INVESTMENT UPDATE

March 28, 2018

War! What Is It Good For?

The classic anti-war song of the 1960s performed by Edwin Starr for Motown records was intended as a protest against military conflict during the war in Vietnam. The singer's bold and definitive conclusion that war is good for "absolutely nothing" is equally applicable to the misguided policy of trade wars. Yet here we are in the early days of this exact policy blunder, which has been condemned as shortsighted and destructive by virtually every economist, political scientist, business leader, and elected official — save one: President Trump.

As we look out over the next year at possible events that might disrupt the current bull run in global equities, an escalating cycle of tariffs levied on goods imported into the United States followed by retaliatory punitive actions by its trading partners is high on our list of concerns. A trade war is indeed good for nothing except possibly allowing the President to brag about how effective he is at implementing his campaign promises.

The reality of trade wars is that they are extremely destructive and costly for all players involved. The global economy is a complex system that has evolved over centuries to be a utility-maximizing and cost-minimizing machine. There is a very good reason why low-tech manufactured goods tend to come from China: they have an abundance of workers willing to perform their tasks at a much lower rate of pay than western workers. Likewise there's a very good reason Canada exports so much electricity-intense aluminum: they have abundant hydro-electricity and the infrastructure necessary to produce the metal. Similarly, the U.S. has a high concentration of top-tier schools and a large, diverse, educated, and entrepreneurial population. It makes perfect logical sense for the U.S. to be the power center of the technological revolution. If the global supply chain were to be disrupted, as occurs in a trade war, and each country had to produce what the other countries can do more cheaply and more efficiently, the end results would be declining productivity, rising costs, and weakness in global economic activity. Just how much the global economy deteriorates would depend on the breadth and duration of trade restrictions. Recent global equity market weakness is a signal that earnings would be negatively impacted should trade tensions continue to escalate.

One of the closing lyrics of Edwin Starr's great song says: *"Peace, love and understanding. Tell me, is there no place for them today? They say we must fight to keep our freedom. But Lord knows there's got to be a better way."* We at Zevin Asset Management believe cooler heads will prevail and the "better way" will be recognized. Our base-case outlook is for tensions to simmer down. Thoughtful diplomatic trade negotiations in response to the severe negative economic and financial outcomes of a trade war are likely to resume. That said, we also recognize there is a non-trivial possibility of prolonged destructive trade conditions. One of the founding principles of Zevin's investment process is to plan for the unlikely and as such, we are considering how best to protect clients' portfolios by analyzing assets, regions, and industries likely to be least affected by a prolonged trade war.

Philip Hergel, Senior Quantitative Analyst
on behalf of the Investment Committee

11 Beacon Street, Suite 1125, Boston, MA 02108 • www.zevin.com • PHONE 617-742-6666 • FAX 617-742-6660 • invest@zevin.com