

## Trade Wars – Mutually Assured Economic Destruction

After focusing on domestic matters last week, it's back to the international stage this week as we look at the threat from protectionism. Although "America First" was a key mantra of Donald Trump's campaign, it's taken him over a year in office to really crank up the volume on trade issues, and this represents a major reversal to his more market-friendly interventions in 2017, especially when combined with the changing composition of his key White House advisors. Unhelpfully, this all boiled up during a week that included a meeting of the Federal Reserve Open Market Committee at which members took a slightly more hawkish turn, and also when the reaction to Facebook's unauthorised release of data put downward pressure on the whole Technology sector. If there is one consolation, it is that equity markets, although weak, did not display the extremes of volatility witnessed at the start of February.

Why are trade wars back on the political agenda? Once again it is the rise of populist forces that are the prime motivation. As we have discussed in the past, not least when considering the outcomes of elections and referendums, there is a substantial minority of the electorate – certainly big enough to constitute a meaningful swing vote – that feels it has not benefitted from the relentless march of globalisation over the last few decades. Manufacturing jobs, in particular, have been relocated to lower cost countries primarily located in emerging economies, and whole industries and communities have been "hollowed out". The situation has been exacerbated by the use of unconventional monetary policy since the financial crisis, which has increased wealth gaps by boosting the value of financial assets, which tend to be owned by a wealthier minority. Protectionist policy, taken at face value, is directed at an attempt to level the playing field in favour of domestic production.

So far, so simple. But there is more than a suspicion that Trump's motives are self-serving. He is under intense pressure from Robert Mueller's investigation into Russian influence on the outcome of the 2016 election, while also facing the bad publicity surrounding an alleged affair with a star from the adult entertainment industry; mid-term elections are on the horizon in November, with the Republicans facing the threat of losing their majority in the House of Representatives. What better way to shift the narrative and rally the voters than by sticking it to the Chinese? And it's fairly clear that China is the main focus of his policy, because the EU, Mexico, Canada, Australia, Argentina, Brazil and South Korea were all granted exemptions from the tariffs on steel and aluminium.

Of course, China is not guilt-free in all of this. It has championed mercantilist policy in the past by allowing its currency to be weak and investing hugely in excess industrial capacity, but it has been reining back such behavior more recently. Of perhaps greater concern is the alleged theft of intellectual property. China has recognised for a while that being the world's bargain basement is not a sustainable path to greater wealth, so has been working on raising the value-added content of its exports. Although it's very difficult to prove these things, one can see that it's tempting to take a short cut by using someone else's ideas rather than taking the time and expense to develop your own. One need only type "Range Rover Evoque Chinese copy" into an internet search bar to see a striking example of this (alleged) behaviour. And that's the clever thing about Donald Trump – he probably does have just enough evidence to make his actions seem justifiable, so it's hard to see him backing down.

However, Trump has decided to take on a formidable opponent, which probably has greater tolerance to sustain hostilities – and the fact that President Xi is not beholden to the whims of voters is a plus for him. China's exports to the US account for about 4% of Chinese GDP and the trade surplus in goods and services is around 3%. China is growing at a real 6.5% per annum, so has some cushion even if it exports nothing to the US. China is already undertaking massive investment in its "New Silk Road" initiative to broaden trade ties across Eurasia, South-East Asia, and the subcontinents of Asia and Africa, and so has no shortage of new trade opportunities. It also boasts the fastest-growing consumer economy (in terms of money spent), which remains massively alluring for overseas companies who want to do business there. American corporations can already see this crock of gold fading, and are lobbying the president to tread more carefully. Interestingly, the Chinese themselves have been relatively measured in their responses so far.

In reality, a resolution of this spat will probably require that all parties involved "save face" and that Trump, in particular, can project a certain image at home. However, it is also incumbent upon politicians in much of the western world to recognise what is driving the populist agenda and to address issues such as inequality – and this will involve making unpopular decisions, which politicians never like because it reduces the chances of being re-elected. From an investment perspective, greater trade friction reduces overall global growth and tends to create more inflationary pressures, owing to the tariffs imposed and less choice for consumers. It also reduces innovation as domestic companies are shielded from international competition. That is quite the opposite of what we have experienced for much of the last half-century, a period that has been generally kind to investors. It is important that the rest of the world is not sucked into Trump's drama. Finally, the song Andrew Lloyd Webber won as Oscar for in 1996 was *You Must Love Me*, from *Evita*. . This week, which body of water lies between the southern tip of Argentina and the South Shetland Islands in the Antarctic?

**John Wyn-Evans**  
Head of Investment Strategy

### FTSE 100 Weekly Winners

Next	4.7%
Evraz	4.1%
Reckitt Benckiser	3.3%
London Stock Exchange	3.2%
Royal Mail	2.6%
Land Securities	2.0%
Berkeley Group	1.1%

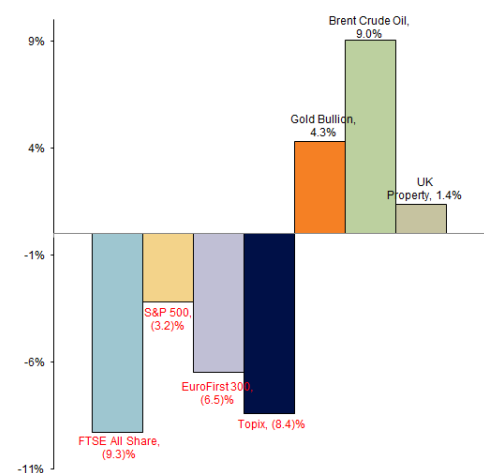
Source: FactSet

### FTSE 100 Weekly Losers

Micro Focus International	-49.3%
Kingfisher	-13.6%
Smiths Group	-7.7%
Scottish Mortgage Investment Trust	-7.1%
Standard Chartered	-7.0%
Shire	-7.0%
Glencore	-7.0%

Source: FactSet

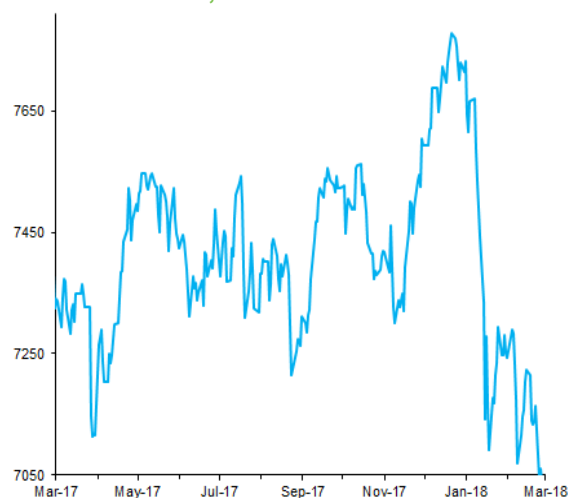
### Year to Date Market Performance



\*Lagged to latest UK IPD Total Return All Property Index (Feb 2018)

Source: FactSet

### FTSE 100 Index, Past 12 Months



Source: FactSet

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Registered No. 2122340. Registered Office: 2 Gresham Street, London EC2V 7QP.

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