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# The Trade War That Isn't - Yet

When most of us hear talk about something described as a "war," we intuitively recognize that there could be very unpleasant outcomes on all sides. Wars have one thing in common: there is seldom a clear-cut "winner" amid the damage and destruction.

So, when President Trump declares a "trade war" against the world's second-largest economy, it's natural that many people—including, apparently, a large number of investors—would feel spooked about what's to come in our collective future. This explains why every escalation of words, and new lists of things that will be taxed at U.S. and Chinese borders, has provoked sharp downturns in the markets.

But what, exactly, is a "trade war?" Beyond that, what is a "trade deficit" and why are we trying to "cure" America's trade deficit with China?

To take the latter issue first, every bilateral trade deficit is simply a calculation, made monthly by government economists, that adds up the value of products manufactured in, say, China that are purchased in, say, the U.S. (Chinese exports or U.S. imports), and subtracts the value of products manufactured in the U.S. that are purchased by Chinese consumers (U.S. exports or Chinese imports). The first thing to understand is that this is not a very precise figure. To take a simple example, Apple manufactures its iPhones in southern China, ship them to the U.S. for sale, and the value of each of the millions of smart phones is counted as a Chinese export to the U.S. market. Apple reaps extraordinary profits, but this is considered a net negative in terms of U.S. trade.

Moreover, the full value of each iPhone is considered on the import ledger, without subtracting out the value of the "services" that Apple provides. The software and design were, after all, created in the U.S., and are a large part of the value of the phones that people become so addicted to. But these financially valuable aspects of the phone, made in America, are not reflected in the trade numbers.

Beyond that, many economists question whether a trade deficit is a bad thing in the first place. Chances are, you run a significant trade deficit with your local grocery store; that is, it brings to your neighborhood the food you put on the table, and you exchange money for it. You import food, but the grocery story doesn't import a comparable amount of things you make in your garage. Are you materially harmed by this economic opportunity that takes dollars out of your pocket and puts them in the hands of the grocery store? If you were, you might take your business to the grocery store further up the road, and run a trade deficit with a different establishment.

How does this relate to the U.S./China trade relations? Simple mathematics indicates that Chinese manufacturers are taking dollars from U.S. consumers, but they have to do something with those dollars to balance the ledger. That money finds its way into purchases of U.S. debt (Treasury bonds) or reinvestment in the U.S. economy, buying real estate or investing in domestic companies.

You fight trade wars with tariffs, which are simply a government tax on specific items when they cross the border. So, when the Trump Administration announces the list of 1,300 different products that will become the targets of its tariff plan, that means that anyone buying those products will see their taxes go up—invisibly, in a higher cost of living.

The bigger potential damage comes when China retaliates in kind, and certain sectors of the U.S. economy have to pay the Chinese government a tariff for the privilege of selling their products to the Chinese market. China represents 15-20 percent of Boeing's commercial airline sales, so a proposed 25% tariff could sting. More directly impacted are U.S. farmers. Soybeans represent the largest agricultural export from the U.S. to China ($14.2 billion worth of shipments in 2016, about one-third of the U.S. crop), and the Chinese consume a lot of U.S.-raised pork. When the tariffs were announced, pork futures dropped to a 16-month low, and soybean futures fell 5% overnight.

The larger concern is that China is preparing to shift its sourcing of agricultural products from the U.S. to Brazil and Argentina, and the retaliatory tariff makes this economically attractive for Chinese consumers. Will that business ever come back again?

If this has you worried, or searching China's latest list to see which stock might be impacted as the rhetorical trade war escalates, it might be helpful to take a step back. So far, none of these tariffs have been levied; no actual shots have been fired in the trade war, which means it is not yet a "war" at all. The U.S. and China are trading retaliatory lists of potential targets, and there is some escalation in the value and extent of those lists. But when it comes time to actually fire those shots, the most likely scenario is a generous compromise that leaves us with the status quo.

Remember how worried the markets were when the Trump Administration abruptly announced new levies against global steel and aluminum imports? It turned out to be mostly bluster. A full 50% of all U.S. steel imports, from Brazil, South Korea, Mexico, Canada and others, were exempted from those tariffs. Larry Kudlow, the White House's new economic advisor, said several times last week that there would be, in fact, no new tariffs, and no trade war with China. It will be months before any of the proposed tariffs could be put into place, which is plenty of time for Kudlow's prediction to come true—and make all the panic sellers who drove down stock prices look a little bit silly.

-Bob Veres

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# The market at a glance

## March

**U.S. Large Cap**
(S&P 500)
**2,640.87** (-2.69%) ▼

**U.S. Mid/Small**
(Russell 2000)
**1,529.43** (1.12%) ▲

**International Large**
(NYSE International 100)
**5,654.92** (-1.03%) ▼

**U.S. Treasuries**
(U.S. 10-year Treasury yield rate)
**2.74** (-4.53%) ▼


# The market in action

- Coming off a month where investors were becoming increasingly skeptical of the ongoing bull market, the Bureau of Labor Statistics reported that jobless claims fell to their lowest in nearly 50 years.
- The senate passed a bill that avoided a government shutdown until at least September. The bill, which included a spending package that exceeded $1.3 trillion in funding, was signed into law before the deadline on March 23.
- Just months after filing for bankruptcy, prominent toy retailer Toys R Us is closing all of its stores in the United States after 70 years in business. Reasons for the collapse include a high amount of debt and an inability to increase its revenue amid big box retailers and online shopping competitors.
- Stock valuations for Facebook fell 7 percent on March 19, representing the largest one-day decline in the six years since the company's IPO. The tumble came after reports that the social media powerhouse "improperly shared" data of over 50 million users.
- After years of controversy, infamous pharmaceutical figure Martin Shkreli was sentenced to seven years in prison for fraudulent activity. In addition to the sentence, Shkreli must abdicate ownership in Vyera Pharmaceuticals and turn over $5 million in cash, a painting by Pablo Picasso, and a one-of-a-kind Wu-Tang Clan album.
- According to a new study from GoBankingRates, about 42 percent of Americans have less than $10,000 earmarked for retirement and are subsequently "at risk of retiring broke." From the same survey, almost 19 percent of Millennials have nothing saved for retirement.

# Know your *financial math*

**In addition to tax filing season, April is Mathematics Awareness Month. This is a great time to review some useful math tricks to improve your short-term budget and long-term financial plans.**

*It is important to remember that the following equations are simple estimations and are not to be treated as precise technical calculations. Each equation can be influenced by a number of factors and do not take your personal financial situation into account. The formulas are meant to provide a rough estimate, not an exact projection.*

## Income – expenses = surplus or deficit

This is the easiest place to start. By subtracting all planned expenses from gross income, you find the total surplus or deficit you have each month. If you find you are running a deficit most months, you need to cut your expenses down, find a way to boost your income, or some combination of the two.

## Cost x 12 = annual expense

Another easy formula is how to calculate the cost of a monthly expense over a whole year; this is an important insight for any budget. Paying $8 a month for a subscription may seem cheap, but you may reconsider if you realize it is costing you $96 over the course of a year.

## Cost of 1 gallon of gas x 500 = annual gas expense

The EPA estimates that the average car owner uses about 500 gallons of gas a year (but can be as much as 700 if you drive a truck or SUV). Volatile gas prices make it impossible to project your exact gas expenses for a year. This formula, however, makes it easy to understand the effects of a fluctuation in gas price: For every cent devaluation of gas, you could expect to save $5 annually.

## 72 / percent of return = years to double

Have you ever wanted a quick estimate of how long it takes for money to double? Try the "Rule of 72." Just divide 72 by the annual growth rate of your account, and you get an approximation of how many years it takes to double.

(Example: Six percent growth would be 72/6 = 12 years to double).

*If using this formula for an investment account, remember that the market is unpredictable and average market performance does not guarantee future returns. Investments can be subject to losses, which will significantly change their nominal rate of return.*

## (Years of ownership + 1) x .10 = car depreciation percentage

Although there are some major outliers, most new cars depreciate around 10 percent when driven off the lot and another 10 percent each year they are driven (for the first five years). So, when looking at new cars, remember that most lose their value fast. Without a down payment, you will likely be underwater on the loan for the first year or two.

## Mortgage x (.03+(Rate x .75)) = annual mortgage cost

This equation is a bit more complex, but it is pretty handy for people wondering how their rent cost compares to a 30-year mortgage. Take 75 percent of the expected mortgage interest rate and add 3 percent to get the annualized rate of repayment. If you multiply this number by the initial mortgage amount, you get the annual cost.

For example: A 30-year mortgage issued at 4 percent would have an annual repayment rate of .03+(.04×.75) = 6 percent. If the mortgage was for $200,000, you would pay ($200,000×6 percent) = $12,000 per year (or $1,000 a month) to stay on the 30-year schedule.

Keep in mind that this is an estimation of the mortgage costs only and does not include home insurance, mortgage insurance, property expenses, or any of the other various costs of owning a home.

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