Weekly Digest

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The weekly insight into world stock markets

Investec
Wealth & Investment

Redback Rising

Last week saw significant developments in both Geopolitics & Global Monetary Policy – two key areas of current concern for investors who are looking for threats that might bring an end to the healthy economic growth picture that has supported corporate earnings and share prices.

Decisions from the Central Banks of the US, Europe and Japan were delivered. With America increasing rates (and likely to continue to do so) and Europe winding down its “QE” programme by the end of the year, the withdrawal of the extraordinary stimulus in place since the Great Financial Crisis is continuing. Although there was some weakening in the Euro/Dollar exchange rate, market reactions suggest that the move to a more normal global monetary policy environment is proceeding largely as expected and that so-called “transition risk” (the possibility of a policy mistake) remains low.

Developments in Geopolitics were less encouraging. The unexpected decision by the Trump Presidency to impose tariffs of $50Bn on Chinese goods complicates a picture that had appeared to be improving. The Trump Presidency has again delivered the message to the world that America First is a reality even if it comes at the expense of traditional allies. In addition, this policy will be implemented unilaterally rather than through traditional negotiating channels.

So how should investors judge these developments? In the short term the material effect will be small, since the tariffs come against a strong economic backdrop. Furthermore the Chinese reaction is also likely to be measured – they recognise that President Trump is at least partly playing to his voter base ahead of the upcoming mid-term elections. Nevertheless there is always the possibility that trade skirmishes turn into something worse. The characterisation of these tariffs as punishment for Intellectual Property (IP) theft as opposed to an adjustment to unfair subsidies or mispricing of goods, increases that risk.

The potential for material push-back from a broader base is also growing. There is some basis for the assertion that America has disproportionately bourne the cost of “Pax-Americana” since the end of the Cold War, it is harder to argue that it has not fully shared in the benefits. A foreign policy (both military and economic) that targets both more burden sharing and also a larger slice of the pie is difficult to swallow for allies and trading partners alike. All of America’s trading partners will now be re-assessing the magnitude, nature and stability of their relationships. Just as the heartland of America celebrates their more assertive stance, so a populist backlash against America will almost certainly gain momentum in Europe.

Global investors can see this and, having overcome their initial aversion to him, they are increasingly building a Trump “risk premium” back into their decision making processes. They are also asking whether there could be a silver-lining to this cloud – who could benefit from America’s retrenchment and how?

Perversely, America’s current policies look likely to be of longer term benefit to those whom it is targeting most directly in the short term. Specifically, China has embraced the role of the guardian of the world trade order and has simultaneously been wooing its neighbours with direct investment. In so doing, it is taking advantage of a golden opportunity to step-in to the vacuum left by America and re-assert its influence in its region. The dividends to them over the long-term could be substantial. One of the strategic goals for China is to make the “Redback” (a nickname for the Chinese Currency – the Yuan, as opposed to the “Greenback”, which is the common nickname for the Dollar) a key global trading currency. In pursuit of this goal, after initially surprising world markets in 2015 when it moved suddenly to a “dirty float” just prior to entering the World Bank currency reserve basket, it has worked hard to keep the Yuan stable.

Still, the trading usage by third parties of the Chinese currency remains insignificant as a share of world trade and has not increased. America may now be helping this goal, since if countries and companies feel more secure with China and less so with America – so they will agree to price more contracts, trade, settle and hold reserves in the Yuan – at the expense (almost certainly) of the Dollar. Whilst it will be many years (probably decades) before the Yuan could hope to challenge the Dollar as the world’s default reserve currency, as the Chinese would say ‘a journey of 1000 miles starts with a single step’. Just as America looks to borrow more, they may be met with less demand for their Government Bonds. The Trump administration is playing a very high stakes game indeed.

John Haynes
Head of Research

FTSE 100 Weekly Winners

Rolls-Royce Holdings	13.7%
Evraz	6.0%
Carnival	6.0%
Reckitt Benckiser Group	4.9%
Marks and Spencer Group	4.7%
Centrica	4.6%
Royal Mail	4.2%

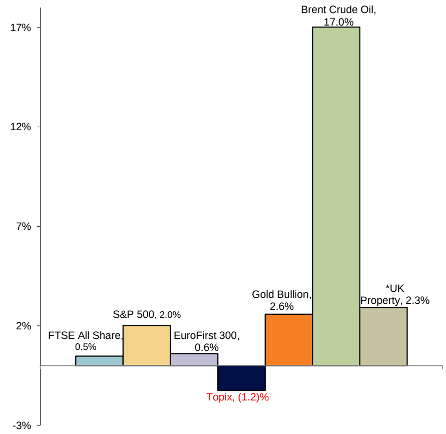
Source: FactSet

FTSE 100 Weekly Losers

Just Eat	-8.1%
Anglo American	-7.1%
Antofagasta	-7.1%
Persimmon	-6.7%
BHP Billiton	-5.3%
Barratt Developments	-5.1%
Royal Bank of Scotland Group	-4.9%

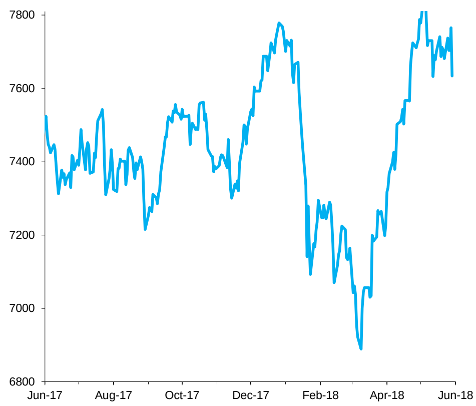
Source: FactSet

Year to Date Market Performance



Source: FactSet

FTSE 100 Index, Past 12 Months



Source: FactSet

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