FORSTRONG GLOBAL

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WHAT DO ESCALATING TRADE TENSIONS MEAN FOR MY PORTFOLIO?

Trade Tremors: Separating Fact From Fiction

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In the post-war period, free trade has become something of a sacred cow for economists. Few challenge its benefits and almost all support the unhindered movement of goods and services across national borders. In practice, global trade doesn't always happen in a frictionless fashion. But the so-called "comparative advantages" of each nation (where countries focus on their industry specialties and lower opportunity costs) supports the theory that international trading partners are best served without trade restrictions.

Yet, this decades-old orthodoxy is now under siege. Since taking office in early 2017, the Trump administration exited the Trans-Pacific Partnership, demanded NAFTA revisions, and announced tariffs on numerous imports. The recent resignation of Trump's top economic adviser, Gary Cohn, dealt a big blow to free-trade proponents inside the White House. Now, with the US singling out China, the threat of a trade war between the world's two largest economies has unnerved investors.

Although the economic impact of recently proposed trade actions is actually quite small, the main danger is that the rules may now be re-written, with the world moving away from an era of liberal trade and open markets. Full-blown protectionist policies in the US would undoubtedly prompt retaliation from other nations and convince the world that the global trading system is unravelling. Such a shift would mark the largest and most dangerous change in economic thought and order in decades.

However, it is imperative to delineate aggressive rhetoric from underlying motives and intentions. While Trump has stated that trade wars are "good and easy to win", the reality is that America has worked hard to shape the global trading system, and US multinationals have benefitted immensely. While Trump's base may cheer "America first" policy-making, such actions are largely to their detriment. Rising import prices will disproportionately hurt lower income households, while jobs are unlikely to return to the US' hollowed out manufacturing sector. Free trade has been a staple of the GOP platform, with past Republican presidents including Reagan and both Bushes embracing globalization. This ideology remains intact, as Cohn's resignation drew condemnation from at least half the GOP caucus in Congress. Accordingly, we believe Trump's bark will be bigger than his bite. Trade threats will likely continue, but are more likely aimed at drawing concessions from trading partners than instigating an all-out trade war.

INVESTMENT IMPLICATIONS

While the recent global equity sell-off may present a buying opportunity, we prefer to maintain a balanced asset mix approach while closely monitoring developments between the US and global trading partners. From a regional perspective, our preference for equities in Europe and Asia has been further strengthened. In today's highly interconnected world, we believe the perceived instigator of trade tensions will ultimately be the "biggest loser". Further nationalistic actions from the US would likely strain domestic households, erode US multinational companies' earnings, and encourage trade partners to diversify their export bases. If the US withdraws as global country leader, expect other leadership (namely China) to fill the hegemonic void.