



Clark D. Wagner  
Chief Investment Officer

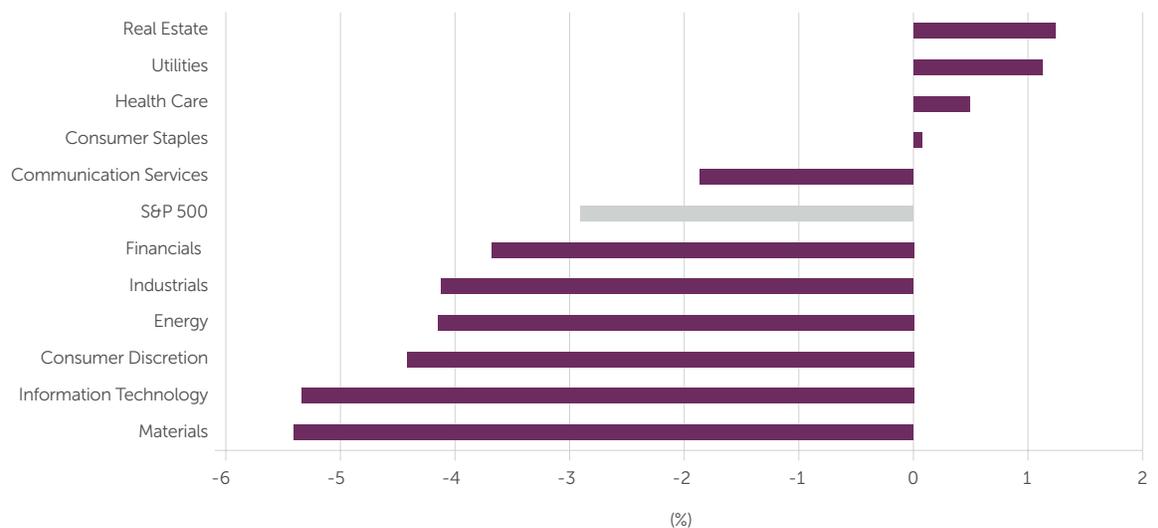
## Who wins in a trade war?

### Key highlights:

- Trade talks dominate news headlines on a daily basis, yet nothing substantive seems to be happening to bridge the gap between the U.S. and China.
- Bond markets have rallied, while stocks have traded down.
- Investors seem to think that a resolution lies over the horizon.
- Utilities, Real Estate and Information Technology offer some attractive opportunities.

Heading into the summer, trade tensions with China have been dominating news headlines, with both the U.S. and China ratcheting up their rhetoric and leveling trading sanctions against one another. Despite this still-unfolding drama in which most sectors of the U.S. economy have been negatively impacted (see *Exhibit 1*), many investors remain complacent, seemingly embracing the idea that the U.S. and China will come to an eventual agreement later this year, while no real blueprint has been produced to show exactly how that result will be reached.

### Exhibit 1: Few sectors spared from the trade fallout Performance, month to date (as of 5/23/19)



Source: Morningstar, 5/23/19. S&P 500 sectors shown above.

### Potential impact on U.S. economy

What might happen if the two countries fail to reach an agreement by year's end? To begin with, economic growth for both would likely fall, given the expected drop in trade between the U.S. and China. In addition, inflation could rise due to higher prices because of tariffs. This would likely lead to a significant impact on consumer confidence, which is a key statistic when analyzing expected buyer behavior. Lower confidence would suggest consumers could hold off their upcoming purchases, thus slowing the economic cycle. Risk-off sentiment would increase as stock prices tumbled, while conversely, risk-free assets such as U.S. Treasuries would become more attractive given their perceived safety. The U.S. dollar, which has been strengthening this year (see *Exhibit 2*), would continue, in our opinion, its upward trend.

**Exhibit 2: Dollar gaining ground**  
USD Index (year to date)

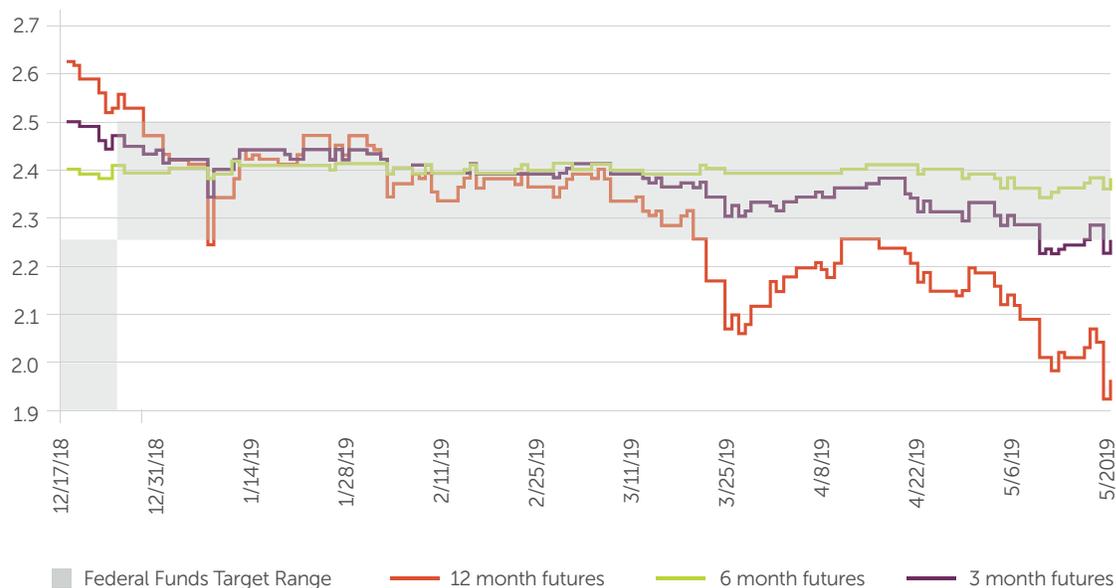


Source: Bloomberg, 5/27/19.

**Potential Federal Reserve reaction**

At this time, as shown in *Exhibit 3*, the market is pricing in a cut in the federal funds rate before year end as the futures contracts show yields less than the current 2.50% fed funds target. This expectation may also be the reason why financial markets have reacted relatively well during the recent trade talks between the U.S. and China. At the moment, the Federal Reserve (Fed) is in a pause mode, but many clearly expect a rate decrease which has resurrected the so-called “Fed put”, the belief the central bank will always help the U.S. economy by lowering interest rates and encouraging risk-taking behavior by investors.

**Exhibit 3: Fed futures showing a cut in interest rates**  
Rates on federal funds futures contracts

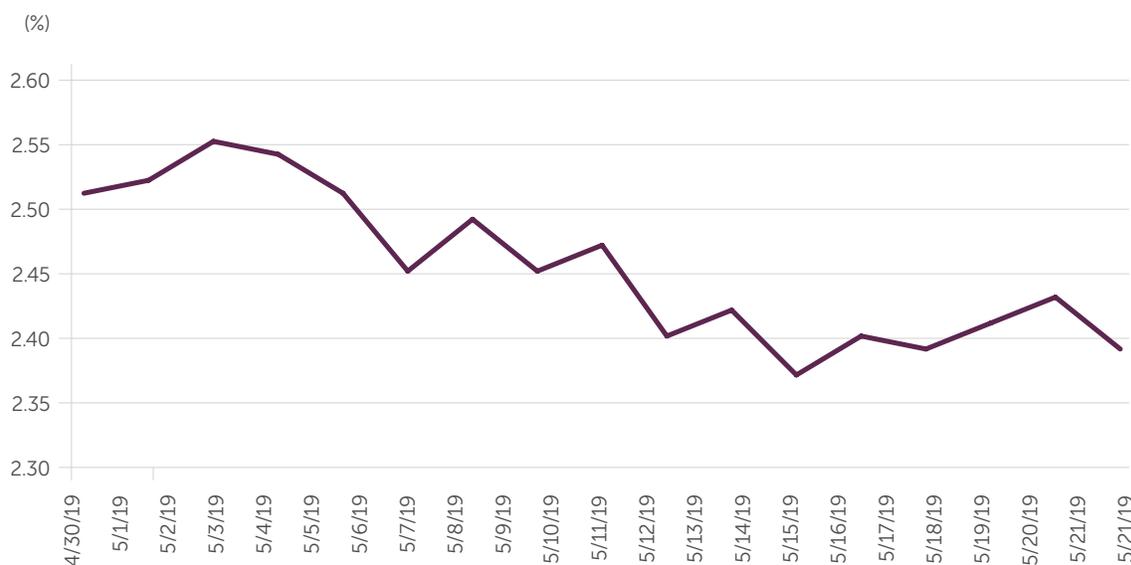


Source: Board of Governors of the Federal Reserve System, 5/28/19.

### What about fixed income?

The U.S. bond market, when compared to equities, has rallied in reaction to the talks surrounding trade issues. Yields have fallen over the month of May, particularly on high quality U.S. Treasury securities (see *Exhibit 4*). Riskier bond markets, such as high yield bonds, have underperformed as spreads have widened. We would point out that if a trade resolution was reached between the U.S. and China, it is likely that interest rates would rise as risk-on sentiment would probably find more support in the market.

#### Exhibit 4: Falling bond yields Benchmark 10-year U.S. Treasury yield

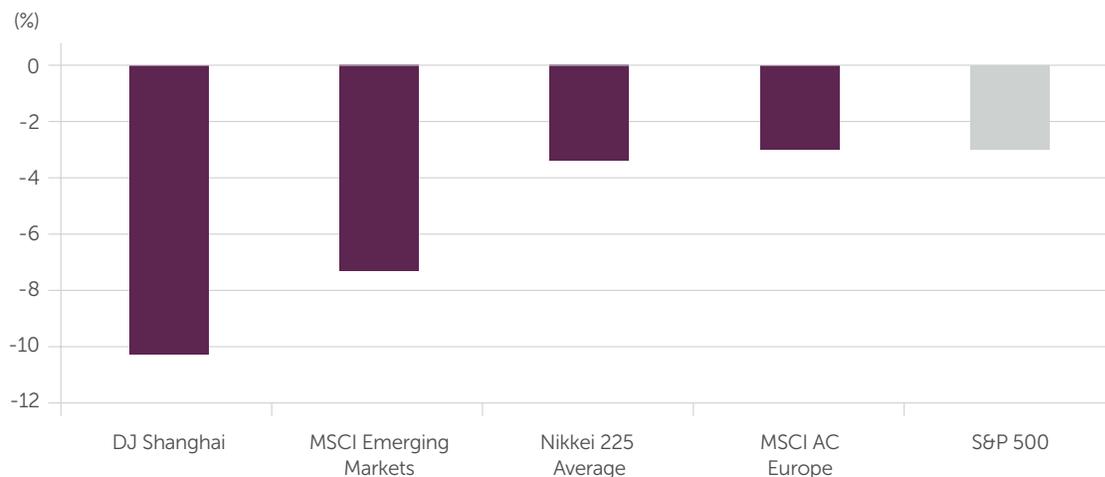


Source: U.S. Department of the Treasury, 5/22/19.

### Potential impact on world markets

As shown in *Exhibit 5*, most global equities have seen negative performance during May. Emerging markets stocks, including China, have been particularly hurt during 2019. It is useful to note that the U.S. has not been spared as the S&P 500 Index has also experienced a downturn in its performance for the month. This suggests that no one truly wins a trade war so we remain hopeful that an accommodation can be found for both sides in the ongoing negotiations.

#### Exhibit 5: Major stock indexes struggled in May, but U.S. fared better than most Month to date performance



Source: Morningstar, 5/23/19.

## What does this mean to investors?

Will there be a resolution by December? The short answer is we aren't sure. It has become abundantly clear that President Trump considers trade to be a major issue for his 2020 reelection campaign and wants to portray the U.S. as being a tough negotiator. This equates to extracting key concessions from China, which equally wants to present itself in the strongest possible terms on the world stage. With an outcome still not visible on the horizon, we would be defensive in the equity market. Defensive sectors such as **Utilities** and **Real Estate** offer a potential safe haven. Additionally, we favor buying **Information Technology** stocks opportunistically at depressed levels. Finally, it is important to maintain a balanced portfolio – stocks, bonds, and cash – during these periods of heightened uncertainty.

These views represent the opinions of the Chief Investment Officer and are not intended as investment advice or to predict or depict the performance of any investment. These views are as of the close of business on May 23, 2019, based on the information available at the time and are subject to change at any time based on market or other conditions. We disclaim any responsibility to update such views.

All investing involves risk, including possible loss of principal. Equities are subject to market risk (the risk that the entire stock market will decline because of an event such as deterioration in the economy or a rise in interest rates), as well as special risks associated with investing in certain types of stocks, such as small-cap, global and international stocks. International investing may be volatile and involve additional expenses and special risks, including currency fluctuations, foreign taxes and geopolitical risks. Emerging and developing markets may be especially volatile. Fixed income investing includes interest rate risk and credit risk. Interest rate risk is the risk that bonds will decrease in value as interest rates rise. As a general rule, longer-term bonds fluctuate more than shorter-term bonds in reaction to changes in interest rates. Credit risk is the risk that bonds will decline in value as the result of a decline in the credit rating of the bonds or the economy as a whole, or that the issuer will be unable to pay interest and/or principal when due. There are also special risks associated with investing in certain types of bonds, including liquidity risk and prepayment and extension risk, or investing in high yield (junk) bonds. There are additional risks associated with the use of derivatives. **Past performance does not guarantee future results.**

The Standard & Poor's 500 Index (S&P 500) is a capitalization-weighted index of 500 stocks. The Index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Dow Jones Shanghai Composite Index is designed to measure the largest and most liquid A-shares traded on the Shanghai stock exchange.

The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The MSCI EAFE (Europe, Australia, Far East) Index is a free float-adjusted market capitalization index that is designed to measure developed foreign market equity performance, excluding the U.S. and Canada. The Index consists of 22 developed market country indices.

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure emerging markets equity performance. The index consists of 24 emerging market country indices.

The U.S. Dollar Index (USDX, DXY) is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies.

It is not possible to invest directly in an index.

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