



**CIO Insights**

**Cusson Leung, Chief Investment Officer**

# **Navigating The Four Essential Forces**

*“May The Force Be With You” - Finding Hope In Its Despair*

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# Four Forces to Shape the Market Outlook

## Mid-Term Election Being the Most Important of All

### 1 The War In Iran.

The US declared victory over its war in Iran, militarily, but both the US and the world's energy market are being held hostage by the closure of the Strait of Hormuz. The market is unwilling to react further to the back and forth of ceasefire and threat, but it will react to the changes in oil price on changes in inflation expectation and therefore the expectation on the changes interest rates. The market is pricing in the worst-case scenario for interest rates right now. **Worst-case is a global recession scenario.**

### 2 Kevin Warsh will become the new Fed Chair by May 16, 2026.

He comes with two seemingly contradictory goals: 1) reducing the size of the Fed's balance sheet and 2) cutting short term interest rates. This might not be so contradictory after all. The good thing is the market has not been factoring any rate cut assumption in 2026. It will be a big positive surprise if he can really pull it off. **If he can't, nothing will change.**

### 3 US-China Summit/Trade War.

Donald Trump is expected to meet Xi Jinping in Beijing on May 14-15, 2026. This meeting is seen to be setting the table for the US-China trade war ahead of the November 2026 expiring of the trade truce from last year. Trump's tactic have always been "escalate to de-escalate". We do expect worsening US-China trade news flow into the November trade truce expiry. **Buy HK/China on any potential corrections and accumulate Gold on trade talk volatility.**

### 4 Mid-term Election.

The approval rating is at record lows. The Republicans' trifecta (the white house, a 217-213 House majority, and a 53-45 Senate majority) is seen to be pro-S&P 500. Any flips to the Democrats are likely to unwind part of the tailwind Trump has built into the big corporates. **+ve on politically neutral sectors such as infrastructure, utilities and cashflow generating companies.**

# The War Doesn't Seem to Be Ending Any Time Soon

## 1. **The Latest Iranian Proposal (May 3, 2026)**Iran submitted a three-phase "peace roadmap" via Pakistani mediators. Key terms include:

- Immediate De-escalation: A 30-day window to end all hostilities and a mutual guarantee of non-aggression between the U.S., Israel, and the "Axis of Resistance."
- The Nuclear "Carrot": In a major shift, Tehran has offered to discuss a 15-year freeze on uranium enrichment and the dilution of its highly enriched uranium (HEU) stockpile.
- The Sequential Catch: Iran insists on lifting the U.S. naval blockade and a total ceasefire before formal nuclear negotiations begin.

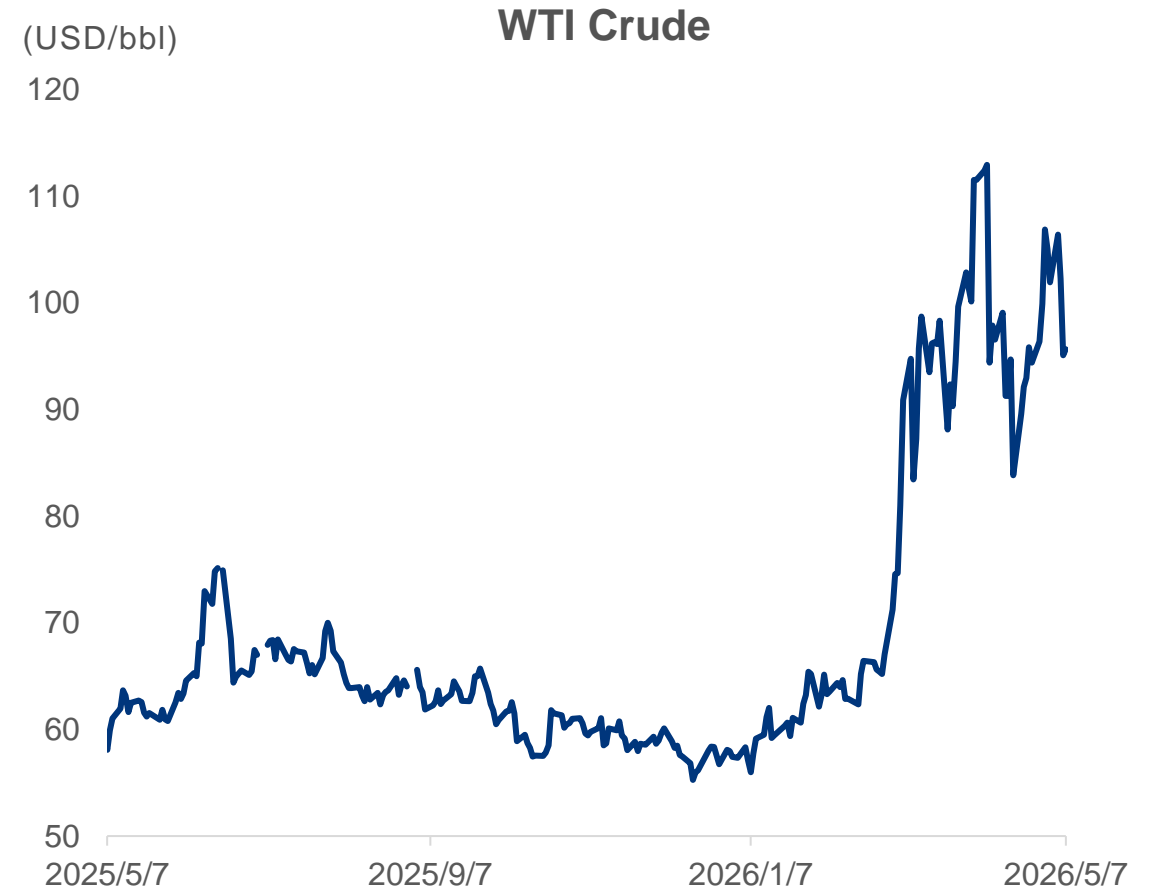
## 2. **President Trump officially rejected the latest proposal on May 3, stating it was not acceptable. U.S. officials remain skeptical of Iran's offer to freeze enrichment, viewing it as a tactical move to buy time for rebuilding damaged military infrastructure.**

## 3. **Escalating Threats & The Strait of Hormuz. As the diplomatic track stalls, the military posturing has intensified:**

- The Naval Blockade: The U.S. has maintained a "near-total shutdown" of Iranian oil and steel exports since mid-April. This blockade is reportedly costing Iran approximately \$4.8 billion in lost revenue every few weeks.
- U.S. "Guiding" Operations: Starting today (May 4), President Trump announced the U.S. Navy would begin "guiding" stranded commercial ships out of the Strait of Hormuz. Iran's Revolutionary Guard (IRGC) has warned that any U.S. interference with vessels in their territorial waters would be considered a "grave violation" of the ceasefire.
- Targeting Energy Infrastructure: The U.S. has issued standing threats to strike Kharg Island (Iran's primary oil terminal) and desalination plants if Iran attempts to re-close the Strait or interfere with U.S. "guidance" operations.

# The Strait of Hormuz Remains Closed

Any Sign of Resolution for Reopening Will Drive Expectation of Interest Rate Cut Off the Ground



Source: Bloomberg, KGI

# The Market Priced-in Zero Rate Cuts Over the Next 12 Months

## Upside From Any Unexpected Re-Opening of the Strait of Hormuz

Meeting Date	#Hikes/Cuts	%Hike/Cut	Imp. Rate $\Delta$	Implied Rate (%)	Assumed Move (%)
2026/06/17	-0.067	-6.7%	-0.017	3.625	0.25
2026/07/29	-0.095	-2.8%	-0.024	3.618	0.25
2026/09/16	-0.138	-4.3%	-0.035	3.607	0.25
2026/10/28	-0.105	3.3%	-0.026	3.615	0.25
2026/12/09	-0.019	8.6%	-0.005	3.636	0.25
2027/01/27	0.085	10.4%	0.021	3.663	0.25
2027/03/17	0.204	11.9%	0.051	3.692	0.25
2027/04/28	0.255	5.1%	0.064	3.705	0.25
2027/06/09	0.196	-5.9%	0.049	3.690	0.25
2027/07/28	0.095	-10.1%	0.024	3.665	0.25

Source: Bloomberg, KGI

# Warsh's Goals: 1) Reducing Fed Balance Sheet; 2) Rate Cut

## There Is No Downside Even if This Cannot Be Achieved

### ■ The "Reverse Operation Twist".

Warsh's strategy is effectively a Reverse Operation Twist. He wants to steepen the yield curve. The Mechanism: By selling the Fed's long-term bonds (reducing the balance sheet), he allows long-term market rates (like the 10-year Treasury) to rise to a "natural" market level. Simultaneously, by cutting the Fed Funds rate, he lowers short-term borrowing costs for banks and households. The Result: A steeper curve that rewards savers and banks for lending long-term, while making short-term debt cheaper.

### ■ Redeploying "Largesse".

Warsh has used a specific phrase in his 2026 testimony: he wants to "redeploy the balance sheet largesse" into lower short-term rates. In his view, the massive balance sheet was a "subsidy" to the government and large corporations by keeping long-term rates artificially low. He argues that by removing that subsidy (shrinking the balance sheet), the Fed "earns" the room to lower short-term rates to support small businesses and households without overheating the total economy.

### ■ The key risk why most likely it won't work

The above was good in theory but when the Fed shrinks its balance sheet, it drains "reserves" (cash) from the banking system. If reserves become too scarce, short-term money market rates (like Repo rates) tend to spike violently, regardless of where the Fed "sets" the official interest rate.

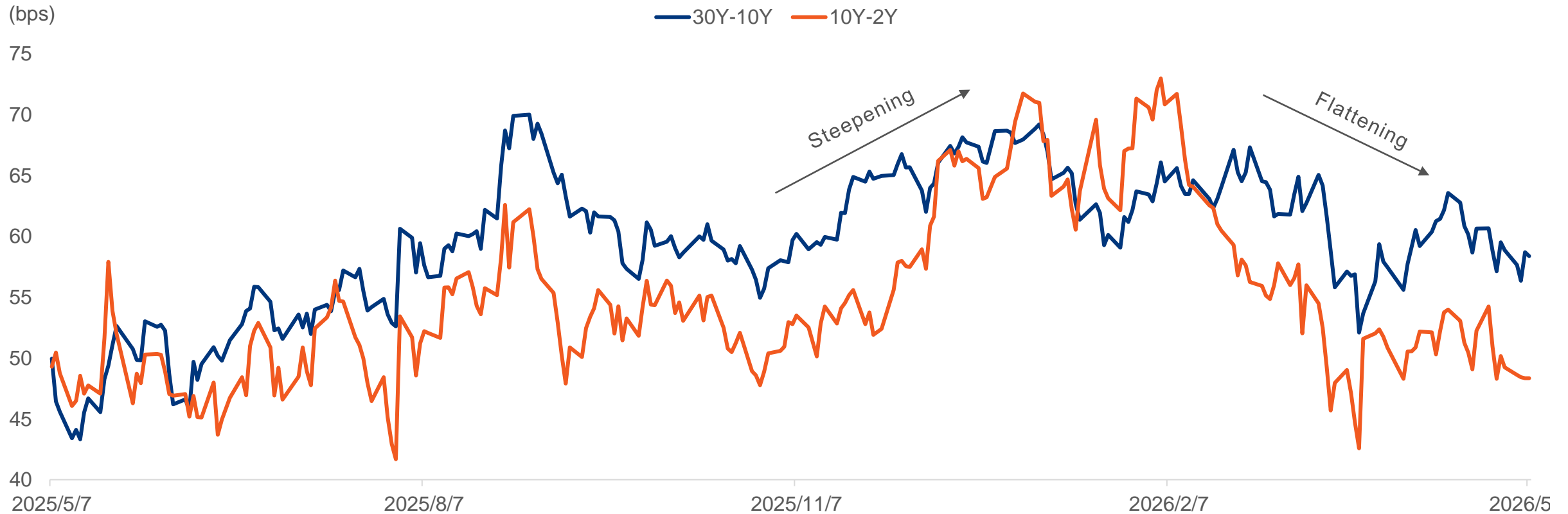
### ■ The good thing.

The market currently has no expectation that Warsh can pull that off.

# Warsh Wants to Steepen the Yield Curve

## By Selling the Long Duration Treasuries From Fed's Balance Sheet

### U.S. Treasury Yield Spread



Source: Bloomberg, KGI

# The Beijing Summit: “The Calm Before the Storm”

## Heavy on Optics and Light on Long-Term Structural Changes



### Trump's Goal

Facing a 36% approval rating and inflationary pressure from the conflict in Iran, Trump needs "transactional wins." Expect announcements regarding large-scale purchases of U.S. soybeans, energy, and aircraft to signal a win to his base.



### Xi's Goal

China seeks "strategic space." By hosting Trump, Xi signals to his domestic audience that China remains a co-equal superpower. He is likely to use the meeting to press for a softer U.S. stance on geopolitical issue in the Asia Pacific and AI chip restrictions in exchange for helping stabilize the Strait of Hormuz.

### The Vibe

High-profile, respectful, and focused on "win-win" rhetoric. Major public arguments are unlikely because both sides want to preserve the fragile stability of the Busan agreement for a few more months.

# The Trade Negotiation Phase (June – October 2026)

## The “Escalate-To-De-Escalate” Playbook Will Likely Begin

### Tactical Escalation

- To gain leverage for the next agreement, Trump is expected to revert to aggressive tactics:
- Tariff Threats: Threats to return to the 145% tariff levels seen in early 2025 if a new deal isn't reached.
- Decoupling Maneuvers: Increased rhetoric around "managed trade" and further restrictions on sensitive technologies to keep Beijing off balance.
- China's Counter-Leverage: China has already expanded its "economic toolkit," including export controls on lithium-ion batteries and graphite. Expect them to "slow-walk" rare earth exports or U.S. agricultural orders to remind Washington of their retaliatory power.
- As the truce expiry nears, expect market volatility. Trump's style often involves walking away from the table or issuing midnight social media ultimatums to force a last-minute concession. This is the period where the relationship will feel most strained.

# An Expected "Busan 2.0"

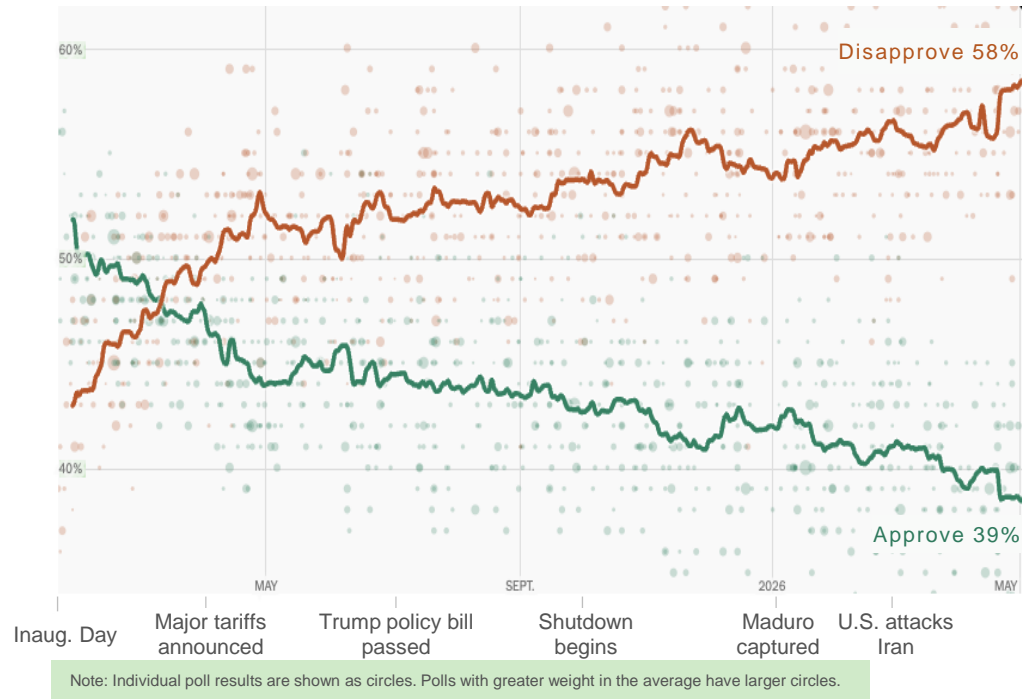
## Neither The Us Nor China Can Afford A Complete Decoupling

- A "New" Managed Trade Deal: A successor to the Busan truce that focuses on narrow, non-sensitive goods.
- Reciprocal Concessions: Trump may offer "carve-outs" for certain AI semiconductors (like the Nvidia H200) in exchange for China maintaining high-volume purchases of U.S. commodities.
- The "Vicious Cycle" Continues: The fundamental issues— geopolitical issue in Asia Pacific, and tech supremacy—will likely remain unresolved, kicked down the road to the next expiry date.
- The Beijing meeting is a diplomatic ceasefire, while the months leading to November will be a commercial battlefield. We expect significant market volatility (especially to Hong Kong/China) during the negotiation phase.

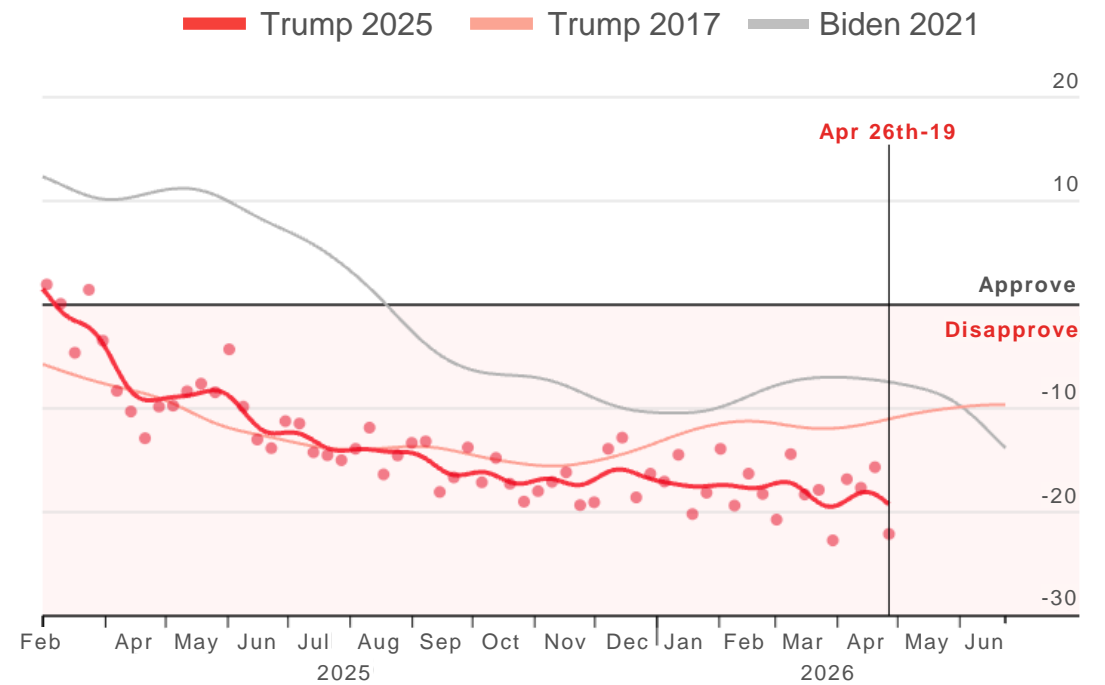
# Trump's Net Approval Rating Is at Record Low

## Uncertainty on Policy Continuity to Rise Ahead of Mid-Term Election

### Trump Approval Rating,(%)



### Net Approval Rating\*,(%)



Source: The Economist, KGI, Note: Net approval rating is the result of approval rating minus disapproval rating.

# A Unified Democratic Flips Will Unwind All Trump's Tailwind

## Mostly Likely Is a Divided House and Senate With Some Destabilization Impact to the Government

Scenario	Probability	Legislative & Executive Impact	Key Policy Implications	Winners	Losers
<b>Unified Democratic</b>	High (House) / Medium (Senate)	<b>Legislative freeze:</b> Trump relies on vetoes and executive orders. Oversight committees launch massive investigations.	<b>Judicial stop:</b> No more conservative judges. Possible rejection of Busan trade terms if viewed as a "weak".	Clean Energy, Healthcare (ACA protected), Consumer Goods (if tariffs are blocked).	Fossil Fuels, Traditional Defense Contractors, Private Prisons
<b>Divided (D-House, R-Senate)</b>	Very High	<b>Budget brinkmanship:</b> Frequent government shutdown threats. The House uses the "power of the purse" to block DOGE and other initiatives.	<b>Fiscal cliffs:</b> Tax cut extensions (TCJA 2017) are used as bargaining chips for social spending.	Infrastructure (bipartisan potential), Cybersecurity.	Sectors reliant on federal stability, Big Tech (due to bipartisan scrutiny)
<b>Unified Republican</b>	Low	<b>Mandate for MAGA:</b> Rapid use of budget reconciliation to bypass Democrats. Civil service "Schedule F" overhaul accelerates.	<b>Trade War 2.0:</b> Implementation universal baseline tariffs. Permanent status for 2017 tax cuts.	Oil & Gas, AI Development (deregulated), Financial Services, Border Security /Defense tech	Retail (hit by tariffs), Multinational Exporters

# Investment Strategy

## Diversifying US Portfolio, Avoiding the Long-Duration Treasury and Buy on Correction in HK/China

- **Liquidity may not be as bad.**

**Liquidity may not be as bad.** Both the war in Iran and the commencement of the new Fed Chair have the possibility of surprising the market on the upside. We will not count on the positive liquidity surprise events to happen. But we will use any relief rally as a chance to lock in profit for the high-valuation equities. We continue to recommend diversify within the US equities by focusing more on the stocks which growth at reasonable price.

- **Avoid the long end of the yield curve.**

Either because of Warsh's intention to reduce the Fed's balance sheet by selling the long duration treasuries, the concern about the rise in inflation expectation or the concern about the fiscal health of the US government in general, there is no strong reason to buy into the long duration treasuries if the new Fed Chair wants to see a steepening yield curve even if the yield appears to be attractive. The likely outcome of a divided house and senate will also be most visibly impactful to the treasury market. On equities, we prefer politically neutral sectors like infrastructure, utilities and cash cow conglomerates.

- **Take advantage of any market corrections in Hong Kong/China.**

After the Trump-Xi meeting in mid-May, we expect increasing negative news flow from the US-China trade negotiation. Although we believe neither country can afford a decoupling and there will be an ultimate "trade deal" by November this year, the market is likely to be negatively affected by the adverse news flow during the negotiation phase. We believe any short-term correction of the market can be seen as opportunity for long term accumulation. We will also recommend accumulation of Gold ahead of the volatility in trade talks which may drive pressure of the US dollar.

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