FAWKES CAPITAL MANAGEMENT

20 February 2025

A Reordering of Global Trade

Dear Investors

The re-election of Donald Trump has signalled a significant shift in the global trade landscape, with the administration actively pursuing a "fair trade" agenda. This new approach, spearheaded by Peter Navarro, seeks to rectify perceived imbalances in existing trade agreements and prioritise American interests. We believe this policy shift will create both challenges and opportunities for investors. In this report, we aim to analyse the potential impacts of this reordering of global trade.

The Resurgence of "Fair Trade"

We believe that global trade is undergoing a fundamental reshaping. The classic arguments for "fair trade" first articulated by Ronald Reagan, form the backbone of this administration's trade philosophy.

During the 1980s, American manufacturing dominance faced challenges from Japan and South Korea. Following periods of conflict, these Asian economies became extremely trade competitive as their technologies improved. Reagan responded by adopting a "fair trade" policy, which he articulated in a 1985 speech:

> *"Above all else, free trade is, by definition, fair trade. When domestic markets are closed to the export of others, it is no longer free trade. When governments subsidise their manufacturers and farmers so that they can dump goods in other markets, it is no longer free trade. When governments permit counterfeiting or copying of American products, it is stealing our future, and it is no longer free trade. When governments assist their exporters in ways that violate international laws, then the playing field is no longer level, and there is no longer free trade. When governments subsidise industries for commercial advantage and underwrite costs, placing an unfair burden on competitors, that is not free trade."*

In the 1980s, Trump advocated for a 15-20% tax on imports from Japan, stating, "I believe very strongly in tariffs…America is being ripped off. We're a debtor nation, and we have to tax, we have to tariff, we have to protect this country."

For decades, the world order established by Western powers facilitated tariff reductions through the World Trade Organization. This arrangement benefited both Western powers and exporting nations, providing inexpensive goods and low inflation to America while generating income for exporters. However, this equilibrium no longer serves the United States. Four decades later, the decline of rural and industrial America has fuelled the rise of the populist Trump movement. This administration has the mandate to dismantle the pre-existing system and create one centred around fair trade.

Peter Navarro is the chief architect of this trade agenda, serving as the key strategist behind the administration's efforts to rewrite global trade rules in America's favour. By all accounts, he is leading trade policy, determined to avoid the missteps of the previous Trump administration. Having served four years in jail for his loyalty to Trump, Navarro remains steadfast in his commitment to reshaping the global trade landscape. In Trump's first term, China failed to fulfill its commitments under the initial trade deal, avoiding the large-scale purchases of American goods that had been promised. Navarro sees this as a lesson learned—this time, he is intent on ensuring that the rules are rewritten in a way that prevents similar evasions. In *Project 2025*, the administration's policy blueprint, the manifesto section titled *"The Case for Fair Trade"* lays out this new vision. Navarro writes:

> *"The clear lesson learned in both the Obama and Trump Administrations is that Communist China will never bargain in good faith with the US to stop its aggression. An equally clear lesson learned by President Trump, which he was ready to implement in a second term, was that the better policy option was to decouple both economically and financially from Communist China as further negotiations would indeed be both fruitless and dangerous."*

We have already seen clear signs that *Trump 2.0* is pursuing a more aggressive trade agenda. His recent tariffs on aluminium and steel underscore the administration's intent to overhaul trade rules, even in dealings with long-standing allies. In section 5 of the order adjusting tariffs on aluminium, he writes:

> *"The Secretary has informed me that, notwithstanding the 10 percent ad valorem tariff imposed by Proclamation 9704 that mitigated the threatened impairment of our national security, aluminium imports into the United States have continued at unacceptable levels as the global aluminium excess capacity crisis continues. In addition, the exclusion of certain countries and products from tariff and efforts by foreign producers to circumvent the tariff have undermined the purpose of Proclamation 9704, which was to adjust the level of imports of aluminium to remove the threatened impairment of the national security."*

Reciprocity and Retaliation

So, what's the plan? The trade strategy outlined in the Project 2025 manifesto, spearheaded by Navarro, centres on the implementation of reciprocal tariffs. The idea behind reciprocal tariffs is simple. Founded upon the concept of fair trade, the US will impose tariffs that match the tariffs of other nations. The concept, rooted in the principle of reciprocity, aims to level the playing field in international trade. While some tariffs have been used to pressure Mexico and Canada to strengthen border security, the underlying philosophy behind these tariffs draws inspiration from Reagan's economic policies

The challenge is that the other countries the US trades with want to preserve their existing advantages. Why wouldn't they want to keep a system that has long favoured their interests? As a result, these countries have been retaliating.

We believe that investment opportunities exist in the change that's created by finding a new equilibrium on global trade. For instance, we saw first-hand how tariffs and anti-dumping measures put in place by the Australian government changed the economics of Bluescope Steel. Such changes create potential for domestic industries to benefit from shifts in trade policy. In our view, a similar transformation is likely to happen with aluminium companies in America, where imported aluminium currently satisfies approximately 50% of total aluminium consumption.

China's Strategic Response

China's retaliatory measures have been particularly strategic. The country has begun to restrict exports of certain metals that are widely used in the industrial world. While we've already noted what they've decided to do with antimony, and the likely implications, China is also placing restrictions on tungsten, tellurium, bismuth, molybdenum and indium. What do these metals have in common? Predominantly sourced and processed in China, these metals are critical components in emerging technologies such as electric vehicle batteries, solar panels, and aerospace applications. By controlling the supply of these vital resources, China aims to maintain its leverage in these strategically important sectors.

In the same way that American restrictions on NVIDIA's chips gives its domestic industries a multiple year advantage over China, we believe China is instituting these restrictions on critical minerals to provide its future industries with an advantage over the West. The West faces significant challenges in replicating China's scale in raw material extraction and refining. Developing new mines and refining processes requires substantial time and investment, making it difficult to quickly overcome China's dominance. While tariffs on Chinese goods may be implemented, establishing alternative supply chains for these essential raw materials will be a considerable undertaking.

We are anticipating a protracted rebalancing of global trade and believe these restrictions will persist for the foreseeable future. The restriction of Chinese exports of these metals to the rest of the world is likely to create bifurcated commodity markets, especially in antimony. We believe this metal presents a compelling investment opportunity due to the anticipated magnitude of change in its supply dynamics.

Gold: A Safe Haven in Uncertain Times

Beyond industrial metals, another potential beneficiary of these trade policies is gold. While often dismissed by value investors as a "useless metal," this perspective overlooks its critical role as a medium of exchange – a role that is becoming increasingly evident in today's shifting economic landscape. Essentially, economic activity boils down to a series of transactions where goods and services are exchanged for a form of currency. Companies with strong competitive advantages can effectively "charge more" for their offerings, as consumers are willing to exchange a greater portion of their resources (income) for those desired products or services.

Currently, these transactions primarily utilize fiat currencies like paper money and coins. However, recent geopolitical events have shaken confidence in the stability and reliability of these fiat currencies. The conflict in Ukraine and subsequent sanctions on Russia highlighted the vulnerability of relying on a global financial system controlled by a few powerful nations. Russia's access to its foreign currency reserves was abruptly cut off, hindering its ability to conduct international trade. This situation has driven Russia, along with nations like India and Turkey to increase their gold reserves significantly. China must also see the writing on the wall.

Gold's enduring history as a globally accepted medium of exchange, its neutrality, and its ability to facilitate discreet transactions make it an ideal alternative in times of geopolitical uncertainty. These countries are demonstrating a clear preference for gold, recognising its enduring value and its ability to circumvent reliance on potentially unreliable fiat currencies.

Where we do agree with the conventional wisdom is that gold is hard to value. However, one lens of predicting where gold prices are set to go is through what Jim Rogers calls the perpetual laws of supply and demand. The central banks of these countries have been buying approximately 12% of the global supply of gold each year since the Ukraine conflict began. Last year's 12% demand from central banks contributed heavily to an approximate 30% rise in the price of gold. Importantly, this trend is likely to continue, especially if major players like China, with its substantial trade surplus, opt to convert a significant portion of their reserves into gold. For perspective, if China were to meaningfully shift some of its annual US$1 trillion in trade surplus into gold each year, this would be equivalent to buying 3x more than all the gold produced in the world each year. While we monitor the potential for a negotiated settlement to end the Ukraine war, we believe flows into gold could accelerate as Trump reorders trade and reduces foreign government faith in traditional reserve currencies.

The Road Ahead: Navigating the New Trade Order

While a "Phase 1"-style deal with China remains a possibility in the long term, several factors suggest it's improbable in the near future:

- The Trump administration has openly acknowledged shortcomings in the previous agreement and expressed a commitment to avoiding similar concessions.
- Kevin Hassett, the administration's Director of the National Economic Council, has indicated that certain structural tariffs will remain in place regardless of any negotiated settlement.
- The deal reached with China in 2020 still left many tariffs intact. Subsequent to this deal, China restricted exports of gallium, germanium, and antimony, demonstrating a willingness to prioritize its own strategic interests.
- Existing actions by the Trump administration show that they are willing to tariff all countries this time around, underscoring a broader and potentially more resolute approach to trade policy.

Perhaps the one force that might emerge as a limiting factor is inflation. While many have argued that any tariffs should only result in a one-off impact on inflation, we're a little more circumspect. Historical examples, like Bluescope Steel's development of annual pricing power after trade policy changes, highlight the potential for longer-term impacts. However, significant inflationary pressures from tariffs have yet to materialise.

The new Trump administration is driving rapid and far-reaching changes on the global stage. These changes create both challenges and opportunities across various industries, and we are actively pursuing investments that capitalise on these evolving dynamics.

Kind Regards,
Fawkes Capital Management

Please click *here* to subscribe to receive future Fund or market updates.