Cumberland Advisors Market Commentary – Does Trump-Navarro Equal Smoot-Hawley?

George Santayana said "Those who cannot remember the past are condemned to repeat it."

In an article titled "The Smoot-Hawley Tariff and the Great Depression," authors Theodore Phalan, Deema Yazigi, and Thomas Rustici assess the role the Smoot-Hawley Tariff Act played in the Great Depression:

"In 1930, a large majority of economists believed the Smoot-Hawley Tariff Act would exacerbate the U.S. recession into a worldwide depression. On May 5 of that year, 1,028 members of the American Economic Association released a signed statement that vigorously opposed the act. The protest included five basic points. First, the tariff would raise the cost of living by 'compelling the consumer to subsidize waste and inefficiency in [domestic] industry.' Second, the farm sector would not be helped since 'cotton, pork, lard, and wheat are export crops and sold in the world market' and the price of farm equipment would rise. Third, 'our export trade in general would suffer. Countries cannot buy from us unless they are permitted to sell to us.' Fourth, the tariff would 'inevitably provoke other countries to pay us back in kind against our goods.' Finally, Americans with investments abroad would suffer since the tariff would make it 'more difficult for their foreign debtors to pay them interest due them.' Likewise, most of the empirical discussions of the downturn in world economic activity taking place in 1929–1933 put Smoot-Hawley at or near center stage." (https://fee.org/articles/the-smoot-hawley-tariff-and-the-grea t-depression/)

In 2019, nearly every economist disagrees with the Navarro-advised Trump tariff policy. At our recent gathering in Maine we polled the group, which represented about $2 trillion in assets under management and thousands of households and many hundreds of thousands of beneficiaries of retirement plans and millions of investors and savers in the US. Asked about Navarro, 1 supported him, 36 opposed, and 3 weren’t sure. Asked about the Trump trade policy, about 3/4 of our group opposed it and saw it doing increasing damage to the US.

The late Allan Meltzer noted in *A History of the Federal Reserve Volume 1: 1913-1951* that “Research suggesting a small effect [i.e., from tariffs] ignores the pronounced effect on farm exports, distress, bankruptcies, and bank failures in farm states” (p. 564, note 299). Readers are invited to check the rising bankruptcy statistics in farm states in 2019. The Trump-Navarro trade policy is responsible; the correlation between the Trump trade war and rising distress is very high.

How historic and vital are the fundamental economic lessons of the Smith-Hawley Tariff Act and its consequences? As Milton Friedman and Anna Jacobson Schwartz note in *A Monetary History of the United States, 1860–1967*, “To find anything in our history remotely comparable to the monetary contraction of 1929–1933, one must go back nearly a century to the contraction of 1839 to 1843” (p. 299, chapter 7). I recommend that readers who wish to take a deeper dive study all of Chapter 7.

Dear readers, this is a brief response to the events of Friday, August 23, 2019. I could easily add 100 citations.

Peter Navarro owns the advisory role and the argument in favor of the present US trade war policy. President Trump owns the decisions. Together they are digging a hole, and that hole is getting deeper. Market agents know it. Farm-state voters know it. Financial agents know it.

No matter what Navarro says and whom Trump blames, the truth is that the responsibility for the economic slowdown and the financial volatility lands squarely on the Oval Office desk and in the lap of the president and his advisors. He does not have the courage to admit an error. He avoids any self-blame. He constantly bashes the Fed since it (and Jay Powell) is a convenient and distracting target.

There is a fitting adage attributed to Will Rogers: “If you find yourself in a hole, stop digging.”

Mr. Navarro, Mr. Trump, read history. You are digging a deeper and deeper hole for the nation and the world. Stop digging.

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Cumberland Advisors Market Commentaries offer insights and analysis on upcoming, important economic issues that potentially impact global financial markets. Our team shares their thinking on global economic developments, market news and other factors that often influence investment opportunities and strategies.

Tariffs & Draining the Swamp?

Mr. David Malpass, at the US Treasury, will meet with Chinese Commerce Minister Wang Shouwen in late August. This is excellent news.

Dennis Gartman beat me to this on Thursday morning. I'm in complete agreement with Dennis' assessment:

"Mr. Malpass, as everyone should remember, is an old Wall Street 'hand,' for he was at one time Bear Stearn's Chief Economist. He served in the Reagan and Bush administrations in various positions of economic authority and has been a close economic advisor to President Trump before being given the position of Under Secretary of the Treasury for International Affairs. His are capable hands."

Over the years I've spoken with David Malpass from time to time. He is and was always gracious. And his skill set is deep. He was a very early economist addition to candidate Trump's team. He has made thoughtful policy arguments while carefully avoiding the political infighting.

While I personally do not agree with Peter Navarro's broad tariff approach and believe it has done a disservice to POTUS and to the US, I have to confess some relief and new encouragement at seeing David Malpass now prominently added to the Kudlow and Lighthizer negotiating team which is now led by Treasury Secretary Mnuchin. The outlook is starting to offer hope for a positive turn in the US versus China trade war.

Why did I list the US first and not alphabetically in the previous sentence? Because we started the war, that’s why. We followed the Navarro script and now we have a mess which the new team must straighten out.

Below is a list of the top 20 countries ranked by GDP. Look at it and count all those involved in protectionism and tariffs that have been expanded or enlarged in 2018. Count the USA first, since we are now involved in tariffs and retaliatory tariffs with most of the globe (if we measure by GDP). Yes, some tariffs and trade barriers have been around for years. But, on the whole, the WTO had accomplished a global reduction. Until 2018.

Here is the chart, courtesy of Brent Donnelly of HSBC.

1	United States	20,412.87
2	China	14,092.51
3	Japan	5,167.05
4	Germany	4,211.64
5	United Kingdom	2,936.29
6	France	2,925.10
7	India	2,848.23
8	Italy	2,181.97
9	Brazil	2,138.92
10	Canada	1,798.51
11	Russia	1,719.90
12	Korea	1,693.25
13	Spain	1,506.44
14	Australia	1,500.26
15	Mexico	1,212.83
16	Indonesia	1,074.97
17	Netherlands	945.33
18	Turkey	909.89
19	Saudi Arabia	748.00
20	Switzerland	741.69

Is the tariff war peaking? We don't know. Is it starting to show up in anecdotal inflationary evidence? Yes. Is it slowing growth? Yes. Is it exacerbating credit risk? Maybe.

The important thing to know is that the Mnuchin-led team has the skills to see and understand the dangerous effects of growing protectionism, and we may begin to see damage control and a shift away from the harmful direction in which we've been headed.

Time will tell, as preparations and negotiations leading to a Trump-Xi November summit unfold.

Let’s move to an insightful post by Xi Sun, entitled “Will US-China trade war reshape global value chains?” We thank Lyric Hughes Hale for making it available via her EconVue site. Lyric is a longtime friend who has contributed economic and political affairs commentary to a broad range of publications and who, with her late husband, David Hale, coauthored the book *What’s Next? Unconventional Wisdom on the Future of the World Economy*, as well as the influential article “China Takes Off,” published in *Foreign Affairs* in 2003. She is a member of the Council on Foreign Relations and has served on numerous boards.

Here’s the link to her site: https://www.econvue.com/pulse/will-us-china-trade-war-reshape-global-value-chains.

Tariffs beget tariff exemption applications; and as the following article in the *National Review* states, “Their proliferation has empowered government bureaucrats ill-suited to the task to pick industry winners and losers.” https://www.nationalreview.com/2018/08/tariffs-bad-government-exemptions-worse/

The backlog of exemption applications has grown to over 20,000, and the swelling Dept. of Commerce bureaucracy must review and decide each one – but without the industry expertise necessary to balance the arguments being made (though they have plenty of input from Washington lawyers and lobbyists). What generally happens is that the players with the deepest pockets and most political clout prevail. The *Wall Street Journal* has remarked, “Far from draining the swamp, tariffs feed the swamp.”

Thus, the Navarro policy recommendations to POTUS have created an entire new, costly, and nonproductive government intervention into Americans’ businesses and lives. We can only hope the Mnuchin-led Kudlow, Malpass, & Lighthizer team can control and reverse this damage. We will close with a link to another instructive chart on the present and future global economy. Hat tip, Steve Blumenthal. Think about this trajectory and please consider how and where protectionism fits in. Or where it doesn’t. https://twitter.com/sblumenthalcmg/status/1031121108865622017

Western Trip-Part 1

We’re back. During travels in four states (CO, ID, UT, WY) and participating in the Rocky Mountain Summit public conference, two private roundtables, client meetings, and prospect presentations, I encountered hundreds of business-people, econ and financial types, legal and accounting professionals, and others.

They mostly leaned Republican; most were Trump voters; and most were high-income and high-net-worth individuals.

My Takeaways:

1. They like tax cuts, repatriation, and deregulation.

2. They don’t like uncivil, personal-attack politics.

3. They don’t like attacks on constitutional freedoms like religion or assembly or press. They resent the use of the term fake news.

4. They nearly all fear trade wars and believe they are real. They didn’t, however, fear Trump’s blustering trade war rhetoric. They worry Trump’s trade war is giving back all the benefits of item 1.

5. Peter Navarro is seen as a powerful influence who has Trump’s ear, and people fear he is sinking the president.

6. They watch Fox, Bloomberg, CNBC – few watch CNN. However, they trust neither Fox nor CNN, which are viewed as polar opposites, and many think neither of them are neutrally honest.

7. They use electronic devices and newsfeeds to glean information, but they increasingly realize how seriously social media and machine learning are manipulating and distorting their information flow. And they don’t like it.

8. They are family-oriented, communal, and charitable. This is Western territory – you help people who need help.

9. They love the outdoors, the environment – horses, fly rods, hiking. They fear global warming, and most believe climate change is the result of human behavior, not just natural weather cycles.

Now to some direct business notes:

1. Some businesses employ undocumented labor, because they have to. The average among privately owned businesses seemed to be about 20% of total hires in the hospitality, maintenance, and construction sectors. Many of these businesspeople will not bid federal jobs because they cannot comply.

2. They are watching cost increases accelerate. This is a theme I heard repeatedly.

3. Those who are subject to global supply chains are starting to see trade war effects.

4. Foreign investment is being delayed or deferred, both outgoing and incoming. I learned of two foreign owned manufacturing facilities in Idaho whose construction has been canceled because of the Trump-Navarro trade war. Other

American owned are repositioning abroad.

5. Many travel to China or have supply-chain business with China. They say Navarro doesn't get it. Here is a link to a Peter Navarro interview with Maria Bartiromo on Fox. All of his forecasts are now proven wrong. http://video.foxbusiness.com/v/5743778657001/?#sp=show-clips

6. They fear Trump's ignoring input from political leaders in his own party. Here is a Bloomberg report on Kevin Brady, chair of the House Ways and Means Committee. https://waysandmeans.house.gov/chairman-brady-calls-for-trump-xi-face-to-face-meeting-to-craft-fair-trade-deal-with-china/

My conclusions:

1. Economic growth peaked in the just finished second quarter and after trade war rhetoric became trade war actual. The next six quarters will see the growth rate decline. Decline in growth was a dominant view. Some see recession in less than two years.

2. Inflation risk is rising due to the trade war.

3. Failure to solve immigration, DACA, and the status of 12 million undocumented people working in the US is a political failure that is now translating into an economic cost with rising uncertainty premia.

4. The flatter yield curve suggests the bond vigilantes agree with the prospect of a slowing economy.

5. I agree with many economist colleagues that it is going to take a considerable shock to jolt America hard enough that we make a political policy change.

6. The political direction of the country is at a crossroads. The Pelosi–Schumer–Maxine Waters Democrats are not getting traction. The Republican hard right is scaring other Republicans who are seeking solutions, not confrontational

combat.

7. I end my four-state Western trip with reinforced deep respect for the many local people I met who are caring and patriotic and are genuinely worried about the behavior of their president but who are not being given an acceptable alternative.

8. An emerging alternative is Mitt Romney, who will win the Senate seat in Utah and be his own national voice. He owes nothing to Trump. He is becoming a deficit hawk.

For investors, Bonds are telling three stories. The Treasuries curve is flattening, the muni curve less so. High-yield and junk spreads are too tight and have no room for error. We would counsel to Avoid junk credit: You are not getting paid for the risk it involves. Avoid long Treasury debt: You are not getting paid for term-structure risk. Use barbells, not ladders, in munis. The middle of the curve is very expensive.

Stocks: Watch out for FAANMG. Stay domestic and exercise caution on internationals. Favor banks, biotech, and staples. And remember, trade war risks are rising every day.

It is nice to be back in Sarasota.

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Trump Trade War, Soybeans, Danielle DiMartino Booth, Bill Poole

Former St. Louis Fed President Bill Poole who also was an economic adviser to Ronald Reagan has written about Trump-Trade policy and published this profoundly instructive commentary on July 2. He reveals the money conflict of interests that lurk behind some of the tariffs and he proposes a simple solution. Here is the link: The New Tariff of Abominations?

The Trump-Navarro trade war is only just starting to bite, and the growing list of casualties spans Americans from businessmen, investors, bankers, and lenders of all types to beleaguered US farmers and workers in impacted industries. With Danielle DiMartino Booth's permission, we are featuring her excellent analysis. She recently devoted a full research note to soybeans. If you are in Iowa or Illinois or other ag states, you are now seeing the start of the damage.

If you are in Maine or Massachusetts, you see it in lobsters. If you are an auto dealer or provide dealer software support, you see it nationwide. If you are building a pipeline and need certain steel, you see it. If you are a healthcare service provider, you see it. If you are administering a college or university, you see the drop in revenue as your student headcount declines. Add cheese and diary products.

The list of impacts grows daily. Trump-Navarro took punches at China and Canada and Europe and landed those punches on the US farmer and consumer. The fallout will get worse. We see GDP growth peaking right now. The next few quarters are likely to see sequentially slower growth. Fiscal pressures are likely to intensify in many states.

How quickly collateral damage mounts and what the resulting suffering will mean for the November midterm elections remain to be seen. Over 40 House Republicans are retiring. But those who observe markets also worry when they realize that Congresswoman Maxine Waters is the ranking Democrat on the House Financial Services Committee and wants to chair that committee if the House Democratic Caucus achieves a majority after the midterms.

Let's get to Danielle and her brief on soybeans. Danielle has developed a national persona as a regular commentator on CNBC, Bloomberg, and Fox Business and is the publisher of Money Strong, an acclaimed weekly investing newsletter. Danielle is also CEO and Director of Intelligence at Quill Intelligence LLC, where she writes the Daily Feather, a daily briefing on the economy, market trends, inflection points, and transactions. This letter offers 5-minute daily briefings like those she used to prepare for Richard Fisher during the Great Recession, when Fisher served as President of the Dallas Fed and she as his advisor. The Daily Feather is incisive, substantive, and reasonably priced. It is a designed for investors, financial advisors, investment managers, CEOs, CFOs, corporate strategists, policy makers, academics, and indeed anyone who follows the global economy. You can learn more about it here: https://quillintelligence.com/welcome-cumberland-advisors/.

Here is Danielle DiMartino Booth on farmers and soybeans and trade war damage with who wins (Brazil and Argentina) and who loses (you, my dear reader, and me) in the recent Quill Intelligence Daily Feather, **"Fireworks Over the Farm Belt"**.

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"Fireworks Over the Farm Belt"

VIPs

• By the summer of 2012, top quality Iowa farmland that traded hands for about $4000 an acre in 2006 soared past $15,000 while farm income more than doubled from 2006 to 2013.

• In 2017, China took in 57% of US soybean exports. Early this year, the USDA estimated that within a decade, China would absorb 70% of US soybean exports.

• Accumulated exports of US soybeans to China for the marketing year have fallen 27 million metric tons, 20.5% less than this time last year.

• U.S. soybean prices have now fallen from about $10.50 per bushel in late May to $8.60 as of last Friday’s close.

• Call the U.S. farmer, and Illinois and Iowa in particular, collateral damage in what is now becoming a broader trade battle.

• Next, tariffs will begin to stifle U.S. economic growth as the price of affected goods begins to bite into household paychecks.

As if Illinois didn’t have enough fiscal fireworks to contend with this Independence Day, with market weakness further crippling the state’s pensions, budgeting in Lincoln’s home state will be crimped further by the 25% tariff on U.S. soybean exports to China, which becomes effective July 6th.

Illinois is the top-producing soybean state and exports about 60% of its crop. Half of that goes to China, which equates to $7.5 billion of the state’s economic output. Craig Ratajczyk, CEO of the Illinois Soybean Association, recently warned that smaller and rural communities would be hit the hardest and that the lower-tax-revenue “multiplier effect” would cut beyond lost industry into school and hospital funding.

Though its state’s finances aren’t nearly as fragile as those of Illinois, farmers in the second-biggest soybean-producing state, Iowa, would suffer a similarly damaging setback. Life across the farm belt is already volatile enough with the whims of Mother Nature. Though they are a boon to several South American mega-soybean exporters, tariffs are the last thing American farmers need.

While it’s always been feast or famine for the American farmer (pun intended), farming has been a particularly wild ride these past few decades. By the mid-1980s, the commodity bull market of the 1970s had faded to recession. Crop prices crashed, and farmers folded under the weight of too and $10 per bushel. Imagine the challenge of your main crop’s either doubling in price or halving with zero predictability.

The tables turned in 2006, a year that marked the advent of a glorious era in farming. Soybean prices recovered and by 2007 had broken free of a 30-year price range. A bonus: the price of farmland went haywire. By the summer of 2012, top quality Iowa farmland that traded hands for about $4000 an acre in 2006 soared past $15,000 amid wildly overheated auctions. As per the USDA, farm income more than doubled from 2006 to 2013.

It’s no chronological coincidence that China’s appetite for every natural resource on the planet, including food and grain exports, skyrocketed over the same period. This was especially the case for soybeans, a robust source of nutrition with which to feed a vast population that powered a historic industrial revolution. In 2017, China took in 57% of US soybean exports. Early this year, the USDA estimated that within a decade, China would absorb 70% of US soybean exports.

Did someone mention the vagaries of Mother Nature? As welcome as the Chinese demand no doubt is, it’s been anything but a smooth ride for American soybean farmers. First came the summer drought of 2012, which sent soybean prices to historic highs. The snapback was equally vicious. By 2016, prices had sunk to 50% of their peak levels. And that same prime acre of farmland in central Iowa now goes for about $9000. Farm income has been cut in half.

As for this week’s tariff imposition, it’s apparent China has seen no need to wait out the deadline. Last month, CNBC reported that, “China canceled 136,000 metric tons of U.S. soybean purchases in the week ended May 24…. That brings accumulated exports of US soybeans to China for the marketing year to 27 million metric tons, 20.5% less than this time last year.”

While beleaguered Brazil and Argentina count their blessings as China’s new “it girl” soybean exporters, U.S. soybean prices have fallen from about $10.50 per bushel in late May to $8.60 as of Friday’s close.

Call the U.S. farmer, and Illinois and Iowa in particular, collateral damage in what is now becoming a broader trade battle. If the result is a more level playing field on trade, we can optimistically conclude that American farming communities are taking one for the team. But good sportsmanship won't pay the bills come harvest time this fall.

In the coming weeks, as second-quarter earnings roll out, we'll likely hear countless lamentations about the implementation of tariffs on hundreds of products by not just China, but Canada, Mexico, the EU, and others. We hope this too shall pass, and soon.

In the meantime, the tariffs will begin to stifle U.S. economic growth as the price of affected goods begins to bite into household paychecks. You are correct to deduce that the stock market will not like any combination of these factors – lower earnings, slower economic growth, and rising inflation.

But just imagine how much worse it could be. You could be the state comptroller of Illinois where it "Ain't That America" for residents of this textbook example of fiscal dysfunctionality. Given its broken pensions and reliance on Chinese soybean exports, the state will soon sustain not one, but two fiscal body blows.