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Monthly Insights

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Handling Disappointment Right

- Analysts now predict earnings of S&P 500 will shrink by 2.8% last quarter. The litmus test isn't perfunctory. So what's the plan?
- Don't freak out. Poor expectation, in and of itself, shouldn't be frowned upon, as it too often is. It might be a blessing in disguise. Trust, but verify.
- One step at a time. Prof. Daniel Kahneman, the Nobel economics laureate in economics, has long highlighted that the essence of investing comes down to regret minimization. We should adjust our portfolios in baby steps. Take time to bring it about.
- Luck favours the prepared. Keep a watch list of companies you'd really like to own. Early on. Compound interest is, as coined by Einstein, "the eighth wonder of the world."
- Float like a butterfly. If nothing keeps your blood pressure down and enables you to sleep at night, opt for index funds. Being heroically wrong is no substitute for being right. Let someone else be surprised.



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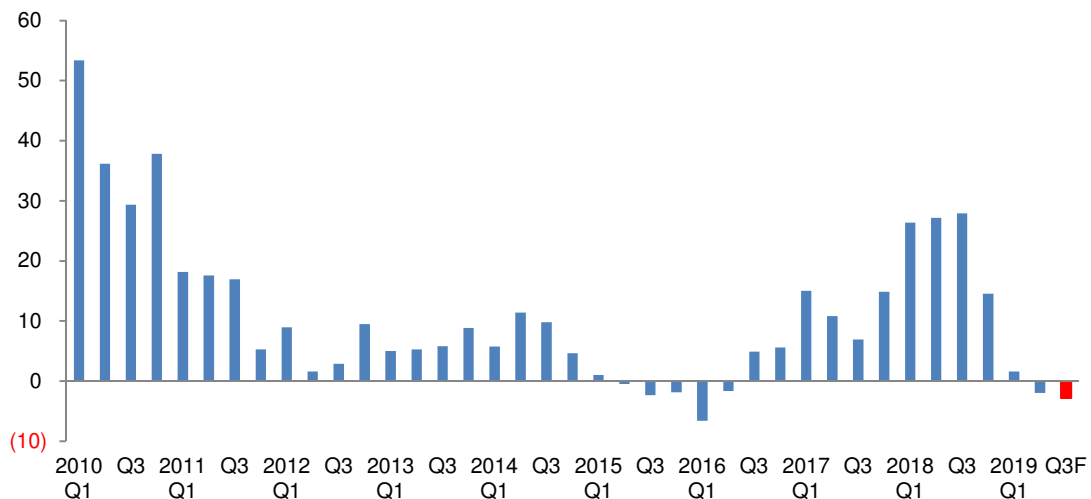
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Theme Article

The lack of news bullets features the serenity of the summer sessions. Over the past two weeks, our sole obligation is to repeat our well-worn view on the Fed. Keeping only one plate spinning at a time, complaining in any kind is a sin.

But our days to bask under the sun are numbered. We are living in a Newtonian world that every action has an opposite force. The summer tranquility set us up for a turmoil. Now, the earnings season begins in earnest, an unrecognizable vista is going to open up before our eyes. Analysts predict earnings of S&P 500 will shrink by 2.8% last quarter (Exhibit 1). The first earnings recession since 2015, if materializes, feels like a hot stone in stomach. The litmus test isn't perfunctory.

Exhibit 1: S&P 500 Earnings Per Share (% YoY)



Source: FactSet, Bloomberg, Shanghai Commercial Bank

In a nutshell, we shall cash in all our chips. Before panic sets in, it's worth learning that stocks are expensive for a reason. Shall we plow extra money to buy dips if stocks go on sale? What's the plan?

Planning is everything

Let's be honest with ourselves: economists are not and never will be the go-to person when it comes to time the market. Luckily, we don't have to. To borrow from Dwight D. Eisenhower, supreme Commander for the Allied forces during World War II, "plans are worthless, but planning is everything." Here's what we think about planning:

Don't freak out. How much profit the company ekes out, as we were told, moves the needle. Don't fall for that. Barring a widespread intellectual laziness, expectation should be "priced in". Or simply put, relative profit performance to expectation is the only thing matters.

Poor expectation shouldn't be frowned upon, as it too often is. Indeed, it might be a blessing in disguise. Stocks would look like bargains if a string of disappointments reverses. The wisdom can be summed up by a Russian proverb: Trust, but verify.

One step at a time. Prof. Daniel Kahneman, the Nobel economics laureate in economics, has long highlighted that the essence of investing comes down to two words: regret minimization.

Kahneman's insight calls our hasty decisions into question: the more drastic steps you take, the more likely missteps occur and you are to regard them as mistakes afterward. What's the bottom line? We should adjust our portfolios in baby steps. Take time to bring it about. Let's put our cards on the table here: You should trim your risky asset holdings by a few percentage points every month, if necessary; or sell your cyclical stocks and put the proceeds in defensive shares, instead of stashing cash under your mattress.

Luck favours the prepared. What is the secret to Warren Buffett's success? Stock-picking ability almost tops everyone's minds. Lesser known is his mind-boggling investment horizon. The Oracle of Omaha owned his first stock when he was 11 years old. Compound interest is, as coined by Einstein, "the eighth wonder of the world."

Admittedly, merely telling a procrastinator to act is like telling someone to calm down in a rowdy discussion. It doesn't work. "Know thyself" is, after all, Socrates' challenge. Keep a watch list of companies you'd really like to own. Early on.

Float like a butterfly. As boxing legend Mike Tyson observed, "everybody has a plan until they get punched in the mouth." If nothing keeps your blood pressure down and enables you to sleep at night, opt for index funds. Being heroically wrong is no substitute for being right. Let someone else be surprised.



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UK

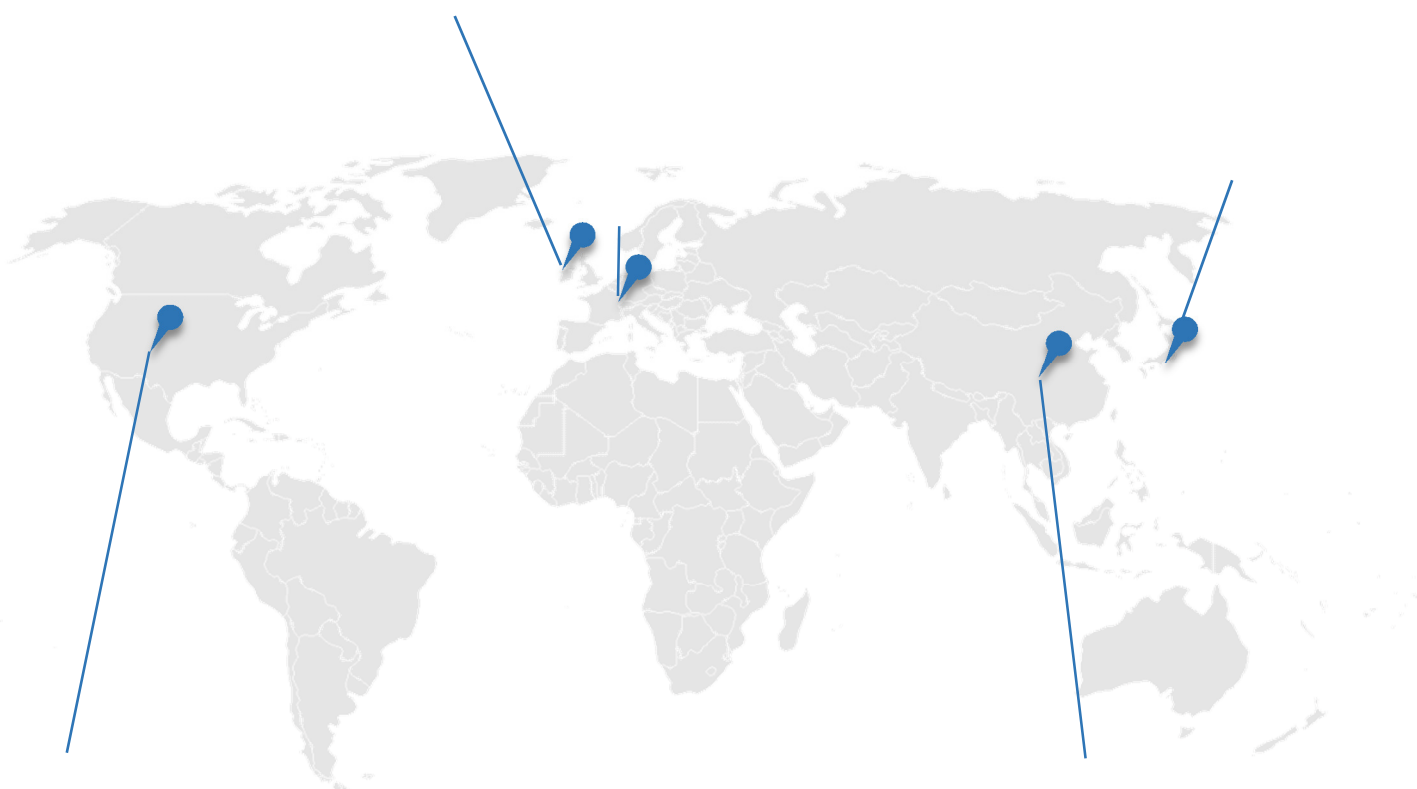
The UK may escape contraction in Q2 marginally, but a no-deal Brexit left business demonstrably nervous. It takes much more to win the hearts and minds of investors.

EU

More issues added to its already burgeoning list of threats: the Airbus-Boeing subsidy dispute, potential tariffs on autos, a no-deal Brexit, and Italian debt dilemma etc. Little hope for a pick-up in growth.

Japan

The Japanese economy is crawling along at a slow pace. It looks increasingly likely that a fiscal boost will be rolled out in the autumn.



US

The household sector is healthy. The caveat is that the diminished inflation expectations is getting cemented. A preemptive rate cut can help get inflation anticipation back on track.

Mainland China

June figures are generally surprised to the upside. It was, however, largely a result of car dealers attempt to liquidate their inventories ahead of new emission standards come into effect and favourable base effect. Akin to the blip of a recovery in March, we are less sure about its sustainability.



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Foreign Exchange Outlook

 USD	<p>Overweight</p> <p>Neutral</p> <p>Underweight</p> 	<p>In spite of an uneventful G20 meeting, the blowout job report tempered expectations of Fed rate cuts. Carry trade is starting to be instated. The upside for dollar is limited however, as long as corporate earnings remained on a soft footing.</p>
 EUR	<p>Overweight</p> <p>Neutral</p> <p>Underweight</p> 	<p>The ECB comes under pressure to act shortly amid disappointing data. Besides, Lagarde's candidacy for ECB chief points to an extension of Draghi's dovish approach. It will take deeper US rate cuts to push the euro higher. Which is a high hurdle. It feels like market still wants to be short.</p>
 GBP	<p>Overweight</p> <p>Neutral</p> <p>Underweight</p> 	<p>The threat of a "no-deal" Brexit is hair-raising. Leading contestants for Conservative leaderships are keen to flaunt their "no-deal" credentials. In any event, this tail risk is unlikely to wane and the pound will remain as the outcast. We're inclined to add shorts around 1.2560.</p>
 RMB	<p>Overweight</p> <p>Neutral</p> <p>Underweight</p> 	<p>Uncertainty still abounds as the US-China trade war grinds on unresolved. The disagreement between the two countries remains too wide for a deal. Trump's saber-rattling provides no excuse to let one's guard down. USD/CNH will likely hover near 6.9 in thin summer markets.</p>
 JPY	<p>Overweight</p> <p>Neutral</p> <p>Underweight</p> 	<p>Nothing much to report from the JPY seat. This leaves the yen to move at the whim of risk sentiment and US Treasury yields. Overall, it feels like that this uninspiring range play will continue.</p>
 AUD	<p>Overweight</p> <p>Neutral</p> <p>Underweight</p> 	<p>Apparently, investors are not gung-ho on running for the hills with the Aussie. It doesn't catch us off guard though, given its dovish monetary backdrop and material headline risk in US-China trade talk. Investors will remain embroiled in a wait and see game.</p>
 NZD	<p>Overweight</p> <p>Neutral</p> <p>Underweight</p> 	<p>As another whipping boy for the trade war, the Kiwi got beaten. Considering its relatively stretched valuation following its recent rally, the Kiwi is on higher alert.</p>

■ >1% within 3 months
■ +/-1% within 3 months
■ <1% within 3 months

Table 1: GDP Growth and Rates Forecasts

	GDP growth (% YoY)				Key policy rate (% yearend)			
	2016	2017	2018	2019F	2016	2017	2018	2019F
US	1.6	2.2	2.9	1.8	0.50-0.75	1.25-1.50	2.25-2.50	2.25-2.50
Eurozone	2.0	2.4	1.8	1.4	0.00	0.00	0.00	0.00
UK	1.8	1.8	1.4	1.3	0.25	0.50	0.75	0.75
Japan	0.6	1.9	0.8	0.8	0-0.10	0-0.10	0-0.10	0-0.10
China*	6.7	6.9	6.6	6.2	4.35	4.35	4.35	4.35
Hong Kong^	1.9	3.8	3.5	2.0	5.00	5.00	5.125	5.125

*1-year lending rate, ^Prime rate

Source: Bloomberg, Shanghai Commercial Bank

Table 2: Foreign Exchange Outlook

	Yearend target		
	Current	2019F	2020F
EUR/USD	1.12	1.15	1.14
GBP/USD	1.24	1.26	1.31
USD/JPY	108	108	103
USD/CNH	6.88	6.85	7.00
AUD/USD	0.70	0.70	0.67
NZD/USD	0.67	0.66	0.63

Source: Bloomberg, Shanghai Commercial Bank

Table 3: Implied Volatility (At-the-money)

	1-month		3-month		1-year	
	Value	Monthly Change	Value	Monthly Change	Value	Monthly Change
EUR/USD	4.97	-4.0%	5.00	-4.5%	5.86	-4.0%
GBP/USD	6.56	+4.8%	8.67	+24.3%	9.37	-3.0%
USD/JPY	5.90	-2.7%	5.95	-4.7%	6.52	-6.4%
USD/CNH	3.38	-35.0%	3.70	-28.9%	4.44	-22.5%
AUD/USD	6.62	-6.0%	6.74	-7.5%	7.62	-8.0%
NZD/USD	7.06	-9.3%	7.16	-6.90%	7.98	-7.0%

Source: Bloomberg, Shanghai Commercial Bank

Table 4: Strategy Performance Summary

Date		Key recommendations	Entry level*	Ex post performance (1-month)			
				Low	High	Period-end level	1-month return
5-Jul-19	10:10	The theme of (HKD) normalisation will unfold yet again	7.7900	7.7883	7.8290	7.8147	0.3%
4-Jun-19	17:30	We see little value in chasing the AUD higher	0.6980	0.6833	0.7048	0.7021	-0.6%
22-May-19	15:50	The pound will test lower levels in the short run	1.2676	1.2512	1.2759	1.2723	-0.4%
8-May-19	14:15	The idea of sell (AUD) in May still looks appealing to us	0.7023	0.6865	0.7023	0.7000	0.3%
2-May-19	11:00	Dollar spike is more than flashes in the pan	97.60	97.04	98.13	97.76	0.2%
29-Apr-19	10:00	The BoC might deliver something for bears to get their teeth into	1.3458	1.3378	1.3505	1.3488	0.2%
9-Apr-19	19:00	It could take weeks for the USD/HKD to revert back to 7.85	7.8423	7.8324	7.8494	7.8483	0.1%
21-Mar-19	10:50	Playing the high-carry USD from the long side	95.88	95.74	97.52	97.39	1.6%
13-Mar-19	10:20	The resolution in sight warrants holding a GBP long position	1.3084	1.3081	1.3381	1.3090	0.0%
8-Mar-19	10:35	EUR/JPY is a cleaner expression of the EUR-bearish view	124.86	123.85	127.45	124.99	-0.1%
19-Feb-19	9:10	Underweighting the dollar and staying nimble	96.83	96.29	97.71	96.48	0.4%
12-Feb-19	9:10	For HKD bear, it is the Trojan horse you want to smuggle in	7.8470	7.8470	7.8500	7.8500	0.0%
31-Jan-19	10:40	The USD will going on struggling	95.26	95.16	97.16	96.06	-0.8%
30-Jan-19	10:10	We have interest in chasing GBP higher	1.3094	1.2779	1.3335	1.3293	1.5%
16-Jan-19	11:20	The GBP remains a buy-in-dip play	1.2845	1.2839	1.3217	1.2905	0.5%
12-Dec-18	10:30	Fate will smile upon the GBP once again next year	1.2513	1.2473	1.2862	1.2844	2.6%
14-Nov-18	11:00	We prefer to sell the EUR into rallies	1.1304	1.1263	1.1437	1.136	-0.5%
14-Nov-18	11:00	We prefer to sell the GBP into rallies	1.3010	1.2485	1.307	1.2627	3.0%
9-Nov-18	10:30	The resurgence of the USD will continue	96.7	96.08	97.7	96.7	0.0%
8-Oct-18	11:20	USD/CNY remains a buy-in-dip play	6.9036	6.8725	6.9769	6.9320	0.4%
3-Oct-18	16:30	A re-test of the lows (for EUR) around 1.1450 is on the radar	1.157	1.1306	1.1617	1.14	1.5%
21-Sep-18	15:00	USD/HKD to hit 7.83 in October	7.8100	7.8033	7.8423	7.8423	0.4%
13-Sep-18	9:50	We prefer to trade GBP on the long side	1.2960	1.2927	1.3294	1.3168	1.6%
30-Aug-18	12:30	A re-test of the 1.30 handle could be on the cards	1.2920	1.2892	1.3224	1.293	0.1%
27-Aug-18	17:00	The fragile political backdrop remains a cause of concern for holding AUD	0.7320	0.7088	0.7362	0.7230	1.2%
23-Aug-18	11:00	The USD will feel bid once again	95.3	93.84	95.71	94.2	-1.2%
15-Aug-18	11:00	JPY won't be our first choice to seek asylum	111.3	109.84	112.14	112	0.6%
*Entry level recorded at the time of publication, if not stated otherwise				Total return		13.1%	
^Citi Parker Global Currency Manager Index				Benchmark return^		-3.9%	
				Hit ratio		76.9%	

Source: Shanghai Commercial Bank



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