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The slow boat to China develops a leak

Using tariffs to address a non-trade issue with Mexico creates a destabilizing undertow.

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In our May 21 post, **The slow boat to China**, we warned that the blow-up in negotiations over what looked like a soon-to-be signed China trade deal had most likely put the resolution of trade-related uncertainty on a slower trajectory. Now, that boat seems to have developed a leak.

Indeed, news that President Trump intends to use tariffs as a political weapon to address other diplomatic disputes, in this case illegal immigration at our southern border, is unequivocally bad news for our economy and markets. Whatever your view is on the immigration crisis and the President's position, this use of tariffs introduces not just the prospect of significant near-term economic pain for U.S. manufacturers and consumers (Mexico is almost as large and significant a trading partner for us as China), it also could result in other sudden trade policy shifts even after a "deal" is reached.

Until now, we've been working through an economic soft patch partly due to the current uncertainty surrounding the rules of trade. With this latest move, it will be difficult for businesses and investors to plan future investments given the prospect that other completed trade negotiations might suddenly be re-opened for non-trade reasons. To paraphrase the President, "Bad!"

This additional short-term economic pain and at least intermediate-term economic uncertainty have effectively opened a leak in our slow boat to China thesis, raising the possibility of additional stock market downside and perhaps capping upside even if or when a new China deal is inked (in pencil, apparently).

While the fundamentals otherwise support our 3,100 year-end target on the S&P 500, the market will now need substantial good news on both China and Mexico trade AND politics to climb these heights. Probably still likely, but for now, we will need to attend to our bailing buckets. This morning Federated's PRISM® committee cut its equity allocation by 300 basis points, taking 100 basis points from emerging markets and 200 from large-cap domestic stocks. A cautionary measure to be sure, but by no means a call to abandon ship. We remain overweight stocks versus bonds, just less so given the expanded set of downside risks.

TAGS

MARKETS/ECONOMY | POLITICS | EQUITY

DISCLOSURES

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.

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