Entente cordiale en désordre.

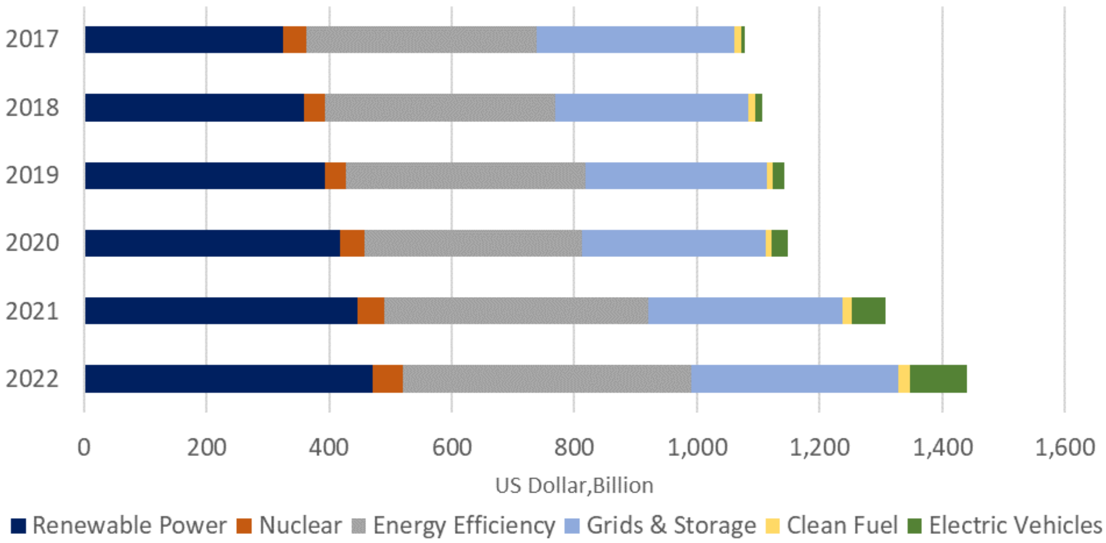
The United States of America has a long record of adopting protectionist strategies when it comes to trade with the rest of the world. In 1789 the newly formed United States passed the Tariff Act, imposing tax of between 5%-15% on all imports, but Alexander Hamilton's policies were trivial compared to the 1828 Tariff Act that applied a 25% tax on all imports. It took until the 20th Century for the US to properly enter into bilateral tariff reduction agreements, which were eventually replaced when the World Trade Organisation took over the mantle of trying to establish uniform tariff rates.

Enter Donald Trump and his 'America First' agenda, which reversed much of the work of the WTO, with far-reaching tariffs not only on China, but many international partners too. The hope that the arrival of President Biden might see a de-escalation in protectionist measures has been short lived and we now face a slowing economy while nations and regions adopt tit-for-tat measures to try and attract investment into the respective regions.

Although tariffs do play a part in the current measures being played out, there is more of a carrot and stick approach being adopted as an arms race in subsidies has now come to pass. The US Inflation Reduction Act (IRA) allegedly breaches the WTO rules, by requiring a percentage of domestic content in products, but that did not stop Capitol Hill passing the act, leaving the EU threatening to take the US to the WTO over the incentives. The WTO wants to be left out of the argument, so we expect that the subsidy war will continue unabated.

Within the IRA is $369 billion of spending targeted towards energy security and climate change, and this is on top of the spending outlined in the $1.2 trillion Infrastructure Investment and Jobs Act (IIJA), passed in 2021. With unparalleled amounts of governmental support and investment, the acceleration of growth in the green energy sector, which saw over $1.4 trillion of investment last year, is likely to increase in size significantly.

Green energy spending on the rise.

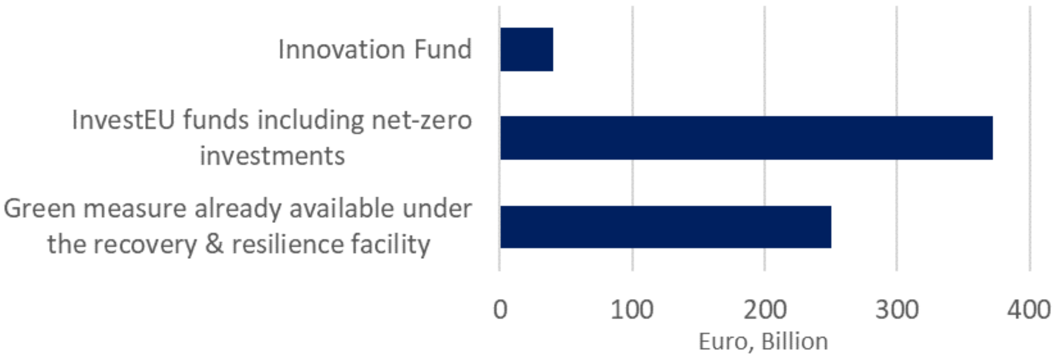


Source: TIM/ IEA

In an attempt not to lose ground in the green tech race, and to maintain its position as the leader in net-zero technologies, the EU has plans of its own. To counter the huge US and Chinese subsidies the

EU had drafted a Green Deal Industrial Plan which saw €225 billion of loans and €20 billion of grants towards investments in carbon capture & storage, renewable energy, batteries, and renewable hydrogen production. In the wake of the US expansion of their plans the EU has also gone further with €662 billon on the table for a green transition. The Union talks of forming partnerships with trading nations; however, the scale of the subsidies is a thinly disguised form of protectionism. While these subsidies will help with net-zero strategies, we doubt that the end solution will have been done in the most cost-effective manner due to national self-interest over efficiency as price competition.

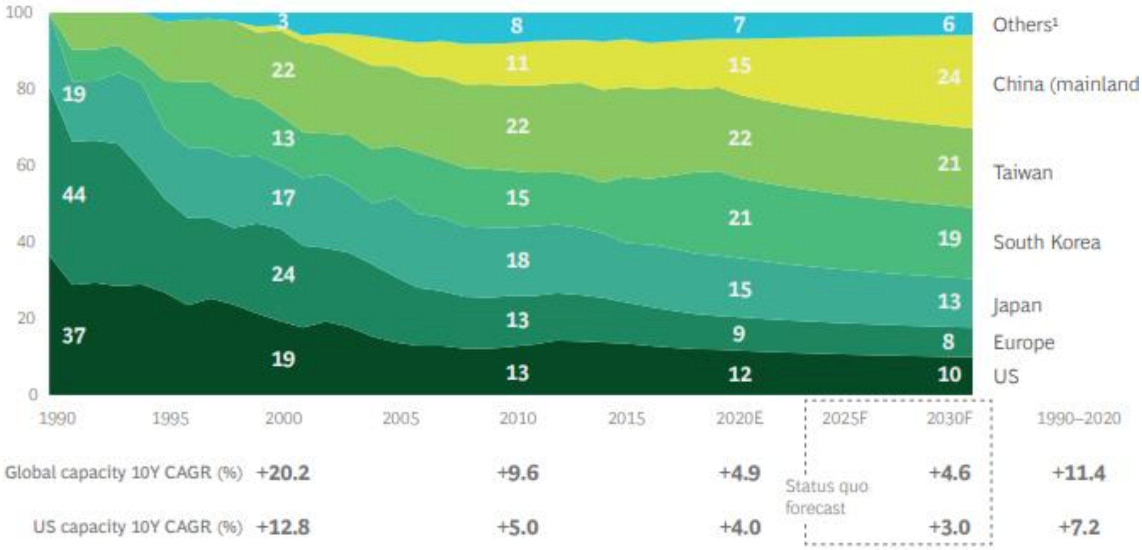
The EU turns up the heat- Funding for the Green Transition



Source: TIM/Bloomberg

Away from green energy, national security and local production of technological products has been on the minds of many nations, highlighted by the semiconductor shortages that came about in 2021, in a sector dominated by the Chinese and Taiwanese.

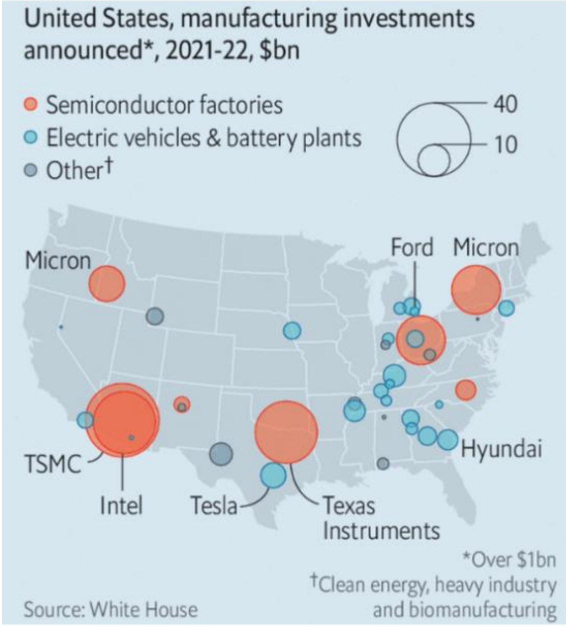
Global semiconductor chip production by region



Source: Boston Consulting Group

The US has been the most vocal in the subsidies that it will give to the semiconductor fabrication companies to build the plans in the US, with the passing of the Chips Act, which earmarked $52 billion for domestic production. Texas, Intel. Micron and TSMC have all committed to large scale plants on the back of this act, although the time lag until production comes on-stream is in years not months. TSMC alone, is committing $40 billion to its Arizona plant, tripling their original plans, and agreeing to produce leading edge 3-nm and 4-nm chips there.

The IRA and Chips Acts are already attracting investment.



Source: The Economist

However, the Chips Act was just the start of the US's plans for the semiconductor industry, and it followed up with sweeping exports controls on goods and services that support the production of chips in China without a license. Without the supply of key-components and services from US, companies will be severely hindered in their expansion plans, but simultaneously it has a large impact on US companies that have lucrative contracts in China; Applied Materials has estimated that it will lose $400 million of regular income if it was to terminate its Chinese service contracts.

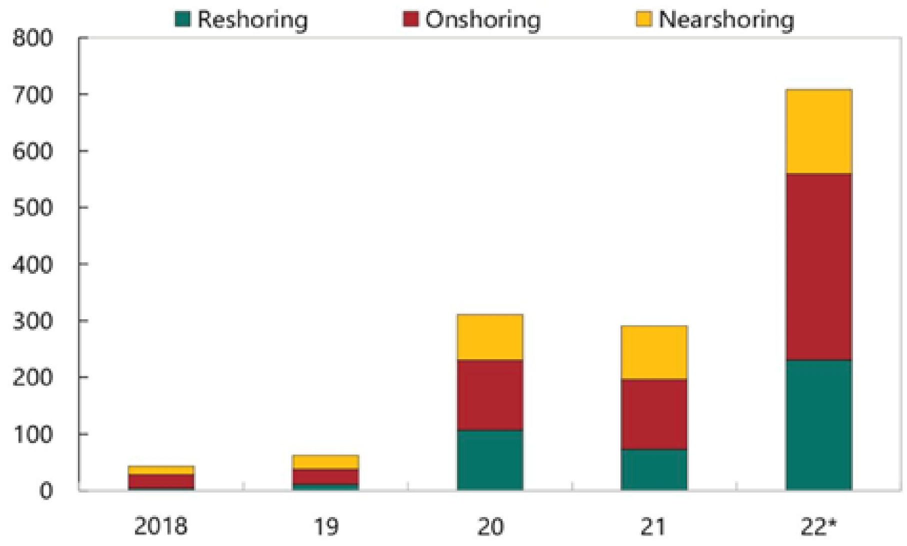
In its attempts to reverse the growth of the Chinese, the US has stepped up pressure, with success, on the Dutch and Japanese governments to halt exports also. The Dutch lithography manufacturer, AMSL[1], has a near monopoly in state-of-the-art deep UV lithography systems, vital for leading node and 3D NAND semiconductor production, and the Japanese companies such as Kioxia and Renesas are key suppliers of parts to the Chinese as well.

The rest of the world is not sitting still, letting the US regain is past dominance of the sector; Europe, India, Japan, South Korea and Taiwan have all announced subsidy packages to lure semiconductor production within their shores. The European Chips Act promises €43 billion for investment in the sector within its boundaries through to 2030, and Intel has already requested €5 billion to build a plant in Germany, covering almost one-third of the production costs.

After years of globalisation and low-cost, just in time production, the tide has turned, and a new age of protectionism is emerging. Security of supply has led to a revitalisation of onshoring and nearshoring by companies, and now governments are luring both national and international firms to invest in their territories, often by methods that contravene (or sail very close to the wind) international trade standards and in doing so weakening the standing of bodies such as the WTO. This dynamic will disrupt production chains and likely lead to margin pressures as costs will inevitably rise.

[1] The VT Tyndall Global Select Fund owns a position in ASML.

Number of references in corporates' earnings presentations.



Source: IMF

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