Trade dispute between China and the United States

Over the last weekend, the United States and China have agreed to resume their trade talks and seek for a solution of the conflict. As the two largest economies negotiate a lasting agreement during three months, the intended increase from 10 to 25 percent of import tariffs is suspended. In a first reaction, the stock markets jumped on the cease-fire in the trade conflict and increased by several percentage points. Is this the turning point of a declining market or is the uncertainty and volatility soon back and dominates market behavior?

We assume that the chances for a lasting and satisfying solution of the trade dispute are quite significant and the mood of relief will stay with the markets for a while. In addition, the technical market constitution is in favor of a year-end rally. This could be quite strong, as a reversal in the trade, direction initiated by algorithms may take place, and in many single stocks, the short positions are outstanding, more pronounces so in the small mid cap segment.

The signs of a slowdown outside the United States have accentuated slightly towards the end of the year and especially in China. The Chinese Government has indeed every reason to solve the trade dispute, as an economic slump threatens the political and social stability. In the United States, the economy runs on a high level, still without signs of overheating. In the future, less support will however come from fiscal policy (after the massive tax-reduction package). Moreover, the real estate market is far from levels seen before the Great Recession. Higher mortgage rates are trimming demand. Recently, the Central Bank signaled that further interest rate increases have to come, but the process could be on a somewhat slower path. In any case, it would be reasonable to expect that the longest boom will come to an end just by 2020 when the re-election of Donald Trump is on the agenda. It is fair to assume that the current government will do whatever it needs/takes to prevent such a scenario. This includes also a de-escalation of the conflict in trade.

Contrary to the opinion in the media that the conflict is postponed and not solved, we believe that the time window of three months offer good opportunities to find a solution. With this perspective, an even broader rally in the equity markets is possible.

December 2018