Investment Event

10 May 2019
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US tariffs raised from 10% to 25%, but negotiations continue

US tariffs increased from 10% to 25% on USD200bn worth of Chinese goods, effective on Friday, mostly affecting parts and components imports

The reaction of Chinese authorities has been cautious, stating counter-measures instead of retaliation

The outcome of the negotiations remains unclear, but any extension of tariffs to other Chinese goods would take time. It is also in both sides interest to reach an agreement

Our views

Our core asset class views are unchanged. We remain overweight global equities as economic growth should remain resilient. We also retain our underweight positioning in advanced economies' government bonds

US tariff increases implemented

As announced on Sunday 5 May by President Trump, US tariffs on USD200bn worth of Chinese goods were raised from 10% to 25% on Friday 10 May. The initial threat of the tariff increases took investors by surprise, given previous signals that talks were progressing well and that a number of hurdles had been cleared. Global equity markets came under pressure as a result. However, the reaction to the actual decision to raise tariffs has been more muted.

According to media reports, the latest sticking point relates to how China is planning to enforce agreed measures to curb technology transfers and to protect US intellectual property. The US would like these measures to be enshrined in law, while China is arguing the issue could be dealt with by altering regulations. There could also be disagreements on the schedule for removing existing tariffs, and industrial subsidies.

China's negotiating delegation, led by Chinese Vice Premier Liu He, stated immediately after the tariff increases became effective that China will have to take "counter-measures", without developing further, while expressing its hope that a negotiated resolution of the current tensions will be achieved. Interestingly, the Chinese delegation refrained from mentioning retaliation, which would have been seen as a sign of escalation. Instead, counter-measures could take the form of monetary and fiscal stimulation of the economy to mitigate the negative impact of higher tariffs. Negotiations between the US and China are expected to resume later today.

Extending tariffs will take time

The US President also threatened on Sunday to impose fresh tariffs of 25% on USD325bn worth of Chinese goods "shortly". Implementing tariffs on the remaining imports from China would likely take a number of months in order to go through the required regulatory process (including public comment). It is important to note that more of these goods cover finished consumer goods rather than imported components/raw materials.

The potential reaction from China is hard to predict. At present it has USD50bn worth of goods imports from the US at a 25% tariff, and another USD60bn at around an 8% tariff, which together cover all goods imports. As a first step China could raise the 8% tariff to 25%, or even higher given the lower value of US exports to China.

It could also take symbolic decision like discouraging the consumption of US services by Chinese households and firms, for instance by making it harder and/or less attractive for Chinese citizens to study and go as tourists to the US, and being (even) more restrictive in allowing US movies to be shown in Chinese cinemas.

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Market considerations

We continue to maintain a pro-risk stance in our multi asset portfolios, for a number of reasons:

1. Valuations for equities remain relatively attractive, while corporate fundamentals look reasonable.
2. Even if China reacts by raising its own tariffs, we have previously shown the adverse economic impact to be relatively minor. Overall, US and Chinese growth would still be expected to perform well this year and next.
3. There is also room for policy easing to offset any adverse effects.
4. An escalation of tariffs to the full suite of US imports from China would be more economically damaging. However, we think the probability of this scenario is low.
5. Ultimately, it remains in both sides' interests to strike a deal. Significant progress has been made so far and it would be surprising if negotiations were scrapped.

Overall, we think increased market volatility creates buying opportunities for equities.

Meanwhile, we remain comfortable with an underweight position in DM government bonds given low prospective returns. Further tariffs raise the risk of higher US inflation, which could weigh on bond prices. Nevertheless, government bonds may still deliver diversification benefits, should concerns over economic growth intensify (prospective risk-adjusted returns are higher in shorter duration Treasuries). Dovish central bank policy is also a positive.

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