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GOLD'S RISING ALLURE

On May 5 of this year, President Trump tweeted that tariffs on $ 200 billion of Chinese goods coming into U.S. would increase from 10% to 25%. He further indicated that the remaining untaxed imports of $300 billion would also start getting taxed at 25%...shortly. Gold had closed at $1,279 per oz the day before.

Trump's tariff actions were in response to an apparent walk back of the Chinese from a trade deal that was reportedly agreed upon. Financial markets, which had been focusing on the FED's blunders and *pivots*, suddenly found a bigger threat on hand. Risk-aversion ensued until hopes of a truce emerged to turn the sentiment around. Risk assets had more than recovered the losses suffered in May by the time the truce was indeed announced at the G20 summit in Osaka on June 29. Gold had closed at $1,414 per oz the day before.

As per the Osaka agreement, the two sides met in Beijing in the last week of July to resolve outstanding differences. Market participants were optimistic as risk assets held up very well going into the meeting. However, that meeting failed to bridge differences. President Trump followed through with his earlier warning and announcement a 10% tariff on the remaining $300 billion of Chinese goods imported into the U.S. on August 5. Risk-aversion again followed, this time only more vigorously. Gold had closed at $1,457 per oz the day before.

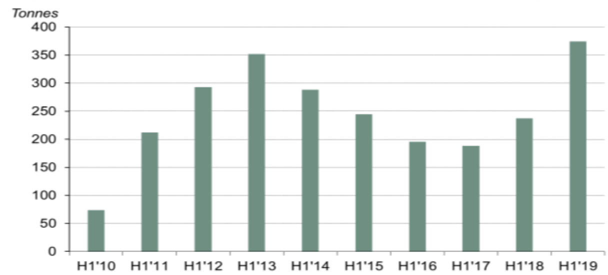
In the chart alongside from Macrotrends.com, we can see that Gold is now trading over $1,500 per oz and at the highest level since August, 2013. What is remarkable about its performance over the last few months, of course, is its rapid ascent regardless of market sentiment. It moved up when news was favorable and it moved up when news was unfavorable. Many explanations have been put forward for this notable occurrence with the most common being risk aversion in conjunction with lowering of interest rates by the FED.

While we agree with the above rationales, we think there are other factors in play as well. An important one is the negative interest rates in two major economies – Japan and Europe. As of this date, Japanese 10-year bond yield is -0.24% while European 10-year yield, as represented by its largest economy, Germany, is – 0.68%. While these negative yields can certainly get more negative, we suspect large institutional global investors without the explicit mandates of investing in such securities, might increasingly question the wisdom of making that bet. Gold offers those investors an increasingly attractive alternative to holding investments with a *guaranteed* loss.

(In Tonnes)	Q2'18	Q2'19		% chg
Gold demand	1,038.8	1,123.0	▲	8
Jewellery	520.8	531.7	▲	2
Technology	83.3	81.1	▼	-3
Investment	282.0	285.8	▲	1
Total bar and coin	248.2	218.6	▼	-12
ETFs products	33.8	67.2	▲	99
Central banks & Ins.	152.8	224.4	▲	47

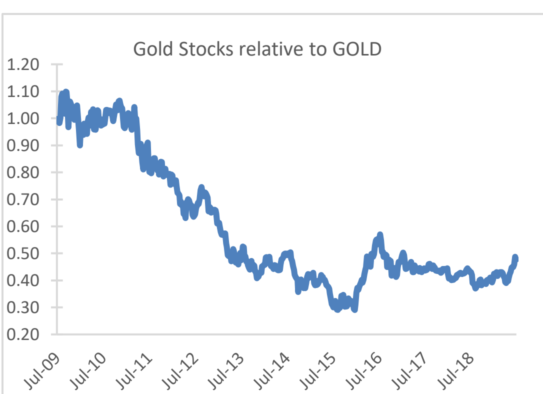
Source: World Gold Council

Highest level of H1 purchases since central banks became net buyers



Source: Metals Focus; Refinitiv GFMS; World Gold Council

Data from the World Gold Council above does indeed indicate institutional activity in the direction that we are suggesting. Net inflows for Gold-backed ETFs and buying from Central Banks & Other Institutions were extremely strong in 2Q19. Central banks' buying, in fact, reached the highest since at least the first half of 2010. Such accelerated buying reflects either their deepening anxiety about the current economic environment or an increasingly confusing outlook on interest rates/currencies. Gold's price action suggests to us it is both!



Data Source: Yahoo Finance

We have viewed Gold as a better hedge than U.S. Treasuries for quite some time now. More specifically, we have preferred exposure to Gold Miners versus physical Gold due to the relative value as shown in the adjoining chart. While all our strategies have benefitted immensely during the 1H19 from our position in Gold Miners, we think that hedge is going to prove its worth even more going forward. Our conviction in this alluring idea keeps rising.

Performance Review

Beginning this update, we are including the performance review of our CONSTRAINED (CNSD) strategy as well given the completion of three years of its operation. For those unfamiliar with our CNSD strategy, it is designed for risk-averse investors with shorter time horizon and seeking current income. Capital appreciation is not a necessary consideration. Another unique feature of this strategy is that it only holds Exchange Traded Products (ETPs) and Closed End Funds (CEFs) to dampen volatility. It does not hold individual stock or bond positions. These constraints were put in place given the feedback we received from existing and prospective clients for such a product. We think this strategy is an excellent fit for certain investors and are very pleased with the results it has achieved so far.

OppoQuest Strategy	1H19 Strategy Gross Returns	Strategy Benchmark	1H19 Benchmark Returns	Outperformance / (Underperformance)
CORE	19.69%	S&P Target Risk Growth Index	11.91%	7.78%
CONSERVATIVE	16.70%	S&P Target Risk Moderate Index	9.94%	6.76%
CONSTRAINED	14.11%	S&P Target Risk Conservative Index	8.96%	5.15%

Core strategy

OppoQuest's Core strategy (CORE) had an exceptionally strong first half 2019 with roughly 8% points of outperformance versus its benchmark. We had flagged the strong rebound in our last review and so these numbers should not be a surprise. All sectors contributed positively indicating broad-based gains.

Among the top contributors was ROKU which rose close to 200% in 1H19. Market is clearly rewarding ROKU for continuing the scorching pace of subscriber additions (30+ Million after 2Q19) and proving that it is rapidly becoming the streaming platform of choice for consumers. More importantly, we think, it is becoming an indispensable partner for streaming content providers. We expect ROKU's competitive position to keep strengthening even against some formidable players like Amazon.

NOK was among the negative contributors, although quite negligible in terms of the impact. We continue to remain baffled at the volatility in investor sentiment on this name despite well-understood positive catalysts. Imminent explosion in 5G capex spending and potential market share gains from U.S. administration's unrelenting pressure to restrict and even eliminate the participation of Chinese telecom giant, Huawei, from 5G networks' buildouts worldwide, are essentially being ignored. 2Q19 results that were announced after our review period, were a welcome relief in that regard as management backed up its long-held positive outlook with top and bottom-line beats. It also announced that 45 5G commercial deals pipeline had been reached along with 9 live networks. Stock closed +10% that day.

With respect to changes in CORE's positioning during 1H19, we used the rally in risk assets to shed exposure in equities by almost 4% points. Short-term bond exposure commensurately went up by 4%. Recall that we had increased risk exposures by almost 11% in 2H18 when FED induced risk-aversion presented lucrative opportunities to go long. In this half, we have harnessed some of the gains of those actions and our intent is to continue on that path going forward.

A special mention here about our Gold Miners position, GDX, which we have held across all our strategies as a hedge and for its leverage to gold prices. The higher beta of GDX was on full display as it rose +20% on the back of +10% rise in gold prices during 1H19. While acknowledging that leverage works both ways, we are convinced that gold mining companies offer a rare opportunity this cycle as fundamentals (falling financial leverage and rising interest coverage) are positively inflecting just as gold prices rebound. Consolidation among major producers with Barrick buying Randgold and Newmont buying Goldcorp, is also an important reason for our optimistic outlook. Having said that, we could not resist trimming GDX exposure across all strategies given the price appreciation, although, we still continue to hold full sized positions.

Conservative Strategy

OppoQuest's Conservative strategy (CNSR) also strongly outperformed its benchmark with solid margin of close to 7% points. As in CORE, all sectors contributed positively and gains were broad-based. First Trust Technology Dividend Fund (TDIV) was among the top contributors as the fund rose more than 18%. This funds' constituents are large-cap dividend paying technology companies such as MSFT, INTC, TXN, CSCO & APPL. These names have been in favor for the last several years now and we think they continue to offer a favorable risk-adjusted exposure to the secular growth of the Tech sector. A dividend yield of +2% makes it even more attractive.

Similar to CORE, NOK was among the larger drag on performance here as well with the impact being negligible too. Repositioning actions in this strategy were more pronounced than CORE with risk exposures reduced by 7% and bond exposure going up by a similar amount. Most of selling occurred in the Material and Financial sectors with Healthcare actually seeing net buying. However, the reduction in many high-yielding positions led to a significant decline in the overall yield of the strategy to 3.64% from 4.53%. Recall that we do not view yield as a target in itself but a byproduct of the opportunities available.

Constrained Strategy

OppoQuest's Constrained strategy (CNSD) opens its reporting account with a strong outperformance margin of just over 5% points against its benchmark. As in other two strategies, all sectors contributed positively indicating broad based gains. Similar to CNSR, First Trust Technology Dividend Fund (TDIV) was among the top contributors for this strategy as well. We have already commented on the attributes of this position but would like to add that TDIV is a maximum sized position in both strategies and therefore even a 18% move has outsized influence on the overall performance.

Remarkably, none of the fifteen holdings in this strategy declined in value and hence there were no negative contributions to the performance.

Taking advantage of the rally, risk exposures were reduced in this strategy as well. In fact, close to 16% in equity exposure was sold as opportunities to shed risk were more than the other two strategies. Around 13% was reallocated to short-term bonds and the remaining to cash. As a result, the yield of this strategy, which we do try to maintain at 3% or more, dropped to 3.43% from 4.09%.

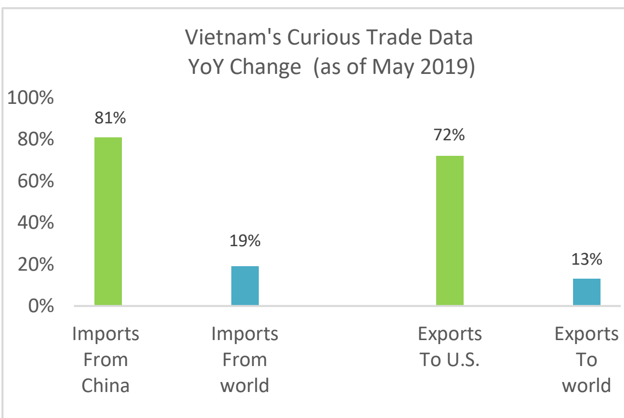
Outlook

The negative impact of trade uncertainties between U.S. and China is evident now with most emerging markets on the ropes and even many developed markets struggling. For things to turn around, we think both parties will have to reach a compromise. Do we think they will? Well, there is hope as both have powerful incentives to end the stalemate. Let's look at the circumstances.

In the U.S., President Trump is preparing for his re-election bid next year with his record on the economy likely to be his strongest and maybe his only card. We think it will be difficult for him to get reelected if the economy is not in excellent shape by the summer of 2020. And the only path for him to get the economy in that shape is to get a China deal signed and in motion by spring of next year. It does mean that his administration may have to give up on some of the issues that it has been insisting on including in the deal. Maybe the final chapter in his *Art of the Deal* bestseller is yet to be written.

For the Chinese, the issues are a lot more complicated. Ceding any ground on trade issues will seriously undermine their claim that they have been playing fairly in the global trading system. Even more serious is the possibility that their other trading partners, European Union in particular, will demand equal treatment if U.S. gets better trading terms.

Another issue the Chinese will be extremely concerned about is how a new agreement alters their existing economic model which has worked so well for them over the last 40 years and made China the second largest economy in the world. While that economic miracle has to be marveled upon, there have also been serious allegations about forced technology transfers, willful abrogation in enforcing intellectual property rights, subsidies to state-owned enterprises, lax labor standards and disregard for environmental protection. Indeed, disagreement on enforcement provisions regarding those issues reportedly led to the original deal being put on hold in May of this year. If they do give in to even some of those provisions, their economic model will get exposed to global competition which has complained about the lack of level-playing field for long.



And finally, President Xi will likely also be thinking about the long-term damage U.S. tariffs actions are causing. Press reports indicate that many companies are now either actively setting up alternate supply sources or relocating their existing supply base from China. In a sign of desperation, there are even reports of outright cheating by local exporters in order to maintain their market share. Take a look at the above data that Wall Street Journal reported recently. While it's hard to conclusively say there is transshipment activity to circumvent the new tariffs, eye brows will likely be raised. Although things can muddle along in the short run, China runs a huge risk of losing its supply chain dominance the longer this impasse continues. And that, by the way, is also the reason why we think it is unlikely that President Xi will wait until after November 2020 elections to act.

So, there are clearly powerful incentives for both sides to come to an agreement. However, we admit that despite compelling logic, both parties could surprise negatively with their actions. We are dealing with an unprecedented situation and a lot is at stake. Therefore, we are not going to assume any specific outcome and instead wait till an agreement is actually signed and delivered. Yes, that would also mean we likely give up some upside, but sometimes, as they say, *discretion is a better part of valor*.

For OPPOQUEST
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