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Pence Perspectives, Q3 2018

Bottom Line Up Front:

Rising interest rates and escalating trade tensions have contributed to an increase in equity volatility during the first half in 2018. This will most likely continue until (and after) the November mid-term elections. Meanwhile, markets are expected to continue to benefit from tax reform and global growth, despite the latter exhibiting slowing momentum. Stock prices at their core are reflections of earnings expectations and—according to FactSet, analysts are projecting earnings growth of 20% and revenue growth of 8% for all of 2018. The second quarter earnings season has been stellar with positive surprises on both the top line (sales) and bottom line (Earnings Per Share, EPS). As of August 7, of the 413 S&P 500 companies that have reported, sales have risen 12% and EPS have increased 24%, while 80% of reports have topped estimates. If the beat rate holds, it will be the highest on record dating back to the first quarter of 1994.

Given strong corporate earnings and current multiple trailing within the historical band[1], we maintain our belief that the S&P 500 index will finish the year in a positive territory. Historically, the S&P 500 has closed at its calendar year high in the second half of the year 74% of the time (source: BTN Research) and we don't expect this year to behave any differently.

Markets

Growth stocks lead the market

Ticker	Company	Sector	2018 sales growth est	2018 eps est	Total return YTD	Mkt cap weight
AAPL	Apple	Information Technology	16%	30%	25%	4.0%
AMZN	Amazon	Consumer Discretionary	33%	119%	64%	3.7%
GOOGL	Alphabet	Information Technology	24%	23%	21%	3.5%
MSFT	Microsoft	Information Technology	12%	12%	30%	3.3%
V	Visa	Information Technology	14%	33%	23%	1.1%
MA	Mastercard	Information Technology	20%	40%	35%	0.8%
NFLX	Netflix	Consumer Discretionary	36%	83%	82%	0.6%
NVDA	Nvidia	Information Technology	36%	78%	33%	0.6%
ADBE	Adobe Systems	Information Technology	23%	60%	45%	0.5%
CRM	Salesforce	Information Technology	26%	73%	43%	0.4%
	10 contributors average		24%	55%	40%	19%
SPX	**S&P 500 Index**		8%	20%	8.2%	100%
% of S&P 500 Index			51%	45%	82%	

Source: FactSet, Bloomberg, Pence WM *as of 8/8/2018*

In stark contrast to last year, 2018 has been more of a *stock picker's* market. Dispersion among stock returns has risen with capital appreciation being concentrated in a few sectors such as technology and consumer discretionary, while laggards have been spread out across other sectors. We believe this theme will continue for the rest of the year. In the first half of the year, companies with higher growth outlooks have outperformed those with lesser growth (see tables).

[1] S&P 500 forward price-to-earnings (PE) multiple has contracted 11% to its 5-year average of 16.2x from 18.2x since beginning of 2018

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Value stocks fell out-of-favor

Ticker	Company	Sector	2018 sales growth est	2018 eps est	Total return YTD	Mkt cap weight
JNJ	Johnson & Johnson	Health Care	6%	12%	-5%	1.4%
WMT	Walmart	Consumer Staples	3%	7%	-8%	1.0%
T	AT&T	Telecommunication Services	8%	21%	-13%	0.9%
PG	Procter & Gamble	Consumer Staples	1%	6%	-9%	0.8%
PM	Philip Morris	Consumer Staples	4%	7%	-18%	0.5%
MMM	3m Co	Industrials	6%	13%	-12%	0.5%
GE	General Electric	Industrials	-2%	-11%	-24%	0.4%
MO	Altria	Consumer Staples	0%	22%	-15%	0.4%
CAT	Caterpillar	Industrials	21%	79%	-10%	0.3%
KHC	Kraft-Heinz	Consumer Staples	0%	4%	-22%	0.3%
	10 contributors average		5%	16%	-14%	7%
SPX	**S&P 500 Index**		8%	20%	8.2%	100%
% of S&P 500 Index			4%	4%	-10%	

Source: FactSet, Bloomberg, Pence WM *as of 8/8/2018*

As of July 31, 10 large *growth* stocks that constitute 19% of the S&P 500 market size were up 40%, on average, contributing to **82%** of the S&P 500 total return. These 10 companies alone are expected to provide **50%** the sales growth and **45%** of the earnings growth of the entire market in 2018. On the other hand, 10 large *value* stocks with relatively lower earnings expectations were down -14%, on average, during the same period. They alone dragged the market down by -0.77%, partly due their small contribution of 4% to overall sales and earnings growth of the entire market. Very clearly, this year is a stock picker's market.

Economy, Fed and Interest Rates

The US unemployment rate fell to 3.8% in May, tied for the lowest unemployment rate seen since 1969, and the Federal Reserve (Fed) now projects the rate will fall further to 3.5% in 2019 and 2020. Overall, the US economy remains in good shape and we don't expect a recession any time soon. Its current recovery has stretched out long enough to make it the second-longest since 1785 and will become the longest if it survives another year.

***The Economist poll* of forecasters,** August averages

	Real GDP, % change, 6-month ago average	
	2018	**2019**
Australia	2.9 (2.8)	2.8 (2.8)
Brazil	1.6 (2.6)	2.4 (2.8)
Britain	1.3 (1.4)	1.4 (1.5)
Canada	2.3 (2.2)	2.2 (1.9)
China	6.6 (6.5)	6.3 (6.4)
France	1.8 (2.0)	1.8 (1.9)
Germany	2.1 (2.5)	2 (2.1)
India	7.2 (7.3)	7.4 (7.6)
Italy	1.2 (1.5)	1.2 (1.3)
Japan	1.2 (1.5)	1.2 (1.1)
Mexico	2.2 (2.1)	2.2 (2.5)
Netherlands	2.7 (2.7)	2.4 (2.5)
Russia	1.7 (2.1)	1.7 (1.8)
South Korea	2.8 (3.0)	2.8 (2.9)
Spain	2.7 (2.6)	2.2 (2.2)
Sweden	2.8 (2.7)	2.3 (2.4)
Switzerland	2.2 (1.8)	1.9 (1.9)
Turkey	4.3 (3.7)	3.3 (4.2)
United States	2.9 (2.6)	2.5 (2.4)
Euro Area	2.1 (2.3)	1.9 (2.0)

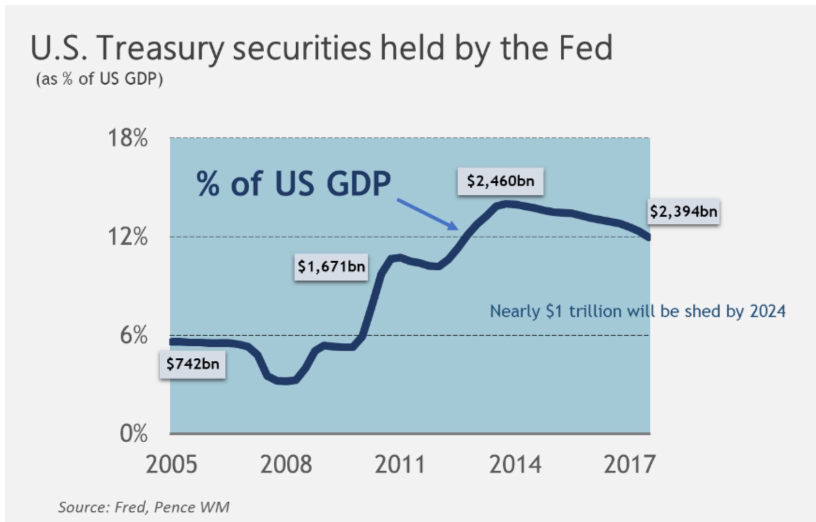
Source: The Economist

Currently, the median estimate for 2018's economic growth is 2.9%, up from the 2.6% in January estimate, with projections unchanged for 2.5% in 2019 (see table below). We maintain our long-term "sustainable" growth view between 2.5% and 3.5%. Elsewhere, global growth is losing a bit of steam in Latin America, Germany and Japan, but is not yet at the point of alarm. For the rest of the year and into 2019, we think there are two substantive global macroeconomic risks: **interest rates** and **trade uncertainties**.

The Fed remains a key influencer of the market, though investors seem to be happy with the actions and communications the Fed has conveyed so far. On June 13, the Fed raised interest rates for the second time this year and upgraded their interest rate forecast from three to **four** total increases in 2018. However, the long-term "natural" rate forecast of 3.5% is still very accommodative compared to the historical average.

The Fed's balance sheet has begun to shrink for the first time in a decade, pulling back on purchases or reinvestment of the principal of the maturing US Treasury notes that represent $2.4 trillion of its total $4.3 trillion assets. This comes while the US government needs to borrow more due to the tax and spending bills passed earlier in the year, leading some analysts to fear that while the

Fed is simultaneously reducing its buying, it leaves more to be financed in the market, which may cause further increases in rates.



Historically, the Fed's US Treasury holdings have accounted for about 6% of US GDP. Today, it stands at twice that amount though down from the 14% level reached in 2014. Based on the Fed's projections, we expect about 40% or nearly $1 trillion of the Fed's US Treasury holdings will be shed by 2024. However, given the size of the global bond market – over $100 trillion today according to PIMCO – along with the attractiveness of US Treasury yields compared to their counterparts in Europe and Japan, we believe the market has the capacity to absorb the amount left by the Fed.

In rising interest rate environments, it's prudent to remain cautious and selective to bond positions in portfolios. We favor shorter-duration bonds over longer-duration bonds because those with a longer-duration tend to decline in value more than their duration counterparts when rates rise.[2] Having short term bonds can mitigate the negative impact of rising rates and also help dampen portfolio volatility. Year to date, there have been 36 daily swings of at least 1%, while in 2017 there were only 8 over the course of the entire year. For more information on this, look at our 2018 Q2 Newsletter.

US-China Trade Balance

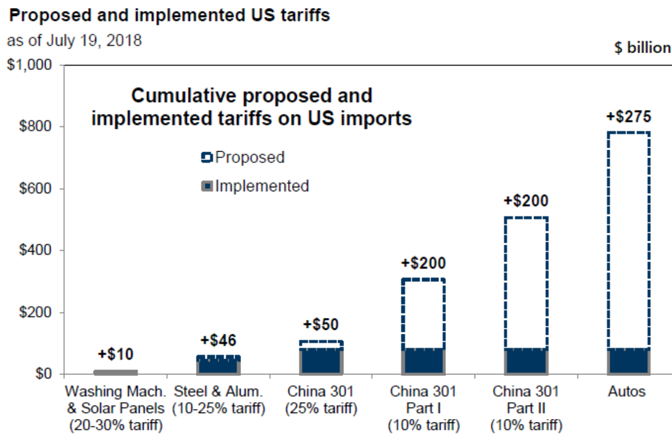
The US government has recently taken a more aggressive stance toward China, causing the Chinese stock market to plummet into bear market territory. Investors believe that in a full-fledged trade war, China will likely be the bigger loser. The math on this is simple: In 2017, the US imported $505 billion of goods from China while China imported only $130 billion from the US. The Chinese economy is only slightly above half the size of the US and is built on exports. In 2017, China's total exports accounted for 18.5% of China's GDP, 4.5% of this went to the US, whereas US total exports only accounted for 11% of US GDP, a mere 0.7% of this was with China. If China buys nothing from the US, it is of little consequence; however, if the US buys nothing from China, it would be a major problem for Chinese economy.

Given the fact that the annual trade deficit is expected to reach over $600 billion in 2018, with China accounting for nearly 50% of it, President Trump insists the trade deficit with China needs to be reduced by $200 billion a year in coming years and that this is the time to do it as US economic growth is accelerating and unemployment is at historical lows. Mr. Trump also believes that tariffs are the right strategies to curb China's rising dominance

[2] Investment professionals rely on duration because it rolls up several bond characteristics (such as maturity date, coupon payments, etc.) into a single number that gives a good indication of how sensitive a bond's price is to interest rate changes. For example, if rates were to rise 1%, a bond or bond fund with a 5-year average duration would likely lose approximately 5% of its value (source: Fidelity)

in the world while decreasing the trade deficit between the US and China, and other trading partners (see chart below).[3]

Trade (Balance of Payments)



In global trade, assigned bilateral trade balances are not necessarily good or bad. Certain countries are good at the production of a specific product or commodity, while others are not. As a result, they sell what they have a competitive advantage in and purchase what they don't. A nation can have a surplus with one country and a deficit with another. Therefore, in theory, there are no "trade imbalances." No one is going to give something and get nothing in return.[4] What we call a "trade imbalance" is actually a process by which one party in the trade accepts – instead of goods and services – some form of asset, typically a financial asset such as stocks or bonds (capital account) that are not reflected on the current account.

An understanding of the trade deficit begins with the **balance of payments**, the broadest accounting of a nation's international transactions. The balance of payments is defined as the **current account** and the **capital account**.

Balance of Payments = Current Account + Capital (Financial) Account

(Included in GDP) **Current Account**: Imports and Exports (Trade Balance) plus Workers Income

(Not included in GDP) **Capital Account**: Direct and Portfolio Investments as well as Loans and Reserves

By definition, the balance of payments always equals zero - that is, what a country buys or sells in the global market must equal what it sells or receives - because of the double-entry nature of international bookkeeping.

The *current account* side of the ledger covers the flow of goods, services, as well as income receipts of US workers working abroad and payments of foreign workers working in the US. Within the current account, the ***trade balance*** includes goods and services only.

The *capital account* includes the buying and selling of investment assets such as real estate, stocks, and bonds. Big changes in the capital account can indicate how attractive a country is to foreign investors. In 2017, global net inflows of foreign direct investment (FDI) stood at $1.86 trillion and the US captured nearly **$350 billion**, 19% of the total, more than twice the amount China received, according to the World Bank, and was almost equivalent to the US goods deficit with China.

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[3] In 2015, China announced "Made in China 2025" objective which aims to help China become a major competitor in advanced technologies with both commercial and military applications. This initiative will be achieved via heavy state subsidies and regulatory control on foreign entities. Made in China 2025 would allow China to seek greater military and geopolitical power, a direct threat to the US. With no numeric goals explicitly stated, the Trump administration seems determined to deter that effort as much as possible.

[4] This does happen, in the form of official foreign aid or nonprofit contributions. But, these are placed in a separate category.

The important economic truth to grasp about the US trade deficit is that it is not purely a function of trade policy, which therefore is a limited tool for reducing the trade deficit. A nation's trade deficit can be determined by the flow of investment funds into or out of the country – which is essentially how much the people of a nation save and invest. Put simply, a trade deficit *can be* a ***lack*** of national ***saving*** over domestic investment while a trade surplus *can be* an excess of national saving over domestic investment.

Alan Blinder, a professor of economics and public affairs at Princeton University, argues that bilateral surpluses and deficits are the norm, not aberrations. He points out that the problems with China reside mainly in intellectual-property protection, not in the bilateral trade deficit. In his words, "Think about your personal trade patterns. You almost certainly run a large, persistent surplus with the organization you work for. It pays you for your work, but you probably buy little or nothing from it. Rather, you take the money you earn and spend it elsewhere—on rent, at the local supermarket, at restaurants and dozens of other places, thereby running trade deficits with all of them. You probably can't name a single trading partner with whom you have balanced trade." If you examine bilateral trade flows, you find surpluses and deficits everywhere. That's how trade works. The problem with the US is its citizens don't save much, and its government actually saves a negative amount by running persistent budget deficits.

The Economist

For example, last year Germany ran a $300 billion trade surplus, roughly 8% of its economy. This is not the result of mercantilist government policy but rather a decades-old accord between business and unions in favor of wage restraint to keep export industries competitive. Such moderation served Germany's export-led economy well through its postwar recovery and beyond (see: *The Economist*). Germany is not alone; China, Japan, and Switzerland along with major oil exporters have been piling up big surpluses, too. To offset such surpluses and sustain enough aggregate demand, countries with low national savings such as the US and Britain must borrow and spend with equal abandon.

In Japan, high domestic savings rates provide a pool of capital that far exceeds domestic investment opportunities. The main reason that America's bilateral trade deficit with Japan exploded in the 1980s was the Japanese government lifting many of its capital controls with the passage of the Foreign Exchange and Foreign Trade Control Law in 1980. This allowed Japanese savings to flow across the Pacific to the US, where it could draw a more favorable rate of return.

The US has been running trade deficits every single year since 1976 and we believe there are other factors that are peculiar to the US and different from just the **lack of national savings hypothesis**.

Why do Americans save less? We tend to spend more than other nations because the nature of our economy means we are more *confident in our futures*. This is a luxury most foreign nations don't have. Instead, they provide the capital for the amount of investment we need, resulting in a deficit as they send us more capital as investments than we purchase as goods. According to FRED, consumer spending in the US accounts for 68% of US economy, compared to 56% in the European Union (according to Eurostat), 39% in China (according to CEIC), 49% in South Korea (according to World Bank), and 60% in Japan (according to Japan Macro Advisors). America offers great **investment opportunities** for foreign investors such as low taxes, a stable world currency dollar, the

rule of law, political and economic stability and consequently attract more and more foreign capital to the US causing American households to save less and consume more.

The *twin deficit hypothesis* argues that there is a strong causal link between a nation's **budget deficit** and its **current account deficit**. Government consumption of capital to finance budget deficits hurts domestic savings that are needed for investment. Moreover, because of the size of our national debt at $15.3 trillion, over $6 trillion of which is held by foreign governments and investors (see table below) we not only mismanage our national savings but also send some of it abroad as interest payments. In fiscal year 2019, the US government will pay nearly $363 billion in interest payments, and about **$150 billion** of which will go to foreign governments and investors, further adding to the deficit.

Major Foreign Holders of Treasury Securities

Country	2018					2017							
	May	*Apr*	*Mar*	*Feb*	*Jan*	*Dec*	*Nov*	*Oct*	*Sep*	*Aug*	*Jul*	*Jun*	*May*
China, Mainland	$1,183	$1,182	$1,188	$1,177	$1,168	$1,185	$1,177	$1,189	$1,182	$1,202	$1,167	$1,147	$1,102
Japan	$1,049	$1,031	$1,044	$1,060	$1,066	$1,062	$1,084	$1,094	$1,096	$1,102	$1,113	$1,090	$1,112
Ireland	$301	$300	$318	$314	$328	$327	$324	$312	$311	$309	$312	$304	$298
Brazil	$299	$294	$286	$273	$266	$257	$265	$270	$273	$274	$272	$270	$270
United Kingdom	$265	$263	$264	$251	$243	$250	$238	$226	$237	$225	$230	$236	$236
Switzerland	$243	$242	$245	$248	$251	$250	$251	$254	$253	$248	$245	$244	$239
Luxembourg	$209	$214	$222	$219	$221	$218	$218	$218	$214	$213	$213	$212	$208
Hong Kong	$192	$194	$196	$197	$194	$195	$195	$192	$194	$195	$197	$201	$197
Cayman Islands	$186	$181	$166	$177	$168	$171	$240	$247	$247	$243	$241	$249	$250
Taiwan	$165	$168	$170	$171	$175	$181	$180	$182	$184	$182	$184	$186	$181
Saudi Arabia	$162	$160	$151	$151	$144	$147	$148	$145	$137	$138	$143	$142	$134
Belgium	$151	$138	$126	$126	$124	$119	$115	$116	$105	$97	$99	$98	$99
India	$149	$153	$157	$153	$149	$145	$141	$141	$145	$139	$136	$130	$127
Singapore	$119	$118	$118	$118	$123	$125	$124	$130	$125	$119	$112	$106	$108
Korea	$105	$100	$100	$101	$102	$96	$99	$100	$94	$95	$98	$97	$100
Canada	$97	$89	$93	$89	$86	$86	$82	$78	$75	$74	$76	$77	$80
France	$90	$83	$81	$77	$78	$81	$77	$78	$78	$76	$80	$72	$74
Germany	$78	$86	$77	$79	$71	$72	$72	$73	$75	$73	$73	$68	$68
Bermuda	$64	$65	$66	$67	$68	$67	$64	$63	$62	$62	$62	$60	$60
Thailand	$62	$61	$57	$68	$67	$61	$68	$68	$71	$72	$67	$66	$67
United Arab Emirates	$60	$60	$59	$58	$55	$58	$58	$58	$54	$56	$60	$59	$61
Norway	$50	$39	$40	$50	$47	$51	$55	$61	$64	$58	$55	$54	$48
Sweden	$46	$45	$46	$46	$46	$44	$45	$45	$46	$44	$43	$41	$41
Netherlands	$45	$43	$44	$45	$45	$49	$48	$45	$48	$50	$51	$53	$52
Kuwait	$44	$43	$37	$36	$37	$37	$37	$39	$38	$36	$33	$32	$32
Mexico	$43	$42	$45	$35	$34	$39	$41	$42	$41	$35	$36	$32	$39
Poland	$40	$41	$40	$40	$41	$40	$38	$39	$37	$36	$36	$34	$35
Italy	$40	$36	$37	$37	$35	$35	$36	$35	$35	$35	$36	$36	$36
Australia	$38	$36	$34	$39	$38	$38	$41	$39	$37	$38	$38	$38	$37
Spain	$35	$31	$32	$32	$35	$34	$36	$37	$38	$38	$38	$37	$38
Turkey	$33	$38	$41	$46	$50	$53	$61	$62	$61	$58	$55	$59	$50
Philippines	$32	$32	$32	$33	$34	$36	$36	$36	$36	$36	$38	$38	$38
Chile	$30	$28	$30	$30	$29	$29	$29	$29	$26	$26	$27	$27	$27
All Other	$513	$534	$575	$576	$571	$576	$585	$581	$583	$567	$568	$556	$566
Grand total	$6,214	$6,169	$6,217	$6,216	$6,187	$6,210	$6,306	$6,324	$6,302	$6,249	$6,230	$6,152	$6,109
Of which:													
For. Official	$3,991	$4,000	$4,050	$3,730	$3,998	$4,026	$4,055	$4,079	$4,070	$4,052	$4,035	$3,994	$3,935
Treasury Bills	$346	$323	$319	$34	$325	$317	$340	$332	$325	$324	$331	$330	$329
T-Bonds & Notes	$3,645	$3,677	$3,731	$3,696	$3,673	$3,709	$3,715	$3,747	$3,745	$3,728	$3,704	$3,665	$3,606

Department of the Treasury/Federal Reserve Board
July 17,2018

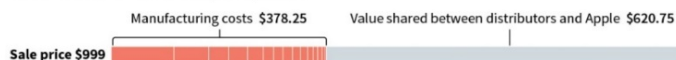
Understanding the Characteristics of US Economy and Adjusting Trade Data

We believe the total benefits America gets from *free trade* far exceed total costs reflected in current account deficit. Persistent trade deficits imply that the rest of the world has been cutting prices for American consumers who have enjoyed lower prices and higher standards of living for generations. Other nations would seek to run a trade deficit if they could. For years, they have shipped us more than we provide in return.

Manufacturing the iPhone X

The manufacturing costs of the 64GB iPhone X is about 38% of the sale price. Although China puts the phone together, the value of an iPhone X is spread between parts suppliers in Taiwan, South Korea, Europe and the United States.

BREAKDOWN OF IPHONE X (64GB) COSTS



BREAKDOWN OF MANUFACTURING COSTS*

Item	Cost	Headquarters of manufacturers
Display/touchscreen module	$110.00	South Korea
Major mechanical/Electro-mechanical elements	$61.00	(Not available)
Cameras	$35.00	(Not available)
Memory	$33.45	Japan, South Korea
Apps processor	$27.50	UK, Switzerland, U.S.
Radio frequency chipset	$18.00	U.S.
TrueDepth sensing suite	$16.70	Switzerland, U.S.
Radio frequency power amplifier section	$16.60	U.S.
Power management integrated circuits	$14.25	UK, Switzerland, Singapore
Box contents / other	$12.00	(Not available)
User interface integrated circuits content	$10.05	Netherlands, U.S.
Basic manufacturing cost	$8.00	China
WLAN/Bluetooth module	$7.35	Japan
Battery packs	$6.00	China
Sensors	$2.35	Japan, Germany, Austria, Swtizerland

*Cost figures are based on IHS Markit data, except for the basic manufacturing cost, which is based on estimates by Reuters.
Sources: IHS Markit; company websites; Reuters
J. Wang, C. Cadell, A. Jourdan, 21/03/2018

Since the Industrial Revolution, *western civilizations* such as the US, Japan, and western Europe happened to be **origin of *ideas*** while the rest of the world were looked at as the ***origin of inputs*** such as raw materials and manual labor—lowering costs for manufacturers and helping them hone their competitive edge. Today, US imports bring **lower prices and more choices for American families**. US companies' imports of intermediate goods, raw materials, and capital goods account for more than 60% of all US goods imports. According to the Chamber of Commerce, access to imports is estimated to boost the purchasing power of the average American household by about $18,000 annually. This is the equivalent of **$2.1 trillion**, almost the entirety of US exports.

By far the **most popular currency** in the world, the **US dollar,** represents 63% of all known central bank foreign exchange reserves, according to the IMF. A constant demand for US dollars outside the US and the reality that commodities are priced in greenbacks makes the existence of a US trade deficit almost inevitable. Nations are willing to accept US dollars in exchange for their goods because they trust that the dollar will retain its value. We have frequently referred to this as the *stability premium*, for more details on this please see our 2014 Q3 Newsletter. A strong dollar means that Americans can buy more foreign goods, and this is beneficial for both consumers and international travelers because objects they want to buy and places they want to go are cheaper. However, the downside is when selling American goods to foreign customers, it costs more, hence resulting in a trade deficit.

One of the biggest misconceptions of global trade is the way trade data is collected – which fails to account for the **complexity of global supply chains** and artificially inflates the size of the US trade deficit. According to the OECD, China contributes only around **two-thirds** of the value of its exports to the US. In contrast, the US contributes **85%** of the value added in its own exports to China. This suggests that only 67% of "Made in China" products in the US are Chinese, whereas 85% of "Made in America" products in China are American. Recognition of this alone would cut the China-US trade deficit by 36% or roughly **$125 billion,** according to Louis Kuijs, head of Asia economics research at Oxford Economics.

Take the **iPhone X**, designed by Apple and assembled in China. The latest version of the iPhone X costs $1,000 in the US; its components are estimated to be worth **$378**, according to IHS Markit in a Reuters report. But those components come from all over the world— such as Korean displays and Japanese or Korean memory. The report identified China's combined valued-added contribution to the iPhone X totaled just **$14**. Yet, when Chinese firms like Foxconn ship a fully assembled iPhone X to the US, US Customs assigns their gross value of **$378 to China**. This not only omits the other suppliers' contribution such as South Korea, Japan, and the US (US parts make up the largest share of the total) but also inflates the value of China's exports to the US.

Reuters reports that 61 million iPhones were shipped from China to the US in 2017 and suggests that just a single phone, the **iPhone 7** – released in 2016 and on sale for all of last year – accounted for **$15.7 billion** of the trade deficit, or 4.4%. The iPhone example shows why a bilateral trade war is counterproductive. Global supply chains have become much more integrated since the 1990s. Trade is no longer about relying on cheap labor in one country, it takes the diverse skills and resources of many countries to make technology accessible.

Why can't Apple just make iPhones in the US? The main problem is that the manufacturing side of the global electronics industry was moved to Asia in the 1980s and 1990s. There's not much value to be gained for the US economy or its workers from simply assembling iPhones here from parts made in Asia and Europe. While it's possible to do so, it would take at least a few years to set it up, cost more per unit than production in Asia, and require a number of concessions from policymakers to get the many companies involved to do so.

Another adjustment suggested by the Council on Foreign Relations is to combine US-Hong Kong trade with US-China trade. US goods exports to Hong Kong are about one-third of goods exports to all of China. Most of these exports end up in China. The US had a trade surplus with Hong Kong of about **$29 billion** in 2016.

A major aspect in this whole discussion that tends to get glossed over is that nations don't trade; people do. To this point, the US has a very unique and inherent nature that makes trade imbalances harder to calculate or interpret. The US is a large and diverse economy and population, the existence of which is realistically the envy of a vast majority of the world. We host over 800 thousand foreign students each year who have a significant positive economic impact on the economy. According to NAFSA, international students alone contributed nearly **$37 billion** to the US economy last year, creating or supporting 450,000 US jobs.

Furthermore, the United States is the second most visited country in the world, after France. 76 million tourists visited and spent over **$245 billion**, directly supporting about 1.2 million US jobs and **$32 billion in wages**, according to US Travel. Every time a foreigner visits Disneyland and spends $100 on a day pass, in trade terms, that is the same as if they bought a $100 pair of shoes made in New York and shipped it overseas.

Conclusion

At the midway point of 2018, we expect the remainder of the year to be largely similar to the first. Trade will continue to be a talking point as both the Chinese and American governments tangle for ascendancy. Headline volatility will remain omnipresent as media outlets use the uncertainty to postulate the outcome of the midterm election in November. Interest rates can be expected to continue on their current trajectory with the Fed communicating the strong possibility of 2 further rate hikes in this calendar year.

However, the current strength of the United States economy should not be underestimated. Corporate revenue growth is strong, and earnings are even stronger. Through July, the economy has had a net addition of jobs for 26 consecutive months and the search for workers is becoming progressively more difficult. Part-time jobs are becoming full-time, and people who haven't been a part of the workforce are returning. There's plenty of reason for optimism, and a sense of clarity, perspective, and composure will be increasingly important going forward.

We appreciate your trust and the opportunity to be of service.

All the best,

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