Protectionism Rattles Markets: Should You Head for the Exits?

Description

Indexes in the United States and Canada were battered on June 25. The Dow and S&P 500 fell 1.33% and 1.37%, respectively, while the NASDAQ dropped 2.09%. The S&P/TSX Composite Index plunged 266 points on the same day.

The spectre of economic nationalism and protectionism loomed large in 2017, but for the most part, the Trump administration pursued a conventional Republican platform of tax cuts and deregulation. This year has been a different story, as President Trump has allowed his protectionist impulses to direct policy and put into power staff that are in tune with this worldview. This has resulted in prickly diplomacy and a volatile stock market.

NAFTA negotiations appeared to be moving in the right direction in early spring, but talks deteriorated as auto content remained a sticking point. The U.S. followed that up by imposing tariffs of up to 25% on steel and aluminum imports from the European Union, Canada, and Japan. It has also moved forward in its trade dispute with China and will impose tariffs of $50 billion worth of Chinese goods in July. The administration has threatened to impose an additional $200 billion in tariffs if China moves forward with its threat to retaliate.

Stelco Holdings Inc. (TSX:STLC) stock has felt the pinch from steel tariffs in recent weeks. Shares are down almost 1% month over month as of close on June 25. This is unfortunate considering the positive results the company posted in successive earnings.

There is also the threat of another bout of tariffs on Canadian autos. President Trump has ordered a review, which is set to conclude later this summer. Some experts estimate that we could see auto tariffs imposed by the late summer or early fall. This could hurt automotive parts manufacturers like **Magna International Inc.** (TSX:MG)(NYSE:MGA), which saw its stock fall 2.3% on June 25.

Back in April, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) CEO Bharat Masrani voiced concerns that trade tensions could eventually trigger a recession. Over the past few weeks, central bankers have also warned that the imposition of tariffs and retaliatory tariffs could hinder global trade.

In the summer of 2017, Ray Dalio, the billionaire founder of Bridgewater Associates, predicted that politics would play a greater role in affecting markets

. It has been almost a year since Dalio published his warning, and it has proven to be prescient. More concerning are the implications of rising protectionism and geopolitical conflict.

The exacerbation of trade tensions between the largest economies in the world does not bode well for global growth going forward. Stock markets in the developed world have erupted since the 2007-2008 financial crisis, but from a historical perspective the recovery has been relatively weak. This has also forced central banks to move back plans to raise rates that have remained around historic lows since the global recession.

Should investors retreat to the sidelines?

Investor anxiety is understandable, as trade tensions have heightened, but capitulation is not warranted at this stage. Two significant elections — the federal election in Mexico, and the November midterms in the United States — could lead to progress on North American trade. Add to that the increased urgency on the Republican side to go into the midterms on a positive note, and I expect that we will see positive steps taken this summer.

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3. TSX:MG (Magna International Inc.)
4. TSX:STLC (Stelco Holdings Inc.)
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