Portfolio Talk
Quarter One 2018

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FINANCIAL GROUP

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SAVE THE DATE!

Open House
Tuesday, May 15, 2018
3-7 PM
More details to follow!

"A politician thinks of the next election; a statesman of the next generation."
–James Freeman Clarke

Trade wars can be quite scary, and on a global scale even scarier! One only has to think back to the "Smoot-Hawley Tariff Act of June 17, 1930" and our fears escalate! Why? Many scholars pin the blame of the great depression on the implementation of this law. Many also believe this caused what could be considered as one of our country's lowest points for its citizens. In essence Smoot-Hawley put tariffs on more than 20,000 imported items causing retaliation by other countries, causing real national income to decline 36 percent, unemployment to increase from 3 percent to over 25 percent, more than 40 percent of all banks were permanently closed and international investment and trade declined dramatically.[1] The fear the markets face is could we be heading for the same kind of outcome? Given the President's signing of a 25 percent tariff on imported steel and 10 percent on imported aluminum, some think so! Then most recently he imposed a $60 billion tariff package aimed at China? What's next is a concern causing uncertainty and increased volatility both domestically and around the globe!

But let's take a view from 30,000 feet and see if there's a possible silver lining to this oppressive dark cloud overhead. Experience has shown that our President is known for dropping the bomb (in a figurative way) when negotiating, in essence asking for the extreme and then wait for a response. This is often times a tactic used in business but is very

[1] FEE; Foundation for Economic Education, DTD 2/29/12, by Theodore Phalan.

unusual and scary when negotiating in politics. But should it? We've already heard over the weekend of March 24-25th, during March Madness, that meaningful talks have already begun between our trade diplomats, Treasury Secretary Steven Mnuchin and U.S. trade representative Robert Lighthizer, and Chinas' negotiators to find some middle ground in trade! Could this be a sign that a resolution that's beneficial to the U.S. is possible, avoiding the negative effect of a tariff war? Time will tell…We've all been frustrated with the slow pace of change, the bickering and the partisanship in Congress. By continuing with the status quo wouldn't we end up continuing to run in place? The idea of tariffs may scare us, but our country has been taken advantage of in our trade deals for decades. The prime example is the tweet from Elon Musk, C.E.O. of Tesla Inc., to the President at the signing of the Tariffs that said, "When I ship a car to China, China imposes a 25 percent tax on Tesla. But when China ships a car to the U.S. they are charged only a 2.5 percent tax! China's 10x greater!" This is where free trade falls apart and reciprocal trade should be implemented. In other words, what you charge us we'll charge you! Make sense? I believe so. Let's hope the trade talks continue…it's for the good of all.

But can tariffs hurt company earnings? The simple answer is yes, how much is the real question. For example, if as Wilbur Ross said, U.S. Commerce Secretary, that the cost of a can of soup would increase by less than a penny and "who in the world is going to be too bothered?" The problem is more complicated than the fractional penny. The corporation that makes the can of soup has to try and pass that cost onto the consumer. But if the cost point takes the can of soup from $.99 to $1.00, breaking the dollar barrier, may cause some consumers to look elsewhere for their product. Keeping in mind that the profit margin on a can of soup as well as most canned products is very slim, in the 2-4 percent range. This simple one penny move can cause some companies to shut down canning manufacturing plants and outsource their operations, much the same as when President George W. Bush imposed steel tariffs of up to 30% in 2002. According to an analysis done by the CITAC Foundation[2] "200,000 Americans lost their jobs to higher steel prices during 2002. These lost jobs represent approximately $4 billion in lost wages from February to November 2002. One out of four (50,000) of these job losses occurred in the metal manufacturing, machinery and equipment and transportation equipment and parts sectors." More important, the report goes on to say; "More American workers lost their jobs in 2002 to higher steel prices than the total number employed by the U.S. steel industry itself (187,500 Americans were employed by U.S. steel producers in December 2002)." This "ripple effect" is what's most concerning. President Bush was forced to lift the "punitive tariffs" just days before the European Union was preparing to impose sanctions worth $2.2 billion in retaliation. All of this occurred in a 20 month time period![3] Morale to the story is; "be careful what you wish for!" Let's hope the negotiations don't break down and a repeat of the "Bush Tariffs" are avoided.

On the Markets

The Federal Reserve Open Market Committee decided to increase the Fed Funds Rate to between 1.50-1.75% on Wednesday, March 21, 2018. This was expected and the language in Jerome Powell's comments, Federal Reserve Chairman, was quite bullish for the economy. The fear of inflation was low, economic growth projections raised, employment base to improve with wages increasing and overall confidence continuing to improve. However, as interest rates increase, market multiples tend to contract. But with interest rates still at historic lows, our belief is that multiples could stay above the historic average of 18.6x. Current 2018 forecasted EPS for the S&P 500 gives us a market multiple of 17.13x, well below the historical. If we trade at the historical level the S&P 500 Index could trade at 2900 plus, approximate upside of 11.2% plus a dividend of 2.0% for a total

[2] "The Unintended Consequences of U.S. Steel Import Tariffs: A Quantification of the Impact During 2002." By; Dr. Joseph François & Laura M. Baughman, DTD 2/4/2003

[3] "The Guardian; Bush Lifts steel tariffs to avert trade war; by Mark Tran, DTD 12/4/03

return of 13.2%. Keeping an eye on technology with the Facebook's fall off. Large cap value looks cheap as well as small & mid cap companies. Tax relief has not had time to work through the system, but earnings could get a meaningful bump in the 3rd & 4th quarters. We are cautiously optimistic. Staying the course!