Why investors should worry about rising US stocks, dollar and bond yields

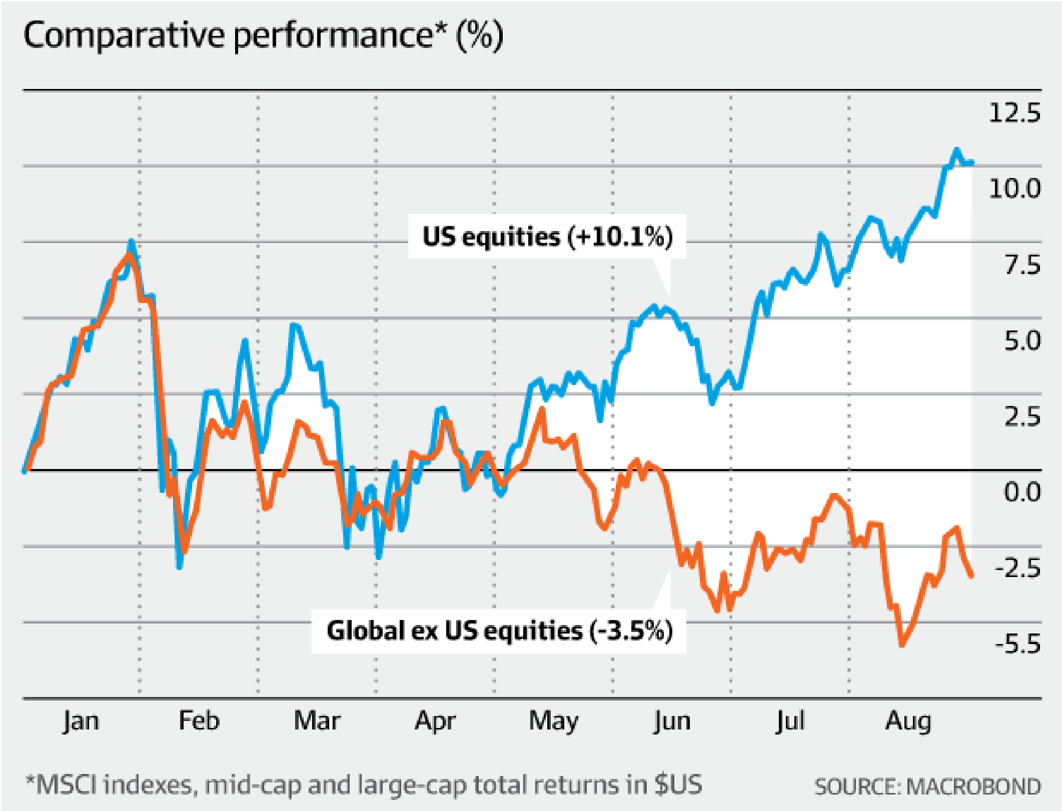

*Our dollar has suffered a uniquely Australian "double whammy". **AFR***

by **Stirling Larkin**

Global investors take pause when the United States 10-year government bond yield rises above the historically significant 3 per cent, the greenback levitates on the anticipated outcomes of upcoming mid-term political referendum and US sharemarkets continue to rip higher on the presupposition that neither rising bedrock bond yields or a strengthened US dollar affect rich prices or valuations.
For Australian domestic investors exposed to the S&P/ASX 200, which continues to take its lead from its larger S&P500 US cousin, the clear and present danger is becoming more obvious: by way of symmetry but also happenstance, our Australian dollar, long-dated government bonds and S&P/ASX 200 investments are being redefined as risk and not defensive assets.

This is thanks to a Trump presidency, a current account dependence on trade with China and our domestic free-floating currency, which has yet to find a pattern of its own since then Treasurer Paul Keating floated it in 1983.

The Australian dollar – seen as a proxy for China-related trades as well as a barometer of broader risk sentiment – has in recent months suffered a uniquely Australian "double whammy": it has become the cannon fodder of Donald Trump's hyperbolic "trade war" with China and has remained anchored to the bottom of its 78-71¢ range, predominantly thanks to the US dollar levitating on November mid-term election presumptions.



The danger to Australians waiting for a recovery in the our dollar is that whatever happens on November 6 during the mid-term elections, the Australian dollar loses and continues to suffer in either outcome.

If Republicans retain both houses and Trumponomics remains unabated, Trump's obvious Robert Mueller countermeasure and 2020 re-election political stump is to make his hyperbolic cold trade war with China into a real one. This would propel our dollar to an entirely new lower-bound range.

Such a shift in Pacific bloc trade would inevitably damage Australia's long-dated government bonds and S&P/ASX 200 trading constituents.

If, unexpectedly, Trumponomics is abated by a Democratic takeover of either house, our dollar would still suffer because the S&P500 sharemarket would be likely to grind to a halt given its Faustian pact with the continuation of Trumponomics.

Trumponomics has always been more than simply a recalibration of what globalisation means within a nativist American administration. However it's presented, the administration's rhetoric will always endeavour to be fiscally stimulatory, which is bullishly received by US markets.

Importantly, Trump has never hidden the fact that his administration has no plan, or intention, to curtail a strong US dollar.

Dangers continue beyond the vulnerability of our Australian dollar or satellite proximity to Trumponomics for the S&P/ASX 200. Australian ultra-high-net-worth investors also recognise that US benchmark 10-year government bond yields crossing the arbitrary 3 per cent threshold opens up the potential to the triggering of a bear market for global bonds, ending the unprecedented and uninterrupted secular bull run seen in fixed income markets which began in October 1981 when 10-year yields reached 15.8 per cent.
It is clear that Australia's investments are being recategorised as risk assets because of our "happenstantial" proximity between a resurgent China and a nativist America. This cannot be avoided.

US officials believe that China has not lived up to the commitments it made when it was allowed to join the World Trade Organisation in 2001, and that Beijing continues to treat foreign firms unfairly while keeping vital sectors closed to foreign competition and supporting state champions through illegal subsidies and loans at below market rates.

Pushing China to change that model is a key goal of Trumponomics.

But many of the US's core demands go to the very heart of China's economic model, and changing them at the behest of a foreign power would be both a domestic and international embarrassment for Beijing.

If the US refuses to settle for anything short of a structural remake of the Sino model, the dispute could not only entangle Australian risk assets but our underlying real economy.

Australian investors have few places to hide when two world powers vie for supremacy with them as cannon fodder. But what the considered globally-minded investor can do is pay less attention to Twitter and more to the symmetric manoeuverings visible in currency and government bond dominions.

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