FRIDAY, FEBRUARY 7, 2025

Hello and welcome to The Dividend Cafe. I am your host, David Bahnsen. I am the managing partner at The Bahnsen Group, and this week I am absolutely, totally exhausted talking about tariffs. We have done a significant amount of work this week in the subject of tariffs, because that was the topic of du jour and it all came to a head over last weekend, going into Monday day in the markets.

And I decided to devote today's Dividend Cafe to the subject at large, because I feel that it's important that especially clients of ours, you know, I care about everybody, but I care about our clients the most. And I feel that there is a understandable complexity and ambiguity around the issue right now that is making it very hard for investors to really narrow down what it is we're talking about, what is going on, what could be going on, what the risks are going forward and so forth.

And I want to do something today that I don't get a chance to do very often, which is kind of deconstruct what has become a largely political issue, but deconstruct it sans politics really allow the noise of the political and the controversial to come out and just sort of have a more specific talk about the economic impact and reality and the risk reward paradigm that exists for those of us who are of course, investors, you know, we'll start with what exactly happened this week and then move forward from there.

And I hope the sequence in which I do this. Provides a little logic and simplicity to the topic at large. Easier for me to talk about tariffs outside of a particular moment in political reality. You know, to talk about tariffs philosophically, to talk about what tariffs do, what they don't do, where they could be good, where they could be bad, and so forth.

You don't really have a chance to have that conversation right now, because what investors most care about is, hey, is this thing that happened Monday real? Or is this thing that happened Monday gonna happen again? What did happen Monday? Or what's gonna happen a week from Wednesday? You know, it's ad hoc.

In 2018, the conversation was not about, let's pull out our old economics textbook and review David Ricardo's Law of Comparative Advantage. It was not refreshing Milton Friedman. Although I will say I put a link to a Milton Friedman YouTube in Dividend Cafe today and I did it for a very good reason.

But it wasn't philosophical in 2018. It was Well, what tariffs are going through with China and what's it doing to the market? And what's it mean for us manufacturers? And that I think is the situation right now that, you know, I have this desire constantly to talk about macroeconomics and do so from a philosophical standpoint and then bring it down to microeconomics where it impacts investor portfolios.

But we have this, the analogy I used, which is a very overused cliché, I understand, but in Dividend Cafe today I talked a little bit in the introduction about Lucy moving the football, is how do you get a chance to talk about the macroeconomic impact of tariffs that never happen? How do you get a chance to talk about the macroeconomic impact of tariffs?

Tariffs when you're talking about macroeconomics one day, and you're talking about drug policy, the next or national security or border control. When you're talking about computer products from China or avocados from Mexico, these just are different conversations. And so trying to narrow it down and become a bit more coherent, I think would be useful.

And so let's start with the recap of this week and allow that to kind of parlay in a broader conversation. President Trump we actually started last Friday and the Dow and markets were down on Friday at the end of the day in response to the rumors and reports of some Trumpian tariff impositions, but then they became reality over the weekend, and when I say reality, I should use air quotes, but over the weekend, it was said, there's now nothing that can be done.

We're done. We're going forward midnight Monday. So meaning going into Tuesday, both Mexico and Canada face 25 percent universal tariffs on all imports coming to the U.S. except for Canadian energy would be 10%. which I would point out changes the definition of the word universal. And then additionally, a 10 percent tariff on Chinese imports.

And there wasn't a lot of clarity as to what would be included, not included there and where tariffs that have already been added under section two 32 would be adjusted and whatnot. So futures dropped a lot. Markets Monday morning were down a lot and then they opened Monday down. But then they didn't stay down because I think it was an hour and a half into the market day, that Mexico announced a deal had been worked out where the tariffs would be suspended, not happen, and they would be providing border reinforcements and troops, and I can't remember if the fentanyl czar is part of the Mexico deal or the Canadian deal, but there's some sort of Zara, Fentanyl involved and all that kind of stuff.

And so, you know, that took place in the middle of the market day, Monday markets came back and the Dow ended up. And then after the market closed almost immediately, Canada announced something basically very similar. So you ended up all on Monday getting a microcosm of a really important idea of what's going on right now, which is I'm going to summarize these things in four basic points.

Well, actually, I'm going to wait to do that. What I would say is, it's very hard to evaluate the impact of these tariffs when they haven't happened, and we don't know that anything will happen, and then, you know, a lot of people want to say, well, look at the genius of what took place, but that does become a political question, and I have a lot of respect for people that say, This clearly worked out very well.

President Trump got a big victory. I mean, it's indisputable. He did get a political victory net that more people see this as him having gotten something without having to give up a lot, then don't, and obviously there's some who don't think he got a lot and it was just sort of, you know, saber rattling and hyperbole to kind of claim a rhetorical victory.

Cosmetic victory, whatever you want to use. But the truth is I would guess somewhere in between, and that seems to be the case all the time these days that there's people who hate president Trump that say, this is all nonsense. There's people that just adored Trump that think he just pulled off the greatest art of the deal ever.

And, you know, my view is not because I'm just constantly trying to land somewhere in the middle, but in reality, there, there was something accomplished and it probably wasn't earth shattering, but and I don't feel like that's a very controversial statement and it is somewhat apolitical, but it isn't relevant to the market side of it.

It doesn't help us evaluate what investors ought to be thinking about the current tariff moment, or even if we're in a tariff moment. And so, you know, what we hear is. Two things being said by the administration, and they're said at once, but the two things do not, cannot co exist. And that is one, tariffs are beautiful, they're this great source of revenue we can't wait to get, we're going to make trade deals fair with tariffs, and they're going to bring money to the U.S. from other countries, those countries are ripping us off, we're going to get money from them, and all the while it's going to protect American jobs. That's one theory of the case that is being said, but then also being said, not in a replacement of, but in addition to, it has said tariffs are a negotiating tool, and we don't want to use them, we're just using them to extract concessions from allies and adversaries, and the current focus in that is, of course, things like immigration or border security.

So the National Economic Council director, Kevin Hassett, was on CNBC Monday morning saying exactly that, saying this is not a trade war, it's a drug war. I thought, well that makes sense, and I don't mind hearing that. But then even Pete Navarro, who's one of the most protectionist people with any kind of access pass to the Oval Office, Said the same thing, and he has explicitly said over the years how effective tariffs are and how good it would be to not trade with foreign countries.

And so there is all at once a conflicting message going on, and I don't believe both can happen at once, but then I'm forced to try to extract some investment messages here. And so that's where these four takeaways I want to offer to you are there and allow you to see for yourself how we want to apply these things into what we're doing with the portfolio and the way we think about markets.

Number one is that the indication thus far is clearly that hyperbole, rhetoric, and audacity notwithstanding the new administration favors tariffs as threats more than tariffs as policy. That could change. That's most certainly been the indication so far, no matter what gets said and flexed along the way.

Number two, cosmetically, this approach has generated headlines. And real policy concessions that President Trump loves, the thing with Columbia a week ago, this thing this week with Mexico and Canada. Number three, market volatility skyrockets at the threat of tariffs, and more specifically, the uncertainty.

around them. Even with this concession now and the 30 day waiver and the hope and belief that Mexico is going to provide troops and they're not going to go forward, there's economic activity out there that's not happening because people don't know exactly where this thing is going. So it has some uncertainty cost associated with it.

Number four, the president of the United States is as concerned with market response to tariffs as foreign countries are with tariff impact on their economies. So essentially, when you combine those four things, I think it helps inform the way one ought to think about tariffs. Now, when you unpack the data around it all, at one point, 22 percent of China's exports were coming to the United States.

It's now only 15. So we're a lower percentage of their customer base than we used to be, but we're still a significant, you can imagine no business wants to lose 15 percent of their customers. It's not really primarily things like food. So when you look at where food and energy. Are what drive the headline inflation that is most politically problematic.

Tariffs on food and energy are not likely to happen with China. And so there's less of an inflationary risk there, but the lion's share of what we do import from China are in the computer electronic product space. That's about 30 percent of our imports from China. And less so things like chemicals, rubber, Leather, metals, but those things all put together add up to something.

Textile, apparel, clothing, that's 10%. You know, electrical equipment, which is different than electronics and computers. Electrical equipment's another 12%. So those are the categories that are more pertinent. But then Mexico has become our largest trading partner in terms of who we import from. They were about, I believe 10% just a decade ago, and now they're 15% of our imports.

So they've increased their share a lot while China's come down, but 50 percent of our motor vehicle imports, which is largely parts and components, come from Mexico, China, Canada, the three countries together, which is mostly Mexico and China there. With Canada, by the way, it's largely energy. Oil and gas is 25 percent of our imports, 18 percent are transportation equipment. There's negligible relevance with Canada on computer, electronic and all that. So, you know, definitely with Mexico, the largest is the automotive side, 34 percent of imports are transportation oriented. But the thing I wanted to point out is from a stock market standpoint, The MAG7, those big huge tech names that are such an important part of the S&P, they're currently 55 percent seven names of the Russell 1000 index, the growth index, and 34 percent of the S&P 500, seven names, and They have virtually no revenue relevance with Mexico or Canada at all, but a significant amount with China.

So, you know, there are certain sectors, certain companies that are more impacted if some of these things were to happen than others. But again, the issue that I want to share with you, that I know is subject to people pushing back on, because these people will give me an opportunity to look bad. So please hear me out.

I believe Secretary of Treasury, Scott Bessent, is a free trader at heart. and Mind, who knows that tariffs are a cost on the U. S. economy. I believe Kevin Hassett, the National Economic Council Chair, believes that. I believe that Stephen Moran, the Chair of the Council of Economic Advisors, believes that. And so, I believe all three will, on occasion, In the moment and somewhat understandably for circumstances that I hope you can get, we'll have to say things that sound a little bit more economically nationalistic.

We'll say things that have to sound a little more protectionist, but that I do think they know that trade offs are at the heart of all economics. They are the crux on which economics turn and that there are trade offs involved with tariffs. What do I mean by trade offs? It's the reality of scarcity.

Economics is the allocation of scarce resources and this is really what all you need to know about economics is that human beings are out acting and reasoning around this law of scarcity and they're allocating resources because of the reality of scarcity and they're trade offs. You have to get rid of something to get something.

And with tariffs, I think that there are people who fall on my side of this issue, which is that how do I say this? Tariffs come at a big cost, and it is not worth it. There are some who believe tariffs come at no cost at all. They are the people who should most be ignored. There are people who believe tariffs come at a cost, but it is worth it.

And then there is the political moment now, where It's not really so analytical. It's not really so philosophical. It's, you know, let's throw it out there now, see what happens. Adjust. It's a little more chaotic. And I disagree with those who believe we can implement 150 billion of tariffs and that the cost will be worthwhile to some other agenda, but I at least think they're intellectually honest to acknowledge the cost.

My intent here is to say that the cost is significant. Now, people will say. But what about 2018? It didn't seem like things were that bad and look how good the economy was in 2019. However, it was a very minimal amount of tariffs with, and I put links all through Dividend Cafe for you to see this for yourself.

I didn't go to left wing press. I didn't go to right wing press. I didn't go to commentary. I put the U. S. trade representative governmental page. There were so many exceptions and exemptions. There were 27 billion of subsidies given to the farmers who were hit hardest by the retaliatory tariffs. The 2018 case is proof of my side of this issue.

Their costs to the tariffs were so high that they did everything they could to avoid the cost. The cost of the tariffs because of the inevitable retaliation was so high they went and had to go have taxpayer fund subsidies to help the people most negatively impacted. So there cannot be any serious denial that there were costs and as you see in the chart of the week in Div Cafe the domino effect of it all took down ISM manufacturing in the U.S. and it stayed down. And so I do believe that the 2018 analogy is very disingenuous, but I also would just point out the magnitude of it is such that we don't have any kind of apples to apples analogy. I don't know if I need to be making this point because my earlier point that President Trump number four is very focused on market response point number one, that they're mostly interested in tariff as threats, not tariff as policy.

It largely seems to make a lot of this moot. But I don't think the conversation's going away. I don't think the threats are going away. I don't think the media coverage is going away I don't think the uncertainty dynamic is going away. And so if people are just asking do you really think there would be this sort of response?

I think it's very much worth pointing out that I do and the answer is the reason for that is no more complicated than the obvious fact that taxes tariffs or taxes and it come at a cost and To the extent someone says yeah, but it does something we like You Not the threat of it that gets us a better drug deal in Mexico, but the actual tariffs that it protects a certain American actor.

It does not do that without hurting another American economic actor. And that's the problem, is I would love to be able to make this point by demonstration, but we can't, it's non falsifiable. The claims that the tariffs have no cost is non falsifiable if they never happen.

People ask me, are you petrified? Do you think you go to global trade war? You think these things could be so, you know, complex and problematic and downward pressure on economic activity and animal spirits? First of all, I do believe a course correction would be quick if something were to fully happen. I don't know if it'd be as quick as Monday, you know, that lasted about five minutes.

But again, that wasn't done from the vantage point of we're gonna go use tariffs for revenue. We're gonna go use tariffs for trade policy. It was done from the vantage point of we're gonna go extract border security. Once they got that victory and whatever rate are one to 10, you want to give the victory.

Once that was done, it moved on. Should we go forward with a full blown situation? I stand on the side of the invisible effects being problematic. That's not to say I don't acknowledge there would be visible effects. Some may believe it would help protect a certain economic actor, but the assumption that exporting more than we import.

would be good. And the better way to put it is that importing more than we export is bad, is itself an economic fallacy. I think it's usually a well meaning one. I've met some people that know better that say it anyways, and I think they're intellectually dishonest. But for the most part, I think people are coming at this from a good place, but it's really problematic.

Good intentions don't help. It is not true that to import more than you export is a bad thing, but regardless, when one manufacturer in the United States benefits from us hurting a foreign competitor with tariffs, I do believe the price goes on to American consumers, but I also believe retaliatory tariffs hurt other U S based manufacturers that are in the business of exporting goods.

So you're just picking winners and losers. You're not there's no option on the box that you're checking a win for actor US economic actor A and a win for US economic actor B. There's not that option. And because of trade offs now I do want to say that having a national policy framework that avoids any kind of supply chain dependency that is relevant to national security.

Vital goods and services from the national health, the national defense, pharmaceutical, there's all kinds of things out there that involve a lot of complexity and nuance that don't involve tariffs and are not rooted in. Let's go pick a winner or loser in the economy. So this is not to say that there is not room for some national policy around national security.

However, that is just simply not what's happening here. Are all these tariffs really on the table now? I don't think so. Will there be a Enhanced volatility, like we saw with this Mexico Canada thing again, maybe will there be one when we get around a more substantive deal with China?

I think there will be, I don't think this is done. Markets though are the great mediator and the president of the United States cares about markets. And some can say he shouldn't, some could say he should, and some could just say he does. That's my view. And so I think there's a lot of competing voices in the president's ear.

Okay. I think that there will be up and down movements, not just in the way the press covers it and the way markets respond, but in the actual flow of consideration in the Oval Office. I think that's just something that's been kind of embedded into the reality of this particular president, for good or for bad.

Ultimately, it's my belief, societies get wealthier when they freely exchange more, not less. And, I believe that those who disagree with that statement have a privilege that many don't have. Which is, their theory doesn't have to be case tested in the real world. At least, not yet, thank God. Thanks as always for listening to, for watching, and for reading The Dividend Cafe.

I do, by the way, believe there's other additional questions that might exist about tariffs. I wanted to keep this simple enough to focus on market considerations, what the framework is we're in now, where I see things going, and I've tried to do that in as simple and succinct a way as I could. But if people want to ask about IP theft, if people want to talk about unfair trade deals, whatever that means, if they want to talk about how our founding fathers used tariffs comparative analysis of a tariff system versus income tax, I'm open to all those questions.

And if I need to do a part two on this, I will. We'll see what the feedback is, questions at thebahnsengroup. com, but it also may be that you guys are as exhausted by this topic as I am, so we'll see where it goes. It's a political moment, it's a noisy moment, we're in early stages of a new administration, lots to go here, but I stand by the reasoning I presented to you today around both my view of the tariff subject, but also what we should expect in markets now and expect in terms of the real machinations of this administration.

Thanks again. Have a wonderful weekend. We'll see you again next week in The Dividend Cafe.
