Quadrant
ASSET MANAGEMENT

Teeming with Ts

QAM Perspectives – July 2018

Quadrant's regular newsletter that highlights topics we believe will affect markets or are important in understanding them.

"Every decision on trade, on taxes, on immigration, on foreign affairs, will be made to benefit American workers and American families. We must protect our borders from the ravages of other countries making our products, stealing our companies, and destroying our jobs. Protection will lead to great prosperity and strength."

President Donald Trump

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Trump, Twitter, tariffs, trade war, threats, tantrums…tiresome? Since the beginning of this year, tariffs and trade war talk have dominated news headlines. And it's dominating conversations everywhere and in unexpected ways.

For example, in Canadian grocery stores a growing number of customers are making the decision to buy French's versus Heinz ketchup. Canadians are making the switch as they want to make a statement about buying a Canadian product over a U.S. one. Apparently, there is a condiment movement gaining momentum in response to President Trump's protectionist stance. Who knew?

Kidding aside, this story illustrates how the seemingly non-stop trade war headlines are permeating our culture and thinking. The constant dialogue in the press also makes it challenging to isolate what actions have actually taken place (as opposed to threatened). Below we have highlighted tariffs that have been implemented along with the estimated dollar values (in billions of U.S. dollars).

	U.S. actions taken	**Actions taken in response to U.S.**
Canada **$12.8B**	25% tariff on steel 10% tariff on aluminum NAFTA renegotiation underway	Imposed retaliatory tariffs of equivalent value.
European Union **$3.3B**	25% tariff on steel 10% tariff on aluminum	Imposed retaliatory tariffs of equivalent value.
China **$50B**	Tariffs on $34 billion with an additional $16 billion to come.	Imposed retaliatory tariffs of equivalent value.
Mexico **$3B**	25% tariff on steel 10% tariff on aluminum NAFTA renegotiation underway	Imposed retaliatory tariffs of equivalent value.
Japan **$0.4B**	25% tariff on steel 10% tariff on aluminum	Filed a notice with the WTO that they may impose retaliatory tariffs.
Russia **$0.5B**	25% tariff on steel	Imposed partial retaliatory tariffs of less than $0.1B.

The actual dollar values of tariffs implemented to date are a far cry from what headlines tout. An example is President Trump's comments that he is ready to impose tariffs of up to $500 billion USD on China, having already identified a list of $200 billion worth of targeted goods. To date, only $50 billion has been implemented.

Based on the tariffs in effect, the negative impact on global gross domestic product (GDP) is estimated at 0.2% by 2020, according to the Bank of Canada Monetary Policy Report released earlier this month. The Bank of Canada also estimates that U.S. trade actions already implemented will reduce Canadian GDP by nearly 0.7% by the end of 2020. In other words, the consequences of the tariffs implemented to date are not expected to have as material a negative impact as feared.

Market Response to Tariffs

The market's response was commensurate with the estimated impacts of the tariffs in effect. Given the muted impact tariffs implemented to date are expected to have on the global economy, it's not surprising that financial markets chose to focus on the continuance of strong economic growth, allowing equity markets to increase over the quarter in Canada and the U.S.

The U.S. economy has been expanding at a solid pace amid a tight labour market, as the benefits of the past corporate tax rate cuts continued to provide a boost to business investment growth. Although some U.S. businesses are beginning to report that current trade conditions are dampening growth forecasts, this is not evident in the data seen to date. In Canada, the economy continues to operate close to capacity with real GDP growth expected to average 2.0% over 2018 to 2020, according to the latest Bank of Canada forecast. International equity market returns for the second quarter were slightly negative given the slower economic growth versus previous quarters (although growth was still positive).

Returns (local currency) as of June 30, 2018	**3-Month Returns**	**YTD**
Canadian equities (S&P/TSX Index)	6.77%	1.95%
U.S. equities (S&P 500 Index) USD$	3.43%	2.65%
International equities (MSCI EAFE Index) USD$	-1.06%	-2.40%
Canadian fixed income (FTSE TMX Canada Bond Universe Index)	0.50%	0.61%

After a significant lag during the first quarter, Canadian equities had a strong second quarter as the S&P/TSX was up 6.8%, outperforming both U.S. equities and international equities, even after taking into account the 1.8% depreciation in the Canadian dollar versus the U.S. dollar (-4.3% on a year to date basis). The largest contributing factor to Canadian equities' strong quarterly performance was due to the Energy sector, which was up almost 16% during the quarter and carries a 19% weighting in the broad index.

Fixed income markets experienced modest positive returns during the second quarter in Canada and modestly negative returns in the U.S. As widely expected, the U.S. Federal Reserve raised its benchmark policy rate during the second quarter by 0.25%, which is the second interest rate increase so far this year. Current expectations are for two more 0.25% interest rate increases in 2018 given the strong economic growth.

In Canada, it's a bit of a different situation. As expected, the Bank of Canada raised interest rates in early July by 0.25% but only one more 0.25% interest rate increase is expected later this year. The Bank of Canada is adopting a careful, measured approach in balancing the management of economic capacity constraints (which are at/near their peak), versus trade tariffs, the ultimate outcome of NAFTA renegotiations, and uncertainty surrounding Canadians' debt financing capacity. The Bank of Canada did make it clear at their July Monetary Policy press conference that they remain mindful of trade related risks but will remain focused on making decisions based on actual data. Governor Poloz also noted that the high debt levels currently carried by Canadians will be monitored closely relative to the effects of higher interest rates in conjunction with the revised mortgage lending rules.

Ts for Thought

At this point, it remains unclear how much of the current trade war rhetoric is going to actually be implemented. There is the risk that rising political tensions may lead to a large-scale trade war. Or we may remain in a prolonged period of uncertainty. Regardless, it is important to not be swayed by short-term volatility while being mindful of potential long-term impacts, should there be any.

When it comes to investing, it is best to focus on things you have control over. From a portfolio perspective, here are some Ts to keep in mind:

- Trust your long term financial plan. It was developed based on an understanding of your investment objectives, constraints, time horizon and risk tolerance. Volatility is inherent in the capital markets and your portfolio should be designed to ride out such short-term volatility so that long-term goals can be met.
- Talk to your advisor. Communicate any changes in your financial circumstances that may warrant a revisit of your financial plan.
- Tune out the noise of market headlines. Be mindful of developments that may have long term implications but don't get swayed by short-term or uncertain events.

At Quadrant we tenaciously maintain a thoughtful long-term view and focus our efforts on asset allocation policy, manager selection, systematic rebalancing and understanding our clients' individual financial circumstances.

If you or someone you know could benefit from our services, please have them contact our offices at 204-944-8124 or email us at inquiries@quadasset.com.

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