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QS Investors
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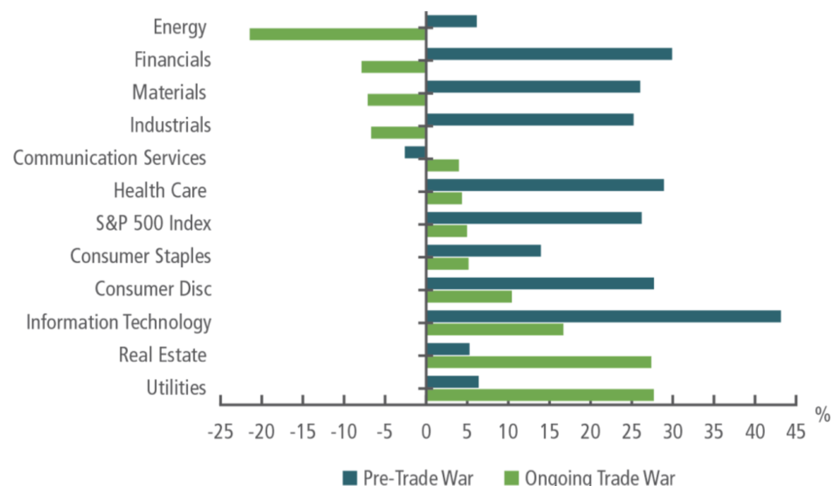
Seeking Domestic Dividend Stocks Amidst Prolonged Trade Uncertainty

On January 22, 2018, President Donald Trump implemented steep tariffs on foreign washing machines and solar energy cells and panels, marking the beginning of a "trade war" between the US and China. While the implementation of new tariffs has been delayed, it is clear that the persistent and prolonged trade uncertainty is having an impact on both equity markets and growth prospects of the global economy. The potential for higher market volatility and softer economic growth (expected and realized) increases as the trade war rhetoric continues on. In fact, central banks in several developed markets have started to brace for softer economic growth by pivoting to a more accommodative monetary policy, pushing interest rates lower.

> The potential for market volatility and softening economic growth (expected and realized) increases as more tariffs continue to be implemented and the trade war rhetoric continues on.

Since the onset of the trade war, the S&P 500 Index has returned 4.97%[1] despite reaching a historical market high on July 26, 2019. Prior to that, since President Trump's inauguration to the last stock session before the tariff war started, the S&P 500 Index was up 26.21%.[2] However, not all sectors were affected equally by recent developments. The impact of trade wars has been particularly pronounced on multi-national, cyclically oriented stocks, especially those with exposure to China. As a result, and bolstered by yet lower interest rates, dividend paying stocks such as Utilities and Real Estate have outpaced Information Technology and Consumer Discretionary stocks.

US EQUITIES PRE-TRADE WAR AND ONGOING TRADE WAR RETURNS BY SECTOR



Source: Bloomberg. Pre-Trade War period is January 20, 2017 through January 21, 2018. Ongoing Trade War period is January 22, 2018 through August 12, 2019.

[1] January 22, 2018 through August 12, 2019
[2] January 20, 2017 through January 21, 2018

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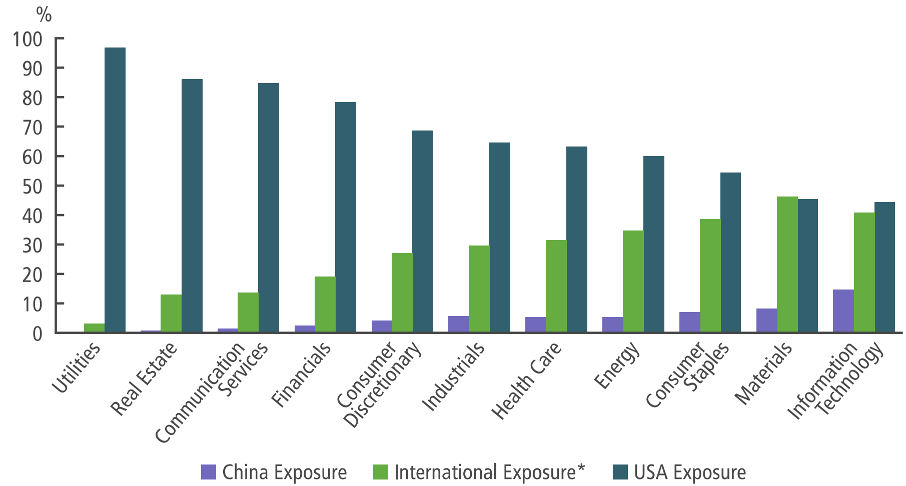
Sectors such as Information Technology and Materials remain far more exposed to the ongoing trade tensions, with the US making up less than 45% of their geographic revenue and China making up 15% and 8% of their revenue, respectively. In contrast, Utilities and Real Estate have close to 90% of their geographic revenue exposure to the US and less than 1% revenue exposure from China.

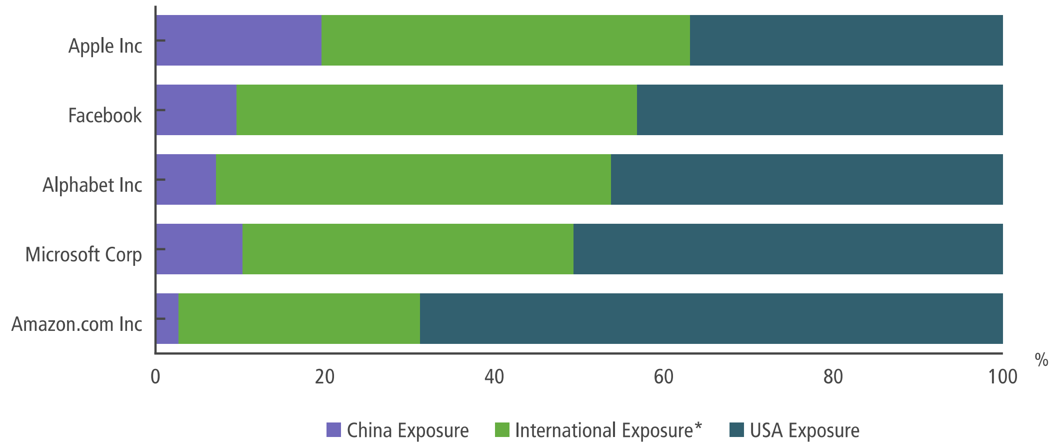
GEOGRAPHIC REVENUE EXPOSURE BY SECTOR



*Includes all countries excluding China and the USA. Based on the MSCI USA Index as of June 30, 2019. Sectors based on GICS classification. Source: MSCI.

US equities broadly remain quite vulnerable to the ongoing tariff dispute and global uncertainty at large. Currently the five largest stocks make up over 15% of the S&P 500 Index. On average, these companies generate less than 50% of their revenue domestically.

TOP 5 S&P 500 SECURITY GEOGRAPHIC REVENUE EXPOSURE (%)



Source: MSCI. *Includes all countries excluding China and the USA. Based on the MSCI USA Index as of June 30, 2019. Sectors based on GICS classification.

The current environment seems to be more suited for sustainable dividend stocks in defensive sectors, with a lower overall beta and less vulnerability to drawdowns amidst heightened volatility.

The escalating market volatility, up nearly 50% since the onset of the trade war, as measured by the CBOE Volatility Index (VIX), coupled with the potentially lengthy extension of a trade war does not bode well for cyclical equities. In contrast, the current environment seems to be more suited for sustainable dividend stocks in defensive sectors, with lower overall beta and less vulnerability to drawdowns. Additionally, as increased risks are associated with every asset class, it is important to maintain and/or add to alternative allocations such as Equity Market Neutral. Maintaining exposure to an uncorrelated source of returns, distinct from traditional stocks and bonds, becomes more and more crucial against this backdrop.

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