Six Months After The 2018 Bear Market, Trump's Trade War And His Disinformation Campaign About It Rage On

Since January 2018, President Trump has been engaged in a trade war with most of the U.S.'s major trading partners. Not only have the tariffs destabilized the global economic growth trajectory, but they have also severely damaged the U.S.'s relationships and reputation with our trading partners. The President has been hitting trading partners with tariffs unilaterally, with no support from traditional international governing bodies and little to no support from even his own party. The President is also hard at work on a disinformation campaign about how his tariffs function in order to persuade his base of support that tariffs are actually a good thing for our economy – though clearly they're not.

Tariffs work like this – you tax your own companies to create incentives for them not to import products made outside the U.S. In theory this could provide some long-term benefit if a country, like the U.S., were able to make structural changes like reducing production costs enough to incentivize U.S. companies to produce products here, as opposed to low labor cost countries like China, Pakistan or Vietnam. The truth however is that tariffs do direct harm to U.S. companies and U.S. consumers. The United States has a mature economy that, even with heavy tariffs, will not become a low-wage production center like it was 50 or 100 years ago. American workers won't accept the extremely low wages that Vietnamese or Pakistani workers might. Also, the cost of living in the United States is high and requires high livable wages to survive. Our economy has simply evolved to a consumer and high tech economy and will not devolve into the manufacturing economy President Trump imagines from his childhood, no matter how many trillions are lost to tariffs.

It's clear that the President's understanding of how tariffs function and how they might produce the end-goal he's trying to attain is poor at best. What's worse than his grip on basic economics however, is that he's making up bold faced lies to try to sell his base on his tariff war. Repeatedly, via in person interviews, at his rallies or on Twitter, President Trump has stated the China is paying for the tariffs and that those payments go directly to the U.S. Treasury. This is a truly mind boggling lie and Trump's supporters deserve to know the truth – that U.S. companies and consumers directly pay Trump's tariffs, not China or any other trading partner.

Here is a quick, easy to understand example of how U.S companies and consumers pay the President's tariffs. Let's say an American automotive parts company is producing parts in a Chinese manufacturing facility, and then imports those parts to the U.S. to sell to American consumers. When the parts arrive at the U.S. border, the American company has to pay a 25% tax on those parts arriving in the U.S. In order for the American company to maintain profitability, keep its workforce intact, etc. that American company must raise prices (probably by 25%) to U.S. consumers just to tread water. This problem is immediately becoming widespread because all products imported from China, either by Chinese companies, American companies or others, are being hit with a 25% tariff. The Chinese have retaliated with tariffs of their own, so now American companies importing and exporting products to or from China are getting hit by tariffs on both sides of the Pacific.

These tariffs, which are essentially taxes that bypassed the Congressional approval process, hurt companies worldwide, especially American companies. Consumers are then hurt since the companies hit with the tariffs must raise prices in order to maintain profitability. While it is true that the goal of the tariffs is meant to change corporate behavior, President Trump believes the tariffs will lead to companies producing more products in the USA. To believe this however, one must pretend that the 21st century American economy is the same economy our Grandfathers and Grandmothers had – and that's just not the case. The U.S. today is far more a consumer, tech and intelligence based economy that it is a manufacturing economy. No amount of tariffs will make manufacturing as cost effective for American companies as it is to manufacture products in lower wage countries like China, Vietnam, etc.

Tariffs Aren't Just Focused On China

China isn't the only country President Trump has engaged in the global trade war. Since early 2018 the President has been imposing tariffs on many of our main trading partners, including China, Mexico, Canada, the European Union, South Korea and others. In response, these trading partners have imposed retaliatory tariffs on the U.S. Although the Dow Jones Industrial average remains near all-time highs, the trade war has now caused two significant market corrections, in early 2018 and the Spring of 2019, and a historically bad bear market during the 4th quarter of 2018. Also, because the tariffs have been unevenly applied against various countries and various economic sectors, there has been a strange hodgepodge of winners and losers in the trade war.

Here is a very brief history of some of the main battles in the trade war:

- January, 2018 – President Trump imposes tariffs on solar panels & washing machines.
- February, 2018 – The Trump Administration states that imports of steel and aluminum products threaten national security and imposes 25% metals tariffs on Canada, Mexico, China, South Korea and the European Union.
- April, 2018 – The Trump administration lists $50 billion in Chinese product imports in consideration for 25% tariffs. China retaliates with a list of $50 billion in tariffs on U.S. exports to China.
- May, 2018 – President Trump considers 25% auto tariffs against the European Union, claiming imported autos and parts are a national security threat.
- June, 2018 – The EU retaliates with tariffs worth $3.2 billion of U.S. products.
- July, 2018 – Canada retaliates with tariffs worth $12.8 billion of U.S. products. First phase of U.S./China tariffs go into effect. Trump threatens to impose tariffs on all imports from China, totaling about $500 million in value.
- Late July, 2018 – President Trump announces up to $12 billion in subsidies for farmers damaged by the trade war. A total of $27 billion of agricultural exports are now affected by the trade war.
- August, 2018 – President Trump announces 50% steel tariffs against Turkey and the Turkish government immediately retaliates with their own tariffs on U.S. products. Trump also considers

raising China tariffs to 25% and China retaliates with an additional round of tariff considerations worth $60 billion.

- November and December, 2018 – as global markets crash, economic data begins to show the negative impacts of President Trump's global trade war. Raw materials costs are beginning to increase worldwide due to tariffs, with the poorest countries and small cap stocks hit the hardest.
- December, 2018 – A historic bear market in global stocks and bonds is underway. After the G-20 meeting Presidents Trump and Xi announce a temporary trade war truce. Stock markets worldwide immediately begin to rebound.
- April, 2019 – The trade war truce deal begins to fall apart as China and the Trump Administration cannot come to a final trade deal by the truce deadline. Economic data continue to show deterioration in global growth. Many global stock markets in emerging market countries and Europe, and in the Energy and Manufacturing sectors slip back into bear markets.
- May, 2019 – President Trump suddenly announces he will formally increase existing China tariffs from 10% to 25% and threatens to impose 25% tariffs on all Chinese imports. China immediately retaliates by announcing tariffs on an additional $60 billion in U.S. exports to China.
  Source: Peterson Institute for International Economics, 5/13/2019

The Winners And Losers So Far In President Trump's Trade War

The trade war has been negative for most industries, sectors and businesses worldwide. Not only are companies literally paying higher taxes in the form of tariffs, but other countries are retaliating with tariffs of their own and of course the economic uncertainty of the trade war is causing global reverberations. However, not all companies and industries are affected evenly and 18 months into the trade war, we're seeing some clear winners and losers. Here's a brief rundown of the temporary effects the trade is having on various market participants.

- Automotive industry: Companies who produce vehicles, vehicle parts and components or even those who simply count auto industry companies as their customers are all suffering. General Motors recently projected an additional $1 billion for the costs of tariffs and related raw materials price increases for 2019 (Source: Reuters). Ford Motor Co is projecting close to $1.3 billion in tariff related costs for 2019, reduced sales and increased commodity costs. Ford has responded by laying off about 10% of its workforce (Source: CNBC). Smaller companies are likely to have an even tougher time adjusting to the auto industry tariffs because they have less ability to switch suppliers and rely on a small number of major customers.
- Technology chipmakers – The main legitimate complaint I view from the Trump Administration regarding trade with China is the forced technology transfer that China requires for U.S. businesses to gain access to the Chinese market. It's unfair to companies trying to gain access to China and equates to outright theft of intellectual property. Basically for U.S. companies to gain access to the Chinese market, the Chinese government requires U.S. companies to do joint ventures with a local Chinese company. As part of the joint venture process, the U.S. company has to share literally everything with their Chinese joint venture partner company. That Chinese

company then simply steals the intellectual property, business processes, trade secrets, etc. to duplicate what the American company is doing. This is obviously not free market behavior and is literally outright theft. Huawei, a Chinese tech company accused of international espionage has been blocked from doing business with many U.S. tech companies. Stock prices of companies like Qualcomm, Xilinx and Advanced Micro Devices – to name just a few – have been collapsing. The loss of one Huawei as one of their biggest customers will likely lead to serious problems for many U.S. tech companies, but again the Chinese IP theft is a legitimate issue. It's the intellectual property theft issue that I believe is the lone element of the President's trade war worth pursuing.

- U.S Farmers – American farmers are absorbing as much of the pain from the trade war as any group. China has drastically reduced imports of U.S. agricultural products, leaving many farmers with no place to sell their products – effectively losing their biggest customer since the trade war began. Major American agricultural companies like Deere & Co, Cargill and others are seeing huge profit declines and are responding with cost-cutting measures like layoffs.
- The Energy Industry – as far as stock market sectors are concerned, none has been hammered as badly as the Energy sector. With the U.S. now the world largest crude oil producer, much of the Country's GDP and employment comes from energy companies. Just as the Energy sector was beginning to fully recover from the 2014-15 oil crash, tariffs have increased costs for many companies, especially oilfield services companies, and raised concerns about oil demand. China before the trade war was the largest importer of U.S. crude oil, but now that has slowed to a trickle, effectively erasing U.S. oil producers' ability to export oil to China. This has helped lead to increased domestic oil inventories, which has a bearish effect on oil prices. Increased uncertainty around trade, President Trump's sanctions on Iran and Venezuela, and an expected global growth slowdown from tariffs have also caused underinvestment in oil exploration. Because energy stocks have been hammered so hard they make up a relatively small percentage of the overall stock market. However, our strategies are heavily invested in energy companies because we feel they represent, overall, some of the best value stocks available and we expect strong future returns from this sector.
- Raw materials, Importers and Others – The trade war has made raw materials used for anything from construction of commercial buildings to furniture more expensive. This obviously is hurting profitability in some sectors and companies more than others. Also temporarily damaged are U.S. companies who use Chinese manufacturing facilities to produce their products, only to get hit with tariffs when shipping those products to the U.S. to be sold. Even companies who only source parts of the manufacturing process in China or other "trade war" countries are suffering since increased costs filter their way through the entire production process, increasing costs for nearly all producers and consumers.

Short Term Vs Long Term Impacts Of The Trade War

The short term impacts of the trade war are becoming clearer by the day. Companies are finding where their increased costs are and after some analysis, deciding whether they can change their product sourcing, increase product prices or cut costs. Many companies are doing all of the above. This is leading to immediate decreases in corporate profits, certain areas of the stock market getting hit much harder than market sectors less affected by tariffs, and sadly – we're beginning to see companies announce large layoffs. Investor confidence is suffering because of stock market declines, but also because of the uncertainty the trade war is causing. The public at large and institutional investors are not convinced the Trump Administration has a holistic game plan to the trade war. Often it simply appears as if the President seeks revenge for some perceived slight with his tariffs. Clearly President Trump views the trade war, like most things, through a personalized lens and doesn't seem capable of understanding the greater good of the nation or the economy. The Administration doesn't have a cohesive message about their strategy and thus it's unclear to Americans and foreign countries what the end-game is and what will lead to an end to the trade war.

President Trump's messaging about the trade war has been deceitful to put it mildly, in order to win the approval of his political base. The President has fed lies to his supporters in order to get them to buy into his world view and to support his tariffs. He's told his supporters that trade wars are easy to win. He's told his supporters that China pays for the tariffs directly. He's given his supporters the idea that the tariffs are somehow punishing China. In fact, none of these things are close to true. American companies literally pay the tariffs to the U.S. government and no foreign country directly pays a single dime for the tariffs imposed on their countries. Companies pay governments for tariffs because tariffs are taxes. Chinese, Mexican, Canadian, European and yes, American companies, are paying these tariffs. The truth is that no one wins in trade wars, history has shown us that. The President is either ignorant to this reality, is pretending that his lies are the truth or he knows he's not telling the truth and is only interested in getting his base to believe him. It's clear to all observers other than him though that the tariffs won't accomplish anything other than economic damage.

Even if the trade war abates before the 4th quarter, many leading economists see the impacts for 2019 being a continued stock market downturn and a continued global growth slowdown. The public will suffer, but this pain is likely temporary if the U.S. and China come to some sort of trade agreement. We would also need the Trump Administration to remove the tariffs imposed on our trading partners and American companies since the beginning of 2018 and those trading partners would need to also remove the retaliatory tariffs.

If the trade war continues long-term however, widespread economic damage and a recession look like virtual guarantees. At the beginning of May, Washington and Beijing looked ready to come to a trade agreement. Then, according to reporting, China backed out of much of what they'd initially agreed to, and predictably, President Trump responded with an angry twitter rant – again taking things personally and threatening global economic harmony with threats of imposing 25% tariffs on 100% of Chinese imports. The longer the trade war goes on, the more material damage it does to those sectors of the economy most affected. We're starting to see farmers, raw materials and some energy companies already going bankrupt. Certain market participant simply cannot change product sourcing, move manufacturing facilities to non-tariff zones or pass rising costs onto consumers. Other market participants will increase costs, directly harming consumers and consumption based economies. And virtually all industries could see layoffs in large quantities as companies seek to reduce costs to maintain profitability.

Julian Cook, a portfolio specialist at T. Rowe Price, recently said the increased tariffs could lead to 20 basis point decrease in GDP in the second and third quarters this year alone. However, the longer-term effect higher tariffs might have is much more difficult to estimate. The longer the trade war goes on, the more countries and businesses will have to find new ways to navigate higher trade costs. This could lead to structural changes in how global trade is conducted, how supply chains function and we'll find out which businesses can adapt and survive to the new trade environment. In the immediate term, U.S. farmers have been locked out of the largest consumer market – China. Long-term, if tariffs continue, many of these farms will not be viable businesses and many would permanently disappear. That would permanently alter the U.S. farming landscape.

The bottom line is that the trade war may improve our trade deficit in the short run, but will lead to job losses, reduced corporate profits and could cost the United States the hard fought economic growth we've built as the Country has continued recovering from the 2008 recession. A continued trade war will inevitably lead to a recession and could only hope that we'd eventually regain our economic footing. The damage a trade war causes though could set the U.S. back a decade or more however as we would try to recover with increased national debt, new economic dynamics built around tariffs and a damaged international reputation with trading partners. Market participants, consumers and portfolio managers like us are now left waiting to see if President Trump will change his mind or continue his fight into the 2020 election season.