

The portfolio implications of trade disputes

July 2018

TRADE POLICY IS OF FIRST-ORDER IMPORTANCE IN A MORE CONNECTED WORLD, AND MARKETS HAVE BEEN REACTING NERVOUSLY TO U.S. TRADE DISPUTES WITH CHINA, EUROPE AND NORTH AMERICAN FREE TRADE AGREEMENT (NAFTA) COUNTRIES. Our latest research explores the portfolio implications of trade policy uncertainty, at a time when trade-related market shocks are becoming more frequent.¹

Our baseline view is that trade policy uncertainty will continue driving higher levels of volatility but will not fundamentally alter the direction of markets over the next 12-18 months. Moderate, negotiated solutions remain our base case outcomes for NAFTA and China trade disputes. There is a rising risk, however, that if these disputes drag on or intensify, market reactions could become deeper and more persistent.

A key feature of trade disputes is the non-linear pass-through to economic outcomes. Small or narrow tariffs have generally had small effects on near-term growth and inflation. Combining all U.S. tariffs on Chinese exports (those announced and threatened), we estimate an effect of only about a 25 basis point (bps) decline in U.S. real GDP growth and 20bps on core CPI inflation. These are non-trivial but not devastating in an economy currently growing at an above-trend pace.

AUTHORS



Benjamin Mandel
Global Strategist, Multi-Asset Solutions



Hannah Anderson
Global Market Strategist,
Global Market Insights Strategy

More severe problems would likely arise if trade barriers began to affect economic sentiment and damage private sector confidence—currently, business sentiment readings remain high, but at the margin they have begun to reflect trade fears. There is also the risk that the balance of winners and losers from tariffs has spillover effects. For example, the prospect of auto tariffs could be sufficiently threatening to dampen confidence. In addition to autos, the burden of U.S. tariffs under consideration will fall disproportionately on U.S. consumers of electronics made in China and on U.S. businesses utilizing imported machinery and metal inputs. Other countries' retaliation will likely deliver the biggest hit to U.S. exporters of agricultural products and U.S. business operations overseas.

Thus far, these grave possibilities have been more fear than fact, and markets have cycled through trade policy episodes relatively quickly. By our estimation, a “typical” announcement effect over the past 18 months has corresponded to a 30bps fall in S&P 500 total return on the day of announcement, followed by a 1ppt cumulative recovery over the subsequent five trading days (**EXHIBIT 1**).

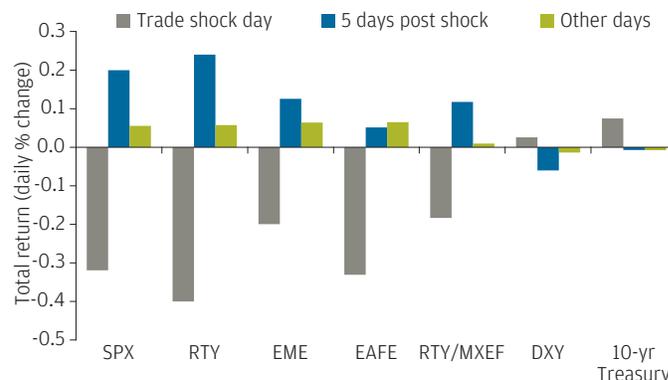
¹ This note distills the investment implications discussed in a forthcoming research paper, “What is a trade war, and are we in one?” by Benjamin Mandel and Hannah Anderson, J.P. Morgan Asset Management (July 2018).

Some investment implications of our research include:

- Trade war headlines spark negative reactions for equities on impact (creating disproportionately higher volatility in emerging markets and Europe), and a temporary boost to the dollar.
- Trade disputes have been more pronounced in the more trade-exposed markets of Asia and Europe than in the relatively closed U.S., where assets also generally do relatively better in risk-off situations.
- Higher overall volatility, emergent downside risks and the lower relative sensitivity to policy outcomes support the U.S. at the top of our list of preferred equity markets; Europe is collateral damage in these disputes and among our least-preferred markets.
- Over the past year, duration has acted as a moderate hedge for trade shocks, with stock-bond correlations modestly more negative during recent trade risk episodes.

U.S. trade announcements have led to sharp declines in equities, followed by sharp bounces

EXHIBIT 1: MARKET REACTIONS TO TRADE POLICY



Source: Bloomberg, J.P. Morgan Asset Management; data as of July 2, 2018.

NEXT STEPS

For more information, contact your J.P. Morgan representative.

J.P. MORGAN ASSET MANAGEMENT

For the purposes of MiFID II, the JPM Market Insights and Portfolio Insights programs are marketing communications and are not in scope for any MiFID II / MiFIR requirements specifically related to investment research. Furthermore, the J.P. Morgan Asset Management Market Insights and Portfolio Insights programs, as non-independent research, have not been prepared in accordance with legal requirements designed to promote the independence of investment research, nor are they subject to any prohibition on dealing ahead of the dissemination of investment research.

This document is a general communication being provided for informational purposes only. It is educational in nature and not designed to be taken as advice or a recommendation for any specific investment product, strategy, plan feature or other purpose in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any examples used are generic, hypothetical and for illustration purposes only. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit, and accounting implications and determine, together with their own professional advisers, if any investment mentioned herein is believed to be suitable to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yields is not a reliable indicator of current and future results.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide. This communication is issued by the following entities: in the United Kingdom by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions by JPMorgan Asset Management (Europe) S.à r.l.; in Hong Kong by JF Asset Management Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited; in Singapore by JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), or JPMorgan Asset Management Real Assets (Singapore) Pte Ltd (Co. Reg. No. 201120355E); in Taiwan by JPMorgan Asset Management (Taiwan) Limited; in Japan by JPMorgan Asset Management (Japan) Limited which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Korea by JPMorgan Asset Management (Korea) Company Limited; in Australia to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Cth) by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919); in Brazil by Banco J.P. Morgan S.A.; in Canada for institutional clients' use only by JPMorgan Asset Management (Canada) Inc., and in the United States by JPMorgan Distribution Services Inc. and J.P. Morgan Institutional Investments, Inc., members of FINRA; and J.P. Morgan Investment Management Inc.

Copyright 2018 JPMorgan Chase & Co. All rights reserved.

PI-TRADEWAR-SF | 0903c02a82284d61