

TRENDLINES BY PRENTICE LEE - CIM, FCSI

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PRENTICE LEE WEALTH MANAGEMENT

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Trump's Trade Wars Impact Our Asset Allocation

There is a Chinese proverb "Kill the Chicken to Scare the Monkey". It refers to making an example out of someone in order to threaten others. This tactic is currently being deployed by president Trump in his treatment of Canada on non-existent trade issues. Let's review the facts:

1. The US/Canada trade is the world's largest trading partnership between 2 countries.
2. According to a 2018 White House "Economic Report of the President, which was signed by Donald Trump - "The United States ran a trade surplus of \$2.6 billion with Canada on a balance of payment basis*".
3. Canada is the United States' most important trade market and vis versa.
4. 36 states count Canada as their largest trading partner.

Contrast that with the utterances of Trump:

"We lose a lot with Canada. People don't know it. Canada's very smooth. They have you believe it's wonderful. And it is – for them. Not wonderful for us; it's wonderful for them."

"We do have a trade deficit with Canada, as we do with almost all countries (some of them massive). P.M. Justin Trudeau of Canada, a very good guy, doesn't like saying that Canada has a surplus vs. the U.S. (negotiating), but they do ... they almost all do... and that's how I know!"

"I like free trade, but free trade is not free trade, it's dump trade because we lose...with Canada – big-league. Tremendous, tremendous trade deficits with Canada."

*"No, I have a good relationship with Justin Trudeau. I really did, other than he had a news conference, that he had because he assumed I was in an airplane and I wasn't watching. He learned. **That's going to cost a lot of money for the people of Canada.** He learned. You can't do that. You can't do that."*

"I love Canada, but they've taken advantage of our country for many years!"

"We shouldn't have to buy our friends with bad Trade Deals and Free Military Protection!"



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The US takes advantage of Canada's natural resources, mainly oil and lumber. We have a lot more trees than people in Canada and it is an advantage to American builders to have an abundant, reliable and cost-effective neighbour to supply lumber for building American homes.

Even more importantly, Canada's only market for her oil is the US which results in the US being able to buy Canadian oil at a discount. It is a huge strategic advantage to have a large supply of oil captive and unable to find other markets. These are trade advantages, not deficits for the USA.

Now if you take out oil and lumber, the US has a huge trade surplus with Canada in goods and services which includes among other things, telecommunications, accounting and legal services and tourism. (Think of the subscription service of Netflix, Amazon, and Apple for example).

So it is clear, Trump is showing his contempt for Canada. Given the long-standing, deep cultural, economic, geographic and personal ties between the two countries it beggars the question – "Why would Trump treat his most important ally so contemptuously?"

I think the answer lies in that old Chinese proverb. In this case, Canada is the chicken and China is the monkey. Trump is showing China that he treats his closest ally and biggest trading partner with contempt, so his real target, China can expect very tough negotiations on trade.

Trade Wars Heating Up

This scenario of tariffs and trade wars is now starting to rattle world markets. Since the beginning of the year, markets outside of the USA have done poorly.

YTD** (Sept 13, 2018)

S&P 500	+8.6%
S&P/TSX	-1.3%
FTSE All-Share	-4.7%
STOXX Europe	-3.3%
Hang Seng	-9.7%
Shanghai Composite	-18.8%
Nikkei	+0.2%
MSCI Emerging Markets	-13.4%***
CAD/USD	-3.4%
US aggregate fixed income returns	-1.4%

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Given this scenario, managing a globally balanced portfolio has become increasingly challenging. In light of this and our belief that Trump is miscalculating the difficulty of bullying his trade partners (thereby potentially leading to a more protracted and escalating trade war), we have exited our positions in emerging markets and Europe. This was not a difficult decision given that we had a healthy allocation in those areas and their 12 month returns were negligible while their momentum continues to be negative. Moving to cash out of sectors with negative momentum seems to be a rational strategy. We have done so on a much more incremental basis with regards to fixed income. We now sit with historically high levels of cash in our portfolios, which we deem prudent at this time.

*According to the World Trade Organization (WTO) “balance of payment basis” is Trade data with national income accounting methods (the value of trade in goods and services changing hands between residents and non-residents sometimes without crossing borders); the figures for good trade are derived from customs data (the value of goods trade crossing borders).

** RBC Wealth Management Global Insight – September 6, 2018

*** Yardeni Research Inc. – Performance 2018: Global Stock Markets - September 11, 2018

Regards,

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