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Trade truce extension

Last Saturday, March 1, the trade deadline imposed by the US on China came to pass. But instead of escalating trade tensions, the Trump administration has shelved its plan to implement steep tariff hikes on $200b of Chinese goods. Meanwhile, talks between the US and China are ongoing as they seek to forge a lasting trade deal. Without dwelling on specifics, both countries claimed that they have made notable progress on many fronts.

Truce extension averts an escalation

Trump's decision to defer the tariff hikes until further notice shows his willingness to proceed with the talks despite the presence of many contentious issues such as intellectual property and technology transfers. The truce extension averts further escalation of trade sanctions which will worsen China's economic slowdown and cloud the outlook for global growth. Moreover, an escalation of trade tensions would have further weakened the stock market and possibly trigger a full-blown bear market.

Progress on trade drives US stock market rally

Since hitting a low on Christmas eve last year, US stocks have rallied on the back of positive developments on the trade talks and a shift in the Fed's tone on monetary policy from hawkish to dovish. The S&P 500 gained 3.6% in February and is now up 11.8% year-to-date. Meanwhile, Chinese stocks surged on the continued progress of the US-China trade negotiations.

China – best performing market in 2019

After rising 15.8% in February, the Shanghai Composite is now up 20% year-to-date, making it the best performing stock market in the world. In addition, the Chinese yuan has appreciated 2.5% year-to-date, lifting the Philippine peso and many other Asian currencies with it. A trade deal with the US can be a game-changer for the slowing Chinese economy and complement the economic stimulus that the government is currently employing.

From belligerent to conciliatory

After initially adopting a belligerent stance on trade, Trump surprised many investors when he started being more conciliatory towards China. He explained that delaying the tariff hike is justified because a deal with China is imminent, even boasting that it will be the biggest in history. Trump also alluded to a signing summit with Xi Jinping once a comprehensive agreement is completed. Trump is determined to deliver a significant trade deal to bolster his chances in the next election. In addition, Trump closely monitors the performance of the US stock market and intends to appease investors who are anticipating progress on the trade talks.

'Fantastic progress'

Last week, US chief economic adviser Larry Kudlow stated that 'fantastic progress' has been made in the trade negotiations with China. US Treasury Secretary Steven Mnuchin and US Trade Representative Robert Lighthizer said that the US and China have more work to do in finalizing an extensive trade agreement. This will contain structural commitments from both parties and mechanisms for the monitoring and enforcement of the terms of agreement. The deal will cover important issues such as tariffs and non-tariff barriers, agricultural trade, currency management, intellectual property, and technology transfers.

A tricky market

Despite notable progress in the US-China trade talks, the final outcome is still shrouded with a cloud of uncertainty. It remains to be seen whether the US and China can forge a deal that can satisfy both countries and resolve contentious issues such as technology and currency. Will Trump resort to further escalation if he does not get a deal that he wants? Will Trump walk out from negotiations with China, similar to what he did in a summit with North Korea's Kim Jong Un? Given these lingering questions, the stock market may experience volatility as investors grapple with different possibilities and outcomes which have far-reaching consequences.

Global ramifications

A US-China trade deal will have wide-ranging global ramifications. On the one hand, a lasting ceasefire and trade agreement with the US will cause a turnaround in China's slowing economy and lift other EM economies including the Philippines. A deal with China should also boost key sectors of the US economy and support a rebound in global growth. On the other hand, a no-deal scenario or further trade escalations will be bad for stocks and the global economy. It will dent business confidence and cause a cut back in investments. It will ultimately trigger a global economic recession, a vicious selldown in stocks and the start of a bear market. Just as in armed warfare, economic warfare in the form of trade or currency wars can determine the fate of the stock market and the global economy.

Happy 10th anniversary, bull market

This week, we enter the 10th year of the bull market. This bull market started when the S&P 500 touched an intraday low of 666 on March 6, 2009 and a closing low of 676 on March 9, 2009. An extension of the truce or a final resolution of the US-China trade war will help in sustaining the 10-year old bull market. In our book Opportunity of a Lifetime and in various Philequity Corner articles, we explain how the current bull market started, how it continues to this date and how one can profit from it.

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