ALTMAN
INVESTMENT MANAGEMENT

BRIEF INSIGHTS

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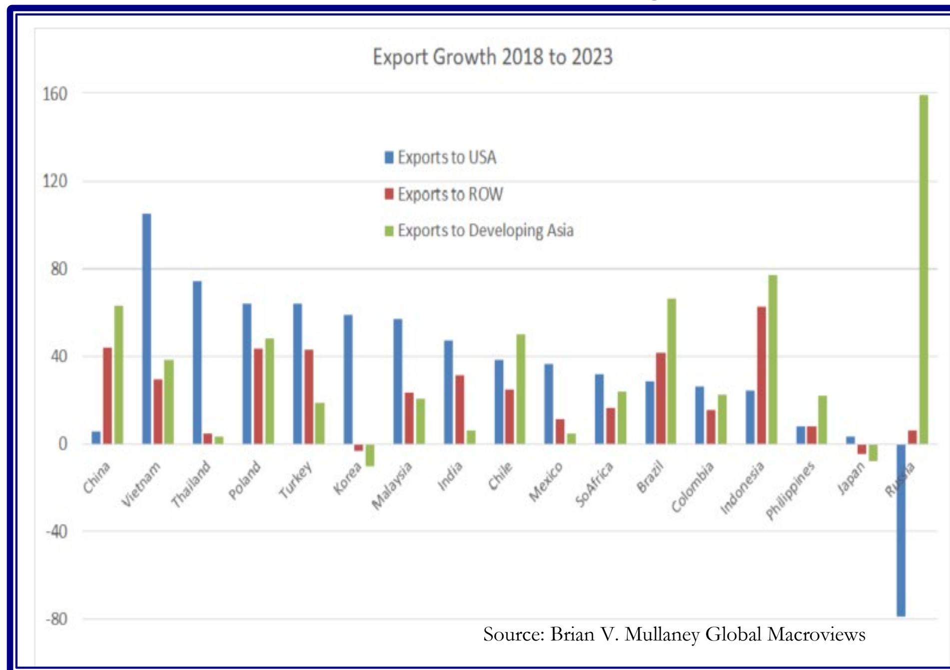
Uncertainty Underscores the Case for Diversification:

Mexico and Canada have already successfully negotiated an immediate pause on anticipated tariffs on their country for at least a month. It seems with concessions on both sides, the countries are willing to work together to better trade relations. 10% tariffs on China however were met with retaliatory 10-15% levies on select imported goods such as coal, liquid natural gas, crude oil, agricultural equipment and pickup trucks. This doesn't necessarily translate into a trade war just yet; it could simply be an initial setup leading up to negotiations. While these recent developments can be interpreted as either a valid threat or simple posturing, the biggest concern in the market is that the United States maintain its reputation as a reliable trading partner.

There has been a lot of confusion as to the viability of tariff strategies. This is due to differing viewpoints as to who in fact pays for them. On one hand, higher import prices are paid for by U.S. businesses who in turn pass along the higher costs to the consumer to maintain profit margins. In some cases, a foreign exporter could choose to discount its prices to offset the impact of the tariff to avoid losing sales. Alternatively, the importer can look to other countries for cheaper substitutes. But countries that may initially supply cheaper alternatives are not immune from higher prices, as trade wars do not occur in isolation.

Alternatives to the U.S. as a Trading Partner



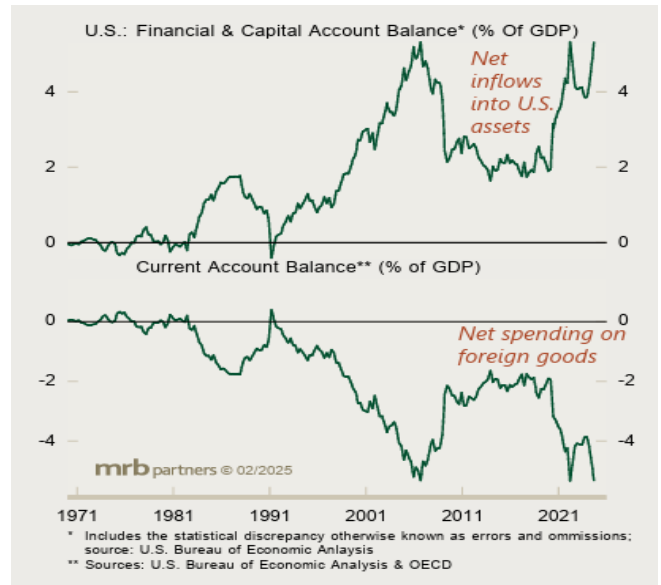
Source: Brian V. Mullaney Global Macroviews

Brian V. Mullaney, a London-based economist, wrote about tariffs during Trump's first term in his *Global Macroviews* commentary. After tariffs were imposed on exports from China in 2018, China offset the impact by boosting trade with other nations. Should Trump's aggressive trade policies translate into foreign countries reconsidering the U.S. as a reliable trading partner, they too will look to other markets. A number of countries have already strengthened regional ties (green columns in chart to left). The rise in export growth into the U.S. over China in some countries such as Vietnam and Mexico (blue vs green line), are due at least in part to the rerouting of products from China into the U.S. through other countries.

Another risk to using aggressive tariff policies is that, similar to what it has done in the past, China could allow its currency to depreciate against the dollar. This would help offset the deflationary impact from tariffs. Its Asian competitors could just as easily follow suit by devaluing their currencies as well. The devaluation of currencies against the dollar, whether intentional or a result of market forces, will only add to trade tensions with the U.S.

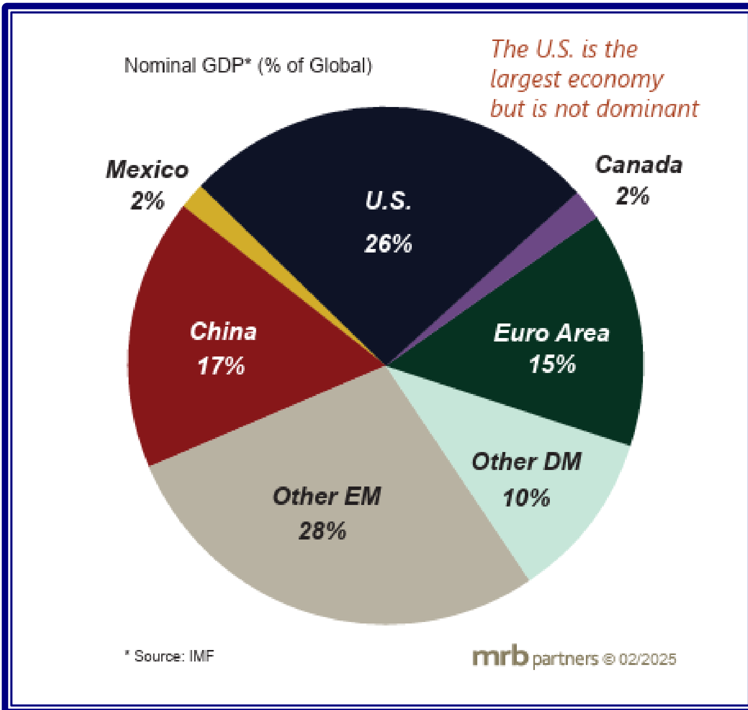
The next phase of Trump's plan is to simultaneously impose tariffs on the Euro area nations. This has the potential to escalate triggering retaliation and in turn another more aggressive U.S. response. The U.S. is starting out from a position of strength in that the economy is strong as we are a net importer in most cases. But what gets lost in translation is the negative correlation between the U.S. Trade Deficit and the U.S. Financial and Capital Accounts. Meaning, that if the trade deficit were to shrink significantly by the imposition of tariffs, that would in turn decrease foreign investment in the United States, putting downward pressure on equity markets and home prices.

Financial Account Surplus Is Flip Side of the Current Account Deficit



Another disadvantage to the United States as it prepares to navigate a global trade war is that although it contributes 26% to global GDP; other countries have sizeable contributions as well. A more productive approach, according to MRB Partners, would be to rally U.S. allies in a trade war against one smaller target. But in initiating potential trade war against all allies simultaneously, puts the U.S. at a significant disadvantage. At the start, the U.S. is on an uncertain path, and the chances of the winning a global trade war, as opposed to a more limited one is minimal at best. The market action today tells us that it is not pricing in a major global trade war. Therefore, markets are not prepared for the scope that the war could escalate to.

Contribution to Global Economy



Adding to market uncertainty, China announced its latest AI version causing a major sell off in the markets early last week. This underscores that the markets continue to focus too narrowly on several stocks. The notion of Nvidia losing even a fraction of its competitive edge was enough to send its shares and other AI favorites tumbling. A rotation into lagging sectors outside of AI occurred. Although the transition was short lived, it illustrates the direction stocks will move once a full rotation is underway. The move last Monday shows us that American exceptionalism has carried a few stocks into overvalued territory as compared to the rest of the investing universe.

This leads us to question whether the peak of the bull market is now in the rearview mirror. Are investors heading for the exits or is this just the end of a Mega-7 two-year run (a $10 trillion rise in market capitalization according to MRB MacroResearch) and a 'great rotation' into cheaper more cyclical sectors of the global market is now unfolding?

We remain in the latter camp with a macro backdrop that is historically supportive of an overweight position in stocks over bonds in balanced accounts. We believe that the U.S. economy is still on solid footing confirmed by this week's fourth quarter GDP report. It would take a major financial disruption to alter the U.S. economic trajectory. Even the 'tech wreck' in the late 1990's took some time before capital spending and the negative wealth effect meaningfully slowed consumption.

We were encouraged last week by the rally in U.S. treasuries. This move reinforced our view that an important relief valve remains intact, unlike the end of most equity bull markets when Treasury yields continue to rise as stock prices fall. These market tops reflect tightening cycles induced by restrictive Fed policy in an attempt to reduce inflationary pressures. Improving real incomes, elevated job security and healthy household balance sheets support our confidence that U.S. consumption growth will continue. We believe that a Trump-induced tariff war is most likely to be followed by negotiations and less drastic outcomes as evidenced in the last several trading hours on Monday.

We are not currently altering our investment strategy based on the market rout over the past week but are watching for continued evidence that the AI stampede over the last two years has finally subsided. We continue to validate a strategy that focuses on the less overheated sectors of the market such as healthcare and financials. We have written about this extensively in the past, and the current political landscape only emphasizes the need to strategically position portfolios for a broader-based market participation. The likely beneficiaries are under appreciated, low multiple stocks with growth potential at reasonable prices.

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No gross performance returns that are referenced that are calculated after brokerage commissions but before investment counsel fees are presented without the comparable net performance figures after both commissions, investment counseling fees and other custodial charges. The net counseling fees are the actual average counseling fee calculated across all the portfolios included in the composite. All performance figures are presented on a time-weighted total return basis and assume all income is reinvested. The investment advisory fees are disclosed in Part II-A of the Investment Form ADV. Some clients may benefit from available discounting in the management fee schedule associated with the overall size of the portfolio. Management fees will reduce overall returns to the client.

The composites were created in 2001 and the inception dates start on August 17th, 2001.The composites include only discretionary fee-paying accounts managed in the strategies, and additional information associated with the composites are available such as: dispersion in individual portfolio results as well as the % of the firms AUM in the strategy. All performance calculations are presented within the GIPS® guidelines of the CFA Institute. The CFA institute does not endorse or promote this organization nor does it warrant the accuracy of the content herein.

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