

Cumberland Advisors Market Commentary – Defense Expenditures

Most Americans have never heard of the Stockholm International Peace Research Institute, www.sipri.org. A few minutes surfing their website might just inspire you to add it to your list of independent research sources.



You can check out the role of the military in Venezuela and how it is supporting Maduro as a result of the financial support the military has enjoyed. This mutually beneficial relationship helps to explain the difficulty of regime change in that country.

One can also check out many other informative research pieces.

Try the report “Trends in World Military Expenditure, 2018” (<https://www.sipri.org/publications/2019/sipri-fact-sheets/trends-world-military-expenditure-2018>). Take a look at Table 1 on page two for a summary of the 40 highest military expenditures, listed by country. The US tops the list. China is second. The economic data in this report helps to identify some macro themes. Worldwide military spending is estimated at

about 2.1% of global output (GDP). America accounts for more than one-third of the world's military expenditures. France spends more than Germany does. South Korea spends more than Brazil or Italy or Australia or Canada does. Macro data helps put things into perspective when that data is combined with geography.

One takeaway for us is critical.

We know the world is a dangerous place, and it seems that it is becoming more so. Traditional diplomacy seems to be failing. The latest North Korean missile firing is an example of this failure as Dictator Kim has demonstrated after two summits with President Trump. Let me be clear. Kim is a really bad guy. This next comment is about tactics and strategies and not in any way offered to protect or defend a strongman/dictator. Whether its Kim or Maduro or others, ruthless despotic dictators are the enemy, always and every time.

Note that a physical "walking out" of a meeting can occur only once in diplomacy and then the rules of engagement are forever changed. Ending a meeting without a joint statement used to be the way to message the world and the other side about discontent. No dictator/strongman leader can tolerate a direct insult since it raises risk to him from those at his home government who want to remove him or kill him. This is particularly so with dictators and strongmen who do not need to face elections.

So all the negotiations needed to deal with dictators and strongmen have now changed. The second summit with Kim was a victim of a real estate negotiating tactic. I've seen that tactic personally and used it on occasion. Negotiations can be tough and hard. So, you get up in the middle of a meeting to send a message that you are serious. You walk out. You also leave a channel open to resume if that is what you want to do. But in a business transaction, you do not have to proceed.

That is why merger talks and transactional negotiations get broken off and then resumed.

In diplomacy, the reopening of a negotiation can happen but the methods used now have to be changed. The change occurs in the back channels and we do not see them in the public domain.

One side cannot take any risk or insult by the other side. Once you walk out the first time, you need to rewrite the rules. Unlike a real estate transaction, the “walking out” card can be played only one time. We shall see how the US deals with that principle in its global geopolitics. Negotiations between Trump and Xi are now subject to these new rules. The world’s two largest economies are also the world’s two largest military expenditures listed in the SIPRI report.

Meanwhile, the aggregate of military expenditures worldwide is heading higher and doing so from a record level.

We also know that the technology of war is intensifying at lightning speed. Check out: <https://www.sipri.org/media/press-release/2019/emerging-technologies-pose-challenges-control-biological-weapons-new-sipri-report> . Destructive capacity grows and is now expanded into the cyber realm. Here is another report to digest: <https://www.sipri.org/research/armament-and-disarmament/emerging-military-and-security-technologies/cybersecurity> . Nothing appears on the horizon to stem this accelerating trend.

At Cumberland, we continue to hold the defense sector ETF in our US ETF accounts. We rebalance it on weakness.

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