Claro Advisors, LLC.

Advisor Insights
August 2018

Trade Wars

August 28, 2018

By Michael E. Mullin

Chartered Financial Analyst® (CFA), and

Chief Market Strategist for Claro Advisors, LLC.

About the Author

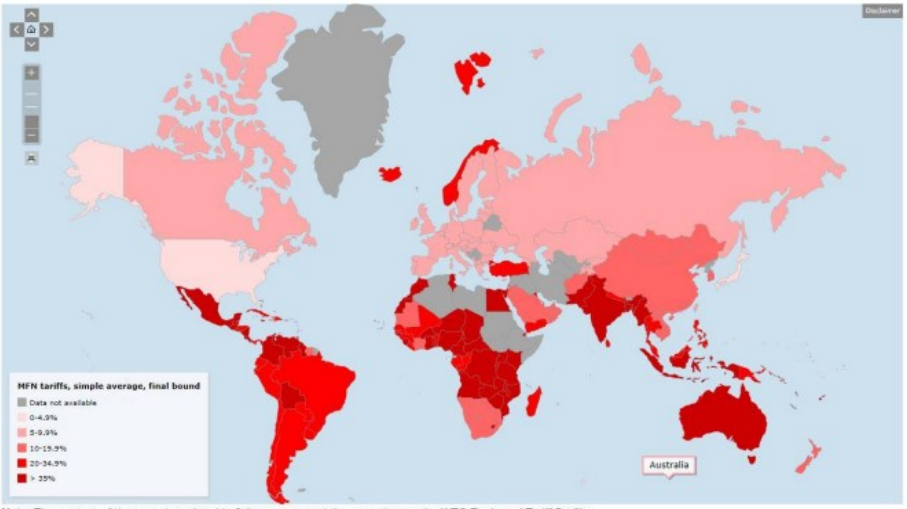
Many of our clients are asking about the implications of U.S. trade policies and why the United States would choose to engage in a trade war with China and some of our allies. This was a topic of discussion at a recent CFA Boston Society meeting as well and there were varying opinions presented. To get a more definitive answer, I consulted with a colleague of mine, Vitaly Veksler, CFA of Beyond Borders Investment Strategies, LLC. who manages global portfolios for institutions. He shared some valuable insight and research on the topic which presents a compelling picture of the global trade landscape. The following is an excerpt from his recent research report:

> ***"The U.S. Has Been Playing on an Uphill Trading Field Since WWII.*** *On March 1, 2018, the President tweeted that the U.S. steel and aluminum industries need "free, fair and smart trade" before announcing 25% tariffs on steel imports and 10% tariffs on aluminum imports. Trade data provided by the World Trade Organization (WTO) shows why many believe that while free trade is good, it may not necessarily be fair and smart from the U.S. standpoint. The U.S. currently has the lowest tariffs on foreign imports in the world. It is also one of only two global economies, along with Japan, that have average Most Favored Nation (MFN) tariffs of less than 5.0% of imports. For comparison, let's look at the tariffs imposed by the world's top four economies, or the "economic engines" of the global economy that are each responsible for more than 5% of the*

...continued from page 1

world's GDP. The U.S. imposes average "final bound" tariffs of 3.4%, Japan 4.5%, European Union (EU) 5.0%, and China 10%. The partners of the United States in the North American Free Trade Agreement (NAFTA) also impose higher tariffs: Canada 6.5% and Mexico 36.2%."

Most Favored Nation (MFN) Tariffs, Simple Average, Final Bound



Note: The content of the maps is updated in July every year, at the same time as the WTO Trade and Tariff Profiles.

Source: World Trade Organization. Downloaded on July 17, 2018.

The U.S. has long been an advocate for free trade, doing its part to help open global markets. Other countries have attempted to follow suit, but with varying degrees of participation and success. It is clear from the data that China, among others, has more work to do before they would also be considered advocates of free trade. The U.S. argues that China is using tariffs and subsidies to protect industries which should no longer need the protection, and this undermines the global competitive landscape. The report goes on to say that despite previous efforts made by the Bush and Obama administrations, trade policies have been mostly unchanged since the end World War II when Europe and Japan's economies were decimated and needed support. He also noted that China should no longer be considered an Emerging economy (since currently it is the third largest economy in the

---

1 Reuters, "Trump Says U.S. Steel, Aluminum Sectors Need 'Free, Fair' Trade," March 1, 2018.

2 World Trade Organization. https://www.wto.org/english/res e/statis e/statis maps e.htm. Downloaded on July 17, 2018.

3 According to the WTO, "final bound" tariffs are the legally binding ceilings after reductions have been made as a result of trade negotiations." We use this map rather than trade-weighted tariffs because high tariffs can simply eliminate trade between countries in some sectors of their economies (see the example of Canadian dairy tariffs for all practical purposes eliminating US dairy imports to Canada). Since trade is eliminated, the trade-weighted map would not clearly indicate countries imposing these high tariffs.

4 Ibid.

5 Ibid.

...continued from page 2

world). The point of the report is that it should be time for China to "take the training wheels off" (as we suggested in our most recent quarterly letter) and reduce its protectionist trade practices. In prior administrations, diplomacy was less effective in re-negotiating trade agreements. A "strong-arm" approach may be needed, but with it also comes great risk in the form of retaliatory measures. And it could escalate quickly into an all out trade war which could cause more harm than good.

As asset allocators, we believe that despite the additional geopolitical risk and headline news affecting markets today, our investment models are designed to withstand the short term volatility resulting from this trade disruption. In fact, if the U.S. is able to renegotiate more fair-trade relations with other nations it should help boost overall global production, and the investments in our portfolios would stand to benefit from that growth. Moreover, the U.S. economy has substantially strengthened since the last recession in 2008, while interest rates have remained somewhat stimulative even with the Federal Reserve's actions to normalize rates. With the additional boost from tax reform, this could help the economy continue to grow while the U.S. seeks to renegotiate trade agreements. However as the situation develops, we may need to make adjustments to our models with a primary concern being the extent and duration of a possible trade war with China. If tensions continue to escalate or if it leads to a more permanent discord between the two countries, both economies would be negatively impacted. Hopefully a more "fair, free and smart" trade deal occurs and it happens sooner, rather than later. ■

About the Author

Michael E. Mullin ("Mike") is a Financial Advisor with Claro Advisors where he focuses on constructing portfolios for individuals and families. As a Chartered Financial Analyst® (CFA) part of his investment process includes conducting in-depth macroeconomic research to ensure that his clients' portfolios align with an ever-changing global landscape. Mike also serves as Claro's Chief Market Strategist and leads the firm's Investment and Due Diligence Committee.

Mike obtained an MBA and an MS in Finance from the Carroll School of Management at Boston College, as well as an Economics degree from Colby College and has been active in the investment industry for over 20 years. Mike earned the Chartered Financial Analyst® (CFA) designation in 2003 and is a member of the Chartered Financial Analyst Institute (CFAI) and the Boston Security Analysts Society (BSAS), where he serves as a member of the Strategist & Economist Committee. Prior to joining Claro, he founded MEM Capital Advisors, a Registered Investment Advisor in Quincy, MA providing comprehensive portfolio management to individuals, families, businesses, and nonprofit organizations. Before forming MEM in 2011, Mike managed portfolios at Boston Research & Management where he also contributed to the firm's investment committee and quarterly newsletter. Prior to that, he served as a portfolio manager both at Jefferies and BNY Mellon. He began his career as an advisor at Merrill Lynch.

Mike is a member of the Quincy Board of the South Shore YMCA and is also a member of the SSYMCA Finance and Investment committees. He is an active volunteer with the Angel Fund and the MDA, charitable organizations focused on the fight against ALS (Lou Gehrig's Disease). He has completed three Boston Marathons to raise money towards ALS research. Mike currently lives in Quincy, MA with his wife Ann and two children, Cassidy & Caeden. He enjoys spending time with his family, coaching his kids' sports teams, golf, exercise and reading. Mike can be reached at mmullin@claroadvisors.com.

CLARO ADVISORS, LLC.

BOSTON, MA (Main)
185 Dartmouth St.
6th Floor
Boston, MA 02116

WORCESTER, MA
328 Shrewsbury St.
Suite 250
Worcester, MA 01604

DEDHAM, MA
#3 Allied Dr.
Suite 303
Dedham, MA 02026

WWW.CLAROADVISORS.COM

Toll Free # (800) 604 - 2838

Please contact us here with any questions.