THE CAPITAL MARKETS

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Special Edition: Tariff Talk

Markets have reversed course in May, down around 3-5% from the April 30 close at the time of this writing. A surprise tweet signalling trouble in the U.S. - China trade negotiations, followed by tariff increases from 10% to 25% imposed by the U.S. on $200B of Chinese goods has led to the market weakness. China has since announced retaliatory tariffs on U.S. goods, triggering further volatility in the capital markets. In this newsletter, we will outline the effects of tariffs, how they work, and our view on the risks to the economy moving forward.

"Many now worry that those frictions will upend the recent calm, potentially marking a return to the sustained declines that rattled markets in November and December." (Amrith Ramkumar, May 14, 2019, *Escalating Tariffs Test Investor's Faith in U.S. Growth*, The Wall Street Journal)

What's a Tariff and Who Pays the Tariffs?

A tariff is a tax imposed by one country on goods and services imported from another country. Prior to the start of the federal income tax in 1913, tariffs were often the primary source of federal revenue in the U.S. Besides tax revenue, tariffs have also been used to support domestic industries by making their foreign competitors more expensive, or occasionally to punish other nations for unfair or uncompetitive trade practices.

Importantly, tariffs are paid by the importing company, the costs of which are typically passed through to the U.S. consumer. As a simplified example, if an American retailer wishes to import $100.00 shoes from a foreign nation and the tariff is 20%, that retailer will pay $120.00 for the order, vs. $100.00 with no tariff. The most likely outcome is that those shoes will be more expensive to the U.S. consumer when the tariff is charged vs. no tariff.

Our view

Uncertainty continues to surround the issue of tariffs and U.S. - China trade. Whether the tariffs will become a long term reality or a short term negotiating tactic is unknown to market participants at this time. A trade resolution is likely to spark optimism in markets, while negative developments could lead to a sharp drop in stock prices. In the longer term, persistant uncertainty and rising tariffs are likely to affect consumer and business confidence, inflation, and global growth. Certain industries such as agriculture and heavy equipment manufacturers are likely to be especially affected, with one trade group expecting the new tariffs this could lead to as many as 400,000 manufacturing job losses in their industry alone over 10 years. Given the uncertainty and possible impact to markets, we encourage investors to continue to be prepared for potentially volatile markets in the coming weeks and months, and to avoid sudden investment decisions based on short-term market moves or dramatic news headlines. We will continue to monitor the capital markets and developments which may affect your portfolios, if you have any concerns or questions about your specific situation don't hesitate to reach out to us, we are happy to help.

"Still, investors and analysts say a breakdown of trade talks risks damaging business and consumer confidence, potentially crimping spending at a time when growth is already widely expected to moderate. UBS analysts estimate U.S. growth could drop by 0.75 to 1 percentage point and stocks could fall by double-digit percentages if the U.S. hits all Chinese exports with 25% tariffs." (Akane Otani, May 13, 2019, *Stocks Post Worst Day in Months on Trade Anxiety,* The Wall Steet Journal)