ASSET ALLOCATION STRATEGY

MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES

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"Trade war worries have revived risk aversion"

The risk of protectionism has resurfaced with a bang in recent weeks following Donald Trump's decision to impose tariffs on steel and aluminium imports. The list has since been extended to a basket of Chinese goods although there have not yet been any details on which and for how much. Equity markets reacted by falling across the board uncertainty prompted a risk premium.

RISK IS TURNING SYMMETRICAL

It is tempting to see a trade war ahead and although this is a real risk we continue to believe that it is not the most probable scenario. First, **China has so far taken a conciliatory tone** and will only retaliate by taxing US imports to the tune of $3bn. Moreover, initial China-US talks began very quickly, a sign that Beijing is considering making significant concessions on opening up China's markets and companies.

Second, China's protectionism is now out of step with its current stage of economic development, especially as the situation is clearly unbalanced. US companies have suffered a host of setbacks in China, notably in the tech sector which is protected by a genuine strategy over industrial policy. Europe is tech-light which is probably why European companies have complained less. As a result, direct European investment in China is close to double that of US companies. And the US trade deficit with China is still much higher than Europe's. All this suggests some effort to rebalance is due. Washington naturally thinks so and Beijing probably agrees now that it has been asked to make a move.

At the same time, US policy has become hard to read. But if we look at two of Donald Trump's declarations, "I like chaos" and "The worst of times often create the best opportunities to make good deals", we cannot help wondering if his negotiating technique actually relies on first blowing things out of proportion to get a better deal than would otherwise have been possible.

Seen in this light, the **White House is arguably trying to secure less, not more, protectionism**. Nevertheless, it is too early to be fully convinced of this. Above all, we first need to be sure that the execution of such a high-risk strategy does not fail. And as all major trade talks are long and complicated, we do not expect the risk premium to evaporate overnight. As it is, markets are now factoring in a risk of protectionism, but the latest developments suggest the worst-case scenario is far from being certain. We might even be in for some pleasant surprises. Consequently, risk is now more symmetrical.

KEY POINTS

- Overweight equities
- Focus on the eurozone and Japan
- Underweight bonds

We are sticking to our investment policy and still overweight eurozone and Japanese equities and underweight fixed income. The eurozone is positioned mid-cycle, margins could still grow thereby fuelling earnings growth, central banks are still highly accommodating, and valuations are still rather attractive compared to the US. We remain generally underweight bond markets but have no particular concerns about the segment. However, with the marked fall in European long bond yields in recent weeks, we have once again become a little more cautious over European duration.

NEXT HEADLINE EVENTS

- ***April 26: next ECB meeting***
- ***April 26 & 27: next BoJ meeting***
- ***June 12 & 13: next Fed meeting***

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