

July 1, 2018

Greetings,

The primary reason for the recent market pull back as well as the selloff of many of our holdings is because of the proposed tariffs and the possibility of an all-out trade war with China. My take on this, is that if a trade war does ensue, it will adversely affect the stock market significantly more than it will affect the economy. The stock market hates uncertainty. I am not sure how much more uncertainty you can have than a trade war with China, never mind how it can escalate into something that could do damage to an improving, arguably strong economy. Looking at the glass as half empty; the Presidents trade policy has created a black cloud that will hover over the stock market until this is resolved. Looking at the glass as half full, assuming there is a trade war, it will eventually end as clearer heads will prevail. The problem being no one knows when it will end. Once trade issues are resolved, since earnings are rising at a 20% growth rate (for the time being), stocks will have compelling valuations and there is a probability that a strong market rally will ensue. Since 90% of all market gains occur over just 10 trading days a year, you have to be invested before these gains occur, otherwise you miss out. Translation, market timing is not an option. That is precisely why I don't want to take too much money off the table.

I am a big American history buff, partial to biographies. I am currently reading the biography of Ulysses S Grant. I find him fascinating both as a Civil War General and as a President. I find Grants strategy as a General similar in some ways to the Presidents strategy in the possible trade war against China. The thesis in winning a trade war is that since China needs our consumers to buy their products more than we need China, then we will ultimately prevail. Part of that thesis is also that because China's economy will be hurt more than ours (its stock market is already down 20% from its high), China will be forced to the negotiating table and will be willing to abide to our countries terms. How this relates to General Grant's strategy during the Civil War is as follows; even though General Grant won just about every battle, he was unpopular during much of the war, especially with the press. Sound familiar?? You might be thinking why would a General who won his battles be unpopular? The answer is because the populace was impatient because the war took so long to end and more importantly, the press referred to him as a "butcher" since even though he won the battles, the casualties were huge even for the "winning" side. This was even more so towards the end of the war. Part of General Grant's grand strategy was that even if he lost 9,000 soldiers in a battle but the South also lost 9,000 soldiers, he looked at it as a win since the South couldn't replace their lost ones while the North was continually able to come up with fresh new troops to replace the ones that were killed. For those of you who don't know, the Civil War was a war of attrition. The problem I see with the theory of China being hurt more than our country and this being a trade war of attrition (and our country being able to "outlast" China) is that I think the President is underestimating China's staying power. China is not exactly the South

during the Civil War. China is a country essentially being run by a dictator who is in his position for life. I find it difficult to see the head of a country who can't be voted out not trying to outlast a President who can either be voted out in just 2 years or bow to political pressure prior to the election if the U.S economy is adversely affected by an escalating trade war. I believe that China will have the staying power to see how things turn out post-election or at least to read the tea leaves leading up to the election. If President Trump is reelected, then I can see the Chinese President giving in. If not, then I can see China figuring to get a better deal (or no deal) with the new President. That will be 2 ½ years down the road. Meanwhile, with corporate earnings doing fantastic and the economy improving, a great opportunity for the economy to continue to improve which would result in growth numbers we haven't seen in 20 years could be squandered. I won't even go into the potential of strong stock market returns. Do I believe the bull market is coming to an end as a result of these trade policies? NO. I do believe the bull market will be similar to a speed boat with its anchor in the water, slowing it down. Once the storm clouds dissipate, the anchor will be lifted and the bull market will resume in full force. This could result in a "market melt up". Translation, whatever returns we lose now will be postponed and should be made up later.

Please either call or email me if you have anything that you want to discuss or have any questions.