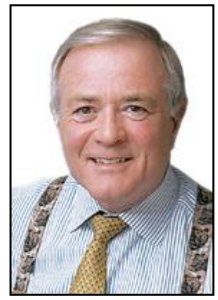
DJC
THE DAILY JOURNAL OF COMMERCE, PORTLAND, OREGON



William Rutherford

Talk Of Tariffs Raises Investor Uncertainty

Published July 9th, 2018

U.S. equity markets show uncertainty and less growth. The economy stumbles over trade conflicts and rising interest rates, amid evidence of inflation and a strong dollar.

Year to date, the S&P index is up a meager 2.65 percent, about the annual rate of inflation. June saw only a 0.62 percent increase in the S&P. The Gross Domestic Product annualized growth for the quarter was 2.0 percent versus the forecast 2.2 percent and White House boasts of 4 percent. The Atlanta Fed forecasts a slowing GDP growth rate. Personal consumption fell slightly on the quarter. Why are the market and the GDP pausing now?

A host of negatives provide headwinds for the market.

Interest rates are on the rise. The Fed has already raised them this year, and three to four more increases are being discussed. The White House, through Larry Kudlow, President Trump's top economic advisor, took the very unusual step of admonishing the Fed about interest rate increases. No White House in memory has told the Fed what to do. Since it was first established, the Fed was to be independent of politics.

Kudlow also took time to assure the markets that the massive deficits incurred by the tax cut were disappearing. No signs that the deficits are disappearing have been noted. The Congressional Budget Office says the deficits are persistently large and show no signs of decrease.

Rising interest rates have the effect of strengthening the dollar. A strong dollar coupled with proposed tariffs make U.S. products more expensive to foreign buyers, which means a slowing economy and fewer jobs in the U.S. Many companies have warned that their production will be curtailed and their employment reduced.

Increased tariffs are inflationary to U.S buyers. Auto makers have warned the government that tariffs will slow auto sales and result in layoffs. Tariffs on steel threaten the very infrastructure program that President Trump has touted. Some projects are being delayed or cancelled altogether. The Fed, of course, will look negatively at inflation over 2 percent and lean toward more interest rate increases. A policy once set in motion can be like a snowball rolling downhill.

Contributing to market risk is the effect on emerging markets. Emerging market economies are always somewhat fragile, but their economies have strengthened of late, and they have borrowed money on the strength of their growing economies. However their borrowings are generally in stronger currencies, typically the dollar, so rising interest rates and a strong dollar make it harder for emerging markets to repay their debt load. The inability to repay adds additional risk to global markets.

Trade conflicts present a large risk to markets around the world. The stock market does not like tariffs. Let's look at the Smoot-Hawley tariff that President Hoover signed into law in 1930.

While the events listed here do not prove causation, the question for investors is how did the markets react?

- May 28, 1929 — The House passed the Smoot-Hawley tariff, although it was not clear that it would become law.
- October 28, 1929 — After some wrangling over the coverage of the tariff, President Hoover agreed to support the legislation.
- October 29, 1929 — The stock market crashed.
- March 24, 1930 — The Senate passed the Smoot-Hawley bill.
- May 4, 1930 — 1,028 economists warned Hoover not to sign the tariff bill into law.
- June 17, 1930 — Hoover signed Smoot-Hawley into law.
- The GDP dropped 8.5 percent during the remainder of 1930, 6.4 percent in 1931, and 12.9 percent in 1932.
- The Great Depression ensued.
- Hoover and the Republicans were swept from office.
- In 1934, then President Roosevelt cut tariffs. The GDP grew 10.8 percent in 1934, 8.9 percent in 1935, and 12.9 percent in 1936.
- On May 3rd of this year, a letter signed by 1,140 economists warned President Trump against tariffs. Trump has ignored the letter.

"Tariffs are beginning to take a toll on American businesses, workers, farmers, and consumers as overseas markets close to American-made products and prices increase here at home," said U.S. Chamber of Commerce CEO Thomas Donohue.

"Tariffs are simply taxes that raise prices for everyone. Tariffs that beget tariffs that beget more tariffs only lead to a trade war that will cost American jobs and economic growth", he continued.

No friend of journalists, President Trump recently imposed a 30 percent tariff on newsprint. In a move expected to affect as many as 600,000 workers, the tariff will reduce circulation of newspapers and magazines. Our founding fathers thought it important that we have a strong independent press to guard against excess and keep the public informed.

What to do in times like these? As long as the economy is growing, stock values should grow too. Remember that at its bottom in 2009, the market was down 54 percent. But by the end of the year, the market was up 60 percent off its low. The only investors who lost were those who sold. The market recovered all its losses and more after 2009, and is up 302 percent for the second longest bull market in history. Continue to hold high quality stocks. Remember there will always be times like these.

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