LOMBARD ODIER
LOMBARD ODIER DARIER HENTSCH

Investment Strategy Bulletin

US-China trade talks: back to the drawing board and what it means for markets

Investment Solutions 1 July 2019

The G20 meeting between Xi and Trump has shown good intentions with the US and China coming back to the table and avoiding escalation, but we see no short-term resolution of the trade war. We maintain our current portfolio positioning.

On the positive side, the two sides have agreed to resume talks. The US has postponed its threat of additional tariffs on remaining Chinese goods worth roughly USD 325bn, and showed a willingness to ease restrictions on Huawei (although details are lacking for now). However, the existing tariffs will remain in place and there were no discussions about a process to remove them. How quickly talks can progress remains unclear, as the remaining issues proved the hardest to resolve in previous rounds.

Global trade flows are unlikely to recover materially as long as the existing measures remain in place and investment continues to suffer from uncertainty and lower business confidence. Any return to above-trend growth is questionable given the weakness in global trade, so the slowdown looks likely to persist over the coming months.

In this context, central banks – although limited in their influence on trade flows – will add to easing measures, looking to counter the slowdown. The Fed has effectively ended its tightening cycle, while the ECB eliminated the prospects of a rate hike before mid-2020 and has added accommodation via new TLTRO facilities. Both are likely to announce new measures in their upcoming meetings. In China, stimulus continues, while the PBoC has signaled that it is ready to boost growth. Several other central banks around the world have followed the example of the three majors and have shifted to easing, including Australia and New Zealand in the G10, as well as India and Russia in emerging markets.

In all, while the G-20 meeting did not result in a breakthrough, the two sides will come back to the table, averting the risk of a breakdown and renewed escalation. This puts us in the second scenario of our framework, where dialogue continues but a potential deal is postponed to late-2019 or even to 2020. While central banks will mitigate some of the uncertainty, a prolonged trade war makes a sharp recovery in the business cycle less likely.

Market impact and portfolio positioning

Investors are buying the trade war truce: Asian equity markets were supported by the news (CSI 300 +2.88%, Nikkei +2.13%, futures on S&P 500 +1.1% at the time of writing), while safe haven assets were generally trading lower (gold -1.4%, USDJPY up 0.4%). Yet, more importantly, the pricing of Fed cuts wasn't affected by the G20 outcome: a 25 bps cut in July is still fully priced-in (four cuts expected at a 12-month horizon). US Treasury yields are marginally higher across the curve (2-3bps). USD/CNY has grinded lower, trading now below 6.85.

The asset allocation decisions made over past few months – favouring carry strategies over equities while seeking diversification and hedges – reflected our expectations that this G20 meeting would not be a game changer. In this context, **we keep our current portfolio positioning unchanged**. More precisely, we think that the current relief rally should prove short-lived, as the weekend's announcements are unlikely to trigger a sustained global trade recovery.

In this respect, the coming earnings season will be important. We still expect mid-single digit earnings growth in 2019, close to the long-term average, but we continue to watch for signs of trade uncertainty impact on companies' CapEx and growth plans. Without additional support from declining bond yields (and the current market pricing for Fed cuts is already relatively aggressive in our view), **equity prices have limited upside from now on and will primarily be driven by earnings dynamics** (and the outlook on global trade as a result).

Important information: Please read the important information at the end of the document.
Publication of Lombard Odier – Contacts: Investment Solutions, investment-solutions@lombardodier.com
Data as of 1 July 2019 unless otherwise stated.

Supportive central banks are providing a counterbalance to trade uncertainty, against a background of slowing growth and low inflation, and we do not currently see catalysts for a meaningful increase in yields. **Hence our preference for carry strategies such as emerging market debt in local currencies, corporate bonds and real estate**.

While volatility is currently subdued, we should not be surprised if it rears its ugly head over the slow summer months. **We thus maintain the portfolio hedges (JPY and gold, mainly)**. More specifically, after an impressive rise in June (+8%), gold may suffer from profit taking in the coming days but we think that the rationale for holding it in a multi-asset portfolio is reinforced today. Indeed, as the hopes of a quick recovery in global trade fade, Fed cuts are now warranted, such that USD depreciation should continue (see below) and investors' search for alternatives to negatively yielding government bonds is here to stay. **We have accordingly revised our 12-month target up to USD 1400/oz**. In a geopolitical / financial stress scenario, we think that the USD 1500/oz mark may easily be reached.

Turning to the foreign exchange markets, we think it is useful to separate what we believe will be the near-term implications from the medium-term outlook.

As we recently discussed, the interplay between US yields and global growth expectations will be key to FX markets' direction.

The small uptick in US yields experienced this morning (and potentially, some further small upward moves in the next few days) may lend support to the USD, especially against reserve, safe-haven currencies such as the yen and the Swiss franc. Nevertheless, we believe that this is likely to be short-lived because the Xi-Trump truce still leaves a meaningful amount of uncertainty that may lead to Fed easing, and also because US growth is set to slow on the back of fading fiscal impulses.

At the same time, although the odds of a strong rebound in global activity remain small, by avoiding new tariffs, the chances of an outright global contraction are reduced.

Fundamentally, and looking beyond the FX markets' near-term reaction, we believe that the environment will be characterised by still low core yields, the Fed erring towards an easing cycle, and the fading probability of a global recession alongside some trade-related uncertainty.

In this respect, we stand by our call for (moderate) USD depreciation over the next few months. We expect small EURUSD gains (1.15 by year-end) and, once the dust settles, a resumption of USDJPY weakness given the likely Fed easing (JPY has exhibited a very high correlation with US yields), the maturity of the US business cycle and JPY undervaluation. That said, if this expectation of only a very small upward move in yields does not materialise, we stand ready to change our view and neutralise the short USDJPY position in our portfolios. GBP developments will largely be dictated by Brexit political headlines, which we see as sterling-negative over the next few months. In the meantime, we expect the recent strength of the Swiss franc to fade on the back of deeply negative rates and a dovish Swiss National Bank.

In emerging markets, we judge the G20 outcome as somewhat positive over the medium term because we believe investors will keep looking for yield. With a disaster scenario averted, we expect to turn gradually from neutral to constructive on emerging currencies. As long as our assumptions on US yields are right, we will opportunistically add to our EM FX overweight in our portfolios over the next few weeks. Finally, we expect CNY stability in the near term, and some appreciation against the US dollar by year-end.

As always, we continue to closely monitor future developments and will promptly communicate any change of views.

Samy Chaar, Chief Economist
Bill Papadakis, Macro Strategist
Carolina Moura Alves, Head of Asset Allocation
Sophie Chardon Cross-Asset Strategist
Vasileios Gkionakis, Global Head of FX Strategy

Important information
This is a marketing communication issued by Bank Lombard Odier & Co Ltd (hereinafter "Lombard Odier").
It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it aimed at any person or entity to whom it would be unlawful to address such a marketing communication.
This marketing communication is provided for information purposes only. It does not constitute an offer or a recommendation to subscribe, purchase, sell or hold any security or financial instrument. It contains the opinions of Lombard Odier, as at the date of issue. These opinions and the information contained herein do not take into account an individual's specific circumstances, objectives, or needs. No representation is made that any investment or strategy is suitable or appropriate to individual circumstances or that any investment or strategy constitutes personalised investment advice to any investor. Tax treatment depends on the individual circumstances of each person and may be subject to change in the future. Lombard Odier does not provide tax advice. Therefore, you must verify the above and all other information provided in the marketing communication or otherwise review it with your external tax advisors. Some investment products and services, including custody, may be subject to legal restrictions or may not be available worldwide on an unrestricted basis.
The information and analysis contained herein are based on sources considered reliable. Lombard Odier uses its best effort to ensure the timeliness, accuracy, and comprehensiveness of the information contained in this marketing communication. Nevertheless, all information and opinions as well as the prices, market valuations and calculations indicated herein may change without notice.
Investments are subject to a variety of risks. Before entering into any transaction, an investor should consult his/her investment advisor and, where necessary, obtain independent professional advice in respect of risks, as well as any legal, regulatory, credit, tax, and accounting consequences. **Past performance is no guarantee of current or future returns, and the investor may receive back less than he/she invested**. The value of any investment in a currency other than the base currency of a portfolio is subject to foreign exchange rate risk. Exchange rates may fluctuate and adversely affect the value of the investment when it is realised and converted back into the investor's base currency. The liquidity of an investment is subject to supply and demand. Some products may not have a well-established secondary market or in extreme market conditions may be difficult to value, resulting in price volatility and making it difficult to obtain a price to dispose of the asset.
European Union Members: This marketing communication has been approved for use by Lombard Odier (Europe) S.A. in Luxembourg and by each of its branches operating in the following territories: **Belgium:** Lombard Odier (Europe) S.A. Luxembourg • Belgium branch; **France:** Lombard Odier (Europe) S.A. • Succursale en France; **Italy:** Lombard Odier (Europe) S.A. • Italian Branch; **Spain:** Lombard Odier (Europe) S.A. • Sucursal en España; and **United Kingdom:** Lombard Odier (Europe) S.A. • UK Branch. Lombard Odier (Europe) S.A. is a credit institution authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.
Notice to investors in the United Kingdom: Lombard Odier (Europe) S.A. • UK Branch is authorised in the UK by the Prudential Regulation Authority (PRA) and is subject to limited regulation by the Financial Conduct Authority (FCA) and the PRA. **Details of the extent of our authorisation and regulation by the PRA/regulation by the FCA are available from us on request. UK regulation for the protection of retail clients in the UK and the compensation available under the UK Financial Services Compensation Scheme does not apply in respect of any investment or services provided by an overseas person.**
In addition, this marketing communication has also been approved for use by the following entity domiciled within the European Union: **Spain**: Lombard Odier Gestión (España) S.G.I.I.C., S.A.U., an investment management company authorised and regulated by the Comisión Nacional del Mercado de Valores (CNMV), Spain.
Panama: This marketing communication has been approved for use in Panamá by Lombard Odier (Panamá) Inc., an entity authorised and regulated by la Superintendencia del Mercado de Valores de Panamá. Licensed to operate as an Investment Adviser. Res. SMV No.528-2013.
Israel: This marketing communication has been approved for use in Israel by the Israel Representative Office of Bank Lombard Odier & Co Ltd, an entity not supervised by the Supervisor of Banks in the Bank of Israel, but by the Swiss Financial Market Supervisory Authority, which supervises the activities of Bank Lombard Odier & Co Ltd.
South Africa: This marketing communication has been approved for use in South Africa by the South Africa Representative Office of Bank Lombard Odier & Co Ltd, an authorised financial services provider. Registration number 48505.
Switzerland: This marketing communication has been approved for use in Switzerland by Bank Lombard Odier & Co Ltd, a bank and securities dealer authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).
United States: Neither this document nor any copy thereof may be sent to, taken into, or distributed in the United States of America, any of its territories or possessions or areas subject to its jurisdiction, or to or for the benefit of a United States Person. For this purpose, the term "United States Person" shall mean any citizen, national or resident of the United States of America, partnership organised or existing in any state, territory or possession of the United States of America, a corporation organised under the laws of the United States or of any state, territory or possession thereof, or any estate or trust that is subject to United States Federal income tax regardless of the source of its income.

SWITZERLAND

GENEVA
Bank Lombard Odier & Co Ltd[1]
Rue de la Corraterie 11 · 1204 Genève · Suisse
geneva@lombardodier.com
Lombard Odier Asset Management (Switzerland) SA
Avenue des Morgines 6 · 1213 Petit-Lancy · Suisse
Support-Client-LOIM@lombardodier.com
Management Company regulated by the FINMA.

FRIBOURG
Banque Lombard Odier & Cie SA · Bureau de Fribourg[1]
Rue de la Banque 3 · 1700 Fribourg · Suisse
fribourg@lombardodier.com

LAUSANNE
Bank Lombard Odier & Co Ltd[1]
Place St-François 11 · 1003 Lausanne · Suisse
lausanne@lombardodier.com

VEVEY
Banque Lombard Odier & Cie SA · Agence de Vevey[1]
Rue Jean-Jacques Rousseau 5 · 1800 Vevey · Suisse
vevey@lombardodier.com

ZURICH
Bank Lombard Odier & Co Ltd[1]
Utoschloss · Utoquai 29-31 · 8008 Zürich · Schweiz
zurich@lombardodier.com

EUROPE

BRUSSELS
Lombard Odier (Europe) S.A. Luxembourg · Belgium branch[2]
Avenue Louise 81 · Box 12 · 1050 Brussels · Belgium
brussels@lombardodier.com
Credit institution supervised in Belgium by the Banque nationale de Belgique (BNB) and the Financial Services and Markets Authority (FSMA).

LONDON
Lombard Odier (Europe) S.A.· UK Branch[2]
Queensberry House · 3 Old Burlington Street · London W1S 3AB · United Kingdom ·
london@lombardodier.com
The Bank is authorised and regulated in the UK by the Prudential Regulation Authority (PRA) and subject to limited regulation by the Financial Conduct Authority (FCA) and the PRA. Details of the extent of our authorisation and regulation by the PRA and regulation by the FCA are available from us on request. Registered in Luxembourg No. B169 907.
Lombard Odier Asset Management (Europe) Limited
Queensberry House · 3 Old Burlington Street · London W1S 3AB · United Kingdom ·
london@lombardodier.com
Investment firm authorised and regulated by the Financial Conduct Authority (FCA register No.515393).

LUXEMBOURG
Lombard Odier (Europe) S.A.
291, route d'Arlon · 1150 · Luxembourg · Luxembourg
luxembourg@lombardodier.com
Credit institution authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.
Lombard Odier Funds (Europe) S.A.
291, route d'Arlon · 1150 · Luxembourg · Luxembourg
luxembourg@lombardodier.com

MADRID
Lombard Odier (Europe) S.A. · Sucursal en España[2]
Paseo de la Castellana 66 · 4ª Pl. · 28046 Madrid · España · madrid@lombardodier.com
Credit institution supervised in Spain, by the Banco de España and the Comisión Nacional del Mercado de Valores (CNMV).
Lombard Odier Gestión (España) S.G.I.I.C, S.A.U.
Paseo de la Castellana 66, 4ª Pl. · 28046 Madrid · España · madrid@lombardodier.com
Management Company supervised by the Comisión Nacional del Mercado de Valores (CNMV).

MILAN
Lombard Odier (Europe) S.A. · Succursale in Italia[2]
Via Santa Margherita 6 · 20121 Milano · Italia
milano-cp@lombardodier.com
Credit institution supervised in Italy by the Commissione Nazionale per le Società e la Borsa (CONSOB) and la Banca d'Italia.

MOSCOW
Bank Lombard Odier & Co Ltd · Representative Office Moscow
Letnikovskaya st.2, bld.1 · 115114 Moscow · Russian Federation · moscow@lombardodier.com
Under the supervisory authority of the Central Bank of the Russian Federation.

PARIS
Lombard Odier (Europe) S.A. · Succursale en France[2]
8, rue Royale · 75008 Paris · France. RCS PARIS B 803 905 157 · paris@lombardodier.com
Credit institution supervised in France by the Autorité de contrôle prudentiel et de résolution (ACPR) and by the Autorité des Marchés Financiers (AMF) in respect of its investment services activities. Business permit No.23/12. Registered in Luxembourg - No.B169 907. Insurance intermediary authorised by the Commissariat aux Assurances (CAA) No.2014 CM002. The registration with the CAA can be verified at www.orias.fr.

AFRICA | AMERICAS | MIDDLE EAST

ABU-DHABI
Bank Lombard Odier & Co Ltd · Abu Dhabi Global Market Branch
Al Maryah Island · Abu Dhabi Global Market Square · Al Sila Tower · Abu Dhabi · abudhabi@lombardodier.com
Arranging Deals in Investments · Advising on Investment or Credit · Arranging Credit. Regulated by the ADGM Financial Services Regulatory Authority.

BERMUDA
Lombard Odier Trust (Bermuda) Limited
3rd Floor, Victoria Place · 31 Victoria Street · Hamilton HM 10 · Bermuda · bermuda@lombardodier.com
Licensed to conduct Trust, Investment and Corporate Service Provider Business by the Bermuda Monetary Authority.

DUBAI
Bank Lombard Odier & Co Ltd · Representative Office Dubai
Conrad Business Tower · 12th Floor · Sheikh Zayed Road · P.O. Box 212240 · Dubai · UAE ·
dubai@lombardodier.com
Under the supervisory authority of the Central Bank of the UAE.

ISRAEL
Israel Representative Office · Bank Lombard Odier & Co Ltd
Alrov Tower 11th floor · 46 Rothschild Blvd. · Tel Aviv 6688312 · Israel · telaviv@lombardodier.com
Not supervised by the Supervisor of Banks in the Bank of Israel, but by Swiss Financial Market Supervisory Authority which supervises the activities of Bank Lombard Odier & Co Ltd.

JOHANNESBURG
South Africa Representative Office · Bank Lombard Odier & Co Ltd
140 West Street · Sandton · Johannesburg 2196 · South Africa
johannesburg@lombardodier.com
Authorised financial services provider Registration number 48505.

MONTEVIDEO
Lombard Odier (Uruguay) SA
Luis Alberto de Herrera · Torre 2 · Oficina 2305
11300 Montevideo · Uruguay
montevideo@lombardodier.com
Supervised by Banco Central del Uruguay.

NASSAU
Lombard Odier & Cie (Bahamas) Limited
Goodman's Bay Corporate Centre · West Bay Street · P.O. Box N-4938 · Nassau · Bahamas · nassau@lombardodier.com
Supervised by the Central Bank of the Bahamas and the Securities Commission of the Bahamas.

PANAMA
Lombard Odier & Cie (Bahamas) Limited · Representative Office in Panama
Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com
Supervised by the Central Bank of the Bahamas and the Superintendencia de Bancos de Panamá.
Lombard Odier (Panama) Inc.
Oceania Business Plaza Torre 2000 · Oficina 38-D · Blvd. Pacifica · Urb. Punta Pacifica · Corregimiento de San Francisco · Panamá · panama@lombardodier.com
Supervised by the Superintendencia del Mercado de valores de Panamá. Licensed to operate as an Investment Adviser. Res. SMV No.528-2013.

ASIA - PACIFIC

HONG KONG
Lombard Odier (Hong Kong) Limited
3901, Two Exchange Square · 8 Connaught Place · Central · Hong Kong · hongkong@lombardodier.com
A licensed entity regulated and supervised by the Securities and Futures Commission in Hong Kong.

SINGAPORE
Lombard Odier (Singapore) Ltd.
9 Raffles Place · Republic Plaza #46-02 · Singapore 048619 · singapore@lombardodier.com
A merchant bank regulated and supervised by the Monetary Authority of Singapore.

TOKYO
Lombard Odier Trust (Japan) Limited
Izumi Garden Tower 41F · 1-6-1 Roppongi, Minato-ku · Tokyo 106-6041 · Japan · tokyo@lombardodier.com
Regulated and supervised by the Financial Services Agency (FSA) in Japan. It holds a trust business license (FSA No.208) and is registered with Kanto Local Finance Bureau for Financial Instruments Business Operator (No.470).

1 Private bank and securities dealer authorised and regulated by the Swiss Financial Market Supervisory Authority (FINMA).

2 Branch of Lombard Odier (Europe) S.A., a credit institution based in Luxembourg, authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg.

06.2019