Stirling Bridge
Wealth Partners, LLC

MARKET COMMENTARY – JULY 1, 2018

Trade War?

Despite our hyper-political culture and our best judgment, we are going to attempt to have a conversation about the growing global spat that seems centered on the U.S. and its trade with other nations. Our ultimate goal here is to educate ourselves and others as well as decipher what the implications are for our economy and the market.

For several decades now, the trend of the leading economies in the world has been toward free trade. Stated otherwise, the U.S. sought to reduce barriers such as tariffs and national quotas that favor homegrown companies or industries with the expense borne by consumers and the competition. With fits and starts, the journey toward open trade continued until recently. It had further to go. <u>But even before the current U.S. administration put a bullseye on trade, barriers were being erected worldwide.</u>

A sane person asks, why? Why upset something that has reduced costs for billions of consumers? Why risk tipping the strong economy into recession?

It turns out that free trade, like all market-based economic institutions, works best when the participants operate on the same, ongoing terms. Essentially, countries should trade with partners so that both sides exchange value and are better off as a result of the transaction or relationship. In the short and long run, things are better.

We've had the privilege of meeting many hardworking business leaders over the years. To a person, if they've been involved in a market that competes with Chinese goods, they report firsthand knowledge of blatant theft of intellectual property (trademarks, patents, etc.). From autos to high technology, China's policy seems to be 1. Import 2. Replace. So they import products long enough to copy and master the manufacturing. Then they begin to produce their own with oftentimes state-supported companies.

Furthermore, think of the most innovative, fastest growing companies in the U.S. Google? After being banned from China for many years, Google has set up a tiny footprint in the country recently. However, China requires them to utilize homegrown companies for many services, ensuring very little revenue can be earned from its billion consumers. Facebook and many other web-based services offered by U.S. companies remain barred from any operations in China.

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Amazon? While it dominates the world retail market, has only 1% of China's online market, partially due to unfair competition. Netflix? Was only allowed to enter China in 2017 via a licensing deal with a Chinese company.

We have spent some time discussing our trade with China as it is likely to continue to be the most contentious. But there remain some sticky issues even with our closer partners. Most goods between these regions have small (3-5%) tariffs to pay for customs and inspections. But the E.U. has a 10% tariff on automobiles from the U.S. We have a 2.5% tariff on European cars. Agricultural products remain a flashpoint between the U.S. and Canada (270% tariff on U.S. milk).

Finally, there are other funky things countries intentionally do to favor their own companies. This can be termed a Quiet Trade War, which has been raging for years. Some have set quotas (a ceiling on how much can be imported). Others put foreign goods through lengthy, unnecessary inspection, documentation, and safety procedures, thereby jacking up the costs. To varying degrees the U.S. has also been occasionally involved in offensive operations of its own in the Quiet Trade War.

Our research suggests that there are legitimate gripes about the fairness of global trade. Some American interests are being taken advantage of. So, perhaps the tariff battle is a viable way to bring the issue to the forefront and solve it. Perhaps not. We generally favor freer trade. But for now, we'll leave the actual policy steps for another discussion.

Taxes and corporate fundamentals remain robust today. But interest rates are rising. And if, when companies report earnings, enough begin to guide future expectations lower due to the trade spat, we may finally have enough negative news to at last tip us into recession. <u>However, as of this writing, we do NOT expect recession this year.</u>

Stay tuned.

Stirling Bridge Wealth Partners, LLC is fortunate to count many of you as clients. In the good times and bad, we remain committed to providing customized investment solutions and robust financial planning wrapped in a package of exceptional service. We thank each of you for your dedication to us and for your trust.

Sincerely

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