THE DANA VIEWPOINT

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China

We have not discussed the trade war with China in this newsletter since it first reared its head last spring. We may be in the minority, but we do not believe it is the biggest threat facing the market and the economy. We still see the deflationary risk brought on by a behind-the-curve Fed as the biggest threat to the market. U.S. imports from China are valued at three to four times the value of U.S. exports to China. The U.S. economy is 50% larger than the Chinese economy. As a result, Chinese exports to the U.S. are six times larger as a percent of their economy than U.S. exports to China. From late September through Christmas Eve 2018, the S&P 500 Index dropped 20%, much the result of the most recent Fed rate increase. As the Fed began to reverse their stance on rates in early 2019, the market reversed its decline and made a new all-time high four months after the December low.

It seems clear that the U.S. (or at least President Trump) is willing to tolerate some short-term pain in order to level the trade playing field with China. Yes, some areas of business will have to adjust during this process. The most important goal for the U.S. is to limit the intellectual property theft now practiced by China. Some have called this misappropriation of intellectual property the largest wealth transfer in history from one country to another. The best time for us to try and correct this situation is when our economy is at its strongest. Currently unemployment is at historic lows, inflation is below 2%, and the stock market reached an all-time high last month. By contrast, Chinese GDP is slowing, their currency is at an all-time low, and their stock market is near a low. Stemming the loss of intellectual property to the Chinese would be a huge gain for the U.S., so the stakes are high for both sides.

However, China has much more to lose. While China represents about 13% of the U.S.' total trading volume in goods, both Mexico and Canada carry a bigger share of trade with the U.S.. The U.S. also exports intermediate goods that are assembled in China and become finished products. The Chinese only hurt themselves by levying a tariff on an intermediate good, as it increases the price of the final good assembled and exported from China. China is an importer of agricultural products, and they have said they will not buy those products from the U.S., but agriculture is a global market, and the U.S. can simply sell to the country that now exports to China. Chinese airlines are a large customer of Boeing, are they going to stop buying planes? Airbus cannot ramp up production to fill the gap. But will they stop buying our Treasuries? Of course not. As the dollar appreciates against the Yuan, Treasuries are one of

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China's best investments, and they provide stability due to the dollar's status as the world's reserve currency.

So where does this end? We do not know. But since the dispute adds investment uncertainty, it makes the Fed seem tighter than if the risk did not exist. The Fed should respond by cutting rates. The yield curve is urgently telegraphing that message, even more so in the last 30 days as the curve has inverted and the 30 year Treasury has reached an all-time low of 1.95%. Despite the increased volatility the trade war is causing, stock and bond markets are enjoying strong years with the S&P 500 Stock Index up over 16% and the Bloomberg Barclays Aggregate Bond Index up over 8%. Investors always have risks to consider, and structuring portfolios to navigate these risks remains our keen focus.

Random Thought for August 2019: "I feel there's an existential angst among young people. I didn't have that. They see enormous mountains, where I only saw one little hill to climb."

Sergey Brin, Google Co-Founder

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