

# thenavigator

Summer 2018

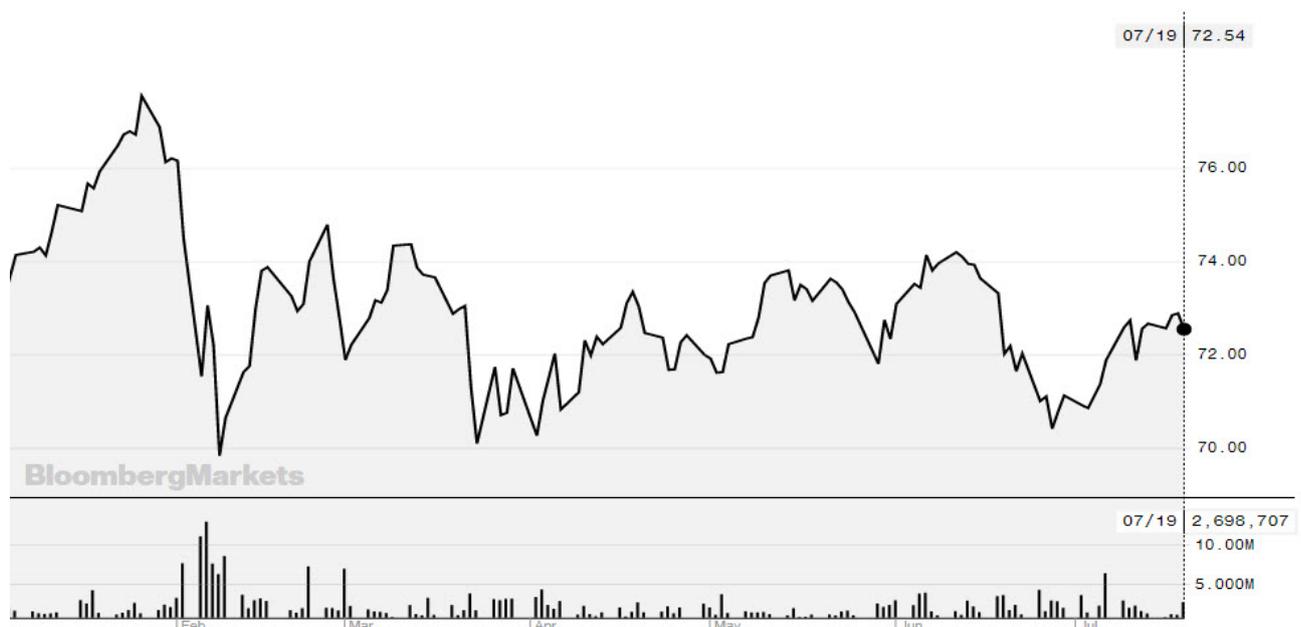
## “Gimme Shelter” (Rolling Stones)

Oh, a storm is threat'ning  
My very life today  
If I don't get some shelter  
Oh yeah, I'm gonna fade away

Ooh, see the fire is sweepin'  
Our very street today  
Burns like a red coal carpet  
Mad bull lost its way

Looking at the relatively sharp movements in global equities, as measured by the MSCI World Index (illustrated by the underlying ETF graph below) and in tune with the lyrics introducing the summer navigator, you can clearly see the market's frustration, susceptibility and sensitivity to headline news.

iShares MSCI World all countries index ETF (1 January - 19 July 2018)



Source: Bloomberg L.P.

Just when you have thought we have made a positive break out as in January, March or May, some headlines come out to slap markets down again. It has been incredibly tiring and really a case of 2 steps forward and 1 step back or more like 3 steps forward and 2 steps back. Perhaps it is the sudden change to increasing volatility having come from an extended period of quantitative easing that lead to suppressed volatility.

Was there any shelter? Not really much.

When you consider traditional safe havens like US bonds, which, when looking at the 10-year US Treasuries, reveals that they have also been somewhat volatile. Yields have been perhaps capped and have come off year-high levels when equity markets have stayed weak but have, on an overall basis, remained vulnerable to inflation worries.

**US 10-year Treasury Notes Yield (1 January – 19 July 2018)**



Source: Bloomberg L.P.

**TRADE WARS?**

“A battle is a combat in warfare between two or more armed forces, or combatants. A war usually consists of multiple battles. Battles generally are well defined in duration, area, and force commitment. A battle with only limited engagement between the forces and without decisive results is sometimes called a skirmish.”

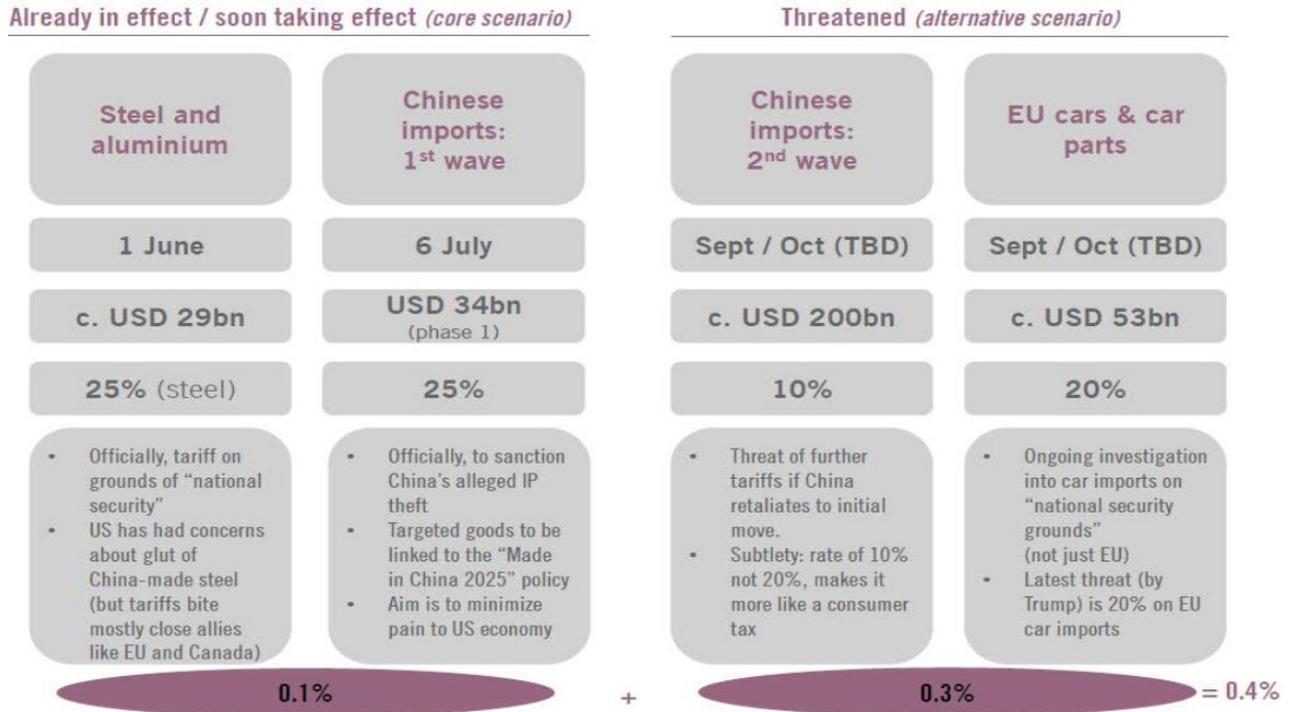
Source: Wikipedia

So, there we are then. We are currently in a trade skirmish, which could escalate into a battle and in the worst-case scenario end up in a war.

Whilst this may seem a mere semantics, the differences are vitally important. At the moment, we believe

the risks are manageable although, perhaps, they have increased somewhat with the proposed 10% tariffs on USD200bn of Chinese imports. Doing the math, if you add the 25% tariffs on USD 29bn on steel and aluminum to the 25% on USD34bn on Chinese imports, which are in effect already, to the proposed tariffs, you arrive at the figure of USD35.5bn. However, we did not include the proposed tariffs on cars & car parts from the EU as we consider them highly unlikely to be enacted. Consequently, the effect on global growth will likely turn out to be 0.1% less than described on the following table.

**Estimated impact from initiated and planned trade tariffs on global growth**



Source: Bloomberg L.P.

Whilst this may sound like a lot if you look at the tariffs as a kind of tax hike, it is essentially equivalent to a sustained 33% increase in retail gasoline prices. In fact, when you look at the USD170bn price tag of this year's tax cuts, the tariffs seem somewhat dwarfed in magnitude.

**STUPID IS AS STUPID DOES (FORREST GUMP)**

Some Wall Street commentators have already declared that the US has won the trade war because the US stock market has gone up while the Chinese market has gone down. It is still a skirmish and no one can predict the outcome of a war after the first shot has been fired. Of course, there may be an element of patriotism here, but we may be wiser to remember Voltaire, who once mused that "It is lamentable, that to be a good patriot one must become the enemy of the rest of mankind".

Of course, one could simply conclude that, because China does not export USD200bn of goods to the US, victory is assured. Once again, this fails to take into

Of course, there are worries about how the tariffs may impact the Chinese economy, but with the offshore Chinese Yuan having already depreciated by 6%, all things being equal, the net 4% tariff should be manageable, especially given the increased focus on boosting consumption by the domestic Chinese consumer.

account subtle nuances like holding up approvals for US companies to do business in China or discouraging Chinese inbound tourism to the US.

At the moment we are effectively playing a game of chicken with both the strong men of the US and China, unwilling to back down. The cars are heading closer towards one another but a head-on collision is not imminent. There is still plenty of scope to find a face-saving compromise allowing both to take back to their countries the usual declaration of victory. Assuming stupidity, stubbornness and grandstanding does not get in the way.

## RISE OF THE BERSERKERS

Berserkers (or "berserks"), as the definition goes, were champion Norse warriors who are primarily reported in Icelandic sagas to have fought in a trance-like fury, a characteristic which later gave rise to the English word "berserk."

These champions would often go into battle without mail coats. Berserkers are attested to in numerous Old Norse sources, as were the Úlfhéðnar ("wolf-coats").

The rage the berserker experienced was referred to as berserkergang ("going berserk"). This condition has been described as follows:

This fury, which was called berserkergang, occurred not only in the heat of a battle, but also during laborious work. Men, who were thus seized, performed

things which otherwise seemed impossible for human power. This condition is said to have begun with shivering, chattering of the teeth, and chill in the body, and then the face swelled and changed its colour. With this was connected a great hot-headedness, which at last gave over into a great rage, under which they howled as wild animals, bit the edge of their shields, and cut down everything they met without discriminating between friend or foe. When this condition ceased, a great dulling of the mind and feebleness followed, which could last for one or several days. *Source: Wikipedia*

Whilst the berserkers were considered to be expendable 'shock troops', used to intimidate enemies, the world is not used to generals or a commander in chief behaving in such a manner.

## STAY THE COURSE

The current volatility, daily headline barrage and negligible gains for global investors (the MSCI world index is up just under 2%), with over half the year gone, have led many investors to throw in the towel. We believe, this year will be back-end loaded in terms of returns as investors scale the wall of worry and focus on fundamentals such as economic growth, corporate profit growth and consumer spending.

We may just get a tailwind from the tariffs as consumers, who were delaying purchases, act now rather than waiting for the price of the goods they want to increase in price. Think of it as a stimulus for consumers effectively bringing consumer purchasing decisions forward.

Whilst the cliché that the only certain things in life are death and taxes still remains appropriate, I think you can add to this, that politicians are really only interested in being re-elected and getting votes. In this context, it is important to take note of the back down by President Trump on the immigration crisis and most recently on his comments made at the Russian

summit. We also notice the sensitivity of the administration to any sharp falls in equity markets. The performance of the equity market has been touted as a direct result of the current government's policies.

Picking up on the recent comments by the Chairman of the Federal Reserve; "The US economy is doing well and interest rates are likely to rise further in a moderate way. However, there was some disappointment in the weakness of wage growth." It doesn't take a rocket scientist to figure out that if the cost of goods increase and wages remain static, the consumer's disposable income is going to be squeezed with negative effects on the quality of life. This is hardly a vote winning strategy.

I therefore fully expect the current loud din to fade towards background elevator music as the year progresses and in the meantime the EU and Japan signed a trade deal, which eliminates nearly all tariffs on products they trade. It is the largest bilateral trade deal, covers one third of the global economy and markets of more than 600 million people.



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