Multi-Asset Solutions Team (MAST)

Market Musing

- U.S.-China trade negotiations warmed up recently with President Trump claiming they had reached a "substantial phase-one deal". For China, this was only pitched as "substantial progress achieved."
- Trade risks have diminished, but we don't expect a major trade deal soon. Negotiations may progress, but the path to a deal could be bumpy. We maintain a relative preference to U.S. and Canadian equities vs. more trade-sensitive equity markets such as continental Europe.

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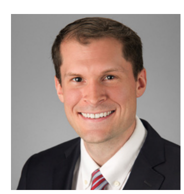

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Mini-Deals are better than "Taxing the Hell Out"

The outline for a limited trade deal was announced on Friday between the U.S. and China which involves the U.S. postponing increasing tariffs on $250bn of Chinese goods from 25% to 30%, which was scheduled for October 15. In return, China agreed to increase agricultural purchases and make some modest concessions on access to its financial markets and curbs on intellectual property theft. The December tariff hikes were not addressed and no concessions were made on Huawei.

By all accounts, trade discussions between the U.S. and China last week were a positive step, with at least temporary de-escalation of trade tensions. However, President Trump's characterization of what was agreed to following the talks were significantly different from what was reported by China's official Xinhua news agency. President Trump claimed that the two sides had reached a "substantial phase-one deal" while reports from China were much less committal, indicating only "substantial progress achieved." Importantly, there was no agreement in writing which limited the market response to the news.

The Way Forward to a Deal

President Trump said it would take up to five weeks to complete the "phase one" deal, which would coincide with a potential meeting with Chinese President Xi at the APEC summit in Chile in mid-November. On Monday, Treasury Secretary Mnuchin said "I expect there will be a deal" and indicated that he expects President Trump and President Xi to finalize the agreement at the APEC summit. Potential areas for negotiation include a) currency language, b) Huawei and c) a cancellation of U.S. tariffs on $156bn of Chinese goods that are scheduled to go into effect on December 15.

Our take

Trade risks have diminished at least for the time being. We think the trade truce may be extended to the December 15 tariff hikes. However, we don't expect a broader deal on the large issues (i.e. state subsidies and intellectual property reform) before the 2020 election and would

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not expect a smooth path toward a multiple phase deal, but rather a potentially bumpy ride. Additionally, the deal would not address existing U.S. tariffs of 25% on $360bn of Chinese goods that have been put in place by President Trump which would limit the impact.

Implications for Asset Allocation

That said, this does remove some of the tail risk and is supportive of equities overall. As we don't expect a major trade deal and think that discussions could move in fits and starts, we maintain a small, cautious overweight to stocks versus fixed income. Within equity markets, we also maintain a relative preference to U.S. and Canadian equities vs. more trade-sensitive equity markets such as continental Europe.