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"Printing ink, not black, solid."

"Yarn (not sewing thread) of synthetic staple fibers, mixed mainly with artificial staple fibers."

"Meat of swine other than hams, shoulders, bellies and cuts thereof, salted, brined, or smoked."

"Organic surface-active products and preparations for washing the skin, in liquid or cream."

You're probably wondering what in the world I'm talking about.

The items above are just four of the *five thousand* products potentially affected by the trade war between the U.S. and China.[1] Meat, vegetables, auto parts, construction materials, chemicals – it's all part of more than $200 billion in tariffs proposed by President Trump's administration.[2] China, in turn, has imposed tariffs on over five hundred American products worth approximately $34 billion.[3]

And that's not getting into all the trade-related skirmishes between the U.S. and Canada. Or the U.S. and Mexico. Or the U.S. and the European Union.

I'm sure you've heard at least *something* about these tariffs in the news. But unless you do it for a living, trying to keep track of every development or possible outcome is dizzying, to say the least. In fact, many of my clients have reached out to ask the following questions:

"What's going on, and why?

"Why does it matter?"

"What's going to happen?"

As your financial advisor, it's my job to answer your questions! So, let's cover each of these in this letter. We'll start with:

What is a trade war, and why is there one in the first place?

A trade war, in case you're not familiar with the term, is an economic conflict in which countries impose import restrictions on each other in order to harm each other's trade.

Why is the U.S. in a trade war with China?

The issue, at least from the U.S. administration's standpoint, is a $375 billion trade deficit[4] with China, which many see as being due to unfair or even illegal trade practices. China, on the other hand, contends the deficit has more to do with American fiscal policy, and the fact that the U.S. exports services more than goods.

A trade deficit is the difference between how much a nation imports from another country compared to how much it exports. One of President Trump's earliest campaign promises was that he would decrease the trade deficit. His tool of choice?

Tariffs.

Put simply, a tariff is a tax on goods produced in another country. Tariffs make foreign goods more expensive, so, in theory, people will become more likely to buy local products instead. For example, a tariff on foreign steel would prompt consumers to buy more steel from American companies. That would be an enormous boost for the American steel industry.

Tariffs can also be used as a negotiating tactic of sorts. If Americans buy fewer Chinese products, that could lead to economic pain for many Chinese companies. This, President Trump believes, will drive China to the negotiating table. Then, he can broker a new trade agreement that will be more favorable to the U.S.

Historians and economists are divided on whether tariffs are a good idea. That's because tariffs can come with negative side effects. For one thing, higher prices can make life difficult for consumers, whether they be individuals, families, or businesses. To return to our steel example, if a company must pay more for the steel it needs, that could significantly eat into its own profits.

And of course, tariffs can lead to trade wars. In this case, American industries that produce goods China has slapped tariffs on could experience a massive drop in revenue.

Timeline of the trade war so far

Date	Event[5]
March 1	President Trump announces 25% tariff on imported steel and 10% on aluminum
April 2	China issues tariffs on $2.4 billion U.S. exports
April 3	President Trump announces new list of tariffs on $50 billion worth of Chinese goods
April 4	China responds by issuing tariffs on roughly $50 billion in U.S. goods
April 5	President Trump proposes tariffs on another $100 billion in Chinese goods, but does not yet impose them.
June 15	President Trump releases an updated list of tariffs worth $50 billion, to go into effect on July 6. China responds with a revised list of $50 billion in U.S. products, to start on the same date.
July 6	Tariffs on $34 billion in Chinese goods go into effect, as do Chinese tariffs on the same amount of U.S. goods.
July 10	President Trump proposes a 10% tariff on another $200 billion in Chinese imports.

As you can see, the numbers are so large, and seem to change so often, that it's not exactly easy to keep track. But for now, tariffs on $34 billion in goods have actually been implemented by both the U.S. and China, with many more proposed.

Why does this matter?

A bit of news that broke on Tuesday, July 24, serves as a good illustration. The Trump Administration announced its plan to provide $12 billion in aid to farmers and ranchers who may be hurt by Chinese tariffs.[6] While China has proposed fewer tariffs than the United States, they have chosen their targets with care. Specifically, they have targeted industries largely located in states that voted for President Trump in the 2016 election. Think soybean farmers, automotive dealers, manufacturers, etc. It's still early, but if history is any judge, these industries could soon feel the pain of lost revenue, wage cuts, and even job losses.

If the Trump Administration is right and tariffs lead to more favorable trade deals, that could be a major benefit in the long run. But in the short term, well… there's a reason that economists call it a *war*. There may be no bloodshed, but that doesn't mean there's no pain.

From an *investor's* perspective, this all matters because prolonged economic pain can lead to prolonged market volatility.

So how are the markets taking all this?

The quick answer: In stride.

If you follow the markets closely, you'll notice a pattern: Whenever a new salvo of tariffs is launched, by the United States, China, or whoever, the markets tend to dip. In fact, 100-point falls are not at all uncommon in the Dow. But then a funny thing happens: The markets recover a day or two later. Why is this? I'll tell you in the form of a word search:

What Moves the Markets

E	A	R	N	I	N	G	S	O	O	R	C	R	T
G	M	N	O	I	T	A	L	F	N	I	O	D	T
F	X	E	I	G	R	X	E	S	P	R	R	N	S
R	I	T	S	R	L	S	P	R	R	D	P	A	R
E	F	N	C	E	R	G	R	E	A	A	O	M	E
R	F	U	I	E	S	G	F	E	E	E	R	E	H
G	U	E	T	D	E	S	E	X	A	T	A	D	T
R	T	O	I	L	P	R	I	C	E	S	T	U	A
E	S	T	L	U	Y	A	S	T	E	C	E	S	E
S	R	A	O	S	L	I	S	E	S	P	N	S	W
A	E	P	P	O	P	S	R	E	G	R	E	M	A
P	H	C	O	G	P	R	A	C	O	S	W	L	A
I	T	L	E	S	U	R	E	P	D	R	S	E	R
E	O	E	G	C	S	O	L	F	E	A	R	R	P

Okay, you don't *really* have to do the word search. It's just for fun. I'll tell you the words right now: *Supply, Demand, Earnings, Inflation, Deflation, Interest Rates, Corporate news*, etc. etc. There's a few more in the puzzle if you care to find them – and there's a *lot* more I left out altogether. The point is, market performance is based on so many factors. Even something as important as international trade is just one ingredient in the cake.

That's why trying to predict what the markets will do is a fool's errand.

Right now, the markets are still being powered by a strong economy and lower taxes among other things. As I mentioned before, the trade war is still in its infancy, so its effect on the markets has been muted compared to what some analysts might have expected.

But trying to predict where the markets will go next is harder than trying to predict the weather. Meteorologists rely on a huge array of computers, algorithms, satellites, and techniques to give people a reasonable expectation of what the weather will be tomorrow – and they're still often wrong! That's because the weather is a vast, complex system. There are so many factors, so many variables, each affecting the other. The markets are much the same.

We could certainly try to guess how the next round of tariffs will impact the markets. But then we'd be ignoring all the other variables mentioned earlier. I've said it time and time again: *No one* has a crystal ball. And a crystal ball is exactly what you'd need to know where something as vast and complex as the stock market will go.

Which is why our investment strategy is based on *principles,* not predictions.

What are those principles? For starters, we invest for the long-term. We avoid making emotional decisions. We don't overreact to the day-to-day swings of the market. We choose investments based on *you*: your goals, your comfort-level with risk, your time frame.

The current trade war, especially between the U.S. and China, is an important story, and one we'll keep monitoring. But from an investing standpoint, right now it's *just a story.* And we don't allow stories to affect our strategy. Of course, if at any point we feel the trade situation could harm your portfolio or impede your progress towards your goals, we'll let you know immediately.

In the meantime, remember: My team and I love hearing from you! Please let us know if you have any questions or concerns. Our door is always open. Have a great month!

Sincerely,

Robert G. Elliott, CFP
Vice President

[1] "What's at stake in US-China trade war," *The Financial Times,* July 19, 2018. https://ig.ft.com/us-china-tariffs/

[2] "Trump Administration Prepares $200 Billion In Additional Tariffs on Chinese Imports," *Time,* July 10, 2018. http://time.com/5335200/trump-200-billion-additional-tariffs-chinese-imports/

[3] "China hits back after US imposes tariffs worth $34bn," *BBC News,* July 6, 2018. https://www.bbc.com/news/business-44707253

[4] "U.S. Announces Tariffs on $50 Billion of China Imports," *The Wall Street Journal,* April 3, 2018. https://www.wsj.com/articles/u-s-announces-tariffs-on-50-billion-of-china-imports-1522792030

[5] "The U.S.-China trade war has begun. Here's how things got to this point." *The Washington Post,* July 6, 2018. https://www.washingtonpost.com/news/worldviews/wp/2018/07/05/a-timeline-of-how-the-u-s-china-trade-war-led-us-to-this-code-red-situation/

[6] "Trump to offer farmers $12B in trade aid," *Politico,* July 24, 2018. https://www.politico.com/story/2018/07/24/trump-trade-aid-for-farmers-737108