US Market Commentary

Trade war and Tech regulation fears largely replaced inflation worries during the month, conspiring to drive the S&P 500 down 2.5% in March and retest the correction's low before regaining some ground in the month's final week. This still seems like a classic sentiment-driven correction (sharp drop of roughly -10% to -20%), with the continued search for causes still in question. Corrections both begin and end without warning, and while it is impossible to know when this one will cease, we still expect stocks to have a great year as they resume weighing fundamentals.

While new tariffs aren't positive, we believe those announced thus far are too small to derail the economic expansion and bull market. The tariffs announced through the end of March are twofold: A global levy of 25% on steel imports and 10% on aluminum and a separate $50 billion tariff on certain Chinese imports. The former have been watered down greatly since President Trump initially announced them in early March. In the following days, the US granted exemptions to Australia, Canada, Brazil, South Korea, Mexico and the EU—collectively responsible for 63% of steel and 55% of aluminum imports. The exemptions more than halve the tariffs' potential impact.

The China tariffs might seem like a bigger deal, with higher potential for retaliation. China has already responded to the steel and aluminum tariffs by slapping duties on nearly $3 billion worth of US goods, and officials have signaled retaliation to the China-specific tariffs is in the pipeline. But not every trade spat becomes a full-blown trade war. America has participated in numerous trade disputes over the past several decades, but the world hasn't seen a true trade war since the backlash to Smoot-Hawley in the early 1930s. The current pales in comparison. Even without the steel and aluminum exemptions, the new tariffs (including the announced Chinese tariffs) would raise total duties to just 2.1% of total US imports for consumption. By comparison, Smoot-Hawley raised total tariffs to nearly 20% of total imports for consumption by 1933. This spat looks unlikely to reach that level. While both sides are jawboning, White House officials have been rather clear that their goal is to urge China into improving intellectual property protections—trade deficit discussion seems mostly like a sideshow. To that end, Chinese leaders have already announced loose plans to address some of these concerns, demonstrating some behind-the-scenes progress. We suspect this issue won't settle quickly, but it seems highly unlikely tariffs escalate into the trillions of dollars in the meantime.

Concerns about Tech regulation seem similarly unlikely to derail the bull market. While events like the Facebook/Cambridge Analytica scandal and the president's Tweets about Amazon can roil sentiment, they appear unlikely to lead to sweeping new regulations that could dent profits across the entire Information Technology sector. Some lawmakers are jawboning about toughening privacy and data protection rules in the wake of Cambridge Analytica, but this seems unique to the social media sphere, which isn't representative of the broad Tech sector. Actually, in late September, Facebook will officially be classified as a media company, not a technology company, as part of a GICS update. As for Amazon, Trump's tweets about the firm's relationship with the US Postal Service recall tweets about Lockheed's aircraft cost overruns early in his presidency. That uproar went nowhere. Indeed, in early April, the

White House indicated it has no plans to take action against the firm. Should that change, legal experts say any lawsuit from the administration would be a long shot with little chance of success. Congressional legislation is also possible, but gridlock—especially ahead of midterm elections—likely prevents any great changes to Tech's regulatory environment. More relevant to Tech stocks, in our view, are solid underlying global demand trends for cloud computing and mobile usage. Rather than signaling Tech's imminent danger, we believe regulatory jitters show scepticism persists, which should prove bullish—buoying stocks as worst-case prognostications blow over.

While political chatter dominates headlines, economic fundamentals remain strong. Some monthly indicators released in March did slow or fall, but this seems tied mostly to heavy snowstorms blanketing the nation's east, hurricane recovery spending (e.g. replacing flood-damaged cars) pulling forward some consumption into Q4, and the Commerce Department's well-known struggles with wintertime seasonal adjustments. This fed into retail sales ticking down in February for its third straight monthly decline and broader real personal consumption expenditures staying flat, while the BEA revised January's consumption figure to -0.2% m/m from -0.1%. Yet data released throughout March weren't uniformly weak. February industrial production rose 1.1% m/m, and durable goods orders enjoyed a 3.1% month-over-month rise. Though volatile aircraft orders boosted the latter, even core capital goods orders (non-defense ex. aircraft) rose 1.8% m/m.

Moreover, forward-looking markets likely already moved on from February and March. Leading economic indicators point to solid growth for the foreseeable future. The Institute for Supply Management's Purchasing Managers' Indexes (PMIs) suggest ongoing business activity expansion. February's headline manufacturing (60.8) and non-manufacturing (59.5) PMI results got most of the attention, but we find the forward-looking new orders gauges of both more compelling—today's orders are tomorrow's production. Manufacturing new orders hit a robust 64.2, and non-manufacturing new orders rose to 64.8. With levels above 50 signaling expansion, these readings imply broad swathes of industries should continue growing. Meanwhile, The Conference Board's Leading Economic Index (LEI) increased 0.6% m/m in February, with 8 of 10 components contributing positively. The two most consistent and forward-looking—the yield spread and Leading Credit Index—both signal US credit conditions remain favourable and support further economic growth. In its nearly 60-year history no recession has occurred when the LEI is high and rising.

Outlook:

This year's volatility after a long stretch of relative calm seems unsettling, and it is impossible to know when the correction will end, but volatility doesn't alter our forecast. We believe the bull market continues, and we still expect a great year for US stocks. The economic outlook remains bright, gridlocked government is unlikely to change that and sentiment is still far from euphoric, which trade and Tech fears illustrate. A better-than-expected reality helps propel stocks past the correction, sending the bull to greater heights.

Sources: FactSet, S&P 500 total return, "Trump's Long-Awaited Steel and Aluminum Tariffs Are Just the Beginning," Chad P. Brown, Peterson Institute for International Economics, US Bureau of Economic Analysis, US International Trade Commission, US Bureau of Economic Analysis, Board of Governors of the Federal Reserve System, and US Census Bureau, Institute for Supply Management, The Conference Board.

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