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WILL A TRADE WAR DERAIL THE ECONOMY?

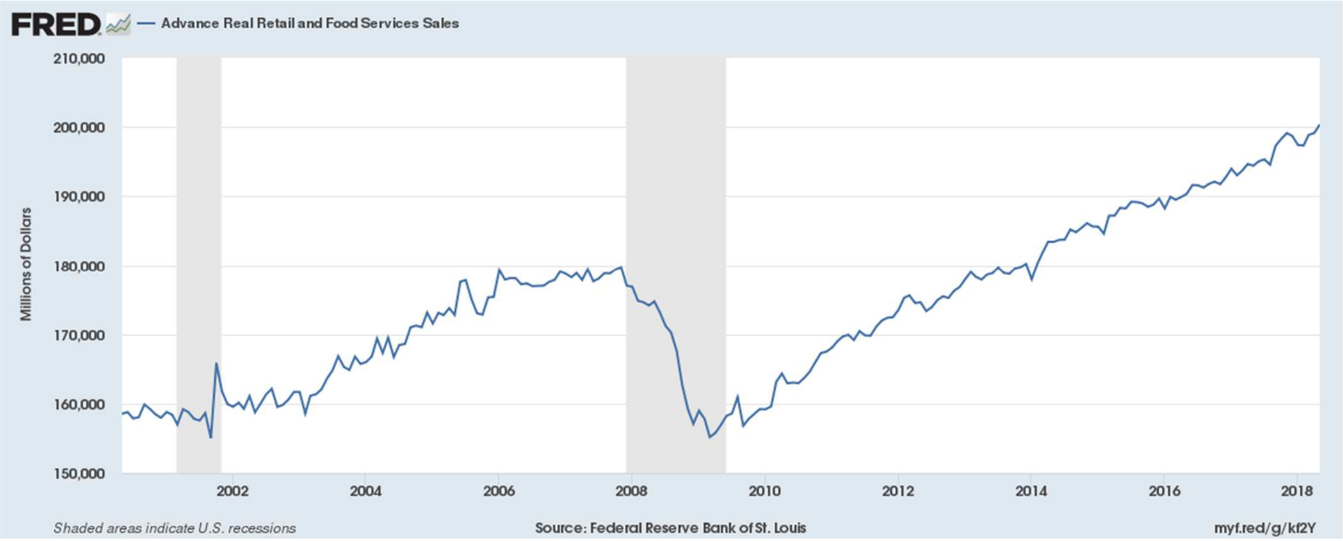
SUMMARY

- The positive data from MACROCAST™ surged higher in June. Real retail sales reached a new all-time high in May, and initial claims for unemployment remain at historic lows.
- Concerns remain. The prospect of an escalating trade war would likely be a negative for the US economy. Slower growth in the economy could leak to the stock market. For now, it remains to be seen if a full-blown trade war actually happens, and even then, the impact is unclear. One major offsetting factor could be the tax cuts enacted late last year, in addition to the spending increases Congress passed in March.
- Summer in the Northern Hemisphere began with the solstice on June 21. When the market has been up at least 3% for the year heading into the summer solstice, returns the rest of the year were better than average.

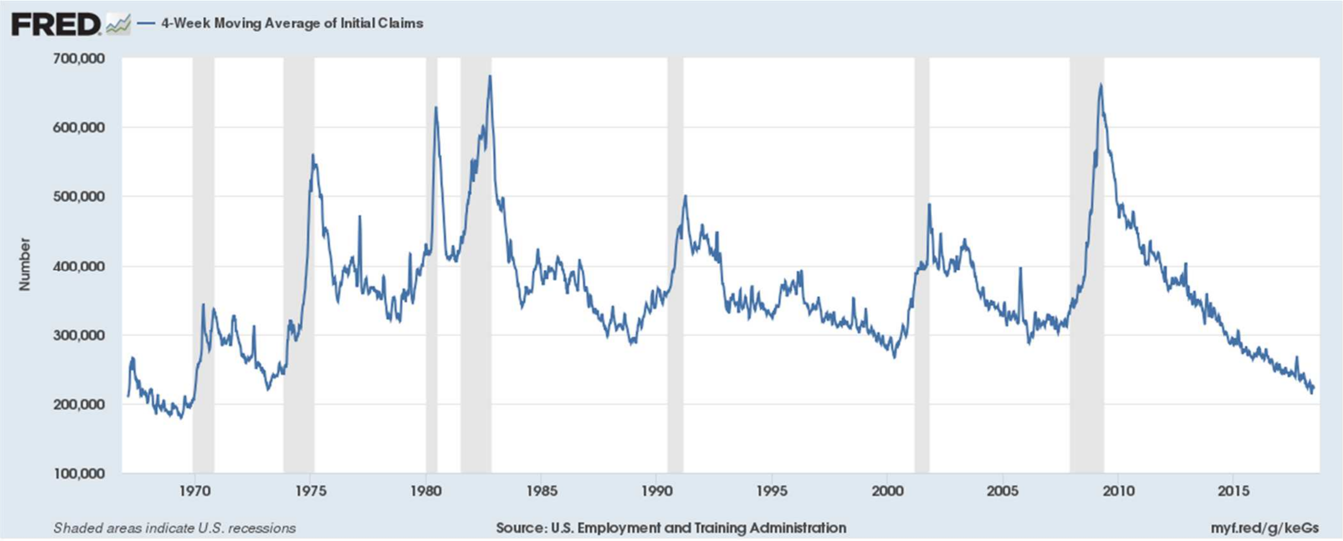
A STRONG ECONOMY WITH LITTLE SIGN OF RECESSION

With thousands of economic indicators to look at, one can easily find data points that suggest the economy is strong, weak, or neutral. Our process focuses on the ones that we feel have the biggest impact and really move the needle in terms of economic impact. Retail sales and employment data are two of those key indicators.

After a slight dip late last year, real retail sales reached a new all-time high in May, growing 3.1% year over year:



Meanwhile, employment data is still solid. Initial claims for unemployment are near historic lows:



The only time claims have been lower was in the late 1960s, when the working age population was much smaller than today.

In almost all cases, both real retail sales and initial claims weaken ahead of a recession. Based on the latest data points, neither indicator has started to turn negative, and recession in the next 6-12 months is unlikely.

WHAT ABOUT A TRADE WAR?

The ongoing trade dispute between the United States and its major trading partners continues. This summary from Merrill Lynch, via the Calculated Risk blog sums up the latest happenings:

Early this week, trade tensions ratcheted up another notch. President Trump announced that he has directed the US Trade Representative to prepare another round of tariffs on $200bn in Chinese imports at a tax rate of 10%. This comes after China announced that it would retaliate dollar for dollar against the initial round of tariffs that are set to go into effect on July 6. While the actual amount of tariffs that have been imposed by the US to date remain modest at just over $100bn worth of goods imports (only 4.2% of total goods imports), the latest announcement shows that trade tensions are likely to get worse before it gets better. Although we remain of the view that the likelihood of a full blown global trade war remains low, below we try to put some numbers on how a major trade confrontation could potentially impact the US economy….The good news is that we are still many steps away from a full blown global trade war. The bad news is that the tail risks are rising and our work and the literature suggest a major global trade confrontation would likely push the US and the rest of the world to the brink of a recession. So far, the trade actions taken by the Trump White House and trading partners have been relatively modest and in turn have had a limited impact on the economy and financial markets. The next round of $100-$200bn of tariff between US and China may prove more substantial. Further escalation like auto tariffs would lead us to reassess the US economic outlook.

For the most part, we agree with this assessment. What we've seen so far is not enough to damage the large and dynamic US economy. That said, any escalation will not be positive for anyone involved.

Whether or not a trade war by itself would cause a recession remains to be seen. The tax cuts passed last year, and the spending bill passed in the spring offered stimulus to an economy already running at full speed. It is possible that any trade war could be offset by the fiscal stimulus. Furthermore, the potential damage from tariffs could cause the Fed to "hit the brake" on rate hikes, or even cut rates, if necessary.

To be clear, we do not believe a trade war would be a good thing for the economy. If the economy deteriorates, we will analyze the potential impact through MACROCAST™ and act accordingly.

UP 3% HEADING INTO SUMMER HAS BEEN A POSTIVE SIGN

The market is positive this year, but its performance so far is by no means exceptional. The S&P 500 is up 3.5% through June 20. Still, the numbers suggest more upside for the rest of 2018, based on historical patterns.

LPL financial looked at all of the years the S&P was up at least 3% heading into summer. The results were encouraging, with a median gain of 8% for the rest of the year:

THIS MAY BODE WELL FOR THE REMAINDER OF 2018

S&P 500 Up >3% Year-To-Date Heading into Summer Solstice			
Year	YTD Return	S&P 500 Return Rest of Year	S&P 500 Return Full Year
1951	7.2%	8.5%	16.3%
1952	3.4%	8.1%	11.8%
1954	17.0%	23.9%	45.0%
1955	11.6%	13.3%	26.4%
1958	12.2%	23.1%	38.1%
1959	3.5%	4.8%	8.5%
1961	12.1%	9.8%	23.1%
1963	11.0%	7.2%	18.9%
1964	7.8%	4.8%	13.0%
1967	15.1%	4.3%	20.1%
1968	4.2%	3.3%	7.7%
1971	7.4%	3.0%	10.8%
1972	6.3%	8.7%	15.8%
1975	35.1%	-2.6%	31.5%
1976	15.0%	3.6%	19.1%
1979	5.7%	6.2%	12.3%
1980	5.7%	19.0%	25.8%
1983	20.2%	-2.4%	17.3%
1985	11.6%	13.2%	26.3%
1986	17.2%	-2.2%	14.6%
1987	26.8%	-19.5%	2.0%
1988	8.8%	3.3%	12.4%
1989	15.7%	10.0%	27.3%
1991	13.4%	11.2%	26.3%
1995	18.7%	13.0%	34.1%
1996	7.5%	11.9%	20.3%
1997	21.3%	8.0%	31.0%
1998	13.4%	11.7%	26.7%
1999	9.2%	9.4%	19.5%
2003	13.2%	11.7%	26.4%
2007	6.7%	-2.9%	3.5%
2012	7.8%	5.2%	13.4%
2013	11.4%	16.4%	29.6%
2014	6.2%	4.9%	11.4%
2017	8.9%	9.7%	19.4%
2018	3.5%	?	?
	Average	7.5%	20.2%
	Median	8.1%	19.4%
	% Positive	85.7%	100.0%

	Average Year (1950–2017)	
Average	4.3%	9.1%
Median	5.2%	11.6%
% Positive	70.6%	72.1%

Source: LPL Research, FactSet 06/20/18

Please see important disclosures at the end of this article

The most positive development was that if the market was up at least 3%, the full calendar year finished in the green. Should that occur in 2018, it means that the S&P 500 Total Return Index will have increased 10 years in a row. This is something that has never happened before.

Based on the current MACROCAST^{TM} score and positive market momentum, we believe that there is a strong chance that happens.