October 10, 2019

"If it weren't for the last minute, nothing would get done"
-Rita Mae Brown

It has been fifteen months since the first tariffs were imposed on China and roughly eighteen months since President Trump first threatened using them to bring China to the negotiating table. For years trade issues have festered between the US and China and there is bipartisan support in Congress recognizing something must be done. Among the most egregious trade issues are China's disregard for intellectual property rights and a failure to comply with international trade rules. President Trump's decision to use tariffs as a negotiating tool is unconventional and has brought the two largest economies in the world into a trade war. With another round of tariffs set to begin at the end of the month we thought it was timely to evaluate the impact the trade war is having on the overall economy and the financial markets.

Tariffs are controversial because they disrupt business supply chains and consumer markets. The impact on the US economy is evident in the decelerating GDP growth rate. Manufacturing and farming are two areas that have been hit particularly hard. The Institute of Supply Management (ISM) Manufacturing index, a forward-looking indicator of manufacturing activity, has been declining since early 2018 and fell to 47.8 in the latest period, its lowest level since June 2009. Offsetting the effects of trade tension has been the resiliency of the US consumer. The employment market remains strong which contributes to wage gains. While the tariffs are impacting some American businesses, consumer spending, which represents almost 70% of the economy, has not yet weakened.

Corporate earnings increased over 20% in 2018 but are projected to be only slightly higher in 2019, as the initial benefit from the corporate tax cut in 2018 has passed. The longer-term benefit of cutting the corporate tax rate from 35% to 21% has been masked by the headwinds inflicted by the trade war. We continue to believe it is in the best interest of the US and China to resolve the trade war as neither country benefits from slowing economies.

With the Chinese in Washington DC this week for another round of trade negotiations, the time is now to resolve the fight. The financial markets have stalled since the dispute began in early 2018 as investors try to predict the outcome, and corporate managements struggle to adjust to the expanding tariffs. The stock market valuation has fallen from 19x to 16x P/E multiple since the trade war began, so stocks are cheaper. Bond yields have collapsed from nearly 3% to 1.6%, a level that is less attractive than the dividend yield on the S&P 500 of 1.9%. Analysts are currently predicting corporate earnings growth of 10% in 2020. If that occurs, then

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there is room for stocks to move higher over the next year. Should the uncertainty of the trade war be removed, the outlook would improve further.

Thank you for entrusting Ayrshire Capital Management LLC with management of your money. We work hard to be responsible stewards of your wealth through all business cycles.

Sincerely,

JM Sam Nevin, Jr
Managing Partner

W. Joseph Ryan III
Partner

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