MARKET BULLETIN

ST. JAMES'S PLACE
WEALTH MANAGEMENT

Monday 8 October 2018

Dancing Queen

"You know, as a business principle, it's not good to have all your eggs in one big basket," said Sonny Perdue, US Secretary of Agriculture last week. "And that's what we did with China, because they were customers and hungry. And we fed them and fed them and fed them, and they kept buying."

Perdue's opening line might have been referring to stock selection and the value of diversification. As it happens, his subject was soya beans, by far and away the US's largest export to China. Since July those exports, now subject to a 25% tariff as they enter China, have fallen by 90%. That, in turn, has boosted the price of Brazilian soya beans. That, in turn, has raised prices for Japanese food producers, who import soya beans to use in tofu production. Such is the domino effect tariffs can set off – and who can say if it has ended?

As for US tariffs on China, at least some of the impact has been absorbed by a 10% drop in the value of the Chinese currency against the dollar. Whether China will allow a similarly symmetrical devaluation to take place when tariffs rise to 25% remains to be seen. At any rate, figures released last week by Deutsche Bank showed that a number of US states have been stockpiling soya beans in order to wait out the end of the tariff war – some are significant swing states that may express their view on tariff wars in the November midterms.

Yet the White House could also point to a trade victory last week, as Canada signed up to NAFTA's successor, known as USMCA. Changes were not major, but a slackening of the rules governing the trade in dairy products and a tightening of the rules governing the trade in cars and trucks seem to have been the most significant changes. The deal largely enables manufacturers to stick with long-established supply chains and was welcomed by investors. Congress must now vote it through.

Some analysts see diplomatic dividends for Trump too, with the successful completion of a North America deal enabling the US to exert greater pressure on Beijing. One US central banker warned that China and the US are now at risk of a "10- or 20-year trade war". Last Wednesday, tensions took on another form as a Chinese vessel sailed within a mere 40 metres of a US navy ship that was passing through disputed waters in the South China Sea.

Even if major trade fallout is yet to be felt, signs in the global economy look decidedly mixed. In a report released last week, Capital Economics argued that, following a slowdown in recent months, the global economy is liable to slow further over the coming year. It argued that the recent slide in world trade growth was due primarily to a fall in global demand, rather than a rise in tariffs – although the latter may yet escalate of course.

In the shorter term, however, good economic news in the US had the effect of pushing up Treasury yields and pushing down stock prices. In the middle of the week Jerome Powell, Chairman of the Federal Reserve, expressed his belief in the "remarkably positive outlook" for the US economy, raising investor expectations of inflation – and therefore interest rate rises – in the process. As Treasury yields surged to their highest level since 2011, sovereign bonds elsewhere in the world also came under pressure.

On Friday, the US payrolls report showed the slowest increase in job creation for a year, but markets were more interested in two significant details: unemployment struck its lowest level since December 1969 and average hourly earnings rose by eight cents.

"The biggest headwinds for the portfolio at the moment are high valuations and increasing interest rates," said Stefan Marcionetti of Magellan Asset Management, manager of the St. James's Place International Equity fund. "The risk of US inflation is also significant, as the labour market tightens and wage growth returns – the Fed will be walking a fine line as it unwinds quantitative easing."

Wages have been the focus of one of the Republican Party's most vocal opponents, Bernie Sanders. Last week, the leftist senator won a political victory as Amazon apparently succumbed to ongoing pressure by raising the minimum wages paid to

its workers in both the US and UK (although it later transpired that workers would accordingly lose their monthly bonuses and stock awards). In line with the S&P 500, Amazon lost some ground on markets last week, but losses need to be seen in context. The S&P 500 opened the fourth quarter close to record highs, and technology stocks have led the way. (Moreover, for those who believe in politically driven market patterns, October is historically a good month for US stocks in years when there are midterm elections coming.)

ABBA laugh

As politics turned increasingly serious internationally, it was party conference season in the UK. Theresa May approached the podium in Birmingham for her own speech to the tune of 'Dancing Queen' and delivered a self-mocking – and robotic – jig on her way. But jokes could not hide the increasingly awkward political manoeuvring she faces in trying to come up with a version of the Chequers deal that her party, the UK parliament and all other 27 EU parliaments will agree to by the deadline – and one that won't create a hard border in Ireland or down the Irish Sea.

In this context, Boris Johnson's star turn at the party conference – not to mention her foreign secretary comparing the EU to the USSR – was probably the least of her worries. Instead, she may have been perturbed to note the French government stealing her lines, when Nathalie Loiseau, France's Europe minister, told the press that, when it comes to Brexit, "no deal is better than a bad deal". But the president of the European Commission, Jean-Claude Juncker, said on Saturday that a deal had drawn significantly nearer in the past few days.

The plot thickened on Sunday when Nicola Sturgeon, speaking at the Scottish National Party's conference in Glasgow, said that the 35 SNP MPs in Westminster were likely to vote against any deal that meant leaving the customs union and single market – and would vote in favour of holding a second Brexit referendum. A poll published at the weekend showed that half of Scots would vote for Scottish independence if Brexit went ahead.

Data came in last week showing that UK business investment in the first half of the year had slowed more quickly than expected, with two consecutive quarterly declines. Last week, the FTSE 100 slipped. Among other news, Unilever lost a shareholder vote to simplify its set-up by restricting itself to a single headquarters in Amsterdam. Instead, the manufacturer of Marmite and Flora will retain dual headquarters, staying in London too – a victory for the City.

Pension worries

Meanwhile, as Budget coverage intensified, there was growing speculation that the chancellor, desperate to find cash after a party conference in which Theresa May pledged an imminent end to austerity, would be hard-pressed to resist dipping into pension tax relief to make savings. A cut in the annual allowance may be the lowest hanging fruit but, if he felt more daring, the tax relief rate itself could be targeted; then he may turn his attention to Inheritance Tax and Capital Gains Tax.

Magellan Asset Management is a fund manager for St. James's Place.

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