01. Jul 2019 CIO Flash

G20: marginally positive, but uncertainty remains.

G20 meeting ended with little progress. But postponed tariff hikes are not canceled ones.

- Overall, the G20 meeting in Osaka produced few tangible results
- At least the U.S.-Chinese conflict did not get any worse, talks are continuing and there has been some appeasement in the case of Huawei.
- However, we don't believe that corporate uncertainty about the trade conflicts has been reduced, which is likely to be negative in the medium term.

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The G20<javascript:void(0)> meeting in Osaka, Japan, ended on Saturday as expected: inconsequential, with a non-binding final declaration. More important were the talks on the fringes of the meeting, especially between U.S. President Donald Trump and Chinese President Xi Jinping. Given that Xi's participation was still uncertain at the beginning of June, that he was there at all was thought by many to be a positive signal – albeit one picked up a few days ago. The most important results of the meeting were:

- Talks between the U.S. and China are continuing.
- While they proceed the U.S. will not impose new punitive tariffs on Chinese imports – 25% of goods worth $300 billion per year had been threatened recently.
- U.S. companies may again supply products to the Chinese telecommunications group Huawei, as long as it does not impact the U.S. national security.- In return, according to Trump, China has committed itself to buying a "tremendous amount"[1] of U.S. food and agricultural products.

Ambiguity begins with that final point. Since now, contrary to many years of diplomatic practice, there is often no joint final declaration for U.S. foreign-policy agreements with other countries, there is also regular uncertainty as to whether both sides have a common understanding of the outcome of the negotiations. The Chinese side merely confirmed that it had agreed to resume talks "on the basis of equality and mutual respect"[1]<javascript:;> and was endeavoring to reduce the trade deficit.

Trade: This brings us to the key problem of the U.S.-Chinese trade war and the reason why the G20 meeting makes us less optimistic and reinforces our cautious outlook. Even if the tone between the two countries has improved since the temporary low point at the beginning of May, it should be clear to all participants, especially global companies, that most likely there will be no return to 2016 for global trade. It remains unclear where the trade-dispute journey will eventually take us, in which the U.S. moves away from multilateral trade agreements and increasingly turns to bilateral deals. What is clear, however, is that there is now a cross-party consensus in the U.S. that China should be clearly restrained in the future. For this reason, too, we believe it is likely that the conflict will remain on the boil until the U.S. presidential election at the end of 2020.

Macro: The summit result has no impact on our growth forecasts, as we had already assumed that there would be little change in direction. Our forecasts incorporate the negative effects from already announced tariffs. But the imposition of 25% tariffs on $300 billion worth of goods, with the risk of retaliation from China, could, in our view, have driven parts of the global economy into recession. On the other hand, the summit result does not remove the uncertainty weighing on companies' investment decisions. This is also likely to mean that the U.S. Federal Reserve (Fed)<javascript:void(0)> will also feel that its cautious assessment of the global picture has been confirmed. Unless some surprisingly positive data from the U.S. economy appears in the course of the month, a preventive rate cut by the Fed in July remains our main scenario.

Bonds: Following the surprisingly dovish<javascript:void(0)> announcements by the U.S. and European central banks<javascript:void(0)>, we had already become more positive on higher-yielding bonds (emerging markets<javascript:void(0)> and U.S. and Eurozone corporate bonds). The moderately positive result of the G20 meeting initially confirms this assessment, even if the longer-term challenges remain, given what is happening in world trade. Now, the focus is on the Fed's decision at the end of the month. This time the Fed is likely to find it difficult to surprise the market again – unless it comes up with a surprisingly hawkish<javascript:void(0)> announcement. U.S. government-bond prices, meanwhile, have already risen sharply and we imagine the momentum may ease towards the end of the month.

Equities: As part of the update of our strategic forecasts following the Fed statement, we decided not to revise up our index targets. We do not believe that the Fed's interest-rate cuts, which the market has now anticipated, will provide the real economy with important impetus. Uncertainty about the various trade conflicts remains too high for that. This is already clearly evident in corporate-sentiment surveys. The focus is now on upcoming quarterly reports. We expect visible traces of the U.S.-China trade conflict in the manufacturing sector and would not expect a continuation of the current positive market reaction. More companies have given a negative profit outlook in the run-up to the reporting season than at any time since the second quarter of 2006 [2]<javascript:;>. We continue to expect low single-digit earnings-per-share (EPS)<javascript:void(0)> growth in the developed world in 2019 and 2020. The risk/return potential of equities does not currently appear attractive to us.

Markets that had already responded very positively to June’s dovish central-bank statements are now getting a further G20 boost. As a result, many valuation<javascript:void(0)> parameters have again reached demanding levels. This reinforces our view that the market is susceptible to any kind of disappointment in the short term, and we are taking a more defensive stance.

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1. <javascript:;> "5 Takeaways From the G20 Summit: Easing Off Trump’s China Trade War, for Now", New York Times, https://www.nytimes.com/2019/06/29/world/asia/g20-summit-takeaways.html as of 6/29/19.
2. <javascript:;> Defined as EPS pre-announcements that are below market consensus levels. Source: FactSet Research Systems Inc. as of 6/28/19