Investment Strategy Update

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Markets mostly shrug an increasingly tense US-China tech war

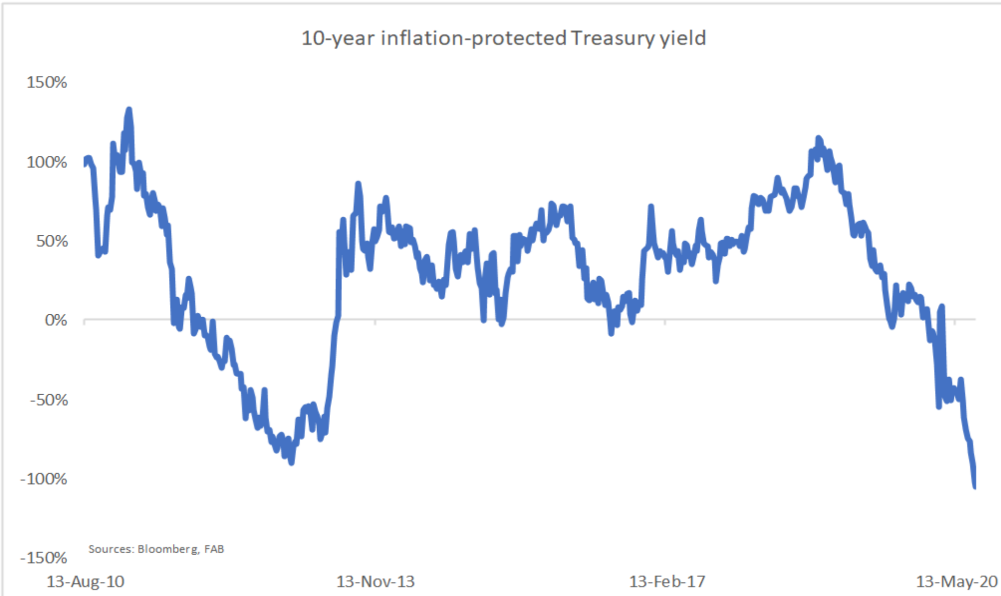
♦ President Donald Trump vows to close down Chinese social media giant in the US or to forcefully sell it to an American company.

♦ Editorial in Beijing today suggests China could retaliate against the action if it is carried out as promised.

♦ Stocks take a negative tone in early trading but investors mostly shrug off the growing noise from Washington.

♦ Bond markets, however, price in some risk aversion, making real yields more negative and turning risk assets even more attractive.

♦ The FAB AAC remains overweight in investment grade corporate bonds and emerging market dollar debt.



Two years ago, when the Federal Reserve was still raising rates, the news flow seen today would have probably prompted a significant move downwards for stocks. Back then, headlines indicating rising trade tensions between the US and China had serious impact on the market.

Now, under the power of the Fed holding rates at a record low, keeping dollar bond yields hovering close to all-time lows, and pumping liquidity into the system, the market seems almost immune to that sort of disturbance.

And the noise level has been high. On Monday, President Donald Trump followed up on a push to ban TikTok, a social media platform owned by Chinese technology giant Bytedance, or to have its operations sold to a US company. The President said one of the two outcomes would happen before 15 September.

Beijing has not watched quietly. This morning, an editorial in the China Daily, a state-owned newspaper, said that the country will not allow the “theft” of the business of a Chinese company. “China will by no means accept the ‘theft’ of a Chinese technology company and it has plenty of ways to respond if the administration carries out its planned smash and grab,” the editorial said.

The words seemed to reverberate in Wall Street as the S&P 500 started the day in retreat, albeit a mild one. It makes sense too. A fifth of the value of the S&P 500 is concentrated in five technology companies, one of them being Microsoft (the purported buyer of TikTok). Hence, if China targets one of these behemoths, it could have a bearing on the entire market.

There is, however, a caveat. Because China has kept its internet under control, US tech companies have little exposure to the country and any restrictions from Beijing may have minimal impact.

The yield on 10-year inflation-protected US Treasuries was near its lowest in history

They are, however, not immune. Beijing can accelerate its efforts to have some of its allies replace the US technology and could even use the same arguments the US has directed at China: that the data being harvested by American companies could end up in Washington.

Even though the risk of a long-term effect on US tech companies from the dispute is real, the market is likely to continue to mostly ignore it. The reason can be summarized in two words: low rates. The yield on the 10-year inflation protected US Treasury fell to a negative 1.08% today, one of the lowest in history.

With interest rates so low, investors have little alternative to buying risk assets, even if the risks in the background are rising.

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