

How will the trade war between US and China affect your investment portfolio?

When US President Donald Trump came to power last year, he brought with him an ambitious list of goals, including; building a wall between the US and Mexico, preventing some ethnic groups from entering the US, reforming corporate tax, withdrawing the US from climate pacts and addressing the trade deficit with China. He wanted to drain the swamp and fight the status quo - a rebel if you will. He promised to shake things up and has recently been doing just that, by pursuing his protectionist agenda - much to the dismay of global markets. The threat of a so called 'trade war' is rising, and the main target of Trump's opening salvos – China – can and will strike back.

The US currently runs a trade deficit of around $375 billion USD with China on an annual basis, with goods such as consumer electronics streaming into the US from Chinese factories, produced at lower cost thanks to cheaper labour and cost of input. Their consumer-heavy economy relies on these goods being affordable for the average household. The relationship, seemingly lopsided in China's favour, works both ways as US goods do also flow to China, ranging from soya beans to passenger aircraft. Despite this, Trump's White House is not happy with either the trade balance deficit, which it says is costing the US

jobs, or an alleged intellectual property theft that China is also being accused of.

At the beginning of March, Trump's first move was a scatter-gun effect, a threat that would affect all US trading partners. He announced the intent to impose 25% and 15% tariffs on the imports of steel and aluminium respectively, potentially affecting Canada, Japan, China and many European countries, amongst others. In swift succession, the affected countries threatened retaliation, should he press ahead with his measures. Sabres were rattled a little and markets were ruffled. Having been recently harrowed by a global market correction in February, markets were already on edge and once more headed into the red. On this threat, Japan's Nikkei 225 index fell around 2.5% on the news alone. European markets followed suit and US markets themselves took a 1.5% lurch downwards. A key downside risk identified during Trump's election campaign was being brought to life – the risk of US protectionism – and more was to follow.

After countries that might be affected by US trade tariffs lined up to say they would take retaliatory action against the US's unilateral trade plans, complexities emerged, and it seemed the White House would be willing to consider concessions for close security partners such as Canada and Europe. This favouritism increasingly singled out the likes of China, leading to Trump's next move – a direct shot across China's bow. It was never any secret that Trump had the US-China trade relationship high on his agenda, but the announcement on the 22nd of March that the US was planning to hit China with a 25% levy on $60 billion worth of imports, confirmed he was now locked and loaded.

This time, global markets really sat up and paid attention. Valuations have recovered somewhat from the volatility in February but are still in a fragile state, so perhaps had more value to shed. Japan was clobbered the hardest, with the Nikkei 225 seeing a 4.5% drop immediately after the announcement, closely followed by Chinese markets losing between 2.5% and 3.5% in a day's trading. Once more, the US did not escape the selling, with its markets falling around 2.5%.

It is perhaps telling that China responded with the threat of less severe retaliatory measures - a planned 15% to 25% levy on $3 billion worth of US goods reaching China. Many, including Trump, would argue that China have more to lose from a trade war, and that their so far relatively cool and collected responses are a form of bluff. China have now said they will take legal action via the World Trade Organisation, so they do appear to be preparing for the worst-case scenario – the US following through with their threats. Arguments can be made to the contrary, however, based on the fact that rising costs of Chinese imports would hurt the US consumer and producers more deeply than vice versa, raising US inflation along the way. From the Chinese perspective, exports to the US have been a shrinking proportion of its overall global exports, which themselves, more broadly, are contributing to a diminishing proportion of its GDP.

Arguments aside, it is clear that the stakes are high for both sides as in parallel with the threats flying, talks are also being held behind the scenes. US Treasury Secretary, Steven Mnuchin, has now publicly said that he is hopeful that the two countries can reach an agreement to prevent a trade war, causing US markets to see their biggest one-day gain since 2015, underlining how easily developments in this story can move markets.

It is often said that bull markets rise on a wall of worry and this has been particularly true of the last few years where we have seen the global economy power ahead with stock markets almost in unison and, more recently, with vigour. There have been many bricks of worry built into the wall – Brexit, US elections, European populism, North Korean tensions and Trump's literal wall with Mexico. As 2017's key risks increasingly take a backseat in 2018, the risk of US protectionism becomes central. Central banks agree that the risk of an escalating trade war is not only the key threat to the global recovery in 2018, but that it will also have a bearing on monetary policy throughout the year.

Historic low equity market volatility was never bound to last as we have continually outlined. Currently, it is likely that volatility will increasingly be driven by trade related rhetoric and any measures that leaders eventually follow through on. If this threatened trade war starts to heat up further, it will be more important than ever for investors to be positioned into assets that help manage volatility, such as broad diversification across equities and other alternatives such as property and absolute return funds with lower correlation to equity markets. The value of government debt is more of a concern due to the fact central banks are now possibly being pulled in two directions – both in the direction of tightening due to strong global economic growth, but also potentially in the direction of the doves if global growth is to be threatened by a trade war.

TAM continues to position client portfolios to navigate these markets, notwithstanding we expect to see continued volatility, thus allocating equity exposure across a broad range of global markets remains vital. We continue to have a dimmer view of fixed income, instead favouring multi-asset and absolute return managers who can help stabilise portfolio volatility and protect client capital from the full extent of the draw-downs we have been seeing of late. Despite market conditions becoming more volatile, we continue to believe this breeds opportunity and maintain a positive outlook for our portfolios in 2018.

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