ADVISOR PERSPECTIVES

Trade Tension Flare-Up: Not So Surprising

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Any hope for a quiet August in Washington was dashed when President Donald Trump took to Twitter last week announcing he would move forward with imposing 10% tariffs on about $300 billion of Chinese goods on 1 September. This threat comes in addition to the 25% tariffs already imposed on $250 billion of Chinese imports to the U.S.

China responded quickly on 5 August by allowing the yuan to depreciate to its lowest level in more than 10 years and halting imports of U.S. agriculture, spurring a global bond market rally.

In many ways, the escalation is not a surprise. For one, the U.S. has been officially engaged in trade talks with China since March 2018 and has had very few tangible results. While some promises have been made, few have been kept (as the president has been quick to point out). Without a meaningful breakthrough, simmering tensions were likely to boil over at some point.

In addition, while the market narrative has been that the president “needs” a deal with China going into 2020, the polls do not necessarily bear that out. Indeed, according to several recent polls, the majority of Americans – and especially of Republicans – support pushing hard on China to change its policies, and a majority of Republicans (one recent poll found nearly 70%) support the imposition of tariffs to do so.

So politically, Trump seems to have the support of his base to continue with tariffs on China in the pursuit of a strong deal, even though one may never emerge. It also should be noted that many Democrats, including U.S. Senate Minority Leader Chuck Schumer, also support the president on this latest escalation.

Timing matters as well. If Trump were to enter into a trade deal with China now, he could make himself vulnerable to criticism from his opponents (and 24 of them are currently running for the Democratic nomination). So a deal closer to the election may be safer for Trump politically.

Lastly, Trump believes – and has said as much for four decades – that tariffs increase leverage over negotiating partners and achieve more optimal outcomes. Recently, he credited the imposition of tariffs on aluminum and steel for delivering a more robust NAFTA 2.0 agreement, and he has also claimed that tariffs brought China to the negotiating table in the first place.

What’s next?

We think investors should take Trump at his word that he will move forward with the next round of tariffs on China. The administration is certainly concerned about the possible adverse effects on the financial markets and U.S. consumers (this round of tariffs will disproportionately affect consumer goods like toys, apparel, and technology), and that may hinder an increase beyond 10%. But there are no signs that the president will walk back from applying as much pressure as he can come September.

The latest escalation in trade tensions drove the U.S. 10-year Treasury bond yield down to 1.74% on Monday, its lowest level since 2016, as investors sought a haven from uncertainty. Indeed, we see trade conflict and politics as ongoing risks for the markets and reasons to maintain defensive positioning overall.

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