Weekly Trends

PRIVATE CLIENT SOLUTIONS

Jason Castelli, CFA

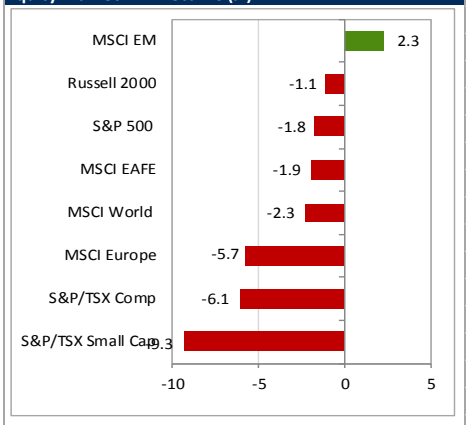
March 28, 2018

Trade Realities

There is no doubt that a full-blown trade war would have a significantly negative impact on global economic growth. The tariffs announced thus far, however, represent a drop in the bucket and are more headline grabbing than economically impactful, in our view.

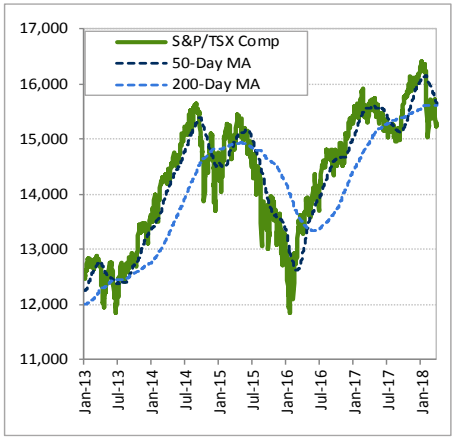
- The protectionism headline-grabbing policies give the impression that Trump is fulfilling his 2016 election campaign promise to level the trade playing field. However, behind closed doors the measures are scaled back to ensure economic activity is not adversely impacted.
- Even if all the Chinese tariff 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. In short, even if the existing tariffs were implemented as announced, they would have a small and short-lived impact on the overall economy and inflation.
- With the S&P 500 essentially erasing all the gains achieved from tax reform, we're left with a market set to grow earnings in the double-digit range, accelerating corporate buyback programs and sentiment somewhat reset. The S&P 500 now trades at ~16.5x forward earnings, down from 18.7x achieved in January and a peak of 20.1x in December 2017.

Equity Market YTD Returns (%)



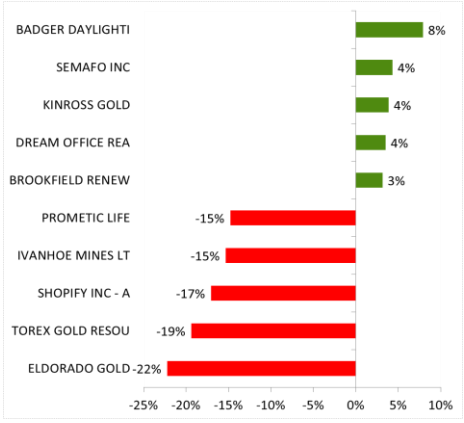
Canadian Sectors	Weight	Recommendation
Consumer Discretionary	5.5	Market weight
Consumer Staples	3.6	Underweight
Energy	18.3	Overweight
Financials	35.1	Market weight
Health Care	1.2	Market weight
Industrials	9.7	Overweight
Technology	3.8	Market weight
Materials	11.4	Overweight
Communications	4.6	Market weight
Utilities	3.8	Underweight
Real Estate	3.1	Market weight

Technical Considerations	Level	Target
S&P/TSX Composite	15,224	17,650



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	78	31%
Weekly Decline	172	69%
Advance-Decline	-94	
New 52 wk high	2	1%
New 52 wk low	17	7%
No. Stocks Above 50-d	77	31%
No. Stocks Above 200-d	89	35%
Arms Weekly Index	0.91	Neutral
RSI (14-day)	35.7	Neutral
50-DMA	15,653	Downtrend
200-DMA	15,611	Downtrend

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

Please read domestic and foreign disclosure/risk information beginning on page 4

Raymond James Ltd. 5300-40 King St W. | Toronto ON Canada M5H 3Y2.
2200-925 West Georgia Street | Vancouver BC Canada V6C 3L2.

Headlines versus Reality

There is no doubt that a full-blown trade war would have a significantly negative impact on global economic growth. The tariffs announced thus far, however, represent a drop in the bucket and are more headline grabbing than economically impactful, in our view. To review:

- Trump announces tariffs on foreign washing machines and solar panels, largely targeting China and South Korea (SK). For washing machines, the US imposes a 20% tariff on the first 1.2m units in the first year and a 50% tariff on machines above that number. The tariffs decline to 16% and 40% respectively in the third year. A 30% tariff will be imposed on imported solar cells and modules in the first year, with the tariffs declining to 15% by the fourth year. The tariff allows 2.5 gigawatts of unassembled solar cells to be imported tariff-free in each year.
- Trump announces tariffs on steel and aluminum. Leading up to the announcement, there was speculation of a blanket tariff, but the watered-down version exempted Canada and Mexico (until May 1) and left the door open for talks with other allies. Over the weekend, the US and SK reached an agreement on revising their trade deal, with SK avoiding steel tariffs and the US gaining increased access to the SK auto market. The US has imposed a quota on SK steel imports allowing 2.68 mln tonnes of steel imports, or ~70% of the annual average Korean steel exports to the US. In exchange, the US can export 50,000 vehicles per automaker per year to SK. From the headline to finalized version of the metals tariff, there were many changes in aggregate, as it morphed from a tariff on all imports to one where countries accounting for around 77% of the steel and aluminum imports gained exemptions.
- Trump announces US$60bln worth of tariffs on Chinese imports. A 25% import tariff measure would focus on IT, aerospace and machinery. Over the last weekend, China and the US reportedly worked on ways to improve US access to Chinese markets. According to *The Wall Street Journal*, Chinese President Xi Jinping's top economic aide, Liu He, US Treasury Secretary Steven Mnuchin, and US trade representative Robert Lighthizer met to discuss a reduction of Chinese tariffs on US automobiles, more Chinese purchases of US semiconductors and greater access to China's financial sector by American companies.

Winning

The protectionism headline-grabbing policies give the impression that Trump is fulfilling his 2016 election campaign promise to level the trade playing field. However, behind closed doors the measures are scaled back to ensure economic activity is not adversely impacted.

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. In short, even if the existing tariffs were implemented as announced, they would have a small and short-lived impact on the overall economy and inflation.

Similarly, the steel and aluminium tariffs' initial scope also represented ~2% of total imported goods, but the vast majority of exporting countries (77%) won last minute tariff exemptions thus having a limited economic impact.

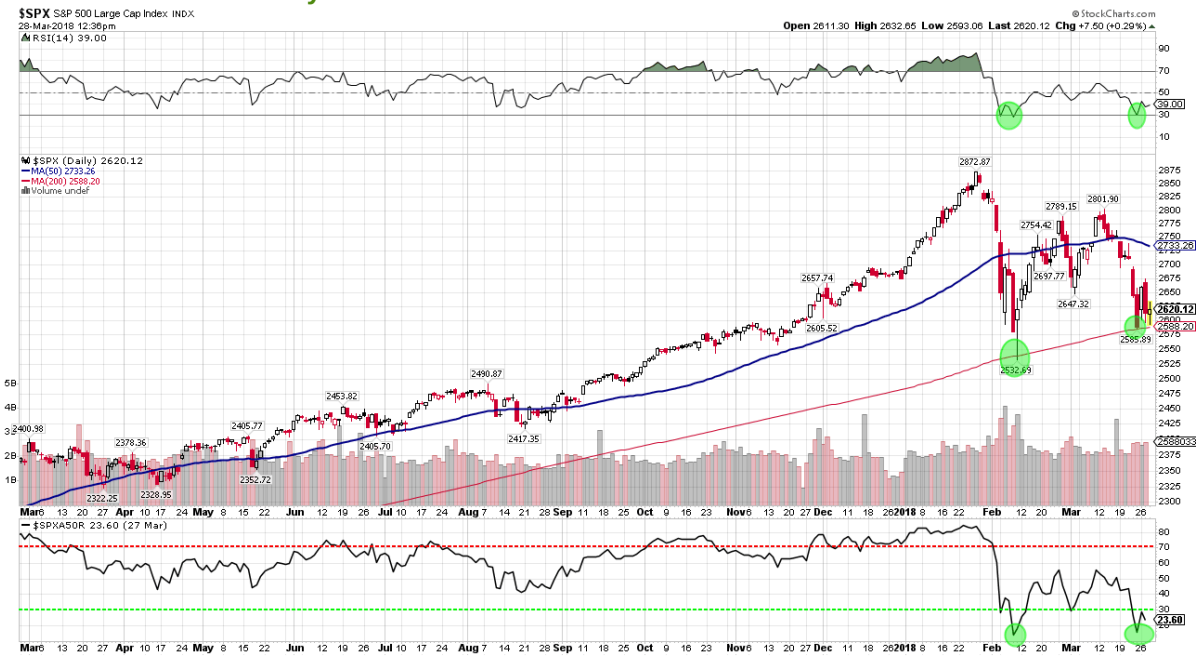
We don't discount the severity of an escalating tit-for-tat trade war, which is the reason behind the recent selloff and negative sentiment. According to Bloomberg Economics, if the US slapped a 10% import tax on all goods and trading partners retaliated the cost to the global economy would be equivalent to ~0.5% of world GDP, or US$470bln. But, the measures announced thus far have close to zero economic impact and would barely change the trajectory of the US economy or corporate earnings. A true trade war would be very disruptive to the US economy and we highly doubt Trump would be willing to put American jobs at risk ahead of the mid-term elections.

With the S&P 500 essentially erasing all the gains achieved from tax reform, we're left with a market set to grow earnings in the double-digit range, accelerating corporate buyback programs and sentiment somewhat reset. The S&P 500 now trades at ~16.5x forward earnings, down from 18.7x achieved in January and a peak of 20.1x in December 2017.

Last Friday, the S&P 500 bounced off the 200-day moving average on oversold conditions. A 14-day RSI reading of 30 and the percentage of S&P 500 companies trading below their 50-day moving average at 15.6% were both near extreme readings, similar to the February reading (RSI = 17 and % Stock < 50-d = 13.6%).

Unfortunately, headlines will continue to dominate the tape both on the downside and upside. Friday's headline was the US and China entering a trade war and Monday's was the US and China finding common ground. Tomorrow's may potentially undo Monday's gains or may propel the S&P 500 to retest its 50-day moving average. Regardless, the long-term trend in the S&P 500 remains decidedly positive at this time.

S&P 500 Kisses the 200-day



Source: stockcharts.com, Raymond James Ltd.

Important Investor Disclosures

Complete disclosures for companies covered by Raymond James can be viewed at: https://www.rjcapitalmarkets.com/Disclosures/Index.

This newsletter is prepared by the Private Client Services team (PCS) of Raymond James Ltd. (RJL) for distribution to RJL's retail clients. It is not a product of the Research Department of RJL.

All opinions and recommendations reflect the judgement of the author at this date and are subject to change. The author's recommendations may be based on technical analysis and may or may not take into account information contained in fundamental research reports published by RJL or its affiliates. Information is from sources believed to be reliable but accuracy cannot be guaranteed. It is for informational purposes only. It is not meant to provide legal or tax advice; as each situation is different, individuals should seek advice based on their circumstances. Nor is it an offer to sell or the solicitation of an offer to buy any securities. It is intended for distribution only in those jurisdictions where RJL is registered. RJL, its officers, directors, agents, employees and families may from time to time hold long or short positions in the securities mentioned herein and may engage in transactions contrary to the conclusions in this newsletter. RJL may perform investment banking or other services for, or solicit investment banking business from, any company mentioned in this newsletter. Securities offered through Raymond James Ltd., Member-Canadian Investor Protection Fund. Financial planning and insurance offered through Raymond James Financial Planning Ltd., not a Member-Canadian Investor Protection Fund.

Commissions, trailing commissions, management fees and expenses all may be associated with mutual funds. Please read the prospectus before investing. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated. The results presented should not and cannot be viewed as an indicator of future performance. Individual results will vary and transaction costs relating to investing in these stocks will affect overall performance.

Information regarding High, Medium, and Low risk securities is available from your Financial Advisor.

RJL is a member of Canadian Investor Protection Fund. ©2018 Raymond James Ltd.