MAERKI BAUMANN & CO. AG

PRIVATBANK

# Geopolitics, (cheaper) money and gold

Market Comment, July 2019

**A number of traditional "safe haven" investments such as gold have racked up price gains in recent weeks. US Treasuries, the Japanese yen and the Swiss franc have likewise been in vogue with investors against a backdrop of increasing uncertainties. In our view, broad diversification across all asset classes makes sense given the various unresolved geopolitical rivalries and tensions. A dialogue is a fine thing, but it is not the same as a deal – the geopolitical rivalry between the US and China remains very much in place after the G20 summit in Osaka, as do the simmering tensions between Iran and the US.**

The rise in the price of gold, which has been evident for quite some time now – along with increases in the value of other investment "safe havens" such as the Swiss franc, the Japanese yen and US government bonds – begs the question of what the common denominator of all these movements is. We see two underlying causes: the general rise in geopolitical risks worldwide, and the market's expectations of significantly declining US interest rates.

But let's start by going back to the start of the millennium. When China joined the World Trade Organization in 2001, it kick-started the trend of outsourcing the production of industrial and consumer goods from Western countries (particularly the US) to China, for reasons of cost efficiency. The benefits were plain to see: an increase in corporate earnings on the back of surging profit margins thanks to a huge reduction in production costs. As a logical consequence, global equity prices have risen strongly since 2001. But the drawbacks have only come to the fore recently – firstly, the increasing dependency of global manufacturing and supply chains on China, and secondly, the increasingly problematic transfer of technological expertise from the US to China. The first of these phenomena has boosted the popularity of nationalist politicians all around the world, a trend apparent not just in the US, but also in Asia and Europe. This in turn has helped to undermine the stability of the geopolitical situation. More nationalist tendencies are evident in Europe in particular. This much can be seen not just in the enormous popularity of the fledgling Brexit party in the European elections, but also in the growing support for Salvini's League party in Italy. What's more, European geopolitical stability is currently overestimated: A "hard" exit of the UK from the EU is a very real possibility, and one that would affect not just the UK economy but also – via the exports of other European countries to the UK – Europe itself, including Switzerland.

Where China is concerned, the dependency of global production on China (and by extension on the Chinese government) for consumer goods in particular, but also for technology products via supply chains, is as great as it has ever been. This has consequences.

> "The rivalry between the US and China is not about to go away – a dialogue is not the same as a deal."
>
> Gérard Piasko, Chief Investment Officer

The US government feels it must not just push back against China's increasing technological ambitions for military reasons, but also counter Beijing's more aggressive Asian and wider foreign policy thrust (cf. latest developments in Hong Kong) in order to prevent China carving out too powerful a geopolitical role. While it is true that after the G20 summit in Osaka trade discussions between the US and China resume, it cannot be said that any real agreement was reached. The negotiating positions of the US and China, with the latter determined to maintain its geopolitical ambitions as well as its "Made in China 2025" technology agenda, remain far apart.

A dialogue is not the same thing as a deal – the geopolitical rivalry between these two superpowers is not about to go away. At the same time, geopolitical tensions between the US and Russia have also failed to be resolved. Far from it – the escalating conflict between the US and Iran, which enjoys Russian support (as seen in the civil war in Syria), is becoming ever more dangerous. A belligerent Iran has acquired enormous geopolitical significance in recent years, influencing events from the Lebanon to Pakistan in the east.

At the same time, Iran is creeping ever closer to the point where it will have a sufficient supply of enriched uranium to make nuclear weapons. Indeed, experts believe it will attain this capability within the next year. As a compounding factor, Iran is becoming politically more aggressive as the US sanctions continue to bite, as evidenced in the attacks on international oil tankers in the Persian Gulf over the last few weeks. Some 30–35% of all global maritime oil trade is reliant on passage through the Strait of Hormuz, which is bordered on one side by the Iranian coast. Iran has clear potential to do damage to the global economy here through mine or rocket attacks. However, such a development would affect not so much the US itself, but above all Asia, which is the main recipient of oil transported through the Strait of Hormuz.

What are the consequences of all this? The world's key central banks are observing the increasing economic risks from the various geopolitical conflicts and showing a willingness to once again loosen monetary policy should this prove necessary. But financial markets are anticipatory by nature, and have already priced in multiple interest rate cuts as well as bouts of quantitative easing. The equity markets in particular appear to been eager to embrace an optimistic outlook, with realism surely a more appropriate response in view of the stubborn persistence of economic risks.

All in all, we take the view that diversification across all asset classes remains the most expedient approach against a backdrop of increasing geopolitical rivalries and risks. This means that bonds – and in particular those of financially robust countries – very much justify their inclusion in asset allocation, while gold and other commodities such as oil also have a diversifying role to play in a world characterized by heightened geopolitical risk.

Gérard Piasko

Gérard Piasko is CIO and head of the investment committee of private bank Maerki Baumann & Co. AG. Before he was for many years CIO of Julius Baer, Sal. Oppenheim and Deutsche Bank.

**Modular investments with Maerki Baumann**

The topics of the current market comment concern tollowing focus modules:

| | | | |
|---|---|---|---|
| Equities Switzerland | Equities USA | Bonds CHF | Global Balanced |
| Small & Mid Caps Switzerland | Equities Emerging Markets | Bonds EUR | Commodities |
| Equities Eurozone | Equities Global | Bonds USD | |
| Equities Germany | | Bonds Emerging Markets | |

Please contact your client advisor for further information or visit our website.
www.maerki-baumann.ch/modular-investments



Editorial deadline: 5 July 2019

Maerki Baumann & Co. AG
Dreikönigstrasse 6, CH-8002 Zurich
T +41 44 286 25 25, info@maerki-baumann.ch
www.maerki-baumann.ch