

Global Matters Weekly

19 October 2020

Relationship problems

– Robert White, CFA

With the US election now just two weeks away, investors are busy forming expectations on the result and looking at the potential policy implications of either a Biden or Trump victory. While there is plenty of short term focus on the eventual shape of any additional stimulus package to emerge from Congress, perhaps the most important issue for long term investors will be how US-China relations develop from here. For those wanting a detailed outline of our thinking on this issue, we have recently published a thought piece in addition to this week's blog which is available here.

While US-China relations have undoubtedly soured under the Trump presidency, polls from The Pew Research Centre show that anti-Chinese sentiment is rife among both major parties and has been increasing this year¹. Attempts to constrain China's rising influence were taken under the Obama administration, and whoever wins the election, it is likely that there will be continued tension which goes beyond pure trade issues.

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The prominence of two ideologically opposed superpowers invites comparisons with the Cold War era, when the US and Russia extended their influence via proxy states and maintained exclusive economic and political systems with little mutual cooperation, occasionally leading to military conflict. Such comparisons are somewhat exaggerated and there are plenty of reasons to be optimistic that the relationship will take on a completely different dynamic.

Firstly, China's brand of communism is nothing like that of USSR; their economic success has largely come from the embrace of free market principles through reforms instigated under the leadership of Deng Xiaoping, a far cry from the Soviet command economy of the post-war era. Secondly, this relative openness has meant that both economies are fundamentally interconnected and rely on each other for healthy sustainable growth. Over the last year, the Chinese Communist Party have relaxed foreign ownership rules, allowing US companies to own majority stakes in Chinese financial institutions for the first time, and the country's 400 million-strong middle class are already an important market for US businesses.

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Investors should however be cognisant of the potential risks of a deterioration. The US and China combined make up over a third of world GDP in purchasing power terms, and any move towards decoupling could be painful. The most crucial battleground remains over technology, as the recent bans of TikTok and Huawei show. New developments in areas such as AI, machine learning, robotics and quantum computing all have the potential to revolutionise economic productivity and military capabilities, and China's goal to be world leading in these industries is an explicit aim of the "Made in China 2025" initiative.

Given the importance of these industries, it is possible that the grounds have been laid for two distinct competing global technology platforms to emerge, each remaining closed to the other using different hardware and operating in different jurisdictions. This would increase production costs for companies and may even shut them off from certain markets, creating problems for some of today's technology giants.

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We could also see the development of separate global financial systems, as the US becomes less willing to supply capital to its competitors. America has already made it more difficult for Chinese companies to maintain US listings through the Holding Foreign Companies Accountable Act, and China has also taken initial steps down this path with the creation of its own global payments system (CIPS). These changes are incremental at present however, and the primacy of the dollar reserve system remains firmly intact for now.

How should investors position for such uncertainty? While some may be tempted to simply avoid China in their portfolios, we believe this would be a costly and ineffective strategy. Instead, we believe careful selection of positions and effective diversification is the best defence, and we run our portfolios accordingly.

¹ <https://www.pewresearch.org/fact-tank/2020/07/30/republicans-see-china-more-negatively-than-democrats-even-as-criticism-rises-in-both-parties/>

The Marketplace

- A relatively flat week for global equities which returned -0.3%
- The IMF upgraded their global growth projection to a -4.4% contraction this year, from a -4.9% contraction forecasted in June
- Brent crude rose +0.2% ending the week at \$42.9 a barrel
- Gold fell -1.6% to end the week at \$1899.3 an ounce.

Market Focus

US

- The large-cap US equity benchmark returned +0.2% over the week
- There is hope for a new fiscal stimulus deal before the election, following discussions between House Speaker Pelosi and Treasury Secretary Mnuchin over the weekend
- CPI data for September shows a year-on-year figure of 1.4%, in line with expectations
- Core retail sales (excluding purchases at auto dealerships, gas stations and food services suppliers) rose 1.4% in September
- Weekly jobless claims rose to a two-month high of 898,000

Europe

- The main continental European equity index returned -0.5% last week

- ECB Chief Economist Philip Lane said that the ECB will decide “meeting by meeting” whether more monetary stimulus is needed, due to the poor inflation outlook
- ECB policymakers are said to be waiting for further data before deciding on a policy response

UK

- UK equities fell -1.8% over the week
- Unemployment in the three months to August rose to 4.5%, against 4.3% expected
- Downbeat remarks on Brexit negotiations from PM Boris Johnson suggest an impasse may have been reached, but discussions continue this week

Asia/Rest of The World

- Global emerging markets rose +0.1% last week
- People’s Bank of China (PBoC) announced that they are lowering the reserve requirement for some forwards instruments amid concerns about the rapidly rising value of the Yuan
- China’s exports last month grew to 9.9% year-on-year in US Dollar terms, beating market forecasts. Imports also increased in September.
- Japanese PM Suga is looking into a third stimulus package to boost consumption and will likely be discussed in the January Diet.

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| Asset Class/Region | Currency | Currency returns | | | |
|-------------------------------------|----------|-----------------------------|------------------|----------|-----------|
| | | Week ending 16 Oct. 2020 | Month to date | YTD 2020 | 12 months |
| Developed Market Equities | | | | | |
| United States | USD | 0.2% | 3.6% | 9.0% | 18.1% |
| United Kingdom | GBP | -1.8% | 0.6% | -21.1% | -16.7% |
| Continental Europe | EUR | -0.5% | 2.1% | -5.9% | -1.1% |
| Japan | JPY | -1.8% | -0.5% | -3.9% | 1.6% |
| Asia Pacific (ex Japan) | USD | 0.1% | 4.2% | 7.1% | 15.7% |
| Australia | AUD | 1.2% | 6.2% | -5.3% | -5.3% |
| Global | USD | -0.3% | 3.1% | 4.9% | 13.0% |
| Emerging markets equities | | | | | |
| Emerging Europe | USD | -3.2% | -2.7% | -30.5% | -22.2% |
| Emerging Asia | USD | 0.4% | 4.4% | 12.8% | 23.4% |
| Emerging Latin America | USD | -1.3% | 3.9% | -33.6% | -27.8% |
| BRICs | USD | 1.0% | 4.8% | 7.0% | 18.1% |
| China | USD | 2.1% | 5.6% | 23.0% | 35.9% |
| MENA countries | USD | 1.0% | 2.8% | -5.4% | 2.1% |
| South Africa | USD | -0.6% | 3.1% | -19.0% | -13.1% |
| India | USD | -1.9% | 4.8% | -5.4% | 0.8% |
| Global emerging markets | USD | 0.1% | 3.9% | 2.7% | 12.2% |
| Bonds | | | | | |
| US Treasuries | USD | 0.3% | -0.4% | 8.9% | 8.4% |
| US Treasuries (inflation protected) | USD | 0.2% | 0.1% | 9.9% | 10.8% |
| US Corporate (investment grade) | USD | 0.5% | 0.6% | 7.3% | 8.8% |
| US High Yield | USD | 0.1% | 1.4% | 2.0% | 4.5% |
| UK Gilts | GBP | 1.5% | 0.6% | 9.1% | 7.1% |
| UK Corporate (investment grade) | GBP | 0.7% | 0.7% | 5.6% | 6.7% |
| Euro Government Bonds | EUR | 0.6% | 1.1% | 4.9% | 3.0% |
| Euro Corporate (investment grade) | EUR | 0.3% | 0.9% | 1.7% | 1.7% |
| Euro High Yield | EUR | -0.1% | 0.9% | -1.9% | 0.0% |
| Japanese Government | JPY | 0.1% | 0.0% | -1.0% | -1.8% |
| Australian Government | AUD | 0.8% | 0.7% | 5.7% | 3.5% |
| Global Government Bonds | USD | 0.2% | 0.2% | 7.5% | 7.2% |
| Global Bonds | USD | 0.1% | 0.4% | 6.8% | 7.2% |
| Global Convertible Bonds | USD | -0.3% | 2.2% | 14.2% | 19.8% |
| Emerging Market Bonds | USD | 0.3% | 1.3% | 2.7% | 5.8% |

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| Asset Class/Region | Currency | Currency returns | | | |
|--------------------------------|----------|-----------------------------|------------------|----------|-----------|
| | | Week ending 16 Oct. 2020 | Month to date | YTD 2020 | 12 months |
| Property | | | | | |
| US Property Securities | USD | -3.8% | 2.6% | -15.7% | -16.7% |
| Australian Property Securities | AUD | -0.1% | 4.2% | -14.3% | -18.2% |
| Asia Property Securities | USD | -1.9% | -0.8% | -18.5% | -15.7% |
| Global Property Securities | USD | -2.5% | 1.4% | -16.3% | -14.9% |
| Currencies | | | | | |
| Euro | USD | -0.9% | 0.0% | 4.4% | 5.8% |
| UK Pound Sterling | USD | -0.7% | 0.1% | -2.6% | 0.6% |
| Japanese Yen | USD | 0.3% | 0.1% | 3.0% | 3.1% |
| Australian Dollar | USD | -2.0% | -1.2% | 0.9% | 4.8% |
| South African Rand | USD | -0.4% | 0.9% | -15.5% | -9.7% |
| Swiss Franc | USD | -0.6% | 0.7% | 5.6% | 8.7% |
| Chinese Yuan | USD | 0.0% | 1.4% | 4.0% | 5.9% |
| Commodities & Alternatives | | | | | |
| Commodities | USD | 0.3% | 2.4% | -17.4% | -13.0% |
| Agricultural Commodities | USD | 1.3% | 3.4% | 3.1% | 7.5% |
| Oil | USD | 0.2% | 4.8% | -35.0% | -27.8% |
| Gold | USD | -1.6% | 0.1% | 24.7% | 27.6% |
| Hedge funds | USD | 0.2% | 1.1% | 2.6% | 5.3% |

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