Current market commentary

There seems to be a new “safe haven”, the Nasdaq 100, and no matter what happens in the world, such as trade uncertainty, negative earnings revisions like in 2018, geopolitical tensions in the Middle East or the spread of the coronavirus, tech stocks in the US are rising. Supported by loose Fed monetary policy, a US stock-minded president, massive stock buyback programs and high earnings growth rates. China-sensitive asset classes such as oil, industrial metals and emerging market equities, on the other hand, have recently lost a lot of ground. The optimism resulting from the trade deal was met by the coronavirus. According to our economists, its macro consequences should be limited. However, uncertainty among consumers and market participants has increased. Oil has already lost more than 10% YTD. We stick to our view that markets remain volatile in the short term, especially as the US primary elections start in Iowa today. In the medium term, the current uncertainty should represent a buying opportunity, especially for more cyclical positions.

Short-term outlook

The development of the coronavirus is overshadowing the current corporate reporting season and will continue to keep the markets in suspense in the coming days. However, if the infection rate begins to decline significantly, a recovery rally is likely to set in. Today, Monday, the Democratic and Republican primaries will begin in the US state of Iowa. In the case of the Republicans, however, incumbent Donald Trump is almost set. On February 8th, the early parliamentary elections will take place in Ireland. For the USA, the ISM index for the manufacturing industry is due today. On Tuesday, Factory Orders will be published, on Wednesday the ISM for the service sector and on Friday the labour market figures. China, Italy, and the eurozone will be released on Tuesday with the Purchasing Managers’ Indices (Service), and Germany’s Factory Orders on Thursday and December Industrial Production and Exports on Friday.

Virus-weakened investor sentiment towards emerging market equities

The bi-weekly Monitor gives you a structured overview of the current capital market environment and highlights important developments:

- Performance
- Positioning
- Sentiment
- Surprise Indicators
- Economics
- Foreign Exchange
- Equities
- Sovereign Bonds & Central Banks
- Corporate Bonds
- Commodities

While economic data has recently been better in emerging markets than in developed markets, equity market performance has been exactly the opposite. The coronavirus has significantly depressed investor sentiment.

In the short term, the uncertainty surrounding emerging markets is likely to continue. In the medium term, the calm in the trade dispute that should last until the US elections and improvement in the global economy should support emerging markets.

Source: Bloomberg, Time period: 31/01/2014 - 31/01/2020
Multi Asset

<table>
<thead>
<tr>
<th>Performance</th>
<th>4-week &amp; YTD</th>
<th>12-month periods over that last 5 years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>YTD (31/12/19 - 31/01/20)</td>
<td>31/01/19</td>
</tr>
<tr>
<td>Gold</td>
<td>24.1</td>
<td>6.5</td>
</tr>
<tr>
<td>REITs</td>
<td>16.4</td>
<td>12.0</td>
</tr>
<tr>
<td>Global Convertibles</td>
<td>16.7</td>
<td>6.0</td>
</tr>
<tr>
<td>Global Corporates</td>
<td>14.0</td>
<td>6.7</td>
</tr>
<tr>
<td>Global Treasuries</td>
<td>9.3</td>
<td>7.7</td>
</tr>
<tr>
<td>MSCI Frontier Markets</td>
<td>16.3</td>
<td>-1.2</td>
</tr>
<tr>
<td>USD/EUR</td>
<td>3.2</td>
<td>8.4</td>
</tr>
<tr>
<td>MSCI World</td>
<td>21.6</td>
<td>1.3</td>
</tr>
<tr>
<td>Eonia</td>
<td>-0.4</td>
<td>-0.4</td>
</tr>
<tr>
<td>MSCI Emerging Markets</td>
<td>7.2</td>
<td>-7.0</td>
</tr>
<tr>
<td>Industrial Metals</td>
<td>-5.2</td>
<td>-5.9</td>
</tr>
<tr>
<td>Brent</td>
<td>8.6</td>
<td>0.1</td>
</tr>
</tbody>
</table>

The last few weeks were mainly characterised by a risk-off environment. REITs, gold and bonds have clearly outperformed. The US dollar has also risen.

China-sensitive asset classes such as Brent oil and industrial metals, on the other hand, fell sharply. Brent oil has now lost more than 10% since the beginning of the year.

US equities are increasingly becoming a “safe haven”. No matter what happens in the world, e.g. geopolitical tensions in the Middle East or the coronavirus, the S&P 500 seems to gain.

Since the beginning of the year, Asian emerging markets have lost more than 4%, while the S&P 500 has gained more than 1%.

Within fixed income, government bonds have recently performed best. They benefited from a rising demand for safe havens. High-yield bonds underperformed, unsurprisingly.

Italian government bonds were also among the winners. They benefited from the market-friendly regional election outcome in Emilia Romagna.

Total return of selected fixed income, in euros and in percent, sorted by 4-week performance.
Source: Bloomberg, Time period: 30/01/2015 - 31/01/2020
**Non-Commercial Positioning**

- Speculative investors remain only moderately positioned in equities. They are most optimistic for US small caps.
- Within commodities, long positions in precious metals are the strongest. Natural gas remains a popular short.

The Commodity Futures Trading Commission (CFTC) publishes the Commitments of Traders Reports every Friday. A distinction is made between "non-commercial" and "commercial traders' positions. Non-commercial traders enter into purely speculative positions. Commercial traders hedge underlying transactions with futures or options. The chart shows the historical, normalized distribution in standard deviations and focuses on the net future position (long positions minus short positions) of non-commercial traders, thus indicating how speculative investors have positioned themselves.

*Duration weighted average bond position.

Source: Bloomberg, CFTC, Time period: 28/01/2010 - 28/01/2020

**Put-Call Ratio**

- In the last few weeks, put-call ratios for European and US equities went up. Investors have become more cautious in the wake of geopolitical tensions in the Middle East and the spread of the coronavirus.
- After the latest setback on the stock markets, put-call ratios fell again - an indication that market participants regard the selloff as only temporary.

The put-call ratio is the ratio of traded put options (speculation on falling prices) to call options (speculation on rising prices) across all maturities. The higher (lower) the ratio, the more cautious (optimistic) are the market participants. The data have been available for the S&P 500 since 20 December 1993 and for the Euro Stoxx 50 since 24 February 2006.

Source: Bloomberg, Time period: 20/12/1993 - 31/01/2020

**ETF Flows**

- Most ETF inflows have been seen in commodities over the last four weeks. Investors have mainly bought gold ETFs.
- Japanese equities were sold recently, however. Emerging market investments have also lost a lot of momentum - despite good economic data. The coronavirus has significantly dampened investor sentiment.

Estimated ETF flows in percent of assets under management, sorted by 2-week average.

Source: Bloomberg, Time period: 31/12/2019 - 31/01/2020
**SENTIMENT**

**AAII Sentiment Survey (Bulls vs Bears)**

- Sentiment among US private investors has drastically turned recently. After the bull-bear spread was at an unusually high level in the previous week, the bears now outweigh the bulls with just under 5%.
- The trigger for this pessimistic picture is the rapidly spreading Coronavirus.

The sentiment survey conducted by the American Association of Individual Investors determines the percentage of private investors who are optimistic, pessimistic or neutral regarding the US equity market outlook for the upcoming six months. It has been carried out since 1987. The survey is conducted from Thursday to Wednesday and the results are published every Thursday. For the stock market, it tends to be supportive when there is a high proportion of bears and a low proportion of bulls. However, it is a negative indicator when there are significantly more optimists than pessimists.

Source: Bloomberg, AAII, Time period: 23/07/87 - 30/01/20

**Realised Volatilities**

- Risky asset classes in particular showed increased realised volatility due to the virus compared to two weeks ago. Commodities and emerging market equities suffered from the increased uncertainty in the market.
- However, in comparison with its own 5-year history, the realised volatility of most asset classes still remains below average.

Realised volatility (in percent) measures the historical range of variation of a time series and is defined here as the standard deviation of the daily returns over the last 60 trading days. Volatility is often used as a measure of risk.

Source: Bloomberg, Time period: 01/01/2015 - 31/01/2020

**Implied Volatilities**

- The risk off movement was also accompanied by an increase in implied volatilities across all asset classes presented here.
- The VIX currently stands at over 18 - a level last seen at the beginning of October last year.

The price of options depends on the volatility of the underlying instrument. Implied volatility can therefore be interpreted as a measure of the currently expected fluctuation range of the underlying compared to the market over the remaining term of the option. It is a measure of prevailing uncertainty in the financial markets.

Stocks = VIX Index, Oil = OVX Index, Government Bonds = MOVE Index, Currencies = CVIX Index

Source: Bloomberg, Time period: 01/01/2015 - 31/01/2020
The trend of positively surprising economic data is continuing in developed countries (G10), in emerging markets and on a global level. All regions are now reporting positive economic surprises.

In emerging markets, South Korea saw Q4 economic growth of 1.2% (QoQ), Russian industrial production grew 2.1% (YoY, Dec.) and the purchasing managers’ index (PMI) of the service sector of China saw improvement, while the manufacturing PMIs were mixed.

See explanations below.
Source: Bloomberg, Time period: 01/01/2015 - 31/01/2020

Positive economic surprises in the eurozone are ahead of those in the USA. While the Ifo Business Climate Index for Germany disappointed, the ZEW Index surprised positively. Industrial market PMIs in Germany and France have also surprised to the upside. By contrast, Q4 growth figures for the eurozone were disappointing.

In the US, in addition to Q4 economic growth, consumer confidence (Jan.) was a positive surprise. By contrast, the Markit purchasing managers’ index for industry has disappointed.

See explanations below.
Source: Bloomberg, Time period: 01/01/2015 - 31/01/2020

Economic surprises in Japan and the UK are still in the negative territory. However, purchasing managers’ indices in the UK have recently surprised to the upside. In Japan, industrial production disappointed in December and exports fell for the 13th time in a row.

Citigroup Economic Surprise Indices are defined as weighted historical, normalized data surprises (actual releases vs. Bloomberg survey median) over the last three months. A positive value of the index indicates that the economic data have exceeded the consensus on balance. The indices are calculated daily based on a rolling three-month period. The indices use a time decay function to replicate the markets limited memory, i.e. the weight of a data surprise decreases over time.

Source: Bloomberg, Time period: 01/01/2015 - 31/01/2020
OECD Leading Indicator

- The OECD leading indicator continued to rise in November. At least according to this indicator, the global economy is on the road to recovery. This is also suggested by the number of countries with a rising indicator compared to the previous month. The value was recently close to the 50% mark.

The OECD Leading Indicator is composed of a series of selected economic indicators whose composition provides a robust signal for future turning points. A turning point in the indicator usually signals a turning point in the economic cycle in 6–9 months. However, lead times are sometimes outside this range and turning points are not always correctly detected.

Source: Bloomberg, Time period: 31/01/1994 - 31/11/2019

Manufacturing Purchasing Managers Index (Manufacturing PMI)

- In Europe, Germany, France and the UK all recorded a rising purchasing managers' index in January.
- Outside of Europe, Japan and India saw its PMI rise, while both China's PMIs fell slightly.

The PMI is an overall index that provides a general overview of the economic situation in industry. The PMI is derived from a survey of a relevant selection of purchasing managers regarding the development of economic indicators whose composition provides a robust signal for future turning points. The index has on average lead time before actual industrial production of three to six months. The PMI is based on a survey of a relevant selection of purchasing managers regarding the development of parameters such as incoming orders.

Source: Bloomberg, Time period: 31/10/2017 - 31/01/2020

Headline Inflation

- Inflation in Germany rose to 1.6% in January. Core inflation, however, fell to 1.5%. This was primarily due to special effects (winter sales and package tours) and the reduction in VAT on rail tickets.
- At 1.4%, inflation in the eurozone remains well below the ECB's target.

Inflation is measured (in percent, year-on-year comparison) using a consumer price index, also known as a shopping basket of goods. This shopping basket contains all goods and services that a household purchases on average per year.

Source: Bloomberg, Time period: 31/10/2010 - 31/01/2020
The risk-off movement of the last two weeks was also clearly visible in currency markets. The biggest winner on a trade-weighted basis was the Japanese yen. The safe haven is now trading back at the level of the Iran conflict at the beginning of the year. The US dollar was also able to profit from investors’ risk aversion.

The biggest losers were emerging market currencies, but the euro also depreciated noticeably.

A trade-weighted index is used to measure the effective value of an exchange rate against a basket of currencies. The importance of other currencies depends on the share of trade with the country or currency zone.

Source: Bloomberg, Time period: 01/01/2019 - 31/01/2020

Among the G10 currencies, safe havens have prevailed against the euro over the past four weeks, while commodity currencies have suffered.

In view of the Coronavirus, losses in some Asian currencies still appear moderate at present.

Crypto-currencies remained in demand as an uncorrelated asset class and have maintained their gains since the beginning of the year.

Performance of selected currencies against the euro, in percent.
Source: Bloomberg, Time period: 01/01/2020 - 31/01/2020

The euro has been on a downward trend since mid-January and at times even fell below 1.10. As long as the economic recovery is in a forced pause due to the virus, the euro’s upside potential remains limited.

The interest rate differential between Bunds and US Treasuries has remained around the 2% mark in the last two weeks.

EUR/USD exchange rate and interest rate differential (in percentage points) of 10-year US Treasuries and 10-year Bunds.
Source: Bloomberg, Time period: 01/01/2015 - 31/12/2020
**European Sector & Style Performance**

<table>
<thead>
<tr>
<th>Sector</th>
<th>4-week &amp; YTD</th>
<th>12-month periods over that last 5 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utilities</td>
<td>1.6</td>
<td>30.3</td>
</tr>
<tr>
<td>Health Care</td>
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<tr>
<td>Growth</td>
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<tr>
<td>Consumer Staples</td>
<td>-5.4</td>
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<tr>
<td>Industrials</td>
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</tr>
<tr>
<td>Information Technology</td>
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<tr>
<td>Finance</td>
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<tr>
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<tr>
<td>Materials</td>
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<td>10.1</td>
</tr>
<tr>
<td>Energy</td>
<td>-3.9</td>
<td>-5.6</td>
</tr>
</tbody>
</table>

Consumer Discretionary: MSCI Europe Consumer Discretionary NR; Consumer Staples: MSCI Europe Cons. Staples NR; Energy: MSCI Europe Energy NR; Finance: MSCI Europe Financials NR; Health Care: MSCI Europe Health Care NR; Industrials: MSCI Europe Industrials NR; Information Tech.: MSCI Europe Info. Tech. NR; Materials: MSCI Europe Materials NR; Telecommunications: MSCI Europe Telecommunication Services NR; Utilities: MSCI Europe Utilities NR.

Value: MSCI Europe Value NR; Growth: MSCI Europe Growth NR.

- Within European equities, defensive sectors such as utilities and consumer staples have recently outperformed.
- Cyclical sectors, on the other hand, have been left behind - the coronavirus and the uncertainty surrounding its economic consequences weighed heavily.

Total return of European equity sectors and European style indices, in euros and in percent, sorted by 4-week performance. The difference between Value and Growth lies in the valuation. A growth stock is highly valued because the company is expected to grow strongly. Value stocks generally have less growth potential and are valued lower.

Source: Bloomberg, Time period: 30/01/2015 - 31/01/2020

**Changes in Consensus Earnings Estimates**

- Over the past month, the aggregate has seen only slightly negative earnings revisions for emerging markets and developed markets. Within emerging markets, analysts have revised earnings estimates for Eastern Europe and Latin America the strongest downward.
- However, the coronavirus is likely to lead to more negative earnings revisions in the coming weeks, especially in Asia.

1-month and 3-month changes in consensus earnings estimates for the next 12 months, in percent.

APAC ex Japan = Asia Pacific ex Japan

Source: FactSet, as of 31/01/2020

**Earnings Growth**

- Only a slight increase in global economic growth, coupled with low inflation, will limit corporate sales growth in 2020. US companies’ high level of debt in conjunction with slightly rising wages and tariffs is a burden. The margin expansion expected by the consensus appears unrealistic. Global corporate earnings in 2020 are likely to increase by 4-7% at best compared with the previous year.

Calendar year earnings growth expected to the consensus for selected equity regions, compared to the previous year and in percent. The earnings estimates of the individual companies are aggregated using the index weights (bottom-up).

APAC ex Japan = Asia Pacific ex Japan

Source: FactSet, as of 31/01/2020
The liquidity glut of central banks worldwide continues to support stock markets. While corporate earnings have hardly risen at all over the past 12 months, valuations have risen massively. One reason for this is the relative unattractiveness of bonds. Globally, bonds with a volume of more than USD 13 trillion are yielding negatively.

Analysis of the stock market drivers over the last 12 months. This takes into account the change in earnings estimates and the change in valuation (price/earnings ratio). EPS = earnings per share

Source: Bloomberg, Time period: 01/01/2010 - 31/01/2020

Stable earnings revisions, falling stock markets - this inevitably leads to lower valuations.

Compared to their own history, however, European and especially US equities remain ambitiously valued.

Compared with bonds, equities have recently become even more attractive. Yields on 10-year German government bonds, for example, have fallen towards -0.4%, while the DAX dividend yield stands at 3%.

P/E valuation based on earnings estimates for the next twelve months for European and US equities and the respective P/E average since 1988 * For the Stoxx 600, the history prior to 2000 is of MSCI Europe.

Source: Bloomberg, IBES Time period: 31/12/1987 - 31/01/2020

Valuations have recently fallen across the board. Compared to the historical median, however, they remain elevated.

Emerging market equities are the most favourably valued compared to their own history.

Historical distribution of valuation indicators for selected stock regions since 2006, showing the current value, the observation four weeks ago and the historical median, the maximum (upper limit of the grey bar) and the minimum (lower limit of the grey bar).

Source: Bloomberg, Time period: 01/01/2006 - 31/01/2020
First, the Iran conflict and now the coronavirus. In the wake of uncertainty, investors are seeking protection in safe government bonds. Thus, yields have fallen across the board.

Speculation about a possible interest rate cut by the Bank of England put additional pressure on yields on British government bonds, despite this not materialising.

After the defeat of the opposition (Legi) in the most recent regional elections, Italian government bonds saw a disproportionate decline in yields.

Effective yield of 10-year government bonds and change in the last four weeks in basis points (in brackets).
Source: Bloomberg, Time period: 01/01/2015 - 31/01/2020

Bonds with long maturities benefited significantly from the recent risk-off environment compared to short maturities. The steepness of the yield curves has thus decreased again. However, an inversion is not yet to be feared.

The yield curve distinguishes between the so-called short and the long end. The reason for this lies in the way in which factors influence returns. Central banks control the short end of the curve through their monetary policy and key rates. By contrast, the long end is influenced less by central banks than by inflation expectations, supply, demand and risk premia.
Source: Bloomberg, Time period: 01/01/1998 - 31/01/2020

Both the Fed and the BoE decided at their January meeting to leave interest rates unchanged for the time being. However, the Fed stressed that if inflation remains low, another rate cut cannot be ruled out.

The market is already pricing in two interest rate cuts for 2020 - one already before the US presidential elections.

In UK, the market considers a cut in interest rates as early as May to be likely.

Derivatives on money market rates - such as the Fed funds futures - can be used to determine changes (number of steps) in the key interest rate priced by the market.
Source: Bloomberg, Time period: 31/12/2019 - 31/01/2020
Since the beginning of the year, spreads in the investment grade segment have barely changed. They have remained at a relatively low level, even though there has recently been a slight increase in spreads due to the coronavirus. This has particularly affected the USD side. In a two-week comparison, USD non-financial bonds saw the largest spread widening at 11 basis points.

By contrast, spreads for high-yield bonds have risen significantly. USD high yield bonds saw a spread widen by more than 60 basis points in a two-week comparison, while EUR high yield bonds saw a spread widen by about 30 basis points.

Spreads on emerging market high-yield bonds also increased significantly by more than 40 basis points.

In the wake of increased uncertainty and the fall in oil prices, USD corporate bonds saw significantly rising spreads. With fewer energy companies than in the US, EUR corporate bonds are less affected by the falling oil price and central bank purchases are supporting demand side.

The extent of the risk associated with a corporate bond is shown by its asset swap spread (in basis points). This indicates the yield that the issuer must pay in addition to the swap rate for the respective term to offset its credit risk. See further explanations below.


Source: FactSet, Time period: 31/01/2010 – 31/01/2020
The picture in commodity markets has been very clear over the past four weeks. Only precious metals managed to record a positive development. Industrial metals and especially energy commodities suffered from increased economic uncertainty.

Palladium leads the picture by far, but the precious metal, which is mainly used in the automobile industry, had to give up part of its year-to-date performance in the last two weeks.

Instead of supply concerns - as was the case at the beginning of the year during the Iran conflict - demand concerns due to the Coronavirus are currently dominating the oil market. The loss since the beginning of the year for Brent is more than 13%.

In contrast, oil-specific news has received little attention. Production losses in Libya of 900 thousand barrels per day due to the ongoing civil war have so far been unable to boost the oil price.

Higher oil production and higher inventories tend to depress oil prices and vice versa. An increase in active oil rigs indicates a future increase in oil production.

Most recently, the Coronavirus has driven investors back into gold. As a result the precious metal is currently trading at around USD 1,575 an ounce.

In contrast to the Iran conflict, this time it was mainly ETF investors who drove the price. ETF holdings have reached a 7-year high.

The US dollar and the real interest rate, i.e. adjusted for inflation, are among the fundamental price factors of the gold price. Rising real interest rates tend to depress the price of gold, while falling real interest rates have a supportive effect. The same applies to the US dollar. The development of gold ETF holdings reflects the demand for gold from financial investors.
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