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Proactive Investment Management & Financial Planning

Global Perspectives, March 2018: U.S. International Trade and the Challenge of Globalization

International commerce has been all over the news recently, as President Trump started to act on his campaign promises to get tough with U.S. trading partners and lower the country's trade deficit. It's therefore an especially good time to review the basic parameters of U.S. trade in 2017, and to dive more deeply into what's driving the trade deficit. We also want to examine the implications for a particular aspect of investing.

Exports, Imports, and the Trade Balance

Based on preliminary data from the Census Bureau, U.S. exports in 2017 had a total value of some \$2.329 trillion. That means that, on average, U.S. entities sold some \$6.4 billion worth of goods and services to foreign buyers every day of the year. The value of exports in 2017 was 5.5% greater than in 2016, reversing the decline in the previous year and slightly beating the average annual increase of 4.7% over the last two decades. Physical goods accounted for almost exactly 2/3 of U.S. exports in 2017. The trade data for goods is quite detailed, and the figures show the top destinations for U.S. goods exports in 2017 were Canada, Mexico, and China (see Table 1). Exports of services (such as royalties earned from foreign manufacturers or insurance policies sold abroad) made up 1/3 of exports last year, but it's harder to get firm data on them. However, we suspect the main destinations for U.S. service exports last year were similar to the destinations for goods exports.

Table 1.

U.S. Goods Exports: Top Ten Destinations, 2017

Source: U.S. Bureau of the Census

Country	Export Value (Bil. \$)	Share of Total Goods Exports
Canada	282.4	18.3%
Mexico	243.0	15.7%
China	130.4	8.4%
Japan	67.7	4.4%
United Kingdom	56.3	3.6%
Germany	53.5	3.5%
South Korea	48.3	3.1%
Netherlands	42.2	2.7%
Hong Kong	40.0	2.6%
Brazil	37.1	2.4%

The Census Bureau data show the value of U.S. imports came to \$2.895 trillion in 2017, equal to about \$8,880 for every man, woman, and child residing in the country. The value of U.S. imports last year was some 6.7% higher than in the previous year, compared with an average annual increase of 5.3% over the last two decades. In contrast with exports, U.S. imports are heavily skewed toward goods. Physical merchandise accounted for more than 4/5 of all U.S. imports in 2017. As shown in Table 2, China was by far the biggest source of U.S. merchandise imports last year, distantly followed by Mexico, Canada, Japan, and Germany.

Table 2.

U.S. Goods Imports: Top Ten Sources, 2017

Source: U.S. Bureau of the Census

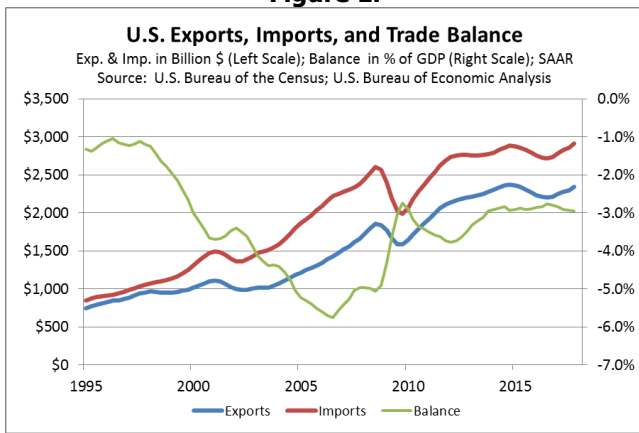
Country	Import Value (Bil. \$)	Share of Total Goods Imports
China	505.6	21.6%
Mexico	314.0	13.4%
Canada	300.0	12.8%
Japan	136.5	5.8%
Germany	117.7	5.0%
South Korea	71.2	3.0%
United Kingdom	53.1	2.3%
Italy	50.0	2.1%
France	48.9	2.1%
Ireland	48.8	2.1%

With its exports more than offset by its imports, the U.S. trade balance last year showed a deficit of \$566.0 billion, widening from the deficits of \$504.8 billion in 2016 and \$500.4 billion in 2015. Excluding the surplus in services, the deficit in physical merchandise was even bigger, at \$862.7 billion in 2017. Those are certainly big numbers, but not so much when compared with the size of the U.S. economy (as measured by gross domestic product, or GDP). Total U.S. exports only amounted to 12.0% of GDP last year, while total imports only came to 14.9%. That means international trade is a much smaller part of the economy in the United States than in most other major countries. Moreover, as shown in Figure 1, the U.S. trade deficit last year was equal to only about 2.9% of GDP, meaning it was narrower than the average deficit of 3.7% of GDP over the last two decades and only about half as wide as its peak of 5.6% of GDP in 2006. Since

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the U.S. investment environment remains very attractive to foreigners, we believe the current U.S. trade deficits can be easily financed by foreign investors buying U.S. stocks, bonds, and other assets.

Figure 1.



Why the Trade Deficit Has Widened

Although current U.S. trade deficits are too modest to cause big economic problems right now, that doesn't mean they haven't contributed to disruptions over the last few decades. Trade trends certainly have created problems for particular industries and communities. In order to understand those impacts, it might help to first examine why the trade deficit has expanded over time and what's driving it now.

In our view, a lot (but not necessarily all) of the trade trends in recent decades reflect free-market policies advocated by some politicians, corporations, and economists. The cornerstone of those policies has consisted of bilateral and multi-lateral free-trade deals like the North American Free Trade Agreement (NAFTA) of 1994, which lowered or eliminated tariffs and other trade barriers between the United States, Canada, and Mexico. The economic theory behind these deals was that if international trade could take place without the distortions of tariffs, import quotas, artificial inspection requirements, and the like, then eventually each country would start to focus more strongly on its most competitive industries. Freed from the constraints of artificial trade barriers, the country's most competitive companies would grab global market share, increase investment, and boost hiring. The country's less competitive industries would lose sales to foreign rivals that could produce better or cheaper goods and services. That was considered an acceptable trade-off because consumers would benefit from lower prices and more choice, while the workers laid off from weaker industries would presumably find new employment with the stronger, more competitive firms.

We wholeheartedly subscribe to the notion that well-functioning free markets should help boost a country's efficiency and raise living standards over time, but it now seems clear that many workers and communities have had trouble adjusting to the increase in international competition that arose from free-trade deals. To make matters even more challenging, the impacts from dismantling trade barriers were reinforced by other aspects of globalization. For example, falling energy prices made it cheaper to transport supplies across the globe, while new communications technologies made it easier to manage global production chains. What's more, all these changes happened just as large, developing countries such as China, India, and Russia were undergoing economic reforms and itching to join the global economy again. In sum, free trade and globalization have created "diffuse gains" (lower prices and increased supply for everyone) but also "concentrated pain" (for instance, job losses for steel workers in the Midwest and furniture makers in the South). Anger over such concentrated pain may have contributed to the populist political trends of 2016 and the election of President Trump.

U.S. Trade by Industry

To a significant extent, some countries have violated the agreed bilateral and global trade rules. A prime example is China, which has provided big subsidies to certain companies so they can charge lower prices, even as it has dragged its feet on lowering import barriers and extortionately pressured foreign companies to share their technology in return for permission to operate in the country. Nevertheless, we think the free-trade policies of the last few decades have worked out pretty much as planned. To illustrate this, the Appendix at the end of this article presents a detailed overview of U.S. merchandise exports and imports *by industry*. The Appendix is much more detailed than the tables we normally include in our publications, and we apologize in advance for the small print! Still, we wanted to provide a sense of just how diverse and complex international trade really is, and how different the experiences can be for various U.S. industries. The underlying figures and classification system come from the United Nations International Trade Center (INTRACEN), which we've correlated and checked against the U.S. Census Bureau data. INTRACEN provides data for almost all countries and literally hundreds of very specific trade categories (such as, "air conditioning machines comprising a motor-driven fan and elements for changing the temperature and humidity, including those machines in which the humidity cannot be separately regulated; parts thereof"). We have lightly edited the INTRACEN category descriptions to help clarify exactly what they include.

For the United States – with its vast swaths of prime agricultural land, strong universities and technological prowess, and relatively expensive labor – we think it's logical that the country is most competitive in areas such as grain farming, chemicals, and aerospace, while it is less competitive in the production of relatively low-value, labor-intensive products like clothing, furniture, and toys. With the dismantling of trade barriers, many economists expected the United States to be more successful at the former and less successful at the latter, and that is indeed what is shown by the Appendix. There are multiple ways of measuring an industry's international competitiveness, but as shown in the Appendix, the U.S. industries that enjoy a trade surplus or near-surplus are basically those that theory suggested. For example, the country's biggest trade surplus (at this level of categorization) is in "aircraft, spacecraft, and parts thereof." U.S. exports of these valuable, technologically-complex products exceeded imports by \$100.3 billion in 2017. Looked at another way, U.S. exports in this category were 4.2 times greater than its imports. The second-largest U.S. trade surplus was in "soybeans, hay, alfalfa . . .," where the country was able to export 10.7 times more than it imported and generate a trade surplus of \$24.0 billion.

Generally, the biggest U.S. trade deficits last year were in those industries that theory suggested would be less competitive. For example, the country's biggest deficit was a shortfall of \$182.5 billion in a broad category that includes "integrated circuits, cell phones, and other electronic equipment & parts." The United States did have a trade surplus in certain segments of this category (including a positive balance of \$4.6 billion in integrated circuits). However, it had a huge negative balance of \$79.1 billion in cell phones and other wireless communications equipment, and significant shortfalls in many other electronics categories where U.S. producers can't easily compete with the cheap labor and inexpensive assembly available in Asia. For the overall category, the United States exported only about half as much as it imported. Similarly, the United States had a deficit of \$147.5 billion in "data processing equipment, manufacturing machinery, turbines, etc.," largely because of a negative balance in computers and related goods. In fact, a lot of the U.S. trade deficit came from shortfalls in consumer-related categories. The country had a deficit of \$164.5 billion in "vehicles other than rail rolling stock; parts & accessories thereof," mostly because of a shortfall in autos and auto parts. These three categories alone accounted for more than half the overall U.S. trade deficit, while petroleum and other industrial supplies accounted for much of the rest.

Conclusion: The Need to Prepare to Compete

We suspect that many of our readers have seen trade discussions similar to this one, and they may be familiar with the economic and financial implications. For example, we've noted before that it may make sense to invest more heavily in those U.S. industries that are most globally competitive. Here, we want to focus on a more fundamental question that applies to everyone, investor or not: How do I prepare myself to compete in today's globalized economy? How can I survive and prosper when foreign workers are increasingly able to compete with me? Our basic idea is that U.S. workers cannot "compete on price" against the millions making only a few dollars a day in places like China and Vietnam. Rather, U.S. workers must accept that they have to compete on quality and innovation. In other words, they must raise their skill level to the point where they can produce goods and services so highly valued that they can't be produced abroad. This is certainly true for factory workers producing tradable goods, but we think it also applies to many service workers. After all, note that your latest X-ray may have been interpreted over the internet by a radiologist in India!

One implication of this is that U.S. citizens must put increased focus on education, training, and skill development. For parents and educators, we think it's essential to work even harder to cultivate a sense of direction in their kids and an expectation that they will have to invest in some kind of advanced skill building, whether at the college level or at a vocational school. For business owners, we think it may be time to consider putting more effort into employee training, especially since the benefits should accrue to them as much as the workers. Finally, for all of us in the workforce, we think it's important to adopt a love of continual learning, constant evolution, and never resting on one's laurels.

Fortunately, education and training is something we can help with here at WMI. Whether you want to explore education-related savings and investments for yourself, your kids, or your grandkids, we can work with you to develop a plan and identify appropriate investment accounts. For each kind of account – education, retirement, or regular – we apply detailed, in-depth analysis of global economic and financial market developments to guide our investment strategies, and we would look forward to using our approach to benefit you and your family as you prepare to compete in the new global economy.

Patrick Fearon, CFA
Chief Investment Officer

Appendix

U.S. Merchandise Exports, Imports, and Trade Balances by Selected Product/Industry

Figures for 2017

Source: United Nations International Trade Center

Product/Industry	Exports (Billion \$)	Imports (Billion \$)	Exports / Imports	Balance (Billion \$)	Export Market #1	Export Market #2	Import Source #1	Import Source #2
Foods, Feeds & Beverages								
Soybeans, hay, alfalfa; other miscellaneous grains, seeds, and	26.5	2.5	10.7	24.0	China	Mexico	Canada	China
Corn, wheat, rice, and other cereals	18.7	2.5	7.6	16.2	Mexico	Japan	Canada	Thailand
Beef, pork, poultry, and other meat and edible meat offal	16.4	8.2	2.0	8.2	Japan	Mexico	Canada	Australia
Residues and waste from food industries; prepared animal fodder	9.6	2.9	3.3	6.7	Canada	Mexico	Canada	China
Milk, cheese, other dairy produce; natural honey	4.5	2.6	1.7	1.9	Mexico	China	New Zealand	Italy
Horses, cows, pigs, and other live animals	1.0	2.8	0.4	(1.8)	Canada	Mexico	Canada	Mexico
Sugars and sugar confectionery	2.0	4.2	0.5	(2.2)	Mexico	Canada	Mexico	Canada
Edible citrus and non-citrus tree fruit, nuts, grapes, melons, etc.	14.9	18.1	0.8	(3.2)	Canada	Hong Kong	Mexico	Chile
Edible vegetables and certain roots and tubers	4.8	10.3	0.5	(5.5)	Canada	Mexico	Mexico	Canada
Coffee, tea, maté and spices	1.2	8.7	0.1	(7.5)	Canada	Japan	Colombia	Brazil
Fish and crustaceans, molluscs and other aquatic invertebrates	5.4	17.9	0.3	(12.5)	China	Canada	Canada	India
Whiskey and other liquor, wine, beer, and other beverages	8.3	24.7	0.3	(16.3)	Canada	Brazil	Mexico	France
Industrial Supplies								
Reagents, catalysts, insecticides, herbicides, misc. chemicals	27.7	13.8	2.0	13.9	Canada	Mexico	Canada	Japan
Raw cotton, cotton yarn, cotton fabric and other cotton products	7.6	0.9	8.1	6.7	Vietnam	China	China	South Korea
Ethylene polymers, resins, polyesters, and other plastics	61.5	54.9	1.1	6.6	Mexico	Canada	China	Canada
Pulp of wood or other cellulosic material; waste or scrap paper,	8.9	3.3	2.7	5.6	China	Mexico	Canada	Brazil
Soap, detergents, lubricating preparations, candles, etc.	7.2	3.4	2.1	3.8	Canada	Mexico	Canada	China
Ores and concentrates (of copper, zinc, iron, etc.); slag and ash	6.0	2.8	2.1	3.2	Canada	Mexico	Brazil	South Africa
Inorganic chemicals; radioactive organic/inorganic compounds,	12.4	11.5	1.1	0.9	Mexico	Japan	Canada	China
Precious metals, precious or semi-precious stones, pearls,	60.4	60.0	1.0	0.4	Hong Kong	Switzerland	India	Israel
Knitted or crocheted fabrics	0.9	1.0	0.8	(0.2)	Mexico	Honduras	China	South Korea
Raw wool, woolen yarn, woolen fabrics; other animal hair	0.1	0.3	0.3	(0.2)	Mexico	China	Italy	UK
Special woven fabrics; tufted textiles; lace; tapestries;	0.5	0.8	0.6	(0.3)	Mexico	Canada	China	Taiwan
Nickel and articles thereof	2.0	2.4	0.8	(0.4)	UK	China	Canada	Germany
Paper & paperboard; articles of paper pulp, paper or paperboard	15.8	16.4	1.0	(0.7)	Canada	Mexico	Canada	China
Lead and articles thereof	0.2	1.6	0.1	(1.4)	Mexico	Ecuador	Canada	South Korea
Zinc and articles thereof	0.4	2.2	0.2	(1.8)	Mexico	Canada	Canada	Mexico
Fertilisers	3.9	6.1	0.6	(2.2)	Canada	Brazil	Canada	Russia
Copper and articles thereof	7.2	10.1	0.7	(2.9)	Mexico	China	Chile	Canada
Organic chemicals	36.2	46.1	0.8	(9.9)	Mexico	Canada	Ireland	China
Wood and articles of wood; wood charcoal	9.7	21.1	0.5	(11.4)	China	Canada	Canada	China
Aluminium and articles thereof	11.6	23.4	0.5	(11.8)	Mexico	Canada	Canada	China
Iron and steel	16.1	28.8	0.6	(12.8)	Canada	Mexico	Canada	Brazil
Rubber and articles thereof	13.4	28.0	0.5	(14.6)	Canada	Mexico	China	Thailand
Articles of iron or steel	18.4	39.1	0.5	(20.7)	Canada	Mexico	China	Mexico
Petroleum oil & gases, coal, other mineral fuels & distilled	138.0	204.2	0.7	(66.2)	Mexico	Canada	Canada	Saudi Arabia
Capital Goods								
Aircraft, spacecraft, and parts thereof	131.2	30.9	4.2	100.3	China	France	France	Canada
Railway or tramway locomotives, rolling stock, parts, equipment	3.2	1.7	1.9	1.5	Canada	Mexico	China	Canada
Medical instruments, orthopedic appliances, analytical apparatus	83.6	86.2	1.0	(2.6)	China	Canada	Mexico	China
Tools, implements, cutlery, utensils, of base metal; parts thereof	4.6	10.1	0.5	(5.5)	Canada	Mexico	China	Japan
Data processing equip., manufacturing machinery, turbines, etc.	201.7	349.1	0.6	(147.5)	Mexico	Canada	China	Mexico
Integrated circuits, cell phones, other electronic equipment &	174.2	356.8	0.5	(182.5)	Mexico	Canada	China	Mexico
Autos & Auto Parts								
Vehicles other than rail rolling stock; parts & accessories thereof	130.1	294.6	0.4	(164.5)	Canada	Mexico	Mexico	Canada
Consumer Goods								
Photographic or cinematographic goods	2.2	1.7	1.3	0.5	China	Mexico	Japan	Germany
Tobacco and manufactured tobacco substitutes	2.1	2.2	1.0	(0.0)	Canada	Switzerland	Dom. Rep.	Brazil
Printed books, newspapers, pictures and other printed products	4.4	4.6	1.0	(0.2)	Canada	UK	China	Canada
Industrial vessels; warships; yachts & other sport/pleasure boats	2.2	2.6	0.8	(0.4)	Canada	Mexico	Mexico	Italy
Essential oils & resinoids; perfumes, cosmetic or toilet	12.9	13.6	1.0	(0.6)	Canada	Mexico	France	Ireland
Clocks and watches and parts thereof	1.4	4.9	0.3	(3.5)	Hong Kong	Switzerland	Switzerland	Japan
Footwear, gaiters and the like; parts of such articles	1.4	26.6	0.1	(25.2)	Canada	Vietnam	China	Vietnam
Toys, games and sports requisites; parts and accessories thereof	6.9	32.7	0.2	(25.8)	Canada	Mexico	China	Mexico
Apparel and clothing accessories, not knitted or crocheted	2.3	37.8	0.1	(35.6)	Canada	Mexico	China	Vietnam
Apparel and clothing accessories, knitted or crocheted	2.7	45.8	0.1	(43.1)	Canada	Mexico	China	Vietnam
Pharmaceutical products; bandages, gauze, and wadding, etc.	45.1	96.4	0.5	(51.4)	Belgium	Netherlands	Ireland	Germany
Furniture; bedding and similar stuffed furnishings; lamps	10.8	67.2	0.2	(56.5)	Canada	Mexico	China	Mexico
Other								
Arms and ammunition; parts and accessories thereof	5.4	3.0	1.8	2.4	Saudi Arabia	UAE	Austria	Italy
All physical products/industries (i.e., excludes services)	1,546.7	2,409.5	0.6	(862.7)	Canada	Mexico	China	Mexico

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