

Trade Barrier Casualties

The St. Louis Federal Reserve Bank recently published research on some nuanced effects of strained relationships with international trading partners. The results of the research showed that trade tensions have often permanent implications for the companies that exchange goods and services across borders. Once the relationship is strained or broken, the findings show that it is not likely to resurrect the partnership. The World Bank performed a survey sampling manufacturing plants with 50 to 5000 employees across 12 countries between 2008 and 2009. The survey asked the direct and telling question, “If this establishment shut down its business, how long would it take your largest customers to find an alternative supplier for its main product?” The table below shows the results of how long the replacement took, broken out across all non-exporters, exporters, and those with or without competition. The conclusion is that when the manufacturer is an exporter with a number of competitors, the relationship with importers is likely irreversible.

Time to be Replaced

Firms	Less than One Month	More than One Month	Never
All Firms	58%	36%	5%
Nonexporters	65%	30%	5%
Exporters	42%	50%	8%
No Competitors	14%	10%	76%
One to Five Competitors	57%	40%	3%
More than Five Competitors	65%	32%	3%

Small Cap Smoke Signals

While the S&P 500 hits all-time records, analysts are looking at the small caps for cues on the timing of when the economy moves from expansion to contraction. The Russell 2000 index dropped by nearly 20% in Q4 2018, with expectations that the Federal Reserve would continue to raise rates in 2019. The chart from Refinitiv shows that the forward price to earnings ratio has come down recently, currently around 21 times projected earnings. 82% of revenue for small cap companies is derived domestically (Goldman Sachs Asset Management). The downward trending PE multiple may be the canary in the coal mine of a slowing US economy and the conclusion of an economic expansion. Small companies tend to take on more debt than their large cap counterparts. Rising rates could further punish these companies.

