Weekly Market Flash

1-2-3-4, I Declare a Trade War

April 6, 2018

There are weeks when covering financial markets is interesting and engaging, where all sorts of macroeconomic variables and corporate business models demand analysis and discerning judgment for their potential impact on asset prices. And then there are weeks like this week, when none of those things seem to matter. “OMG Trump’s going to start a trade war and everything is going to be terrible” frets Ms. Market, just before the opening bell at 9:30 am. “No, silly, nothing’s going to happen, it’s just boys being boys, talking tough as always” say Ms. Market’s girlfriends while taking away her double espresso and offering some soothing chamomile tea instead. And so it goes, back and forth, up and down, day after tiresome day.

Soya Bean Farmers for Trump

We continue to believe that an all-out trade war between the US and its major trading partners is an unlikely scenario. But it has now been just shy of two months since the first announcement by the US administration of proposed new tariffs on steel and aluminum. The war of words, at least, shows no sign of fading into the background. Attention must be paid.

Moreover, the contours of the dispute have narrowed and hardened. Recall that the original steel and aluminum tariffs were comprehensive, drawing responses from all major trading partners. This week’s tough trade talk has been a much more bilateral affair between the US and China, starting with the formalization of $50 billion in new tariffs announced by the US on April 2. China promptly responded with its own countermeasures: $50 billion including major US exports like soya beans – a move that would go straight to the wallets of farmers in Trump-friendly rural America. Now here we are, on Friday morning, with the stakes raised to $100 billion after the latest US White House release. $100 billion represents about 20 percent of the total value of US imports from China. It would necessarily include many of the consumer products Americans buy – potentially suggesting a catalyst for higher inflation.

What Are Words For?

The message from the administration’s policy voices, such as they exist, to world markets has been essentially this: ignore our blustery words, they’re just harmless morsels of red meat for our rabid political base. All these tariff proposals, according to this line of thought, are just opening gambits for negotiation. Nobody really wants a trade war. This message was persuasive enough to bring Ms. Market out of her early morning funk on Wednesday. What was shaping up to be another one of those disheartening two percent-plus intraday plunges reversed course and finished north of one percent in the green column. We’ll see if the sweet talk is able to work its magic again today, with the S&P 500 back on the fainting couch during morning trading.

The other reason why markets may be inclined to not read too much into the playground tough talk is that actually executing a trade war would be far more complex than simply reading off lists of products and associated tariffs. The global economy truly is interlocked. What this means in practice is that trade is not anywhere nearly as simple as “China makes X, US makes Y and Germany makes Z.” Companies have invested billions upon billions of dollars in intricate value chains that start with basic raw inputs, go through multiple levels of manufacturing, wholesaling and retailing, and involve many different countries throughout the process. Dismantling these value chains, while theoretically possible, would result in an economy barely recognizable to the employees and consumers who have become used to them.

The earnings season for the first quarter is about to get underway, and it looks to be a barnstormer. FactSet, a research company, estimates that earnings per share for S&P 500 companies will grow around 17 percent year-over-year on average, which would make it the strongest quarter in more than 5 years (and, rationally, provide a nice tailwind for stock price valuations). The vast majority of these companies have absolutely no interest in being conscripted as foot soldiers in a trade war, and they will be sure to make their voices heard through plenty of influential lobbying channels. On the US side, at least, there is nothing remotely like a unified “team” suited up to do trade battle – and if they were to push the envelope further, they would almost certainly encounter more unity and clarity of purpose on the Chinese side.

In the end, the trade hawks in the administration may find a way to make do with a few cosmetic, harmless face-saving “wins” while quietly retreating from the battlefield. Meanwhile, though, we may have to put up with a few more of these irrational weeks in the market. Oh well. At least it’s springtime.

Masood Vojdani
President & CEO

Katrina Lamb, CFA
Head of Investment Strategy & Research