Legacy Trust

Investment Perspectives

Trade Tensions Far From Settled

June 2019

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Key Takeaways

- The trade war between the U.S. and China was reignited in early May by an increase in tariffs on Chinese imports
- Stock markets experienced volatile swings in May and June as trade tensions climbed
- The U.S. and China reached a deal on June 30 to restart trade talks, but a resolution still seems far away
- The uncertainty surrounding trade policy is having a dampening effect on economic activity and is a key threat to global growth

Despite a truce reached in late June between the U.S. and China, heightened global trade tensions are far from over. Stock markets dropped significantly in May only to climb back up in June as prospects of a trade deal shifted quickly. While China has agreed to come back to the negotiating table, the two sides appear to be far apart on key structural issues – and the practice of using trade as a political bargaining tool may be here to stay.

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Global equities have been on a rollercoaster ride since early May, when President Trump announced an increase of existing tariffs on $200 billion of Chinese imports from 10% to 25%. Up until that point, both the U.S. and China were sending signals that a trade deal very close to being achieved. U.S. equities had gained more than 18% YTD due in part to expectations for a deal. However, the U.S. apparently felt that China was reneging on previously settled items during negotiations and lost patience with the process.

Suddenly the trade war which had seemed all but settled was back on. China retaliated by raising tariffs on $60 billion of U.S. imports. The tariffs were targeted on a specific list of goods including textiles, beef, coffee, and certain technologies like microwaves and printers. U.S. agriculture was particularly impacted. Trump went on to threaten a 25% tariff on another $300 billion of imported goods - essentially all remaining imports that hadn't already been hit, many of these direct consumer goods. The S&P 500 fell 7% over the course of the month as investors digested the reignition of the trade war.

As expectations began to build toward a face-to-face meeting between President Trump and Chinese President Xi at the G20 summit in late June, equity markets gradually began to rally in anticipation. By the end of the month, the S&P 500 had rallied back 7% and had climbed back up to the previous market high from early May.

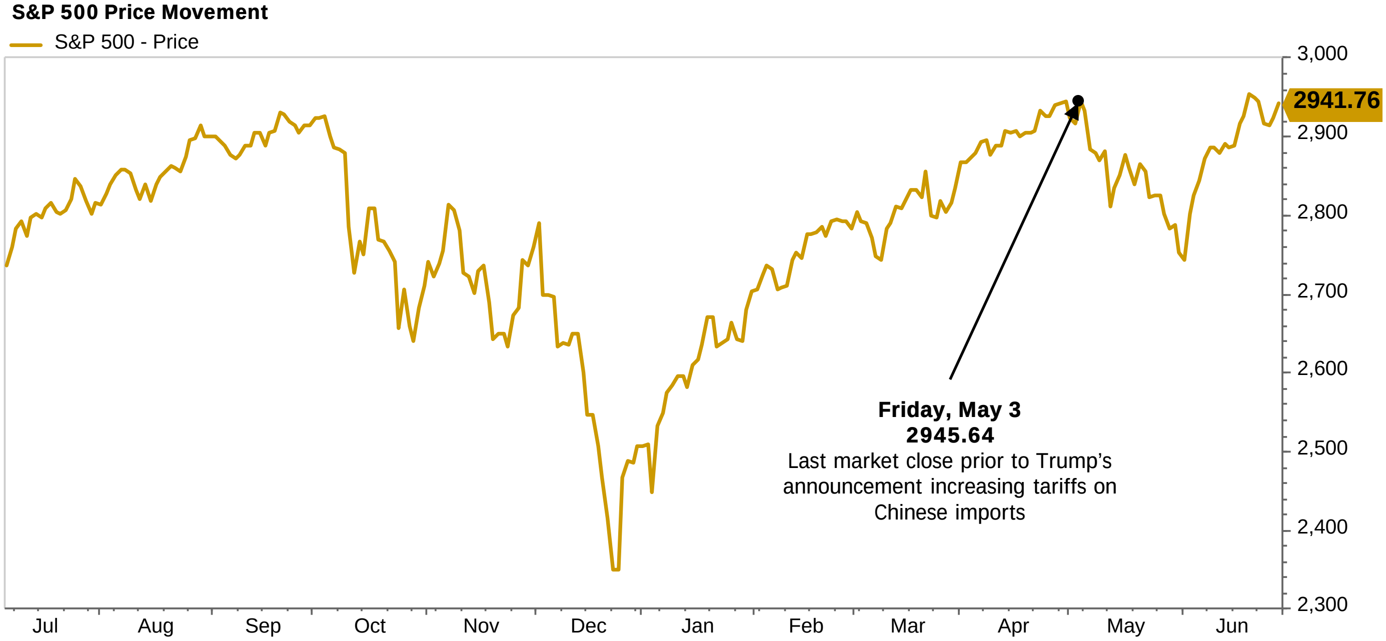
Sure enough, on June 30 a truce was announced between the U.S. and China that would bring the two countries back to the negotiating table. President Trump agreed to hold off on the $300B of new tariffs while China agreed to purchase more goods from American farmers. Further, the key to reaching a truce was for the U.S. to lift the ban on American companies doing business with Chinese telecom giant Huawei – a ban that had been imposed by the Trump administration due to national security concerns, theoretically unrelated to trade negotiations.

While markets have reacted positively to the trade truce, the issues at play still appear to be far from a resolution and will undoubtedly continue to drive market volatility going forward. Already, the uncertainty surrounding global trade has had a dampening effect on economic activity. The IMF has already lowered its global growth forecast for 2019 to 3.3% from 3.6% going into the year and said that ongoing trade tensions could result in a more significant downgrade.

Further, the practice of using tariffs as a bargaining tool on unrelated political matters as occurred with Huawei and China (as well as in last month's spat with Mexico over border control) could have long-reaching implications for investors. If companies fear than any country can be targeted with little to no warning based on the political issue of the day, they will find it difficult to have confidence in their global supply chains. This could potentially lead to a slowdown in the flow of capital and to businesses that are run less efficiently and profitably.

With Q2 earnings season about to start, we expect to learn much more about how the reignition of the trade war is impacting American businesses. Our outlook for equities remains generally positive as the U.S. economy still appears fundamentally solid and consumers are financially healthy, but there is no question that markets will be sensitive to trade developments moving forward.

S&P 500 Price Movement



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