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Investment Insights

The state of global trade tariffs in 6 charts

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FOR PROFESSIONAL INVESTORS ONLY

Global trade tensions are on the rise. And while much of the attention has centered on a series of retaliatory tariffs between the United States and China, trade disputes with European and North American allies also have strained traditionally friendly relationships.

Investors should avoid putting too much emphasis on the short-term noise of daily trade rhetoric, but the eventual outcome likely will have economic, investment and political implications across the globe. To provide guidance on a complicated and rapidly changing situation, Capital Group's investment team selected six charts that highlight a key takeaway for the current state of global trade.

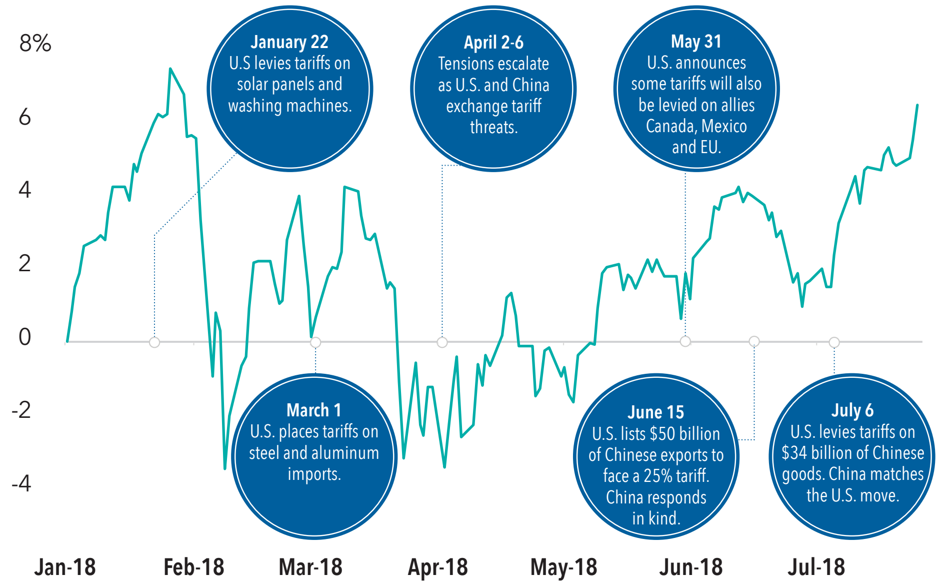
Concerns over a possible trade war with China have unsettled markets.

Markets were calm in 2017, but that changed early this year. With equity valuations near historic highs, external factors are having a greater influence in unsettling markets. And while regulatory scrutiny of tech companies and threats of higher inflation also have contributed to market jitters, the looming shadow of global trade has overshadowed most other issues.

Matt Miller

Political Economist
Based in Los Angeles
32 years of investment experience
(as at 31 December 2017)

S&P 500 Index cumulative total return



Past results are not a guarantee of future results.

Source: RIMES. As of 25/7/18.

The initial announcement of U.S. tariffs – on solar panels and washing machines in late January – preceded the country's first market correction since 2016. Since then, equities often have moved in step with global trade headlines. Markets bounced around wildly when the first week of April saw a volley of escalating threats between the U.S. and China. As trade talk diminished, investors felt more comfortable returning to riskier assets. Markets drifted upward until late June, when the U.S. threatened $200 billion in tariffs on Chinese goods and sent markets downward once again.

The situation remains in flux. In just the last week, the U.S. went from suggesting automobile tariffs could be on the way to issuing a joint statement with the European Commission chief announcing an intention to work toward "zero tariffs, zero non-tariff barriers, and zero subsidies."

So far, it's more talk than action.

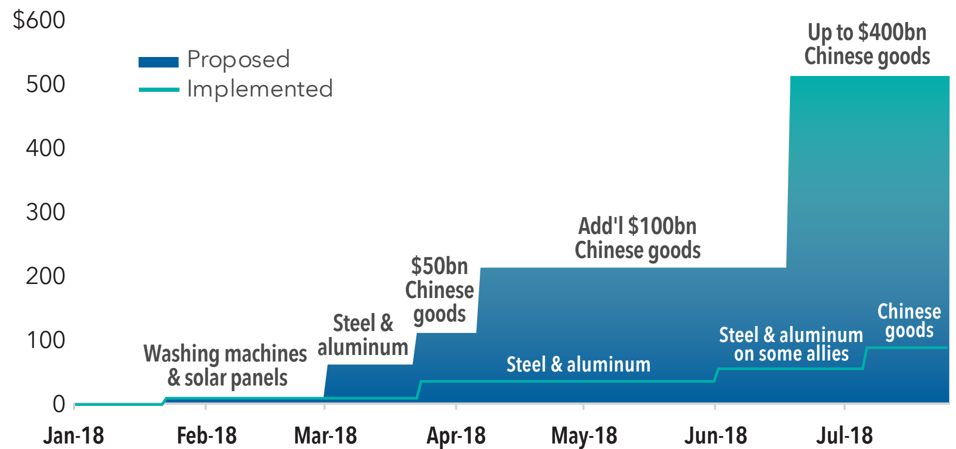
Much of the volatility has been a result of investors trying to interpret to what extent the threats would come to fruition. So far it has been a small portion, although the situation remains fluid. Recently the U.S. threatened tariffs on an additional $400 billion of Chinese exports – a figure that far exceeds China's imports from the U.S. Capital Group political economist Matt Miller believes this imbalance raises the risk that Beijing will retaliate with non tariff measures, such as consumer boycotts or heightened enforcement of regulations on American businesses operating in China.

"Even as the battle heats up, one shouldn't assume that President Trump's unusual and aggressive negotiating style is a prelude to an all-out trade war, which would hurt both sides," Miller said. "As each side feels the other out and tests the other's mettle and ultimate goals, it seems likely that we're in for an unsettling period of tit for tat that may rattle markets and companies caught in the crossfire."

Rob Lovelace

Equity Portfolio Manager
and Vice Chairman of Capital Group
Based in Los Angeles
32 years of investment experience
(as at 31 December 2017)

Cumulative U.S. imports subject to tariffs (billions)



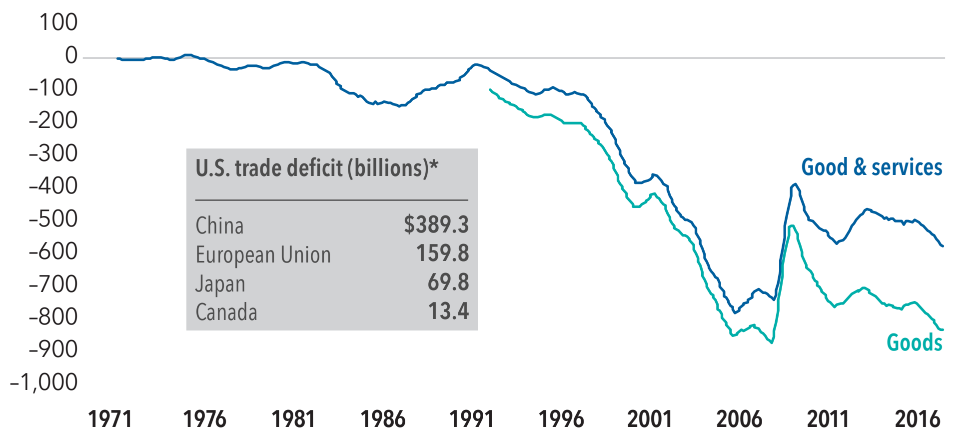
For illustrative purposes only.

Sources: Capital Group, Goldman Sachs Global Investment Research, U.S. International Trade Commission. As of 25/7/18. Implemented tariff amounts are estimates.

Tipping point: U.S. trade imbalances have deteriorated for years.

The U.S. trade deficit has increased dramatically over the last 25 years, prompting the new administration to try to reverse the trend. Capital Group Vice Chairman and portfolio manager Rob Lovelace noted this approach has been a long time coming.

U.S. trade balance (USD billions, rolling 12 months)



U.S. trade deficit (billions)*	
China	$389.3
European Union	159.8
Japan	69.8
Canada	13.4

Sources: Thomson Reuters, U.S. Census Bureau. As of 31/5/18. Data series for goods as an isolated category began in 1992. *Trade deficit table only includes goods.

"President Trump has talked about his issues with trade deficits for decades," Lovelace said. "It features in many of his public comments throughout his business career. He has stated the U.S. needs better balance in trade accounts with all other countries. In line with this view, the administration wants a dramatically reduced trade deficit in physical goods."

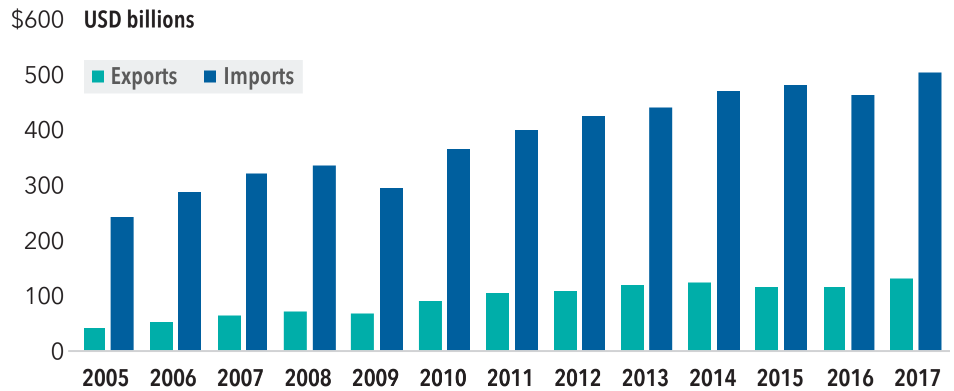
Steve Watson

Equity Portfolio Manager
Based in Hong Kong
30 years of investment experience
(as at 31 December 2017)

China is in the spotlight after reaching record trade deficit.

Although Trump would like to reduce the deficit with all countries, his biggest target has been China. The U.S. trade deficit with China was $376 billion in 2017, with exports at $130 billion and imports at $506 billion. In addition to tariffs, the administration has considered blocking Chinese firms from buying U.S. companies with industrially significant technology. But even then, it backtracked on some of the toughest restrictions initially proposed.

U.S. trade with China



Sources: Thomson Reuters, U.S. Census Bureau. Trade figures exclude Hong Kong and Macau.

Hong Kong-based portfolio manager Steve Watson noted that although risks have increased, he remains optimistic about the future of Chinese stocks. "If I step back and consider the long-term outlook, I remain enthusiastic about China from an investment perspective," Watson said. "I think China's economy will continue to grow at a healthy pace, and we should be able to find attractive investment opportunities there for many years to come."

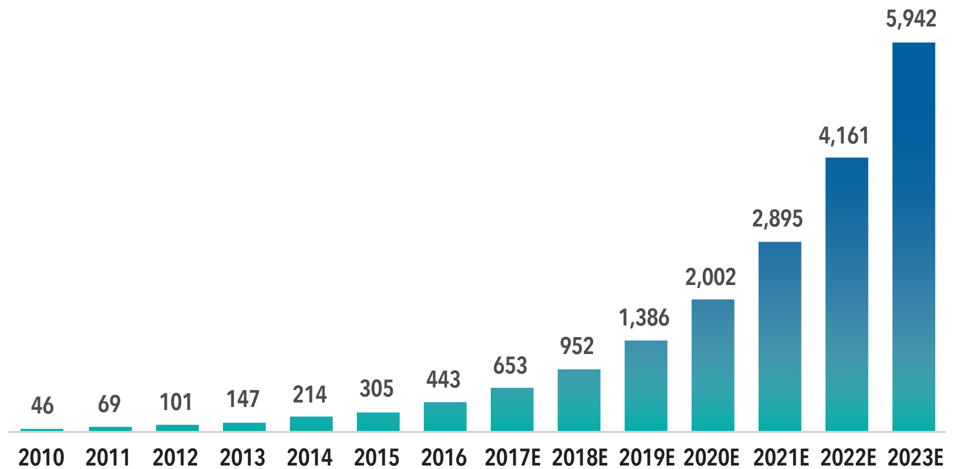
Digital trade is skyrocketing – and tariffs shouldn't stop that.

Most of the uncertainty has centered on the trade of physical goods. A possible silver lining is that an increasing share of transactions now involves digital assets and ideas rather than tangible products. Cross-border digital traffic surged in the last decade and its growth is projected to accelerate over the next several years. Many aspects of the digital economy cannot be easily dictated by governments, so the impact of trade negotiations is likely to be less severe for technology companies than manufacturers.

Jody Jonsson

Equity Portfolio Manager
Based in Los Angeles
29 years of investment experience
(as at 31 December 2017)

Global cross-border bandwidth (terabits per second)



For illustrative purposes only.

Source: TeleGeography, Global Bandwidth Forecast Service.

Despite the uncertainty, investors should still think globally.

Over the past several years, the rise of globalization has supported corporate growth and investment returns. And that doesn't need to change now. Despite the potential headwinds, many of our investment professionals still find global exposure a good long-term strategy.

Exposure to China's economy has boosted returns for global companies

Past results are not a guarantee of future results.

Sources: MSCI, RIMES as of 25/7/18.

"Of course, not all global companies will thrive in this environment," said portfolio manager Jody Jonsson. "Fundamental research will be key to identifying potential winners. Having invested in global companies for nearly three decades, I have found that successful multinational companies typically have innovative management teams, diverse sources of revenue and resilient balance sheets. These are the attributes I will be looking for as globalization enters a new era."

Rob Lovelace agrees. "Shifts in economic and trade regimes and turning points in markets provide managers like us the opportunity to capitalize on short-term distortions in asset prices and to invest in companies that we view to be winners in the long term," he said.

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- **This material is not intended to provide investment advice or be considered a personal recommendation.**
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- **If the currency in which you invest strengthens against the currency in which the underlying investments of the fund are made, the value of your investment will decrease.**
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