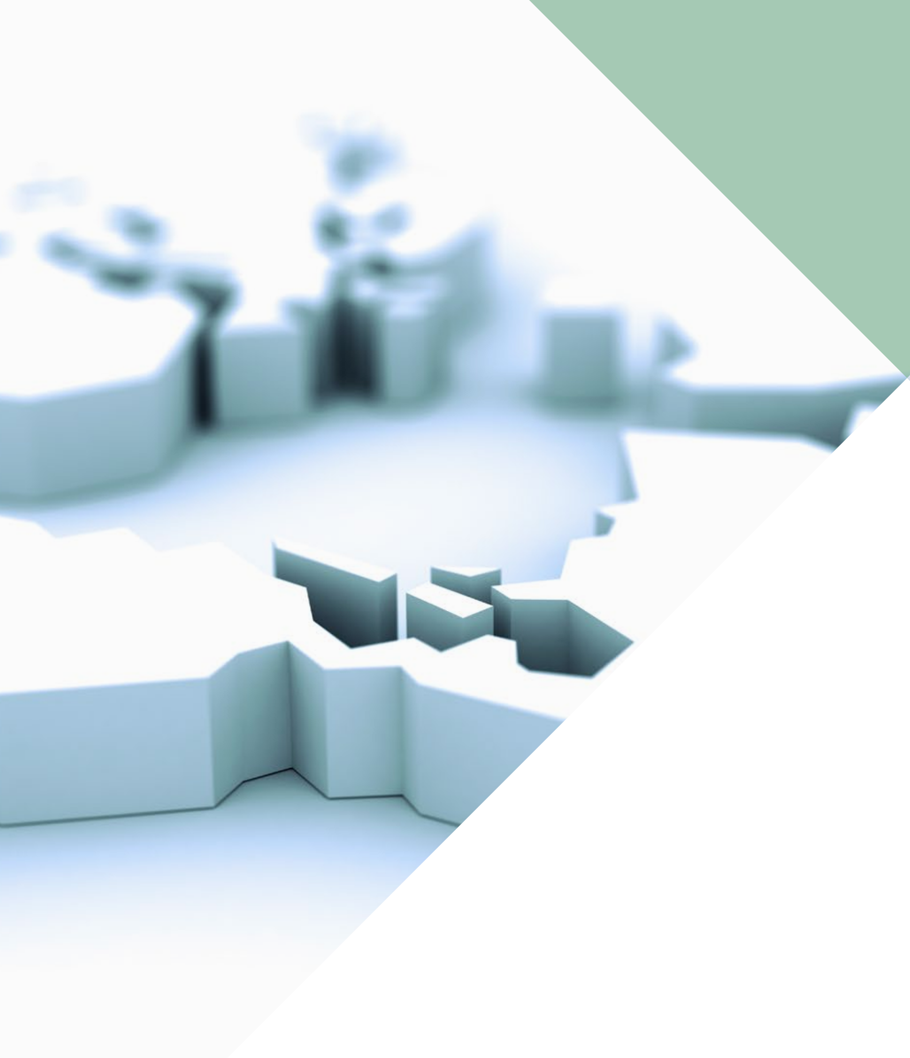


THE DRIVE YOU DEMAND

LOOKING BEYOND G-20

Spotlight

July 2019 | Global Investment Committee

UNION BANCAIRE PRIVÉE

Key points

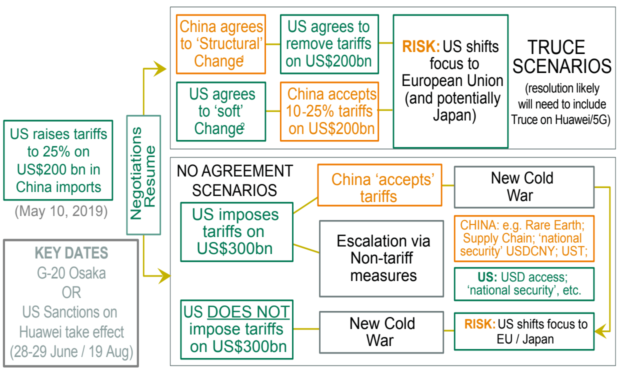
- *Despite 'as expected' reports following G-20, two important surprises emerged from the weekend.*
- *With the US having ceded some ground on Huawei, the 19 August deadline for implementation of US sanctions on the Chinese telecom giant may be less concerning for investors over the summer.*
- *In addition, a weekend announcement suggests the White House may be shifting to campaign mode with signals that the risk on fiscal policy may be favouring an expansionary surprise looking into 2020.*
- *Such a shift would complement the Fed pivot of May and, more importantly, potential fiscal-monetary coordination emerging in China, Japan and possibly the European Union.*
- *Potential re-emergence of global fiscal policy momentum may mitigate the ongoing geopolitical risks on the horizon, leaving valuation headwinds as our primary concern. We continue to believe 'asymmetric' risky asset exposure remains valuable for 2H19.*

Two surprises post G-20

Despite most reports focusing on the "as expected" restart to negotiations without additional new US tariffs following the Osaka G-20 meetings, the weekend still provided two important surprises as we enter the second half of 2019.

First, the US president appears to have ceded some ground on American sanctions against Huawei due to take effect on 19 August.

Chart 1. UBP US-China Trade War 'Decision Tree'



[1] China agrees to codify the US-China trade agreement into domestic Chinese law
[2] US accepts domestic enforcement in China will be via administrative means
Sources: BCA Research and UBP

We see US restrictions on Huawei which constrain access to the chips and technology the Chinese telecom giant needs for its market leading 5G base station business to be the key potential deal breaker in any renewed negotiations. Indeed, without concessions on this front, Chinese negotiators will find it hard to compromise on the comparatively less strategic issue of tariffs on trade between the two nations.

While the extent of the concessions offered by President Trump over the weekend are not yet clear, they appear to be sufficient at least to pave the way for negotiations to resume.

Secondly, press reports suggest that the White House will attempt to pursue a second round of tax cuts by adjusting the US capital gains tax by executive order, effectively bypassing the US Congress. Estimated to amount to US$100 billion over ten years, the amount clearly pales significantly in comparison with the most recent proposed Trump tax cut.

However, even with its more modest size and though unclear whether President Trump's attempt will survive a likely legal challenge from Democrats in the US Congress, the tax cut trial balloon may demonstrate future White House policy intent. In other words, the move may suggest that US fiscal policy risks are more decidedly pointed towards an expansionary surprise as we enter the formal campaign season for the 2020 US presidential elections.

If this happens in practice, it would complement the pivot in Fed policy following May's FOMC meeting. Such a US shift would add to the combined fiscal and monetary easing prospects emerging globally as we enter the second half of 2019 including in:

1. China, where we expect fiscal and monetary boosts in July.
2. Japan via either a delay in the scheduled September Japanese VAT increase or alternatively, a fiscal offset of the VAT hike that could provide fiscal impetus to the worlds' third largest economy as well, and
3. the euro area, where perhaps the most intriguing (and admittedly still speculative) potential for coincident fiscal-monetary stimulus exists. Additional monetary support has the potential to be matched by the convergence of political winds in France and Germany to bring more broad-based support for fiscal easing in the single currency area as European Union leadership positions are filled in the month ahead.

Asymmetric strategies and gold to benefit

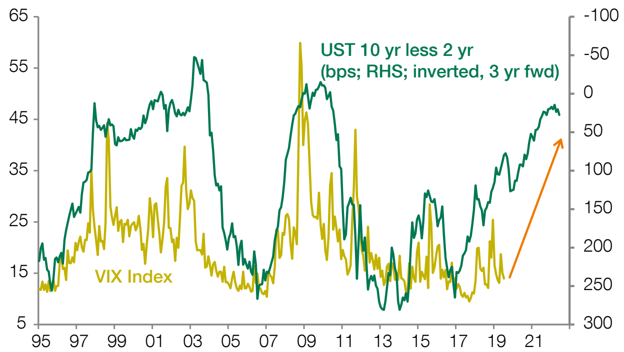
So, with economic and earnings data still looking worrisome, continued cautious sentiment among investors has been among the few glimmers of hope for more optimistic investors.

Now, the prospect of combined fiscal and monetary easing across major global economic blocs for the first time since 2009 could provide a potentially more durable catalyst to turn investor caution around, especially should valuation headwinds once again ease as they did in the market declines of May.

As a result, we continue to believe that investors can benefit from 'asymmetric' exposure to risky assets going into the second half of 2019.

In particular, with post-G20 volatility (chart 2) approaching March-April lows, the cost of protecting portfolios against May-style geopolitical shocks is increasingly attractive.

Chart 2. Volatility set to rise looking ahead



Sources: Bank of America Merrill Lynch, Chicago Board Options Exchange, Bloomberg Finance L.P. and UBP

The shift in volatility similarly presents opportunities like we saw over the summer of 2018 and again in April, 2019 to expand the use of partially capital protected structured product strategies. These strategies can help to contain downside potential in equity exposure within portfolios while allowing investors to continue to participate in any upside potential in equity markets which should arise in the event that fiscal momentum builds around the world.

Beyond this, we continue to use select long-short hedge fund strategies that have proven their ability to deliver similar 'asymmetric' exposure to market volatility. With China and China-related equities having borne the brunt of the trade-related concerns in markets, we see opportunities in the China long-short hedge fund arena to build exposure looking ahead.

Should fiscal stimulus emerge globally while at the same time global central banks are leaning towards an easing bias, we see an opportunity to make a tactical addition to existing gold positions within portfolios. The shift from tightening to easing removes the interest rate headwind that has plagued gold in recent years. Moreover, the US-easing bias in particular and the prospect of fiscal momentum in the eurozone may remove another key headwind for gold namely US dollar strength.

On balance, though global uncertainties remain elevated, the increasingly supportive policy backdrop suggests that investors should seek to participate in markets in a risk-managed way by exploiting 'asymmetric' opportunities afforded by markets in the current environment.

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