

SOM Macro Strategies

State of The Markets: Buy US Equities--Phase 1 Agreement & UK Election Is
A Stimulus For Growth

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State of The Markets: Buy US Equities--Phase 1 Agreement & UK Election Is A Stimulus For Growth

- ***Step 1: Macro Theme: State of The Markets: Buy US Equities--Phase 1 Agreement & UK Election Is A Stimulus For Growth***
 - Election and agreement should increase GDP by reducing policy uncertainty
- ***Step 2: Fundamental Economic Framework***
 - Recent events have the potential to boost world growth
 - ***US/China Phase 1 agreement rolls back current and potential future tariffs***
 - ***UK election provides complete clarity about Brexit***
 - World growth has slowed in part because of the slowdown in investment, which reflects a rise in policy uncertainty
 - Phase 1 agreement/UK election results should reduce policy uncertainty which has been a headwind to investment and ultimately to growth
 - Phase 1 agreement/ UK election results could also be a tailwind for US growth by reducing the uncertainty surrounding the US 2020 presidential election
 - Economic models of the 2020 election suggest that Trump is the favorite, increasing GDP by a Phase 1 agreement could enhance his chances
 - Fall of the labor party and its economic manifesto could portend a similar fate for democrats given the similarities in their platform
- ***Step 3: Identify Potential Repricing Events***
 - GDP growth accelerates as policy uncertainty falls and adds to the force of the monetary stimulus already in place
 - Fed cut rates both current and on a potential forward basis to offset the slowdown in GDP
 - If policy uncertainty falls then those cuts become an even more of a force to push up US GDP
- ***Step 4: Find Asymmetric Trades***
 - Trade 1: Buy calls on US equities

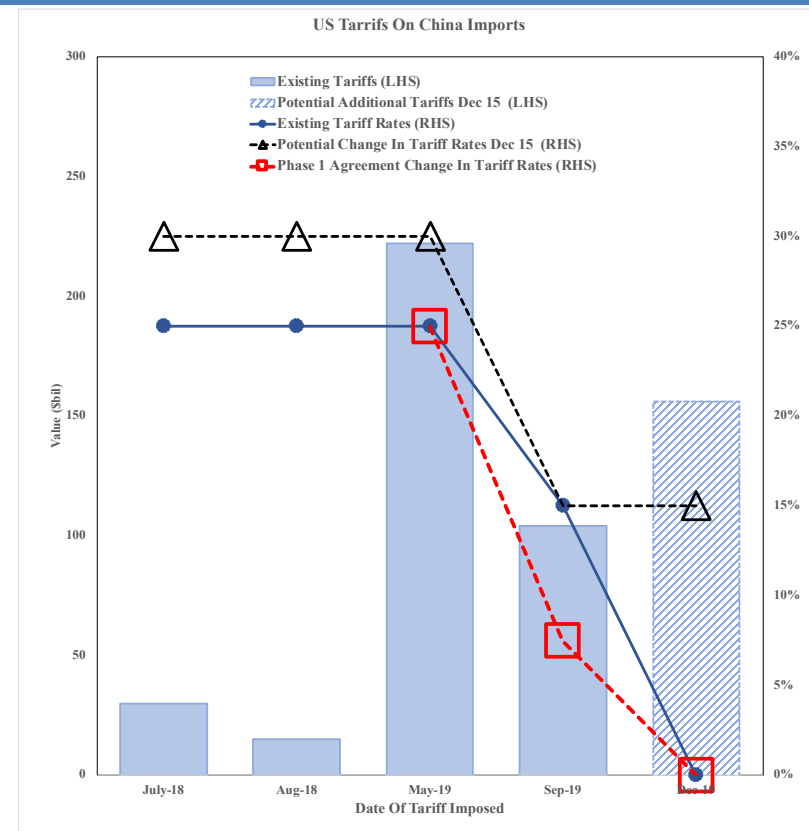
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Step 1: Macro Theme

China/US Phase 1 Agreement And The UK Election Is A Stimulus For Economic Growth

Phase 1 Agreement Lowers Current And Potential Future Tariffs^{1,2}



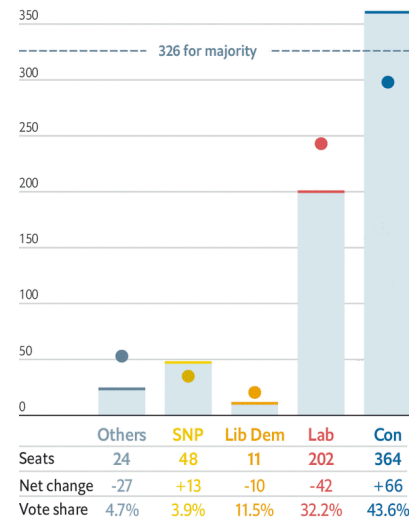
Conservative Landslide In UK Provides Clarity On Brexit³

Blue rinse

Britain, general election results 2019

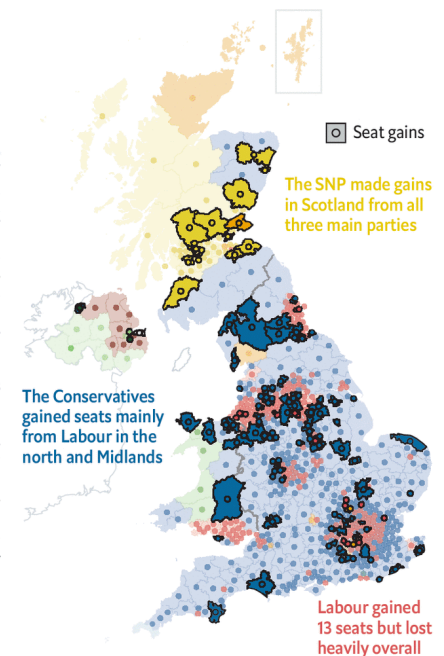
At 9am December 13th 2019, 649 of 650 seats reported

● Pre-election seats ■ Result



Source: Press Association

The Economist



1. Office Of the US Trade Representative

2. Bloomberg

3. The Economist

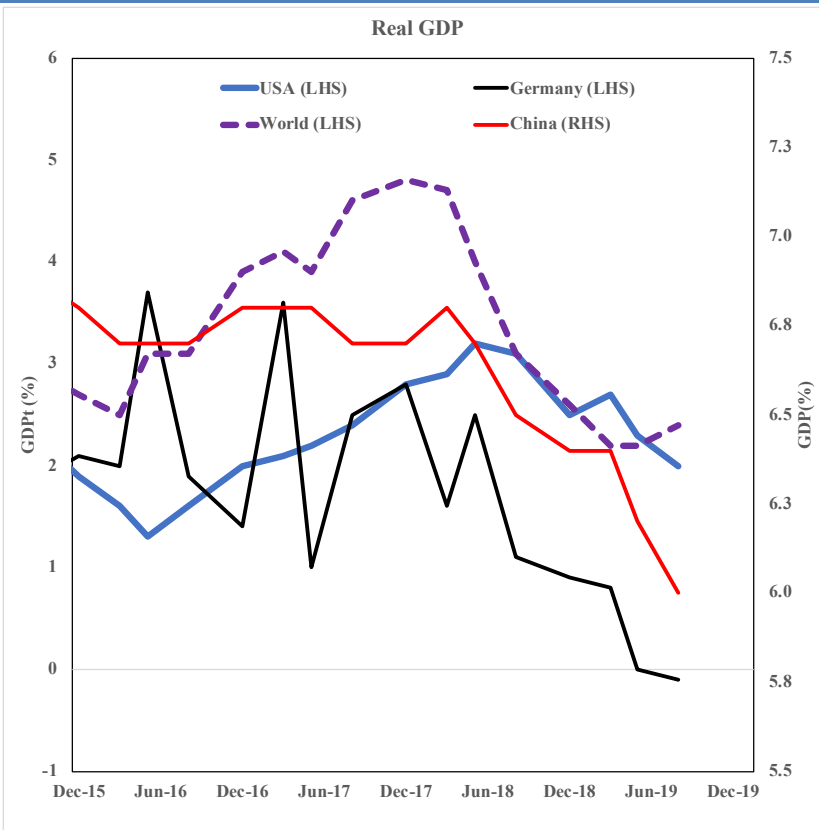
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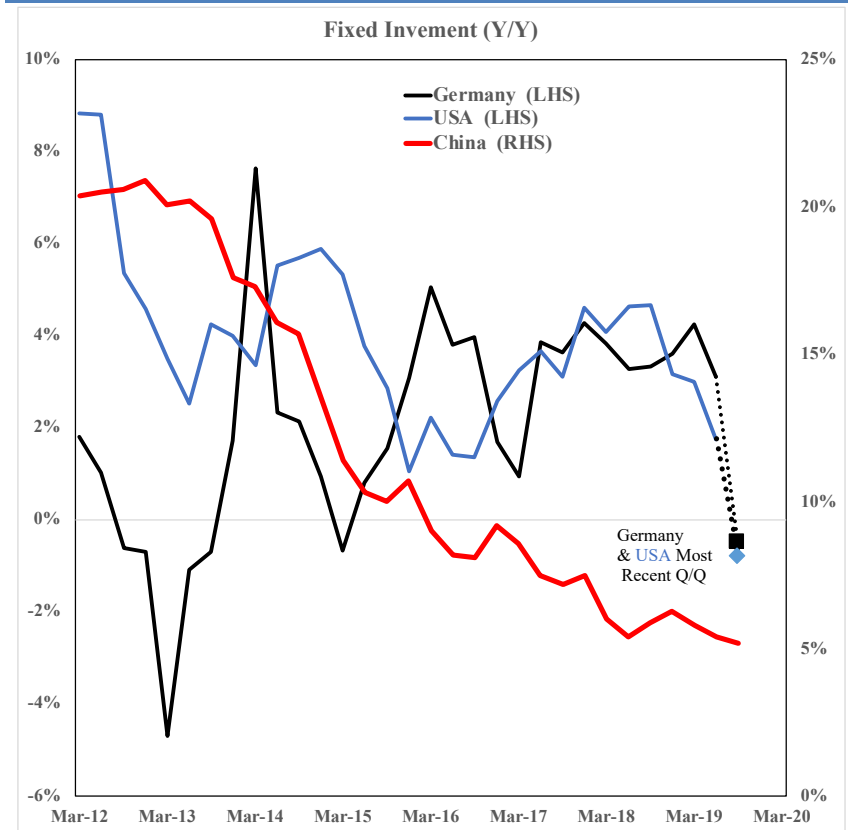
Step 2: Fundamental Economic Framework

Phase 1/UK Election Will Act A Stimulus For Growth By Reversing The Slowdown in Investments¹

Economic Growth Has Slowed Around The World...



Driven In Part By The Fall In Investment



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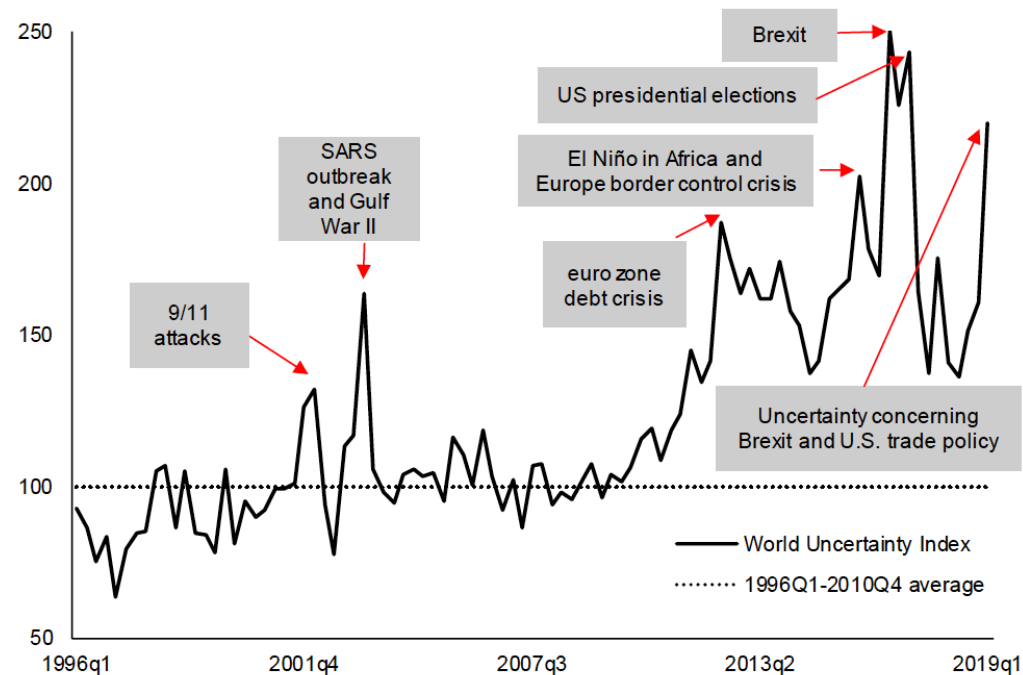
Step 2: Fundamental Economic Framework

A Major Factor Behind The Fall In Investment Is The Elevated Level Of Economic Policy Uncertainty

US Presidential Elections, Brexit, UK Election, US/China Trade War Has Pushed Uncertainty Back Near Its Historical Highs¹

Figure 1B. Global WUI over time

(unweighted global average)



¹. Ahir, Bloom & Furceri, "The World Uncertainty Index", SIEPR, Working Paper, May 2019

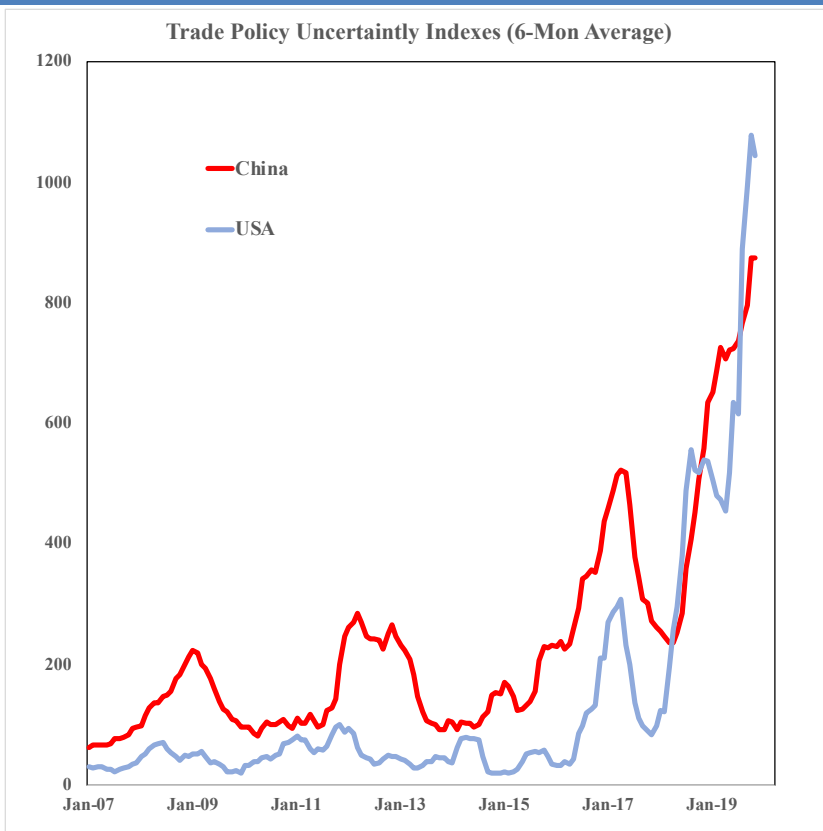
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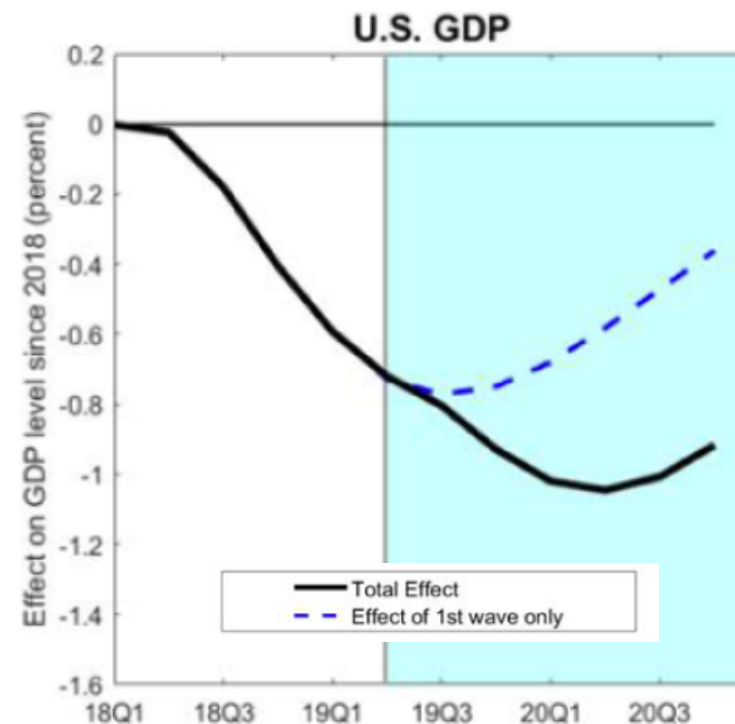
Step 2: Fundamental Economic Framework

Rising Trade Policy Uncertainty (TPU) Is Projected To Slow World Growth In 2020

TPU In China And The US Has Surged¹



Rising Uncertainty Will Impact 2020 US Growth²



1. Bloom, Baker and Davis' Economic Policy Uncertainty Index, Data Accessed on their web site on Dec 2019

2. Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo (2019). "Does Trade Policy Uncertainty Affect Global Economic Activity?," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, September 4, 2019, <https://doi.org/10.17016/2380-7172.2445>.

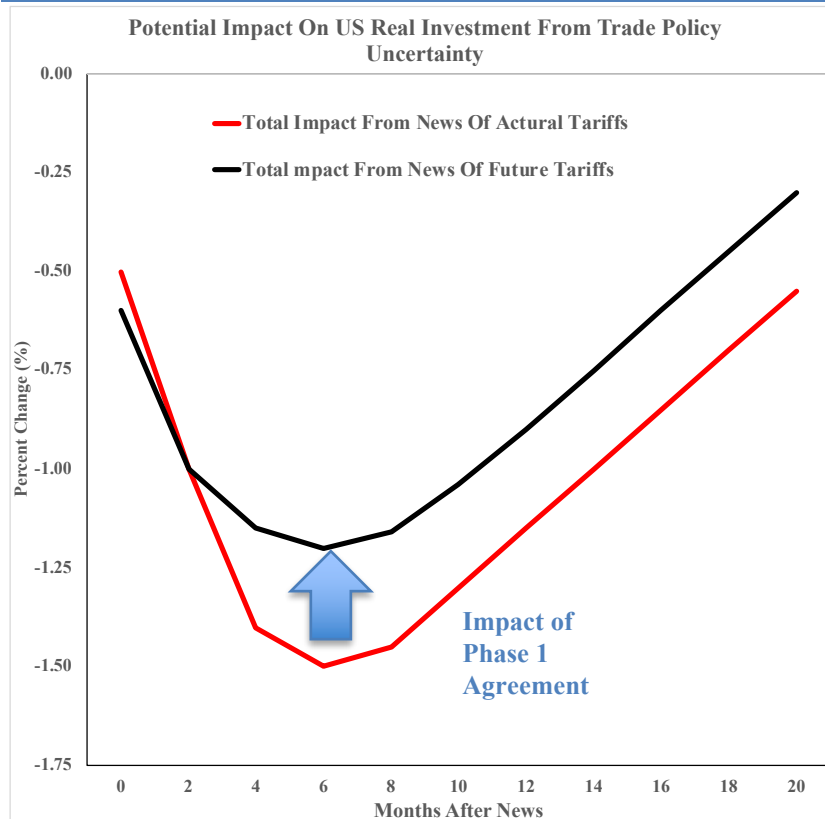
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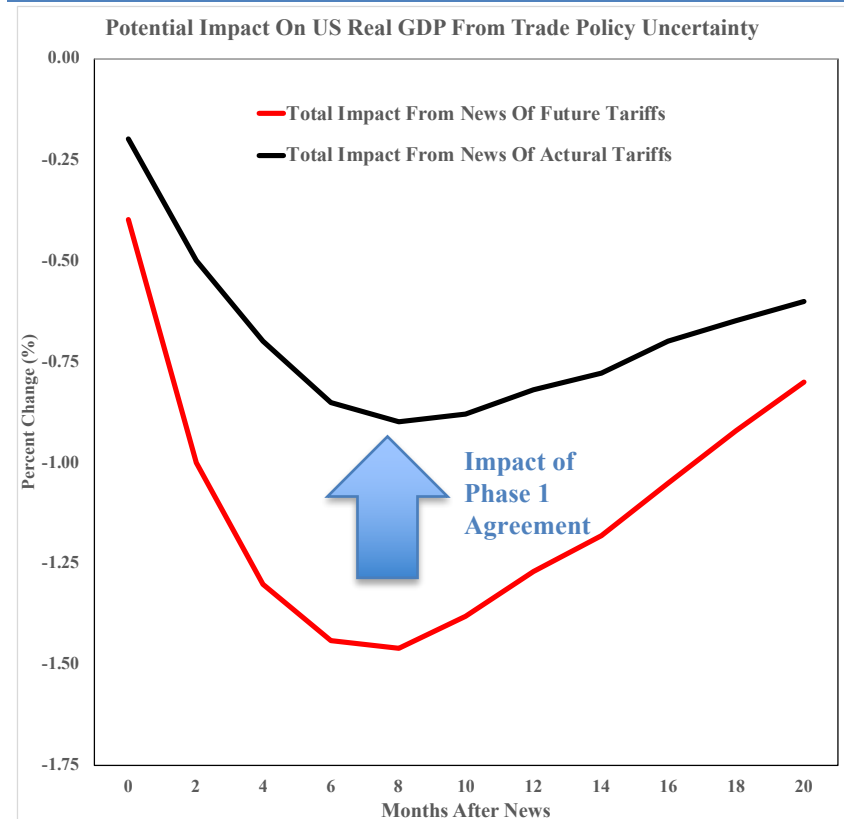
Step 2: Fundamental Economic Framework

The Phase 1 Agreement Should Be A Tailwind For Growth As It Reduces Tariff Uncertainty¹

Agreement Push Up US Investment And This ...



Could Push Up US Growth In 2020



1. Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino, and Andrea Raffo (2019). "Does Trade Policy Uncertainty Affect Global Economic Activity?," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, September 4, 2019. <https://doi.org/10.17016/2380-7172.2445>.

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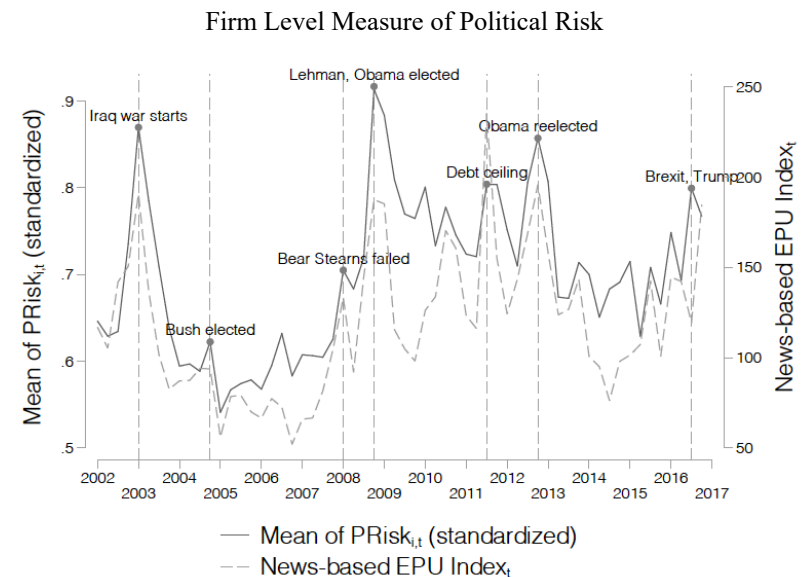
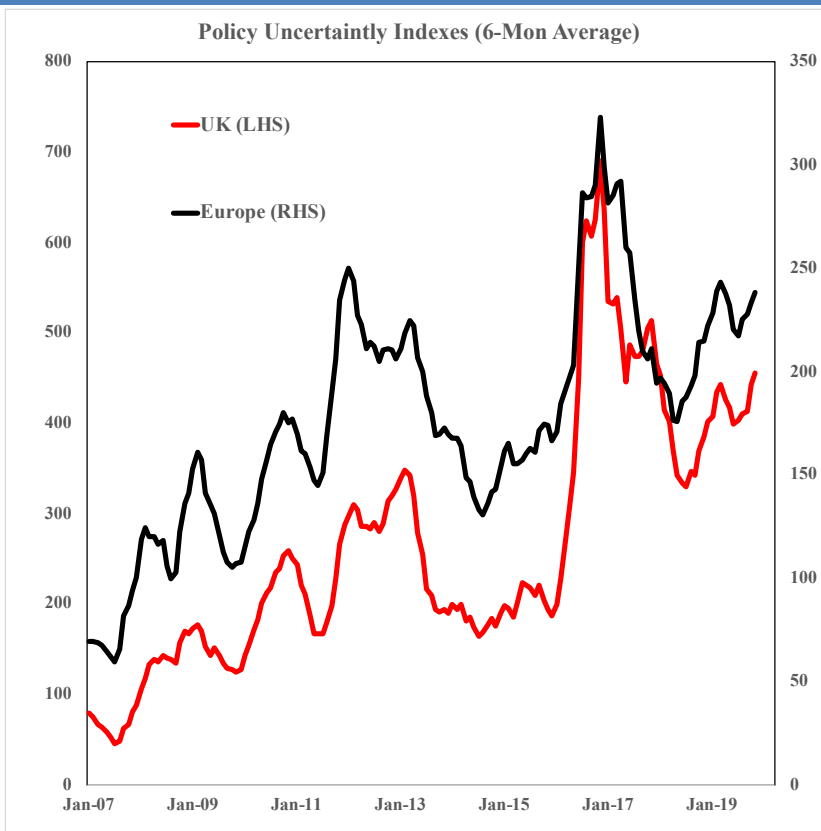
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Step 2: Fundamental Economic Framework

European Growth Should Be Helped As Well, While Another Channel Could Help US Growth

UK Election Should Also Give A Boosts To Growth In Europe¹

The 2020 US Election Is Another Source of Uncertainty²



1. Bloom, Baker and Davis' Economic Policy Uncertainty Index, Data Accessed on their web site on Dec 2019
2. Hassan, Holander, Lent, Tahoun, "Firm-Level political Risk: Measurement and Effects", working paper, April 2019

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Step 2: Fundamental Economic Framework

Phase 1/UK election Could Reduce The Uncertainty Surrounding The 2020 Presidential Election

Falling Uncertainty Increases GDP And Prob of A Trump Reelection¹

Moody's 2020 Presidential Election Models (As Of Sept 2019)			
	Pocketbook	Stock market*	Unemployment
Democrats Electoral College Votes	187	249	206
Republican Electoral College Votes	351	289	332
Important Variables			
2-yr Real Household Income Change	X	X	X
2-qt S&P 500 Change		X	
2-qt Unemployment Change			X
*S&P Up 2.8% YoY As of Sept 2019, Now Up 14% YoY			

Could The Defeat of Labor Imply A Similar Fate For Democrats?²

UK Labor Manifesto 2019	
Plank	Proposal
Taxes	Hike personal income taxes on top 5% of incomes Hike corporate taxes back to 2010 levels, about 30% increase
New Green Deal	Zero Carbon Emissions By 2030, 90% Public funding of retrofitting of homes and buildings to make them energy efficient 90% of electricity from renewable Delisting of corporations that fail to address their carbon emissions Public ownership of utilities Sales ban on internal combustion engine cars by 2030
New Capitalist Model	10% ownership of companies by workers 1/3 of corporate boards reserved for worker-directors Eventually 32 hour work week with no loss of pay Minimum real living wage of 10 an hour 100% public ownership of utilities, energy companies, and public transportation
Immigration	Establish a humane immigration system Affirm that refugees have rights to work and access to public services
Health Care	Increase funding for public health and stop privatization Establish a government funded generic drug company to combat rising drug costs
Education	Abolish tuition fees for higher education Task the new social justice commission to study merging private schools into state system

1. Zandi, White, Yaros, "2020 Presidential Election Model", Moody's Analysis , September 2019

2. Labor manifesto taken from their web site

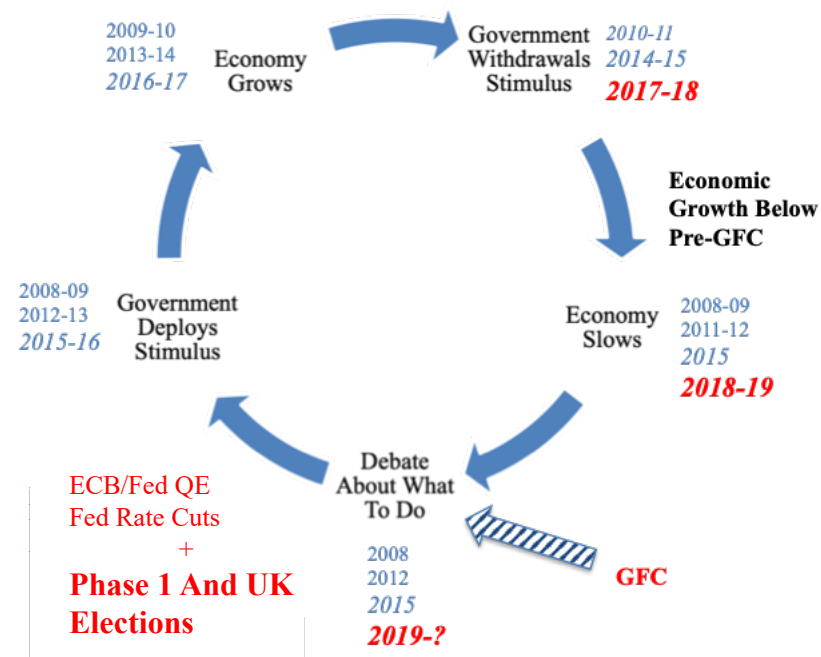
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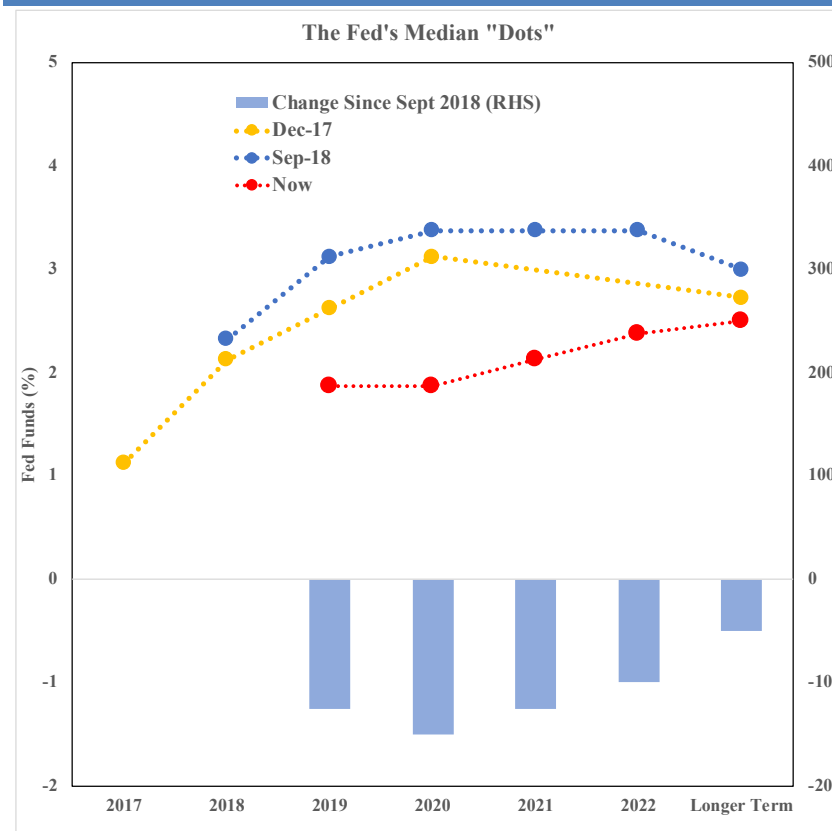
Step 3: Identify Potential Repricing Events

Falling Policy Uncertainty Will Amplify The Impact of Monetary Stimulus Already In Place¹

Another Turn Of The Stimulus/Economic Cycle



Fed Actual And Projected Rate Cuts Has Been Substantial



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Step 4: Identify Asymmetric Trades

Trade 1: Buy Upside On US Equities^{1,2}

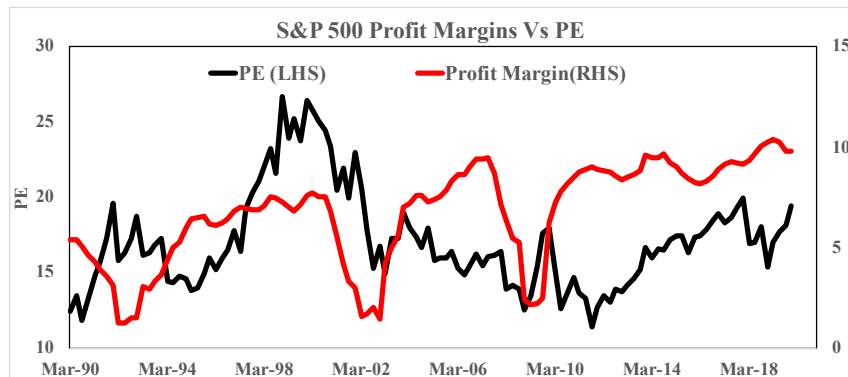
Trade Thesis

Buy 6-month 25 delta calls on S&P

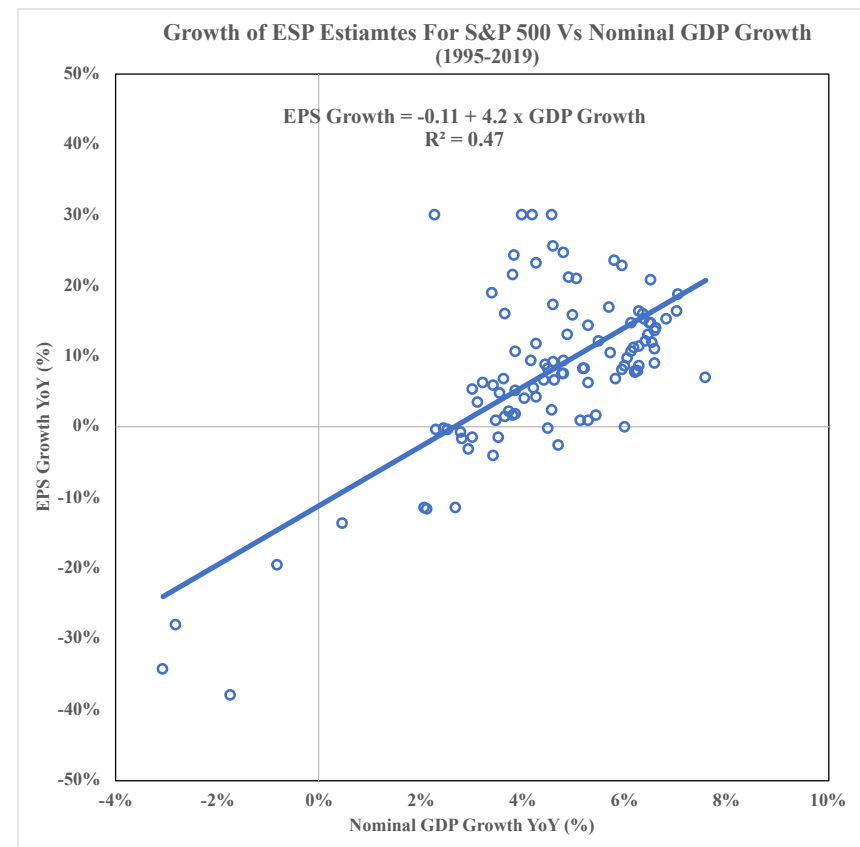
- Phase 1 agreement and UK election results act as a stimulus for US/European growth
- Falling policy uncertainty will drive up GDP by pushing up investment
 - GDP has slowed due in part to falling investment
- Phase 1 agreement and the UK election results could also help US growth by reducing uncertainty about the 2020 presidential election
- Catalyst could be the combined impact on growth from Fed rate cuts and falling policy uncertainty

Risk is that policy uncertainty remains elevated

Valuations Look Reasonable Given Profit Margins And PE



Equities Could Rally As Earnings Grow From Rising GDP



1. Bloomberg
2. Authors analysis

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