DECALIA

INVESTMENT INSIGHTS

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GAME OF THREATS

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- More rhetoric than action - History shows that such events have limited impact on markets
- Market noise & revived volatility usually offer buying opportunities for long term investors

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- Equities – Stay invested in a more diversified manner while keeping an opportunistic approach
- Fixed Income – Still see downside risk despite recent rise in both nominal & real yields
- FX – Potential short-term consolidation in EUR/$ but remain bullish over the medium term

Editorial View

Game Of Threats

- Unpredictable & stubborn political leaders put (again) the spotlight on geopolitical risk
- More rhetoric than action - History shows that such events have limited impact on markets
- Market noise & revived volatility usually offer buying opportunities for long term investors

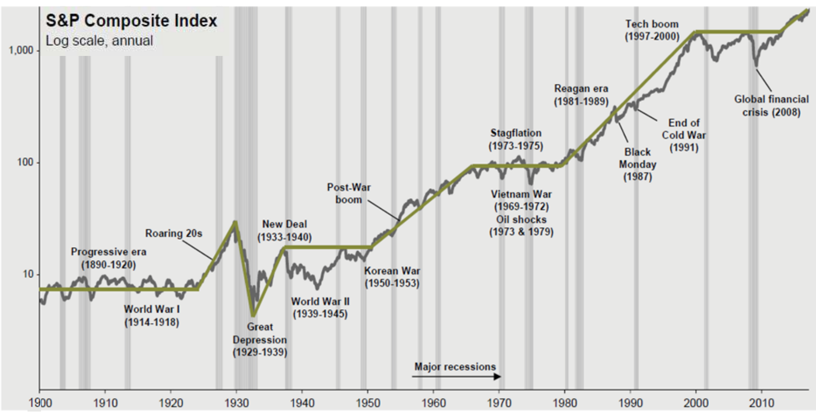
Considering today's larger-than-life authoritarian rulers such as Trump, Putin, Xi or Jong-un, with their ego-driven power struggles, ever-changing web of alliances, and unpredictable plot twists, one would have good reason to believe that the world has turned into a *Game of Thrones* fantasy drama. This, in turn, has raised again the *"spectre"* of geopolitical risk over global financial markets with investors getting increasingly nervous about escalading crises and potential trade wars. Admittedly, *Daenerys*' threat "turn us away, and we will burn you first" may appear somewhat far-fetched in today's context but one must admit that, given the aforementioned cast of characters, the risk of seeing a minor conflict rapidly growing out of proportion cannot be excluded. That said, recent history tells us that most conflicts end up being war of words only, with rhetorical escalation seldom followed by meaningful action as proud protagonists' generally back down with honour after seeking negotiated "win-win" solutions with each side.

The key point here is that, while causing both greater nervousness and higher market volatility, such geopolitical events often provide good entry points for long term investors. Indeed, as a matter of fact, several reports (e.g. 2016 Credit Suisse study on major geopolitical events in the past 100+ years and a 2017 Charles Schwab survey carried over 37 similar developments since 1980) have demonstrated that such occurrences eventually created more short-term noise than sustained impact on markets. In fact, not only have stocks not always declined in response to such incidents, but when they have, drawdowns have on average been limited to 3%, with a duration of just 7 days. Therefore, it was no real surprise to see Trump's recent military response in Syria not bothering the markets much. Moreover, latest concerns about a potential trade war with China rapidly eased after investors realized negotiations would likely follow earlier hostile announcements. Even major events such as the assassination or Archduke Ferdinand (1914), Cuban missile crisis (1962), the invasion of Iraq (2003), and the 9/11 terrorist attacks saw initial equity markets pullbacks of around 10% being reversed within a month or so. On the longer run too, we remember equity markets' strong performance during Reagan's protectionist era in the 1980's.

In other words, whereas most of these events are unpredictable by nature, the pattern of equity markets' reaction is often more so, all else equal. This observation combined with the current robust global economic & earnings growth environment thus keep us constructive on risky assets ahead of further potential geopolitical turmoil (e.g. NAFTA). Indeed, such risks are, and have always been, an inherent and unavoidable element of investing. For long term equity investors in particular, panic selling on negative geopolitical headlines rarely proved to be a smart move. Quite the contrary in fact as initial indiscriminate market pullbacks often provide a unique opportunity to cherry pick high-quality stocks at more attractive levels. As a result, unlike in *Game of Thrones*, we do not believe that "winter is coming" yet for equity investors and thus recommend to stay patient and selective as they look out for bargains.

Chart of the Month

Stock market & major events since 1900



Please see appendix at the end of this document for information on sources, important disclosures, and disclaimers

Global Strategy

Noisy Markets + Nervous Investors = New Opportunities?

- Fading global economic momentum but activity levels remains high – Core inflation under control
- Ongoing positive corporate earnings revisions with still healthy expectations for 2018/19
- Most key risk metrics are back to 3-year average - Commodity prices to be monitored closely

Despite mounting geopolitical risks (i.e. rising tensions in the Middle East; US sanctions on Russia with air strikes in Syria; trade wars), we have decided to retain our constructive stance on global financial markets. Indeed, while acknowledging the economic risks related to a potential surge in protectionism around the globe, we nevertheless believe it is yet too early to assess, and therefore quantify, the impact of such measures (if any) in the future. Our base case macro scenario thus still assumes a negotiated outcome on this matter with no meaningful impact from further potential rhetorical escalation and (still contained) geopolitical tensions other than a higher risk premium across most asset classes. Hence, after already increasing the probability of our downside scenario last month to account for revived macro uncertainties and what we see as a bumpier way ahead for risky assets, we stick, by far and large, to our latest views.

In a nutshell, despite fading momentum recently, global economic growth is still solid and activity levels high across the board. Moreover, core inflation remains under control, below Central Banks targets, with only modest upward pressure to be expected from rising commodity prices. Within this context, we expect the recent "dovish tightening" of global monetary policies to continue, still pointing to a gradual (data-dependent) normalization ahead. As a result, most market risk metrics have now stabilized around 3-year average levels, no longer suggesting (excessive) investor complacency.

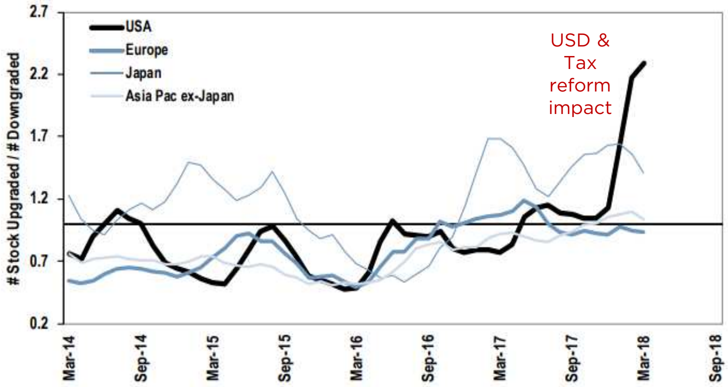
Following latest market turmoil, we remain selectively constructive on global equities. Higher volatility is here to stay but we advise staying invested in a more diversified manner (sector & style) while taking profits opportunistically, hence maintaining a "Neutral" equity portfolio allocation. On the one hand, sound fundamentals with still-loose monetary policies, positive earnings momentum, less demanding valuation levels, and healthier investor positioning all support a constructive near-term outlook. However, on the other hand, sell-off risks related to mounting geopolitical tensions, slower global economic growth, inflation & rates, Tech sector supremacy (FAANG), and potential policy mistakes by Central Banks should not be ignored. As a result, we still see bumpy upside for equities this year, mirroring underlying positive earnings growth.

We maintain our cautious stance on Fixed Income as 2018 is likely to be a turning point for global monetary policies, in our view. Hence, notwithstanding the recent rise in both nominal & real yields, we see further downside risk from current levels. That said, we keep 10-year US Treasuries as a hedge against geopolitical turmoil and, helped by a weak US dollar, still see good value in EM local currency bonds.

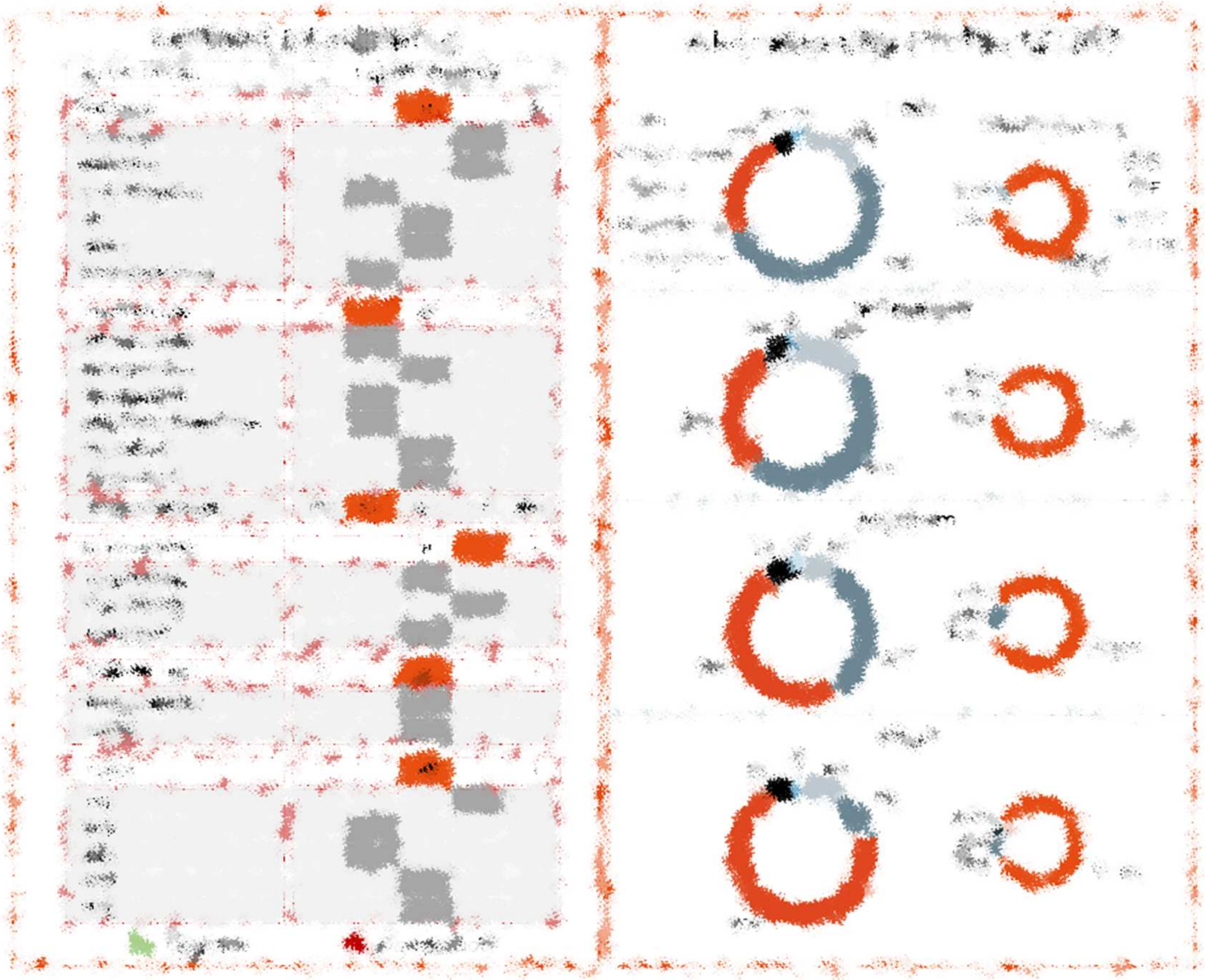
In FX, despite a wider rate differential, we maintain our preference for the EUR vs. CHF & USD. Indeed, the former should further benefit from its more attractive relative valuation (PPP), Europe's current account surplus, and investors re-positioning. In commodities, we keep a position in gold as a hedge against political risks and inflation expectations, while sticking to our positive view on oil. Finally, in the Alternatives space, we continue to favor both uncorrelated strategies in Hedge Funds (i.e. market neutral, arbitrage) and Private Equity/Debt investments.

Blended Confidence Index vs. GDP growth

Global EPS 3M Revision Ratios



Asset Allocation



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External sources include: Bloomberg, BofAML, JP Morgan AM, OECD

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