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Recent market turmoil

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"In my mind, it's always easier to do a sequel than an original" Steven Van Zandt

We are not even at the end of the first quarter of the year and global financial markets have racked up two bouts of significant volatility. Back in late January/early February the dominant fear was higher interest rates/bond yields as central bank stimulus programmes started to wane. In the last week or so, this has been augmented by a ratcheting up of concerns about global trade as proposed steel and aluminium tariffs from the US have threatened to lead to retaliatory actions from countries both in the European Union and Asia. Additional specific intellectual property protection concerns raised by the Americans towards their interactions with China just upped the tension.

History tells us that both higher interest rates/bond yields and the imposition of trade tariffs are negatives for the global economy and, in turn, financial markets worldwide. However the former tends to creep up in impact over time, as any homeowner who has had a mortgage in a time of rising interest rates will attest. This will still come as a shock after nearly a decade of low or ultra-low interest rates but can be offset by other policy measures such as economic reforms like tax cuts or labour market changes by governments.

Challenges to the global trading system potentially are a more serious concern. For the last two generations progressively fewer barriers to global trade have - on balance - significantly boosted the global economy via a broader and cheaper selection of goods for the world's consumers to choose from. Given that around two-thirds of a developed market economy is consumption, this has helped buoy both global growth and consumer satisfaction.

> The world's policymakers know they are playing for high stakes

However, there are always winners and losers from trade because some countries are more productive than others, often based on a strong position in one or more of the factors of production: land (natural resources), labour, capital or entrepreneurial qualities. These shifts have spilled over into political angst in a number of countries including southern Europe and the United States and it is the latter's current administration who are agitating for change based on the notion of 'fair trade not free trade' leading, they hope, to more domestic jobs and economic growth.

This debate is necessarily complex but the key for financial markets is if the threats by the United States to impose tariffs and other protective elements are (a) credible and; (b) lead to retaliation by other big economic groupings. On both fronts, the jury is currently out which has helped lead to the volatility seen in financial markets recently. The United States can certainly impose tariffs but the impact will be felt domestically as many of its leading companies have supply chains that rely heavily on imported goods. Additionally, irking countries like China and Japan may reduce the willingness of these countries to continue buying US Treasury bonds, a move which would likely have the impact of raising US interest rates/bond yields further... which would not be good news for the US or global economy.

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The world's policymakers know they are playing for high stakes when the issues of higher trade tariffs and other impediments to global trade are apparent and, unsurprisingly, the last few business days have seen as much talk about exemptions and negotiations as the threat of new measures. From my perspective, a continued drift down of the US dollar would help the shorter-term outlook for American domestic jobs in a far less confrontational manner than trade barriers and this, combined with continued economic reform by governments worldwide, offers a way for the global economy and financial markets to prosper. For this to be achieved however, calm heads and political leadership will be required.

In the meantime, the old-fashioned investing ideals of knowing what you are investing in and why will continue to be of utmost importance.

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