Did President Trump just start a new trade war with Mexico?

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The punches just keep coming

Since January 2018, the S&P 500 Index has briefly crossed the 2900 level, fallen below 2800, struggled to break back above 2800 three consecutive times, collapsed to below 2350 last December, marched straight higher to a new all-time high of 2954 at the end of April, and now sits meaningfully below where it sat in January 2018.

On Friday, stock prices continued that roller coaster ride, with cyclical areas underperforming defensive sectors, and the 10-year U.S. Treasury yield dipping to 2.13%. Oil prices fell nearly 6.0% on the day after declining by nearly 4.0% on Thursday. Gold prices rallied, and the U.S. dollar was weaker against the Japanese yen in risk-off trading. Broad-based U.S. stock indexes finished May in the red — their first negative month of 2019.

Of course, markets were under pressure Friday but proved resilient, as they have thus far through this latest batch of trade pressures. However, ongoing tariff frictions are dulling investors’ risk appetite, and we suspect the president opening a new trade fight with Mexico will do little to inspire confidence. In fact, we believe a further escalation could begin to hamper business confidence, cause economic growth to slow, and corporate profit estimates for this year to decline. In our opinion, all of this points to more stock market volatility. A multi-front trade war is certainly not conducive for growth and confidence.

Instead of bringing our closest allies into the fold to strengthen our position against Beijing’s controversial business practices, we are pushing them further away. Tariff threats against Mexico, Europe, Japan, and maybe Canada at some point, depending on how President Trump feels on any given day, is not the way forward in solving geopolitical problems and disagreements, in our view.

Importantly, the use of tariffs is a double-edged sword. In situations where they are used infrequently as ‘temporary’ leverage, to prompt discussion and get to a quick resolution — then ‘maybe’ they can be useful. But if tariffs are used frequently to threaten and poke other countries in the eye as a means to get your way, they will undoubtedly have the opposite effect over time.

Mexico’s response is not yet clear. However, in a letter addressed to Trump, Mexican President Andres Manuel Lopez Obrador said, “Social problems cannot be resolved with taxes or coercive measures.” Although the business effects of increased tariffs on Mexico could be most pronounced in the auto and agricultural industries, they have adverse implications across a wide range of goods and industries. Expect stock prices to fluctuate as trade headlines ebb and flow and the trade fight takes unanticipated turns along the way.

Committee View

Global growth is slowing, trade frictions are rising, and both have the potential to eat away at what is already expected to be modest corporate profit growth in 2019. Stalled U.S./China trade talks and a potential new trade fight with Mexico are now raising serious questions about growth prospects for the global economy over the coming quarters. Central banks around the world, the International Monetary Fund (IMF) and Organization for Economic Co-operation and Development (OECD) have already cut their economic growth forecasts for this year. All cited trade issues, lower inflation, and building geopolitical tensions as reasons for their less than rosy outlooks. As long as trade uncertainty weighs heavily on market sentiment, investors should take a cautious approach.

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