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MARKET REVIEW
JUNE 2019



ATG TRUST
C O M P A N Y

THE COST OF THE U.S.-CHINA TRADE WAR

Looking back at April's news coverage of the trade negotiations between the U.S. and China, one may have expected a trade deal in May based on the optimistic rhetoric. Trade officials from both sides were touting progress and President Trump said a "very monumental" trade deal could be announced in the next few weeks. Then an abrupt change in trajectory served as a stark reminder of the negotiation's delicate status.

In early May, President Trump accused China of backpedaling on already agreed-upon commitments made in the negotiations. President Trump subsequently increased tariffs from 10% to 25% on \$200 billion in Chinese goods and threatened to impose tariffs on another \$325 billion of Chinese goods. China promptly responded with tariffs on \$60 billion of U.S. goods. Negotiations appear to be at an impasse as discussions have not resumed and comments from Chinese officials suggest they are digging in their heels and preparing for a prolonged trade war. A potential catalyst to deescalate trade tensions is the G20 meeting in Japan at the end of June where President Trump may meet with China's President Xi Jinping.

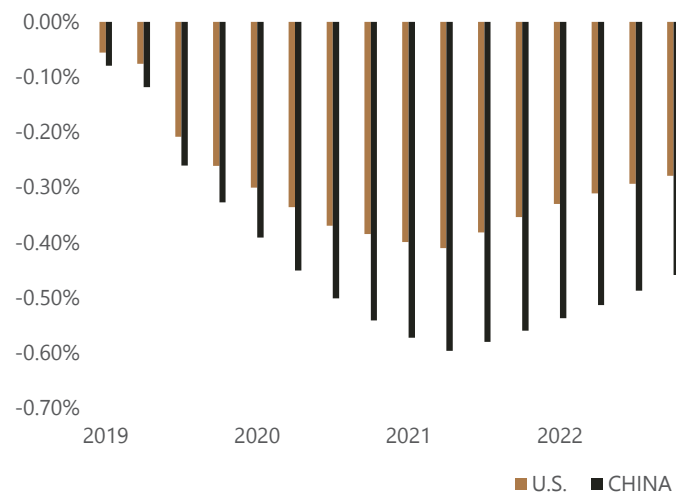
Now that the trade war outlook seems to have taken a turn for the worse with little indication of a resolution in the near term, the economic implications of a drawn out trade war have received more attention among economists and investors. Over the last few weeks, several economists have attempted to quantify the economic impact of a multi-year trade war. The goal of this Market Brief is to outline economists' projections for the economic implications of tariffs so we have a better understanding of potential outcomes.

IMPACT ON ECONOMIC GROWTH

Economic forecasts earlier this year from many economists, including members of the International Monetary Fund (IMF), projected a rebound in global growth in the second half of 2019. An important assumption in those forecasts was an improving outlook for trade tension between the U.S. and China. With that assumption no longer appearing valid for now, some economists have recently lowered their economic growth forecasts. The World Bank revised its 2019 global growth forecast to 2.6% from 2.9%. The World Bank's less optimistic outlook is heavily based on their expectation that the U.S.-China trade war will weigh on global business confidence and trade. The IMF holds a similar view that the trade war will weigh on business sentiment and economic growth, estimating the current and threatened U.S. and China tariffs could reduce global growth by 0.4% in 2019 and 0.5% in 2020.

TRADE WAR IMPACT ON U.S. & CHINA GDP

BLOOMBERG FORECAST QUARTERLY REDUCTION IN GDP

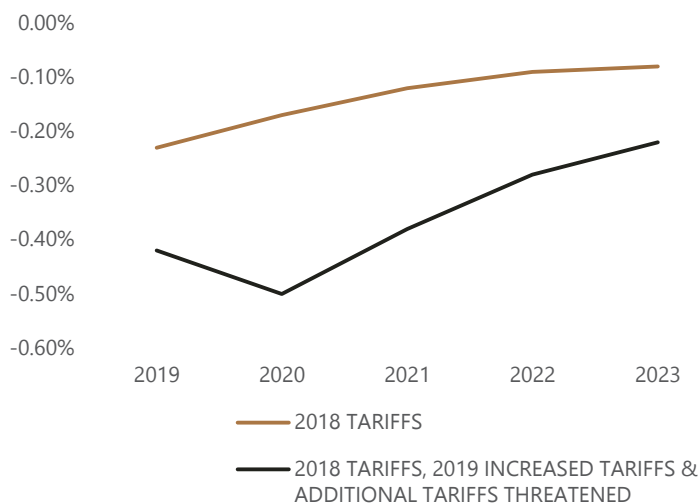


Source: Bloomberg

Past performance does not guarantee future results.

TRADE WAR IMPACT ON GLOBAL GDP

IMF FORECAST ANNUAL REDUCTION IN GDP



Source: International Monetary Fund (IMF)

Past performance does not guarantee future results.

Somewhat surprisingly, the trade war is estimated to negatively affect the U.S. economy almost as much as its impact on China's economy, according to research from Bloomberg economists. The economists forecast the trade war will reduce China's economic growth by around 0.5%-0.6% in 2020 and 2021 while the U.S. experiences an economic drag of around 0.3%-0.4% in those years. The drag on U.S. economic growth is expected to come in the form of higher prices for imported goods acting as a headwind for consumer spending and potential supply chain disruptions related to increased costs for inputs imported from China. The Bloomberg analysis assumes the central banks in both countries do not respond to the trade shocks. If the central banks respond by easing monetary policy then that stimulus could offset some of the economic drag.

IMPACT ON CONSUMERS

The estimated annual cost per U.S. household related to tariffs on Chinese goods is \$831, according to a study published by the National Bureau of Economic Research. This projected cost includes 2018 tariffs and the recent increase in tariffs on \$200 billion in Chinese goods. It does not include President Trump's threat to impose tariffs on another \$325 billion of imports from China which could add another few hundred dollars to the annual household cost.

The cost per household is based on two factors. First, higher prices for Chinese imports are expected to be completely passed on to U.S. consumers and importers. Multiple studies on the tariffs imposed in 2018 found that Chinese exporters did not adjust their prices in response to the tariffs, leading to higher prices for imports in the U.S. The second factor of the estimated cost is reduced economic efficiency from businesses and consumers shifting their purchases to avoid tariffs by sourcing products from other countries such as Vietnam where similar goods may be more expensive than Chinese goods. These two factors result in an estimated annual cost of \$106 billion for U.S. importers which translates into \$831 per household. One item that would likely partially reduce the cost per household is U.S. importers absorbing some of the higher import prices by lowering their profit margins.

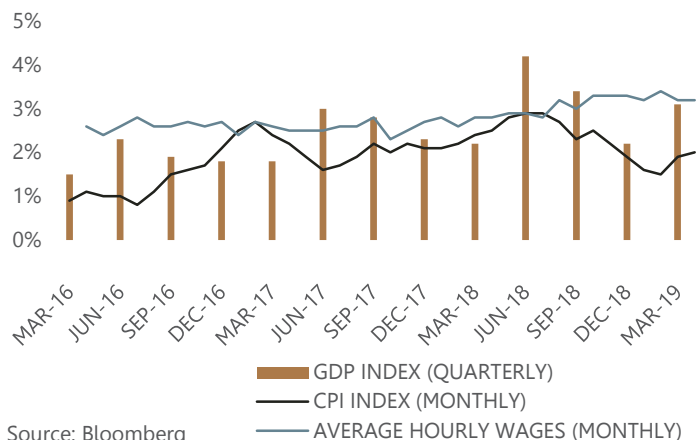
CONCLUSIONS AND INVESTMENT IMPLICATIONS

The fallout from the trade war between the U.S. and China is expected to cause a modest economic drag with an estimated annual detraction from global economic growth of roughly 0.5%. The negative effects from trade shocks could be greatly mitigated if central banks in China and the U.S. respond with fresh stimulus. Overall, we believe the recent escalation in trade tensions does not pose a significant near-term threat to global risk assets and thus does not warrant major asset allocation adjustments. In recent commentary, Bloomberg's Chief Equity Strategist, Gina Martin Adams, indicated that she believes further escalation in the trade war with additional tariffs would be manageable for U.S. equities, and in an extreme scenario the S&P 500 would only see a 2.0% hit to revenue and 0.5% margin compression.

ECONOMY

GDP, CONSUMER PRICES AND WAGE INFLATION

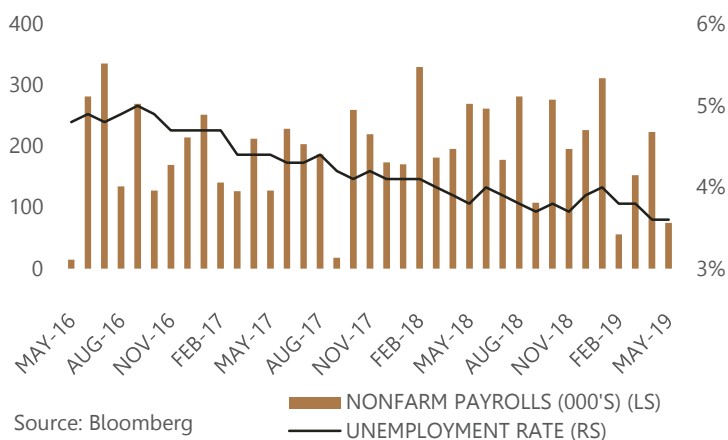
MARCH 2016 THROUGH APRIL 2019



- U.S. economic growth was revised down less than expected to an annualized rate of 3.1% in the first quarter of 2019, ahead of economists' consensus forecast of 3.0%. Stronger consumption and exports helped boost GDP.
- The Core Personal Consumption Expenditure (PCE) price index, the Fed's preferred inflation measure, rose to 1.6%, on a year-over-year basis. After nearing the Fed's 2.0% target in the second and third quarters of 2018, this measure has declined in the following two quarters.
- The Core Consumer Price Index (CPI), which excludes volatile food and energy costs, increased 0.1% in April. The year-over-year reading for Core CPI increased to 2.1%.

LABOR MARKET

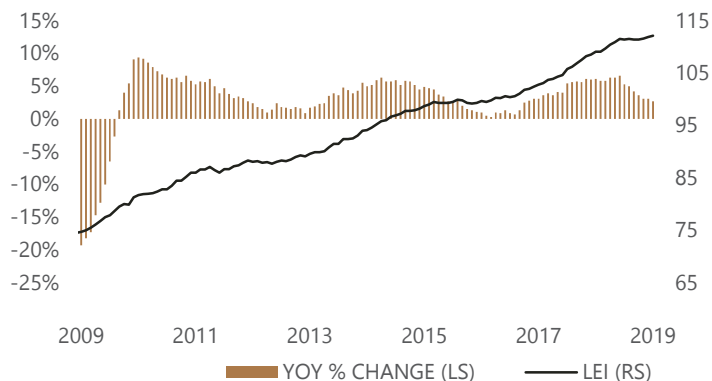
MAY 2016 THROUGH MAY 2019



- May U.S. employment growth was well below economists' estimates, adding 75,000 jobs compared to the Bloomberg estimate of 175,000. April and March job gains were revised lower by 39,000 and 36,000, respectively. This could be an indication the economy might be slowing; however, the three-month average job growth of 151,000 is not too concerning.
- The unemployment rate remained near a 50-year low at 3.6%. The labor force participation rate was unchanged from the previous month at 62.8%.
- The growth in average hourly earnings was unchanged in May on a month-over-month basis at 0.2%. The year-over-year earnings growth rate experienced a slight downtick to 3.1%, compared to 3.2% last month.

LEADING ECONOMIC INDICATORS

APRIL 2009 THROUGH APRIL 2019

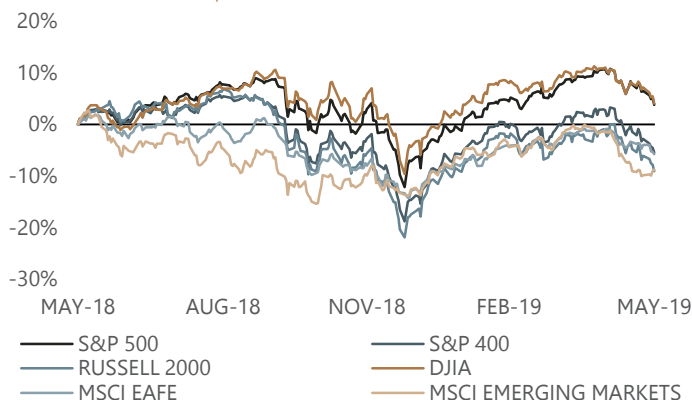


- The U.S. Conference Board Leading Economic Indicator (LEI) index posted its third consecutive monthly increase. The index climbed to 112.1 in April, a gain of 0.2% which followed a 0.3% increase in March and 0.2% increase in February.
- On a year-over-year basis, the LEI index has advanced 2.7% for the twelve-month period ending April 30, marking its lowest level since January 2017.
- Stock prices and consumer expectations for business conditions were the largest contributors for the LEI's increase. As a barometer for U.S. economic growth over the next six-to-twelve months, the recent LEI readings indicate that in the third quarter the U.S. economic expansion will likely become the longest in history.

EQUITY

TRAILING 12-MONTH EQUITY RETURNS

PRICE APPRECIATION, MAY 2018 THROUGH MAY 2019

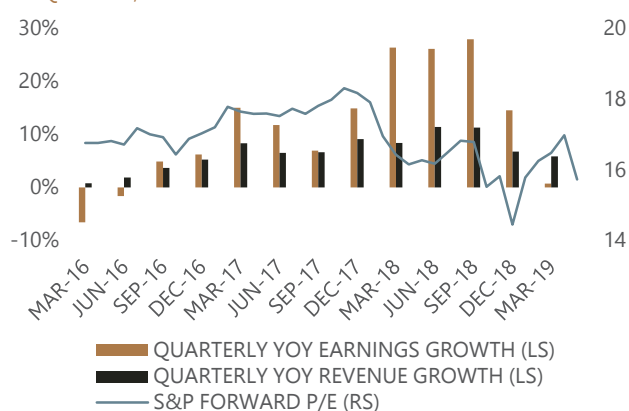


Source: Bloomberg

- Global equities' virtually uninterrupted climb higher this year reversed course in May with the S&P 500 falling 6.4%. The primary catalyst behind the change in risk sentiment was the swift escalation in the trade war between the U.S. and China which included new tariffs from both sides.
- Chinese equities were hit the hardest among global equities. The MSCI China index declined 13.1% in May, leading the MSCI Emerging Market index to a 7.2% monthly loss.
- Foreign developed-market equities were the best performing area within equities as the U.S.-China trade war overshadowed economic and political issues in Europe and Japan. The MSCI EAFE index declined 4.7% last month.

S&P 500 YOY EARNINGS & REVENUE GROWTH

BY QUARTER, MARCH 2016 THROUGH MAY 2019

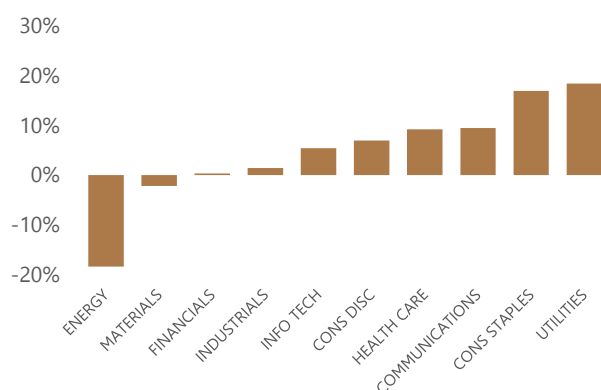


Source: Bloomberg

- Modest first quarter earnings growth of 0.7% was much better than investors initially expected. The consensus analysts' estimate originally projected negative 4.1% growth at the start of the reporting season due to a mixture of tough comparisons versus 2018's strong earnings and slower foreign economic growth. Revenue matched analysts' estimates for 3.9% growth.
- A 5.7% earnings decline in the technology sector was the largest detractor. The decline was mostly due to the sector's especially strong earnings last year and the highest foreign sales exposure among the 11 sectors.
- Analysts are forecasting a trough in earnings growth this quarter followed by an improvement in the second half of 2019.

S&P 500 SECTORS 12-MONTH PRICE RETURNS

MAY 2018 THROUGH MAY



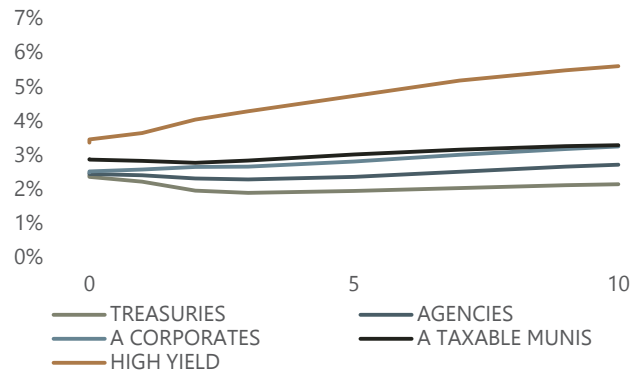
Source: Bloomberg

- Real estate's 1.2% gain last month made it the only sector with a gain. The interest rate sensitive sector benefitted from the U.S. 10-year Treasury yield falling to its lowest level since September 2017.
- Unsurprisingly, defensive sectors such as utilities, consumer staples, and healthcare posted relatively modest monthly losses of 0.8%, 3.8%, and 2.4%, respectively.
- Energy was the worst performing sector with a monthly loss of 11.1%. Crude oil's 16.3% price decline in May weighed on shares of energy companies. Concerns about oversupply in the oil market received additional fuel from U.S. government data showing domestic oil production is at a record level and oil inventory was higher than expected.

FIXED INCOME

CURRENT YIELD CURVES

YIELD CURVES AS OF MAY 2019

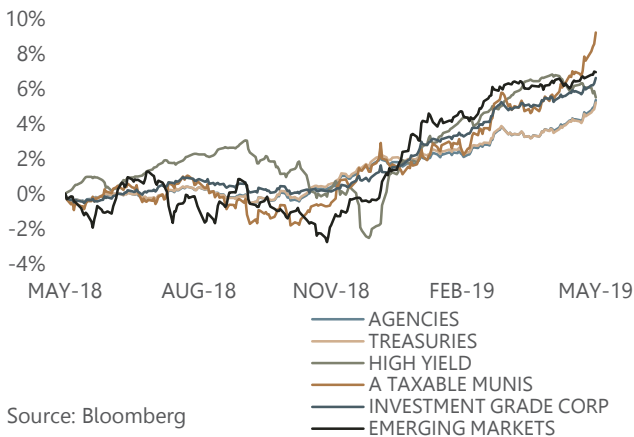


Source: Bloomberg

- The three-month Treasury bill finished May yielding more than the 10-year Treasury note, marking the first month end since July 2007 that occurred.
- Rates fell during the month of May and continued to do so in the first week of June as Fed Chair Jerome Powell remarked that the Fed was “closely monitoring” trade developments and would “act as necessary.”
- In addition to Powell’s comments, European Central Bank officials signaled an easier monetary policy posture going forward and the Reserve Bank of Australia cut interest rates in early June for the first time since 2016. All of these actions have pushed long-term rates lower around the world.

12-MONTH RETURNS, TAXABLE BOND SEGMENTS

MAY 2018 THROUGH MAY 2019



Source: Bloomberg

- Over the last twelve months high yield bonds have posted the best performance of the fixed income sectors tracked in the chart to the left.
- While emerging market bonds have trailed most of their other credit counterparts over the last year, an easier monetary policy stance from the Fed and a weaker U.S. dollar could provide a catalyst for this sector to outperform moving forward.
- A sector not shown on the chart that has performed relatively well this year in comparison to Treasuries is US TIPS, which are meant to provide inflation protection to investors. While Treasuries have returned 4.29%, US TIPS have posted a gain of 5.32% thus far in 2019, according to their respective Bloomberg Barclays indexes.

SPREAD VS. TREASURY LESS 2-YR MOVING AVG

MAY 2016 THROUGH MAY 2019



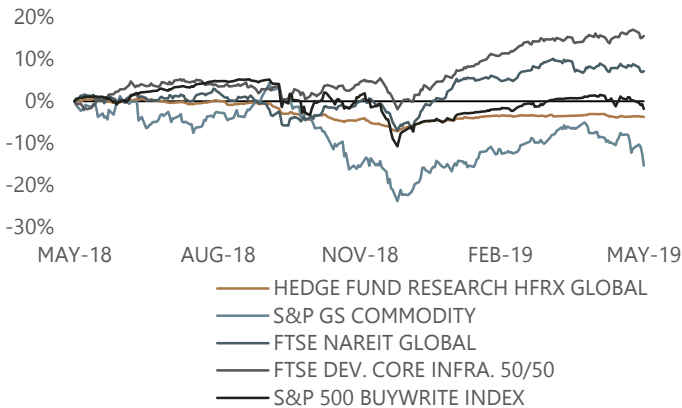
Source: Bloomberg

- Spreads began to widen a bit in May, with much of the move coming in the last two weeks of the month as U.S. Treasury prices rallied significantly.
- Although the overall spread environment has improved, A-rated corporate bonds are the only sector that appears to offer any value relative to spreads over the last two years.
- While spreads are important to monitor, bid-ask spreads provide some context around liquidity and investors’ willingness to take risk as well. Currently, the bid-ask spreads of global high yield bonds stands at 0.96 cents per dollar compared to 1.09 cents per dollar in December 2018, according to Bloomberg data.

ALTERNATIVES

ALTERNATIVES, 12-MONTH RETURNS

MAY 2018 THROUGH MAY 2019

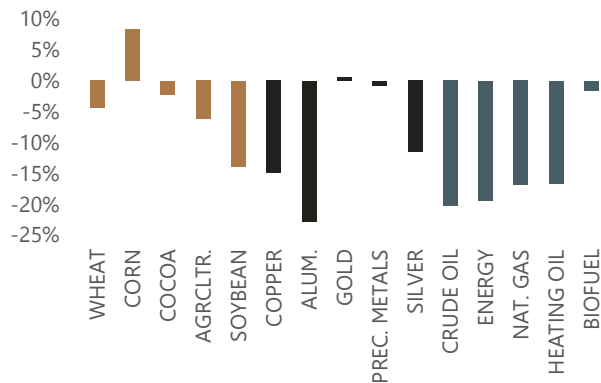


Source: Bloomberg

- Beginning in November, significant dispersion of returns has materialized across the five alternative asset classes tracked in the chart at left. This period has coincided with a steep decline in 10-year U.S. Treasury bond yields from 3.14% on October 31 to 2.12% on May 31.
- As global growth fears increased late in 2018, yield-sensitive areas of the market including the global real estate and developed market infrastructure indexes have outpaced the trade-weighted broad commodities index by more than 20% over the seven-month period ending May 31.
- After climbing 19.3% in the first four months of 2019, the broad commodities asset class declined 8.2% in May, driven by a 16.3% plunge in U.S. crude oil prices.

COMMODITIES, 12-MONTH SPOT RETURNS

MAY 2018 THROUGH MAY 2019



Source: Bloomberg

- Most commodities tracked in the chart at left experienced price declines over the twelve-month period ending May 31 against a backdrop of U.S. dollar strength, concerns about oversupply, and building global growth fears.
- U.S. corn prices surged by nearly 18% in May following a series of floods in the Midwest, weighing on planting activity and expected harvest volumes in 2019 and 2020. The primary corn planting season typically ranges from early April to late May, a period which coincided with some of the most devastating flooding on record across many Midwestern states.
- Commodity market participants will no doubt pay close attention to the effects of U.S. Fed policy on the trade-weighted U.S. dollar in coming months.

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