DWS

Americas CIO View

The summer of tariffs: the heat is going up, seek shade

Tariffs are taxes: the higher and longer tariffs last the more harm we expect to come

We expect the U.S. – China trade conflict to de-escalate in coming months, but this is unlikely in the coming days or few weeks. We expect China's delegation to return home without a deal, with both sides raising tariffs, and the earliest window for an accord being pushed out to the G20 meeting in Osaka, Japan at the end of June.

Before delving into the latest details of this intensifying trade spat, we keep in mind that tariffs are taxes and we get less of what's taxed. Tariffs tax trade and thus can smother an important source of productivity, that being the efficient allocation and specialization of labor at a global level. This makes higher and long lasting tariffs more damaging to gross domestic product (GDP) and profit growth than the mere shift in funds from producers and consumers to the government. Yet using tariffs tactically, and ultimately temporarily, to push China for more intellectual property protection and free market reforms could lead to an even more productive trade relationship by helping to shift trade from goods to higher value services and intangibles. It is this potentially positive result that kept us constructive, albeit a bit tense, while watching these risky tactics be employed since last summer. But now we are entering a period where progress must be made soon to prevent economic harm, diplomatic resentment, and the possibility of tariffs becoming entrenched.

Intellectual property protection and other China reforms require legislation

The U.S. is adamant about wanting better intellectual property protection and enforcement from China.[1] Proper protection requires legislation. Protections for technology and even medicines, which can easily stir political controversy in any country. Legislation takes time to craft and build a consensus for and simply may not come in one package anytime soon, but instead incrementally over time. Other U.S. asks include more liberalization and opening of China's financial system to foreign banks, reducing state owned enterprise subsidies, simpler rules and legal structures to facilitate foreign direct investment, currency stability, etc. These are things that China wants for itself too, but President Xi cannot just decree such changes overnight. Even if he did such things take time to implement without risking instability. That said, more speed is needed from China and more patience from the US to de-escalate.

David Bianco
Chief Investment Officer &
Strategist, Americas

In a nutshell

- Tariffs are taxes: the higher and longer tariffs last the more harm we expect to come
- Intellectual property protection and other China reforms require legislation
- The summer of tariffs: both the United States and China are expected to turn up the tariff heat
- Taking tactical action: we changed our signal so we expect that the next 5% plus S&P 500 move will be down, we reduce the EM allocation

R-050029-88 (5/19)

[1] https://de.reuters.com/article/uk-usa-trade-china-idUKKCN1PX1ZS

The summer of tariffs: both the United States and China are expected to turn up the tariff heat

We expect the 10% tariffs just raised to 25% to stay in effect at least through June. The United States now puts a 25% tariff on 250 billion U.S. dollars (USD) of imports from China, which is nearly half of all imports from China. We expect China to retaliate quickly with details soon coming. The United States would need to make section 301[2] preparations to raise tariffs on remaining China imports. This would take at least a couple of months to implement and we still see this as unlikely. We are convinced that China will not turn to currency devaluation in response. We expect Renminbi support (USD/CNY) at about 7.0. China will employ further stimulative measures to mitigate weaker exports, these measures with the recent encouraging signs of soft landing[3] keep 6% China GDP growth likely for 2019. The U.S. economy should be fine, but this conflict should weigh on manufacturing activity. There is more sensitivity at the S&P 500 to these tariffs than U.S. GDP. We estimate 3 to 5 USD of S&P 500 earnings-per-share (EPS) risk, vs. our standing 2019 estimate of 169 USD, should these tariffs go beyond June. As we noted in the past, we consider the Industrial, Material, and Energy sectors, as well as the Auto and Semiconductor industries most at risk to trade conflict.

Taking tactical action: we changed our signal so we expect that the next 5% plus S&P 500 move will be down, we reduce the EM allocation

By next week, we think it will be evident that it will take longer to reach an accord and that tariffs will be significantly higher while waiting. The cost and operational uncertainty that this will bring to companies is likely to cause the S&P 500 to fall to near 2725. But given the demonstrated resilience of the U.S. economy and profits over the past couple of quarters and low interest rates, we do not think the S&P 500 declines into a 10% plus correction. We think investors save further reactions until after the G20. We reduce our total equity allocation from 60% to 58% and raise our allocation to Treasuries. We cut emerging market (EM) equity exposure from 9% to 7%. While China is sensitive to exports, China's listed companies are more domestically driven. We expect their profits and also the CNY to demonstrate encouraging resilience to this second-quarter shock.

Appendix: performance over the past 5 years (12-month periods)

	04/14 - 04/15	04/15 - 04/16	04/16 - 04/17	04/17 - 04/18	04/18 - 04/19
S&P 500	10.7%	-1.0%	15.4%	11.1%	11.2%

Past performance is not indicative of future returns.

Sources: Bloomberg Finance L.P., DWS Investment Management Americas Inc. as of 5/10/19

[2]Section 301 allows the President to take all appropriate action to get removal of any policy that violates an international trade agreement or burdens U.S. commerce.

[3]A soft landing is when an economy's rate of growth slows in a controlled fashion without major disruptive effects on employment, external balances etc.

Glossary

Correlation

Correlation is a measure of how closely two variables move together over time.

Devaluation

Devaluation is the forced reduction of the value of a currency against other currencies.

Earnings per share (EPS)

Earnings per share (EPS) is calculated as a company's net income minus dividends of preferred stock, all divided by the total number of shares outstanding.

Emerging markets (EM)

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

G20

The **Group of 20** are the largest industrialized and emerging economies in the world.

Gross domestic product (GDP)

The **gross domestic product (GDP)** is the monetary value of all the finished goods and services produced within a country's borders in a specific time period.

Renminbi (RMB)

Renminbi (RMB) is the currency of the People's Republic of China.

S&P 500

The **S&P 500** is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

Treasuries

Treasuries are fixed-interest U.S. government debt securities with different maturities: Treasury bills (1 year maximum), Treasury notes (2 to 10 years), Treasury bonds (20 to 30 years) and Treasury Inflation Protected Securities (TIPS) (5, 10 and 30 years).

U.S. dollar (USD)

The **U.S. dollar (USD)** is the official currency of the United States and its overseas territories.

Important Information

The brand DWS represents DWS Group GmbH & Co. KGaA and any of its subsidiaries, such as DWS Distributors, Inc., which offers investment products, or DWS Investment Management Americas Inc. and RREEF America L.L.C., which offer advisory services.

This document has been prepared without consideration of the investment needs, objectives or financial circumstances of any investor. Before making an investment decision, investors need to consider, with or without the assistance of an investment adviser, whether the investments and strategies described or provided by Deutsche Bank, are appropriate, in light of their particular investment needs, objectives and financial circumstances. Furthermore, this document is for information/discussion purposes only and does not and is not intended to constitute an offer, recommendation or solicitation to conclude a transaction or the basis for any contract to purchase or sell any security, or other instrument, or for Deutsche Bank to enter into or arrange any type of transaction as a consequence of any information contained herein and should not be treated as giving investment advice. Deutsche Bank AG, including its subsidiaries and affiliates, does not provide legal, tax or accounting advice. This communication was prepared solely in connection with the promotion or marketing, to the extent permitted by applicable law, of the transaction or matter addressed herein, and was not intended or written to be used, and cannot be relied upon, by any taxpayer for the purposes of avoiding any U.S. federal tax penalties. The recipient of this communication should seek advice from an independent tax advisor regarding any tax matters addressed herein based on its particular circumstances. Investments with Deutsche Bank are not guaranteed, unless specified. Although information in this document has been obtained from sources believed to be reliable, we do not guarantee its accuracy, completeness or fairness, and it should not be relied upon as such. All opinions and estimates herein, including forecast returns, reflect our judgment on the date of this report, are subject to change without notice and involve a number of assumptions which may not prove valid.

Investments are subject to various risks, including market fluctuations, regulatory change, counterparty risk, possible delays in repayment and loss of income and principal invested. The value of investments can fall as well as rise and you may not recover the amount originally invested at any point in time. Furthermore, substantial fluctuations of the value of the investment are possible even over short periods of time. Further, investment in international markets can be affected by a host of factors, including political or social conditions, diplomatic relations, limitations or removal of funds or assets or imposition of (or change in) exchange control or tax regulations in such markets. Additionally, investments denominated in an alternative currency will be subject to currency risk, changes in exchange rates which may have an adverse effect on the value, price or income of the investment. This document does not identify all the risks (direct and indirect) or other considerations which might be material to you when entering into a transaction.

All opinions and claims are based upon data on 5/10/19 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Source: DWS Investment Management Americas Inc.

R-050029-88 (5/19)

The terms of an investment may be exclusively subject to the detailed provisions, including risk considerations, contained in the Offering Documents. When making an investment decision, you should rely on the final documentation relating to the investment and not the summary contained in this document.

This publication contains forward looking statements. Forward looking statements include, but are not limited to assumptions, estimates, projections, opinions, models and hypothetical performance analysis. The forward looking statements expressed constitute the author's judgment as of the date of this material. Forward looking statements involve significant elements of subjective judgments and analyses and changes thereto and/or consideration of different or additional factors could have a material impact on the results indicated. Therefore, actual results may vary, perhaps materially, from the results contained herein. No representation or warranty is made by DWS as to the reasonableness or completeness of such forward looking statements or to any other financial information contained herein. We assume no responsibility to advise the recipients of this document with regard to changes in our views.

No assurance can be given that any investment described herein would yield favorable investment results or that the investment objectives will be achieved. Any securities or financial instruments presented herein are not insured by the Federal Deposit Insurance Corporation ("FDIC") unless specifically noted, and are not guaranteed by or obligations of Deutsche Bank AG or its affiliates. We or our affiliates or persons associated with us may act upon or use material in this report prior to publication. DB may engage in transactions in a manner inconsistent with the views discussed herein. Opinions expressed herein may differ from the opinions expressed by departments or other divisions or affiliates of Deutsche Bank. This document may not be reproduced or circulated without our written authority. The manner of circulation and distribution of this document may be restricted by law or regulation in certain countries. This document is not directed to, or intended for distribution to or use by, any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction, including the United States, where such distribution, publication, availability or use would be contrary to law or regulation or which would subject Deutsche Bank to any registration or licensing requirement within such jurisdiction not currently met within such jurisdiction. Persons into whose possession this document may come are required to inform themselves of, and to observe, such restrictions.

Past performance is no guarantee of future results; nothing contained herein shall constitute any representation or warranty as to future performance. Further information is available upon investor's request. All third party data (such as MSCI, S&P & Bloomberg) are copyrighted by and proprietary to the provider.

Deutsche Bank AG is authorised under German Banking Law (competent authority: European Central Bank and the BaFin, Germany's Federal Financial Supervisory Authority) and by the Prudential Regulation Authority and subject to limited regulation

All opinions and claims are based upon data on 5/10/19 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Source: DWS Investment Management Americas Inc.

R-050029-88 (5/19)

by the Financial Conduct Authority and Prudential Regulation Authority. Details about the extent of our authorisation and regulation by the Prudential Regulation Authority, and regulation by the Financial Conduct Authority are available from us on request.

All opinions and claims are based upon data on 5/10/19 and may not come to pass. This information is subject to change at any time, based upon economic, market and other considerations and should not be construed as a recommendation. Past performance is not indicative of future returns. Forecasts are not a reliable indicator of future performance. Forecasts are based on assumptions, estimates, opinions and hypothetical models that may prove to be incorrect. Source: DWS Investment Management Americas Inc.

R-050029-88 (5/19)