

## As we see it

July 2018

"No nation was ever ruined by trade"

– Benjamin Franklin

## Trade War?

A casual look on any major financial website yields multiple headlines of recession, crash, trade war, etc. We thought a brief primer on how international trade works might be beneficial for dissecting the constant news coverage of a possible coming trade war.

One should first recognize that in studying international trade there is no single rule, statistic, or equation which is capable of adequately explaining either current or future trade patterns. Trade is too intricate and too variable. Its shape naturally adjusts to conflict, politics, disruptive technologies, and so on. Reliable data is difficult to collect, and the presentation of trade data—like any statistic—can be manipulated to support almost any argument.

If we start by looking at trade at its base level, there are several variables that must be considered. The first variable is the importance of the product to the importer. The second variable is the importance of the trading of the product to the exporter. A third, and perhaps most important variable, is whether the importer could easily find another source for the product in question.

In assessing the relative advantage the importer has versus the exporter, you can compare the exporter's production of the product to the total production of said product in the world. If the total availability of the product indicates that it would be easy to find alternative sources, who really ends up having the upper hand? For example, Japan is an importer of oil while Saudi Arabia is an exporter of oil to Japan. Shouldn't Saudi Arabia be able to charge Japan a premium price for the oil? If these were the only two countries involved in this example, the answer would likely be yes. But since Japan can go to other exporting countries to get their oil, Saudi Arabia has no specific advantage over any other oil exporting country. What would appear to be an advantage to the exporter (Saudi



Arabia) actually turns out to be an advantage for the importer (Japan) in that they can go wherever they want to get their oil.

Another example of the subtle intricacies of trade negotiation is the case of steel. Steel is a commodity, but there are many types of niche steel products. Canada may not be dependent on U.S. steel imports overall, but perhaps it does depend specifically on American coiled stainless-steel wire—which would be very important in determining the specific direction of trade negotiation. This means that to grasp the nuances of dependency requires a highly focused analysis of a specific commodity plus any value-added production. Hence, it may be difficult or impossible to acquire the data to make a precise and meaningful calculation.

One does not need an economics degree to understand relative trade advantage. Real-world observations can describe reality just as much as those results derived from econometric equations. This is not a putdown of economists, but a testament to the investing public's perceptiveness.

While protectionism may be back in the news, it never really went away. The international trade system since 1945 has worn the mask of free trade, but market protecting policies have been the norm for all countries throughout history. The world's progression toward free trade has never been linear, but a normal ebb and flow as countries seek to enhance and protect their citizens' lives through favorable trade policy.

Trade wars are much more difficult to measure than real wars. Trade wins and losses can't be assessed after a single battle. The economic effect must be measured in months or even years. There will be casualties on both sides—some predictable and some not—and it will all come down to which side is better prepared to weather the storm.

As the impact of U.S. protectionist policies continues to ripple throughout the global economy, the ability to evaluate current and future global trade patterns will be as important as ever when attempting to assess the prospects of various investment opportunities.

While attempting to assess the impact of all trade news, we believe that understanding the difference between the reality of the markets and media headlines is crucial. All of the potential outcomes are risks to monitor, but the cold truth is that the fundamentals of the economy and the market (recognized via corporate earnings) remain very strong and will likely remain the driving force of stock market performance.

History teaches no that men and nations behave Wisely once they have exhausted all other alternatives.

- Abba Eban