INVESTMENT COMMENT

August/September 2018

- **Sell-off in September?**

  U.S. companies may have delivered high earnings in Q2, but continued Fed tightening and deteriorating corporate balance sheets may be the last straw causing the proverbial camel's back to break. Additional funds have largely been used for share buybacks. This could turn into a toxic cocktail: more debt, higher interest rates, lower earnings due to an escalating (global) trade war and a Fed that continues to withdraw liquidity in the magnitude of USD 600bn per year. Easier comparisons from lower taxes would only benefit this year.

- **Trade War Clouds Prospects**

  Given that the U.S. imports about four times as much from China than China imports from the U.S., China may soon run out of goods to retaliate. This may force Beijing to look at U.S. companies that produce in China, whose value last year was almost double the amount imported from the U.S. (USD 250bn vs. USD 130bn). We are convinced, nevertheless, that both Mr. Trump and Mr. Xi would want a deal before the U.S. elections in November to appease their electorate.

- **China remains bumpy but here to stay**

  In Q2 2018, 47% of all global venture capital funding went to China. This marks the first time that China surpassed the U.S. in fundraising. After having spent another three weeks in Hong Kong, Shenzhen and Shanghai this past summer, I am even more convinced that not having significant exposure to Asia – and in particular to China – would be an allocation mistake. While at the moment China's weight in the MSCI Global Standard equity index is a mere 1% (compared with 53% for the U.S.), it is scheduled to be increased to 17% in the coming years. This implies that the current huge underweight by the global investment community in Chinese equities will be (partially) closed. When comparing the size of the two economies (U.S. 20tr. vs. China 12tr.) it is easy to see that even 17% does not do justice to the actual size and market cap of the awakening giant's economic prowess and changing self-awareness.

- **"Wall of Worry" weighs on Emerging Markets**

  High grade bonds and credit assets continue to be priced to perfection with negative or near zero yield. Sustained USD strength and worries about Argentina, Indonesia and South Africa could lead to contagion to all emerging markets. The recent implosions of the Argentinian peso and the Turkish Lira are a vivid reminder of the Tequila and Asian debt crisis some 20 years ago (triggered by leverage and overcapacity). While Argentina is working closely with the IMF to introduce reforms and raised short-term rates (to 60%!), Turkey is doing the exact opposite and did not raise rates despite record-high inflation of more than 15%. Pride seems to be preventing the Turkish president from seeking help from the IMF and he even appointed his son-in-law as finance minister. S&P lowered its credit rating on Turkey to B+. The Lira is already down 48% this year – the freefall was only stopped by policy changes on shorting, new tariffs on U.S. imports, and a USD 15bn investment pledge by Qatar.