Investors found themselves wrong-footed by a sudden breakdown in US-China trade negotiations, which had appeared close to the point of agreement until Trump tweeted his intent to raise tariffs to 25% at the end of this week on back-tracking by Beijing.

In part, it seems that some of this can be rationalised in the context of the Trump modus operandi, with parallels in the NAFTA negotiations in 2018.

However, there is also a sense that markets have been served a reminder that relations between the world’s two largest economies are set to stay strained, even if an agreement of trade manifests in the next couple of weeks.

In Washington, there is a sense that Beijing is a strategic rival rather than a partner, is a state which can’t be trusted, and one which has been taking advantage of the US and the global trading system for too long.

Don’t go chasing price action

From a political point of view, taking a tough stance on China has clear political appeal, and with the President already shifting towards campaigning mode, this helps to explain what looks to be a sudden change in direction.

However, Trump is savvy enough to know that what voters really care about is the economy and it has been unsurprising that his rising approval ratings have been closely tied to the economy continuing to perform well.

In this case, it is neither in the US or China’s interest to trigger an unseemly trade war, which creates more losers than winners and which damages stock markets and economic confidence. From this perspective, we believe that a China-US deal will get done, though clearly Trump will be eager to portray this as a great personal win that he alone was able to mastermind.

Bounce-Back-Ability

Unexpected turnarounds become a global theme for the week.
In this context, we see the flight to quality, which Trump’s tweets have triggered, as likely to be short-lived and we doubt that this will end up being viewed as a lasting turning point in financial markets.

Generally speaking, we have observed that chasing price action following tweets from the Commander in Chief has rarely been profitable and that adopting more of a medium-term outlook is key to navigating short-term bouts of volatility.

**Back to growth and inflation**

Away from trade headlines, last week’s jobs report showed that the US economy is in strong health, supporting Powell’s upbeat view on growth, even at a time when inflationary pressures remain very muted. Assuming a trade war isn’t allowed to develop, it appears that the global economy is supported by fiscal and monetary policies and that the backdrop seems relatively benign.

European data has lagged strong numbers on the other side of the Atlantic yet remains consistent with growth in the 1-1.5% range, notwithstanding further downward forecast revisions from the EU Commission this week.

**Eurozone fiscal slippage concerns misplaced?**

In the euro periphery, Spanish elections have passed with little volatility and we don’t perceive major change as a result of European Parliamentary elections later this month. Populist parties will undoubtedly do well, but we continue to highlight that it is wrong to see these as forming an anti-EU or anti-euro coalition.

We see many non-establishment parties as remaining very committed to the European ideal — albeit with a desire to reform and change the EU from one dominated by the policies of Germanic austerity towards one in which growth will be prioritised, with fiscal policy used more assertively to support this — as arguably it should be at a time when borrowing costs are so far below the inflation target.

Notwithstanding this, there does seem to be ongoing angst from investors at evidence of fiscal slippage — particularly in Italy, where slow growth means this year’s deficit will surely exceed 3% of GDP.

However, it appears to us that some of these worries are mis-placed. Debt-to-GDP ratios remain stable, supporting current credit ratings at a time when borrowing costs remain low and Italexit risks are muted.

In Greece, the Syriza government has overseen a fiscal primary surplus of 4.4% of GDP in 2018 — showing that populists can adhere to policy orthodoxy. At the same time, we will look for the ECB to extend policy support by moving in a dovish direction at its June meeting.

We believe that deposit tiering is a likely policy step and, in addition, that Draghi may want to emphasise that the ECB will be ready to start expanding its balance sheet once more by re-starting its asset purchase programme, should additional downside risks merit such action.

**EM: Rising bailout risks**

Elsewhere, in emerging markets (EM), Turkey has been under particular pressure during the past week with bonds and the currency trading weaker against a deteriorating macro and political backdrop.

We see rising risks that an IMF/ESM bailout will be required before too long as central bank reserves dwindle and we retain a negative assessment on Turkish assets.

Away from Turkey (and Argentina)

We believe that the macro backdrop for a number of EM countries looks materially brighter. However, we continue to see more value in EU periphery credit spreads than we do in much of the EM universe for the time being.

We have also been relatively cautious with respect to corporate credit spreads at a time of heavy seasonal supply. Investment grade and high yield spreads have rallied materially in 2019 on a year-to-date basis, but further spread compression seems unwarranted for now and we believe that it is appropriate to retain exposure on a selective basis with respect to specific issuers and sectors.

**Lessons from the pitch**

If there is one thing we can reflect on in the past week, it is that conditions can change quickly. Liverpool football club went into the second leg of their Champions League semi-final facing relatively bleak prospects, three goals down, yet ended jubilant 90 minutes later. The same was true for Tottenham only 24 hours later.

In contrast, it may seem the Trump’s tweets have snatched defeat from the jaws of victory with respect to a trade deal, but logic and self-interest dictate that a deal should get done in the next few weeks. In this context, switching portfolio positioning in the wake of Twitter could end up being akin to a Liverpool supporter switching allegiance to Barcelona after the first leg, only to end up losing twice.

On a slightly different note, one is struck by Jurgen Klopp’s (and Pochettino’s) management of his team and wonders whether he would like a bigger job…running the country perhaps! Indeed, it was mildly amusing to hear how Theresa May was wanting to liken herself to Barcelona manager, in comments which seemed almost ironic.

In the UK, it seems that leadership is a quality that remains lacking in the political sphere and as the Tories await humiliation at the upcoming European elections, it remains surprising to see Theresa May clinging to office — one wonders how long this can remain the case.

As an outspoken critic of Brexit and David Cameron’s decision to hold a referendum, Klopp’s politics may have more of an appeal to the urban elite than even the Liverpool supporting Brexiteers — yet it seems that the gaping open goal in the centre ground of UK politics surely can’t remain vacated for an extended period (one hopes).