

Trade War?

Last quarter we wished a happy 9th birthday to the Bull Market run, the second longest post-war rally. But now, the Market Bull is grappling with a brand new adversary, a tit-for-tat tariff battle which could escalate into a trade war. This quarter's tweets, twists, and tariffs enflamed our trading partners, instigated investor uncertainty, and sparked market volatility. There is much at stake.

Round one began back in March when President Trump imposed a 25% tariff on steel and 10% on aluminum excluding three of our largest trading partners—Canada, Mexico and the European Union. After the renegotiation of NAFTA failed, Canada, Mexico, and the European Union were unhappily hit with these tariffs.

In round two, the White House accused China of "economic aggression" by stealing intellectual property and forcing US companies to share advanced technology with their Chinese partners for just doing business there. On March 22nd, Trump signed a presidential memorandum calling for punitive tariffs on \$50 billion (bn) of imports from China, but imposed a 60-day consultation period before they would take effect.

China's offer to buy \$70bn in US goods was deemed inadequate and a 25% tariff on more than 800 products valued at \$34bn of imported goods are slated to be effective July 6th, with tariffs on the other \$13bn to apply later. China immediately struck back saying it would impose additional retaliatory tariffs of 25% on \$34bn worth of imports from the US, including soybeans and automobiles simultaneously on July 6, with more new duties to be applied later. Trump directed the US Trade Representative to prepare new tariffs on \$200bn in Chinese imports moving the two nations closer to a trade war.

Many believe that no one wins a trade war, while others, as Warren Buffet wrote, feel "America's Growing Trade Deficit is Selling the Nation Out From Under Us." According to the US Census Bureau, the 2017 US trade deficit with China was \$375bn, with the US importing \$505bn, almost 4 times the US exports of \$130bn. In 2000 the US-China trade deficit was only \$83bn. China's GDP has grown 10 fold since the turn of the century from \$1.2 trillion to \$12.8 trillion in 2017. China is now

a strong contender and has vaulted into the second largest economy in the world just behind the US GDP at \$19.4 trillion.

Today we're in the middle rounds and the fight is heating up around the world. Rhetoric between the US and the EU is escalating. The EU insists the US is hitting below the belt ignoring world trade polices, while the US says Europe is "possibly as bad as China". The EU is our largest trading partner and accounts for our second largest trade deficit. At the same time, Canada is not backing down and counterpunched with \$12.6bn in retaliatory tariffs. The prospect of an all out trade war has disrupted the global financial systems.

The US economy and markets have held up surprisingly well, while the rest of the world is already bruised and battered by the trade spat. Asian and emerging markets have been hit the hardest, with Chinese stocks well into the red, tumbling into bear market territory. The trade tensions have driven a surge in the value of the dollar, assisted by the US Federal Reserve rate hikes. The flight to safety in the US Dollar, along with these higher rates, have pummeled many foreign currencies sinking by over 5% during the quarter. The lower foreign exchange rates are effectively an additional tariff on goods they export to the US.

Both the US economy and stock market have absorbed all the body blows thrown by our angry trading partners. Macroeconomic Advisers project a 5.3% GDP surge for the 2nd quarter, the single best quarter since the recession. At the same time, FactSet expects the S&P 500 earnings to grow by 20% from a year earlier and the cost of those stocks to drop below their 5-year average, as measured by their projected earnings. These prosperous financial times here at home obscure the dangers abroad.

These are tense, turbulent times. The contenders are all throwing haymakers while the news media highlights the blow-by-blow conflict. If no one can win a trade war, let's all hope for a split decision draw.

