FLASH NOTE

31.07.2018

Market insights in the Financial Times

Brace for collision between lower growth and weaker central bank firepower



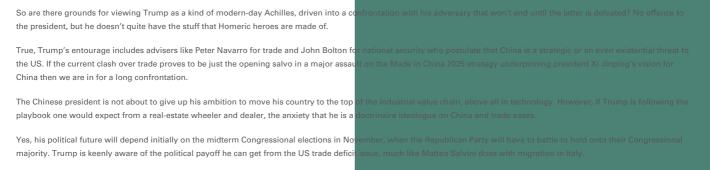
Published Length July 31, 2018 🖉 3 minute(s) read



Download the article

Investors are worried Donald Trump's protectionist crusade will set off an economic crisis or at the very least a sharp slowdown in China.

Over the past month, international investors have shunned emerging-market bonds and currencies, including the Chinese renminbi. Despite the stimulus Beijing announced last week, the Chinese stock market remains down about 13 per cent this year.



But he surely also understands that appealing to some of the general public on the question of trade will encounter resistance from US businesses. Indeed, once a large enough number of US companies have stepped forward as collateral victims, Trump will conclude that he'd better start applying his famous "art of the deal" to his trading partners if he wants his party to make a decent showing at the polls in November.

In the event, Beijing would have little trouble offering an agreement he could hold up as a trophy – provided, that is, that the terms negotiated don't run counter to China's longrange ambitions. But such a deal is unlikely to happen overnight and with almost four months until the midterm elections, expect the current market jitters to continue in coming weeks despite the US and Europe last week agreeing a ceasefire in their trade war. Panic in markets is certainly unwarranted. The short-term spike in volatility we have seen is down to the posturing and one-upmanship typical of negotiations carried out in the public eye, particularly by a showman who revels in that role.

The real risk to investors from Trump's policy is more subtle.

The detrimental effect of uncertainty on the confidence of businesses – especially those with global supply chains - risks throwing into reverse a cyclical upswing that is already losing momentum.

The danger is amplified because central banks are running out of ammunition and governments from the US to Europe have precious little room left for fiscal expansion.

It is a serious problem that potentially lies just a few months down the road. For equity investors, it demands a clear distinction between tactical and strategic positions.

Tactically, as politics will be unavoidable during the summer, equity exposure should be modest but include bullish positions in the options market. The implied vola derivatives instruments is still low, allowing for the purchase of call options at a reasonable price on large equity indices, including those in emerging markets.

This trade would allow investors to catch a spike higher in equities in the event of a trade trade trade trade the US is announced.

However, the strategic challenge for investors is to construct portfolios prepared for the inconvenient collision that looms between a global economic slowdown and central banks with far less ammunition in their arsenals. The key idea is to run a long-short strategy that favours those companies generating earnings growth and that have strong balance sheets. They are typically found in the tech and pharmaceutical sectors, primarily in the US, China and India.

By contrast, cyclical stocks with large financial leverage should be shunned, particularly in Europe and Japan, which will suffer disproportionately when the collision occurs.

Trade tensions may provide opportunities but is more likely to reveal investor complacency over a US economic cycle nearing its end just as central banks retreat.

This article has been published in the Financial Times on 31st of July, 2018. This article is being used with the authorisation of the Financial Times. This article may not be reproduced, in whole or in part, without prior authorisation from Carmignac. It does not constitute a subscription offer, nor does it constitute investment advice. The information contained in this article may be partial information, and may be modified without prior notice. It was not prepared in accordance with applicable regulatory provisions regarding the independence of financial analysts. Carmignac is not subject to the prohibition of entering into transactions in connection with any relevant instruments the may be mentioned in this article may contain information on certain instruments in which Carmionac may have invested at the date it was first published, and it is does not aim to promote a direct investment in any of the instruments in which Carmionac may have invested at the date it was first published, and it is does not aim to promote a direct investment in any of the instruments in which Carmionac may have invested at the date it was first published.

therein.