

# Ballast

With volatility rising on trade uncertainty, investors may desire some stability.

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(**Bal-last**) **Noun: Heavy material placed low** in a vessel to improve stability. *Will you be taking a cruise vacation this summer?* This week's travel took me to Northern Virginia and the greater Baltimore area. My colleague warned me not to drink my water as we got on the D.C. Beltway. He explained that this road experiences two rush hours, twice a day. "The entire beltway is jammed up between 3-6 p.m. every day of the working week." In 1951, the Senate Public Works Committee proposed a limited-access, high-speed loop to encircle D.C. and facilitate the travel of dispersed government employees as the city population expanded into the suburbs. After its completion in 1964, there was a slight sense of urgency to get started on an outer ring road as the suburbs were starting to accelerate their development, but this outer loop was never to be. Consequently, D.C. makes every list of cities with the worst traffic congestion. I was told that Amazon is expected to bring 25,000 to 50,000 new employees to the area. "What's the difference between moving 3 miles per hour and 2 miles per hour?" an advisor joked. Now that's the spirit! Indeed, the traffic was discussed at most every meeting this week. That, and politics, of course.

**Increases in tariffs on China** and retaliation by China will hit Americans heretofore unaffected much, with nearly everything we wear, watch, listen to or put together with Allen wrenches on the list. But it's the breaking down of non-tariff barriers that set off

President Trump. Chinese negotiators reportedly had promised to write such policy changes into law, but subsequently backtracked and said it would be left up to Chinese regulators to enforce. The White House has little faith the Communist Party would follow through, particularly since it's widely viewed as wanting to do to high value-added manufacturing (industries of the future identified in its "Made in China 2025" initiative) what it did to low value-added manufacturing over the past 30+ years, i.e. dominate. This is the battle the Trump administration is fighting. Cowen & Co. says China is focused on critical sectors, including info tech, robotics, aerospace, aviation, marine engineering, advanced rail, sustainable energy, biomedicine and agriculture. Markets and companies can digest and model for tariffs. Non-tariff barriers, export controls and investment restrictions? Not so much. Cowen says these represent potential huge exogenous shocks to global trade flows. There also are colliding non-negotiable demands, Strategas Research says. The U.S. wants to keep some tariffs in place to ensure China complies with any agreement and China wants all tariffs removed for fear more companies may leave for places with no or fewer tariffs. Volatility may stay elevated until—and if—there's a resolution.

**Dramatic market moves tend to be** counter-cyclical, with major tops slow and pondering and corrections sharp and dramatic. This week's decline has the earmarks of such a correction to the big post-Christmas Eve run-up, but Strategas Research believes daily new-high trends continue to send long-term bullish signals. After the best start to a year in decades, investors simply may be peeling off some risk given how one tweet can shake things up. The Institutional Strategist is less sanguine. The models it follows suggest the market may be rolling over, as virtually all 11 S&P 500 sectors appear to be entering downtrends, typical in early phases of 3-4 month downturns. How many times have you gone on summer vacation only to worry about volatile markets? In my memory, a lot. Volatility surrounding policy uncertainty usually is a buying opportunity. Now, I am not worried about tariffs as my research suggests that while certain industries will get hit hard, the two largest economies in the world can both withstand all the tariffs being mentioned so far. My concern is a real trade war that busts up global supply chains that have been in place for decades. That is, if our administration says, "If a company hopes to sell a product to an American citizen, it

better be made within the borders of the U.S.A.” Or, if the leader of China decides to make it extremely difficult for any multinational company to do business there and reach its 1.4 billion consumers. This eventuality would increase inflation dramatically, bring on a global recession and rock the markets. But, of course, this won’t ever happen, right? Both sides would lose! Sure, but how do I know that one of these two leaders, with very strong personalities and very different agendas, won’t storm out of the room? This is just one of numerous issues which are binary in nature and should resolve themselves within the next 12-18 months (others include Nafta 2.0, auto tariffs and Europe, Brexit and our 2020 election), with results the market will either love or hate. I can’t purport to read the future. So while a bull, I think investment portfolios might want some ballast.

## POSITIVES

- **Small business mood improves** A Wells Fargo/Gallup survey found small business confidence rebounded strongly in the second quarter, *matching a record*, as current conditions posted a new high and recession concerns diminished. Top worries were attracting customers and new business, followed by hiring and retaining staff.
- **Low and positive inflation is bullish for P/E multiples** April producer and consumer prices moderated on headline and core bases as both came in below expectations. There were a few areas that saw some pickup, but the underlying trends reflected little that would take the Fed off its no-hike path.
- **The labor market is strong ...** The number of job openings exceeding the number of unemployed widened in March, making it harder for employers to find workers with the required skills they need. This labor scarcity helped push the layoff and discharge rate back to a record low as companies have had to hold on to staff.

## NEGATIVES

- **... but job growth may be slowing** On a year-over-year (y/y) basis, the Employment Trends Index slipped to its slowest pace since January 2017, suggesting more moderate growth in payrolls in the coming quarters. This week’s report on jobless

claims sent a similar signal, as claims unexpectedly remained near late January highs, when they climbed on the government shutdown.

- **A China recession is my biggest worry** China global exports were slower in April after a March spike, falling sharply to the U.S. and near flat to the rest of the world, revealing uninspiring global demand. However, China imports globally rose, consistent with an upturn in its domestic economy.
- **Big-ticket concerns** After spiking in March, April auto and light truck sales fell the most in nearly eight years to their second-slowest annual pace since February 2015. Consumer credit growth, which monitors revolving credit card debt that's often used for big-ticket purchases such as appliances and TVs, also moderated in the first quarter.

## WHAT ELSE

**IPO pickup is bullish** Today's initial public offering (IPO) by Uber will help push capital raised as a percentage of S&P market cap to the high end of its 3-year range this quarter. Jefferies says while there's a tendency to think substantial IPO activity is a sign of market tops, the data suggests the opposite is true. Looking back to 1990, quarters with the biggest IPO activity have tended to produce strong S&P returns during and after the quarter.

**More time to deal than you may think** Higher tariffs that kicked in today could take several weeks to actually take effect, Washington Analysis explains. The reason: they would apply only if both the following are true: 1) the good enters the U.S. after midnight Friday; *and* 2) the good was exported to the U.S. after midnight Friday. The second condition in effect defers the tariffs on any goods currently en-route, and thus the earliest the tariff will practically be paid is a few weeks (given 2-3 week seaborne transit time from China to the U.S.).

**This even isn't listed in my binary-event risk list!** The Institutional Strategist (TIS) is suspicious of Russia, which it notes is talking to North Korea's Kim, helping Venezuela's Maduro and Iran with weaponry, remains active in Syria and boasts of having hypersonic missiles and other super weapons. This is a lot of noise from a

country whose economy is fraction of the U.S.'s or China's. TIS wonders if something important is brewing or perhaps Russia is just trying to make life difficult for the U.S. and its allies just as the China trade deal enters a critical phase.

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### TAGS

EQUITY

MARKETS/ECONOMY

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### DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Price-earnings multiples (P/E) reflect the ratio of stock prices to per-share common earnings. The lower the number, the lower the price of stocks relative to earnings.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

The Conference Board's monthly Employment Trends Index measures eight indicators that reflect labor market trends in the economy.

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