

# OCM Asset Management

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## **Market Update: 4<sup>th</sup> December 2019**

### **A Resurgence of Global Trade Risks Dampens Stock Market Optimism**

Alongside escalating geopolitical tensions and noise over the General Election in the UK, developments in the US-China trade saga are moving markets this week. After months of optimism over a phase one deal, it appears that negotiations may have met a stumbling block in the form of US support for democratic Hong Kong protesters, prompting Chinese retaliation and a deterioration in US-China relations.

After President Trump signed bills offering support to the Hong Kong protesters and condemning Beijing's crackdown on ethnic Muslims in Xinjiang, it was warned that the US would face some repercussions from the Chinese, just as a phase one trade deal was rumoured to be close to completion. Those repercussions came in the form of a report from Chinese state media indicating that the government would be publishing a list of "unreliable entities" that could lead to sanctions against US companies. At the same time, China also moved to sanction some human rights organisations and halt US Naval visits to Hong Kong, however this is likely to be just the tip of the iceberg in terms of the Chinese response. As Hong Kong protests continue and human rights issues in Xinjiang remain in focus, there is room for further escalation here.

#### ***'No deadline' for a trade deal***

This week's re-escalation in global trade risk was solidified by a flurry of trade threats across three continents, all in the space of 24 hours. After signs that US-China trade relations were improving just last month, President Trump reminded financial markets that he has no deadline for the phase one deal, and that he's comfortable heading into an election year using tariffs as his main source of international economic leverage. This raises concerns that the trade deal could be delayed as far as November, indicating very low motivations for even a staged deal in the coming months as first expected. With tariffs already starting to bite, this would derail investor hopes of a sharp recovery in global trade early next year, with uncertainty likely to continue to act as a drag on corporate earnings and consumer confidence.

Given the rollercoaster ride that has been US-China relations over the last year, there's always chance of a breakthrough, however no significant meetings are currently scheduled going into the final weeks of the year, and the Chinese are expected to take a hard line over US involvement in the Hong Kong and Xinjiang issues. Market movements are likely to remain volatile in the coming weeks as new developments in the relationship and trade talks emerge.

#### ***Looming December tariffs***

After a 20-month long trade dispute, President Trump's lack of urgency over a phase one trade deal rocked financial markets over the week, sending equities tumbling while low risk investments such as government bonds gained. It is now uncertain whether the planned US tariff hike on 15<sup>th</sup> December on around \$160 billion in Chinese goods will be avoided, and while there are already considerable tariffs

on a large proportion of Chinese imports, this planned hike poses a significant risk to the US consumer, with tariffs including smartphones, toys and children's clothing. If nothing changes in the coming weeks, it's clear that the US is prepared to go ahead with the tariffs, potentially at the expense of the consumer.

### ***The President reinvigorates his trade offensive***

This week's barrage of bearish trade news began on Monday, when President Trump unexpectedly tweeted that he would be reinstating tariffs on steel and aluminium imports from Brazil and Argentina for reasons relating to currency devaluations. Later in the day, the US also announced plans for tariffs on \$2.4 billion of imports from France as retaliation over a new tax which hits US tech companies. At the same time, it was announced that the US was contemplating increasing the scope of tariffs levied against the EU over illegal Airbus subsidies according to the recent ruling of the World Trade Organisation (WTO).

As a result of the escalation of trade risks this week, investor optimism over a staged resolution to the US-China trade conflict and other trade-related conflicts started to fade as President Trump's more hawkish instincts re-emerged. His actions are underpinned by an apparent belief that his import taxes are having a positive impact on the US economy, highlighting the inflows from the taxes and gains in the US stock market this year as evidence for this in a recent tweet.

### ***Key Risks***

While the President may be stepping up his trade offensive in an attempt to frame his hard stance on trade for his re-election campaign, a key risk arising from this week's actions is a possible trade conflict with Europe, with French tariffs potentially provoking retaliation from Brussels. With the US-China trade conflict still ongoing, a conflict with the EU could cause significant damage to the US economy and provide a further drag on global trade.

Another potential threat arising from President Trump's hawkish trade shift would be a potential currency war, in which nations ignore their G20 pledges in order to target rates for the benefit of their domestic economies. Alongside his trade announcements on Monday, President Trump signalled that he wanted the Fed to weaken the dollar to improve competitiveness of US goods, a task which has proved difficult in recent months despite rate cuts.

### ***Positioning***

Given this week's re-escalation of global trade tensions, most notably between the US and China, equity markets have declined while risk-off assets including bonds gained. The portfolio remains defensively positioned, therefore benefitted from the risk-off rally in recent days. It also benefitted from low overseas currency exposure as sterling strengthened over the week on the back of new polling data ahead of the UK Election. It is clear that markets are likely to continue to display high levels of volatility, therefore our defensive allocation allows us to reduce excess risks and focus on identifying new opportunities as they arise.

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