

# Baer Necessities

November 2019

## Perspectives for Strategic Asset Allocation

### Observations, Markets & News

Are a weak US dollar and strong Emerging Markets (EM) the trends of 2020? - The likelihood for a weaker US dollar has increased due to:

- 1) the Fed's mini-QE of USD60bn per month;
- 2) US rate cuts are more likely than other central banks;
- 3) no-deal Brexit risk has receded, supporting GBP and EUR;
- 4) likely trade deal with China;
- 5) rising odds that Elizabeth Warren will win the Democratic nomination, and her policies are dollar-negative

Meanwhile, EM benefit from fiscal, regulatory and monetary stimulus. A weak US dollar is usually good news for EM. The new Chinese stimulus is positive for EM, not only in Asia. Market friendly changes are underway in several countries. These include fiscal reforms (Brazil, India), structural regulatory changes (Brazil, India, Indonesia), or interest rate cuts (India, Indonesia, Russia and others to follow).

### Economies & Monetary Policies

Ongoing strength in consumer spending in the USA has so far helped to offset weakness in manufacturing.

The current situation for sovereigns was compared to Prince Rupert's Drop<sup>i</sup> ("larme de verre"), in that what is perceived as a strong, balanced system one day could blow up the next.<sup>ii</sup>

### Politics

A trade deal between the US and China is likely signed in November. Trump needs a quick deal. There is mounting evidence of the impact the trade war has had on US manufacturing, agricultural incomes and business confidence. Additional tariffs could severely damage re-election chances.

Trump's impulsive actions and amateur deal making are devoid of plan, process and historical knowledge. His erratic behavior is a permanent tail risk to financial markets.

### Equities

We remain positive on equities with a preference for US stocks, as we have been since January. Q3 earnings season has overall been above expectations with positive forecasts.

Many 10yr government bond yields have fallen to less than 1%, and this means the stock market remains relatively good value. Falling bond yields obviously herald weak economic growth. Concentrate long exposures in stocks that are not dependent on economic growth. But trees do not grow to the sky. Let us keep this in mind.

Themes and sectors we like include Ageing Population, Digital or Cyber Security, Digitization, Automation & Robotics, Artificial

Intelligence & Big Data, Water, and Biotechnology. Note though, sectors with wider dispersion require active managers.

### Fixed Income & Credit

Yields on so many sovereign bonds do not reflect the inherent risks. Remain underweight credit and expect a rising default rate, particularly among high yielding debt.

The world has gone bananas: Greek debt offers negative yield. Investors pay for the right to own Greek debt.<sup>iii</sup> Greece is rated B by Fitch and by S & P, has a debt-to-GDP ratio of 182%, a youth unemployment of 40%, and its nominal GDP has shrunk by 23% in the past decade. Greece has defaulted eight times and has been in default for 90 of the past 200 years.

### Emerging Markets Currencies & Debt

Differentiation among EM is key in all asset classes. Favor countries that are pursuing integrationist policies. Active strategies should outperform passive ETF's.

Hong Kong has fallen into recession, hit by more than five months of anti-government protests that show no signs of relenting. - A bail-out is unlikely, which could mean a permanent change for Hong Kong's status.

### Commodities

Precious Metals remain a complementary asset class to equities. The small negative carry from holding physical gold is still better than the negative sovereign yields.

We remain bullish on Precious Metals as we have been since January because of an overall supply/demand imbalance. Gold could be the harbinger of bad news in the sovereign debt markets. See comments by the Dutch central bank below.<sup>iv</sup>

### Asset Allocation

Geopolitical and macro uncertainties create opportunities for agile speculators investing long and short. This is a time to add active strategies with uncorrelated returns and convexity.

Overweight equities vs. fixed income. Stick to liquid asset classes to stay flexible and nimble without opportunity costs since the premium for lack of liquidity has been eroded.

We are amidst a megatrend of technological disruption. As the world goes digital overweight the disrupters. In sector allocation, consider healthcare, biotech and technology.

Hold Precious Metals.

Roland Eberhard  
November 1, 2019<sup>v</sup>

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<sup>i</sup> Equinox Partners

<sup>ii</sup> Wikipedia: "Prince Rupert's Drops (also known as Dutch tears) are toughened glass beads created by dripping molten glass into cold water, which causes it to solidify into a tadpole-shaped droplet with a long, thin tail. These droplets are characterized internally by very high residual stresses, which give rise to counter-intuitive properties, such as the ability to withstand a blow from a hammer or a bullet on the bulbous end without breaking, while exhibiting explosive disintegration if the tail end is even slightly damaged. In nature, similar structures are produced under certain conditions in volcanic lava.

The drops are named after Prince Rupert of the Rhine, who brought them to England in 1660, although they were reportedly being produced in the Netherlands earlier in the 17th century and had probably been known to glassmakers for much longer. They were studied as scientific curiosities by the Royal Society and the unravelling of the principles of their unusual properties probably led to the development of the process for the production of toughened glass, patented in 1874."

<sup>iii</sup> see also: 'Even Greece Is Getting Paid to Borrow Money in Debt Markets', Michael Hunter, Bloomberg, October 9, 2019; <https://www.bloomberg.com/news/articles/2019-10-09/greece-draws-negative-yield-for-first-time-in-3-month-bill-sale>

<sup>iv</sup> The Dutch Central Bank, known as De Nederlandsche Bank (DNB), wrote on October 15, 2019 that gold would be indispensable in the event of a fiat meltdown. The Central Bank writes: "Gold is the perfect piggy bank – it's the anchor of trust for the financial system. If the system collapses, the gold stock can serve as a basis to build it up again. Gold bolsters confidence in the stability of the central bank's balance sheet and creates a sense of security."

see also:

<https://www.dnb.nl/en/payments/goud/index.jsp#>

<https://www.dnb.nl/en/news/dnb-publications/financial-stability-report/dnb385947.jsp>

<https://www.dnb.nl/en/news/news-and-archive/Nieuws2019/dnb385962.jsp>

<sup>v</sup> **Disclaimer:** This document is for information purposes only. It constitutes neither an offer nor a recommendation to purchase, hold or sell financial instruments or banking services, and does not release the recipient from carrying out their own assessment. The recipient is recommended in particular to check the information in terms of its compatibility with their own circumstances and its legal, regulatory, tax and other consequences, possibly on the advice of a consultant. The data and information contained in this publication were prepared by MBaer Merchant Bank AG with the utmost care. However, MBaer Merchant Bank AG does not assume any liability for the correctness, completeness, reliability or topicality, or any liability for losses resulting from the use of this information. This document may not be reproduced in whole or in part without the written permission of MBaer Merchant Bank AG.

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