FUND MANAGEMENT DIARY
Meeting held on 24th July 2018

Stepping closer to a big trade war

- After a quiet first twelve months of Donald Trump's presidency, the United States has started to ramp up protectionism
- Tariffs on motor vehicle imports could be introduced as soon as August and these could cause severe disruption to supply chains
- The risk of a global trade war is increasing and such a scenario could impact global GDP by 2-3 percentage points

Initial protectionist bluster has turned into reality

After his unexpected election victory in late 2016, the first twelve months of President Donald Trump's term in office were free of any significant protectionist measures. The United States Treasury passed up the opportunity to label China a currency manipulator, which was originally a "day one promise", and the president established a good working relationship with China's President Xi Jinping. Even the North American Free Trade Agreement renegotiations seemed to be progressing smoothly for the first few months.

However, after the threats of protectionism appeared to be just election campaign bluster during the first year, the White House has since adopted a more hawkish policy on trade. There are two key reasons for this change.

First, the balance of power has shifted within the administration and there are few free trade supporters in a position to oppose the protectionists. Second, trade wasn't anywhere near the top of the White House's agenda to begin with because health care and then tax cuts took priority. North Korea, the Russia investigation and immigration sucked up any remaining oxygen in the Oval Office. However, with more time to focus on trade this year, the United States has imposed tariffs on washing machines, steel and aluminium, specific goods from China and is considering implementing tariffs on imports of automobiles and parts. (See Table 1.)

Table 1: Existing and forthcoming trade actions by the United States

Date	Event
22 January 2018	Tariffs imposed on imports of washing machines and solar energy cells
8 March 2018	Tariffs imposed on imports of steel and aluminium, but with exemptions for key allies
1 June 2018	Steel and aluminium tariffs extended to include imports from Canada, European Union and Mexico
15 June 2018	Announced list of $50 billion of Chinese goods to be subject to 25% tariffs. Tariffs on $34 billion of these goods came into force on 6 July
10 July 2018	Announced list of a further $200 billion of Chinese goods to be subject to 10% tariffs following public hearings in August
August	Section 232 national security investigation into auto imports is being fast-tracked and could be concluded in August. Tariffs up to 25% on autos and parts could be implemented

Sources: Capital Economics and United States Department of Commerce

On their own, many of these actions won't have material macroeconomic effects, even accounting for retaliatory action by trading partners. For example, the tariffs on solar panels and washing machines already applied, and the expanded steel and aluminium tariffs, together cover just two per cent of American imports. What's more, $250 billion of Chinese imports that could soon have tariffs account for just 1.2 per cent of United States gross domestic product.

As such, the boost to domestic inflation and the hit to gross domestic product via Chinese retaliation on American exports will be small – perhaps 0.1-0.2 percentage points. However, there is no reason to believe that this is where it ends. Only earlier this month, Donald Trump threatened to impose tariffs on all $500 billion of goods imports from China.

Tariffs on motor vehicle imports would represent a significant escalation of protectionism

Donald Trump has initiated a new Section 232 investigation into whether tariffs on finished vehicles and/or auto parts are warranted on national security grounds[1] . The President wants those tariffs to be in place before November's mid-term elections.

[1] Section 232 of the Trade Expansion Act of 1962 gives the executive branch the ability to conduct investigations to determine whether certain imports threaten the United States' national security. Dependent on the findings, the President can then use his statutory authority to adjust the imports as necessary, including through tariffs or quotas.

As such, the investigation is being fast-tracked and could be concluded by the end of August.

If this results in tariffs on motor vehicle imports then it would represent a significant escalation of protectionism, particularly as supply chains in that industry are so integrated between countries. Last year the United States imported $143 billion of vehicles and $191 billion of parts, with roughly half coming from Canada and Mexico.

The overall impact will ultimately depend on answers to several questions: (i) will the tariff rate be set at 25 per cent or ten per cent? (ii) Will Canada and Mexico receive temporary exemptions while the North American Free Trade Agreement negotiations are concluded? And (iii) will the tariffs cover parts as well as finished vehicles?

A blanket 25 per cent tariff on parts would devastate tightly integrated supply chains in North America, causing significant harm to the economies of Canada, Mexico and probably the United States too. If parts cross the border multiple times and incur a tariff each time, that quickly makes the increase in the final price prohibitive. The more likely outcome, however, is that those countries are initially exempt, meaning that Japan, Germany and South Korea will be hardest hit.

And the risk of a damaging global trade war is growing

If tensions continue to escalate, the logical end-game is that Donald Trump will eventually withdraw from the World Trade Organization and impose or increase tariffs on all imports. Admittedly, it is unclear if he can withdraw from the World Trade Organization without congressional approval. But he could effectively withdraw by imposing broad-brush tariffs and simply ignoring any World Trade Organization rulings that censored those actions.

In such a scenario other countries could try to preserve the global trading system by not retaliating, but the evidence so far suggests that most would be up for the fight. In that kind of worst-case scenario, the economic consultancy firm Capital Economics estimates that a full-blown global trade war (with the imposition of blanket tariffs of around 25 per cent on all imports by all governments) would eventually reduce world gross domestic product by 2-3 per cent. This loss of income would be mainly driven by a loss of efficiency from the unwinding of global supply chains but would also include short-term impacts on confidence and investment too.

With goods exports only eight per cent of gross domestic product, the impact on the United States would be smaller. Along with the resulting hit to business and market confidence, however, it could still reduce United States gross domestic product by around one per cent, and the hit to profits of American multinational firms would be more severe. This would have negative implications for equity markets.

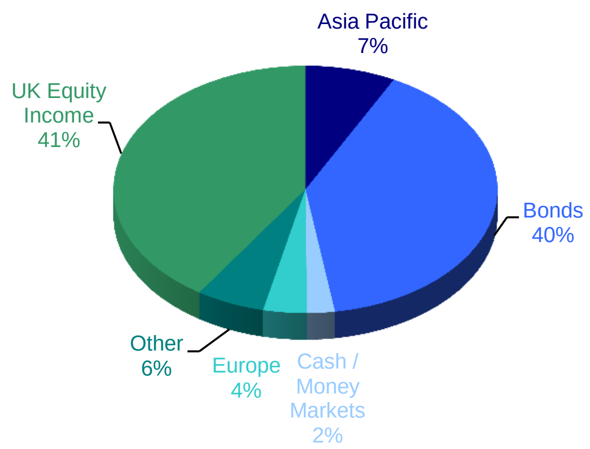
Strategy

We aim to be aware of potential risks, and believe that continuing escalation of trade wars presents a risk to stock markets. We will monitor this risk on a continuing basis, and expect to see further developments at the conclusion of the Section 232 investigation in August.

As well as the escalation scenario described here, resolution of the conflict cannot yet be written off. Given the unpredictable nature of market movements based on geopolitical events we are not making any changes to our portfolios at the moment. We continue to maintain our bias towards value and think that Asia and Emerging Markets currently offer good value for money.

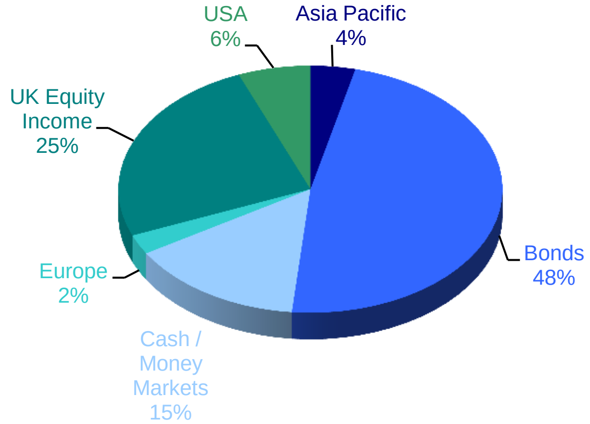
Income

The move from Majedie UK Income to Man GLG UK Income is ongoing, continuing at a gradual pace. Opportunities are currently being considered in the Emerging Market Debt space given attractive yields and weak sentiment, but no decisions have yet been taken.



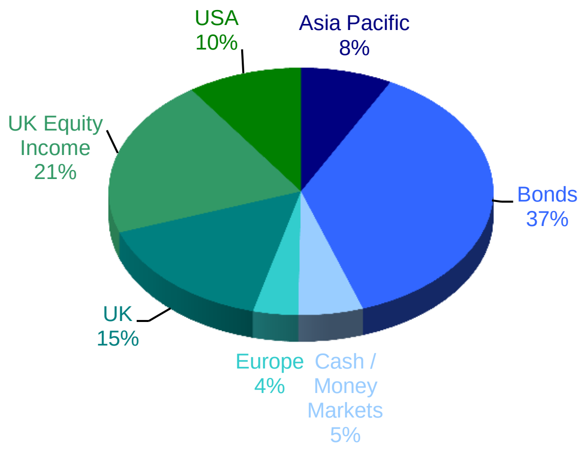
Real Value

Other than the move out of Majedie UK Income and into Man GLG UK Income no changes are currently planned for the portfolio. Threadneedle UK Equity Income continues its recent run of strong performance.



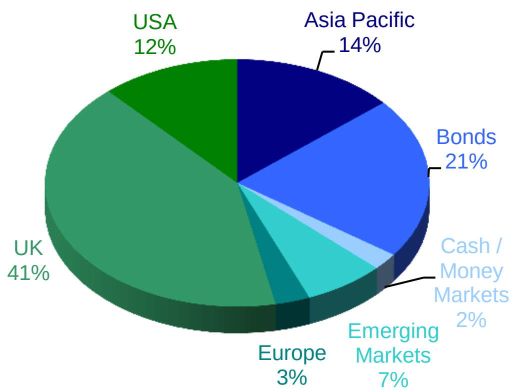
Real Growth

The move from Majedie UK Income to Man GLG UK Income continues. No further changes are currently planned for Real Growth. Threadneedle UK Growth & Income continues its strong performance.



Dynamic Growth

No changes are currently planned for Dynamic Growth. BlackRock Asia has experienced a relatively tough time in recent months, as the fund's exposure has been sensitive to the negativity surrounding the region. However, we expect this to improve over the medium term and so remain satisfied with the position.



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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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