# Perspectives

JUNE 2019

## Sell in May and Go Away?

**Global equity markets declined in May on a flurry of geopolitical news. As tensions persist, stocks are grasping to sustain their former rocket-like pace.**

Roller coaster trade announcements dominated and, ultimately, overshadowed fairly strong fundamental news and set a sober tone for returns. On May 10th, the United States increased tariffs from 10% to 25% on $200 billion of Chinese imports after trade talks broke down. The increase was initially planned for January 1, 2019, but the U.S. delayed the tariffs in order to see if a resolution could be reached by May 1st. China retaliated on May 13th with an increase in tariffs on $60 billion of American goods, effective June 1st.

Markets were caught off guard by the tariff announcement since it seemed only a few days earlier that the two sides were nearing an agreement. Then things went from bad to worse as the U.S. placed Huawei Technologies, a Chinese telecommunications company, on a blacklist for national security concerns. The blacklist blocks Huawei from purchasing goods from American companies. According to the Financial Times, Huawei purchased $11 billion in components and services from companies like Google, Xilinx, and Seagate last year. Not only were cyclical companies who had previously gained revenues supporting China's growth hurt, but the Technology sector suffered. Apple, which generates 20% of its revenue from China and has hundreds of suppliers in China, declined 13.4% and semi-conductor companies (i.e. chipmakers like Intel) fell 13.7%.

Just when markets thought trade volatility could not get any worse, talks continued to sour and last Thursday (May 30th) President Trump announced that the U.S. would impose 5% tariffs on all Mexican imports beginning June 10th, escalating to 25% on October 1st in an effort to curtail illegal immigration at the U.S.'s southern border. This announcement particularly hurt automakers and auto parts suppliers as well as railroads.

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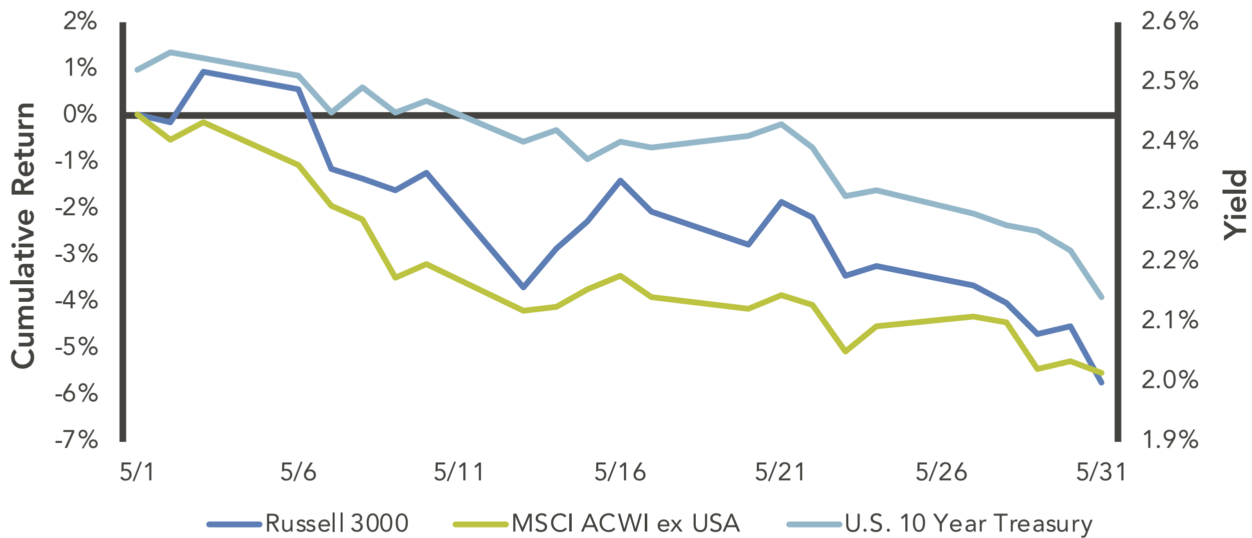
The broad impact of these new tariffs weighed heavily on the markets, as shown below in Exhibit 1. U.S. Equities — as represented by the Russell 3000 index — as well as international equities — illustrated by the MSCI ACWI ex-U.S. index — fell precipitously during the month, down 6.5% and 5.4%, respectively. Not surprisingly, the risk-off environment was beneficial to bonds, with the 10-year Treasury yield falling almost 40 basis points, from 2.51% to 2.14% at month end. Predictably, the equity market drops were good for bonds, as most strategies — not including below investment grade — were positive in May, with core bonds (BarCap Agg) up 1.8%.

**Exhibit 1:** Broad Stock Market Declines and Treasury Yields Fall




Source: Bloomberg

The United States has taken some steps to lessen the blow of these tariffs. First, it has delayed a final decision on whether to impose tariffs on auto imports from the European Union and Japan. Second, the administration reached a deal with Canada and Mexico to end U.S. and retaliatory tariffs on steel and aluminum, which removed a major roadblock in possible passage of the USMCA trade agreement by Congress. However, USMCA still needs to pass through the Mexican and Canadian legislatures to be ratified and the recent tariff announcement clouds its passage.

Although the first three days of equity returns in June would suggest otherwise, timing is not necessarily great for any of these new tariff announcements and helps explain the equity drops in May. Global growth is slowing and geopolitical tensions are seemingly on the rise. While the Street believes that a deal could be reached by the G20 summit in late June, we are more concerned how a prolonged dispute can affect business investment and, eventually, consumer confidence. Just this week, both the Fed and ECB have shown an openness to further stimulus measures to counter slowing growth, most likely in the form of a rate cut before the end of the year, and their decisions bear watching as 2019 plays out. If nothing else, we continue to expect greater volatility which can be tempered by consistent diversification and disciplined rebalancing.

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