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Trade War Worries Weigh on Investor Sentiment

- More trade war rhetoric weighs on investor sentiment.
- Despite market weakness, there are positives to focus on.
- We still expect a trade agreement sooner rather than later as it is in both China and America's best interests.

Global markets have recently weakened as a slew of worries weigh on sentiment. The combination of a U.S.-China trade war that seems like it will last longer than anticipated and weaker economic data, driven partially by this trade dispute, have put a negative tone on stocks. Case in point, this week the S&P 500 briefly dipped below the psychologically important 200-day moving average and closed below its 100-day average for the first time since February. In these volatile times, however, there are still solid fundamentals that investors can point to including a more reasonable stock market valuation, lower borrowing costs, tepid inflation, and a dovish Federal Reserve.

The biggest concern is the ongoing U.S.-China trade dispute. Officials from both nations have exchanged barbs that have inflamed emotions and threatened to prolong the trade war. After months of optimism, investors are coming to grips that an eventual trade agreement may take longer than expected. After President Trump raised tariffs on Chinese goods and China responded in retaliation, investors are concerned with the full impact of these higher costs have not yet been fully felt on the U.S. economy.

Recent data suggest that the combination of fading fiscal stimulus and the lingering trade war concerns have had an adverse effect on the economy. Recent readings, including reports on durable goods, industrial production, and manufacturing surveys, suggest a U.S. economy under pressure. While there are still many encouraging data points for the economy including a strong labor market and a healthy consumer, the general fear is that a lengthy trade war could further weigh on the economy.

Despite these overhangs, there are still plenty of positives to focus on. First, recent market weakness has pushed valuations to more respectable levels. The S&P 500 P/E ratio on forward earnings has fallen from over 17X prior to the recent decline to about 16X today. Second, the combination of safe haven buying and general economic concerns have sent borrowing costs lower. The 10-year U.S. Treasury, a benchmark for many interest rates, has fallen from 3.26% in October 2018 to about 2.25% today. This has helped push the average rate on a 30-year fixed mortgage from a 52-week high of 4.99% to about 4.03% today. Third, the Fed has shifted to a dovish stance and the financial markets have taken notice. For example, the futures market has priced in about an 80% chance that the Fed cuts interest rates this year. A Fed cut could push borrowing costs even lower. Fourth, corporate earnings continue to beat expectations. At the end of 2018, analysts' consensus forecast expected a decline in first quarter S&P 500 earnings. With that earnings season nearly complete, it looks like earnings grew about 1.5%. Lastly, despite the escalated recent rhetoric between both nations, we continue to expect the U.S. and China to resolve the trade war. The consequences of the trade war on the economies and equity markets of both countries, the importance of a strong U.S. economy for President Trump's 2020 election campaign, and its burden on China's attempts to become a more domestically driven economy all suggest a resolution to this trade dispute.

We did not expect equities to continue rallying at their blistering first quarter pace that saw the S&P 500 have its best quarterly gain since the third quarter of 2009. Investors overconfidently priced in a quick resolution to the trade war and a dovish Fed. While the latter remains on track, investors have become increasingly concerned about the trade dispute. We continue to believe the trade war will be eventually resolved. As with any negotiation process, we do anticipate a posturing process where both sides maneuver to get their demands. As investors react to the news, we expect significant market swings and overall elevated levels of market volatility. We do not recommend abandoning equities altogether but do suggest you consult the advice of your advisor who has experience in weathering similar periods of market volatility. While equity markets had their best quarterly gain in nearly a decade, we do believe stocks will be in store for more modest results until these market overhangs get resolved.

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