Weekly Market Summary

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Markets in Desperate Need of Positive News Before the Summer Season Kicks-In!!
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In the spring of 1991 President George H.W. Bush looked unstoppable. Following Operation Desert Storm in the Gulf, his approval rating hit 89% - the highest ever recorded by Gallup. Yet, that was not enough for him to win a second presidential term. What made Bush lose, as Clinton adviser James Carville famously joked, was "*the economy, stupid*", a phrase meant for the internal audience of Clinton's campaign workers as one of the three messages to focus on (the other two being "*Change vs more of the same*" and "*Don't forget health care*"). Team Clinton wagered that the sluggish recovery from the 1990-1991 recession would loom largest in the minds of voters, and they turned out right!

Today, the story is quite different. Recent polls have found that Americans have never felt more positive about the economy. And yet, the same polls also suggest that confident voter attitudes about the economy are not translating into public support for Trump. By a whopping 25-point margin, voters say they are more likely to back a Congressional candidate who promises to serve as a check on president Trump, according to a new national poll from NBC News and the Wall Street Journal. And by a similar margin, they say they are less likely to vote for someone who has supported the president on most issues. Could this be attributed to the various fiascos Trump got himself into over the past 2 years? Surely YES! Just in the last 48 hours, and in the face of overwhelming public pressure, the US president had to abandon his policy of family separation at US borders (just a day after a top aide to the President had noted that he "doesn't want to look weak" and won't back down from this fight!), though his willingness – as well as that of his administration - to plunge ahead anyway with a vicious tactic is primarily a normal outcome of grim promises previously made to their Republican base. When it comes to financial markets, however, the whole focus remains on Trump's trade agenda/policies and their harmful impact (rising frictions) on the US relationship with the rest of the world!

Last Friday, US President Donald Trump brought the world's two biggest economies to the brink of a trade war by officially announcing (*as opposed to previous verbal threats*) a 25% tariff on up to US$ 50 billion in Chinese imports - to take effect July 6th. The U.S. tariffs will cover 1,102 Chinese product lines/items, primarily relating to Chinese industrial machinery, aerospace parts and communications technology, while sparing such consumer goods as smartphones, TVs, toys and clothes that Americans purchase by the truckload from China. In announcing the U.S. tariffs, Trump said he was fulfilling a campaign pledge to crack down on what he contends are China's unfair trade practices and its efforts to undermine U.S. technology and intellectual property. "*We have the great brain power in Silicon Valley, and China and others steal those secrets*," Trump said on "Fox & Friends." "*We're going to protect those secrets. Those are crown jewels for this country*." "*I have an excellent relationship with President Xi [Jinping], and we will continue working together on many issues. But the United States will no longer be taken advantage of on trade by China and other countries in the world*," Trump concluded.

"*It's thorough, it's moderate, it's appropriate*," U.S. Trade Rep. Robert Lighthizer noted on Fox Business Network's "Mornings With Maria." Lighthizer added that "*our hope is that it doesn't lead to a rash reaction from China*."

Instead of caving in to Washington's demands, Beijing quickly responded that it would retaliate with penalties of the same scale on American goods - later providing more details with regards to imposing tariffs on 545 U.S. exports, including farm products, autos and seafood. China's Commerce Ministry also suggested that "*the Chinese side doesn't want to fight a trade war, but facing the short-sightedness of the U.S. side, China has to fight back strongly. We will immediately introduce the same scale and equal taxation measures, and all economic and trade achievements reached by the two sides will be invalidated*."

The U.S. imported $506 billion of goods from China last year and exported about $130 billion, leaving a 2017 deficit of $376 billion, according to government figures. But this misses an important aspect of the relationship that works strongly in favour of the US: Following almost 40 years of US corporate investment in China, the subsidiaries of American multinationals based in China are doing a roaring trade selling goods and services to Chinese consumers (those do not show up in the trade balance or current account figures). So large are these sales – from corporations such as GM, Nike, Starbucks, Ford and others - that they probably far exceed the value of US exports to China.

And whilst the end game is a compromise trade deal that meets US demands for more balanced import/export volumes and stronger Chinese protection of intellectual property rights, the road to a trade deal has surely turned very ugly lately. That was obvious again last Monday, when Donald Trump said he would direct the US trade representative to identify an additional 200 billion dollars of goods for new tariffs (10%) and threatened more to come, accusing Beijing of refusing to change its "*unfair*" practices. "*These tariffs will go into effect if China refuses to change its practices, and also if it insists on going forward with the new tariffs that it has recently announced*," he said according to a statement from the White House. China again promised to retaliate. "*If the U.S. loses its senses and publishes such a list, China will have to take comprehensive quantitative and qualitative measures*," according to a statement from the Ministry of Commerce. It labelled the move "*extreme pressure and blackmail*." The language and directives are almost textbook examples of a trade war, with each side escalating in turn.

More importantly, Trump has made it clear that he has problems not only with China, but even with key allies - including Canada and European nations. The US president has already imposed tariffs on steel and aluminium from Canada, Mexico and European allies, sparking anger and retaliatory threats from some of America's closest long-time allies (the EU triggered the first phase of retaliation against the U.S. over its metal-import tariffs, approving a 25% duty on € 2.8 billion euros of U.S. products including Harley-Davidson Inc. motorcycles and Levi Strauss & Co. jeans). But his proposed tariffs against China risk igniting a damaging trade war involving the world's two biggest economies, not to mention its negative impact on his efforts to bring peace to the Korean peninsula following his summit with leader Kim Jong Un this week in Singapore. Beijing is an important player in talks with North Korea on abandoning its nuclear-weapons program.

Wall Street has long viewed global trade tensions with concern, fearful that they could repress economic growth and undermine the benefits of the tax cuts Trump signed into law late last year. The prospect of a U.S.-China all-out trade war have weighed on financial markets in past week, with the Dow Jones Industrial Average down for an eight straight day (in excess of 700 points since last Thursday close, a 2.9% drop), whilst US Treasury yields have moved slightly lower.

Those latest trade skirmishes are not expected to hold back the U.S. economy just yet, which is booming this quarter as tax cuts power consumers and businesses, but they could surely lead very soon to lower global trading volumes, damage US economic growth and result in higher checkout prices on a range of tech, apparel and household goods for U.S. consumers. "*Let us not understate the macroeconomic impact*," IMF Director Christine Lagarde noted earlier this week, saying the tariffs will have a larger economic toll if they prompt retaliation from trading partners like Canada and Germany. The IMF has said a cycle of retaliation on trade would likely dampen national and international investment, interrupt global and regional supply chains and undermine a system that has supported U.S. growth and job creation (Daimler AG became the first prominent company to cut its profit outlook due to escalating trade tensions between the U.S. and China, claiming Chinese customers will now buy fewer cars after Beijing slaps tariffs on U.S. auto imports). Commerce Secretary Wilbur Ross has disputed concerns raised by the IMF, the US Federal Reserve Chairman Jerome Powell and others that U.S. companies are becoming so anxious about the prospect of a trade war that they are postponing investment and hiring decisions. "*Anyone who thinks the economy is being wrecked doesn't know what they're talking about*," Ross said in a Bloomberg Television interview yesterday (Seriously? Coming from a Trump aide that has benefited from recent Administration decisions to amass extra personal wealth! ☹).

To conclude, investors have had to deal with a deluge of growing uncertainties in past weeks: From bond yields exploding in Italy after months of political drama (yesterday was no different, with the appointment of two Euroskeptics to key posts in Italy's parliament reigniting investor concerns over the populist government's policies), to Spain's sudden government fall, Germany's shaky ruling coalition in past days, Brexit negotiations regularly hitting multiple obstacles, a G-7 meeting ending in public hostility, and now US and China's engagement in a tit-for-tat tariffs standoff that could run into the hundreds of billions of dollars - the list of market negatives keeps growing !! For now, hedge fund managers and traders have simply taken a "glass half-full" approach, keeping volatility low and betting that pending issues would soon be resolved whilst the global economy continues its healthy expansion.

One can surely hope that calmer heads and pragmatism will eventually prevail, and that positive news would soon start emerging on all fronts. Otherwise, should previously cited issues stay un-resolved, one should better be prepared for a full-blown financial disaster later this summer!!

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