SPECIAL COMMENTARY

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Geopolitical Uncertainty

and Portfolio Implications

For over three years financial markets have been rattled by geopolitical events that remain unresolved. Brexit, the United Kingdom's referendum to leave the European Union in the summer of 2016, has been held in gridlock as the British government has been unable to agree on an exit plan. The U.S. – China trade war, started in the winter of 2018, has escalated and is the source of global economic and business uncertainty. While both issues are far from resolution, financial markets appear to trade on every headline.

Brexit

On June 23, 2016, the UK held a referendum on its membership with the EU and a majority (51.9%) voted to leave the European Union. The referendum initially caused volatility in financial markets with the S&P 500 falling -3.59% and the MSCI EAFE down -7.10%[1] the day following the referendum. In the years following the vote, Brexit has had a smaller impact as investors weighed the probability and potential timeline of the United Kingdom leaving the European Union. While originally scheduled to leave the EU on March 29, 2019, the House of Commons voted on extending Article 50 (the right of any European Union member state to leave the EU) and delaying Brexit. After several meetings with EU council, the new Brexit date was pushed back to October 31, 2019. Days before October 31, the EU approved UK's request for a Brexit "flextension" until January 31, 2020. The flextension refers to the option that allows the UK to leave the EU before the deadline if Parliament approves a deal,[2] but the path to a resolution remains unclear.

U.S.– China Trade War

In 2018 the U.S. had $179.3 billion in exports, $557.9 billion in imports, and a trade deficit with China of $378.6 billion.[3] The U.S. – China trade war began in January of 2018. Since then the U.S. has placed tariffs on billions of dollars in goods from China, including a 25% tariff on $34 billion in July 2018, a 25% tariff on $16 billion in August 2018, 25% tariff on $200 billion in May 2019, 15% tariff on $125 billion in September 2019, and further plans to increase tariffs in October and December 2019 (though the October tariffs were not imposed). Financial markets didn't initially react when the U.S. imposed tariffs on China. For instance, on April 3, 2018, when the Trump Administration released plans for 25% tariffs on Chinese imports, the S&P 500 rose 1.26%[4]. However, as trade tensions have increased, markets have reacted negatively. In August, when China announced retaliatory tariffs against the U.S., and the Trump administration reacted with further rounds of tariffs, the S&P 500 fell -2.6%[5]. As more time passes without a trade deal, expectations for an outcome to the trade war appear to have changed; at the onset, tariffs enacted by either the U.S. or China did not appear to hold much weight, as most did not anticipate a drawn-out negotiation. While the world's two largest economies have gone back and forth, the global economy has grown at its slowest rate since the Great Recession, and the IMF has cited "trade-related uncertainties" as posing the biggest risk to the global economy.[6] The global economic slowdown has affected countries across the world, including the U.S. Before they begin spending again, businesses want to see a resolution and confirmation that future tariffs won't be enacted. The U.S. still has plans to impose a 15% tariff on $160 billion of consumer goods in December, although a small one-phase deal with China is now in place.

As we position ourselves for the end of 2019 looking forward into 2020, we expect more volatility surrounding Brexit and ongoing negotiations between the U.S. and China. Brexit remains in limbo as the British government tackles negotiations within Parliament and between the UK and EU over divorce proceedings. The U.S. – China trade war has simmered down in recent months with a preliminary deal in place; however, we believe that a full deal will need to be completed so that businesses can have clarity before they start to spend more and plan ahead. With an upcoming presidential election in 2020, we remain cautiously optimistic that a deal could get done but acknowledge that there will be volatility along the way. Though there are causes for concern that the election cycle may add to the already high level of uncertainty among market participants, it is important to note that dating back to 1928, there have only been four election years where the S&P has been negative.[7] As these issues linger, we continue to maintain an underweight to international and emerging market equities and remain neutral on our overall equity allocation. We maintain a conservative positioning within fixed income and liquid alternatives that should allow us to both mitigate down markets and participate on the upside.

REFERENCES

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