Investment Insights

Trump, Xi Call A Cease-Fire on Trade

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Highlights

- A trade-war "cease-fire" between U.S. and China, following somewhat more dovish Federal Reserve comments last week, suggests a more supportive tone for risk markets into year-end
- That said, a three-month U.S.-China negotiating window seems short in light of the myriad complex issues to be resolved; we expect more short-term volatility as investors assess progress (or lack thereof) into March
- For now, we do not see reason to materially adjust asset allocations; however, we continue to closely monitor risks

In contrast to 2017, 2018 has seen an escalation in trade war rhetoric and action between the U.S. and various countries. While the Trump administration had reached tentative compromises with the European Union (EU), Japan, and Canada and Mexico, the tension in the U.S.-China relationship was steadily ratcheting up over the course of the year. As a result, and given recent general market volatility, the stakes were high heading into this past weekend's Group of 20 annual meetings (leaders of 20 key economies) and the side meetings between the U.S. and China. We were especially focused on Saturday evening's dinner between President Trump and President Xi and their advisors, with two possible outcomes: a de-escalation and pause in increasing tariffs and retaliation, or a failure of the negotiations, allowing previously announced increases in the rate and breadth of tariffs against China to go into effect on January 1.

The news from the weekend's meetings was on the positive side of possible outcomes. There are discrepancies between initial U.S. and Chinese statements regarding what the two sides agreed, but putting together the pieces, we would highlight two key points. The deadline of January 1 for new tariffs to take effect has been pushed back by 90 days while the two sides will negotiate on salient points of contention, namely those around intellectual property rights and Chinese willingness to allow American companies to access their markets. In return, China reportedly has agreed to increase its purchase of U.S. agricultural, energy, and industrial products.

In effect, there now is a cease-fire period during which the two sides can work through these complicated issues — indeed, additional talks are reportedly already set for later this month. Those negotiations appear likely to be broader than just trade: The U.S. statement mentioned that Xi said he would consider again the previously contested merger between Qualcomm Inc. and NXP Semiconductors, and the China statement asserted that the U.S. would continue to recognize the one-China policy, implying an acknowledgement that Taiwan is part of China. Both sides reported that China would help in the U.S. conflict with North Korea over nuclear weapons.

The actual G20 statement released over the weekend was consistent with the idea that world leaders are attempting to find compromise, at least temporarily. Officials watered down wording around flashpoint topics such as multilateralism, protectionism, and trade policy. Media sources cite very difficult negotiations, which could have failed to produce a statement. However, the better tone from the U.S.-China bilateral meetings likely upped the ante for the broader group to find compromise as well.

The benign outcome of these talks is supportive for risk markets into this last month of the year. The other key event last week — a speech by U.S. Federal Reserve Governor Powell — was also supportive in that he softened his tone on the level of the neutral federal funds rate. This suggested to the market that the Fed is not on a preset path for interest rates regardless of economic trends. Given the Fed and trade were the key drivers of the market sell-off beginning in October and continuing in spurts in November, the developments of this past week have been reassuring.

We would highlight that while this most recent news is positive, the market is not out of the woods either on trade or with regard to the Fed as we look out over the next several months. This new round of negotiations between the U.S. and China is sure to be quite complicated, and President Trump's trade representative, Robert Lighthizer, is unlikely to give up much ground on key issues such as intellectual property and access to markets. Meanwhile, the new deadline for a deal of March 1 would fall just before China's annual national legislative session, potentially putting extra pressure on President Xi to appear strong into that important event for his Communist Party. It is likely that the market will continue to react to headlines as the situation unfolds. For the Fed, the next event is the FOMC meeting on December 19, at which we expect an additional increase of 0.25% in the fed funds rate (this is largely discounted already in market valuations). It will be important for investors that the tone of the statement and press conference are consistent with Powell's recent speech, implying that there is room to slow the pace of hikes in the months to come.

As long-term investors, we attempt to look through short-term volatility and decipher whether events are changing the underlying economic trajectory enough to warrant an allocation shift. We believe that the market has entered a period in which higher volatility will be the norm, but that there are likely at least several quarters of positive returns to be had in equities given the strength of the underlying global economy, which feeds into company earnings. The trade war this year already has weighed on non-U.S. economies and markets, and the risk is that a prolonged disruption can feed back into the U.S. economy as well given the interconnected nature of the global marketplace where companies are conducting business (Exhibit 1, following page). For now, Bessemer mandates have benefited from much greater exposure to the U.S. versus benchmarks and from portions of the portfolio that are more defensive in nature, amid neutral positioning in equities versus clients' long-term strategic targets. We will continue to monitor risks to our views and positioning and keep our clients abreast of any shifts. Stay tuned for the next *Quarterly Investment Perspective* piece to be published in mid-December and a webcast outlining 2019 views scheduled for January.

Exhibit 1: Equity Market Performance, Year-to-Date 2018

(Indexed to 100 on December 31, 2017)

As November 29, 2018. Performance is measured using S&P 500 (U.S. Market), Euro Stoxx 50 (Eurozone), MSCI Emerging Market Index (Emerging Markets), Shanghai Stock Exchange Composite Index (China) and Nikkei 225 (Japan) in U.S. dollars and reflects the price return. USTR stands for U.S. Trade Representative.
Source: Bloomberg, MSCI

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