

Trade Wars

Published on: 23 March, 2018 | Author: Investment Team

Our quarterly investment conference takes place next week when we take the time to review the data coming out of the world economy. Is the global economy contracting or expanding, what is the impact for the cost of capital and where should investors be positioned to navigate the changing tides of international capital flows?

What is interesting, is that a decade after the global meltdown, the world is finally getting back to normal. Growth is buoyant, the spectre of deflation seems to have largely evaporated; indeed, inflation is gently accelerating. Fears surrounding the “Zero Lower Bound” for interest rates are receding.

Lead indicators, for example, purchasing manager surveys (PMIs), point to expanding activity across much of the developed world. There is also some evidence that wages are finally growing supporting consumer spending; consumption being the principal driver of growth in developed economies.

On the face of it, this is good news for investors. More activity with higher spending generating higher profits and dividends.

It looks like a regime change; out of crisis mode and back to business as usual. However, markets are facing a number of risks which are depressing sentiment.

We know that stronger growth brings with it the end of “QE” and higher interest rates. This is part of the normalisation process and markets are well aware of the issue. It is no surprise but it does carry the risk that Central Banks tighten too early, too aggressively.

More important is the risk that growth is impaired by reckless politics particularly with respect to international trade. The Smoot-Hawley tariff imposed by the US in the 1930s is widely credited with tipping recession into depression.

The current US administration seems to have a “bar-room” understanding of trade and its role in a heavily integrated global economy and is risking global prosperity by instigating a series of tariffs aimed at its principal allies including, rather bizarrely, Canada!

Tariffs can, for a time, divert spending to the domestic economy to the benefit of a subset of workers, ostensibly in this case US steelworkers in the Rustbelt. Mr Trump is playing to his base. However, this comes at a cost; higher prices for everyone else, less competition and damage to a world trading system under the World Trade Organisation (WTO) that has taken decades to establish.

Even as the economic and financial risks to the world economy diminish, investors now have to deal with a wholly new and unpredictable set of political risks. In this context, portfolio construction with respect to the quantity of appropriate stabilising assets relative to select exposure to growth remains central to navigating a seemingly increasingly unpredictable world. Our Strategies are defensively positioned to account for this uncertainty.

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