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Subject: VALUED CLIENT MAIL LIST: The Political and Economic Realities of the Current Financial Markets

MonacoCapitalManagement

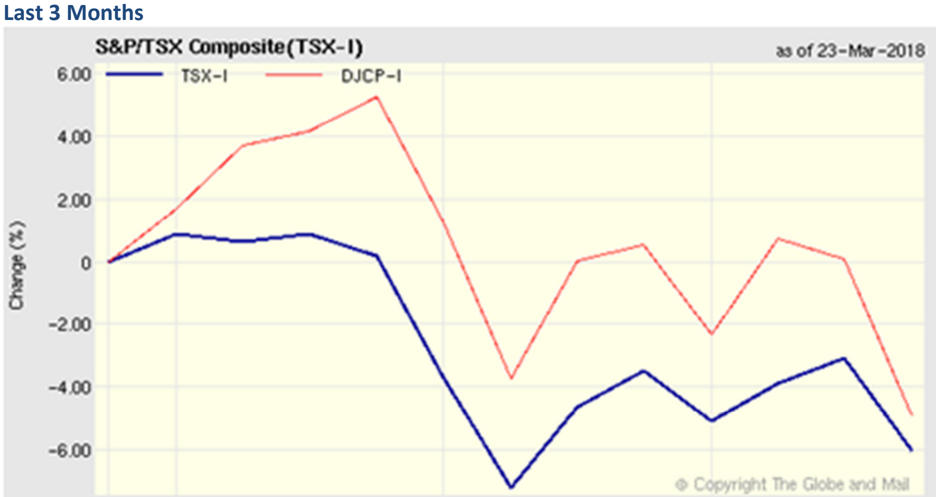
WHEN IT COMES TO TRADE AND COMMERCE …

Source: Google Images

THE WORLD IS A GLOBAL VILLAGE

The North American financial markets have dramatically declined since January of this year driven largely by two policies being implemented in the U.S.:

Last 3 Months



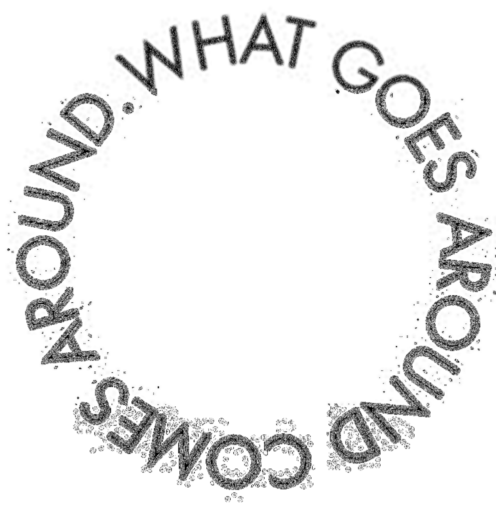
Source: Globeinvestorgold

- The current federal administration is moving to **apply tariffs on specific goods and services** being imported to the U.S. in an attempt to reduce imports and create employment in the U.S. Given most large companies in the U.S. and Canada operate multi-nationally to export their goods and services globally, the investor fear is that retaliatory tariffs will be applied which will hurt exports and corporate earnings.

- The FOMC is pursuing a program to **increase central bank interest rates** in order to "normalize" the level of rates which were held at historically low levels following the 2008 recession. This is intended to counter inflation which is expected to increase as recovery continues. Given the current level of inflation in the U.S. has just risen through 2% to 2.2% (inflation.eu) since the recession, this is considered a pre-emptive action to prevent economic possible future "frothiness".

  Because of the aggressiveness in the number of times interest rates are proposed to be increased, the predictable response has been to cause stock market prices to correspondingly decline, not because of corporate earnings which remain healthy, but, because of the alternative of holding less risky debt instruments at higher interest rate yields.

However, there is an inherent negative consequence to both these initiatives:



Source: Google Images

- Trade tariffs inevitably lead to counter tariffs which ultimately affects all trading partners; there is little likelihood that one nation introduces tariffs on imported goods and services without other nations retaliating. A recent example has been the counter threat by president Trump to place a tariff on German autos after Germany reacted to the initial tariff by the U.S. on steel produced in Europe. Ironically, most German auto makers produce cars in the U.S. and a tariff on German auto manufacturers would threaten U.S. jobs.

- Interest rates are a double edged sword. While they may help contain inflation by discouraging consumer consumption due to higher borrowing costs, they also raise the cost of borrowing for companies, making it less profitable to invest and hire more employees.

But wait, not all is lost:

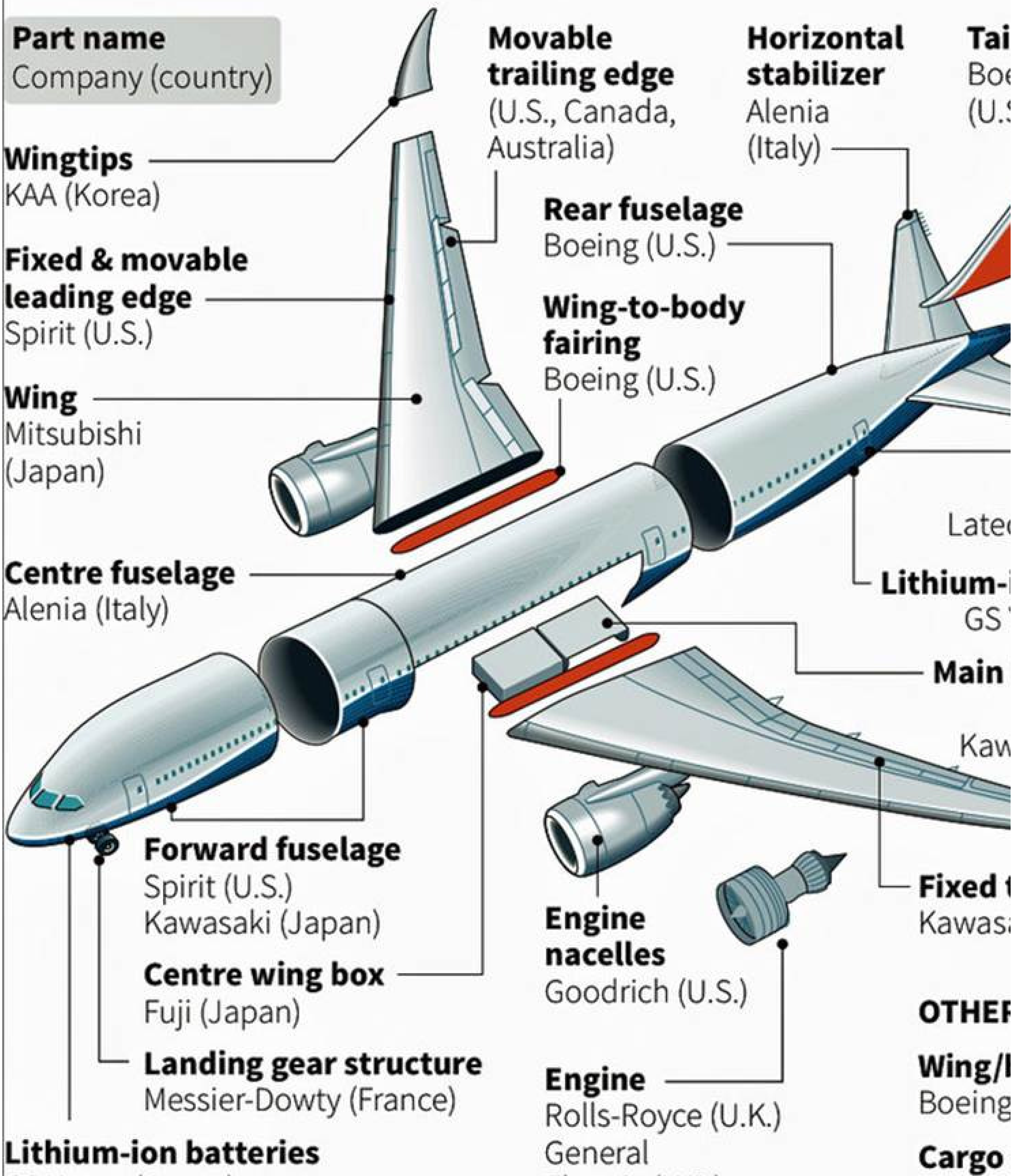
The reasonable conclusion is that these actions are not solely being driven by economic data but by formulated policies intended to achieve certain political aims as well. THIS IS A GOOD THING as political situations can be quickly remedied by change of policy (such as political elections) which the financial markets respond quickly to: Witness the market rally in the U.S. following the tax cuts in 2017. However, true economic dislocation can take much longer to recover from: Witness the number of years of slow recovery since 2008.

What's the takeaway?

Global trade is essential and inevitable for so many reasons, economically, politically and socially. But a fundamental reality is that no one nation can produce all of its goods and services on a timely basis entirely on its own to meet demand on a timely basis. As an example, we can see this in the chart below identifying the sourcing of parts for a Boeing aircraft which needs to diversify its manufacturing in order to more quickly simultaneously produce the necessary parts as well as to foster exports to those countries in which it has created employment.

787 Dreamliner structure suppliers

Selected component and system suppliers.



A country's economic value should be viewed as including the net sum total of all imports and exports such that while trade deficits may be held with one nation, surpluses may be held with others as part of a total closed global system. If multi-nationals such as Starbucks, Walmart or Proctor and Gamble were to be shut out of foreign markets, there would be no possibility for growth as their domestic market is already saturated.

Concurrently, countries with disproportionate balances toward exports should also be aware that more open free trade will ultimately be in their best interest as their domestic consumption and standards of living increase, creating more opportunity at home for growth.

However, any notion that trade barriers will foster domestic growth is a throwback to the cold war era. It represents an outdated philosophy that does not recognize economic evolution. The current federal U.S. administration's attempt to implement this provokes the possibility of an economic slowdown such that inflation and additional interest rate hikes might become irrelevant.

We have become a global economic village. The key is how to best navigate it.

Source: Google Images

In the meantime …

Continue to employ defensive investment management mechanisms including increased cash reserves, income generation and market hedging to help mitigate market weakness and volatility until such time that political factors unwind to allow stability to return to the financial markets globally. It's not unreasonable to expect this to occur this year given the current political turmoil in the U.S..

Regards

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