ALGO
PERFORMANCE FUND

InvestEdge
UCITS
SICAV

March 2018

Fund Manager Commentary

Synchronisation & Tariff Wars

Peter Hollins
Director and Member
of Investment Committee

The US S&P index has fallen some 3% over the month of March. Markets are jittery; already spooked by inflationary Trump tax cuts, markets now have to contend with an inflationary trade war with China.

The $60bn announcement by Trump was twice the market expectations. Exemptions for Australia and Europe does leave China as the specific target. China responded with a reciprocal tariff on 128 US products, although only totalling some $3bn. To this Trump responded...

"Reciprocal. The word is reciprocal."

Meaning, Trump will reciprocate with more US tariffs on Chinese goods.

Behind the rhetoric lies a fundamental issue. Trump was elected by Americans most disaffected by the US trade deficit with China. Traditional US manufacturing jobs have been lost as firms relocate manufacturing to Mexico, or jobs lost as goods from China and South Korea have supplanted US manufactured goods.

Thus far Trump has made good on election promises made. US tax reform has encouraged firms to repatriate profits abroad back to America, leaving more money in the pockets of lower income earners. This has spurred faster growth: some 200,000 new jobs were created last month by mid-sized businesses. Mid-term elections in November for Trump have a focus on rewarding those supporters who elected him.

A weaker US dollar has also helped, and has reduced the trade deficit with Germany slightly from $4bn to $3.5bn. The weaker dollar has not, however, reduced the deficit with China which is $375bn, and getting wider. As Trump has pointed out:

"...It is the largest deficit of any country in the history of our world, it is out of control..."

What are the impacts on markets? Tariff wars lead to fears of rising inflation in the US. This in turn prompts fears of rising interest rates and falling bond and equity markets. Inflation has, however, remained subdued now for some twenty years mainly through the advance of technology. This trend will likely continue unabated.

Another point is that China holds some $1.2 trillion in US Treasury stock; what if they were to sell their holdings and repatriate their money to China? Would the dollar collapse? Would US Treasury bond yields roar higher heralding a depression? In fact, Chinese holdings in US Treasury Stock are less than 10% of the total debt. And whilst the US debt burden is both high and growing, the broader US economy is growing much more quickly.

One should not underestimate Trump's resolve. During trade negotiations with Europe Trump linked the tariff argument and trade deficit to Nato contributions. Whenever the stakes are raised against Trump, he goes one higher, whatever the cost.

Will there be a trade war? The Chinese embassy released a statement:

"China's not afraid of and will not recoil from a trade war."

Trump knows that a trade war with China is ultimately a zero sum game. In a tit for tat tariff war, China will run out of US products to tax long before the US do. Whatever the bravado from the Chinese embassy, China will come to an accommodation at some point; this is a trade war China cannot win.

Markets will inevitably worry about the trade war first, even if they will be happily relieved by the negotiated settlement later. Volatility has increased and we have seen bonds and equities move rapidly in the same direction, in a synchronised manner.

In this regard we illustrate a chart of the Algo Performance USD A plotted against the S&P500 index. From this one can see the desynchronised aspect of the fund during the recent turmoil, thereby providing a counter balance in a portfolio world of worry.