Northern Trust | Jim McDonald: Trade Disputes: A New Threat for Investors

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The recently announced US steel and aluminum tariffs have created rifts, both inside the administration and with our trading partners. While we remain positive on the outlook for growth and inflation, we have modestly pared back our recommended US equity weighting in the wake of the worsened regulatory environment.

The outlook for global growth in 2018 remains constructive, while the potential of increasing trade tensions has become a new risk. Global economic activity did accelerate a touch in February, with improvement in US measures offsetting some modest slowdown in Europe and Asia.

There has been some shift in momentum from the manufacturing sector to services, which will be less vulnerable to trade restrictions. Nevertheless, a tit-for-tat tariff war would not be good for business confidence or investment. The exemption of Canada and Mexico from the tariffs, alongside the potential for other countries to appeal for an exception, has reduced the risk of this individual trade action.

In addition to the new issue of trade, we have a new Fed Chair to assess. Former Fed Chairman Alan Greenspan once famously uttered, "Since becoming a central banker, I have learned to mumble with great incoherence." This playful comment highlights the importance to central bankers of preserving flexibility to minimize the risks around errant forecasts.

The major central banks remain in uncharted waters, as they look to normalize monetary policy after the global financial crisis. We don't expect inflation to force the Fed's hand to earlier rate hikes. And February's labor report showed a welcome moderation in wage gains and an increase in the participation rate. It's unclear how far and wide the trade disputes may spread.

In addition to the steel and aluminum tariffs, the NAFTA treaty is under renegotiation, and a US review of Chinese intellectual property practices present other risks. We did think it's sensible to pare back our recommended US equity overweight this month, in the wake of a deteriorating regulatory environment in the US. However, the constructive outlook for growth and inflation overall keeps us positive on risk-taking over the next year.

We'll be closely evaluating the potential for further trade actions to upset business confidence and activity, and also monitoring the Fed's march toward higher interest rates. As always, we look forward to sharing our updated thoughts as the year unfolds.

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