*current*PERSPECTIVES

Trump, Tariffs and Trade Wars – Six months later

An update on recent developments within the three "T's"

Back in March we released our initial Current Perspectives article titled Trump, Tariffs and Trade Wars, in which we provided background on the Trump administration's stance on the North American Free Trade Agreement (NAFTA) and some of the global trade concerns that were heating up. Fast forward six months. While there have been a few positive developments, some challenges remain and have escalated.

Underlying issues

Market conditions and the investing environment have changed over the past six months with an uptick in market volatility – particularly within the past month. While the main cause can be attributed to the U.S. Federal Reserve hiking rates and removing stimulus, global trade worries - particularly between the U.S and China - are also a contributing factor. The trade issues are particularly acute now as growth in many parts of the world, including China, appears to be decelerating.

Many industry experts view the underlying trade issue stems from the view that China represents a threat to U.S. economic interests, and in particular, its technological supremacy. The root of this concern for the U.S. resides in China's strategic plan titled Made in China 2025 - a state-led industrial plan that seeks to make China self-sufficient in global high-tech manufacturing. While many industry experts see it as China's attempt to move the country's manufacturing industry up the value chain, it appears the U.S. feels this represents a real existential threat to its technology leadership. Against this backdrop, the Trump administration imposed a higher tariff on Chinese goods in June, increasing trade tensions between the countries. The tariff list mainly focuses on the products included in the Made in China 2025 plan, including information technology and robotics-related products. We believe it is unlikely that China will respond to this pressure by relaxing its efforts to modernize its economy. This explains why one of our current themes is that friction between the U.S. and China is likely to be persistent for many years.

Recent developments

USMCA - After what often felt like interminable rounds of back and forth, a refreshed NAFTA - now called the United States-Mexico-Canada Agreement (USMCA) - was finally reached on September 30, subject to legislative passage by the three national governments. Much of the new agreement was as expected, with auto rules that largely mimic those agreed over the summer in U.S.-Mexican bilateral negotiations, a modest opening of Canadian dairy and poultry markets, and the preservation of 'Chapter 19' dispute panels for resolving anti-dumping complaints. While far from perfect, USMCA removes an overhang from the Canadian economy that may have inhibited foreign investment.

U.S/China trade war escalation - Global trade remains the headline maker and a key source of market volatility. President Trump continues to escalate the threats of a U.S. trade war with China. A 10% tariff on $200 billion worth of Chinese goods has already been implemented, which is slated to increase to 25% at the end of the year if no agreement with China is reached. The additional tariffs, on top of tariffs passed earlier this year, means that roughly half of the products that China sells to the United States each year will be hit by U.S. tariffs. This could begin to affect the U.S. consumer and impact corporate supply chains over time. China has said it would retaliate with tariffs on another $60 billion in U.S. goods.

Steel and aluminum tariffs on Canadian exports to the U.S. – The Trump administration imposed tariffs on steel and aluminum imports from many countries. While initially excluded, Canada was subsequently hit with these tariffs. However, since the USMCA agreement, there is hope Canada will once again be excluded.

European trade concerns – The Trump administration and European Commission agreed in July to reduce trade tensions and work toward the elimination of tariffs on industrial goods. Both sides also agreed that no new tariffs would be imposed as trade talks continue, taking U.S. threats to impose levies on European auto imports temporarily off the table.

Our view

While the new USMCA agreement is a positive for the Canadian economy and companies, a deterioration in global trading relationships has been and remains at the top of our list of concerns. However, it is important to remember that the U.S. trading relationship with China is not a foregone conclusion. We will continue to monitor developments carefully as they unfold.

In the meantime, from a portfolio perspective, it's important to reiterate some key themes that might help investors navigate the current market environment. We continue to focus on companies we believe to be at the high-end of the quality spectrum, particularly those that generate substantial free cash flow and return that cash to shareholders through rising dividends over time. In addition, we believe holding some cash so that investors can potentially take advantage of volatility by purchasing high quality stocks that are oversold on trade war news. Finally, we are cautious on Emerging Market (EM) equities as uncertainty in the global economy and trading environment may create challenges for many EM companies.

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