Weekly Digest

3 December 2018

The weekly insight into world stock markets

Kicking Cans

This week has started with a positive tone to equity markets, with most indices rising and much talk of a "Santa Claus rally" to add some much needed gloss to portfolio returns for 2018. The proximate cause is the announcement of a ceasefire in the trade war between the United States and China that was announced at the weekend's G20 summit in Argentina. Given that the outcome of this particular spat is one of the key variables in our current investment outlook, the news is most welcome, but I am reluctant to break out the champagne because this is only a ceasefire, not a peace treaty.

The clock had been ticking down to an escalation of the tariff rate from 10% to 25% on $200 billion worth of US imports from China on December 31st. The ceasefire allows for another ninety days of negotiations. In return China has pledged to buy increased amounts of certain goods from the US to shrink the trade deficit, including, crucially, a substantial amount of soya beans, which is crucial to sustaining support for Trump in the agricultural community. But there is still a long way to go, not least on the important matters of forced technology transfer, theft of intellectual property, fair access to the Chinese market and support for State-Owned Enterprises. It is certainly feasible that this is all resolved before the clocks go forward again – think of this positively, Spring will be here before you know it! – but, if not, up go the tariffs with the threat of further charges on another $267 billion of goods (which would effectively cover all of China's exports to the US).

The point here is that we are only being offered a short term palliative. As the countdown progresses towards the end of March, the tension will ratchet up again and market volatility will increase. If this was just about the trade deficit it might be easier to see a swift resolution, but it's as much, if not more, about the threat that China poses to America's de facto status as the world's top dog, a position it has enjoyed for about the last hundred years. Interestingly, it is one of the few things that both the Republicans and Democrats appear to agree on. There is also a huge difference of time horizons here. The US/China relationship is something that is going to evolve over decades, whereas Trump's focus is currently on re-election in 2020, and so he will look for easy wins that generate positive headlines. President Xi has the luxury of not having to submit to electoral cycles, but it is incumbent on the Chinese government to adhere to the rules of global fair play if it wants to be fully accepted. There are plenty of twists and turns left in this story.

"Can kicking" seems to have become the metaphor of choice for people like me who want to describe political or economic decisions that fail to settle long-term problems but at least remove short-term threats to markets or social stability. Unfortunately there is no shortage of examples. Staying with US politics, one hoary old chestnut is the Debt Ceiling. Pretty much as you might guess, it places a limit on the total amount of debt that can be issued by the government. It sounds great in principle, but ends up being highly impractical and something that can be used as a political football. The limit was suspended last February, with that suspension expiring on March 1st 2019. That will give the Democrats a stronger hand in any negotiations that are taking place in Congress at the time. Lack of agreement to suspend or increase the debt ceiling can, in the worst case scenario, lead to government departmental closures, unpaid bills and even, at the extreme, default. We are not talking Argentina-style default here, to be sure, but be prepared for nerve-jangling predictions to start appearing as we move into next year.
Where else does the sound of clanging cans reverberate? How about in the corridors of Westminster, specifically around the Irish border backstop. It has been apparent for some time that this is the single most difficult area of the negotiations, which runs way beyond normal political and economic considerations. I certainly have no solution (other than no Brexit!), and I expect this to be a bone of contention for some time to come.

And then there's Italy. I have recently written about the Budget negotiations between Rome and Brussels, which are still unresolved. But even if there is a compromise between the two sides it will not eliminate the facts that Italy is carrying a debt burden equivalent to 130% of its GDP, suffers from severe structural problems, and has failed to grow for the past twenty years. Nettles with sharper stings are going to have to be grasped in the years to come.
One person who has tried to grasp such nettles is President Macron of France. He has had a modicum of success with certain reforms in government and in state-owned industries, but raising fuel taxes has been a step too far, resulting in shocking scenes from Paris over the weekend. The fact that the duty rises are ostensibly aimed at helping to curb emissions, which has broad support, carries little weight against the immediate threat to disposable incomes and rural livelihoods. In the face of such protests (which themselves have possibly been hijacked by extreme political factions) it will be very interesting to see what, if any, concessions Macron makes. At least he doesn't have to face voters until 2022.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Vodafone Group	8.9%
John Wood Group	8.1%
Centrica	6.9%
Severn Trent	5.2%
Scottish Mortgage Investment Trust	4.6%
Ocado Group	4.6%
Rolls Royce Holdings	3.9%

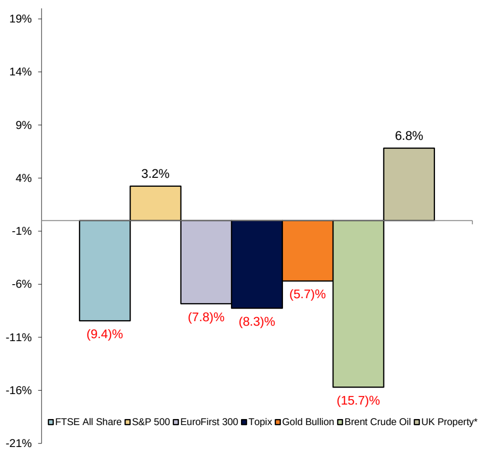
Source: FactSet

FTSE 100 Weekly Losers

Persimmon	-12.6%
Taylor Wimpey	-12.2%
TUI	-10.7%
Barratt Developments	-9.2%
Berkeley Group Holdings	-8.8%
GVC Holdings	-8.7%
NMC Health	-8.6%

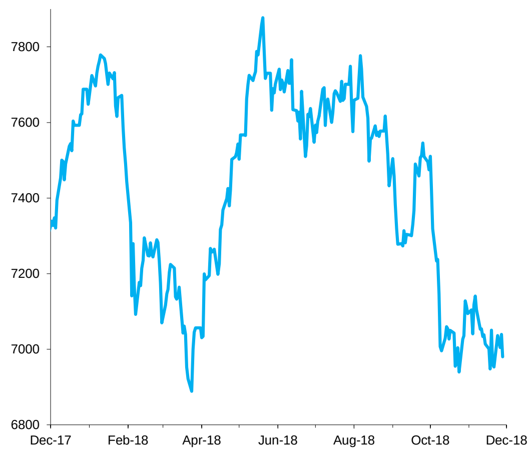
Source: FactSet

Year to Date Market Performance



Source: FactSet
*IPD Total Return to September 2018

FTSE 100 Index, Past 12 Months



Source: FactSet

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