Market Update

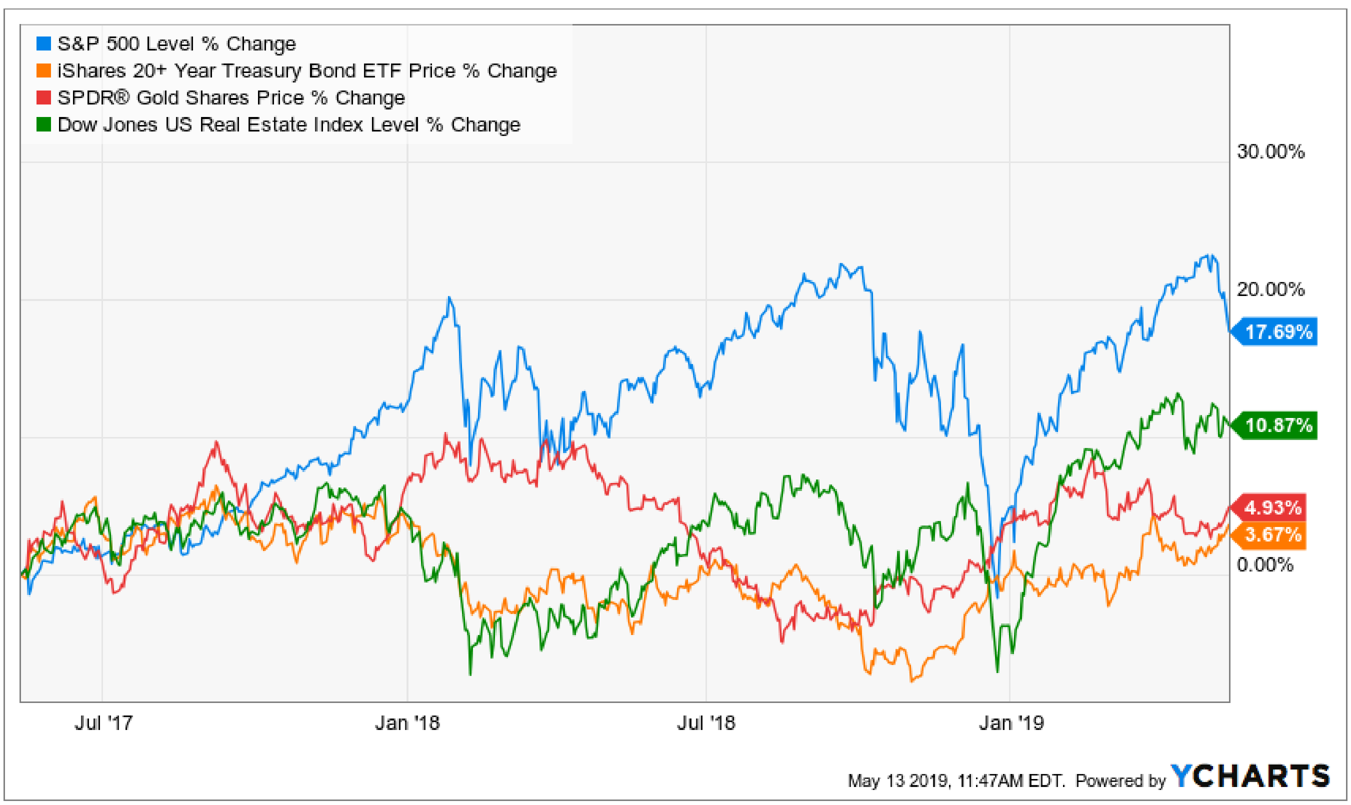
May 13, 2019

China-U.S. Trade Driving Markets

Major Market Driving Theme: China Trade Negotiations

- The U.S. increased tariffs to 25% on $200bn worth of Chinese imports. The threat to extend a 25% tariff to virtually all Chinese imports "shortly" remains. This comes even as the two sides continue negotiations to reach a trade deal.
- China announced its own tariffs on U.S. imports of 25% on roughly $60 billion worth of U.S. goods starting June 1, 2019.
- The U.S. overall trade deficit edged higher in March to $50bn, even as the bilateral goods trade deficit with China declined to a five-year low.
- Consumer price inflation continues to show little signs of accelerating, with both headline and core inflation around 2%. Things could change however, as tariff hikes filter through the economy.

U.S. equities hit new all-time highs on May 1st. This was both new closing highs and intra-day highs for the S&P 500. Right now, U.S. China trade negotiations are taking the spotlight as traders have sold into these headlines.



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Financial markets are experiencing an up tick in volatility largely due to uncertainty over the trade negotiations between the world's largest customer, the United States, and the worlds largest producer of goods, China.

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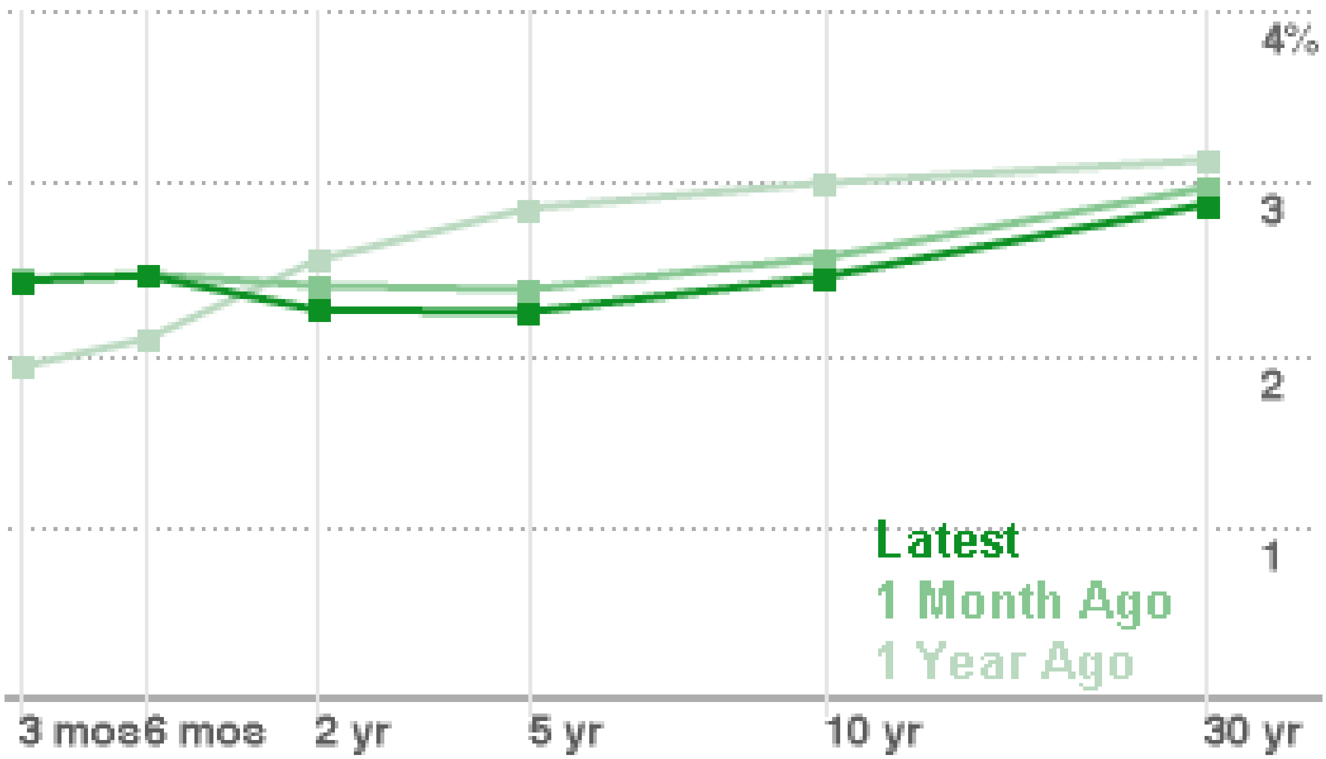
Negotiations seem to have hit a snag as China seemed to renege on its promises in earlier negotiations. Talks are still ongoing and there is some indication of both President Trump and President XI meeting next month at the G20 summit. Both countries have had their top negotiators working on the trade deal for some time. It appears that for a trade deal to become reality the two Presidents likely need to meet to discuss a final trade arrangement.

Below, you will find the U.S. Treasury Yield Curve. We see the curve has steepened since last month. From the prior year, we are still experiencing some inversion between the 6-month to ten-year maturity range. Federal Reserve policy will be very important to the stability of interest rates, and the ability for the economy and the markets to shrug off concerns, over the inversion, in the yield curve. Negotiations with China are also impacting the yield curve as some of the money coming out of the equities markets are going into the liquid treasury market.



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To date, inflationary pressures have been benign. Consumer prices in April rose 0.3% over the previous month and were up 2% year-on-year. However, the threatened escalation in tariffs could see inflationary pressures firm up. The Federal Reserves decisions on interest rates will continue to be of paramount importance in how the U.S. handles the potential of a slowing economy and trade issues.

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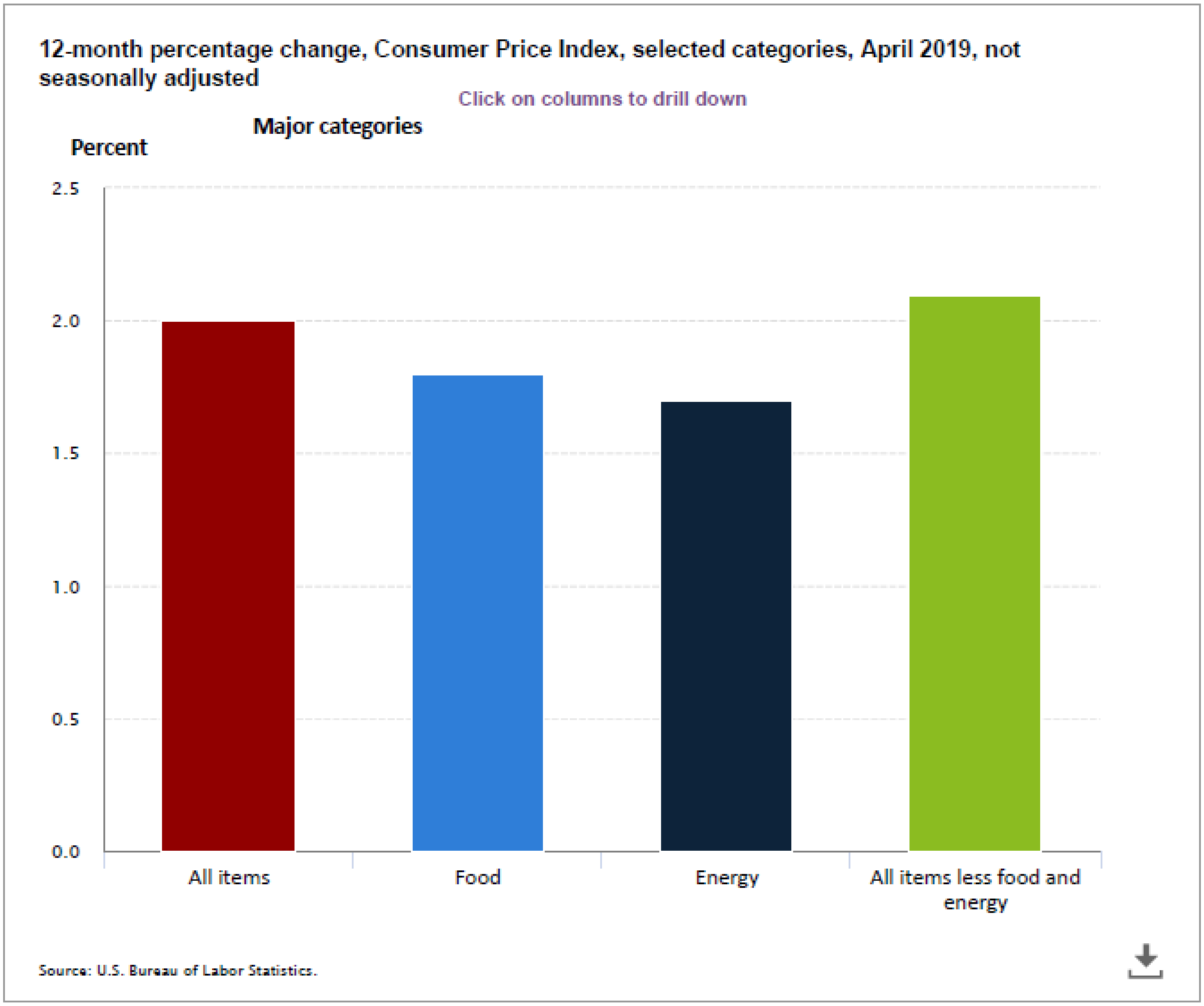

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The trade deficit edged up in March, reflecting the difficulties in attempting to redirect international trade. March trade deficit increased to $50.0 billion up from $49.3 billion revised in February. Of note, the merchandise trade deficit with China, a special area of interest, has been declining for the past few months, and hit a five year low in March according to the Census Bureau, Bureau of Economic Analysis and TD Economics. This development may positively impact ongoing negotiations between the two economic powerhouses. All told, the U.S. and Chinese economies are at an important juncture. Decisions made now are likely to have significant implications for the global economic landscape in the future.

We continue to feel that there are signs of a later stage economic environment. The biggest concern for the economy in the next 12 months continues to be the Federal Reserve interest rate decisions. China trade tensions are front and center and could influence Fed policy. However, the Chinese trade issue could quickly turn into a positive if a deal is made. This would potentially create a reason for equities to rally.

Overall, we prefer domestic equities over international equities. We prefer more value-oriented stocks vs. growth stocks currently, in the economic cycle. As we have stated in the past, value stocks tend to move more slowly in either direction when the markets react to stimulus. In later stage economic environments, a tactical shift to overweighting value type stocks can reduce portfolio risk. This is an area we are looking at, to continue to make tactical changes, over the course of the coming months. We are currently neutral to bearish on fixed-income and interest rates. It is important to maintain discipline regarding long-term strategic asset allocation. However, as market conditions dictate, we are looking at tactical opportunities to reduce risk in portfolios, if necessary.

If you have questions or would like to discuss this further with regard to your personal portfolio, please contact me at 310-469-7254.

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