The China Tariffs: What Retirement Plan Sponsors and Participants Need to Know

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A large part of President Donald Trump's campaign platform was based on creating a more equitable international trading position for America. In an increasingly specialized global economy, free and unhindered trade has unquestionable benefits. However, the opportunity does arise for trade abuses, and President Trump has continued to pursue his promise of being tough on trade. In recent weeks, retirement plan participants have seen the markets - and their account balances - fluctuate daily, with strong talk from the heads of state in the U.S. and China regarding tariffs and trade agreements.

WHY TARIFFS ARE BEING PROPOSED

Threats of tariffs and other trade impediments rile markets because these measures can serve to decrease competition and increase the cost of goods within the economies of two trading partners. While most nations are protective of certain industries (mainly defense), they often elect to import other goods from trading partners that have a competitive advantage in the production of those goods and vice versa. This allows for lower prices for consumers and businesses. On the whole, this is a good thing for the global economy; however, cheating is possible. The President has targeted China for their continued intellectual property and cyber theft. This illicit activity ranges from producing knockoff designer handbags to hacking the computer systems of American companies to steal software and other trade secrets and the lack of enforcement from the Chinese government has been a source of frustration. A significant problem, theft is estimated to cost America $200 - $600 billion per year at this point.

THE REACTION

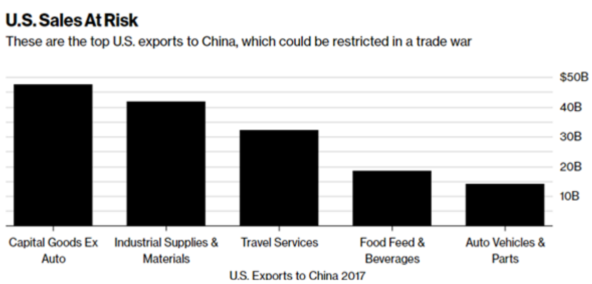
While combating this theft is important, the market reacted poorly to the statements and proposed tariffs from the President. However, this is to be expected, given the implications of a potential trade war with China. Daily tweets and statements from President Trump and retaliation from China have contributed to market volatility. Businesses and politicians, alike, would prefer a more prudent solution to intellectual property infractions from China. China responded vocally as well. However, both nations likely realize that they would not be well-served by a trade war.

IMPORTS, EXPORTS AND THE TRANS-PACIFIC PARTNERSHIP

The Trans-Pacific Partnership (TPP) was a trade pact between the U.S. and a number of Pacific nations, with the goal of enhancing trade and effectively resolving disputes. China was not included in the TPP, partially on their own accord. The TPP had strong intellectual property standards and enforcement, yet offered its members access to efficient trade. China's participation would have been beneficial and likely would have forced the nation to improve their intellectual property standards.

When President Trump pulled the U.S. out of the TPP early in his presidency, it caused panic in the agricultural sector, as American farmers export a great deal of their goods to the nations in that pact.

In 2018, President Trump imposed tariffs on steel and aluminum. China retaliated with tariffs on a number of American exports including soybeans, one of the key exports to China[1]. The Chinese will likely be getting much of their soybeans elsewhere, which is not good for American farmers. The chart below displays the top U.S. exports to China which could be at risk.



Source: Bloomberg

STOCK MARKET IMPLICATIONS

It is also important to understand the implications that this trade posturing will have on the stock market and, ultimately, retirement portfolios. We have already witnessed the market decline during the announcement of these tariffs, yet the S&P 500 has mostly recovered and is roughly even for 2018. However, it has by no means been a smooth ride. While volatility is unlikely to subside anytime soon, market cataclysm brought on by tariffs and other trade measures is also unlikely. The President tends to be sensitive to how he is perceived, and stock market volatility on the heels of his tweets is not what he wants. More recently, there have been positive words from both President Trump and China regarding cooperation and trade. The President will hopefully heed the advice of his economic advisors and pursue a diplomatic solution to trade. In fact, there may be a possibility that President Trump and his advisors are considering rejoining the TPP. While it is unclear as of now what the potential terms would be, any hint of cooperation and diplomacy is positive.

There have been other factors at play causing market volatility in 2018, aside from tariffs. Rising tension with Russia in Syria have moved into the headlines as of late. President Trump has eased off the trade talks considerably and has focused his attention on the issue of Syria. Earnings season is also upon us, and that may have its own market implications. Geopolitical and other non-tariff factors may also have an impact on stocks going forward. Cooler heads and good business will likely prevail, but not without some volatility.

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[1]*Forbes: Why China is Hungry for Brazilian Soy*