FUND MANAGEMENT DIARY

Meeting held on 13th February 2018

US Tariffs Not a Game Changer, For Now

- World trade is thriving after Donald Trump's first year as President of the United States but the threat of his administration turning increasingly protectionist has not gone away

- The United States has imposed new tariffs on imports of solar cells and washing machines, but the overall impact on China's economy – or others in Asia – will be small

- China is striving to paint itself as a champion of global free trade but, if tensions escalated into a trade war, it could use punitive action to hurt American firms

World trade is enjoying something of a renaissance at the moment. The latest available data show that global trade rose by 4½ per cent in three-month year-on-year terms in November. This is more than double the pace of a year ago. Somewhat ironically the upturn in world trade began around the time of the United States election.

Indeed, in his first year in office Donald Trump has proved a more agreeable partner than China's leadership in particular might have feared. There were no across-the-board tariffs on Chinese imports. China was not designated a currency manipulator on "day one" or any day thereafter. And by pulling the United States out of discussions to set up the Trans-Pacific Partnership, he weakened a potential counterweight to China's economic power in the region.

However, the economic relationship may be more fraught in 2018 and there are signs of a shift in the tone of United States engagement. According to the White House, Donald Trump told President Xi Jinping on a call in January that the bilateral trade imbalance was "not sustainable". Tariffs on washing machines and solar panel imports have also been announced that were clearly aimed at China, the world's dominant producer in both sectors.

These tariffs are far from a game changer though. The value of exporting these products to America makes up a tiny share of gross domestic product for China or other Asian economies.

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However, there are still outstanding decisions on: (i) whether steel and aluminium imports harm United States national security (decisions on each industry are due by mid-April); and (ii) whether China is forcing American firms to handover intellectual property (a decision is due by August but is likely much sooner, according to media reports). The decisions on steel and aluminium could lead to tariffs and quotas similar to those announced last week. The intellectual property case could lead to tariffs and investment restrictions more broadly.

Given the harder line from Washington and the recent tariff decision, it seems likely that the United States will introduce further sanctions on trade and possibly investment this year that will affect China. The response to these will depend on how aggressive those sanctions were. If there were simply limited tariffs and investment constraints, this would be nothing new. Successive United States administrations have used targeted protection for individual industries since China joined the World Trade Organization in 2001, both to help selected United States producers and to release pressure for broader protection from foreign competition.

At the other end of the spectrum it is possible to envisage much broader sanctions. These include tariffs on a wide range of products, and on investment from China, for example by centring it on reciprocity: Chinese firms would only be allowed to invest in sectors that in China are open to firms from the United States.

But the chances of China giving in to American demands by levelling the playing field for firms selling to or investing in China are low. On paper, China has more to lose from a trade war – it exports far more to the United States than it imports – but it is far less trade-dependent than it was. Exports to the United States account for around 3.5 per cent of China's gross domestic product, down from roughly 6.5 per cent a decade ago. And state support for Chinese firms through subsidies and market protection plus using the lure of China's market to acquire technology are central to China's economic model. They won't be abandoned lightly.

Instead, China would likely respond by taking the moral high ground and positioning itself as the defender of the global trading system. Retaliatory steps would be low key. China would challenge the United States at the World Trade Organization and probably implement a few tit-for-tat anti-dumping, or similar, measures of its own. There would be reputational gains for China in casting itself as the guarantor of free trade in the face of United States protectionism. But there would be practical benefits, too, for the world's biggest exporter in preventing the global trading system from fragmenting further.

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It is possible that a more concerted United States effort to limit trade and investment flows could result in China applying pressure across the board to American firms. This could take many forms.

More stringent regulatory, phytosanitary and compliance checks could be implemented, for example. Responding to the recent tariffs, an editorial in China's Global Times said, "US beef exports have experienced rapid growth in China, but that could change if Beijing decide to raise the bar on its health and safety standards." Alternatively, consumer boycotts could be encouraged. As Japanese firms have found when bilateral relations have soured, car producers are particularly susceptible. Autos are one of the major United States' exports to China (they account for around ten per cent of the total, a similar amount to aircraft and soybeans).

At a small scale, these kinds of arbitrary actions are common. Recently, for example, Marriott Hotels had its Chinese website taken down for including Taiwan and Tibet in a list of countries. This is a key difference between the two sides. American actions would be much more constrained. On washing machines and solar panels for example, Donald Trump only acted after the United States International Trade Commission determined that American producers had been harmed by imports. Accordingly, while the United States sells less to China than vice versa, Chinese officials have far greater leeway to make life difficult for United States' firms.

Strategy

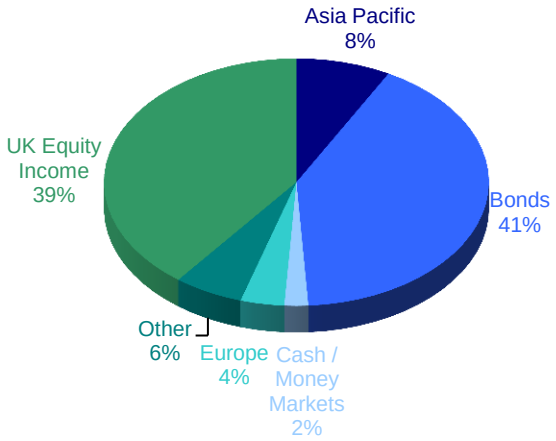
The Investment Committee note that protectionism is likely to be a growing trend, as suggested by Donald Trump during his election campaign. However, Trump has not pushed through on many of the trade 'threats' he has made. The tariffs listed above appear to be much less significant and unlikely to lead to significant trade tensions. Currently global trade is strong and synchronised global growth is predicted over the course of 2018. On this basis we are continuing to favour equities.

Comments on Recent Market Volatility

Following the volatility seen during the previous week, we took the opportunity to top up equities where relevant. This topic will be covered in more detail in next week's diary, but our overall view is that the current market conditions provide an opportunity to increase equity positions with a bias towards companies linked to economic growth, which is expected to remain positive. The rate rising cycle will be gentle, but negative for fixed interest investments, which have a high degree of sensitivity to interest rate rises and we have already limited our exposure to these areas.

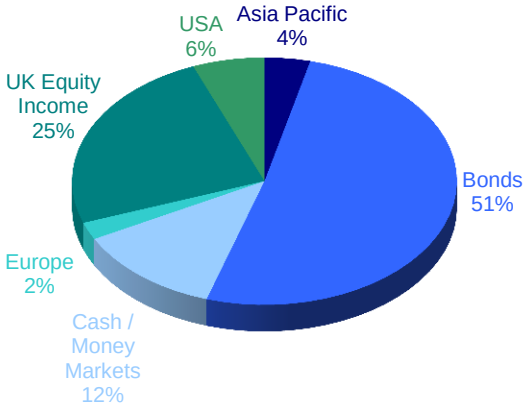
Income

Economic strength is a feature of the majority of the investable world currently, corporate confidence is high and inflation is low, but increasing. These are good conditions for equities. Valuations have fallen in the last fortnight and therefore we believe stocks now offer even greater appeal. As such, a small addition is being made to the M&G Global Dividend fund, with the portfolio's target equity allocation being increased.



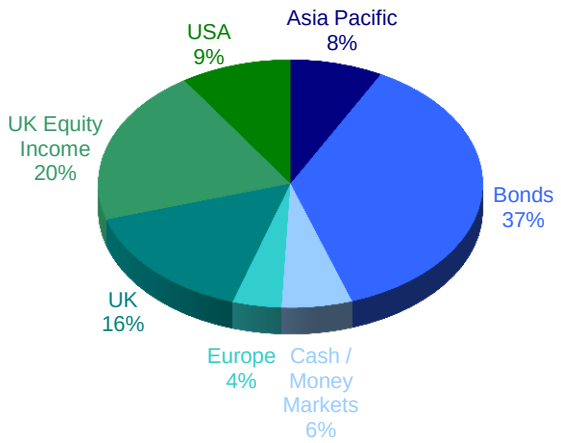
Real Value

In line with the other Future Money funds, a small increase is being made to the portfolio's equity allocation, given greater valuation opportunities following the recent falls. No further changes are currently being considered.



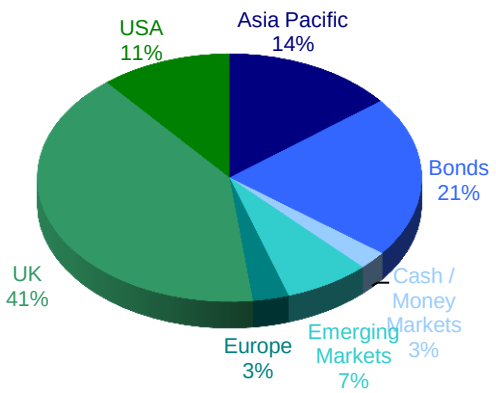
Real Growth

Further to comments made in recent diaries, the Henderson European Focus fund will be removed from the portfolio and replaced with the Schroder European Alpha Plus fund. The Henderson fund has been under review given concerns over the management team, given recent analyst departures. The Schroder fund is largely focused on the fund manager's network of brokers based throughout Europe and is positioned with a pragmatic view on valuation and business cycle positioning. The fund has been strongly rated in our research and is expected to be a strong holding in the European equity space.



Dynamic Growth

A slight increase is being made to the portfolio's target equtiy allcoation, taking it to 77.5%. This increase is being fulfilled with purcahses of the Royal London UK Mid Cap Growth and F&C European Growth & Income funds. No further changes are currently being considered.



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Any research is for information only, does not constitute financial advice or necessarily reflect the views of the author and is subject to change.

It remains the responsibility of the financial adviser to verify the accuracy of the information and assess whether the fund is suitable and appropriate for their customer.

Past performance is not a reliable indicator of future performance. The value of investments and the income derived from them can fall as well as rise and investors may get back less than they invested.

Important information about the funds can be found in the Supplementary Information Document and NURS-KII Document which are available on our website or on request.

For any information about the Future Money funds please contact the authorised corporate director, Margetts Fund Management Ltd, on 0121 236 2380, admin@margetts.com or at 1 Sovereign Court, Graham Street, Birmingham B1 3JR. A copy of their Terms of Business which relates to investments into the funds can also be obtained using these contact details.

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