$2.7 billion for a 20.5% stake in the company. The same month, AstraZeneca unveiled plans to partner with investment bank China International Capital Corp to launch a \$1 billion healthcare fund in the country. These big-name endorsements will attract other potential investors.

Unfortunately, as with many health crazes, this one comes with small-print warnings. Most Chinese biotech firms don't have a long record, so it's difficult to tell good from bad. BeiGene itself was subject to a short-seller attack earlier in 2019. Moreover, clinical trials in developing countries have often been plagued with fraud and other issues. Some unexpected side-effects are inevitable.

First published Jan. 2, 2020

HR nous will make or break tech-driven ambitions

By Antony Currie

Chief executives from carmakers to consumer giants sound surprisingly similar when talking about the future. Artificial intelligence, machine learning and automation crop up, as does the challenge of finding staff qualified to carry out such grand strategies. That gives an unlikely back-office function the power to make or break tech-driven ambitions in 2020: human resources.

It's usually a department with limited scope, performing the grunt-work of hiring, setting workplace-conduct policies and policing unacceptable behavior. At a more senior level, it also involves devising compensation packages to encourage and reward service – sometimes to excess.



Beth Galetti, Senior Vice President of Human Resources at Amazon, speaks during the Wall Street Journal CEO Council, in Washington, Dec. 10, 2019.

The focus is shifting. Over four-fifths of corporate executives and HR bosses surveyed by Randstad Sourceright expect artificial intelligence and robotics to create employment opportunities. Mentions of AI rose almost fivefold between 2012 and 2017 on the earnings calls of non-tech New York-listed companies, reckons Stanford University's AI Index.

Yet hiring the best tech talent pits, for example, Walmart, whose jobs website lists almost 700 vacancies for software developers, against Alphabet and Amazon. The median annual salary for a U.S. software developer with five years' experience is over \$100,000, according to Stack Overflow. CEOs outside of finance, who are not used to paying handsomely for junior staff, have to get comfortable with higher wage bills.

Companies also face frequent battles to stop employees decamping elsewhere. Software firms have higher staff turnover than those in other sectors, LinkedIn found. CEOs hoping to attract and keep coders may therefore have to offer more appealing benefits, like Dropbox's unlimited vacation, or help paying off student loans, or better parental leave. Appealing to millennials' much-hyped sense of social responsibility might also work. Ford Motor could pitch that working on self-driving cars is more beneficial to society than building new phone software. Procter & Gamble can talk up the kudos of creating environmentally friendly shampoo.

Yet CEOs will also have to accept that tech-savvy staff increasingly want multiple changes of job, rather than long stints at one firm. Specialty chemicals group Covestro, for example, set up a tech hub away from its German headquarters in Leverkusen, and assumes those who join will remain for 18 months at best. That means the hunt for good coders may be endless, and that hiring the right hirers will become the most crucial job in 2020.

First published Dec. 31, 2019

ABOUT US

Reuters Breakingviews

Reuters Breakingviews delivers agenda-setting financial insight. Every day, we comment on the big financial stories as they break in the United States, Europe, the Middle East and Asia.

A team of about 30 correspondents based in New York, London, Hong Kong and other major cities provides expert analysis in real time.

You can find our views, along with interactive calculators, archives and e-books, on [Breakingviews.com](https://breakingviews.com) and Refinitiv Eikon. Selected columns also appear on [Reuters.com](https://reuters.com) and in many influential newspapers.

To request a trial subscription please visit: breakingviews.com/trial/ or email tim.dennis@thomsonreuters.com.

You can also find us on Twitter – [@Breakingviews](https://twitter.com/Breakingviews) – and Facebook.

ACKNOWLEDGEMENTS

Production by Katrina Hamlin

Graphics by Vincent Flasseur

Design by Rick Reid

Cover image: A fire is seen on a tract of Amazon jungle at Tenharim Marmelos Indigenous Land, Amazonas state, Brazil, Sept. 15, 2019. REUTERS/Bruno Kelly

BREAKINGVIEWS



Sponsored by

