Tatton

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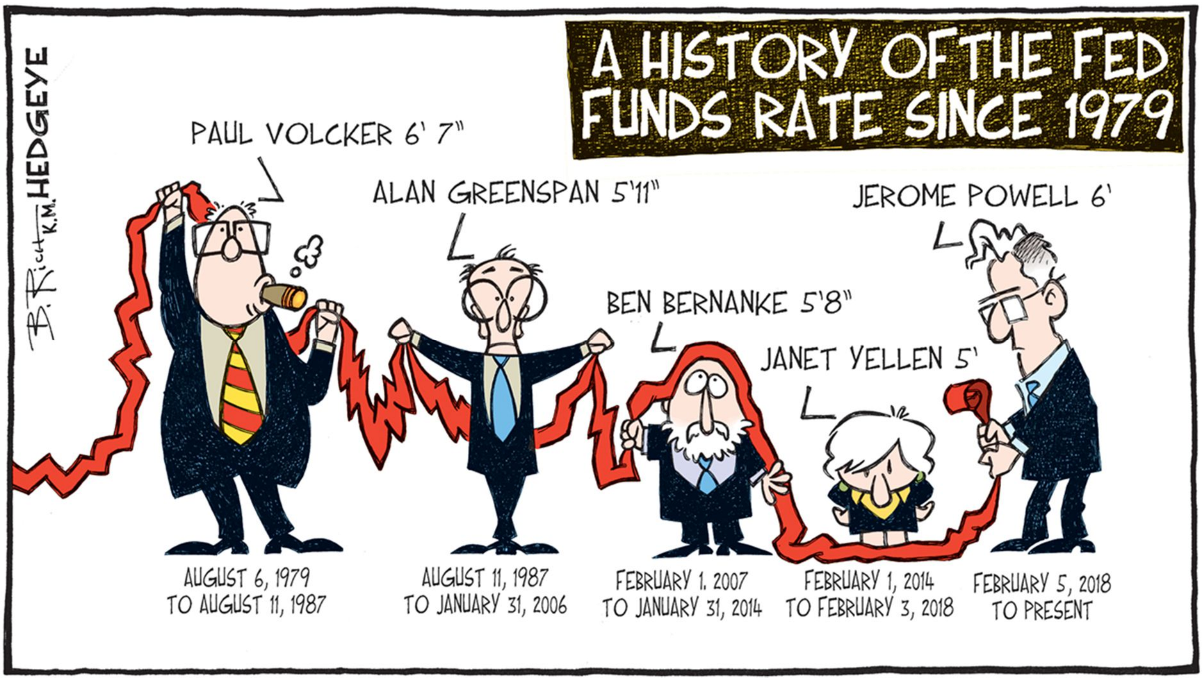


Now we know it's risky

Equity markets have taken a turn for the worse following the US' probable imposition of "section 301" tariffs on China.

Undoubtedly, events that increase uncertainty about the likely path of profits are bad news for any company's share price. In a sense, given that the likelihood of President Trump's action was high and much-discussed particularly in the last two weeks, some might say that this path should have been discounted by the market already.

Of course, markets can be influenced by an incredibly large number of related but constantly shifting factors and "knock-on" effects. Even when the next event can be reasonably clear, the fact that it happens triggers other events. It's that creation of new paths and possibilities which can destabilise markets through increasing uncertainty.

Even when events occur which have equally positive or negative future impacts, if the likelihood of extreme outcomes rises, investors tend to want to insure against the bad ones. Some investors buy options to sell their assets, an explicit insurance contract. As a whole, the market builds in an implicit insurance.

That insurance is the risk premium, the extra expected pay-out an investor estimates that they need to make it worthwhile to hold a risky asset (in comparison to a non-risky asset like a bank deposit or short-term government bond). An event which has balanced outcomes (upside and downside) for a company's earnings shouldn't change analysts' forecasts for earnings. However, because an investor needs a greater return in order to take the risk, the share price they'll pay to buy some more of the company goes down. The "valuation" of the company, (such as the price-to-earnings or P/E ratio) falls.

Most investors are in for the long-term and don't sell. That's because (we would say) the main point of long-term investing is to get paid a diverse portfolio of risk premia on a pretty constant basis. Also, because investors (generally) get information at the same time as everybody else, prices move quickly to discount everybody's worries. One would have to have good reason to believe that one had better information or analysis than others to justify selling. And then, at some point in the future, one would have to decide when to buy.

What matters for each investor is getting the long-term holdings aligned with their risk appetite. A useful working definition of long-term is "not needing the money for a number of years". If one's savings aren't needed in the nearer-term, then history shows that the best strategy is to get the asset allocation aligned to the risk appetite and then leave it that way through thick and thin.

What can happen is that an investor realises that they've taken on more risk than they really wanted. Often, it's because their circumstances have changed but, because investments have been good, they haven't got around to thinking about it. When the environment changes, they're left having to decide while feeling uncomfortable and possibly fearful. (As an aside, this is why clients are asked to review their risks at least annually, hopefully when market moves aren't influencing their perceptions of risk).

Here at Tatton, we accept we probably don't have more information than others, but we do believe that good analysis can be rewarding. So let's delve a bit further…

The rise of trade tensions may have been clear for some time. Meanwhile, as John Authers in the FT says, Trump's move to enact now has come at the same time as expectations of company earnings growth are strong:

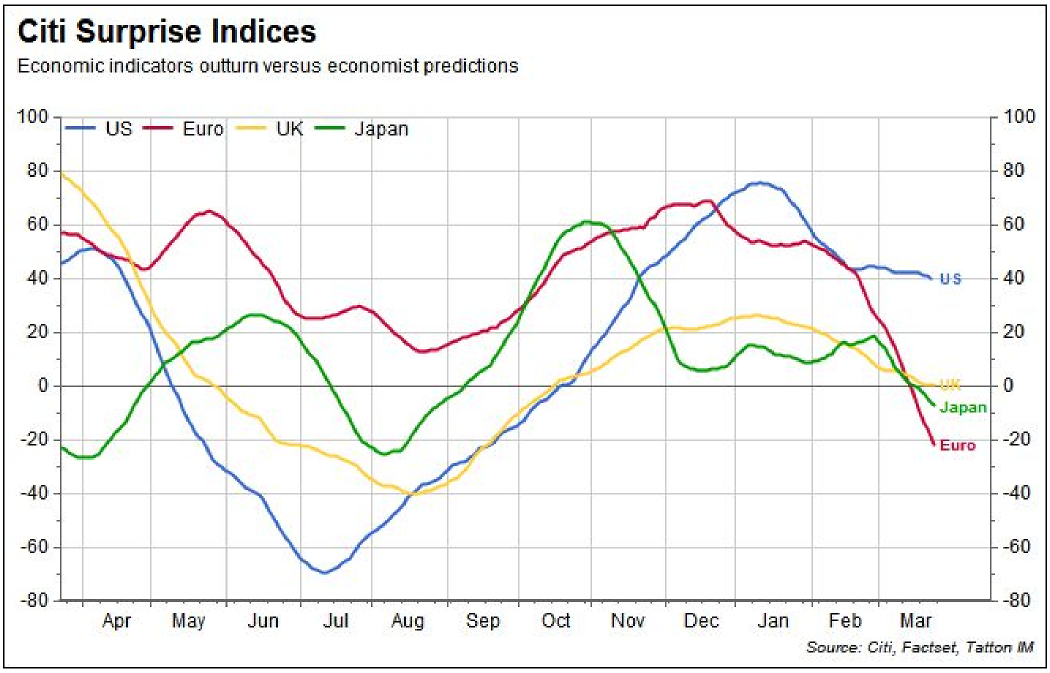
In the US, the tax cuts and fiscal boosts were announced first, and analysts upgraded earnings growth expectations to 20% for 2018.

After a strong 2017, UK, earnings expectations have settled at 7%. Europe's earnings growth is at a similar level.

Asia expectations jumped sharply driven by the US and a strong China. Japan's 2018 earnings are expected to rise a whopping 34%.

These expectations have been weighted towards cyclical sectors; industrials, energy and materials on the back of strong economic growth. Growth indicators have been slipping somewhat since January, particularly in Europe, less so in the US. This week's business survey indicators (the preliminary "Purchasing Manager Indices" or PMIs) were generally a bit lower than economist expectations and lower than February's (which had been lower than January's).

Alongside the Trump policy impacts, US strength could well be down to a weaker dollar at the start of 2018. Europe's relative weakening is probably the mirror of that – a stronger euro. Overall, global economic indicators are now generally in line with economist expectations, after exceeding them for over four months. The graph below is the Citi economic data "surprise" indices:



Final sales growth has been robust globally because of strong economic growth. Those revenues (rather than expanding margins) have underpinned earnings growth. However, if the world is "late cycle" (the growth peak is near or possibly even in the past), equity valuations shouldn't embed lots of earnings growth in the next couple of years. Indeed, P/Es should be relatively low.

Generally, markets do not have very extended P/Es but only Japanese stocks are below their 10-year average. When comparing each equity market to its bond yield, the US is the one that stands out as expensive. If earnings growth in later years is much stronger than elsewhere, it could be justified. However, if there is reason to doubt later growth, it starts to look vulnerable.

That's the rub. In the US especially, despite being a long way through the economic cycle, optimism probably led to an under-appreciation of risk among retail investors, with huge inflows into equity exchange-traded funds in December and January, taking valuations to extended levels. The underpinning of strong economic data had started to wane before the tariff issues came into immediate view, leaving markets in a vulnerable position.

The imposition of tariffs is a problem then. Even if it were a balanced risk to earnings, one would expect cheaper P/Es. It's highly likely to not be balanced. It's not easy to envisage a scenario in which the outcome is greater economic growth at the global level, nor even at any regional level.

However, growth has been good, is good, and tariffs might not have much impact. Trump's removal of the metals tariffs on Europe shows the situation is very flexible, and that the administration is honest when it says it's open to negotiations.

Other good news got rather buried this week. The Bank of England kept rates on hold and showed it recognised that economic data was mixed. It is still probable that rates will rise in May but only if the data doesn't soften further.

Likewise, while the Fed raised rates, it seems that the Powell-led Fed differs little from the Yellen's. The fear was that policy would become more rigid, with a greater commitment to raising rates in the future. While the members' expectations of the path for rates were a little higher, there was no insertion of a fourth rate rise for 2018 – another two remain the expectation. The commentary acknowledged the more mixed data, important because being data-led reassures market participants that the Fed is still mindful of downside risks.

Longer-dated bond yields fell somewhat on that news and then a little bit more under pressure from equity markets. Perhaps one can draw a positive conclusion; the equity market decline is not sparking a flight from risk to non-risk assets. Investors may be less perky but they're not exactly panicking.

A final note: Our chief, and my long-term colleague and friend, has a big birthday today. Happy Birthday Lothar!

A turning point for technology stocks?

The technology sector was one of the darlings of the post-Trump equity market rally, leading the gains in many markets worldwide. This week, technology stocks have reappeared on investor's radars, but this time for all the wrong reasons.

There are growing concerns that valuations for the 'big data' and platform companies exhibit bubble-like properties. As a result, investors appear to be quickly re-assessing the real risks the sector poses, triggered by the 9% plunge in Facebook's share price this week.

There is plenty of analysis about those issues in the press, so we won't comment on those details, but we think there is a bigger story here.

Firstly, 'safe' isn't what it used to be.

Until recently, Tech was seen by some investors as one of the least risky sectors from a volatility standpoint. However, the volatility (vol) earthquake that occurred during February may have put an end to the idea that tech firms are the 'safe' low-vol bond proxies they statistically appeared to be during the rally of the past two years.

Secondly, is tech simply too big and too powerful that the public, politicians and investors are now pushing back?

On the week that Amazon overtook Alphabet Inc (Google) as the second largest company in the US by market capitalisation, there appears to be a growing sense among the public and – following suit – politicians that tech stocks have simply become too big and powerful, which may require a policy response.

The sheer size and scale of the tech sector is staggering. The 'famous five' FAANG (Facebook, Apple, Amazon, Netflix and Google) stocks now account for a stunning 25% of the US Nasdaq Index. These five firms have seen their combined market capitalisation (share price x number of shares outstanding) surge 40% to a whopping $3 trillion in just the past 12 months.

Amazon alone has jumped 85% in the past year, adding $350 billion to its market cap, taking the total to $769 billion as the firm relentlessly expands beyond e-commerce into new markets like banking, mortgages and healthcare. For some, it now appears to be a two-horse race between Amazon and Apple ($900 billion) over who will become the US' first ever trillion-dollar company.

The rapid price increases over the past few years make valuations harder to justify. The current forward price to earnings multiples for the FAANG stocks make for scary reading.

Amazon: fwd P/E 189.9x

Netflix: fwd P/E 116.4x

Google: fwd P/E 27.3x

Facebook: fwd P/E 25.6x

Apple: fwd P/E 15.5x

On a pure average basis, the FAANG's trade on 75x forward earnings or 30x on a blended basis. This means that through earnings it would take an investor 30 years to get back their original investment. The sector's forward PE has nearly doubled since 2011 to 20x, but the S&P 500 trades closer to 17x expected earnings. Perhaps investors believe these stocks will simply keep going up forever, hence the high multiples and crowded nature of the tech sector in general.

The problem with crowded trades is that they become vulnerable to sudden reversals when momentum or confidence fades, which results in higher volatility. The FAANG's positive momentum looks to be moderating in the wake of Monday's sharp tech sell-off, triggered by alleged reports of personal data belonging to almost 50 million people accessed through Facebook by data firm Cambridge Analytica.

The news prompted an angry response from users, while even the founder of WhatsApp – itself acquired by Facebook – launched the #DeleteFacebook Twitter campaign that encourages users to delete their accounts. This comes on top of investor concerns that user engagement (i.e. amount of time spent on a site) is falling, putting at risk the firm's advertising (ad) revenues.

Added to these pressures is the fear that new regulations might restrict how firms collect, process and use customer data, which would hurt their growth. Twitter and Alphabet were also mired in the social-media sell-off, both of which rely on their ability to access data generated by users in order to deliver targeted ads.

However, it seems that tech stock prices reacted differently according to who might and might not be impacted by any crack-down on social media. Amazon was largely unaffected in the selling this week, given that it doesn't have access to your friends, know your political views, read your posts, nor whether you support a specific politician or party. It is 'just' an e-commerce platform.

Amazon does very little on advertising but the Facebook news could see impacts on the entire online ad space, not just the platforms like Google and Facebook. Beyond that, new regulations could limit any company that tries to sell any proprietary personal data.

The Facebook affair may have created an environment in which politicians are given a mandate by users to act and spur a wider debate about the role of big tech in society. Politicians had been previously enamoured by the torch-bearers of the new knowledge economy; even former President Obama was colloquially called the "Silicon Valley President". But we may now see the tide turning against the big tech monopolies.

Reports of a fatality involving an AI-powered Uber car in the US may see new rules introduced (not to mention the insurance implications over 'who' is responsible in an accident). We would not be surprised if calls for a breakup of Amazon emerge given its dominance in, well, everything.

Interestingly, the new more protectionist politicians like Trump may actually lead to a regional, rather than global approach to tackling technology firms. So far, Trump has focused on the manufactured sector and it is notable that he only seems to mention goods rather than services as part of his trade talks. Certainly, China has its "great firewall" and Europe/UK are interested in introducing a new digital levy that would tax the sales made in a country rather than profits and enhancing data protections for users (EU data stays within the EU).

We have also seen a push back from traditional competitors, who have either consolidated into bigger entities or grown through increased investment. Tesla is a case in point. While it certainly benefits from large amounts of hype around its founder and the eventual future of electric cars, so far it has failed in one important metric: production. Tesla's goal of manufacturing 5,000 Model 3 units per month looks in doubt and it may struggle to pass more than 1,000 per week.

Contrast this with the incumbent manufacturers, which invented many of the production processes used in many other industries. Manufacturing something in large numbers is their core competency. Toyota makes 13,400 cars per day and Volkswagen outlined plans to make 1,500 electric cars per day, on top of the 25,000 e-Golf's it has already manufactured in Wolfsburg, which makes Tesla seem insignificant from a production standpoint.

This brings us nicely back to tech valuations and the potential talk of bubbles. One of the biggest hurdles we face in identifying a bubble is that we apply 'old' thinking and experience of previous bubbles, not realising that we fail to apply 'new' thinking when scrutinising new businesses or assets.

Today's asset bubble looks as if it is related to data and platforms. Most accountants would not likely classify these things as traditional assets, but the fact Google or Facebook generate recurring revenue means they are intangible assets to these firms.

To understand these concepts, let's pretend that imaginary firm XYZ Inc offers a "free" service that is paid for by targeted ads. XYZ collects customer data in exchange for its service and hires data scientists to mine the information to serve better ads. XYZ classifies those costs as operating expenses (opex) rather than capital expenditures (capex). As a result, the value of both the data and algorithms used to analyse it (algos) won't appear on a firm's balance sheet as an asset, even though these helped generate recurring revenues.

Investors often understand these points and value a business as though they have such assets, despite a lack of recognition of these in XYZ's book (Book Value) or accounting values and the end result is a higher price-to-book ratio. A realistic value of a XYZ's intangibles would be generated if it was acquired by another party, then the difference between the price paid and BV gets booked as "goodwill".

While some may highlight a lack of investment by the FAANGs, we suggest that these firms have spent on investment. It is just 'hidden' in Opex and goodwill and not appearing correctly in official statistics. The dynamics of intangible and patent-heavy sectors, like tech, have resulted in a "winner takes all" approach meaning the true value of the ongoing data and platform revolution are not equally shared across the economy, which merely widens income inequality. Perhaps that is why Trump is so keen on talking about tangible assets like manufacturing.

It can be easy to see things like trade wars, populism and income inequality as separate, but we think they collectively suggest there is a growing momentum against, and reaction to, intangible-intensive sectors like Tech. Perhaps the Tech sector will come under increasing pressure as investors re-value the prospects of the FAANGs (data/platforms) over the course of the next few years. Equity markets would be an obvious avenue of investor activity, but currencies may also feel some effects. The Yen might be a beneficiary, as Japanese firms are not currently involved in the data/platform space and it has a tendency to remain stable in a volatile world.

Brexit Agreement Reached

A draft agreement on Britain's exit from the EU was reached this week, with negotiators from both camps announcing the document on Monday. 18 months after the referendum result, the type of Brexit we will get has finally become clearer. Crucially, a transition period of effective UK membership in the trading bloc after the official exit date in 2019 has been confirmed. EU law will remain in place in the UK in full until at least January 2021, so that the perilous 'cliff-edge' scenario for businesses unsure about their future trading conditions can be avoided.

The draft copy released to the public came colour coded, with paragraphs highlighted either green, yellow or white. The sections highlighted in green are effectively set in stone, subject only to minor legal wording revisions. Yellow indicates the sections where broad agreement has been reached on the objectives, but clarifications or other revisions are needed. The sections in white are those proposed by the EU where essentially no agreement has been reached. Given the often frustrating and stop-start nature of negotiations so far, it shouldn't come as much of a surprise that there were large sections of the document left in white.

Both the fate of the Northern Irish border and the crucial issue of what happens if the EU thinks the UK is breaking the rules were left blank. Theresa May had previously said of the EU's proposed regulatory alignment between the two Irelands that "no UK prime minister could ever agree".

Areas in yellow included provisions for the financial sector, as well as the rights of some four million citizens affected by Brexit. The fact they are in yellow at least means that negotiators agree on the general direction of these crucial areas, but the specifics will no doubt be at least as tough to nail down as this agreement itself has been.

That having been said, progress has undoubtedly been made. While the transition period has been widely expected for some time, having it in writing (and green writing no less) certainly gives businesses some breathing room. Other greenlit provisions include the UK granting EU citizens arriving during the transitional period the same rights as those already here (something the PM previously ruled out), the UK's ability to sign new trade deals with other countries, the continuation of British contributions to the EU budget throughout the transition period and the retaining of EU fishing quotas.

The government was eager to stress the significance of our ability to sign other trade agreements throughout 2019 and 2020 – though these wouldn't come into force until the transitional period is over. In a time when accusations that the government is giving the Europeans everything they've asked for are rife, this was supposed to be a major concession from the EU side.

Less popular were the last two provisions on the list above. Continuing to pay into the EU's budget and remaining under its law without any representation in law-making naturally evoked the ire of die-hard Brexiteers. Worse still was the fishing issue. Cries of "betrayal" and scenes of Nigel Farage throwing old fish into the Thames was the response to the concession, which will see a continuation of EU fishing quotas – one of the main rallying cries of the vote leave campaign – through the transitional period. For the Brexiteers, this was an area where "taking back control" should have been straightforward; on divorce day Brussels could no longer tell us how much we can fish in our waters. Instead, the transition period will only see the UK being "consulted" on the allocation of quotas.

In truth, the fact that the British government has made these compromises is symptomatic of their tricky negotiating position. While fish quota crusaders bemoan that the EU fishes in our waters much more than we do in theirs, they omit the fact that most of the fish Britons catch gets sold to the EU. Any attempt at limiting European access to British waters could easily be met with retaliatory tariffs. Besides, Britain's fishing industry is tiny in comparison to areas like the financial sector. What little deal-making power the government has would be more beneficially used making agreements there.

This highlights the difficulty: the UK needs to compromise or it will lose access to its largest trading partner. The EU, on the other hand, has comparatively little reason to compromise; the 'cliff-edge' is much smaller for them. This agreement appears largely an acknowledgement of that. Despite all the time spent bemoaning 'unacceptable' measures, as time goes on the most likely Brexit outcome looks softer and softer.

On Ireland, for example, the Prime Minister has ruled out any regulatory divergence between Northern Ireland and the rest of the UK. But the government has also accepted the "backstop" of Northern Ireland remaining under EU law – the default option if an agreement can't be reached in time. If that happens it can only mean one of two things: a divergence of Northern Ireland from UK law – anathema to the PM's backers in the DUP – or the entire UK remaining under full EU law indefinitely.

This is why we see an extremely soft Brexit – verging on the derided 'Brexit in name only' – as the most likely outcome from negotiations. Forgetting political inclinations, this will likely be the most helpful option from the perspective of business certainty, purely because it represents a continuation of the status quo.

Accordingly, the pound rose against the dollar on the news to its highest level in three weeks. Now at $1.40, sterling is in sustained territory not seen since before the referendum against the USD. Although, some of that is due to general dollar weakness this year (a trend which has been reversing lately), and against the relatively stronger euro sterling is still at €1.15 – a level its mostly bounced around for the last 18 months. At those levels, British exporters should still enjoy the relative advantage they've had over European competitors since the referendum (owing to sterling's low euro-value), but potentially without the associated spiralling inflation costs. Combine this with the soft Brexit picture painted above, and the economic fallout from Brexit suddenly doesn't look so bad.

Geopolitical Tensions Rise: Conflict on the horizon?

The Republican and Democratic parties in the US reached a $1.3tn budget deal on Wednesday night, rolling out large spending increases in a number of departments. The compromise plan now needs to be passed by Congress before Friday night, if the perennial federal government shutdown is to be avoided. It's a big boost on the previous budget, with some sources reporting that it will increase the federal budget deficit by $320bn over the next decade.

A big chunk of the increased spending goes towards defence and infrastructure. There will be an $80bn boost to the military's budget this year, heralded by Republican speaker Paul Ryan as "the biggest increase in defence funding in 15 years". For comparison, just $1.6bn is set to go towards Trump's border security policy. So much for building that wall.

It's a big increase across all areas of the military, but with particularly big increases for research and development and missile defence. There have been regular pleas for more defence spending over the past few years, from lawmakers and military chiefs alike. As recently as January, Paul Ryan warned that US forces had been "pushed past breaking point".

But the timing of the boost is unlikely a coincidence. Another regular complaint from US military officials in recent times is that more resources are needed to prepare for potential conflict with the US' biggest global rivals: Russia and China. Both countries have been beefing up their own defences in recent years, and on Monday Chinese officials announced their own boost to defence spending. Coupled with Russia's ongoing involvement in Syria and the controversy surrounding the Sergei Skripal poisoning, there seems to be a sense of urgency from both the government and the military establishment to prepare for conflict.

It is telling, for example, that this increase is the largest in 15 years. In that time, the US has been heavily involved in ground wars in both Afghanistan and Iraq. This speaks to the increase in geopolitical risk we've seen in recent months. And that risk isn't just between the US and its two main rivals. Despite not currently being directly involved in any large-scale wars, the US is still running active overseas military campaigns in seven different countries, with the world superpower bombing Iraq, Syria, Pakistan, Afghanistan, Libya, Yemen and Somalia in 2016.

President Trump looks ever more likely to pull out of the Iran nuclear deal, with his negotiators pushing hard on European allies to accept amendments to the deal without specifying what changes would stop him from walking away. Trump's new pick for Secretary of State is the vehemently anti-Iran CIA chief Mike Pompeo, who is an outspoken critic of the Iran deal. According to one Iranian journalist, the view from Tehran is that, by appointing Pompeo, Trump plans to make his potential withdrawal from the deal “seem a credible and believable threat.”

While pulling out of the nuclear deal doesn’t mean the US is preparing for conflict with Tehran, it does heighten the possibility – especially if European leaders follow suit in pulling out of the deal. The move would follow a pattern of increased pressure against Iran from the Trump administration, who have previously made clear that they view the middle-eastern nation as an international threat on par with North Korea.

It also echoes the sentiment of the US’ Saudi allies. Saudi Crown Prince Mohammed bin Salman visited the White House this week, and Trump told the press afterwards that the US-Saudi relationship “is probably as good as it’s really ever been, and I think will probably only get better.” For Trump, ‘getting better’ here largely means the Saudis giving Americans “jobs, in the form of the purchase of the finest military equipment anywhere in the world”. Luckily for Trump then, the US Senate voted 55-44 against a motion to end support US for the Saudi-led war in Yemen, described as one of the greatest humanitarian crises in recent times.

It’s possible that there’s another element to Trump’s heightened tensions in the Middle East. Beyond the ideological bent against Iran and the strategic support for allies in the region, the Trump administration is coming under a great deal of pressure from the FBI’s Russia probe – one only need look at the apparent desperation with which Trump has been assembling his legal team. Increased involvement in the Middle East – whether in the form of more antagonism towards Iran or heightened activity in Syria – could well serve as a welcome distraction for a President who is feeling the heat.

So, what does this all actually mean in terms of geopolitical risk? Needless to say, direct conflict between the US and either of their main rivals would be catastrophic, both in human and economic terms (particularly with regards to China). Fortunately, that still doesn’t look likely. While China also boosted their military budget by around 8% this week and are taking an increasingly assertive foreign policy in their region, they are not an expansionist state. Xi Jinping – a likely candidate for the title of most powerful leader in the world, given Trump’s isolation in Washington – has overseen a change of Chinese policy away from non-interference, and has big plans for China as a major world power. But those plans mainly revolve around defending their own economic interests and building economic ties with the world, not about trying to conquer it with force. Now that the latest episode of the North Korean affair seems to have fizzled out, it’s highly unlikely that there will be any direct or proxy conflict between the world’s two largest economies.

The situation with Russia looks a little worse. While direct conflict within either of the rivals’ borders is still out of the question, tensions have been building between US-supported and Russian-supported forces in Syria for some time. US and Russian forces are currently staring each other down from either side of the Euphrates river, after a direct confrontation between the two sides in Deir Ezzor last month. On Wednesday, for the second time in less than two weeks, top US and Russian generals held a private phone call to discuss the issues. And of course, all of this isn’t even to mention the recent Skripal furore.

Even if things don’t come to blows, the increased military spending is interesting in itself. After the end of the cold war, there was talk of global economic gains from a reduction in military spending. The thought was that, rather than governments spending money on missiles which will sit in silos for years, more of the money would be put towards things which will help people, boosting productivity and helping propel growth. Indeed, throughout that period productivity boosts did occur (though whether this was a causal link is debatable). Now that lots of the major powers all over the world are putting more and more money towards military build-up, we could see the reverse effect – a dampening of productivity. There's been a great deal of excitement about the growth boosting effects of fiscal stimulus in the US, but if a lot of that stimulus is going towards military spending, it's effect might not be so large.

Trade War?

On Thursday 22nd, Donald Trump announced further tariffs on around $50bn worth of Chinese imports under the auspices of national security. In an article posted by the White House regarding this on 8th March, they draw attention to defence-based uses of metal production:

"Aluminium is used in a range of ground weapons and aircraft, including the Armored Multi-Purpose Vehicle (AMPV), Amphibious Assault Vehicle (AAV), Bradley Fighting Vehicle (BFV), AH-64 Apache Helicopter, and the V-22 Osprey."

Source: Whitehouse.gov, https://www.whitehouse.gov/briefings-statements/president-donald-j-trump-will-protect-american-national-security-effects-unfair-trade-practices/, retrieved on 23/03/2018

The trade relationship between the US and China is the biggest in the world between two single countries. According to FactSet figures, the US imports around $70bn more from China per year than from the entire EU. Perhaps unsurprisingly then, China has reacted to the latest news with some increased tariffs of their own, effecting products ranging from pork to steel piping.

The specifics of the new US tariffs have clearly been crafted with China in mind, targeting steel and aluminium imports. This follows steps earlier this year to limit imports of solar cells and residential washing machines. The White House has also said "Unfair trade practices and industrial policies of other countries have harmed our steel and aluminium industries" noting that there was only one US producer of armour plating and a type of steel used in electrical transformers (source: Whitehouse.gov, same webpage as above). They went on to explicitly mention China and no other country in this release, and then went on to exempt two of the other top (non-US) six producers of steel (source: Factset, World Steel Association): the EU and South Korea.

In reaction to this, markets began to fall sharply, the S&P down some 2.5% on the day. This equates to a fall of around $550bn in market value terms in the US alone. We should remember, however, that retaliation is not the only option for China, and that their current response has been fairly small compared to the US' actions, and some way short of the all-out trade war people are alluding to. Compromise remains an option for China, who could offer concessions on trade, FX markets, and, perhaps most relevant, IP rights. Although whether they would be willing to remains to be seen.

While the US seems to have excepted trading partners like Europe and South Korea for now (source: BBC, http://www.bbc.co.uk/news/business-43505804), we are certainly starting to see a more isolationist stance from the US, as we would have expected on Trump's election. Another reading would be that, as geopolitical tensions have increased with China and Russia, the US genuinely is looking to reduce reliance on trade partners that they see as potential antagonists.

The impact of these new policies has yet to fully manifest, but the pervasiveness of trade links and the tightly coordinated nature of modern supply chains suggests that small disruptions could have serious ramifications. It's also worth sparing a thought for those downstream industries in the US who will potentially be hit with higher input costs. Examples of these industries include: Motor manufacture, which employs 446,000; Industrial Machinery, employing 234,000; Construction Materials, at 57,000; and many others.

Whether this is a good policy in political terms will depend heavily on the geographic specifics of the tariffs. If Trump supporters end up worse off from a poorly thought out trade policy, it could represent a large misstep from the administration, which they might actually worry about.

Rhetoric from China has so far been relatively dovish, suggesting a trade war is far from their ambition. However, their stance may change if the US' moves are not challenged by the WTO or are followed by further measures. We would also add that a US Government who needs to roll over 28% of its debt this year (source: Bond Vigilantes: https://www.bondvigilantes.com/blog/2018/02/15/can-bond-markets-digest-huge-supply-u-s-treasuries-will-issued-year/), could probably do without annoying the biggest single holder of their debt market other than the Federal reserve.

PERSONAL FINANCE COMPASS

Global Equity Markets

MARKET	CLOSE	% 1 WEEK	1 W	TECHNICAL
FTSE 100	6922.5	-3.4	-241.6	↘
FTSE 250	19331.3	-2.4	-473.6	↘
FTSE AS	3830.7	-3.2	-126.4	↘
FTSE Small	5583.1	-3.0	-171.7	↘
CAC	5090.8	-3.6	-192.0	↘
DAX	11873.4	-4.2	-516.2	↘
Dow	23865.2	-4.3	-1081.3	↘
S&P 500	2633.3	-4.3	-118.7	↘
Nasdaq	6617.8	-5.7	-402.2	↘
Nikkei	20617.9	-5.4	-1186.1	↘

Currencies / Commodities

PRICE	LAST	%1W	CMDTY	LAST	%1W
USD/GBP	1.41	1.48	OIL	70.1	5.8
USD/EUR	1.24	0.56	GOLD	1349.4	2.7
JPY/USD	104.86	1.10	SILVER	16.6	1.5
GBP/EUR	0.87	0.93	COPPER	299.2	-3.7
CNY/USD	6.32	0.30	ALUMIN	2075.0	-0.5

Fixed Income

GOVT BOND	%YIELD	% 1W	1 W YIELD
UK 10-Yr	1.453	1.7	0.02
US 10-Yr	2.825	-0.7	-0.02
French 10-Yr	0.757	-7.3	-0.06
German 10-Yr	0.525	-8.1	-0.05
Japanese 10-Yr	0.024	-36.8	-0.01

Global Equity Market - Valuations

MARKET	DIV YLD %	LTM PE	NTM PE	10Y AVG
FTSE 100	4.2	12.8x	13.0x	17.1x
FTSE 250	2.8	14.9x	13.9x	16.9x
FTSE AS	3.9	13.0x	13.1x	16.6x
FTSE Small	3.3	9.9x	-	-
CAC	3.0	15.1x	13.9x	15.4x
DAX	2.6	12.2x	12.3x	16.9x
Dow	2.2	19.1x	15.8x	15.3x
S&P 500	1.8	20.1x	16.5x	17.5x
Nasdaq	1.0	25.6x	20.1x	20.2x
Nikkei	-	-	-	-

UK Mortgage Rates

MORTGAGE BENCHMARK RATES	RATE %
Base Rate Tracker	2.3
2-yr Fixed Rate	1.5
3-yr Fixed Rate	1.8
5-yr Fixed Rate	2.0
Standard Variable	2.0
Weighted Average Interest Rate (BoE)	4.24
Nationwide Base Rate	2.50
Halifax Standard Variable	3.99

Top 5 Gainers / Top 5 Losers

COMPANY	%	COMPANY	%
HAMMERSON	25.6	MICRO FOCUS INTER	-49.3
NEXT	5.0	KINGFISHER	-13.7
RECKITT BENCKISER	3.6	SMITHS GROUP	-8.0
LSE GROUP	3.2	STANDARD CHAR	-7.5
LAND SECURITIES	1.8	MEDICLINIC INTERNA	-7.4

* LTM = last 12 months' (trailing) earnings; **NTM = Next 12 months' estimated (forward) earnings

For any questions, as always, please ask!

If anybody wants to be added or removed from the distribution list, just send me an email.

Please note: Data used within the Personal Finance Compass is sourced from Bloomberg/FactSet and is only valid for the publication date of this document.

The value of your investments can go down as well as up and you may get back less than you originally invested.

Lothar Mentel