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In light of the almost surreal trade-related headlines that confront us on a daily basis, it seems only appropriate to invoke the words of philosopher George Santayana, who famously remarked that "Those who cannot remember the past are condemned to repeat it."

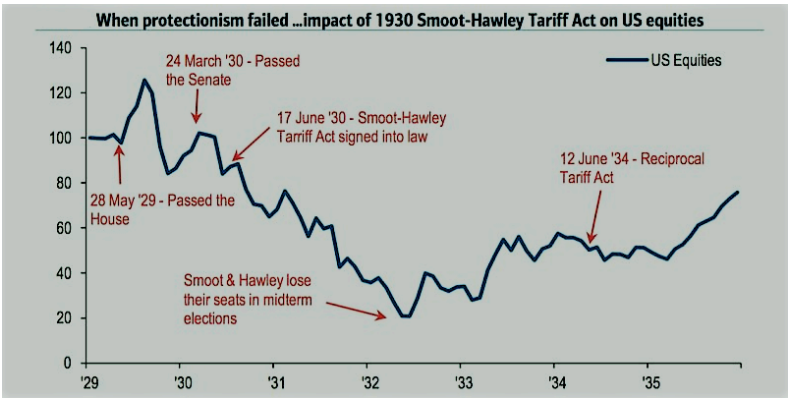
If the founding fathers of the world's various democracies knew then what we know now, they would have mandated that all world leaders pass a history test before taking office. Unfortunately, that requisite does not exist and, as a result, it looks increasingly likely that some old lessons of history may need to be relearned once again.

For those readers who are not already experiencing an uncomfortable feeling of *déjà vu,* let's dust off those old college history books and see what they can teach us.

On June 17th, 1930, the Smoot-Hawley Tariff Act was signed into law. This piece of protectionist legislation ultimately raised U.S. tariffs on over 20,000 imported goods and catalyzed a series of tit-for-tat retaliatory trade tariffs around the world that was largely responsible for global trade shrinking by 66% while the full tariffs were in effect.

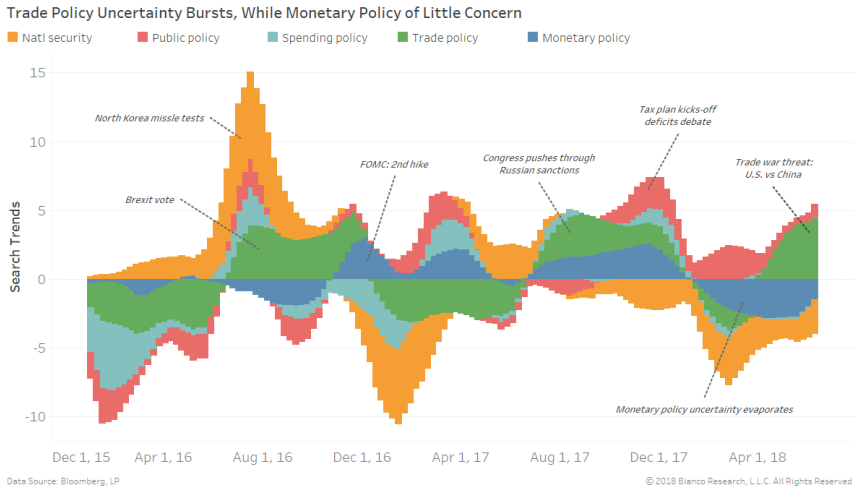
Indeed, while it is difficult to quantify its overall impact, many scholars maintain that this 1930 act, and the resulting trade war, turned a normal cyclical recession into an event that nearly destroyed the economies of the industrialized world.

Ironically, this legislation took place at a time when the U.S. economy was industrializing and when most of the world was still recovering from World War I, which made the U.S. the new dominant force in the global economy. In fact, industrialization led to such gains in agricultural productivity that there was a surplus of food, thus causing prices to drop.



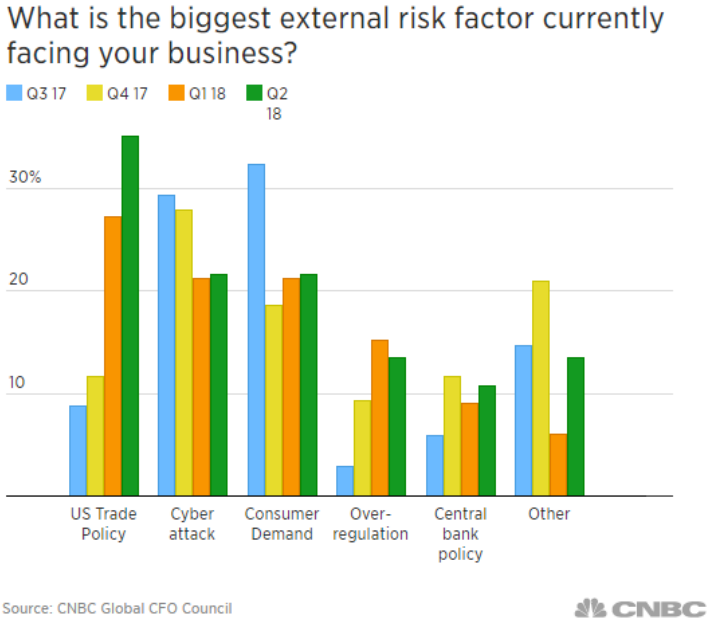
Despite the fact that the U.S. actually enjoyed a trade surplus with the rest of the world (imports represented 4.2% of the economy and exports represented 5%), Senator Smoot and Representative Hawley pushed through this legislation as a means of raising crop prices… a hypothetically noble cause with terrible ramifications, particularly since, by the time that the bill was finalized, special interest groups had added more than 800 separate tariffs to it.

As is the case today, academics and economists alike spoke out against such flagrant protectionism. Indeed, two months before its passage, a petition signed by 1,028 economists asked President Hoover to veto the bill, if it reached his desk. Henry Ford told President Hoover that the bill was "an economic stupidity" and J.P. Morgan's Chief Executive, Thomas Lamont, claimed that he "almost went down on his knees to beg Herbert Hoover to veto the asinine Hawley-Smoot tariff".



President Hoover himself deemed the legislation to be "vicious, extortionate and obnoxious", and expressed his fears that it would undermine the global trading system and valuable relationships with our allies. Nonetheless, he signed it under political duress from the Republican-controlled Congress.

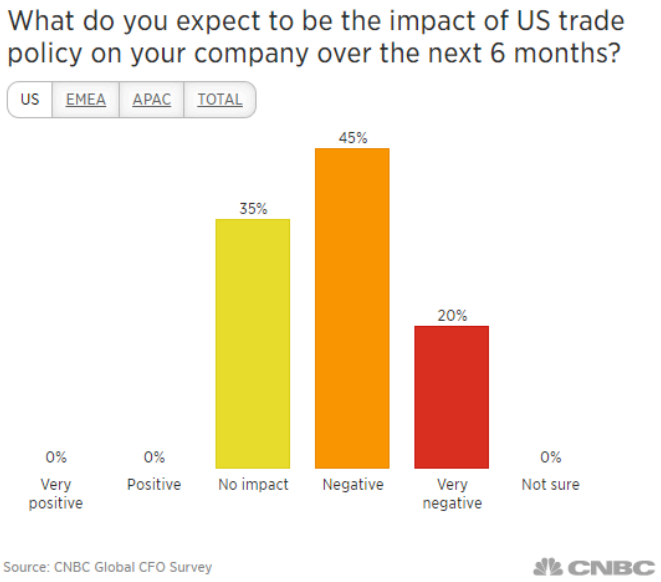
The response from America's 1930 trading partners read just like the headlines in today's media. All trading partners retaliated with tariffs against U.S. goods, and formed new trading relationships with one another.



According to research from the State Department, US imports decreased by 66% from 1929 to 1933 (when the tariffs started being lifted), and exports decreased 61% over the same period. The economic impact was huge, with the size of the economy shrinking from $103.1 billion in 1929 to only $55.6 billion in 1933.

Obviously, history does not necessarily repeat itself but, as Mark Twain famously said, "it oftentimes rhymes". That alone should make President Trump's trade policies an important issue to all investors, and it increasingly appears to be, as illustrated by the fact that trade policy now dominates policy-related search terms on Google. Indeed, according to a just-released CNBC survey of Chief Financial Officers, U.S. trade policy is being viewed by American executives as the "biggest external risk" facing their businesses.

Earlier this month, S&P Global's chief economist estimated that a trade war could reduce global growth as a whole from 3.8% to 2.8%, and the European Central Bank just announced that global growth could contract by 1% in the first year of sanctions, and that world trade could shrink by 3%.

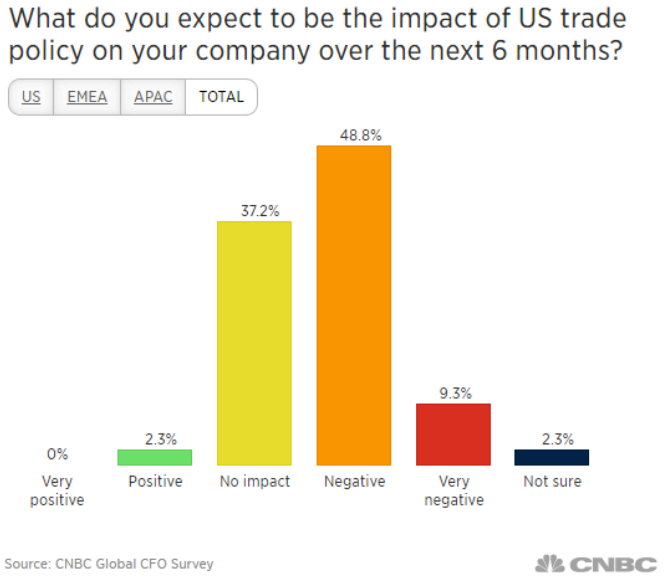


The perspective of corporate executives is remarkably consistent regardless of domicile. Two-thirds of U.S. executives expressed their belief that the impact of U.S. trade policy would be either "negative" or "very negative" for their business over the next six months.

Indeed, a growing number of economists are expressing concerns that a prolonged trade conflict could offset all of the economic gains made as a result of the Trump administration's tax reform, deregulation and fiscal stimulus programs. As evidence, in the aforementioned CNBC survey, 40% of North American executives said that trade-related uncertainty was preventing them from taking full advantage of tax reform.

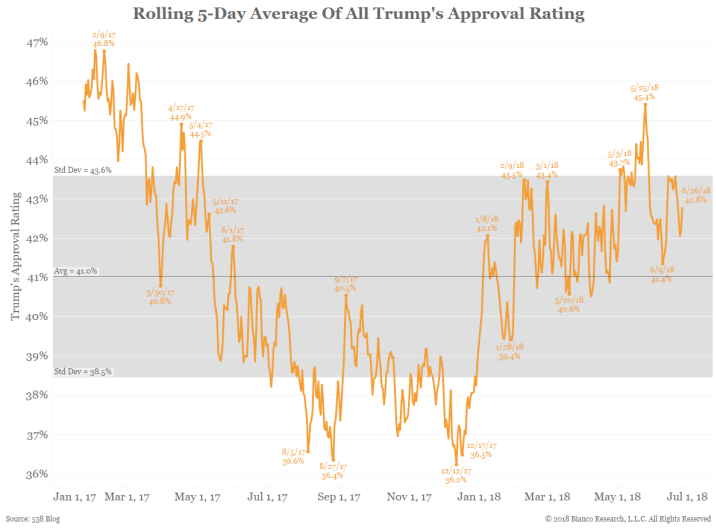
As a whole, executives at foreign companies were a little less concerned than their American counterparts of a "very negative" impact, but nonetheless overwhelmingly considered current American trade policies to be a negative for their businesses in the months to come.

Importantly, trade protectionism is almost never a zero-sum game, even within the same economic border. For example, The Trade Partnership estimates that, while the tariffs mandated by President Trump will save 20,000 jobs in the steel and aluminum industries, the retaliatory measures announced by America's trading partners are expected to cost 400,000 jobs in other industries.



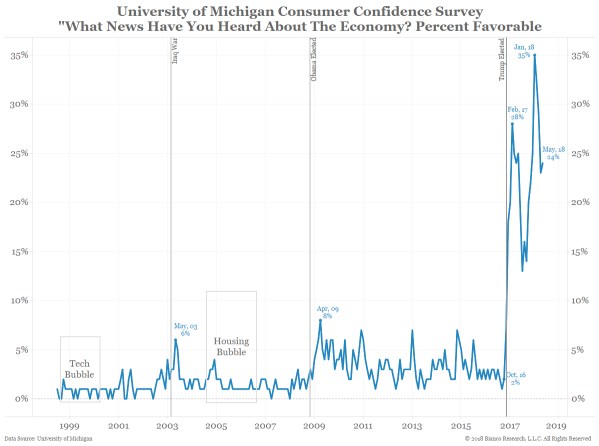
Whether there is rational justification for engaging in such aggressive trade tactics with any nation other than China is highly dubious, but that issue is beyond the scope of this writing. However, we did find interesting the perspective of former Federal Reserve Chairman Alan Greenspan who, in a recent interview on CNBC, replied to a question about whether or not we were already in a trade war by saying, "we're on the edge. I think we should be very sad if we do, because the presumption is that foreigners are ripping us off. It's nonsense."

Of note, we suspect that anyone who thinks that we will see a resolution to Trump's trade jingoism anytime soon is likely to be sorely disappointed. If anything, the upcoming mid-term elections are likely to stiffen both his resolve and his rhetoric, as his trade policies are growing increasingly popular with American voters, and the platform gives the President an opportunity to play to his base which, according to the Cook Political Report, lists "getting things done", "keeping promises" and "putting America first" as their top reasons for supporting President Trump.



For the first time in his presidency, a new CNBC poll (The All-American Economic Survey) shows that the majority of Americans now approve of Trump's handling of the economy. Moreover, 52% of respondents favored the current renegotiation of trade deals (with only 30% opposed). When it comes to the use of tariffs, 45% approved, while 38% opposed their use.

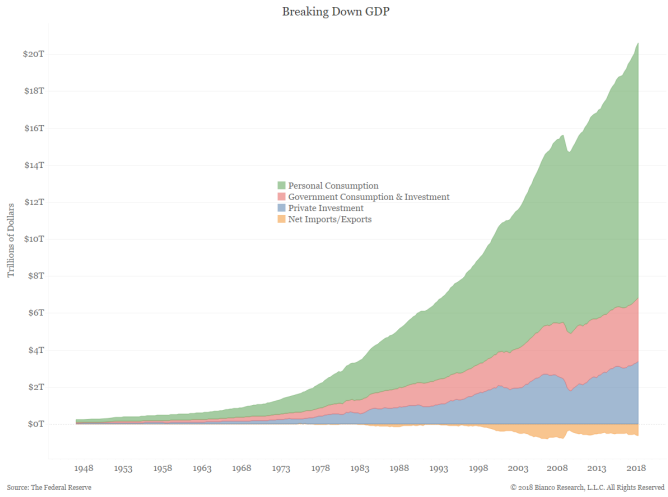
Whereas the Smoot-Hawley Tariff Act was initially started with the rather modest goal of helping American farmers by raising crop prices, President Trump's goals are much more ambitious, and even grandiose in scale. He wants to protect American intellectual property and technology from theft by foreign competitors, he wants to force the global trading community to drop virtually all tariffs and adopt a reciprocal trading system, and he wants to reduce America's trade deficit.



The first objective is critically important and the second would be extraordinary if attainable. The third goal is not necessarily what it seems, as the trade deficit is a tiny part of America's overall economy (see the following chart), because half of the merchandise trade deficit is actually offset by America's surplus in services, and because America's tariffs are currently only slightly lower than those of its trading partners.

The one major outlier to that statement is China, who has been a "bad actor" in so many ways ranging from corporate espionage and forced technology transfers to limitations on foreign ownership, and the Chinese government actively working to give Chinese companies unfair advantages over their free-market competitors in pursuit of the "Made in China 2025 Program" (an initiative to comprehensively upgrade Chinese industry in the German model).

Trump may even be proven to be very forward-thinking with what appears to be a positioning of China as the arch-rival of the U.S. for decades to come, and a policy that commercial technology needs to be protected from China (and "anyone who steals our technology") in the same way as military technology is, and for many of the same reasons.



Actually, a military analogy does seem rather appropriate in any discussion of current U.S. trade policy, as it is rather reminiscent of a quote from General George Patton who said "A good plan, violently executed now, is better than a perfect plan next week." In many ways, that statement epitomizes the approach of the Trump administration.

In contrast, there was some rather calming news over recent days that the Committee on Foreign Investment in the United States (CFIUS) is being granted additional powers under the leadership of Treasury Secretary Mnuchin, who is one of the only two remaining free-traders in the Trump Cabinet. It will be responsible for issues related to the protection of technology. Moving such an issue from the Twittersphere to a committee should help to make the markets less susceptible to unexpected news headlines.

We believe that Trump's policies regarding China are reasonable and justified, and that the U.S. would likely enjoy some economic benefits if Trump is successful. Indeed, if you look at the resulting bear market in Chinese stocks, the sharp decline in the value of the Chinese currency, and the just-leaked report by the Chinese government-backed National Institution for Finance & Development think tank, which warned that "China is currently very likely to see a financial panic", it is quite possible that Trump's tactics are already successfully increasing America's negotiating leverage.

However, there are short and long-term risks associated with these policies, and each has the potential to have a dramatic impact on both stock and bond portfolios. The short-term risk is that Trump is very results-driven, and doesn't seem to care about the damage created along the way as long as his ultimate goal is achieved. Indeed, Trump has already dismissed any concerns that investors might "feel a little pain".

The long-term risk is that things get out of hand, and that the tit-for-tat escalation of tariffs snowballs like it did in 1930. In any event, investors hate uncertainty, and Trump's trade policies are "uncertainty on steroids".

Areas of the equity markets that may provide some shelter from the trade storm include small caps, telecom services, consumer staples, utilities, pharma, REITS, regional banks, domestic drillers, and firms that provide services rather than products.

President Trump's trade policies are likely to be a negative for domestic bond prices no matter how the current trade conflicts are resolved. Protectionism is inflationary, and any extended period of high global tariffs will push prices higher, which will drive interest rates higher and bond prices lower.

On the other hand, if President Trump successfully attains his stated objective of reducing the trade deficit by coercing tariff-free/reciprocal global trade, it will greatly reduce the need for our trading partners to recycle the dollars that they receive in trade into U.S. sovereign debt, thus reducing demand and pushing bond prices lower.

This risk is further exacerbated by the administrations profligate fiscal policies that are injecting massive stimulus into the economy (and ballooning the debt) at a time that traditional economic theory says is the worst possible part of the economic cycle.

As former Fed Chairman Ben Bernanke noted in a recent speech at the American Enterprise Institute, "It makes the Fed's job more difficult all around because what you're getting is a stimulus at the very wrong moment. The economy is already at full employment." Bernanke went on, "It's going to hit the economy in a big way this year and next, and then in 2020, Wile E. Coyote is going to go off the cliff and look down." That would leave the bond market with increased supply to absorb, and the government with less revenues with which to service the ever-ballooning debt.

In our opinion, this conundrum is one of the major reasons why U.S. government bonds have among the highest yields in the world despite the U.S. remaining as the world's best credit risk.

Thus far, investors have largely dismissed Trump's protectionist rhetoric and tariff threats as nothing more than posturing related to the ongoing trade negotiations and have largely maintained that it was still appropriate to "take Trump seriously, but not literally". However, with tariffs and retaliatory tariffs now actually being implemented, we believe that it would be truly foolhardy for investors to remain so dismissive of Trump's words and deeds.