August 2018

It is all about Trump

By Alfred Lam, CFA
Senior Vice-President and Chief Investment Officer, Multi-Asset Management

U.S. President Donald Trump has been busy lately, imposing tariffs on imported steel and aluminum for all countries, targeting Chinese imports for punitive tariffs and adding sanctions on Russia, Iran and Syria. The intention of these significant events was to restrict free trade, but they are unintentionally causing prices to rise and harming relationships between countries. Investors initially believed President Trump was bluffing but as he adds more items and countries to his list, many are now convinced this is not the case.

Thus far, the victims have been China, Argentina, Turkey, and to some degree, Canada and Mexico. China has been hit with tariffs on tens of billions of its exports to the United States. China's local stock markets have lost over 20% from this year's peak and its currency, the yuan, has also depreciated against the U.S. dollar. Argentina had a credit and currency crisis that required a bailout by the International Monetary Fund (IMF) with a record $50 billion credit facility. Argentina borrowed significantly in U.S. dollars and was penalized as the loans in its local currency (peso) ballooned as the U.S. dollar appreciated. Turkey has an unsustainable social welfare system and the sanctions have magnified the problem. Investors have lost faith as the Turkish government is ignoring the issues. Its currency, the lira, is depreciating, driving a rapid rise in inflation. The United States, Canada and Mexico have been significant trading partners through the North American Free Trade Agreement (NAFTA) dating back to 1994. A renegotiation was initiated by President Trump over a year ago but no progress has been made. The renegotiation has created some overhang in both the Canadian and Mexican economies, resulting in stagnant stock prices and weak currencies for both countries.

President Trump's lower tax rates for U.S. corporations and citizens was well received, but his trade tariffs appear to have done more harm than good for global economies and stock markets. Restricting trade may bring jobs back to the United States, but it comes at the expense of higher material and production costs and even tighter labour market conditions (from full employment). This is a lose-lose situation, as the world loses productivity and efficiency as a result of de-globalization.

The stock markets are hopeful there may be stimulating forces from central banks and/or governments to counter Trump's actions. There may also be a chance that President Trump will ease the trade sanctions after the mid-term elections if his agenda is to gain popularity. If things get worse before they get better, sovereign bond prices will continue to rise. Countries and companies that are prepared to endure difficult conditions will survive and find a way to be stronger. The days when one tide lifted all boats are ending with rising rates and Trump's policies. However, while the policies are expected to be negative for economies, they could prove to be positive for stock selection.

Our team and partners have also been busy during this period. The strong U.S. dollar is likely unsustainable and we are managing our exposure via hedging. Emerging markets have been volatile in terms of stock markets and currencies. Some of our portfolio management teams have been defensive by holding larger amounts of cash and avoiding the troubled constituent countries. The downside protection we bought earlier this year has not yet added value as market volatility has been benign. However, our cost has been lower than expected as a result of profit taking earlier this year. We have also been researching new ideas and have been meeting with various portfolio management teams. We expect to implement more enhancements in the fall and will provide an update soon.

Combined top 15 equity holdings as of July 31, 2018 of the Evolution 40i60e Standard portfolio with Alpha-style exposure:

1. AltaGas	6. Alphabet Class A	11. E-L Financial
2. SNC-Lavalin	7. Canadian Pacific Railway	12. Industrial Alliance
3. Atco	8. Toronto-Dominion Bank	13. Apple
4. Gilead Sciences	9. CSX	14. Bank of Nova Scotia
5. Canadian Natural Resources	10. Microsoft	15. Canadian National Railway