IdahoTrustBank

August 2018

WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust Bank

The global financial markets have struggled so far this year. Volatility levels have increased from exceptionally low levels last year. Uncertainties surrounding the global political landscape have clearly begun to impact the investment environment. Most central banks around the world are maintaining an accommodative policy outlook. However, the U.S. central bank has been boosting interest rates as the domestic economy continues to expand.

Global Trade

Most major international equity markets have experienced lackluster returns so far this year as fears of a protracted and pronounced trade war have intensified. The Shanghai Composite index fell more than 20% from its 2-year high reached in late January. European stocks and bonds also declined as concerns that the fragile recovery could be overtaken by the region's significant exposure to international trade. In the US, where the business recovery continued, stocks made further advances, particularly shares of small cap companies that are less sensitive to trade-related actions.

Signs that inflation could accelerate, continued job gains for US workers and speculation that the Federal Reserve might raise rates four times this year, have helped boost U.S. treasury yields. The dollar strengthened against most major

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currencies. The rise in rates and the gains in the dollar amplified struggles in the emerging markets. Countries that issue debt in dollars are feeling the brunt of rising yields since the dollar often rises in tandem with Treasury yields.

Even before U.S. tariffs levied on China officially went into effect, global trade had already begun to show signs of slowing. Several recent business surveys showed that global export growth, which was very strong in 2017, has slowed to a relative crawl, hurting big exporting nations like South Korea and Japan. The data suggest that the synchronized world-wide growth that boosted global corporate earnings for much of last year has hit a soft spot.

The new-exports portion of JP Morgan's Global Manufacturing PMI fell to 50.5 in June, the weakest in nearly two years. The figure remains above 50, indicating export orders are still rising, but it has grown weaker every month since hitting its most recent peak at 54.2 in January (see chart above). The orders data closely mirrors year-on-year changes in world trade volumes, suggesting last year's 4.8% rise in global merchandise trade (the strongest since 2011, according to the World Bank) is unlikely to be repeated. The volume of global trade is so large that even modest changes in its rate of growth are more consequential than what is directly at stake in the rift between the U.S. and China.

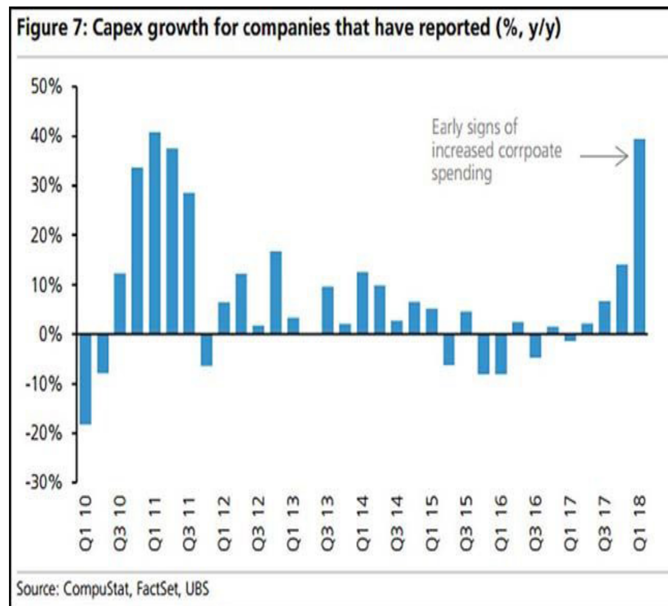
The global trade moderation explains the recent sell-off in emerging-market bonds and equities better than any fears of rising protectionism. Any fall in trade is likely to first hit economies integral to globalized manufacturing processes, such as those of several emerging countries in Asia. The latest manufacturing PMI from Germany, an outsize player in global supply chains, offers some weight to that interpretation. Export sales growth there was the weakest in over two years, and a number of businesses cited declining orders from the U.S. and China.

Tariffs

Businesses are trying to identify the magnitude for disruptions in sales and supply chains as the U.S. and China enact tariffs on billions of dollars in

automotive products, farm crops and other goods. The battle threatens to disrupt commerce around the globe, and the consequences are already being felt. By value, soybeans are the top item targeted by Beijing's proposed tariffs; China imported around $14 billion in U.S. soybeans last year. In all, China's tariffs would cover 545 categories of U.S. products, while the U.S. tariffs would cover 818 categories of products from China. The Trump Administration contends the tariffs are needed to level the playing field in bilateral trade and protect U.S. companies from the pressure they face in China to transfer technology to Chinese partners. One worry many U.S. companies share is that anti-American sentiment will grow, hitting American-branded goods.

In late February, the White House announced its intention to place tariffs on imports of steel and aluminum. The move toward trade protection may not be unexpected to some as the Administration was elected on a platform of leveling the economic playing field with our trading partners. The stated goal is to promote 'American industries and preserve American jobs.' China has been a focal point of many of these trade concerns, but we import relatively little steel from them; and we are a net exporter of aluminum to China. Some of our biggest suppliers of steel are our closest economic and strategic allies, including Canada and Japan.



Conclusion

One concern with imposing tariffs is that it will likely raise the cost of raw materials and could add to inflationary pressures at a time in which markets are especially sensitive to them. Many businesses in the United States use steel; and the measure would probably increase their costs, which would likely limit their willingness and ability to hire workers and invest in new equipment. Another concern would be that increasing production of domestic steel and aluminum could be problematic as many of the American based factories are both outdated and not cost-effective. However, the near-term impact on growth could likely be negative. While we think the chances of a significant trade war are low, the possibility is worrisome. If the rest of the world decides to retaliate against U.S. import tariffs the situation could get worse quickly.

S&P 500 Index

3 Month	6.87%
Year-to-Date	8.10%
1 Year	16.23%
3 Year	12.50%
5 Year	13.11%

MSCI EAFE Net Index

3 Month	-1.07%
Year-to-Date	-1.06%
1 Year	6.40%
3 Year	5.03%
5 Year	5.86%

Barclays Aggregate Bond Index

3 Month	0.61%
Year-to-Date	-1.58%
1 Year	-0.80%
3 Year	1.49%
5 Year	2.25%

As of 7.31.2018

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