

## ***As the Trade War Intensifies – Here is our Playbook...***

***By Bob Deitrick, CEO***

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*The Trump administration should be praised for taking action against China on trade; however, the tariff strategy they have elected to facilitate their achievement is not working. The structure of U.S.-China trade has changed, but this is a complicated topic requiring some nuance, etiquette and compromise. Since 1990, China has emerged to become a middle-class powerhouse. They have done this through hard work, nonreciprocal trade, perseverance, forced technology transfers and intellectual property theft. However, tariffs do not work in the globally connected world of today. We were proponents of the Trans-Pacific Partnership (TPP) because it provided us with some leverage to obstruct China's tactics. Now that we are out of the TPP, we are on our own and the tariff strategy is proving ineffective so far.*

*This is not a political argument as I, like Ben Franklin, am an extreme moderate. We do not care whom anyone voted for. We do care about you, your family, your accounts, and how this volatility may impact your wealth moving forward. **As the DOW dropped 800 points last Thursday, the worst drop all year and the 4<sup>th</sup> largest point drop ever, as Ricky Ricardo might ask Lucy: "you got some splainin' to do."** Therefore, **we wanted to convey to you what is happening and what our strategy is moving forward.***

*On July 31<sup>st</sup>, a few short weeks ago, the market was at a record high. Then the President announced, to our chagrin, that he was going to impose new tariffs on \$300 billion of Chinese goods on September 1<sup>st</sup>. That sent the VIX and the market into a tailspin and the market has dropped 7 to 12% from the highs of late-July... Last week, Treasury Secretary Mnuchin removed most items from the new tariff list and delayed others until December. That showed weakness on our part. Beijing said on early Thursday it would take tariff countermeasures; and they did not agree to begin re-purchasing our agricultural products. This constant economic chaos is what the market abhors. If the trade war is not resolved within 90 days, our strategy is to transition to a defensive stance before this tumor metastasizes.*

*Trump claimed last week that Washington's trade war with China has had little impact on the American economy. However, that is not true. The negative effects of the trade war are showing up in our manufacturing, transportation and distribution sectors. One of the President's tweets on Wednesday remarked that the "U.S. is winning, big time against China," and that "prices to us have not gone up, and in some cases, have come down." However, the economic costs are mounting, and this new threat, if implemented, will cost American business and consumers over \$100 billion over the next 12 months. That's one-half of one percent of GDP and one-half of the tax cuts Americans received last year.*



*We hope the President realizes his stance with China has become ineffective and that he needs to seek compromise. However, China has the upper hand at present, so the question is: Will they take advantage of that, seek a compromise, or will Chinese President Xi Jinping provide Trump an exit ramp?*

*In this protracted trade battle, which goes back to February of last year, the U.S. and China have slapped tariffs on billions of dollars of one another's goods, rattled markets around the world and raised concerns about the global economic outlook. The tariff war has taken a toll on American business sentiment as business investment or CAPEX has flatlined since January. This negative hit may come to roost in the jobs sector next. We are watching job growth; the yield curve and unemployment claims very closely. Problems have shown up already in manufacturing, retail and new home sales. If other sectors of the economy begin to retract on hiring and unemployment starts to rise – that is our next recession.*

*We drew a comparison between last year's jobs stats and those of 2019 to date. In 2018, average monthly job growth in the U.S. was at ~ 225K. In the first six months of 2019, cutting through the data volatility, job growth is at ~ 140K per month. If the monthly jobs figure slips under 100K, unemployment claims and the unemployment rate will begin to rise. We are watching these forward indicators closely.*

***To deal with this uncertainty, we have created a playbook to produce some protection in this ambiguous, risk-on, risk-off environment where tweets and macro headlines rule the day. To the extent a trade deal is not made within 60 to 90 days or to the extent the macro-stats deteriorate further - our protectionist playbook will begin:***

- ***We will purchase stocks, funds and ETF's that are have higher quality and lower volatility characteristics - lower beta positions with stable cash flows and little leverage will be considered in this "risk-reduced" strategy.***
- ***Retail is interesting but our move here would be clicks over bricks - like Costco and Amazon.***
- ***Higher tariffs would benefit the off-price retail stores like TJ Maxx and Dollar General. There store model purchases surplus inventories from traditional department stores. This could all be happening as consumers may be shifting down the price ladder to more affordable retailers.***
- ***We believe defense and aerospace will outperform machinery and equipment manufacturers like John Deere and Caterpillar. So, this is another defensive strategy to protect your portfolio.***
- ***We continue to like technology moving forward but believe software firms will provide more stable returns in this uncertain environment. Apple and Amazon are there as well.***
- ***U.S. Focused companies will be recommended if the global economy weakens.***

*I am an optimist. However, after 19 months of this tit-for-tat tariff strategy, which has been a bust to date, there has been a toll on the equity markets for investors in the range of \$3 to \$6 trillion dollars in lost opportunity cost. The question becomes will all of this have been worth it when all is said and done?*

- ***Our next Client Market Seminars will be held November 13<sup>th</sup> and 15<sup>th</sup> at Eddie Merlot's***
- ***Please email or call us any time with any questions whatsoever. Have a terrific week!***