Weekly Trends

PRIVATE CLIENT SOLUTIONS

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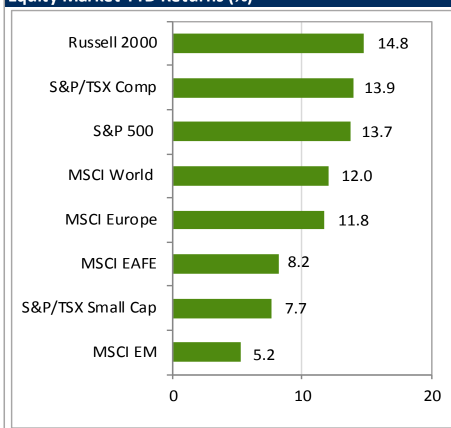
Here We Go Again

It was early last year when trade headlines roiled the markets. More than 12 months later trade is back in the headlines, but as is said, 'time heals all wounds'. Within the market's context, time allows market participants to digest the risks and adjust strategy, so we think the market is better prepared for this round of the trade war. Further, there is likely the realization that tariffs are more of a drag on sentiment rather than a significant drag on actual growth.

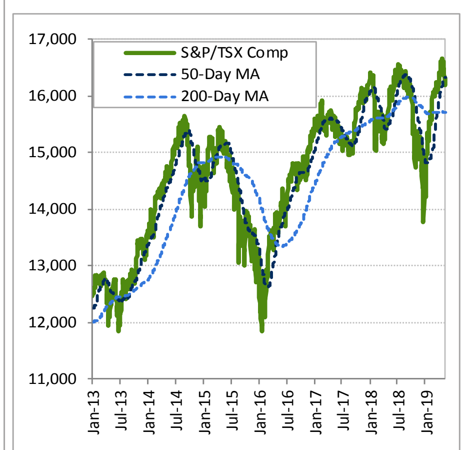
- In our view, tariffs are not the major issue facing the market, but nationalistic boycotts and expanded aggression towards one another is another matter. The trade war appears to be morphing into an 'us versus them' standoff, with each side digging in. While US companies have recognized that tariffs increase the cost of doing business, there appears to be a willingness to make the sacrifice for the greater goal of establishing a fair deal.
- Our long-standing view is that China holds the stronger position in terms of duration of the trade dispute. While the country has significantly more to lose from an export perspective, the Chinese government has the luxury of thinking about policy in decades, compared to the US that must think in four-year election cycles.
- The market has shown resilience amid escalating trade tensions, as there has been buying interest almost every day with the index closing well above its intraday lows. This buying interest could be because there remains time to reach a deal before the full impact of the tariffs are felt and/or optimism ahead of a potential Trump/Xi meeting at the G20 summit at the end of June.

Equity Market YTD Returns (%)



Canadian Sectors	Weight	Recommendation
Consumer Discretionary	4.1	Underweight
Consumer Staples	4.0	Overweight
Energy	18.1	Underweight
Financials	32.2	Market weight
Health Care	2.2	Underweight
Industrials	11.4	Market weight
Technology	4.8	Market weight
Materials	9.9	Market weight
Communications	5.7	Overweight
Utilities	4.2	Market weight
Real Estate	3.4	Overweight

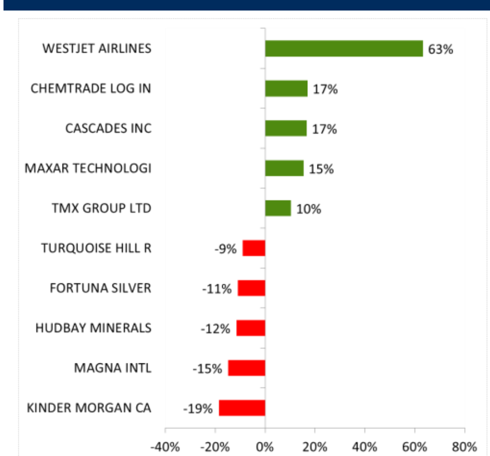
Technical Considerations	Level	YE Target
S&P/TSX Composite	16,318	15,600



Source: Bloomberg, Raymond James Ltd.

Sectors are based on Bloomberg classifications

S&P/TSX Top 5 Gainers/Laggards*



S&P/TSX Market Internals

Weekly Advance	101	40%
Weekly Decline	137	55%
Advance-Decline	-36	
New 52 wk high	18	7%
New 52 wk low	7	3%
No. Stocks Above 50-d	106	42%
No. Stocks Above 200-d	128	51%
Arms Weekly Index	1.36	Neutral
RSI (14-day)	45.8	Neutral
50-DMA	16,325	Downtrend
200-DMA	15,717	Uptrend

*Source: Bloomberg, Raymond James Ltd; * 5-day price return*

Please read domestic and foreign disclosure/risk information beginning on page 6

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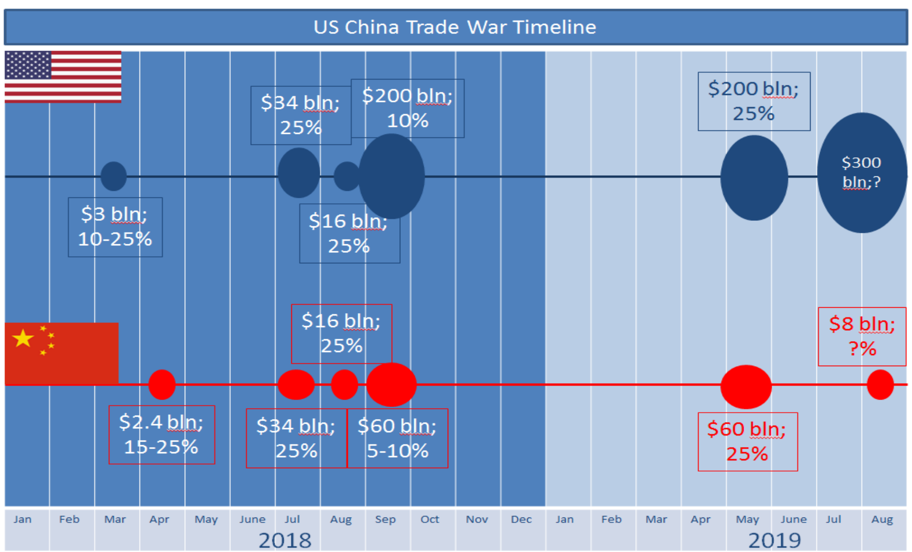
It was early last year when trade headlines roiled the markets. More than 12 months later trade is back in the headlines, but as is said, 'time heals all wounds'. Within the market's context, time allows market participants to digest the risks and adjust strategy, so we think the market is better prepared for this round of the trade war. Further, there is likely the realization that tariffs are more of a drag on sentiment rather than a significant drag on actual growth. As we wrote in our *March 28, 2018 Weekly Trends: Trade Realities:*

"Even if all the Chinese tariff measures were implemented, they would impact less than ~3% of total goods imported to the US. Under a scenario where the tariffs were implemented as announced, the impact on import prices would be an increase of less than 1%, which could be either absorbed by the importer or passed on to the consumer."

The overall loss to China, if all goods were slapped with tariffs, is approximately 0.7% to GDP growth and significantly less of an impact on US growth. In short, the negative impacts, particularly for the US, are manageable. To recap the most recent tit-for-tat headlines:

- Frustrated by the slow progress, the US raised the tariff rate to 25% on $200 bln worth of goods and said tariffs would also be applied on the remaining US$300 bln in Chinese goods.
- In response, China said it will increase tariffs to 25% on US$60 bln in US goods affecting 2,493 products. In addition, China threatened to stop purchasing US agriculture products and may reduce Boeing orders.

US China Trade War Timeline



Source: Bloomberg, Raymond James Ltd.

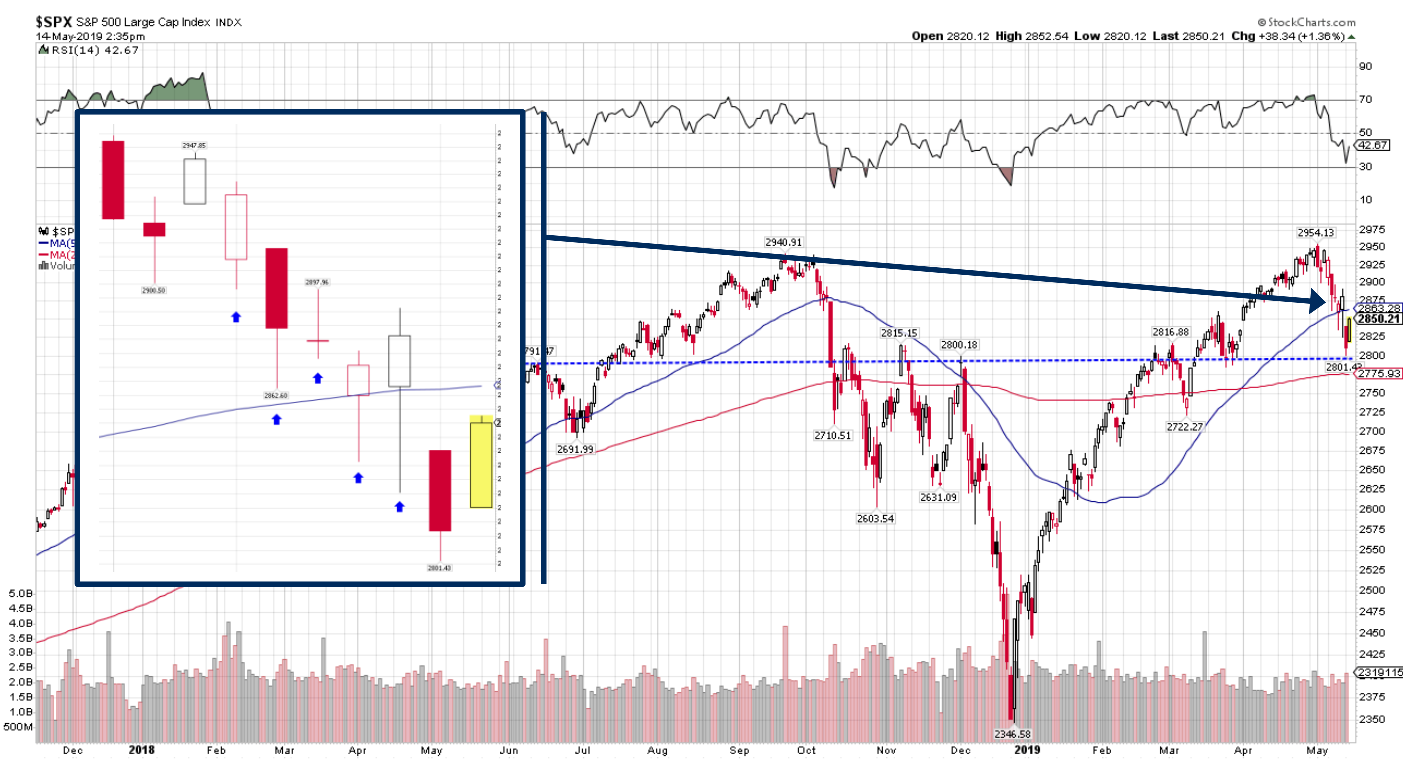
In our view, tariffs are not the major issue facing the market, but nationalistic boycotts and expanded aggression towards one another is another matter. The trade war appears to be morphing into an 'us versus them' standoff, with each side digging in. While US companies have recognized that tariffs increase the cost of doing business, there appears to be a willingness to make the sacrifice for the greater goal of establishing a fair deal. As Iowa Republican Senator Chuck Grassley said, “Americans understand the need to hold China accountable, but they also need to know that the administration understands the economic pain they would feel in a prolonged trade war.”

US farmers have had to bear the brunt of trade war pain and Trump knows he will need these states to win the 2020 election, which clearly explains the motivation behind the US$15bln he has pledged to support the “great patriot farmers” to offset China’s potential threat.

Outside of the tariffs, the US Commerce Department slapped stricter licensing requirements on six companies in China and Hong Kong; four for allegedly breaking US sanctions on Iran and two for selling technology to the Chinese army. Trump is also expected to sign an executive order this week barring US companies from using telecommunications equipment made by firms posing a national security risk, paving the way for a ban on doing business with China’s Huawei. For its part, Chinese state media has been urging citizens to boycott US goods saying, "the trade war in the US is the creation of one person and one administration, but it affects that country's entire population. In China, the entire country and all its people are being threatened. For us, this is a real 'people's war.’”

Nonetheless, the market has shown resilience amid escalating trade tensions, as there has been buying interest almost every day with the index closing well above its intraday lows. This buying interest could be because there remains time to reach a deal before the full impact of the tariffs are felt and/or optimism ahead of a potential Trump/Xi meeting at the G20 summit at the end of June.

S&P 500 Closing Off Intraday Lows



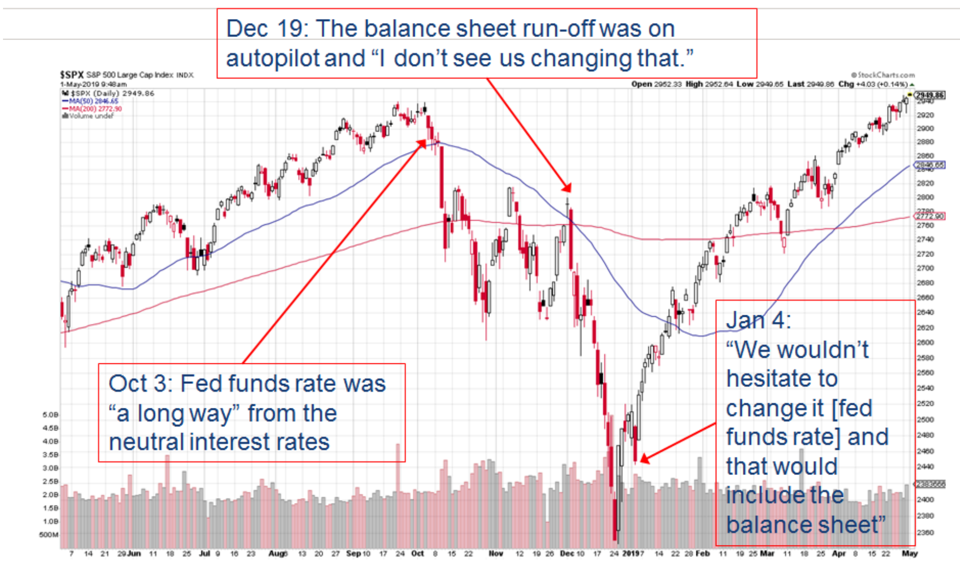
Source: Stockcharts.com, Raymond James Ltd.

Why Now?

President Trump has consistently pointed to the stock market to validate his economic policies. A stock market sitting at all-time highs must then give him the confidence or leeway to play hardball with the Chinese. This surely would not have been the case if the market were sitting near the December lows.

The shift trade tactics could also be a function of the Fed's dovish pivot made in January. With the Fed contributing to the market selling off ~20% in Q4, Powell blinked in his first real test and signaled that he stands ready to support the market. On January 4, Powell did a 180-degree turn which helped propel the market to new all-time highs. The "Powell Put", as it has been coined, now appears to be fully in play if market sentiment sours further and a similar plunge is experienced. In fact, the market is increasingly expecting the Fed to cut rates this year. According to Bloomberg, the implied fed funds rate has moved to a level that suggests the central bank's benchmark will fall by the end of 2019, as traders are now fully pricing a quarter-point reduction.

J. Powell's 180 Degree Turn



Fed Funds Rate Cut Probability

FOMC	Cut Probability	
Meeting Date	On April 1, 2019	Today
6/19/2019	9.5%	12.6%
7/31/2019	18.5%	28.4%
9/18/2019	31.8%	54.3%
10/30/2019	39.8%	63.3%
12/11/2019	53.3%	76.5%
1/29/2020	59.2%	81.2%

Source: Bloomberg, Raymond James Ltd.

From China's perspective, the *Wall Street Journal* ran an interesting article suggesting Trump's attack on the Fed to cut rates prompted the Chinese to believe the US economy was in materially worse shape than what was being reported (in a country where economic data is routinely manipulated, it's easy to understand why the Chinese may have misinterpreted Trump's actions). Under the assumption that the US economy was slowing more than reported, the Chinese would have the upper hand in the negotiations, particularly given the Chinese economy has found a firmer footing this year (although most recent data may suggest otherwise) thanks to simulative measures.

Final Thoughts

Our long-standing view is that China holds the stronger position in terms of duration of the trade dispute. While the country has significantly more to lose from an export perspective, the Chinese government has the luxury of thinking about policy in decades, compared to the US that must think in four-year election cycles. As November 2020 approaches, there is great pressure on the US to strike a deal, or perhaps not. According to media reports, Trump has been telling advisers and close allies he has no intention of dialing back on his escalating trade war with China. He believes the battle with Beijing is highly popular among his political base and may in fact help him secure re-election in 2020.

Trying to understand why Trump does what he does has become a national (and even international) pastime. There are many competing theories, so we propose one potential scenario - Trump is playing politics. By taking a hardline with China and ratcheting up trade tensions, the markets have the potential to react negatively. Any significant weakness in the market, as was seen in December, will in effect force the Fed's hand, delivering the desired rate cut Trump has been calling for. The simulative impact of the rate cut would begin to trickle through the economy towards the end of 2019, just ahead of the US election. With the rate cut in hand, Trump can quickly revert to a more conciliatory tone and compromise on a trade deal.

In this scenario, Trump trades the short-term market pain for the desired economic bump one would expect from the Fed's liquidity injection. He can also sell the American people on winning the trade war, even though it's unlikely there will be any major concessions made by the Chinese.

However, if this scenario comes to fruition, the million-dollar question is, how will the market interpret a Fed rate cut? Do equities rally because the Fed is easing monetary conditions or do equities fall, as they interpret the cut as responding to weaker economic conditions ahead?

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