CURRENT MARKET NEWS

A flurry of positive policy surprises

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- A U.S.-China trade deal looks likely, but a ratification hurdle remains
- Congress avoids shutdown with bipartisan funding agreement
- Boris Johnson election victory propels the UK towards Brexit

What happened?

The U.S. and China agreed to a phase-one trade 'deal in principle' which looks to involve both a delay of the U.S. tariffs scheduled to take effect on December 15, as well as a (possibly significant) reduction in existing levies on Chinese goods. And the removal of new December tariffs on nearly $160B of Chinese goods arrives just in time for the holidays, as consumer goods would have been hit hard in this latest round of adjustments. In exchange for these concessions, officials have indicated that China will substantially increase U.S. agricultural purchases, make commitments to help prevent intellectual-property theft, and not manipulate its currency (a provision that may apply to both sides).

Additionally, Democrats and Republicans reached a 'deal in principle' to avoid a government shutdown in advance of the December 20 spending deadline, another welcome event for investors which further reduces political uncertainty.

Not surprisingly, stocks rose following the news and 10 year Treasury yields spiked above 1.9%, near the top of the recent trading range. The U.S. dollar sold off modestly on the reduced macro risk.

What's next?

We've had a U.S.-China 'deal in principle' before, only to see it go up in flames during the final drafting stage. While a large scale trade deal between the two countries before the 2020 U.S. presidential election is unlikely, we do think both sides have an increased incentive to limit further escalation. This gives us more confidence that a formal agreement could be possible this time around, though just seeing both parties exhibit a directional bias towards less friction should be a positive development for business sentiment. As to a 'grand compromise', China would likely prefer to wait until there is more clarity around the Democratic nominee, and has not yet shown a willingness to negotiate on structural issues such as government subsidies for favored industries and forced technology transfer.

Meanwhile, in the U.K.....

Boris Johnson achieved a decisive General Election victory, which removes some major uncertainties for the U.K.. The opposition and their anti-business agenda has been defeated and Brexit should now be delivered on January 31.

This is positive for sterling and risk assets in the U.K., but great uncertainties remain as the U.K.'s future trading relationship with the EU still has to be negotiated. Nevertheless, a worst case Brexit scenario looks to have been averted, which should be positive for European sentiment in the short run.

Our take

The de-escalation of trade tension reduces a significant headwind for risk assets, and signals that President Trump is focusing on protecting the economy heading into the 2020 Presidential election. While a deal still needs to be signed, the trend is encouraging for now. In addition, a major hurdle has been cleared in Europe, though negotiations will start anew in early 2020.

Bottom Line: The global policy outlook improved this week with the de-escalation of trade tensions, a Conservative Party win in Britain, and a 'deal in principle' to avoid a U.S. government shutdown. All of these developments are positive for global growth and risk assets as we head into 2020.

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