Investment Insight

Friday, 2 March 2018

ARIA | CAPITAL

Trade Off: *President Trump's recent announcement of tariffs on steel and aluminium imports was received poorly by stock markets. Following the sell-off he then tweeted "trade wars are good, and easy to win."*

It is unlikely that the trade wars on a scale that Trump suggests will, in fact, be good for economies and they certainly will not be easy to win. Don't take our word for it though, as in this week's ***Inside Track*** *we share the strong views of Ben Inker from GMO on the topic.*

No-one likes a seller: *Following negative market movements, it's not uncommon to find the Inbox flooded with analyses, charts and theses providing statistical justification for not selling assets. While not exceptional by any standards, the recent correction prompted the receipt of just such missives. While only ever attaining "anecdote" status, they nonetheless on occasion make interesting reading. In this week's* ***Pic of the Week*** *we see why nobody should sell anything. Ever.*

Quoted...

"Pursuing protectionism is just like locking one's self in a dark room: Wind and rain might be kept outside but so are light and air." – Xi Jinping

The Inside Track

Ben Inker is head of GMO's Asset Allocation team and his recent piece: "Trade Wars are Bad, and Nobody Wins" puts forward some strong views refuting Trump's recent protectionist comments.

A trade war is probably more dangerous for investors at this time than at any other time in recent history given the implications it would have for inflation, monetary policy, and economic growth. So from an economic impact standpoint, I believe there are unlikely to be a material number of new jobs created in the U.S. from these tariffs. On the other hand, it is not hard to imagine that jobs could easily be lost. There are hugely more U.S. workers involved in making the products that use steel and aluminum than there are U.S. workers directly in those sectors, and these tariffs and the resulting higher domestic prices for steel and aluminum relative to prices in the rest of the world suddenly make the U.S. a less attractive place to manufacture anything which uses those inputs.

The U.S. economy is large and diversified, and manufacturing is not a large percentage of total jobs, so these tariffs in particular are unlikely to have an outsized effect on overall economic growth. But at the margin, the tariffs would have to be expected to increase U.S. inflation, decrease growth, and decrease our export competiveness. And this ignores the impact of (what is extremely likely to be) retaliatory measures by U.S. trade partners.

Should these tariffs be imposed, the best we can realistically hope for is that things are contained at the level of a "trade skirmish," where other countries respond with targeted tariffs or restrictions on a limited number of U.S. export products. Even this would make it even more likely that the net result of the tariffs will be net job losses along with the inflation increase.

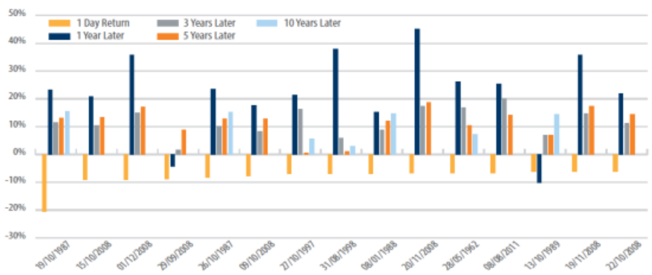
But the real danger is that we see an escalation into a full-blown trade war. Given the rise of economic nationalism and increasing numbers of populist leaders with a shaky grasp of economics around the world, the likelihood of entering a trade war that is in no one's best interest seems higher than should make one comfortable. Such a trade war would be a profound retreat from the globalization trend we have seen over the last 30 years. It can take years for companies to build out their global supply chains. With the stroke of a pen, political leaders can make those supply chains instantly far more expensive. But this does not make the process of building the domestic capability to replace foreign suppliers happen overnight. Such onshoring would necessarily take time, and frankly would not likely be possible in a lot of cases. In the meantime, widespread tariffs would mean large price rises. Those price increases, in all likelihood, would force the hand of the Federal Reserve to raise rates more aggressively than is currently planned, without any corresponding positive such as would come from an unexpectedly strong economy.

The psychological aspects of a trade war are not to be discounted either. One of the most striking features of investors today is their apparent willingness to look far into the future in assessing the value of investments. Whether this is in the form of high valuations for currently unprofitable but fast growing companies, or real estate and infrastructure investments priced with extremely long payback periods, investors today seem serenely convinced that they can predict what the future will look like. A global trade war could (and probably should) cause investors to shorten their time horizons, which is a negative for long duration risky assets such as equities. If one wanted to imagine a scenario in which valuations fall not merely to long term historical averages but right through onto the other side, a global trade war is a strong candidate.

Pic of the Week

The chart illustrates the 15 most recent single-day losses in the S&P 500 Index of -6% or more and the subsequent price performance of the index for the one, three, five and ten year periods that followed. So the message is quite clear: NEVER SELL. Of course, the immediately following message reads: "PAST PERFORMANCE IS NOT A RELIABLE GUIDE TO FUTURE PERFORMANCE". Go figure!

S&P 500 INDEX PERFORMANCE DURING AND AFTER EXTREME DOWN DAYS



Market View

	Last 7 days (€)	Last 12 mths (€)	YTD (€)	5Y Ann. (€)
Global equities	-1.3%	+1.2%	-2.0%	+11.4%
US equities	-1.4%	+0.6%	-1.1%	+15.1%
European equities	-1.8%	+2.6%	-4.3%	+7.5%
EM equities	-0.4%	+11.8%	+0.7%	+5.5%
Irish equities	+0.8%	+2.1%	-4.3%	+12.0%
Commodities	-1.6%	-8.0%	-2.9%	-7.9%
Hedge funds	-0.9%	+0.4%	-1.3%	-1.1%

Currencies	*Current*	*YTD Δ*
EUR:USD	1.2315	+2.6%
EUR:GBP	0.8915	+0.3%
EUR:CNY	7.8052	-0.0%
GBP:USD	1.3813	+2.3%
Bitcoin	9,801	-32.4%

Week ahead: Key events

12/03 UK PMI & US employment Data
13/03 US Retail Sales & Labour Market Statistics
14/03 Eurozone Employment & Industrial Production
14/03 US Mortgage Applications
15/03 US Manufacturing & Initial Jobless Claims
16/03 Eurozone CPI & US Housing Starts

Commodities	*Current*	*YTD Δ*
Gold	1,320.43	+1.4%
Copper	6,872.50	-4.0%
Oil	64.53	-4.1%
Wheat	590.00	+38.3%

Central bank rates	*Current*
Eurozone	0.00%
USA	1.25%
UK	0.25%

Economic indicators	*Bond yields*	*Inflation*	*GDP YoY*
Ireland	+1.0%	+0.2%	+7.2%
Germany	+0.6%	+1.6%	+2.9%
USA	+2.9%	+2.1%	+2.2%
China	+2.0%	+1.5%	+6.8%

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