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UBS House View Briefcase

Could we see a US-China trade breakthrough? 17 April 2019

Chief Investment Office GWM

Key message

Long-running trade tensions have been a major preoccupation for investors. US trade relations with China remain fragile, even as high-level trade talks continue. In addition to the feud with China, the US continues to threaten higher tariffs on auto imports, which if implemented could hit Germany and Japan especially hard. While a renewed trade escalation remains a risk, there are promising signs that President Trump is willing to compromise and is not impervious to the economic impact of his trade policies. Markets are also supported by continued economic growth and rising earnings.

House view

01 Trade frictions look set to persist over the coming years.

- Even as trade negotiations continue, the rivalry between the US and China will not be easy to overcome, especially on the issues of intellectual property and technology.
- A breakdown of talks between the two nations remains a risk, as does the imposition by the US of higher import tariffs on autos.

02 The damage to markets can be contained.

- The Trump administration late last year agreed on a NAFTA replacement, and on 28 February suspended tariff increases on China imports "until further notice."
- Another Trump-Xi summit will likely take place within the next few months, as both sides have grown increasingly supportive of reaching an agreement.
- Equities are still supported by fundamentals, including continued economic growth and rising earnings.

03 This supports our risk-on stance.

- Global economic growth, renewed policy support, and corporate earnings should continue to drive equity markets higher.
- Although trade tensions pose a short-term risk, we think additional progress toward a trade deal could be an upside catalyst.
- Investors should stay invested but protect their portfolios against downside risks.

New this week

Long-running US-China trade negotiations appear to be narrowing in on a deal, with US Treasury Secretary Steve Mnuchin predicting the two sides would reach a settlement that goes "way beyond" previous bilateral trade deals. Media reports suggest this may include enforcement mechanisms governing both sides. Separately, Reuters reported US negotiators have diluted demands that China curb its industrial subsidies and tax breaks for state-owned enterprises. According to US claims in WTO filings, China offers more than 500 such subsidies

One liner

Trade conflicts between the US and its major partners are unlikely to be easily resolved, but the damage to markets can be contained.

Did you know?

- "The old model we had in the postwar period was based on a critical assumption, which is that developing countries including China would become like market economies. That's not going to happen. The Chinese are going to have a different system with a much bigger state presence in their economy," said Nobel Laureate Michael Spence in a *UBS Nobel Perspectives interview*.
- A recent European Commission paper calls for a "more balanced and reciprocal relationship" with China, which has "increasingly become a strategic competitor for the EU while failing to reciprocate market access and maintain a level playing field."

Investment view

We remain tactically risk-on within equities and continue to hold EM USD-denominated sovereign bonds. We remain overweight China in our emerging market and Asia portfolios. We believe China's cyclical market with solid fundamentals and cheap valuations will outperform its peers.

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