Global Trade – Can There be a Win – Win Scenario? May, 2018

SUMMARY

- **The Trump administration has placed a focus on "unfair" trade deals**
- **Recent steel and aluminum tariffs have led to an escalating retaliatory environment**
- **Investors are jittery as historically there are no "winners" in an all-out trade war**

HISTORY & BACKGROUND

International trade is an essential part of today's economy. Whether it be through exports of goods and services or imports of parts or completed products, trade across national boundaries influences growth and the overall health of an economy. Since the 2016 election, President Trump has initiated reviews or revisions of significant trade agreements, including the Trans-Pacific Partnership (TPP) and the North American Free Trade Agreement (NAFTA). Most recently, tariffs on specific goods have been placed on imports to the US. China, in particular, has responded with retaliatory tariffs of its own. Though conversations have been occurring between the major national players, there is no clear end in sight to these skirmishes. Furthermore, there is still uncertainty as to the future of many existing agreements.

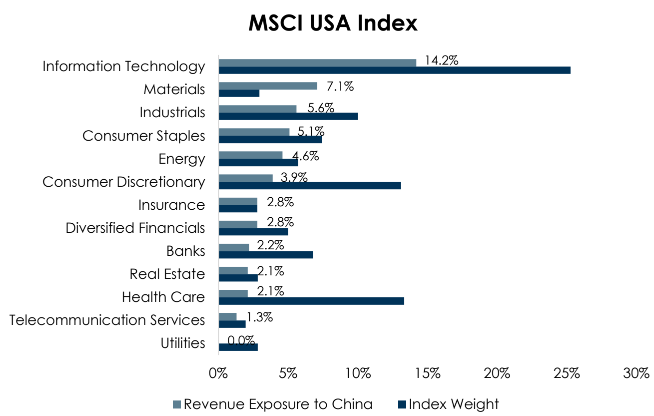
INSIGHTS & PORTFOLIO IMPLICATIONS

A Situation in Flux

A number of governmental entities, including Canada and the European Union, were temporarily exempted from the tariffs on steel. This exemption was recently extended to June 1. The US runs a significant trade deficit with Germany, in particular, so would like some concessions in return for making the exemption permanent. The EU is proposing a new agreement with the US to cover trade between the two parties, but also to include a united approach to trade with China.

What's at Stake

Historically, a trade "war" has led to reduced global trade, increased inflation, and currency volatility. Should the conflict with China escalate, it may have a notable effect in some sectors within the US market. In particular, technology, materials, industrials, and consumer staples have significant (>5.0%) revenue exposure to China. Overall, Chinese companies have about half as much reliance on US-driven revenues, and this is mainly concentrated in the technology and energy sectors.



Source: MSCI

Behind the Scenes

Discussions behind closed doors continue on a number of fronts. US allies are looking for ways to reduce the impact to their countries, while the US administration stands strong publicly in its lofty goal of reducing bilateral trade deficits by ~$100 billion. The United Kingdom, amid Brexit negotiations, also faces trade challenges with the Eurozone as it approaches the official separation deadline in March 2019.

The Outlook

Modifying an existing trade relationship is not an easy task. Each party must weigh the impact of alternatives, both politically and economically. There are a number of upcoming meetings / events that are likely to dictate whether the recent trade antagonism increases or diminishes. Thus far, the market has been fairly resilient, indicating expectations that trade negotiations and diplomacy will alleviate the issue ahead of any trade war erupting. This does not imply a lack of concern by investors, as short-term volatility has increased.

Date	Event
May 7	NAFTA outcome likely communicated
May 21	Product list determined for Chinese tariffs
June 1	Steel and aluminum exemptions expire
June 8	G7 Summit in Quebec
July 11	WTO trade policy review of China
Nov 6	US Mid-term elections

Source: Bloomberg, ACG Research

ACG'S POSITION

With the apparent easing of tensions between North Korea and the rest of the world, the possibility of a trade war has emerged as a driver of market volatility. The US administration has a vested interest in helping businesses in the US do well. As full-blown trade wars do not further that agenda, we ultimately expect more "bark" than "bite" as it relates to these matters. Market volatility will most likely continue to be elevated in the short run, with uncertainty feeding investors' fears. That said, as the post-crisis bull market continues to age, fundamental factors such as earnings, rising interest rates, and inflation are likely to be the real drivers of market outcomes. Contrary to any instinctual desires to flee the markets given increased volatility, we recommend remaining disciplined while keeping an eye on economic and corporate fundamentals that are likely to direct the capital markets over the long run.