OmniStar FINANCIAL GROUP Illuminating The Blind Spots

Market Perspectives

A Glance at How the World Affects You

Tuesday, May 14, 2019

U.S. equity markets fell more than 2% last week, one of the worst weekly performances in 2019. The breakdown in U.S./China trade negotiations, combined with President Trump's announcement of new tariffs, ignited the mild sell-off. However, stocks plunged again on Monday morning amid continuing trade war concerns. China has retaliated with their own tariffs; 5%-25% on some $60 billion of U.S. goods. Investors are also expressing concerns over broader geopolitical tensions which is further dampening sentiment.

What's in focus

1. U.S./China disagreements - The controversial trade issues at the root of the dispute will not be easy to settle. Furthermore, the issues between the two countries go well beyond trade; disagreements over relations with Iran and North Korea, none of which will be easy to resolve. China has more to lose in an all-out trade war than the U.S., but Chinese officials are determined and obstinate which means a speedy resolution is not a likely scenario.

2. U.S./China trade negotiations are expected to continue. Chinese officials announced that further negotiations will be held in Beijing. As of this writing, a time for the next meeting had not been set. In our opinion, the absence of a deal would damage the global economy and a long-term deadlock would likely be imputed for any severe sell-off in equity markets. Both countries recognize that easier trade policies create benefits to all concerned; this should keep the negotiation ball rolling. Nevertheless, implications of a failed intercession would likely include a drag on U.S. GDP and rising inflation.

3. The U.S. economy remains positive. The labor market is strong but slowing manufacturing is worrisome. Historically, weak manufacturing has been associated with lower equity market returns. The good news is that the sector has already recovered from two previous slowdowns in manufacturing in this cycle.

Financial markets are likely to remain choppy as long as the skirmishes continue around trade policy with China. Lest we forget, the imbalance in trade is nothing new and for many years the U.S. has failed to hold China accountable for unfair practices and counterfeiting (knock-off's). These tactics continue to have a tremendous impact on entrepreneurs who take huge risks to create new products and domestic companies have resisted the urge to expand or deploy capital in the face of an unsustainable global trade backdrop. For now, corporate earnings have remained positive and economic growth appears stable, but a sustained trade war could produce enough headwind to unravel the current optimism. Amid all the challenges and possible outcomes, we are confident that China and the U.S. will reach an agreement over the next few months.

As time goes on, greater clarity on trade policy should be forthcoming but financial markets will remain susceptible to intensified volatility as the two economic giants work towards a plausible solution. Anything other than gridlock should have a positive effect on economic sentiment and corporate earnings. All things considered, we think equities and other risk assets will remain under pressure with heightened volatility. In spite of the negative landscape, we find it perfectly reasonable for markets to pull-back after a healthy run that touched fresh highs in recent weeks.

Since the current economic expansion began in late 2009, the economy has grown 38 quarters in a row. We have said it many times in Market Perspectives, economic expansions don't die of old age, rather from problems that emerge as they evolve. GDP data in the first quarter of this year was stronger than we expected, despite a weakened consumer sector. Much of this improvement resulted from the new legislation; tax reduction and the relaxed regulations which make it easier to do business in the U.S.

Looking ahead to 2020, analyst expect a modest recovery from the consumer sector, which is benefiting from a robust employment environment. Another plus is stability in capital investment as tax and interest rates remain low and oil prices have risen year-to-date. The export sector is likely to experience weakness given the recent upward trend in the dollar and growing concerns about tariff threats. For these reasons (and more), our outlook anticipates continued economic expansion for the remainder of 2019 and a moderate slowing in 2020. As we wait for the next round of talks with China, investors should be prepared to navigate through at least the next month (or two) with trade-related disruptions in the markets getting worse before reaching a point of stabilization. In our view, negotiations could take much longer.

In our view, market volatility provides opportunity for long-term investors and increased risk for those who have a shorter horizon. Our investment strategies remain fully invested on the basis that stocks continue to provide greater opportunity relative to bonds. Our investment strategies have always considered dividend growth as a primary tenet for security selection. Dividends grew significantly in 2016 and 2017 but are widely expected to slow over the next two years as the positive effect of tax cuts fade and the stock market recovers from a dismal 2018. Companies that raise their dividends consistently at a double-digit rate are sending off three important signals amid all the recent market volatility: the company's balance sheet is strong enough to pay a dividend; management is focused on providing shareholder returns; and management is confident enough in the near-term outlook to raise the payout aggressively. The third factor is especially important if the economy takes a breather in 2020 and earnings growth slows.

If you have questions about your investment program, please contact us to discuss how your goals and objectives correlate with the way we are managing your assets. Investing should always be viewed as a long-term strategy aimed at achieving your goals and objectives.

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