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The US-China relations have just taken a turn for the worse

♦ **US orders China to close its consulate in Houston and gives diplomats 72 hours to leave.**

♦ **Move comes amid accusations that foreign operatives may have attempted to hack into vaccine research.**

♦ **China vows to retaliate, with newscasters speculating the US consulate in Wuhan could be shut.**

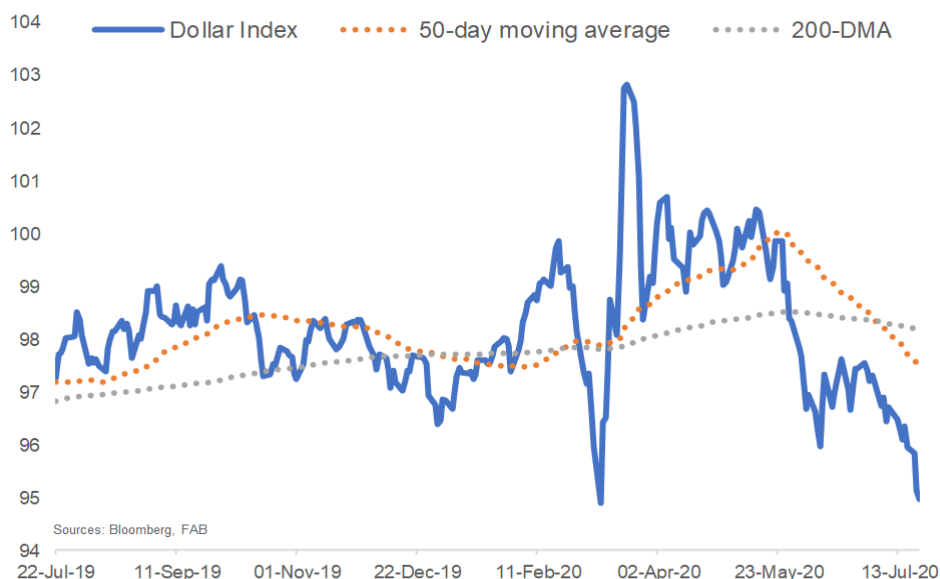
♦ **Markets seem to take tensions in their stride with Nasdaq futures pointing up as investors seem to expect tensions will boil down.**

♦ **In the meantime, the dollar index breached a key level as the hunt for yield pushes buyers further afield.**

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

Nicholas Nassim Taleb famously coined the term Black Swan event in 2001, referring to the idea widely held in the west that swans could only be white, until black birds of the species were spotted in Australia in 1697. In simple terms, it refers to something seemingly impossible that actually can and does happen.

Mr. Taleb has said recently that the Covid-19 pandemic was not a black swan, given the number of global epidemics in the recent past. Hence, it does not constitute something so unlikely that it merits the name. The response of democratic western nations to the pandemic, however, may be closer to a black swan, given how unlikely it was. Similarly, a significant escalation of tensions between the US and China is hardly unexpected.



The extent of that escalation may start testing assumptions of likelihood however. After the two years of trade war between the two countries and nearly a decade of mutual testing in the South China Sea, investors have generally expected that words and threats hardly ever translate into very severe action when it comes to Beijing and Washington. There is a lot of posturing for local crowds, but the action often comes short.

That seems to be the understanding today again, as the Nasdaq was looking at a higher open even as the US ordered the Chinese embassy in Houston to be shut. Beijing promised to retaliate, and newscasters were floating the speculation that the US embassy in Wuhan may be forcefully closed. Given the market reaction, it looks like investors feel like that will be it. Still, given the proximity of US presidential elections and the fact that recently the country spoke out against China's claims in the South China Sea, the event should not be ignored.

The dollar index just broke 95.00, a move some say may signal more weakness

If stocks are shrugging it off, gold is not and it rallied today, as did US Treasuries. Curiously, though, the dollar index retreated further, breaching the key 95.00 level, and compounding on a 7% drop since its recent high on 24 March. This suggests that investors are expecting the Federal Reserve to step in if uncertainty US-China tensions rise.

Indeed, the greenback's drop began when the Fed announced some of its extraordinary monetary stimulus measures and began to open swap lines across the world, increasing the supply of dollars. That has created profitable carry trades using dollars as a funding currency, and those seem to be accelerating. Beware, though, the hunt for yield in such an uncertain environment.

Investment Strategy Update

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