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PERSPECTIVES

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(Trade) Wars! What is it Good For?

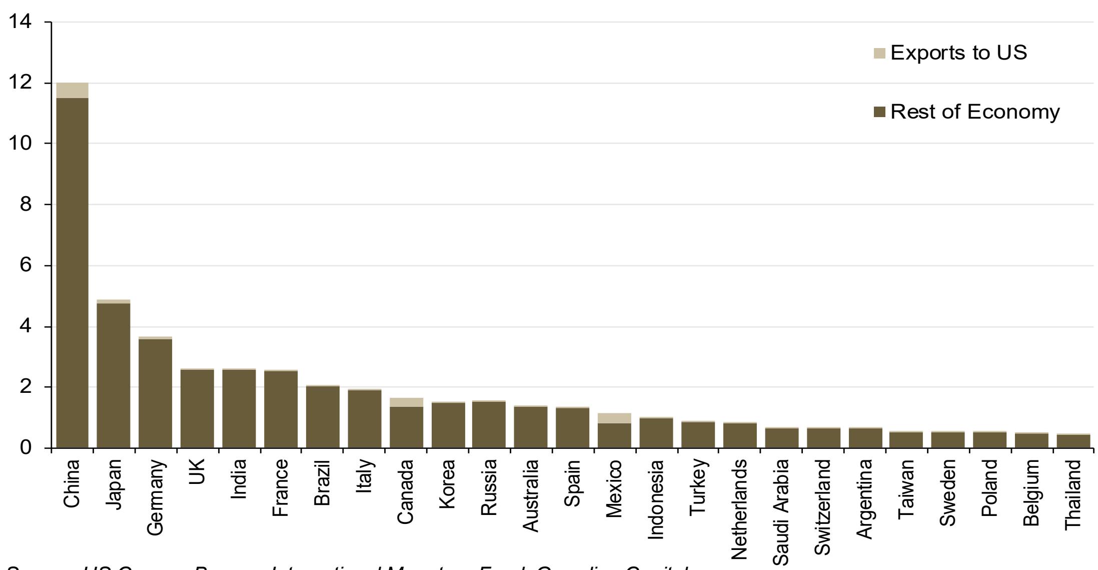
While it is actually the case that underlying economic fundamentals remain in good shape, the risks to the outlook have intensified in recent months. The source of these, as has generally been the case over the last 18 months, is the White House – the main focus now being American trade policy.

The flow of goods and services across borders provides consumers with access to products that would otherwise not be available (or not be available in adequate supply) and provides a broader potential customer base for domestic businesses. Moreover, the ability of firms to produce in lower cost areas of the world has resulted in prices falling across the globe, while also serving as the conduit through which wealth and economic growth can be spread across the world. In other words, international trade is not a zero-sum game; it is mutually beneficial for all parties involved and an important part of the virtuous cycle of growth. It is not a coincidence that for the first time this cycle the synching up of global economies has come as trade flows have accelerated.

The US' decision to put up trade barriers – in the name of protecting American interests – has the potential impact of reversing nearly a century's worth of progress on opening up global trade and setting off a vicious spiral of tit-for-tat tariffs with trade partners that can cause significant damage. Despite what some people may think, trade wars are neither good nor easy to win – in fact, they are typically scenarios where nobody wins and everybody loses, with consumers ultimately bearing the bulk of the burden through higher prices.

It is, however, still important to note that the current slate of tariffs introduced is unlikely to have a material impact on growth prospects around the world. The headline numbers are staggering in size, but the tariffs represent only a small fraction of the numbers bandied about. Even if the US expands its tariffs from the current coverage to the full $500 billion worth of goods imported from China, while not nothing, it still represents just a drop in the bucket for the $12 trillion Chinese economy. The increasing heft of the Chinese domestic economy, combined with a government with a long-term focus, means it can manage the hit.

Scaling the Impact of US Trade with 25 Largest Economies
(trillions of US dollars)



Source: US Census Bureau, International Monetary Fund, Guardian Capital

With that said, the real concern for markets right now arises around the heightened uncertainty over the next steps – which countries or industries will be the next focus of the ire of the Administration are not known with certainty nor are they particularly easy to gauge.

While there is arguably some justification in trying to address some trade practices with China – notably the handling of intellectual property and market access for foreign investors – the reasoning behind the moves against other nations is more confusing (for instance, threatening and imposing tariffs against allies such as Canada and the European Union on national security grounds). In the same vein, imposing a tariff on steel imports from Canada and Mexico comes even as the US was a net exporter of steel to these countries in 2017, suggesting that the tariffs play to the voter base rather than the state of the economy.

Elevated uncertainty weighs on confidence and restricts activity, as businesses are likely to hold back on spending decisions such as committing to new capital investment or entering into long-term supply contracts until there is some clarity on how the chips will ultimately fall. As a result, the persistent threat of escalation of a trade war has the potential of syphoning off some fuel from the engine of growth.

These uncertainties provide a significant drag on market sentiment, increasing volatility and restraining performance – and with these risks unlikely to subside soon, the coming months are likely to continue to see this trend of largely directionless and bumpy trading persist even as earnings and economic growth remain constructive for equity markets.

Such an environment requires patience for investors with a long time horizon, and speaks to the desirability of having exposure to income strategies in investment portfolios. These tend to focus on stocks of more stable and mature companies, whose dividend cushion softens the downside risks while also providing an opportunity to generate positive total returns, as investors are paid to wait in otherwise directionless markets.
While it can be difficult to sit tight amidst heightened uncertainty, it is important to remember that it is "time in" the market, not "timing" the market that is the key to building wealth in the long-term.

To close this note out, the classic song from which we borrow our title needs a response and it can actually be found in the lyrics: "absolutely nothing".