Weekly Digest

3 June 2019

The weekly insight into world stock markets

Huawei to Hell

As we enter June, our gardens are bursting into flower, responding to the warmer weather. Forecasters are optimistic about the prospects of another fine summer, possibly even matching the wonderful one we had last year. Just as the outlook for the weather is becoming balmy, however, the winds in investment markets have turned decidedly chilly. May saw global equity markets fall by approximately 3% in sterling terms, equivalent to around 6% in dollars as a weaker pound has softened the apparent impact for UK investors.

Although global equities still remain handsomely ahead for the calendar year with gains of close to 10% in both pounds and dollars, a message of increased caution is amplified in fixed income markets, where long bond yields in government markets have fallen sharply. US 10 year bonds are now yielding just over 2.1%, almost 0.6% lower than at the start of the year, 0.4% of the fall having occurred in May alone. At the same time, German 10 year Bund yields have fallen by 0.4% over the year, half of which occurred in May, and they now trade at all-time lows of negative 0.2%.

The change in mood can be attributed to one thing – the abrupt resumption of hostilities in the US/China trade dispute. Investment markets went into reverse when, after being encouraged to believe that a trade deal was imminent, on May 5th America accused China of reneging on key components of the outline deal in their revised draft. The accusation, which reportedly centred on China's removal from the original draft of their commitment to enforce key components of the deal (surrounding intellectual property protection, amongst other things) by enshrining them in legislation, was accompanied by an increase in the tariff rate on $200Bn of Chinese imports from 10% to 25%, implemented almost immediately on May 10th. In addition, the US Trade Department was instructed to initiate a public hearing as a preliminary step in placing 25% tariffs on a further $300Bn of Chinese imports to the US. If implemented, American tariffs would be running at 25% across almost all of China's exports to America of $539Bn in 2018.

The rights and wrongs of the issue are too complicated to debate in this short piece, but whilst many hope that America's decision to walk away from the negotiating table will be short lived, there are increasing risks that we may be approaching the point of no return, where a trade spat turns into a full-blown trade war, to no-one's benefit.

America's decision to blacklist China's flagship communications technology company, Huawei, effectively strangling their access to technology supplied by the US and by anyone who wishes to continue to supply the US, compounds this concern. Huawei stands accused of a broad raft of offences, from intellectual property theft, to trading with blacklisted regimes, to supplying equipment that America believes could have "trapdoors" to enable China to spy on those who use it. China naturally protests their (Huawei's) innocence, accusing America of using dirty tricks to lock China out of markets where they have gained legitimate competitive advantage. Whatever the truth of the matter, the move effectively places a Chinese national champion in the same relative positon as Iran and North Korea. No country could accept an infringement of it rights to purchase goods freely available on the global open market for a key strategic industry. China, whose own historical narrative is founded on the memory of imperialist exploitation in the 19th Century, perhaps least of all. Should China choose to unleash the nationalist narrative in response to the American administrations' hard driving negotiating strategy, prospects for global growth will dim significantly.

In this context, Xi Jinping is now under intense internal pressure to defend China's honour. Over the past week there have been ominous signs that China's position is hardening. Analogies by President Xi between today and China's Long March, a period of struggle and triumph against the odds analogous to Dunkirk in the British consciousness, are deeply evocative. More explicitly a ban on the sale of rare earth metals to America is being strongly hinted at. China controls 35% of the world's reserves and supplies 80% of America's consumption of these commodities, which are key to the production of modern battery technology amongst other things.

For now, as reflected in the broad stability of the Chinese currency in foreign exchange markets, most investors still expect a deal to be reached – if only because the alternative is so unpalatable. We would not expect much relief from elevated tensions, however, until after the G20 summit in Osaka on June 28th, when Presidents Trump and Xi are expected to meet.

John Haynes
Head of Research

FTSE 100 Weekly Winners

Fresnillo	5.7%
Severn Trent	4.3%
SSE	3.9%
Vodafone Group	2.6%
Sainsbury	2.5%
United Utilities Group	2.4%
Experian	2.4%

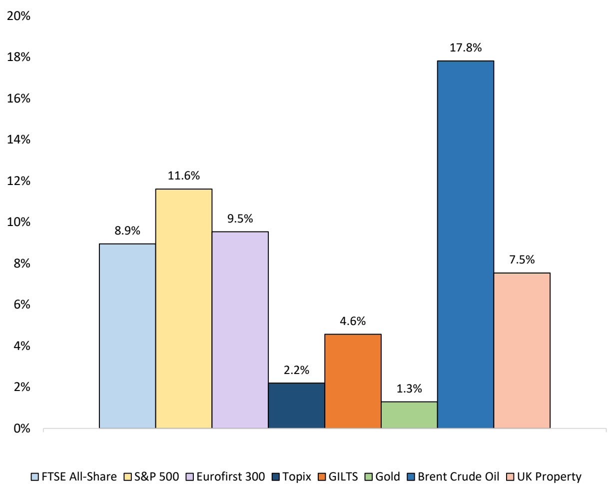
Source: FactSet

FTSE 100 Weekly Losers

NMC Health	-7.6%
British American Tobacco	-7.5%
Imperial Brands	-6.5%
Burberry Group	-6.3%
EasyJet	-5.2%
Ashtead Group	-5.0%
Marks and Spencer	-4.4%

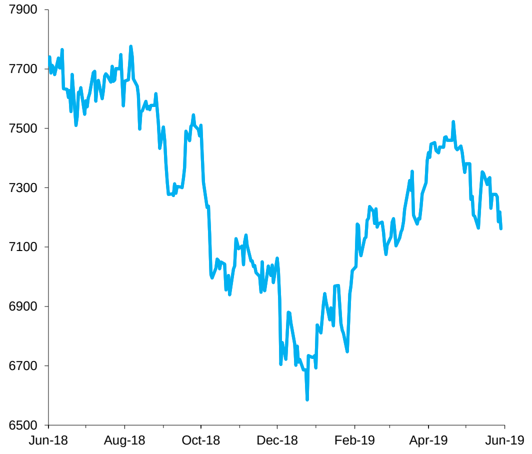
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet