

INVESTMENT INSIGHTS

MONTHLY ISSUE #56

September 1st, 2019



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Editorial View

Currency Warriors

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- Currency manipulation (i.e. *management*): the latest “twist” in the global trade dispute?
- But no matter who wins the currency war, gold is usually the safest bet for investors...

Every year, in late August, the world’s central bankers gather in Jackson Hole, a remote mountain town of West Wyoming. Attendees certainly had much to discuss this time round, with economic growth coming under increasing strain and monetary policy tools – conventional or not – seemingly reaching their limits.

Just consider: the global pool of negative yielding debt hit an astounding USD 17 trillion mid-August, Swiss government bond yields are now negative up to a 50-year term, and Germany just completed its first offering of negative yielding 30-year notes. In the US, the Fed has reversed course, abandoning all efforts to reduce its balance sheet and cutting the Fed Funds rate for the first time in a decade. And it is not alone: some 30 central banks have lowered policy rates this year, including those of New Zealand, India, Thailand and Korea. Europe could soon follow suit, possibly in conjunction with a second round of quantitative easing.

Moreover, longer-term rates are falling faster even than policy rates, causing yield curves to invert. This having historically been a reliable predictor of a turn in the cycle, fears of a global slump are mounting. Whether the yield curve remains a valid recession indicator in the “new” framework of negative rates is, however, questionable.

But the more important questions pertain to what central banks can do going forward to counter economic pressures and what ammunition will be left when the next recession does eventually hit. On this matter, Modern Monetary Theory has been gaining publicity recently – not always of the positive variety. MMT (dubbed by some the “magic money tree”) in essence endorses unlimited money creation to finance government

spending. Running a large deficit is not a problem, the theory argues, since a government cannot be brought to default on debt labelled in its own currency. The central bank will always be there to print more!

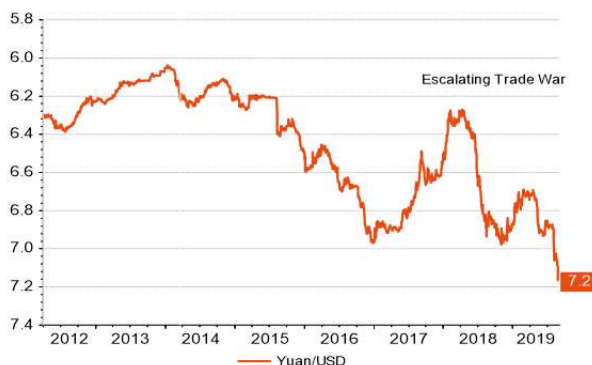
Which brings us to the topic of currency management. President Trump recently chastised China as a currency manipulator, when the symbolic threshold of 7 renminbi to the dollar was crossed – just days after he himself had announced further tariffs on US imports from China. That Chinese policymakers are using their currency as a weapon in the trade conflict seems vindicated by the fact that the country’s global trade surplus (in fact also that with the US) has actually expanded this year. Also, Chinese growth is not in free-fall and foreign currency reserves are stable – no cause for spontaneous currency depreciation.

In other cases, currency moves are clearly of an involuntary nature, be it Swiss franc or Japanese yen appreciation, both collateral “victims” of mounting uncertainties (by virtue of their safe-haven status), or sterling depreciation, due to lingering Brexit discussions. Managing the currency may not be central banks’ usual priority, but monetary authorities are increasingly being called to intervene – very forcibly so in the case of the US (by President Trump himself...).

From an investor’s perspective, identifying the winner of a currency war will be far from easy, especially when tied into today’s trade dispute and geopolitical tensions. However, be it China or the US, this “race to the bottom” is likely to last for some time during which gold should actually benefit the most. So beware, the battle is far from over and you better stick to your safe havens!

Chart of the Month

Chinese Yuan (vs USD) Trading at Extreme levels due to Trade War Tensions



Global Strategy

Playing American Roulette

- Still a “noisy” context but we do not anticipate a full-blown trade war nor a global recession
- Leading indicators: weaker manufacturing vs. solid services & consumer trends – Who’s right?
- Ongoing geopolitical uncertainties & limited visibility still warrant an *all-terrain* portfolio positioning

Our global macro scenario is broadly unchanged. In this “noisy” context, we stick to our cautious but constructive outlook for the remainder of the year, still not anticipating an escalation to a full-blown trade war nor a global economic recession, but rather a gradual stabilization of key manufacturing trends. Admittedly, headline risks have increased (again) but we retain a balanced stance for now. On the one hand, we acknowledge the weakening global macro momentum, the downside risk on earnings and the uncertain geopolitical context. On the other hand, consumer & services trends remain supportive (vs. manufacturing) and, more importantly, “ultra-dovish” central banks stand ready to act further – as the Fed demonstrated late July. Moreover, renewed talks about potential fiscal stimulus in the near future (e.g. Germany/China) could also help keep risky assets afloat in this environment.

At the portfolio level, we maintain an *all-terrain* positioning, i.e. keeping a neutral allocation to equities (at the lower end of the range) with protections (put options) implemented last month in order to lock-in some year-to-date profits while taking advantage of low volatility levels. At this stage, we recommend holding such protections through year-end but nonetheless intend to keep an opportunistic approach as regards potential profit-taking, should volatility or market contrarian indicators provide us with strong signals.

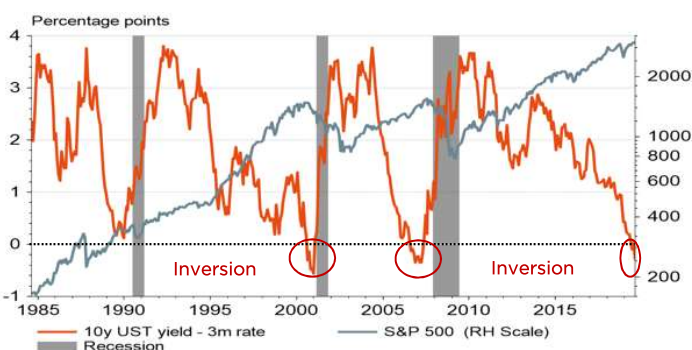
On the equity front, although 2019 “easy gains” are clearly behind, we do not foresee a major correction ahead. True, higher volatility is here to stay given the mounting trade-related recessionary fears, revived geopolitical tensions, high expectations for major central banks actions,

and mixed signals from both diverging economic data & the relentless flattening of the yield curve. That said, the combination of increasingly accommodative monetary policies, easing earnings downgrades (growth expectations have been reset), decent valuation multiples (the equity risk premium looks attractive again), and defensive (i.e. bearish) institutional investor positioning should provide support. Overall, we still recommend focusing on defensive quality (strong FCF, solid B/S, high ROE) and secular growth assets, without taking major tactical bets.

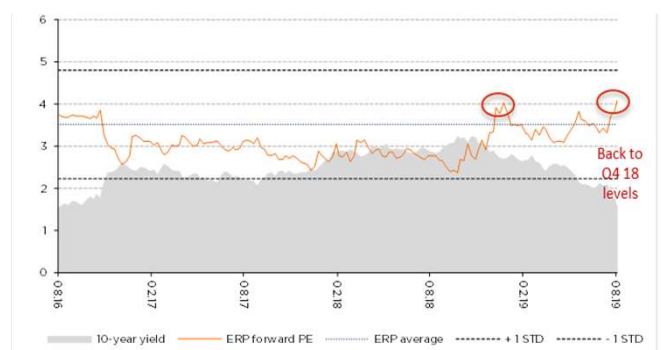
Having already downgraded our stance last month (e.g. EU government bonds), we remain cautious on fixed income in the light of the latest rally and the peaking amount of negative yielding debt globally. As a result, we still recommend a barbell approach with some exposure to defensive segments (higher quality & longer duration assets) on the one hand, and carry-driven allocation to emerging markets bonds on the other.

Finally, we still believe that the resilience of typical “safe havens” such as gold, the Swiss franc or the Japanese yen, will continue to help us navigate this year’s winding roads more comfortably. We actually recently increased our allocation to the latter marginally, hence recognizing greater downside risk to our central macro scenario. Indeed, along with US Treasuries (and other safe government bonds), these assets have proven to be some of the few to demonstrate real signs of resistance during troubled times earlier this year and, as such, should remain an integral part of our balanced portfolio allocation.

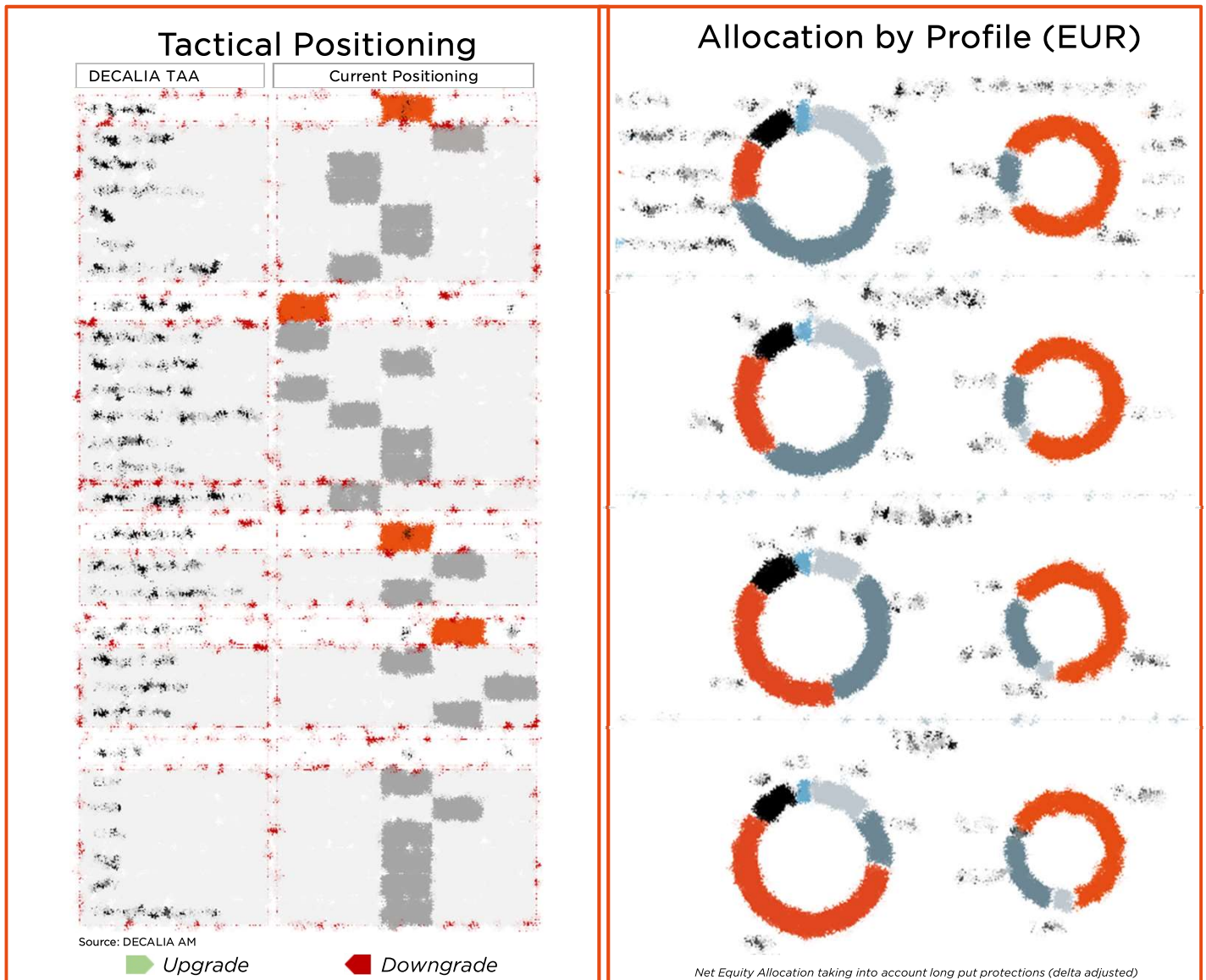
US Yield Curve Slope (10y-3m) & Recessions



US Equity Risk Premium (3 years)



Asset Allocation



- Equities - Keeping a foot in the market but with protections still in place
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- Private Markets - Continue to favor private debt and niche real estate strategies

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Finished drafting on August 31st, 2019