

# Global Sell-off in Risk Assets: Hedge bearish sentiment with short ETPs, focus on quality equities offering superior Income

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- **Macro:** the steep correction in global markets today as a result of fears that China's managed slowdown is turning into a global meltdown may be overdone. This on the back of a resilient US labour market and firming economic growth in the Eurozone. Note also that the potential for China to unleash more stimulus at the monetary and fiscal front is significant, given that the current minimum deposit requirement ratio of 18.5% is much higher than the 15.5% level in 2009. Furthermore, the 12M policy rate of 4.85%, set against decelerating inflation, is too high a borrowing cost in real terms.
- **Valuations:** Financial markets may continue to succumb to further weakness and heightened volatility in the near term. Many equity markets, most notably in the US and Europe, trade at forward P/E valuations in the mid-teens (S&P 500= 16.7x, DAX 30 = 12.3x, EURO STOXX 50 = 13.6x, FTSE 100 = 14.8x). While not expensive at current levels, there is ample room for equity prices to fall further and hit extreme low valuations before sentiment in equities improves and the falling price momentum reverses.
- **Your tactical China hedge:** geared short ETPs can offer a hedge against China's worsening outlook, with slumping commodity prices magnifying deflationary fears and pushing China's overleveraged producers closer to the brink of corporate default. The extent of the correction in base metal prices has been disproportionate to the devaluation of the RMB and as a result has done little to revive China's corporate outlook.
- **Efficient hedging in volatility assets classes:** the global downside momentum across risk assets may present an opportunity to prolong geared short positioning, notably in European and US equities, copper, and crude oil, which may enable maximisation of potential returns or deploy minimum capital to hedge your long equity and commodity exposure.
- **Strategic focus on equity income and quality:** allocating into dividend paying equities offering high dividend yields within Europe and US is a way to position defensively. Coupled with a delayed turn in the interest rate cycle, the added dividend yield premium over bonds instigated by the sharp correction presents an opportunity to take advantage of deep value in Europe and US, with share prices of quality stocks being brought down by sentiment and not by sound longer-term fundamentals. Eurozone equities' dividend yield of ~4% compare favourably to the yield on German 10Y Bund of 60 bps or Italian BTPs of 1.7%.

- **Avoid Value Traps:** this is often a feature of baskets overly exposed to small-and midcap stocks with highly concentrated business models and yield weighted strategies. Instead, it may be possible to seek value within diversified large-cap tilted strategies where the deep value opportunity is apportioned by cash dividends, not yield.

Tactically hedging against souring sentiment in risk assets (both within equities and commodities) can be done in several ways:

**I) Short industrial and energy commodities, long precious metals** Hedge against downside risk to commodity prices by buying geared short copper and crude oil, go geared long gold and silver. The chart below shows the performance of geared short and long commodities.

**II) Short broad equity markets – Eurozone equities, specifically German equities, are the most sensitive to China.** Shorting German, UK and Eurozone equities to hedge long European equity positions. German stocks' global export exposure (most notably to China and US) has worked to make the DAX 30 an efficient beta play on souring sentiment on risk assets. Together with short ETPs tracking the UK large-caps / mid-caps and US large caps, we believe the efficiency of hedging equity market risk is evident from better-than-expected performance relative to delta one underlying benchmarks.

**III) Bullish euro, bearish dollar trade as Fed delays tightening** We believe positioning short dollar, long euro, given how much of market expectations have been built up around the Fed hiking interest rates this year. It is our view that a rate hike as soon as September is unlikely, and may come at the end of Q4. For example, Boost's 5x short USD long EUR ETP that tracks to USD/EUR FX spot rate has risen 16% in the last month.

Investors sharing this sentiment may consider the following UCITS ETFs and S&L ETPs

- [Boost ShortDAX 3x Daily ETP \(3DES\)](#)
- [Boost FTSE 100 3x Short Daily ETP \(3UKS\)](#)
- [Boost EURO STOXX 50 3x Short Daily ETP \(3EUS\)](#)
- [Boost WTI Oil 3x Short Daily ETP \(3OIS\)](#)
- [Boost Copper 3x Short Daily ETP \(3HCS\)](#)
- [Boost Short USD Long EUR 5x Daily ETP \(5EUS\)](#)
- [Boost Gold 3x Leverage Daily ETP \(3GOL\)](#)
- [WisdomTree Europe Equity Income UCITS ETF \(EEI\)](#)

## Important Risks Related to this Article

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