



## Listen when people tell you who they are

I underestimated the chances of an escalating tariff war given the problems it creates for US businesses<sup>1</sup>, for the stock market<sup>2</sup>, for Republicans in the Senate who object to them<sup>3</sup>, for some of Trump's closest advisors<sup>4</sup> and for the President's 2020 political ambitions. Turns out the President is willing to risk all of that, at least for now. As far back as the 1980's and again in 2011, Donald Trump was telling people that if he were President, he would take in "hundreds of billions in tariffs from countries that are screwing us", and that he would start with a 25% tariff on China<sup>5</sup>. **Trump has been telling us who he is all along**; I should have listened to him. Perhaps some tariffs will be negotiated down after the June G20 meetings in Japan, or blocked by Congress; or perhaps the Fed will ease. If either occurs, equities should snap back a few percent after the recent decline. Even so, the US equity market does not deserve 17x or 18x P/E multiples any more, not with the President willing to go against market orthodoxies so readily. A 7%-9% return from today's S&P 500 level by year-end is now our optimistic "trade war resolved" outlook, with downside risk possible depending on what the President says/does as well as from the tech anti-trust issue<sup>6</sup>.

**Many of the world's leading indicators are weakening as the trade war which began in early 2018 takes its toll.** On the next 4 pages, I have included charts on:

- slowing global and US economic trends, declining US-China trade and falling equity valuations
- Trump's proposed tariffs, which if implemented, would approach pre-WWII levels<sup>7</sup>
- how the US is more exposed to China retaliation than the White House may believe
- how tariffs are already negatively affecting US consumption and employment
- asylum and border apprehension trends which led to proposed US tariffs on Mexico
- US fertility/replacement rates which highlight the importance of immigration for growth/productivity

I didn't include any text on these pages; the charts speak for themselves, and just like Trump and a former household pet<sup>8</sup>, we should listen to them.

Michael Cembalest, JP Morgan Asset Management

<sup>1</sup> **The "Own Goals" of US tariffs:** 2/3 of US imports from Mexico are sourced from companies in which the US owns at least 10%. Similarly, a study from the Peterson Institute found that Section 301 tariffs on China mostly impact US and other non-Chinese subsidiaries operating there, rather than Chinese companies (see chart on p.4).

<sup>2</sup> The S&P 500 just had its **second-worst May** since the 1960's, falling 6.6%.

<sup>3</sup> **Senate GOP objectors** to the Mexico tariffs include Portman (R-OH), Kennedy (R-LA), Grassley (R-IA), Ernst (R-IA), Toomey (R-PA) and Cornyn (R-TX). The CEO of the National Association of Manufacturers said that intertwining immigration and trade objections with tariffs "creates a Molotov cocktail of policy."

<sup>4</sup> **Stephen Moore** (Trump's aborted Fed nominee) and **Larry Kudlow** (National Economic Council) wrote an article in 2015 called "*Why Trump's protectionist ways will hurt the economy*", and are presumably against the tariff war. I use lots of lively metaphors in client discussions when describing the transition from Cohn to Kudlow.

<sup>5</sup> From Trump's speech to the **Conservative Political Action Conference** in DC. CNN Money, February 10, 2011.

<sup>6</sup> **Tech anti-trust.** In the 1970's and 1980's, economists and legal scholars from the "Chicago School" helped shape a new Supreme Court/FTC approach to anti-trust based not on "**overall market dominance**", but on "**consumer welfare**" instead (i.e., price levels). Under the latter approach, today's tech titans may obliterate their competition but are not violating anti-trust rules since they improve consumer welfare via lower prices. A shift back to the former approach could spell trouble for big tech since it would re-establish the importance of a competitive market structure that deters predatory conduct, irrespective of price levels. The May 2019 California District Court ruling upholding the FTC's anti-trust judgment against **Qualcomm** is one of several recent steps in this direction in the US and Europe.

<sup>7</sup> Trump's immigration policy is another similarity with **President Hoover**, who oversaw deportations of at least 300,000 - 400,000 Mexicans and Mexican-Americans from 1929 to 1936. However, US unemployment ranged from 10% to 20% in the 1930's when Hoover's repatriation programs were enacted, compared to 3.5% today.

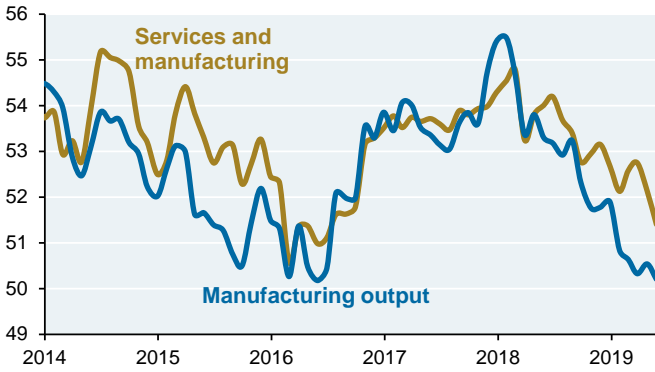
<sup>8</sup> In 1971, we had a cat named **Spiro**, who my father named after Vice President Agnew given the cat's very unpleasant and sometimes angry disposition. We tried various things to alter its personality, and kept believing that it would change. It didn't, and after it attacked an **insurance salesman**, we finally accepted that Spiro just didn't like people and had him quarantined. Through his behavior, Spiro was telling us who he was all along.



**Current and leading indicators of global, Chinese and US economic and trade activity**

**Trade War taking its toll (Part 1)**

Global activity surveys through May 2019



Source: Markit. 2019.

**Trade War taking its toll (Part 2)**

Global activity surveys through May 2019



Source: Markit. 2019.

**Trade War taking its toll (Part 3)**

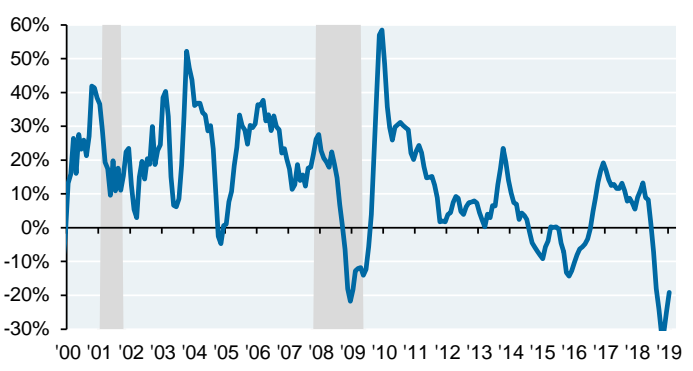
World merchandise trade volume through March 2019



Source: CPB. 2019. Index, 2010 average = 100

**US exports to China**

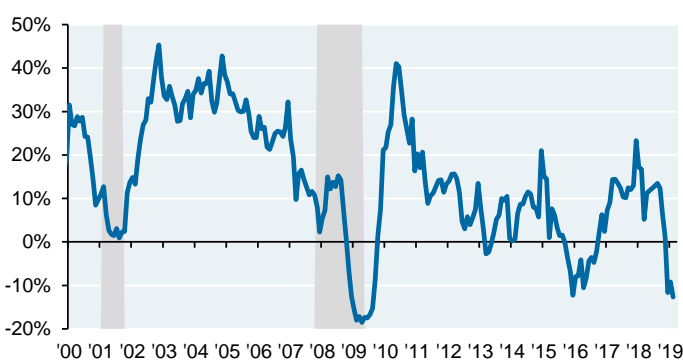
y/y %, 3 months moving average



Source: Census Bureau. 2019. Grey bars indicate US recessions.

**China's exports to the US**

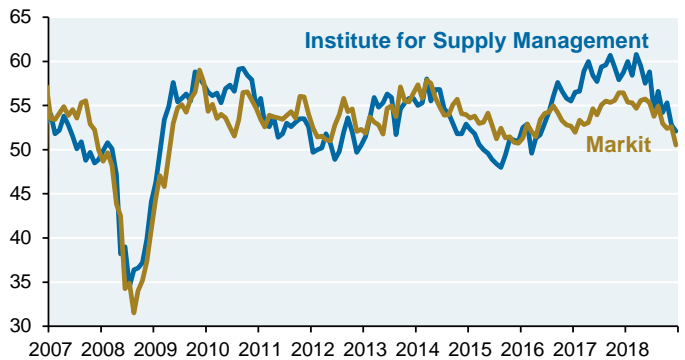
y/y %, 3 months moving average



Source: China Customs. 2019. Grey bars indicate US recessions.

**Two different US manufacturing surveys**

Business survey level through May 2019, 50+ = expansion

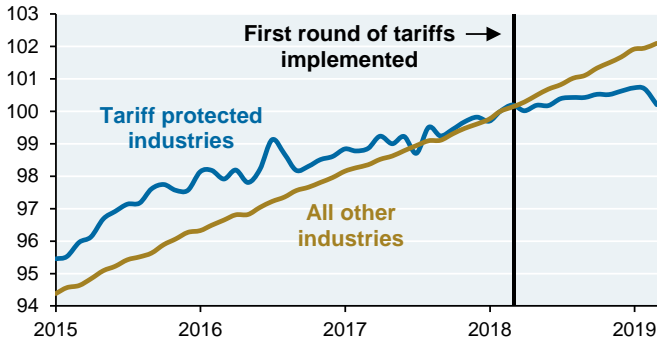


Source: Markit, ISM. 2019.



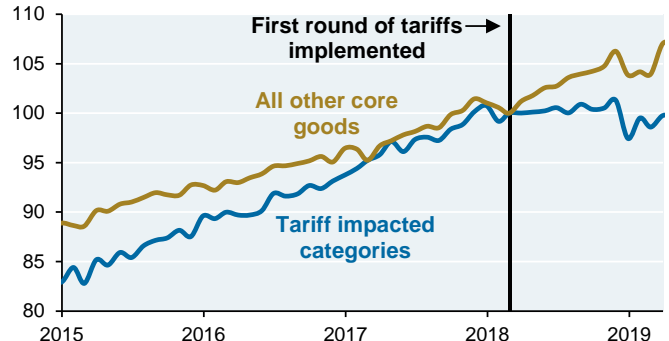
# Impact of tariffs on US consumption and employment; global semiconductor trends; US auto delinquencies; and global equity valuations

## US employment actually weaker in tariff-protected industries, Index, Feb 2018 = 100



Source: BLS, Mar '19. Tariffed industries = household appliances, furnitures, auto parts, aluminum products, steel products, electronic connectors.

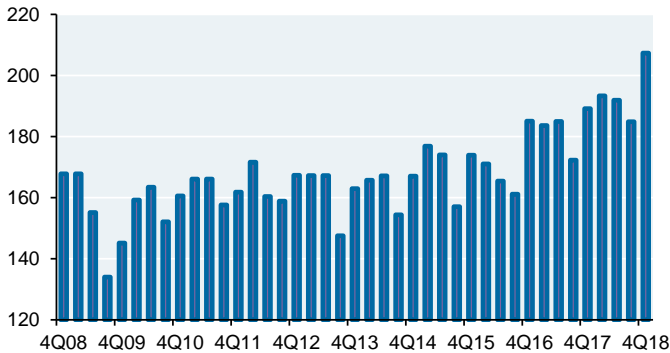
## Real consumer spending weaker in tariffed goods Index, Feb 2018 = 100



Source: BEA, Apr '19. Tariffed goods = housekeeping supplies, furniture, floor coverings, major appliances, sewing machines, sports vehicles, auto parts.

## Days of global semiconductor inventory growing

Supply chain measured across producers, distributors and customers



Source: Morgan Stanley Research. 2019

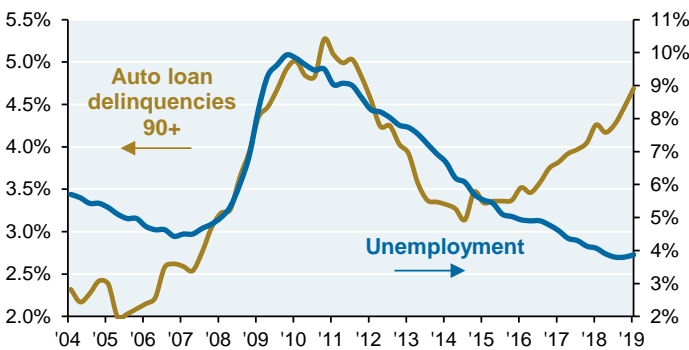
## Global semiconductor sales

3 month moving average, US\$ billions



Source: Semiconductor industry association. March 2019.

## Why are auto loan delinquencies rising at an all-time low in unemployment?



Source: Fed, Bloomberg. March 2019.

## Equity valuation percentiles

12 month forward P/E percentile vs history by market

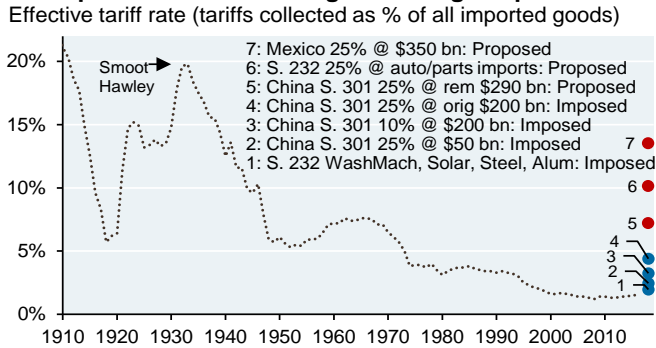


Source: Bloomberg, Datastream. June 3, 2019.



## Trump tariff scenarios; the "own goal" of US tariffs on China; tariff growth/inflation impacts; US corporate exposure to Chinese retaliation<sup>9</sup>; and a measure of Chinese mercantilism

### US tariff history and projections assuming no change in US import demand from targeted foreign exporters

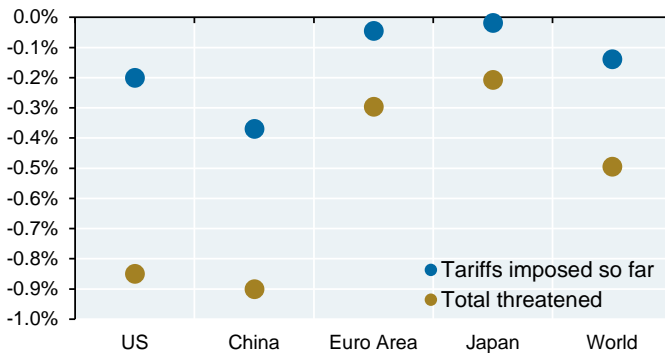


Source: Esteban Ortiz-Ospina and Max Roser "International Trade", US International Trade Commission, USITC, US Census, JPMAM. May 2019.

The "own goal" of US Section 301 tariffs on China Most of them actually affect non-Chinese companies			
Industry	NAICS code	Exported to the US by:	
		US and other non-Chinese companies located there	Chinese companies
Chemicals	325	15%	85%
Machinery	333	59%	41%
Computers	334	86%	14%
Electrical equipment	335	63%	37%
Misc. manufacturing	339	68%	32%

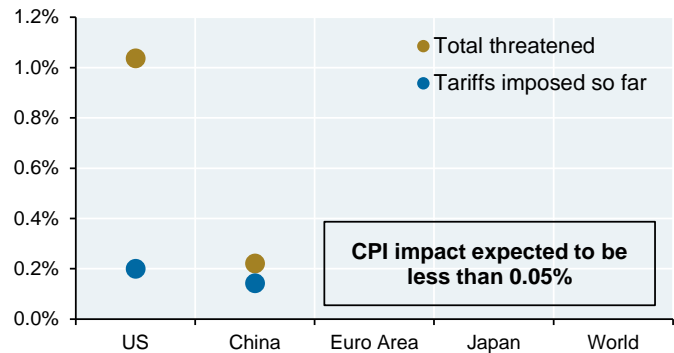
Source: Table 3 in "Trump Tariffs Primarily Hit Multinational Supply Chains, Harm US Technology Competitiveness", M. Lovely, Peterson Institute, 2018.

### Estimating the growth impact from the Trade War Real GDP effect after three years



Source: Goldman Sachs Economics Research. 2019.

### Estimating the inflation impact from the Trade War One-time CPI impact after three years



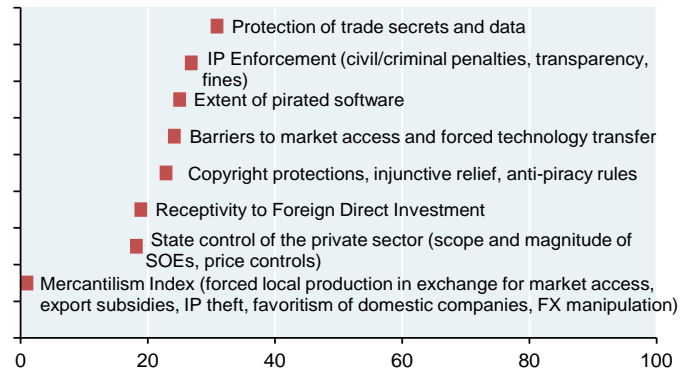
Source: Goldman Sachs Economics Research. 2019.

### US exposed to China retaliation against US subsidiaries operating in China, US\$ billions



Source: Deutsche Bank. June 2018.

### Points of dispute in the US-China trade war; China's rank vs developed & emerging economies, 100 = best, 0 = worst



Sources: OECD. BSA. GIPC. ITIF. Fraser Institute. JPMAM. 2019.

<sup>9</sup> China may retaliate against the very large, profitable US firms operating there. As shown in the chart, the US-China trade deficit actually disappears once you include the sales of US subsidiaries operating in China.

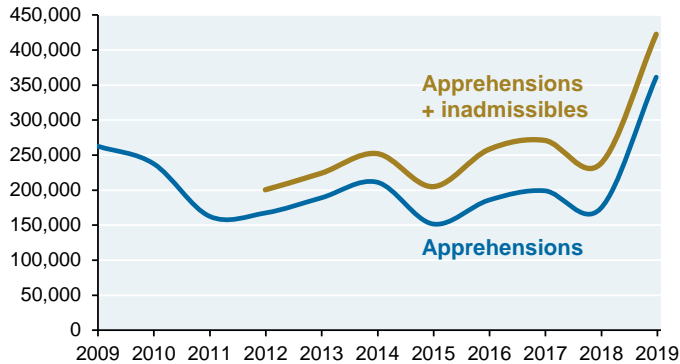


# Asylum applications, border apprehensions, Temporary Protected Status terminations<sup>10</sup>, fertility rates and projected US population growth

Please see page 6 for an explanation of asylum terms

## Apprehensions & inadmissibles at southwest border

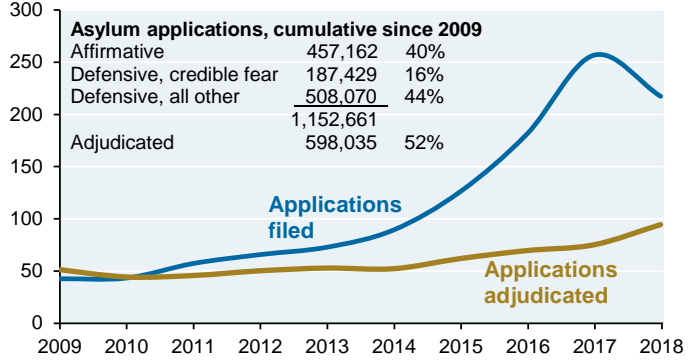
Through first 6 months of fiscal year



Source: US Customs and Border Protection. 2019.

## Asylum applications by year

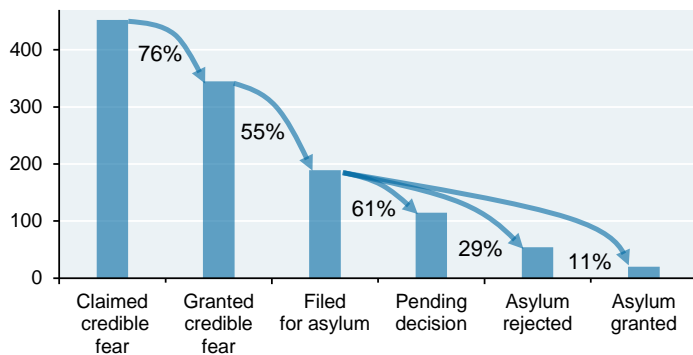
thousands, annual



Source: EOIR, USCIS, JPMAM. Oct 2018. 2015 values include estimates

## Applicant outcomes: US Credible Fear Asylum process

Cumulative 2008-2018 applications, thousands



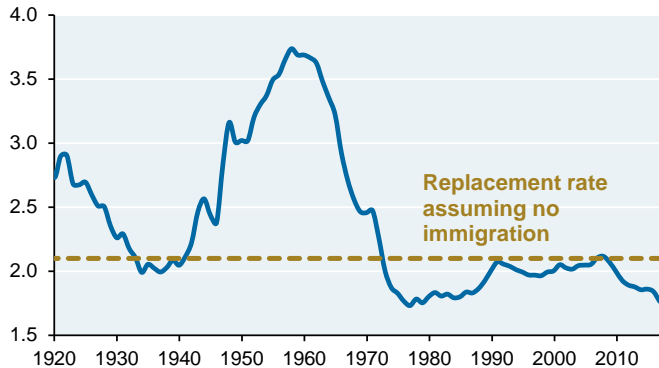
Source: USCIS, EOIR, Congressional Research Service. 2019.

TPS beneficiaries by country of citizenship			
Country	Recent Decision	Expiration Date	Individuals with TPS
El Salvador	Termination	Sep 2019	251,526
Haiti	Termination	Jul 2019	56,209
Honduras	Termination	Jan 2020	80,633
Nepal	Termination	Jun 2019	14,596
Nicaragua	Termination	Jan 2019	4,517
Somalia	Extension	Mar 2020	463
South Sudan	Extension	May 2019	83
Sudan	Termination	Nov 2018	806
Syria	Extension	Sep 2019	7,011
Yemen	Extension	Mar 2020	1,497

Source: CRS. March 2019. Terminations on hold due to court order.

## US total fertility rate

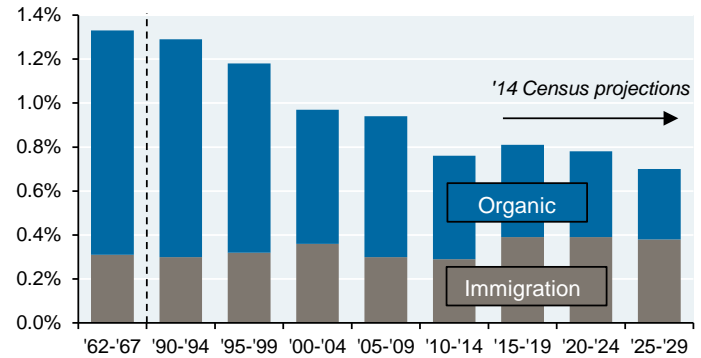
Estimated lifetime births per woman



Source: UN Department of Economic and Social Affairs, CDC. 2019.

## Sources of US population growth

US annual population growth, 5-year average, %



Source: Census Bureau, JPMAM. 2014.

<sup>10</sup> **Temporary Protected Status** covers people who came to the US in the wake of natural disasters in their home countries. Efforts by the Trump Administration to terminate these programs are currently tied up in the courts.



## Appendix: US asylum trends

The asylum process is complicated, so here are the salient points:

- Asylum applications are soaring for a system ill-equipped to handle to volume
- There are two kinds of asylum applications: affirmative and defensive (see box below). The latter can be separated into those based on credible fear, and all others. Affirmative asylum applications are approved at a high rate that hasn't changed much since 2016. Defensive asylum application approval rates for credible fear have fallen modestly since 2016, while other defensive application approval rates haven't changed either from their much lower levels
- Approval rates shown are only based on **decided cases**. Only ~50% of asylum applications filed since 2009 have been adjudicated in some way; the rest are still pending. A recent Trump memorandum reversed an Obama policy by now denying work permits to applicants whose cases are pending, and also to applicants whose cases have been denied
- Within the smaller category of "credible fear asylum", there are a couple of notable trends:
  - The US Citizenship and Immigration Service has found that around  $\frac{3}{4}$  of all applicants do have credible fear, and were referred to an Immigration Judge for a full hearing
  - However, only a little more than half of those approved to proceed actually filed for asylum; the rest did not file. Note: abolishing Immigration and Customs Enforcement (ICE) would substantially reduce the ability of the US to take legal action regarding non-filers, since the jurisdiction of the Border Patrol only extends 100 miles from the US border
  - As with other asylum categories, the majority of filed credible fear cases are still pending

### Asylum terms

**Affirmative asylum eligibility:** aliens who are not in removal proceedings can apply regardless of their immigration status or how they arrived, as long as they have been in the US for less than one year. Essentially a proactive step by those not already in court

**Defensive asylum eligibility:** aliens already in removal proceedings may request defensive asylum to avoid being deported. Removal proceedings may results from:

- USCIS does not grant affirmative asylum and instead refers the case to an EOIR Immigration Judge
- Aliens apprehended without proper legal documents or in violation of their immigration status
- Aliens caught by US Customs and Border Protection trying to enter the US without proper documentation, and who claim credible fear as justification for remaining in the US

USCIS: US Citizenship and Immigration Service

EOIR: Executive Office for Immigration Review

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