Prospects for a U.S./China trade deal dim; The tariff threat increases

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After a strong run, stocks finally give back some gains

Markets move up and down over time. Occasionally, this important point can be lost in the day-to-day shuffle, especially when stock prices unabatedly gravitate higher – much like they have done over the last two months.

On Monday, the S&P 500 Index logged its worst day since October 8th (down 0.9%) following softer than expected November ISM manufacturing data. Manufacturing weakness in the U.S. took the luster off more upbeat reports released out of China and Europe, as U.S. activity declined for a fourth straight month. Many firms cited weaker global trade as a major contributing factor. Combined with weaker construction spending and news the White House was restoring steel and aluminum tariffs on Brazil and Argentina — U.S. stocks moved lower. Nevertheless, the services side of the U.S. economy (88% of GDP, according to the Commerce Department) continues to expand, evidenced by the FactSet chart at the bottom right and a reading above 50. November’s ISM report on non-manufacturing (services) will be released tomorrow, and investors will closely watch for signs of continued strength.

Stock prices declined further today following trade comments from President Trump. The president said it would, “...probably be better to wait for a trade deal with China until after the election...” As a result, markets are factoring in a lower probability for a ‘phase one’ trade deal this month, which isn’t a complete surprise given the volatile trade-related headlines over recent weeks. Investors may also start to anticipate a longer window of uncertainty regarding trade as well as U.S. rhetoric against China’s industrial policies. We believe this could continue to weigh on business confidence and investment next year.

However, if tensions do not meaningfully escalate through the course of next year, and the U.S. Capping what otherwise could be the best year of performance for the S&P 500 since 2013, continue to stay the course.

IMPORTANTLY, THE LACK OF CLARITY AROUND A PHASE ONE TRADE DEAL, A HIGHER LIKELIHOOD OF ADDED TARIFFS, AND THE POSSIBILITY BOTH SIDES REMAINING AT A STALEMATE ON KEY ISSUES FOR THE FORESEEABLE FUTURE SUGGEST THE U.S. AND CHINA ARE INCHING CLOSER TOWARD AN ECONOMIC COLD WAR. CERTAINLY, NOT A POSITIVE.

On the Day

Stocks with meaningful overseas revenue exposure declined sharply. Real Estate and Utilities moved higher, while cyclical sectors declined. Investors gravitated to the perceived safety of gold and government bonds.

Committee View

Is this the start of a repeat of last December? Not necessarily. The fundamental backdrop is very different today compared to last year, and we believe it supports current asset prices. However, if trade headlines continue to darken, investors should expect volatility to remain in a heightened state, capping what otherwise could be the best year of performance for the S&P 500 since 2013. Continue to stay the course.
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