Commodity prices

Higher oil prices would adversely affect heavy users of energy, such as aviation, motoring, and manufacturing sectors. For example, American Airlines' share price went down 6% after it expected $2.3 billion in additional fuel costs.

Winners and losers are expected from conflicts, such as trade wars, but sometimes the outcome can be unexpected.

Unintended consequences

American company Metal Box International was going to shut down after its sales had been decimated by cheap imports, but Trump's protectionist trade policies changed its mind.

Metal Box, and other US manufacturers of products slapped with US import duties, should have seen its market sales rise as it filled the market gap created by reduced imports.

Anti-subsidy and anti-dumping duties imposed by the US on Chinese imports did result in a pick-up in Metal Box's sales, but it was short-lived, because, according to the company, consumers and retailers feared trade war disruption so they stocked up pre-emptively. The company increased its capex in anticipation of higher sales volumes, but the machinery now sits idle.

The company's hopes for business success were set back further by tariffs imposed by Trump on imported steel, because the company will now probably have higher costs of steel raw material.

Stagflation and GDP

Moody's notes that workers employed by US business sectors that use steel far outnumber those employed in its manufacture, by around 5:1. That is also the ratio of job losses: gains predicted by Trade Partnership as a consequence of US tariffs.

"Protectionist trade policies, including tariffs on raw-material imports, could exacerbate these inflationary pressures [caused by global economic growth], running the risk of tighter margins and possible supply-chain disruptions in the manufacturing sector," said Moody's. Inflation could necessitate faster monetary policy tightening, i.e., more interest rate hikes. That would raise companies' costs, denting their profits.

Sustained high interest rates and inflation could stymie global economic growth and create stagflation. A March survey by BoAML found that 90% of investment managers thought protectionism would cause either inflation or stagflation, and protectionism was investors' primary fear.

Whereas some steel users will have the ability to pass on rising metal costs (either contractually, or through their brute forces of negotiating or price-setting), smaller companies will have to absorb higher input costs to maintain market share. For the former, profit margins will be protected, for the latter, they will contract.

Where investors are concerned, borrowers also need to be concerned, because the fortunes of both are intertwined. When investors become risk-averse and hoard cash, borrowers lose access to capital or pay a higher cost. Reduced profits ultimately hurt workers' incomes, the economy's GDP, and investors' return on investment.

Unchecked, stagflation could deteriorate into recession, leading to job losses, reduced investment and further corporate financial distress. With many companies and individuals already highly geared with debt, a recession or stagflation that reduces income and the ability to service debt interest obligations, could trigger a wave of personal bankruptcies or corporate insolvencies, reducing GDP further and leading potentially to recession.

Companies might have to lay off employees to remain profitable or in business. Where last-in-first-out stock valuation accounting policies are used, profits will be quickly dented, reflecting higher stock costs. Cashflow will fall because of more expensive stock, or else companies will try to stretch their trade creditors' goodwill even farther. Companies that can control their working capital interactions are more likely to survive than those with poor credit, stock, and trade creditor management practices.

Credit insurance

Companies' trade credit insurance premia might increase, or be stopped if their financial position deteriorates. Credit insurance providers stopped providing credit protection to Woolworths' suppliers, meaning it had to pay in cash, exacerbating the strain of its debt pile and leading to its administration. Without credit insurance, factoring of invoices, and conventional credit from suppliers, Toys R Us had to buy its games and toys as they were delivered. Without cash, a company's shelves soon begin to empty, payments become overdue, staff are not paid, and operations grind to a halt, i.e., bankruptcy or insolvency ensues.

Gearing

Companies that have low gearing or operate in strong cashflow sectors such as fast-moving consumer groups, might withstand a cash crisis by raising additional debt, but companies already creaking under a mountain of debt and/or debtors, are more likely to break under the strain, and relatively sooner.

Almost 2/3 of aluminium and 1/3 of steel are imported by the US. Caterpillar and Boeing were caught in the firing line between the US and its trading partners because of their heavy and critical reliance on metals, and their international operations. Investors realised the negative implications so dumped both companies' shares, sending their prices down more than 5%.

Winners and losers

Shareholders in US steel makers made a mint from US tariffs. US Steel and AK Steel, for example, rose 6% and 10% respectively. In the longer-term, US steelmakers could lose out from trade wars, however, for example, if manufacturers relocate, cut back on domestic production volumes, or use alternatives materials.

Other winners in the latest trade spat are companies that are more inward-looking or resilient to tit-for-tat retaliation, such as healthcare and BioTech. For example, shareholders in Johnson & Johnson, Merck, and Pfizer were some of the biggest winners in March. Other defensive regions and sectors include: Australia, Brazil, parts of Europe and Japan, and sectors such as telecoms, utilities, insurance, and retail. Countries whose GDP depends heavily on exports to the US, such as Mexico and Canada, are likely to suffer most from US protectionism.

Conclusion

Companies are in the cross-fire between trading countries, so they need to, above all, pay close attention to their cash flow and their survival over the longer term, even at the expense of near-term profit and revenues. They also need to monitor a changing geopolitical landscape and adapt accordingly. At such times, a company is likely to soon find out how committed banks and other investors really are to the company's survival.