Weekly Digest

4 March 2019

Investec Wealth & Investment

The weekly insight into world stock markets

It's Fun To Be In The USMCA

Last week I suggested that global monetary policy, the outcome of trade talks and (more specifically for UK investors) Brexit were the current key macro market influences. A deeper dive into the first of those topics left no room to discuss the others, so this week it's time address that omission.

Conscious of the risk of Brexit fatigue, I will kick off with trade, which turns out to be timely owing to reported news overnight that the US and China are close to signing a deal that promises to reduce the current tensions. It's worth reminding ourselves why trade has become such a big issue. On the plus side it has been a boon for the majority of investors and consumers. Companies have benefitted from being able to source labour and capital inputs from the cheapest (and sometimes more efficient) regions, while also gaining access to new markets. Consumers have enjoyed wider choice as well as being allowed to share some of the cost savings. The disinflationary impulse from globalisation has been a factor in keeping bond yields lower, which has been a contributory factor to higher equity valuations. What's not to like?

Quite a lot it seems! It is now abundantly clear that there is a substantial minority of the developed world population that has suffered as their jobs have effectively been "exported", mainly to emerging economies. Whole industries, notably in manufacturing sectors, have been hollowed out, although services have also seen substantial migration. Thus certain politicians have gained support by advocating protectionist policies, not only to secure remaining jobs, but also to bring previously exported jobs home again. It should come as no surprise that US president Donald Trump is the key figure in this movement, but what you might not expect me to say is that there is some justification for his actions. The biggest problem has been in his abrasive approach. He has been described as "the wrong answer to the right questions". The social costs of globalisation for many western economies are becoming burdensome, and it is broadly agreed that China has not been playing fairly.

Trump started with two relatively easy targets, Mexico and Canada, the signatories, along with the US, to the original NAFTA trade treaty. Both countries' share of trade with the US is so great that they could hardly withdraw, and the new arrangement, the USMCA (not a disco classic, but the US-Mexico-Canada-Agreement), was agreed with minimal tweaks. Importantly, though, it gave Trump an easy win. As I write, negotiations between the US and China continue, which is actually encouraging, since last Friday was the original deadline for China to comply with Trump's demands. An extension was granted and today's news suggests that Presidents Trump and Xi will convene to sign a deal at the end of March. This will cover much more than just trade, with the protection of Intellectual Property, forced technology transfer, state subsidies and fairer market access all on the agenda. If a deal is signed the US will roll back the tariffs it imposed on Chinese imports last year – as opposed to escalating them. We continue to believe that this is the most probable outcome, seeing as both leaders have an interest in supporting economic growth in their respective countries, and markets will respond positively to this.

Even so, devils are often found in the detail, and one such detail is a proviso in the USMCA that neither Mexico nor Canada can forge a separate trade deal with a "non-market economy" – for which read "China" – without risking the breakdown of the USMCA. A document released last week by the US outlining negotiating objectives ahead of a potential US/UK trade deal suggests that the UK would also be subject to such a stricture should it attempt to negotiate a separate trade deal with China in the supposedly unfettered post-Brexit world. This is a very clear message of the Trump administration's long-term attitude towards China.

All in all, protectionism and nationalism has the capacity to cap, or even to reverse, many of the benefits of the last few decades, threatening a noxious combination of lower growth and potentially higher inflation as more grit is thrown into the gears of global commerce. And it's not just big visible barriers such as tariffs. One can also include quotas, levies and sanctions as well as regulatory hurdles and safety standards, not to mention onerous customs paperwork. Therefore it is understandable that equity investors will throw a party when a US/China deal is signed, but it would be wise to be aware that the underlying tension between the US and China will remain.

There is also the small matter of an outstanding US investigation into European (mainly German) car exports. The US has frequently accused Europe (again mainly Germany) of not pulling its weight in terms of its share of global demand and military spending, for example. What better stick to beat it with than the threat of 25% tariffs on cars? Apparently a report (S232) has already been delivered to the White House recommending such action.

It won't have escaped your attention that I have avoided the "B" topic again, but next week I will probably be forced to embrace it as we head into what could be a crucial two days of votes in Parliament. There again, a week can be a long time in politics.

John Wyn-Evans
Head of Investment Strategy

FTSE 100 Weekly Winners

Ocado	16.7%
Just Eat	8.8%
Taylor Wimpey	7.3%
GVC Holdings	6.1%
Standard Life Aberdeen	5.5%
Kingfisher	5.1%
Lloyds Banking Group	4.7%

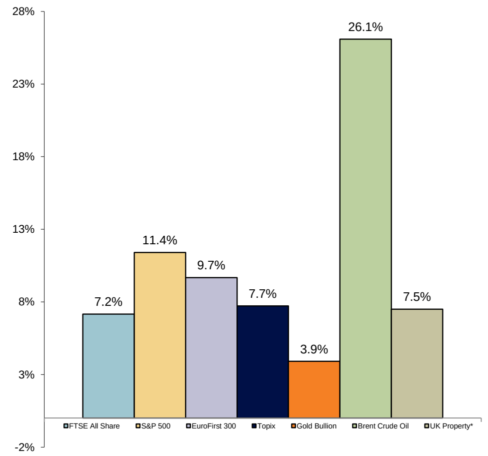
Source: FactSet

FTSE 100 Weekly Losers

Fresnillo	-17.1%
RELX	-9.0%
Rolls-Royce Holdings	-7.8%
Pearson	-6.8%
International Consolidated Airlines	-6.5%
BT Group	-6.0%
Mondi	-5.9%

Source: FactSet

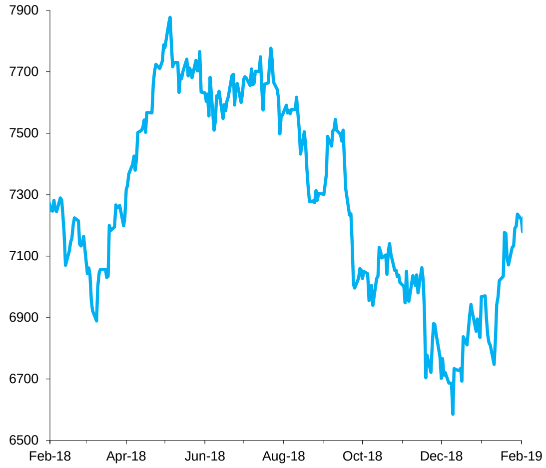
Year to Date Market Performance



Source: FactSet

*IPD Total Return to December 2018

FTSE 100 Index, Past 12 Months



Source: FactSet

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