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Tariff Wars: Echoes of the Past, Notes for the Future

In the spring of 2017, we discussed the initial tremors of a new administration's shake-up of America's terms of trade with the rest of the world. Over the subsequent two years, markets appeared to have gotten used to the cycle of brinksmanship, negotiations pressured by looming deadlines, and the threat of tariffs ricocheting across global supply chains and enterprises.

There was the tense effort to bring Canada along on the U.S./Mexico-led rewrite of the North American Free Trade Agreement (NAFTA). With that new pact seemingly resolved, though still languishing in Congress, attention turned to an array of tendentious issues with China. As 2018 slid into the early months of 2019, a similarly halting yet constructive process appeared to be at work on that front.

Then came May. Suddenly, in a single weekend, expectations of an imminent U.S.-China deal were shattered. Reportedly, Chinese negotiators backed away from major elements of a comprehensive letter of understanding worked out weeks earlier. President Trump moved to raise and broaden tariffs on Chinese goods and barred U.S. firms from dealing with Huawei, China's telecommunications star.

Stocks took the hit as the Standard & Poor's 500 Index gave up 6.5% in May, paring back a chunk of its double-digit gains from the first four months of the year. By the time you read this, that story line and market sentiment may have shifted, and shifted again, so we step back for a little historical context.

Given our decades-long embrace of more open trade, it is easy to forget that high, protective tariffs have an older, longer tradition in U.S. history. They were especially key in promoting the growth of manufacturing in the nation's early years. England had discouraged industrialization in its American colonies, preferring that they focus on producing commodities to feed the mother country's burgeoning industrial base and mercantilist policies.

From the U.S.'s inaugural Tariff Act of 1789 until enactment of the federal income tax 125 years later, tariffs averaged about 20% on foreign imports and represented the federal government's largest revenue source. They were a mainstay of 19th century economic and foreign policy but a contentious issue between industrializing northern states and more agrarian regions.

Maintaining high tariffs was a key plank in Abraham Lincoln's presidential campaign, and a prime driver of southern secession. The Civil War opened with the Confederate bombardment of Fort Sumter, which contained the federal customs house for goods entering the port of Charleston, South Carolina.

Tariff protection remained a lynchpin of U.S. trade policy well into the 20th century. Many histo-

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Is Student *Debt* the Smart Play After All?

Billionaire Robert F. Smith made a big splash recently when he told the graduating class at Morehouse College that he would be retiring their student loans. At least one contender for the Democratic presidential nomination has proposed forgiving much of the $1.5 trillion of outstanding student debt.

The federal government already offers selective relief for some student borrowers, and a few states are establishing programs to help pay down such loans for those who agree to work in selected fields within the state. To cap it off, the IRS recently indicated that businesses could make matching retirement plan contributions based on an employee's student loan payments.

At some point, students and parents may wonder whether the smart move is to take on as *much* student debt – especially the subsidized variety – as possible while preserving other assets as *long* as possible. After all, those loans do not start accruing interest until six months after the borrower graduates or drops below half-time student status. Even then, rates are favorable, and up to $2,500 of annual interest is deductible without itemizing. Why not "buy" that time to see what possibilities materialize for debt relief or forgiveness?

The potential for unintended consequences and perverse incentives is clear. For starters, what about the Morehouse student who worked two jobs and burned the candle at both ends in order to graduate with as *little* debt as possible? Does that now look foolish, or is this being factored into the allocation of Mr. Smith's largesse? This is classic *moral hazard*: the effects of removing or softening the cost or consequences of imprudent behavior.

Nearly eight years ago, as student debt passed the trillion-dollar threshold, these pages examined the 40-year pairing of expanding federal grants and loans with surging tuition costs. Today, according to the College Board and the National Center

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Municipal Bonds Catch an Updraft

A year ago, the *Quarterly* noted that investor appetite for tax-exempt municipal bonds had been cool "despite a modest supply of new issues and a healthy uptick in yields." We mentioned several reasons why that market weakness might change. So far this year, municipal bonds have staged their best start since 2014. There appear to be three main threads of that story

1. This year's tax filing season brought home the impact of the new law's cap on deductions for state and local taxes and raised many high-income earners' sensitivity to still-high marginal rates. Particularly popular for investors who face state income tax are their own state's bonds, which may be double-tax-exempt.

2. A healthy economy has most states and municipalities enjoying a fiscal upswing. As a result, new issuance of municipal debt has been modest, limiting the supply of attractive, investment grade bonds to meet the heightened investor demand mentioned above.

3. Muni yields have stayed quite competitive on a *taxable-equivalent* basis. While the benchmark 10-year Treasury has slipped back below 2.3%, 10-year investment grade munis have been showing yields near 2%. In states with an income tax, high earners can suffer effective rates near 50% on taxable interest. That counts their marginal federal rate, plus the investment income surcharge, plus the state levy.

This trio of supportive fundamentals is reflected in the solid one-year total return for the average long-term municipal bond fund shown in the accompanying table. Most of that result has been realized in 2019, and there is always the reminder that bond prices can go down as well as up. *Diversification* and *quality* have been, and probably will continue to be, the prudent play for tax-sensitive investors. ■

Looking Beyond the Comforts of Home

Are you a contrarian investor? If so, there is little mystery about where you might consider boosting portfolio exposure. Strategists with the Hartford Funds note that the period of outperformance by U.S. versus international stocks has now run over eight years. The average run of such streaks for either side is about seven-and-a-half years. Does that mean the cycle is about to turn?

Picking precise turning points is tricky, and there are plenty of factors reinforcing a stay-at-home posture. U.S. equity outperformance has been more the rule than the exception since 1986, including a markedly better showing this past decade (see accompanying table).

Still, *non-U.S.* companies represent about 45% of global stock market capitalization. And recent U.S. dollar strength represents buying power for acquiring overseas assets. So, where might you look?

Relative valuations are a starting point. European stocks are priced at an average of about 16 times trailing earnings, compared to a 19 multiple for U.S. equities. A counter argument to that European value story is the chronic underperformance of the Continent's largest national economies. But contrarians *look* for muted expectations, right?

Emerging markets, especially in Asia, also may be a compelling alternative. Emerging market stocks are priced at about 14 times trailing earnings. Unlike more mature economies, emerging Asia boasts strong secular growth. Combined retail spending across 11 Asian nations other than Japan has increased nearly *seven fold* since 2001.

Expectations are high for continued growth in disposable income, and the region is now minting competitive firms in robotics, education, and financial services alongside established giants in cyclical industries and resources. Finally, some managers see upside potential for emerging Asia in ongoing trade tensions between the U.S. and China.

That may be a wild card, and you should review any portfolio changes with your advisor, who may already have your global equity diversification well covered. ■

Investment Performance Review	**TOTAL RETURN *** (dividends and capital gains reinvested)			
Selected Mutual Fund Categories *	**--- Annualized through June 6, 2019 ---**			
	1 yr.	***3 yr.***	***5 yr.***	***10 yr.***
Large-Cap Stocks (Blend)	2.7 %	11.0 %	8.2 %	12.6 %
Mid-Cap Stocks (Blend)	- 2.5	8.3	5.6	12.2
Small-Cap Stocks (Blend) †	- 9.2	7.9	5.2	11.8
Foreign Stocks (Large Blend) †	- 7.1	5.5	1.2	5.8
Diversified Emerging Markets †	- 9.8	7.6	0.8	5.0
Specialty Natural Resources †	-15.5	3.3	- 3.2	4.0
Specialty Real Estate †	13.1	6.7	7.2	13.8
Cons. Allocation (30-50% Equity)	2.5	5.0	3.3	6.9
Long-Term Bond	10.4	4.3	5.1	7.9
World Bond †	2.8	1.9	0.4	3.2
High Yield Taxable Bond †	4.5	5.9	3.3	7.9
Long-Term Municipal Bond	6.5	2.7	3.8	4.8

* Source: Morningstar. **Past performance is NOT indicative of future results.**

† Small-cap stocks, high-yield (lower rated) bonds, and sector-specific funds may exhibit greater price volatility than the stocks of larger, established companies and/or more broadly diversified funds. Securities of companies based outside the U.S. may be affected by currency fluctuation and/or greater political or social instability.

Checking Up on Your Social Security

As reported several years ago, the Social Security Administration has mostly phased out paper notices regarding our future benefits. Only those who are over 60 and not yet claiming benefits are still automatically mailed those annual statements. The rest of us should register for an online "my Social Security" account to access our earnings records and estimates of benefits at our earliest and full retirement ages.

Phasing out the paper has saved taxpayer money. The agency's inspector general reports that Social Security spent under $8 million in fiscal 2018 to print and mail statements, versus $65 million in 2010. However, while about 42 million people have registered for "my Social Security" accounts, fewer than half checked their online earnings statements during the 12 months ended last September 30th.

You can register for a "my Social Security" account at *www.SSA.gov*. Be ready to provide your Social Security number, birth date, and answers to a series of questions that help confirm your identity.

Checking your earnings record and projected benefits can be helpful for retirement planning and to guard against identity theft. A discrepancy with your actual earnings history may mean someone has fraudulently used your Social Security number, perhaps to establish and control a "my Social Security" account and try to claim your benefits.

If you still want to receive paper statements, a request form is available on the Social Security site. Bear in mind that receiving such information by regular mail may be less secure. If you see inaccuracies in the information reported by Social Security, contact the agency at 800-772-1213. Have your last tax return or W-2 income form in hand.

Finally, when you check your earnings record and projected benefits, you may want to share the information with your financial planning professional. It can't hurt. ■

A Cogent Tweet Garners Some Blowback

A large banking and wealth management firm recently took a lot of flak for suggesting that moderating our small but constant purchases might help us meet long-term savings challenges. The offending tweet's dialog, under *#MondayMotivation*, ran as follows:

You: *Why is my balance so Low?*
Bank Account: *Make coffee at home. Eat the food that's already in the fridge. You don't need a cab, it's only three blocks.*
You: *I guess we'll never know.*
Bank Account: *Seriously?*

Criticism rained down on the institution for being preachy, snarky, etc. Marketing gurus gave their own snarky lectures on attempts at hip humor by anyone so inherently unhip as a big bank. Perhaps the tweet's real sin was in striking too close to home.

Meanwhile, the House of Representatives, sailing something called the SECURE Act, discovered an island of bipartisanship. One can be *secure* in the knowledge that the bill would probably do little harm and maybe some good by tinkering around the edges of established retirement savings incentives and making a few technical corrections in the recent tax overhaul.

In another can-kicking exercise, the Senate is considering the more prosaically named Federal Retirement Commission Act. It would convene a panel of "experts" to review *private* retirement programs – i.e., *not* Social Secutity – and report to Congress on possible improvements.

We'll certainly report any meaningful measures that come out of these efforts. However, there is no shortage under *current* law of special incentives and vehicles that promote retirement savings. As that big bank's tweet suggested, it's all of life's little luxuries that really get in the way. ■

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rians cite the 1930 Smoot-Hawley Tariff Act and retaliation by other countries as a key contributor to the Great Depression.

Trade *liberalization* has been the salient feature of post-World-War-II policy, but not without pushback and controversy. Many in the economic and political mainstream contend that setting an example of open markets reaps a large benefit for *most* Americans despite strain and dislocation for some industries and workers. Mr. Trump campaigned on the competing view that we have granted access to the world's richest consumer market too cheaply and without true trade reciprocity.

Over the years, that argument has been voiced more often by organized labor and other elements of the traditional *Democratic* coalition. Despite the poisonous partisanship in D.C., a Republican president's aggressive trade posture has garnered some support from leading Democrats. A Democratic House of Representatives has made no move to curtail Mr. Trump's trade prerogatives, while leaders in the Republican Senate have been more critical.

At some point, principle may surrender to practical assessment of gain versus pain. But even if the trade antagonists reach a truce, cross-border economic engagement may have been profoundly altered. Last winter's *Quarterly* highlighted the trend of global companies becoming *multi-local* by basing production closer to end consumers and tailoring products and services to local or regional tastes and customs.

Large trade imbalances between nations are probably a poor gauge of their broad, relative economic well-being. On the other hand, they may signal that at least in some respect, those domestic economies are, in fact, out of balance. ■

Financial Security *Is* the "New Sexy"

Some months ago, our friends at Merrill Edge released some survey results that may either make you uncomfortable or give you renewed hope. The survey, focusing on a sample "mass affluent" population, found that 56% of respondents were more desirous of a life partner who could provide financial security than one who would "sweep them off their feet," so to speak.

Results were about the same for men and women. Only the youngest group, age 18 to 22, voted for romance over financial security, but by a rather slim margin of 54% to 47%. What has happened to the young?

One can't help but speculate on the connection between those findings and the report that the U.S. birth rate for 2018 was the lowest since the government started tracking it in 1909. That persistent trend surely has myriad causes, including evolving social norms, ideas of personal fulfillment, and economic realities.

But let's just cut to the chase. What is the message if you are "in the market" for a mate? Should your online dating profile include a personal balance sheet, a summary of your 401(k) statement, the latest Zestimate of your home's value? Or should those critical issues be broached over a candlelight dinner.

Speaking of dinner dates, is it now considered sexier to go Dutch rather than pick up the check and risk looking like a spendthrift? What a brave new world we live in. ■

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for Education Statistics, average tuition at public four-year institutions is *3.8 times* what it would be if it had risen only at the general inflation rate for the past 48 years.

As with many products and services, subsidies are price supports, benefiting *producers* most directly, while the benefits to consumers are, at best, diffuse. We were taught another lesson on this a decade ago with a sub-prime mortgage debacle that followed in the wake of a multi-decade expansion of policies and subsidies promoting home ownership.

None of this need dim the glow of Mr. Smith's generosity to those Morehouse graduates. Nor is there anything new about politicians seizing on a well-publicized pain point for a growing cadre of voters. Our task is not to critique public policy or private philanthropy, but rather to recognize the implications for strategic financial planning.

That process must look at evolving systems and choices in the real world rather than some idealized version of it. If the trend favors student debt *forgiveness*, whether from wealthy benefactors or the nation's taxpayers, we might expect more students to take on a lot more debt… as a strategy. ■

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