Polaris Greystone FINANCIAL GROUP, LLC

Polaris Greystone Educational Series

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Trade Wars!?!?

President Trump imposed a 25% trade tariff on steel and a 10% trade tariff on aluminum, which are set to become effective on March 23rd. President Trump imposed these tariffs using a rarely used trade provision, Section 232 of the Trade Expansion Act of 1962, claiming national security as the justification for protecting our domestic steel and aluminum industries. He chose to exempt Canada and Mexico from these tariffs and is allowing other allies to petition for similar exemptions.

Before I get into anything to do with tariffs, potential trade wars, and the consequences, I want to reiterate that as the Chief Investment Officer of Polaris Greystone Financial Group I need to be as "apolitical" as possible. My personal beliefs should not cloud my investment decisions. My job is to merely understand what is truly going on and how to make wise investments within the current market environment. We have clients of every belief, from the far right to the far left, and everything in between. Those on the far left might find my comments to be conservative. Those on the right might find my comments to be liberal. Hopefully, most of you will read this in the light that it is intended, purely educational. Let me repeat myself by saying, my job is to understand the current market and invest accordingly, removing all political biases. With this in mind, let me try to take a crack at this current political situation.

Why Did Trump Impose a Tariff?

In 2017, the United States trade deficit was $566 billion. We imported $2.895 trillion in goods and services while exporting only $2.329. Of the $2.329 trillion in goods and services we export, $778 billion is in services (i.e., intellectual property, financial services, computer consulting, etc.). We import $534 billion in services, meaning we are a surplus exporter of services. President Trump is more concerned about the goods we export. As of 2017, we are only exporting $1.551 trillion in goods, versus importing $2.361 trillion, an $810 billion deficit in goods traded. President Trump believes that many of our trade partners are imposing unfair trade practices to gain a competitive advantage, thus creating a trade imbalance. By levying a tariff on steel and aluminum, President Trump is making imported steel more expensive for Americans to buy, thus making American made steel more attractive domestically.

Why Do Trade Deficits Matter?

There are two reasons why a trade deficit matters to a major economy like ours. First, an ongoing trade deficit is detrimental to a nation's economy because it is financed with debt. You can't continue a trade deficit in perpetuity. One day, the lending countries could ask America to repay the debt, which we may or may not be able to do at that time. A second concern about running an ongoing trade deficit is that it makes a statement of the competitiveness of the U.S. economy itself. If we purchase goods overseas for a long enough period, the U.S. will lose the expertise to make these goods, perhaps even eliminating the need for factories to produce these goods. As we lose our competitiveness, more jobs are outsourced, and our standard of living declines.

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Why Tariffs on Steel and Aluminum?

"A strong steel and aluminum industry are vital to our national security," stated President Trump. He went on to say that it was vital for national interest to take action against other nations that have dumped steel into the global market, costing American jobs and the nation's economic standing. He went on to say, "Now we're finally taking action to correct this long overdue problem."

While no nation was directly named, most believe Trump made his decision to implement the steel and aluminum tariffs due to Chinese trade practices. In fact, in the December 2017 World Trade Organization meetings EU Trade Commissioner Cecillia Malmstrom said China's industry subsidies, including for aluminum and steel, were flooding global markets and hurting European workers in a "very, very dramatic" way.

The United States quickly exempted Canada and Mexico from these new tariffs. The exemptions for Canada and Mexico, however, "are not open-ended." The Trump administration is currently renegotiating the terms of NAFTA and a permanent exemption will greatly depend on the progress and changes made to the twenty-five year old trade agreement. Trump was quoted, saying : "I have a feeling we're going to make a deal on NAFTA."

The Trump administration stated that they would be willing to exempt other countries. "If the same goals can be accomplished by other means, America will remain open to modifying or removing the tariffs for individual nations, as long as we can agree on a way to ensure that their products no longer threaten our security," Trump said. "We're going to show great flexibility."

Why Impose a Tariff Now?

Tariffs are not a new thing. Just in January, President Trump placed a 30% tariff on South Korea and Chinese washing machines and solar panels. This did not make the same type of news as the steel and aluminum tariffs. President Trump is also not the only leader trying to protect their economy. According to the British newspaper The Guardian, "the world's 60 largest economies have imposed 7,000 new protectionist measures since the financial crisis of a decade ago, with Washington and Brussels each responsible for 1,000 of the new restrictions."

Why now? My best guess at why President Trump issued the steel and aluminum tariffs was to make good on one of his main Presidential campaign promises ahead of the mid-term elections coming up in the fall. Renegotiating NAFTA or any other major trade deal would be a significant win for the Republican Party. The other reason why I think he announced the steel tariffs now was to shoot a salvo across the bow of some of America's trading partners ahead of the G20 meeting in Argentina, where he will most likely try to begin renegotiating these unfair trade practices.

Who Are Our Largest Trade Partners For Steel?

According to Reuters, the top exporters of steel to the United States are as follows:

1	Canada	16.7%
2	Brazil	13.2%
3	South Korea	9.7%
4	Mexico	9.4%
5	Russia	8.1%
6	Turkey	5.6%
7	Japan	4.9%
8	Germany	3.7%
9	Taiwan	3.2%
10	China	2.9%

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What Happens From Here?

The day before President Trump imposed his tariffs; the European Union detailed a list of U.S. made goods that it would subject to tariffs if the United States moved forward with our tariffs. President Trump was unmoved by these threats stating, "Trade wars are good, and easy to win."

After Trump's tariff announcement, China's commerce minister Zhong Shan was quoted by reporters say, "Trade war has no winners, it will only bring disaster to the economies of China, the U.S. and the world." Shan went on to say, "China does not want a trade war, nor will it actively initiate a trade war. However, we are capable of handling any challenge; we resolutely defend the interest of the country and the people."

Now that this initial salvo has been shot across every country exporting goods to the United States, the Trump administration has turned its focus directly at China for their unfair trade practices. The Trump administration has reason to focus on China. China's infractions against free trade are well known and widespread. It's not just the United States that grows tired of China's trade practices. On December 13, 2017, the EU, Japan, and the United States stated that they would work together to stamp out abuses including state subsidies and forced technology transfers, a directed swipe at two of China's business practices. China is also accused of manipulating their currency to make their products cheaper to export, stealing intellectual property (e.g., music, TV programs, movies, software, copyrights, patents, brand names, etc.), providing export subsidies, and export tax rebates to name a few tactics.

President Trump also has issues with the $92 billion trade surplus (2016) that the EU held over the U.S., according to the U.S. Census Bureau. The EU and the U.S. impose tariffs on each other's goods, but the EU's are higher on average. The ECB has also been accused of manipulating the valuation of the Euro to help their trade.

President Trump's views of unfair trade practices are well founded and should be concerning to all Americans. These foreign practices have impacted our economy and have cost Americans jobs. The issue becomes "how do you renegotiate" the terms of our agreements with countries that have no reason to voluntarily renegotiate their trade practices with us.

To quote Larry Elliott, an English writer for The Guardian, "Trump sees trade negotiations as like one of his business deals: the aim is to get the other side to make concessions. He may be right in his assumption that other countries will blink first. America is, by global standards, a relatively self-contained economy: trade is 28% of GDP. That compares with 41% in China and 51% in Germany, leaving them in a much more exposed position."

The great question is, 'will these countries come to the negotiating table or will this escalate into a trade war?' While our president has been quoted as saying, "trade wars are good, and easy to win," history doesn't agree with his statement. I applaud his tough stance because I think that it is the only way that China and the EU will take the United States seriously about renegotiating their trade policies with us. This negotiation will be done on a razor's edge, with China and the EU fighting and using tough rhetoric along the way. It might even come with a few salvos shot back and forth. As mentioned before, we already have tariffs against our goods right now, so don't view this as a "trade war." My best guess is that President Trump will keep his hard line on unfair trade practices. He will get pushback from both China and the EU. My hope is that China and the EU don't press the issue to see if President Trump is bluffing or if he is serious. My best guess is if he is pushed, President Trump won't back down and he will escalate the tariffs he is placing on goods which could quickly escalate from a few salvos into a full-fledged trade war. That said, it was Trump's tough rhetoric that brought Kim Jung Un to the negotiating table about their nuclear weapons program.

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What's Polaris Greystone's View And What Are We Doing

Right now, there isn't a trade war. Everything going on at this moment is nothing but rhetoric. We view Trump's stance as a negotiating tool to correct an imbalance in trade with NAFTA, the EU, and solve or mitigate unfair trade practices conducted by China. If President Trump was truly fixated on starting a trade war, why would he hire Larry Kudlow, a known anti-tariff economist, as his chief economic advisor? It is our view that President Trump is trying to play hardball and hold our trading partners accountable for the first time in a long time.

We at Polaris Greystone will be watching this situation very closely. We are watching the market's fundamentals and technicals, to see if we need to take defensive measures (sell some of our exposed stocks), or go back to being fully invested in our portfolios. The sentiment of the markets can also have a material impact on the market's price movement, quickly forcing prices up or down purely based on the emotions of investors. The perception of investors in the market can quickly become the reality of the market's price movement. It's not about being right; it's about being right at the right time. PGFG is a tactical manager. We will move more defensively if our research points that direction. Please be assured that we can move quickly into a defensive stance, removing 10-25% allocation increments, if necessary. We do foresee higher volatility for the rest of this year, something that we have been predicting for a month. This will require you, as the investor, to try to mitigate your emotions when looking to the media for some of the answers. PGFG, on the other hand, will be here to provide you clinical investment management and unbiased answers to the complicated questions you might have.

As always, I welcome your questions and comments. I encourage you to meet with your Polaris Greystone wealth advisor to keep up to date with our service offering.

Sincerely,

Jeffrey J. Powell
Managing Partner, Chief Investment Officer