



NEXT GENERATION WEALTH MANAGEMENT

Trump's Tariffs. What Does It Mean?

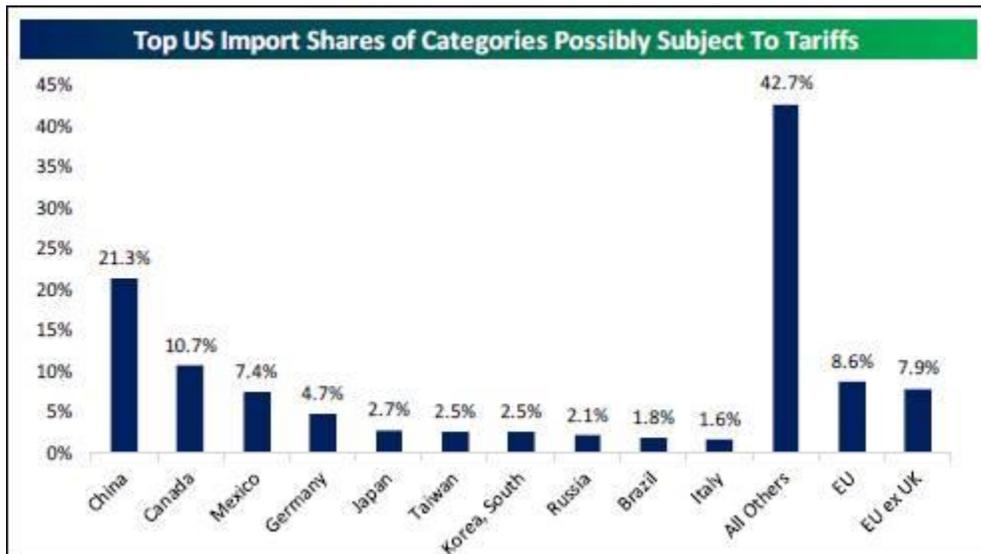
Given the news on Thursday that the Trump Administration announced new punitive tariffs on steel and aluminum imports, Bespoke (independent investment research firm) provided an analysis on the subject, in Q&A form. It's clearly early and no one knows how this will eventually play out, however they provide a very good overview.

How big are the tariffs?

We don't know. The devil is in the details and thus far, they haven't been forthcoming. Using Census trade data, 5 NAICS codes could be relevant. One of those is Fabricated Metals, e.g. fasteners or aircraft parts that aren't yet complete. Including the Fabricated Metals category, US imports of the 5 categories were \$246.8bn in 2017. Ex Fabricated metals, that number is more like \$138.2bn. In practice, the specifics of the policy are likely to be more targeted than those numbers, so they're likely lower.

Who do they impact most?

Below, we show the distribution of total imports for the categories that look subject to the tariffs. China, Mexico, and Canada are the largest by far, with Japan, Germany, South Korea, and the UK the next largest. Notably, the EU would be the third-largest if counted as a single country.



Does this mean trade war?

We do not have a numerical estimate here, but the EU is already considering retaliatory tariffs. Given that the EU is the largest economic bloc on the planet, they have ample options in industries to target with retaliatory tariffs and are unlikely to move rashly. China is already probing US sorghum imports in response to US tariffs on solar panels and washing machines, and made some strong comments in reaction to President Trump's announcement. Our view is that there are feedback loops in place to stop escalation to a full-blown trade war, and that is



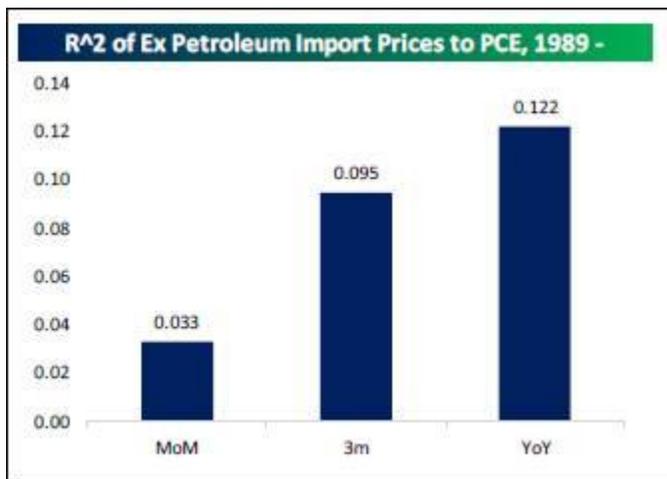
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consistent with prior efforts at punitive steel tariffs from 2002, which were repealed after 20 months. We'll discuss that further in a later section.

What does this mean for inflation?

Very little. After stripping out energy, import prices are relatively uncorrelated to US consumer inflation. The US economy is relatively closed, and the maximum extent of these imports would be 5.3% of 2017 imports/1.3% of US GDP. These tariffs are unlikely to have a direct positive impulse on core PCE.



How will the Fed react?

Based on the comments above, we see no reason for the Fed outlook to change.

So why did the market selloff?

Risk aversion. While the tariffs are not likely to be inflationary, the combination of increased risks to trade, business disruption due to administration policy, and uncertainty about reaction from the rest of the world all drove selling. Tariffs represent a transfer from domestic metals consumers to domestic metals producers. Auto manufacturers (F, GM), aerospace companies (Lockheed Martin, LMT, and Boeing, BA), and other industrial manufacturers like JCI, CAT, UTX, and TDG will all have to pay for this policy via higher costs and lower margins. Traditionally, American policymakers have viewed free trade as an absolute necessity, and while the corporate sector has responded well to the new administration's desire to cut taxes and regulation, attacks on free trade represent an attack on the multi-decade policy framework which has so benefited corporate equities.

This all seems blown out of proportion!

Yes and no! The odds of a significant trade war are low, but they do exist. If the rest of the world gets tough with the US, things could get very rough very quickly. We don't think that's going to happen. More likely: tough talk, and calling of the Trump Administration's poor hand, followed by face-saving measures and little departure from status quo. This is the negative



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feedback loop described earlier. We do not think the administration has the fortitude to attack free trade policy and send equities materially lower, and that price action like we saw this week will mean a retreat from a protectionist “brink”.

What should I own?

We've been talking for some time about the upside for bonds and the USD. A bout of global risk aversion would work very well for both of those trades. Yields were sharply lower across the curve with the belly outperforming. Equities are not likely to perform well in the short-term, but for this scenario we favor defensive, domestically-oriented sectors and names that won't be materially hit by trade news. Stocks with 100% domestic sales exposure fell an average of 34 bps on Thursday, versus a 95 bps de-cline for those with more than 70% international revenue exposure. Among domestic names, Financials, Real Estate, and Utilities are over-represented, while Tech, Materials, and Industrials are more common on the international underperformers list.

Why not buy steel and aluminum stocks?

The S&P 1500 Steel Industry Group gained over 3% on Thursday, with the Aluminum Industry Group up slightly less. Are these viable plays here? We would caution investors from piling in. Infrastructure plays like Martin Marietta (MLM) and Vulcan (VMC) are good examples. After surging 19% and 15% in the week of the election respectively, both have dropped about 10% in the year following the election. The sudden dollar spike post-election before its horrific 2017 performance is another cautionary tone about piling into “Trump Trades” in our view.

Finally, while the actual tariffs haven't been enacted, and with this White House, we have all learned that anything can happen, President Trump did seem to double down on his stance regarding the importance of placing tariffs on imported steel and aluminum in order to protect our domestic industries with a series of early Friday morning tweets. In between, he also let it be known that when it comes to SNL impersonations of him, he prefers Darrell Hammond over Alec Baldwin. Who knows, maybe next week Trump will reverse his decision.