

INVESTMENT INSIGHTS



ANOTHER «G», SIR?

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- 5G promises much greater speed, more density, less latency – and better energy-efficiency
- *Huawei* under US fire - more to do with global 5G domination than trade considerations
- These technological advances will transform our world – opening up investment opportunities too

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- Trump's trade rhetoric back in the spotlight – Louder noise but full-blown trade war unlikely
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- Fixed Income – Further reduced our *Underweight* stance recently, adding more high quality bonds
- Alternatives – Private markets upgraded one notch further in this volatile market environment

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Just when a US-China trade agreement seemed close at hand, President Trump took advantage of new market highs to drop a couple of bombs: the import tariff imposed on USD 200 bn of Chinese products was hiked to 25% with immediate effect and Huawei, China’s flagship telecom company, has been blacklisted - officially for national security considerations. At stake is not just the trade dispute between the two global economic powerhouses, but also technological leadership in the ongoing transition to a 5G world - with all the opportunities, but also challenges, that it entails.

Who even remembers the 1G era, when only voice calls were possible? Then, with 2G, and the shift from analog to digital, came the possibility of sending text messages. 3G marked the advent of mobile data, literally putting internet at the tip of your fingers. The current 4G stage is that of mobile broadband: smartphones have become the norm, and multimedia functionalities indispensable to our way of life.

Beyond responding to the exponential rise in smartphone data traffic, projected to increase tenfold between 2016 and 2022, 5G will mainly deliver extreme speed, some 1000x faster than what we now know. It will also be more reliable and denser, as well as less energy-intensive. As such, it promises to unleash the power of technology in many new fields such as autonomous vehicles, smart cities and buildings, environmental monitoring or e-health.

This opportunity to revolutionize how we work and live obviously comes at a big cost. Total 5G-related capital expenditure required through 2022 is currently estimated at USD 600 bn.

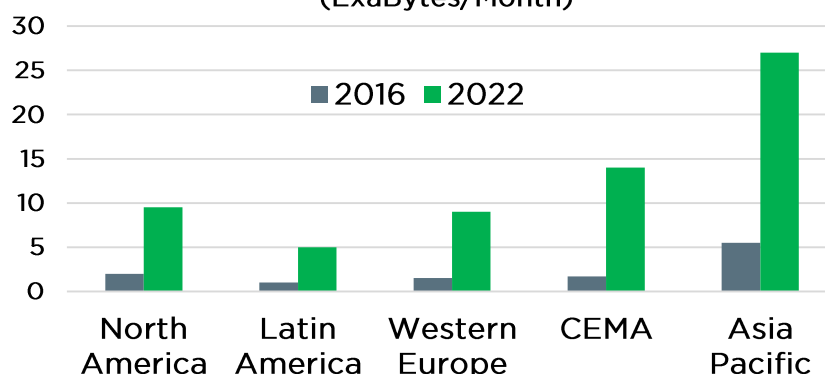
While some Asian governments are providing hefty subsidies, viewing 5G as key to their economic progress, in most developed countries the network/telecom companies will be footing the bill... with cash that they do not have. Consumers can thus look forward to higher operator invoices - in addition to the cost of upgrading to new phones with 5G capabilities. Businesses will also need to undertake additional infrastructure spending, perhaps embracing fee-based subscription models.

From an investment perspective, numerous are the actors involved in the transition to 5G. A first group consists of the phone antennas, semiconductor and software companies, with the likes of Xilinx, Qualcomm or Intel. Then, those involved in actually building the network towers - of which 300’000 more will be needed in the US alone, due to 5G’s shorter wavelength, hence lesser reach (1km vs. 70km for 4G). American Tower stands out in this space, alongside Crown Castle or SBA. Providers of mobile and optical network hardware make up a third group, with Ericsson (well positioned to reap substantial 5G benefits given its 90% revenue exposure to wireless), Nokia or MaxLinear. Mobile network operators constitute an obvious fourth group, notably Verizon, China Mobile or KT (Korea Telecom). And, finally, there are the device manufacturers, such as Apple, Sony or Samsung.

While the timeline to full scale 5G remains uncertain, a sense of emergency is now being felt by several countries, including the US, as telecom operators run out of capacity. 5G deployment has thus become a priority and while the road will unlikely be smooth, the opportunity is huge.

Chart of the Month

Global mobile data traffic on Smartphones (ExaBytes/Month)



Global Strategy

Tariff Man is Back... Game Of Threats Not Over Yet

- Trump’s trade rhetoric back in the spotlight – Louder *noise* but full-blown trade war unlikely
- Global economic growth slowdown underway – Dovish central banks to keep markets afloat
- Higher volatility is here to stay – Remain cautiously constructive with a balanced allocation

Notwithstanding recent volatility across financial markets, we are leaving our global macro scenario broadly unchanged. In particular, we stick to our constructive outlook for the remainder of the year as we do NOT anticipate a full-blown trade war at this stage despite the return of *Tariff Man* (i.e. Mr. Trump) with his new targets (e.g. Mexico). Moreover, the outcome of recent European elections was not as bad as feared by many. That said, in order to reflect revived concerns about the former, and its potential impact on world growth, we have slightly increased the probability of our downside – bear case – scenario. In effect, we are bracing ourselves for further equity volatility but keep a “foot in the market”, as we foresee only some near-term consolidation, not a sharp correction. From a global macro perspective, momentum continues to weaken across the board. But with improving economic surprises (in developed markets), solid consumer confidence data and increasingly supportive central banks, we do not anticipate a global recession.

At the portfolio level, we maintain *all-terrain* positioning, with a neutral allocation to equities, though at the lower end of the range (following the rebalancing carried out in early May) and still intending to take advantage of potential excessive pullbacks to add back risk opportunistically. Meanwhile, we keep our (slight) underweight in fixed income but continue to reinforce defenses through a higher quality & longer duration bucket. Finally, we remain positive on typical “safe havens” such as gold, the Swiss franc and the Japanese yen, which were among the (very) few assets to deliver positive returns last month. We believe the latter should continue to help us navigate this year’s winding roads more comfortably and hence remain an integral part of our balanced allocation.

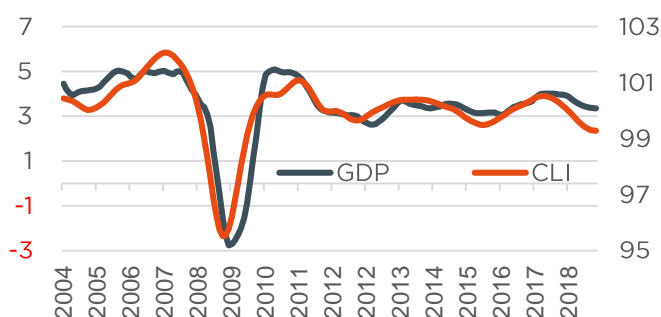
With the trade war fueling short-term volatility in equity markets without (yet) changing the overall scenario, our stance on equities remains neutral. We have, however, downgraded EM back to a slight underweight given the current macro overhang and continue to favor defensive quality markets such as Switzerland and the US. While having recently slightly trimmed our equity exposure after the strong start to the year, we stay cautiously constructive for the remainder of 2019. Valuations are not stretched and earnings momentum is improving. The revival of trade war concerns is healthily challenging investor complacency, reminding us that higher market volatility is here to stay as we navigate a low-visibility transition period. We stay calm for now.

In fixed income, we have further reduced our underweight by adding high quality bonds, on the back of recent dovish signals from major central banks and weakening global macro data. We still favor a barbell positioning combining safer US & EU government bonds with attractive EM debt carry (in hard and local currency) – while remaining cautious on credit for now.

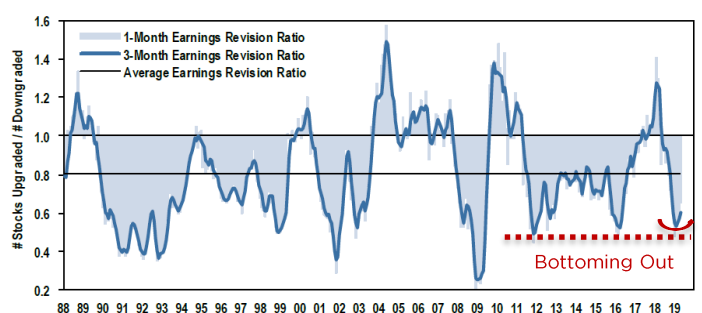
With FED & ECB monetary tightening on pause, we maintain our positive near-term view on the USD vs. EUR given the more attractive rate differential, stronger domestic economic momentum and political risk. Valuation, fundamentals (current account, fiscal deficit, debt to GDP) and positioning should, however, benefit the EUR medium-term. Until market visibility improves, we also recommend keeping exposure to CHF & JPY safe havens, as well as gold.

In alternatives, we upgraded our private markets positioning one notch further. Selective private equity & uncorrelated HF strategies (market neutral, arbitrage) remain our preferred plays.

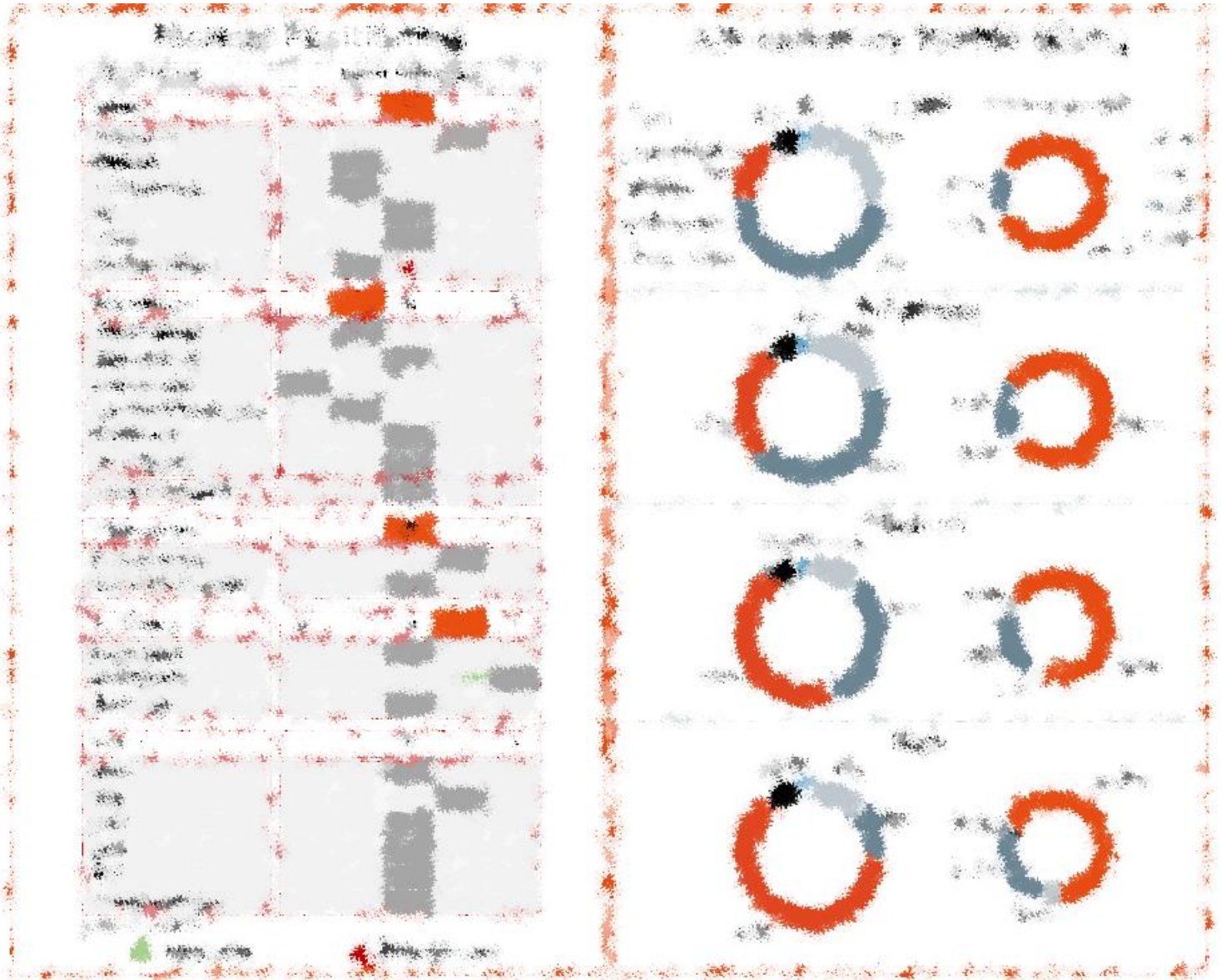
Global Composite Leading Indicators (CLI)



Global EPS Revision Ratios – Inflection Point



Asset Allocation



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Contacts

DECALIA Asset Management SA

31, rue du Rhône
Case postale 3182
CH - 1204 Genève

Tél. +41 22 989 89 89
Fax +41 22 310 44 27
info@decaliagroup.com

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External sources include: The Economist, Ericsson, OECD, Datastream, BofAML Research.

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