Weekly Digest

5 August 2019

The weekly insight into world stock markets

Investec Wealth & Investment

Action and Reaction

The temperature in financial markets has suddenly turned decidedly chilly. Signs of unease were already apparent in falling global bond yields, suggesting that all was not well with the growth outlook. The mood had not been helped by the state of open conflict between the American administration and the Federal Reserve regarding the appropriate monetary policy setting in the world's largest economy, a factor that introduces uncertainty for all who use the dollar extensively in their daily business.

The straw that has broken the proverbial camel's back for equity investors, however, has been President Trump losing patience with the progress of trade talks with China and, on Thursday last week, deciding to impose 10% tariffs on the $300bn of Chinese imports to the US that had until then been tariff free.

Equity markets have taken this poorly for a number of reasons. First, because it was unexpected – there had been no official severance of the negotiations that had only just recommenced following the G-20 meeting between Xi Jinping and President Trump at the end of June. Second, because the move, together with the accompanying threat to increase the magnitude of the tariffs still further, raised the risk that China would push back more aggressively than in the past – taking the trade conflict to an entirely new and more risky (for global growth) level.

This morning, those fears appear to be well founded. The Chinese Yuan has weakened below the psychologically important seven yuan per dollar rate, a level it last saw in June 2008. Why is this significant? It is because, given that the Yuan is a managed currency, this could only have happened with the support of the Chinese authorities. Up to now, in spite of the trade tensions and the tariffs imposed so far, the Chinese have gone out of their way to keep the Yuan stable. This year it has traded between 6.7 and 6.95 to the dollar, with most of the movement being explained by dollar strength rather than Yuan weakness. Allowing the currency to move past a “big figure” signals one of two things – either that China's patience with megaphone diplomacy has run out, or that something in China is causing currency flight that cannot be controlled. Neither of these interpretations is positive for investors.

The former (a deliberate weakening) ups the ante in the trade conflict. Until now the Chinese have simply reacted to American actions, but this opens up a new policy front and sets the US on a course to officially declaring China a “currency manipulator” – embedding the conflict deeper into Sino / American relations. The fact that China has, at the same time, reportedly instructed its state purchasing organisations to cease buying American agricultural products, suggests this is the truth of the matter. The latter, if true, would be even less appealing, since the prospect of the world's second largest economy commencing a downward spiral as liquidity fled, would be highly unwelcome in an already uncertain climate for investors and businesses. In spite of the unrest in Hong Kong, there is little evidence of this. In fact, Hong Kong may be part of the reason for a more robust response to America's recent actions than in the past. Signs of weakness may be less tolerable in this context.

What now? A rational observer would still suggest that America and China have far more to lose than to gain by an escalation in the trade conflict. We should expect a calming in tensions later in the year. In the near term, however, it is difficult to see how ether side can back down from their new positions. Unfortunately, it is business confidence, particularly in Europe, which relies more heavily than the US on global trade, which is the true hostage in this situation..

John Haynes
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FTSE 100 Weekly Winners

London Stock Exchange	20.1%
Just Eat	15.9%
Rentokil	6.5%
AstraZeneca	4.9%
Smith & Nephew	4.8%
Next	3.7%
Diageo	3.6%

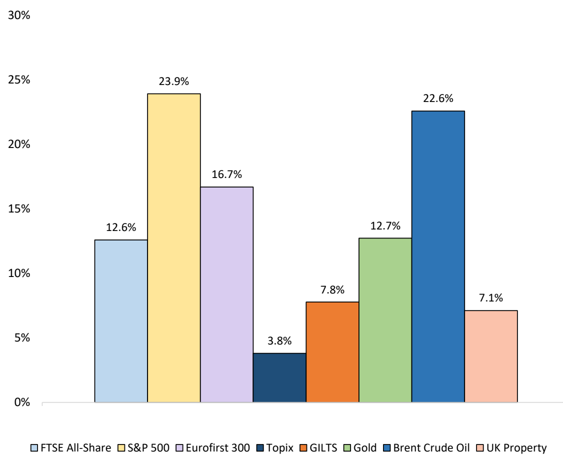
Source:FactSet

FTSE 100 Weekly Losers

Fresnillo	-22.3%
Centrica	-16.1%
St. James's Place	-11.7%
John Wood	-11.7%
Glencore	-11.0%
Royal Bank of Scotland	-11.0%
Mondi	-10.7%

Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months

Source: FactSet

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