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John Dessauer's market review and update as of Wednesday, February 22, 2017

Sometimes history provides scary lessons. The Great Depression of the 1920s has been blamed on the Smoot-Hawley Tariff Act - - protectionist legislation that was designed to protect American farmers and American jobs. It instead triggered a global trade war and a crushing economic depression. Ever since the 1920s, any and all proposals with protectionist provisions have been reminders of the risks of economic crisis. That is why economists, analysts, and investors shiver with fear every time President Trump or Republicans talk about import tariffs and protecting American jobs from foreign competition. The fear is often out of touch with reality because accounting for international trade is complicated and widely misunderstood. In order to assess the risks associated with trade policies you must understand the inflows and outflows of international trade. What follows is my attempt at developing an understanding.

The U.S. capital account.

The United States is the most attractive place to invest. We have a settled legal structure, liquid markets, and a huge, growing economy. Foreign governments and individuals invest billions of dollars every year in American assets. We enjoy a large net capital surplus. That surplus is a credit in our national capital account. But for every credit there has to be a debit; that is basic for double entry bookkeeping. The equal and offsetting debit is in the trade account. The trade and capital accounts make up our national balance of payments and they must always balance. Next time you hear or read

about our national trade deficit, remind yourself that there is an equal and offsetting credit - - our capital surplus.

Another way to look at imports versus exports.

As consumers, we naturally look for bargains. We want to get the best prices for what we buy. That applies to buying goods from foreign sources. As a nation, how do we pay for the goods we import? The answer is exports. The global market place is basically a barter system. We exchange goods and services with our trading partners. When the dollar value of the goods we export is significantly less than the value of the goods we import, it means we are getting a good deal. The bigger the difference between imports and exports, the better the deal we are getting. So, our national trade deficit means we are good negotiators and are buying imports at a great price.

What about jobs?

The United States has been losing manufacturing jobs for decades. The reason is technology, not foreign competition. Machines have been replacing human labor since the beginning of the industrial revolution. Advances with computers accelerated the process. Human machine tool operators have been all but replaced by computer-driven machines. That does not mean a net loss of jobs in the economy. It means a change in skills needed to get a job. Today we need people with computer skills rather than machine operating skills.

Of course, the media and many individuals see only jobs lost when they see news about a factory closing or moving overseas. Those job losses are easy to see and sensationalize. The benefits in terms of product quality or lower prices for consumers are

difficult to connect or quantify. Politicians too often knowingly use misinformation on jobs and competition to stir voters' emotions in their favor.

Currency manipulation.

For at least the last fifteen years China has been accused of manipulating its currency to make exports cheap. Senate Minority Leader Chuck Schumer has been a leader of that lopsided claim. President Trump is following with his own currency manipulating accusations against Mexico and even Germany. The trouble with these accusations is that they ignore the other side of the currency equation, the cost of imports needed to produce the exports. President Obama swallowed the currency manipulation line and penalized tires imported from China. In the case of tires, China has to import rubber. A low Chinese yuan makes rubber imports more expensive. Clothing is made from cotton, which China imports from the United States and other countries. Computers made in China contain semiconductors and microchips, which are imported from the United States and other countries. China needs other inputs, industrial supplies, commodities and materials like chemicals, copper, plastics and lumber, and many of those inputs are imported from the United States. To produce its manufacturing output, China needs equipment and machinery, and much of that comes from the United States. To the extent that an undervalued yuan significantly raises prices for imported inputs, the notion of "currency manipulation to gain an unfair advantage for China's exports to the US" completely falls apart.

The bad news is that President Trump appears to be as clueless when it comes to international trade as President Obama was. The good news is that for all the political tough talk about trade, very little ever really gets done. The reason is

that no country, not even the United States, has all the resources it needs to operate in isolation. China, for example, has rare earth minerals that our military needs to make its sophisticated weapons. We need to trade with China and other countries to obtain the resources we lack, but must have to satisfy our domestic demands.

And there is hope that destructive protectionism will never gain traction. If President Trump and the Republicans change the corporate tax structure as promised, they will stimulate trillions of dollars in new domestic investment. That would increase domestic economic growth and shift attention away from the "evils" of international trade to the "blessings" of domestic business investment.

Federal Reserve chair Yellen told Congress last week that a March interest rate increase is "on the table."

She added: "Precisely when we take action - March, May or June - I can't tell you. I would say that every meeting is live." The members of the Federal Reserve Board remain optimistic about future economic growth. They were too optimistic last year and earlier this year. But if the post-election surge in consumer confidence holds, they could be right this time. The economy could be getting stronger and inflation could be closing in on the Federal Reserve's 2% target. If so, that will be very good news for corporate profits and the stock market.

I will have the next market review and update for you one week from today on Wednesday March 1, 2017.

All the best,

John Dessauer

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