July 8, 2019

TRADE TENSIONS

Dear Investor:

It's been almost exactly a year since President Trump took action on our trade situation with China. We currently have tariffs on $250 billion of Chinese products, and they have tariffs on $110 billion of our products. I still hesitate to use the term "trade war" as I don't think things have risen to that level yet. However, they could, and that fact is currently causing a lot of uncertainty. China has the largest population in the world at over 1.4 billion people. Obviously, that's a huge market and everyone wants a piece of it. According to recent data, the US is still the world's largest economy at over $21 trillion dollars. China is ranked number two and has already grown to around $15 trillion dollars. It seems like only yesterday they were at $10 trillion. Virtually all our major multinational corporations have their own strategy for doing business with China. The current situation is making it very hard for them to know what actions to take, thus causing them to hold back on hiring, spending, and investment. Think about how many things you are aware of that are manufactured in China. Companies have become highly dependent on this "manufacturing ecosystem" to both source and manufacture many of their products. Having to consider other alternatives is not necessarily a bad thing in the long run, but it is highly disruptive in the shorter term. Manufacturing is certainly not the only issue. Many US companies of all different types sell their products in China. If the current tensions were to escalate into a much bigger trade war, it could have enormous implications. There are many ways that China could restrict this flow of business that would be very damaging. Many people believe it would push the world into a recession, and I'm inclined to agree.

During the month of May, the US increased the tariffs on many of these products from 10% to 25%, as certain deadlines for progress were passed. China naturally responded by stating that they would be taking necessary counter measures. Soon after, they upped their tariffs on $60 billion of our goods. We then began to threaten new tariffs on another $300 billion dollars of goods, including cell phones and computers. This escalation caused the market to drop over 6% in May. Fortunately, in June, President Trump and Chinese President Xi Jinping began talking again and agreed to meet at the G20 meeting at the end of the month. As you are likely aware, they called a truce at that meeting, and there was no specific time frame given to resolve some of these issues. This caused great relief, and the market recovered all the lost ground and recently hit a new high. We need to remember that these issues are a long way from resolved. There's no way to know how things will play out in the months ahead.

Alongside the trade problems, there have been some signs of slowing in the US economy and other places around the world. This has led to a whole new round of speculation and demands for the Fed to cut interest rates in response to the slowing world economy and uncertain environment. People

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have started talking about one cut, two cuts, and even three cuts. Now that the trade talks have resumed, I think some of this will subside. The US still seems to moving forward at a steady pace. Wage growth has been running at about 3% a year, and we still have low inflation and low interest rates. Mortgage rates are well under 4% again which should prove helpful. Although this expansion is now entering its eleventh year, there's no specific reason to assume it cannot keep going. If not, the Fed has already said they will cut rates if things slow down. No surprise there.

One of the interesting things we saw this quarter was a notable jump in the gold price. In May and June together, it rose almost 10%. Most investors believe this was caused by the trade tensions and the predictions of lower interest rates. This shows me that gold still plays a valuable role as a safe haven asset. The subject of gold comes up regularly at our client meetings. There's no simple answer, but gold is still a valuable asset in the eyes of many. We have been in a bull market for the last decade so it's only natural that demand for gold would be low at this point in time, at least in the US. There could be a time in the future when things are much different. There was a major story in the Wall Street Journal in June that really caught my attention. The story concerned the gold reserves of Venezuela. If you are aware of the problems in Venezuela, you know they are very serious. Many of their people are enduring extreme suffering. The country once had Latin America's richest economy. They are now experiencing hyperinflation, severe food shortages, gas lines that literally last for days, looting, and much violence. In August of 2018, they did a major monetary overhaul where the largest denomination note put in circulation was 500 bolivars. In June of this year they overhauled the system again and have now released 10,000, 20,000, and 50,000 bolivar denominations for public use, when you can get them. This is what inflation does, 500 bolivars will buy nothing. Getting back to the subject of gold, the story in the WSJ told how the government of Venezuela is selling off the country's gold reserves. They have secretly been sent to East Africa to avoid US sanctions. It's estimated they sent out 7.4 tons of gold with a value in the range of $300 million US dollars. My simple point is that when all else fails, gold is still very valuable and there are people in the world who want it. Gold has been "real money" in many cultures and societies throughout history. In our modern world, we have fiat money with no real asset backing. While there are some people who think we will return to the gold standard someday, I don't think there's a realistic chance. History has shown that governments like to borrow and print much more money than they collect in taxes. A gold standard provides discipline that they are not interested in. I do hope things improve for the people of Venezuela. We always keep an eye on the gold market, and there may be a time when we will want to own a lot more of it.

I hope you enjoy the summer. Please contact me anytime to discuss your portfolio.

Best Regards,

David E. Keim

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