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Trade tensions continue to jolt market; expect no respite

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Investors suffered in August from sharp moves in stock prices, as our nation's trade dispute with China and an inverted yield curve took stocks on a wild ride.

The S&P posted 11 moves of more than 1 percent in only 22 trading sessions for August. The declines included three sessions of at least 2.6 percent as well as the worst day of the year on Aug. 5.

The CBOE Volatility Index, considered to be the best gauge of fear on Wall Street, traded as high as 24.81 in August, before pulling back to around 18.

The increasing volatility was largely due to U.S.-China trade relations and a recession signal being flashed by the bond market.

August began with President Trump tweeting that he would place an additional 10 percent tariff on $300 billion in Chinese imports starting Sept. 1. The announcement wiped out the gain of more than 1 percent on the day, and the S&P finished down 0.9 percent that day.

On Aug. 5, Trump accused China of currency manipulation, and the S&P dropped nearly 3 percent.

Trade tensions escalated when the Chinese announced new tariffs on $75 billion of U.S. products. Trump responded by ordering U.S. firms to leave China and announced higher tariffs.

Overall the market lost nearly 2 percent in August – its worst month since May, when it dropped 6.6 percent.

Energy and financial stocks were the worst performers. Technology stocks suffered too.

Don't expect much improvement in September, which since 1950 has been the worst month for the market. According to the Stock Trader's Almanac, the S&P suffers an average loss of 0.5 percent for the month.

The meeting of the Federal Open Market Committee in September might serve as a wild card. The market now believes the Fed will cut interest rates by 25 basis points.

The trade war has no recent historical precedent, as the trend for tariffs had been down for 200 years. The trade war has driven the U.S. and China apart, economically and politically – not a good sign for either country or for the world.

Since President Trump took office, average tariffs on Chinese goods have surged from only 3.1 percent to 21.2 percent. Worse, there doesn't seem to be any path to reverse this trend. American companies thought that the trade war was a passing phenomenon, but are now realizing that it is lasting. Historically it has proven difficult to lower tariffs once they are imposed.

Initially what was billed as an effort to improve trading conditions has now reached a point where the president refers to China as an enemy. There seems no way back. The administration seems to have a dual goal of making China a fairer place for U.S. companies, while punishing companies that do business there. The conflicting goals are obvious. What started as an effort to bring China to the bargaining table to produce a better trading relationship, now seems beside the point. There will be pointless casualties.

Notwithstanding the trade war, the U.S. economic outlook is healthy, according to key economic indicators. The gross domestic product growth rate is expected to remain 2-3 percent – an ideal range. Unemployment is forecast to come in at an acceptable rate. There is not much inflation or deflation – in other words, the definition of a Goldilocks economy. Surely the GDP growth rate is slowing and the unemployment rate is slowly rising, but not too much. Inflation will rise slowly, but not too much.

The result is subdued economic growth with a recession unlikely. The best thing to do is stay focused on the long term with a diversified portfolio of investments.

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