



Southern Capital Perspective

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TARRIFS and TRUMP

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The most commonly debated topics in the financial media today are: tariffs and what will be the impact on the economy and the stock and bond markets? To begin with it is vital to understand the meaning of the term. The *Dictionary of Finance and Investment Terms* defines a tariff as: "federal tax on imports or exports usually imposed either to raise revenue (called a revenue tariff) or to protect domestic firms from import competition (called a protective tariff). A tariff may also be designed to correct an imbalance of payments. The money collected under tariffs is called DUTY or CUSTOMS DUTY." The next aspect to consider is: what is the Trump Administration attempting to accomplish by the threat of and actual imposition of tariffs?

The President has never indicated that he intended to raise money (revenue tariff) by imposing tariffs. Nevertheless, according to Bloomberg News the steel and aluminum tariffs have raised \$775 million through June 21. Although it seems like a tidy sum in respect to international trade, it is inconsequential and only a by-product of tariffs targeted at a larger purpose.

The steel and aluminum tariffs that have been implemented were intended to be protective tariffs with the added consideration of national defense implications. The Hill.com states: "First of all, it must be understood that these tariffs are aimed at redressing U.S. national security and they are a response to a serious decline in U.S. production and capacity in these two industries." Furthermore, "Both metals are the

very heart of national security. Steel is of course used in every aspect of the military, including land vehicles, seagoing ships, missiles, guns, and more." National defense is vital and key industries that provide it are crucial, but critics of Trump policy say that using national defense is merely an excuse to impose tariffs.

The third objective of tariffs seems to be what the motivation of the Trump Administration is all about, and that is to correct an imbalance of payments. Throughout the 2016 campaign, Donald Trump denounced multi-national trade deals like NAFTA and TPP as being bad for the US. He said many times that he is in favor of "free" trade but not "stupid" trade. He cited the huge trade imbalance with China (\$375 billion) and Mexico (\$71 billion), but also noted that the US has trade deficits with most developed nations of the world. In 2017 the US national trade deficit was \$568 billion. One of the President's main themes is that this imbalance has led to America losing its manufacturing base because of unfair trade rules.

The question as to how unfair trade rules impact the location of a manufacturing plant can be illustrated by the following: China imposes a 25% tariff on autos made in the US and then shipped to China. Therefore, American-made cars are uncompetitive in a nation of 1.3 billion consumers. If

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a US auto company wants to compete, it has to build a plant in China (and in many cases must share its technology with the Chinese and give up 51% of the ownership). Consequently, the auto plant gets built in China and the manufacturing jobs also go to China and American workers lose their jobs. Donald Trump wants to change this non-level playing field and tariffs are some of the weapons in his arsenal.

According to the President, aside from the blatant actions of the Chinese, the bad trade deals with other nations of the world have come about through the laxity or ineptness of our trade negotiators. He has suggested to the G7 leaders (heads of US, UK, France, Germany, Japan, Canada and Italy) that all tariffs, trade barriers and subsidies should be eliminated and we should have totally free trade. It was not surprising that he received no response from the leaders of the other six nations. They enjoy the trade advantages that they have and have no intention of voluntarily giving them up. The US is not innocent regarding the imposition of tariffs: for example, the tariff on sugar dates back to 1789, and in the 1990 Farm bill the sugar industry got its tariffs and subsidies that it still enjoys today costing

American consumers about 1.4 billion extra dollars per year. It is apparent that virtually all nations are guilty and it seems that only Donald Trump wants to upset the proverbial applecart. If he is successful there will be winners and losers but the world as a whole would benefit and grow richer from totally free trade.

Will he be successful in eliminating all world tariffs and trade barriers? Highly unlikely, but by imposing additional tariffs, he may force other nations into negotiating a reduction in these barriers which would be beneficial and could at least get us on the path to fairer and smarter trade. However, there is always the danger of miscalculation on the part of the negotiating parties leading to a costly and painful trade war. We will see if he can successfully work "The Art of the Deal".

Miscalculation can be a grave danger. When Reed Smoot and Willis C. Hawley proposed the Smoot-Hawley Bill in April 1929 they never envisioned that it (according to some economists) would make the Great Depression more severe. The Smoot-Hawley Tariff was a protectionist tariff to benefit US farmers and industry. Their timing was bad, the world economy was already slowing and because of innovation and industrial breakthroughs there was overproduction and declining consumption. Therefore in the present day, it is imperative that President Trump act judiciously in playing the strong hand he has with the US economy but not be unwilling to modify his position if it appears that real damage to the economy would be the outcome.

OUTLOOK

The second quarter of 2018 was slightly positive, but the market generally has been moving sideways since February. That is not to say that there has not been volatility, but there has not been a discernable trend. Often a strong uptrend like we enjoyed from November 2016 to January 2018 is corrected by a sideways "time correction" versus a sharp market drop which is a "price correction." We will have to wait and see how it plays out, but a "time correction" is what seems to be happening.

In regard to the balance of 2018: the third quarter is traditionally the bumpiest one and the fourth quarter is generally the strongest. It is difficult to trade on these generalities, but historically that is how it has occurred. The main factors that the markets will have to digest are: the trade/tariff disputes mentioned above, the progress on Korean denuclearization, the mid-term elections and the strong US economy, and employment. Considering all of the factors, it would not be surprising to see a continued sideways movement with maybe a slightly upward bias through the third quarter and, if we get some resolution on some of the factors, some strength in the fourth quarter. All in all a traditional type of outlook with the ever present caveat that the past performance is no guarantee of the future performance and unforeseeable global events can change everything.

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