



Philequity Corner (July 8, 2019)

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The Art of Brinksmanship

The Philequity Board meeting last June 29 coincided with a crucial one-on-one meeting between Trump and Xi at the G-20 summit. The most-awaited private talk was scheduled at 11:30am, Tokyo time. During the course of our board meeting, our directors closely monitored live updates from Bloomberg, CNBC, and other news feeds for the outcome of Trump and Xi's conversation. We paused our meeting several times as some of our directors alerted the board with minute-by-minute updates. This shows how important the Trump-Xi meeting was to the fate of the global economy and the direction of financial markets.

Importance of psychology in investing

Our directors come from diverse backgrounds. They are businessmen, property developers, engineers, math majors, economists, bankers, miners, lawyers, and stock brokers. This is on top of the fund managers, technical and research analysts that we have. We typically use fundamentals, technicals, and macroeconomics in studying the financial markets. However, the current situation shows that Trump is one person who can cause markets to rise and fall. This illustrates the importance of utilizing psychology in investing. As seen in recent events, understanding the psychology of Donald Trump is a crucial prerequisite in navigating today's markets.

Trump's negotiating tactics

During the discussion in our board meeting, one of our directors commented that Trump has a habit of dangerously pushing negotiations to the edge before pulling-out with a concession or offering a deal. This was highlighted when he walked-out at the last minute during a crucial meeting with North Korea's Kim Jong Un. This was also displayed when Trump cancelled a missile strike on Iran when the bomber plane was already mid flight.

This aggressive negotiating tactic was again seen when Trump waited for the eleventh hour before agreeing to a cliffhanger trade truce with Xi. As the whole world anxiously waited for updates, Trump proudly announced that he had withdrawn his threat of 25% tariffs on an additional \$300b of Chinese imports. More importantly, Trump and Xi agreed to restart trade negotiations which faltered in May. Trump also pledged to ease restrictions on Huawei's purchases of American products.

Trump's game of brinksmanship

The strategy of pushing negotiations to the ultimate edge is called the art of brinksmanship. Merriam-Webster defines brinkmanship as "the art or practice of pushing a dangerous situation or confrontation to the limit of safety especially to force a desired outcome." Looking at his track record as a businessman and his actions as president, one can see that Trump indeed personifies the art of brinksmanship. He deliberately pushes negotiations to the brink while putting pressure on other parties to bargain with him. As a result of this strategy, investors have remained on the edge, closely monitoring Trump's every tweet.

Trade truce brings US market to new highs

US indices have risen to new all-time highs last week on the back of a last-minute trade truce between the US and China. On Friday, the S&P 500 closed at 2,990 and is now up 19.3% year-to-date. The Dow ended at 26,922 last week and is up 15.4% year-to-date. The cliffhanger deal between Trump and Xi has driven the performance of US markets which posted the best first half of a year in 20 years and the best June returns since 1938.

Major bull run follows a spooky Christmas rout

The current bull run comes after a sharp market downturn in the second half of 2018. Major indices plummeted more than 20% from their peaks and posted record-breaking drops on concerns that a Fed policy mistake may worsen the global economic slowdown. Though stocks have strongly rebounded from the Christmas rout, the market's recovery has been fraught with heightened volatility due to Trump's erratic behavior and unpredictable temperament.

The Fed pivot and coordinated central bank action

The groundwork for the bull market's continuation was laid by the Fed's pivot and coordinated central bank easing around the globe. Earlier this year, Powell made a decisive U-turn from hawkish to dovish which was prompted by slowing growth in the US. Recently, the Fed dropped the word "patience" from its policy statement, indicating a further tilt into dovishness while also hinting of future rate cuts. Major central banks have likewise implemented their respective stimulus programs while also easing monetary conditions. The coordinated action of global central banks has supported the resilience of the market despite risks posed by the trade war and Trump's aggressive negotiating tactics.

Bull market continues despite Trump's aggressive tactics

The US market made new all-time highs last week notwithstanding Trump's combative negotiating stance. The strong move of markets is underpinned by the Fed pivot, central bank easing, and hopes for a lasting trade deal between the US and China. Meanwhile, the Fed pivot has resulted in the consolidation of the US dollar, thus supporting the strength of EM currencies including the Philippine peso. This has given the Bangko Sentral ng Pilipinas (BSP) a window to cut its policy rate and reduce reserve requirements for banks without causing the peso to weaken. These factors have contributed to the strength of the PSEi which now has a year-to-date return of 8.7%.

Despite these positive developments, the US-China trade war continues to be a major risk for the stock market and the global economy. The progress of trade negotiations should be closely monitored as anything can happen given Trump's game of brinkmanship. We take comfort knowing that Trump wants stocks to go up because he equates his acceptance rating with the performance of the US market. Given this, we believe that Trump would prefer to secure a major trade deal with China in order to boost his chances in the 2020 election.

Philequity Management is the fund manager of the leading mutual funds in the Philippines. Visit www.philequity.net to learn more about Philequity's managed funds or to view previous articles. For inquiries or to send feedback, please call (02) 250-8700 or email ask@philequity.net.