# Points to Ponder

July 20, 2018

## The First Tee...

**Tariffic or Tariffying?...investors, politicians, companies, workers, farmers and consumers are taking contrasting views on the President's trade-taxation changes:**

- The government's attempt to level the trading playing field certainly has long-run benefits, but the process can be painful and damaging to manufacturers and consumers:
  - Reciprocal tariffs are blocking markets to producers (soybeans) while raising prices to end buyers.
- China syndrome...world's second largest economy is the key antagonist in the global trade conflict:
  - China overtook Canada as the United States largest trading partner in 2015; China comprises 15% of total U.S. imports and exports…there was over $500 billion in total trade with China in 2017, but $461 billion in goods were imported from China while only $116 billion was exported-to by the U.S.:
    - The U.S. has been China's largest trading partner since 1998…China's economic growth is trade dependent:
      - The critical question is, does China's economy have the wherewithal to sustain an extended trade-war with the U.S.?:
        - **Chinese stocks have lost 22% in value since January and the value of China's currency (the yuan) has declined 8% since early April.**
    - Chinese President Xi Jinping has outlined his vision of China's rise as a world power by 2050 *(total world domination?)*:
      - The program includes domination of several strategic industries, build a world-class military and finance global infrastructure.
  - Tracking the tariffs…here are the events to-date since the trade skirmish began this year between the U.S. and China
    - **January**...President Trump places tariffs on solar panels and washing machines…China produces 65% world's solar modules:
      - The tax on solar panels will start at 30% for the first year and decline to 15% over the next 4 years (washing machine tariff is 10%).
    - **March**…the tariff on steel and aluminum is increased by 25% and 10% respectively; China exports 6% of these metals to U.S.:
      - Despite the small amount of steel and aluminum China ships to the U.S., they are the world's largest producer of these metals:
        - China is accused of flooding the market with these metals, driving down the price...additional amounts of Chinese manufactured steel and aluminum make it into the U.S. indirectly, exported by other countries who are middlemen for the Chinese produced metals.
    - **April**…China applies tariffs on $2.4 billion of exports shipped to the U.S.; equivalent to the $2.7b tariff impacting China metals:
      - The Chinese tariff effects 128 U.S. goods, including agricultural products and consumer goods (farmers take the biggest hit).
      - The U.S. bans exports from Chinese telecom company ZTE…for exporting goods to Iran and North Korea, violating trade sanctions.
    - **June**…the U.S. announced a 25% tariff on $50 billion of Chinese goods, the list includes 1,100 Chinese products:
      - Over 90% of the items on the new list are items U.S. companies import to assemble end products *(nationalizing the supply chain?)*:
        - The latest duties target sophisticated technology that are China's central focus in their "Made in China 2025" plan:
          - This technology includes semiconductors, medical devices and flat-screen televisions (shoppers will not be happy with pass-along price hikes)
      - China responds with $50 billion in tariffs on a new list of U.S. goods that has emphasis on agriculture *(mort tit for tat!)*
      - President Trump threatens to impose a 10% on an additional $200 billion of Chinese goods (yet to be enacted).
    - "If mismanaged, and the China-U.S. trade war is fully upgraded, it could expand into a financial war, an economic war, a resource war and a geopolitical war", Ren Zeping…*about the only thing left would be a military war!*
- The trade issues could be laying the groundwork to damage the economy in the future, but actions to-date should not derail 2018 GDP, expected to be the best of the recovery:
  - Both monetary and fiscal policy are supporting economic growth…the downside risk is a full-blown trade war:
    - The tariff measures currently enacted are forecast to negatively impact GDP by a tenth of a percentage point:
      - Consumer spending will continue to be the key driver for economic growth (boosted by strong employment and tax cuts)…business investment is expected to accelerate, but would remain secondary to the consumer as the lead GDP influencer.
  - The implied effective tax from the proposed tariffs is $33 billion (25% tariff on $50 billion and 10% on $200 billion):
    - Despite the tariff cost being unevenly distributed through the economy, the impact has been compared to a sustained 33 cents per gallon increase in the price of gasoline…the average price for regular gas in the U.S. is currently $2.858:
      - This raises the question, if gasoline rose to $3.188 how negatively would the economy be impacted?...from 2011 to 2014 the price of gasoline averaged $3.51, during this period GDP expanded at an average annual rate of 2.1% *(hardly recessionary)*.
      - The implied tax increase from tariffs pales compared to the $170 billion estimated yearly cost from this year's tax reforms.

## At the turn...

## The Back Nine...

### Housing ATM Discipline...the recovery in housing prices has provided homeowners with over $5.8 trillion in equity (a record amount), more than double the level in 2011:

- Despite having leverage opportunities in their property, consumers have been reluctant to borrow against the values of their homes...recalling nightmares from housing crisis in 2008:
  - During the financial crisis home values fell 35%...leaving many borrowers owing more than their homes were worth:
    - Bankers have grown antsy knowing potential borrowers are sitting-on a large amount of collateral in their homes:
      - During the 1st quarter, financial firms increased spending on direct-mail for home equity products by 30% (versus a year ago).
    - Borrowing against a home's value is quite a bit cheaper when compared to alternatives such as credit cards and personal loans.
  - The total amount of home equity lines outstanding have been declining during the past decade:
    - Even with new lending, there are now $398 billion in home equity loans outstanding...down from $674 billion in 2009:
      - Besides a good memory, some of the other factors hindering home equity borrowing are the changes in tax law that limit the interest deduction on home equity lines to only proceeds spent on home renovations, home ownership is down 5% to 64% from pre-crisis levels and the upward move in interest rates is making floating-rate debt less attractive.
    - Americans have been paying down their home loans in aggregate following the crisis *(maybe a lesson has been learned!)*

### The Year Half Full?...stock rally has cooled; will higher interest rates subdue equity bull market:

- Data format: July 1, 2017 / January 1, 2018 / April 1, 2018 / July 1, 2018:

**Equities**

**Dow:** 21349 / 24719 / 24143 / 24271
**S&P 500:** 2423 / 2673 / 2641/ 2718
**NASDAQ:** 6140 / 6903 / 7063 / 7510
**Russell 2000:** 1415 / 1535 / 1529 / 1643

**Commodities**

**CRB:** 174 / 193 / 195 / 200
**Oil:** $46.04 / $60.42 / $64.94 / $74.15
**Gold:** $1241 / $1303 / $1325 / $1253
**Copper:** $272 / $331 / $302 / $296
**Natural Gas:** $3.11 / $2.95 / $2.84 / $2.92

**Borrowing Benchmarks**

**Libor:**
**1mo:** 1.223% / 1.480% / 1.876% / 2.090%
**3mo:** 1.299% / 1.694% / 2.302% / 2.335%

**Treasuries Issues**

**3mo:** .84% / 1.35% / 1.67% / 1.88%
**6mo:** 1.00% / 1.50% / 1.87% / 2.06%
**1yr:** 1.20% / 1.69% / 2.02% / 2.24%
**2yr:** 1.38% / 1.88% / 2.26% / 2.52%
**5yr:** 1.88% / 2.20% / 2.56% / 2.73%
**7yr:** 2.14% / 2.33% / 2.68% / 2.82%
**10yr:** 2.30% / 2.40% / 2.73% / 2.86%
**30yr:** 2.83% / 2.74% / 2.97% / 2.99%

**Federal Funds Open:** 1.16% / 1.41% / 1.68% / 1.90%
**Prime Rate:** 4.25% / 4.50% / 4.75% / 5.00%

**Job / Inflation Indicators**

**Unemployment:** 4.4% / 4.1% / 4.1% / 4.0%
**Consumer Price Index:** 1.6% / 2.1% / 2.4% / 2.9%
**Core PCE Index:** 1.5% / 1.5% / 1.8% / 1.9%

**Currencies**

**Euro:** 1.142 / 1.200 / 1.232 / 1.168
**Yen:** 112.39 / 112.69 / 106.28 / 110.76
**Peso:** 18.12 / 19.65 / 18.18 / 19.91
**Canadian $:** 1.296 / 1.257 / 1.290 / 1.313

**Grain Futures**

**Corn:** $3.81 / $3.50 / $3.88 / $3.71
**Soybeans:** $9.54 / $9.61 / $10.45 / $8.80
**Wheat:** $5.26 / $4.27 / $4.51 / $5.01

## 19th Hole...

***Under capitalism, man exploits man. Under communism, it's just the opposite.*** John Kenneth Galbraith

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