Market Comments

Huntington | PRIVATE BANK

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Trade, Tariffs, Economy & Markets

U.S. trade policy is obviously becoming very proactive. In our view, the U.S. has multiple objectives:

1. Protect U.S. intellectual capital.
2. Policy of Fair Trade by leveling out or eliminating tariffs.
3. Promote U.S. exports.

The U.S. exports a little over $200 billion of goods and services per month, or about $2.2 trillion per year. This is about 12% of the U.S. economy. However, the U.S. imports about $250 billion per month and runs an approximate $500 billion annual trade deficit. This deficit has been fairly consistent since 2010.

By far, the U.S. receives imports from China more than any other country - $506 billion worth in 2017. However, only 8% of U.S. exports go to China ($130 billion in 2017), creating a $376 billion trade deficit in 2017 -- the largest on record.*

**NOTE: All of these numbers are from Bloomberg import/export summaries.*

Much of the recent trade disputes, including the imposition of tariffs on some goods from China, has centered on this trade imbalance and obstacles to U.S. exports to China. While the tariff amounts being imposed to date appear large because they are in the billions of dollars, they remain small relative to the size of the $19 trillion US economy.

- To date, the U.S. implemented a 25% tariff on $34 billion in goods imported from China.
    - This tariff totals $8.5 billion, to which China retaliated with an equivalent tariff on U.S. exports to China totaling $8.5 billion.
- Another $4 billion in tariffs on $16 billion of imports will likely go into effect after the required review process is completed.
- The $12.5 billion in total tariffs that are expected to result on U.S. exports would be less than 0.1% of U.S. GDP.
- The U.S. is now considering a 10% tariff on $200 billion in goods imported from China going for public comment as of this writing (or another $20 billion in total).

While the trade disputes with NAFTA and the EU around aluminum, steel and autos have received much attention, these member countries are highly appreciative of the rich markets the U.S. offers for their exports. Ultimately, new agreements are expected over time that should improve the terms of trade of the U.S. with these countries. If they do not, the Administration has shown that statements to implement undesirable tariffs to foreign imports are credible.

In other words, with respect to all countries, the U.S. is sticking by its objective to level the playing field in trade, knowing that this will take time and many headlines.

In the stock market, our Equity Team has been pointing out the relative outperformance of small cap U.S. stocks versus large caps since earlier this year, when the trade and tariff headlines first began. They also note that the agriculture, auto, industrial and chemical industry groups have trailed in performance, but then outperform on any negotiation headlines. Hence, our Equity Team is staying diversified, but trying to avoid some areas under current stress. For our investment portfolios overall, we are biasing domestic stocks over ex-U.S. and started that process in March with another enhancement in June.

In the bond market, our Fixed Income Team notes that if this were more of an "economically-substantive issues," we would be seeing high-yield bonds underperforming substantially. However, the opposite is true. High-yield bond spreads to treasuries are close to the cycle lows.

In addition, trade headlines could make an interesting scenario for the Federal Reserve as they try to incrementally normalize interest rates (i.e. – push short-term rates higher). While the Fed has one eye on inflation, they are no doubt reading the headlines and do not want to cause any further stress to markets by normalizing interest rates too swiftly. They noted as much in their recent meeting minutes released last week.

For our customers, there are several investment management items on our mind that we are employing:

1) We cannot sell a headline or worry until it actually happens. We monitor market reactions, but do not feel selling or buying headlines is a prudent investment strategy method.
2) Trade headlines seem to have a diminishing daily impact on stock, bond, commodity and currency markets since they began in February.
3) U.S. is going to keep pressing China with tariffs up to the $500+ billion they export to us annually until China agrees to negotiations (with outcomes) on the first three items in this piece.
4) We do not believe there is a threat to the U.S. economy from tariffs at this time, but our economist continues to monitor.
5) Several stock sectors, industry groups and commodities are being affected by the tariffs. We try to avoid these in portfolios where we can and keep more money in the U.S. vs. international.
6) Tariffs, in the near term, will likely be inflationary and that is something we are incorporating into our bond and stock portfolio structures (allocations to TIPS and small caps).
7) Where it makes sense in portfolios, we are using active versus passive managers for risk management purposes.

We hope you found this information useful. Our strategists and analysts are giving this topic a great deal of attention this year for our Private Bank clients.

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