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I hope you and your family had a fun and safe 4th of July!

Tariffs – What They Are and How They Work

I'm not sure it's possible to even breathe these days without hearing about tariffs, retaliatory tariffs and an escalating trade war. What is a tariff? How do they work in a global economy? Does anyone benefit? Let's look at tariffs from purely an economic theory perspective… we're not touching politics on this one.

What's a tariff in the first place? A tariff is a fee assessed on an imported good – a good coming into a country. Let's see what happens when the lovely little country of Annavania levies a tariff on widgets being shipped into Annavania from abroad. Tariffs can be calculated in several ways but for simplicity, let's assume a per-widget charge that has to be paid to the Annavanian government customs agency by every foreign corporation that brings widgets across the border for sale.

Assume that Annavania has some capacity to make widgets but it's certainly not enough to meet the demand for widgets inside Annavania. After all, widgets are a very popular product. Also assume that compared to the global market, the production of Annavanian widgets is so small that Annavanian companies have to sell widgets at the same price that foreign companies sell widgets to Annavania. It's not economically wise to undercut the price and if they charge more, Annavanians will simply buy the foreign widgets.

Without tariffs, the cost of a widget globally is $200. At this price, Annavanians are willing to buy 400 widgets. However, at this price, Annavanian producers are only willing to manufacture 100 widgets because their profit is maximized at that point. Therefore, foreign companies will happily export the other 300 widgets and Annavanians will happily buy them. (For those who didn't sleep through high school economics, this is your basic supply and demand curve.) Everyone's happy!

Wait! There's one enterprising Annavanian producer, Barb. She analyzes her production, costs and the market. If somehow, someway, the price of widgets increased to $250, she could sell more widgets and make more money. But how? How to raise the price of a widget here in Annavania and have Annavanians buy them even though the global price is less? Barb has a friendly lunch with her powerful local politician, shows him her analysis and pleads for help. Low and behold, he exclaims, "Tariffs! Tariffs will do the trick! We'll slap a $50/widget tax on every foreign widget that crosses our borders. Now the foreign widgets will cost $250, meaning that you can charge $250 for our lovely Annavanian widgets too!" Barb's happy, but is everyone else happy?

Fewer Annavanians are willing to pay $250 for a widget regardless of from where it came. Total demand decreases from 400 widgets to 375. 25 Annavanians are unhappy because they are priced out of the widget market. Those 375 who pay the higher price for the same widget are not happy either. Wait? No Annavanian consumer is happy? Nope! Not a single one.

At the higher price, Barb and all the other Annavanian widget makers increase to production to 150 widgets. They are selling 50 more widgets and the per-widget price has increased from $200 to $250. Annavanian widget makers are really happy.

With total demand now only 375 widgets and 150 of them being produced in-country, foreign widget makers are only selling 225 widgets. Sales have decreased so obviously, they're unhappy. Additionally, even though they are selling widgets at the higher $250 price, they have to give $50 to the Annavanian customs agents up front before the widgets even get sold. Less sales… same price... fronting the tariff money before they sell one widget. Foreign manufactures are really unhappy.

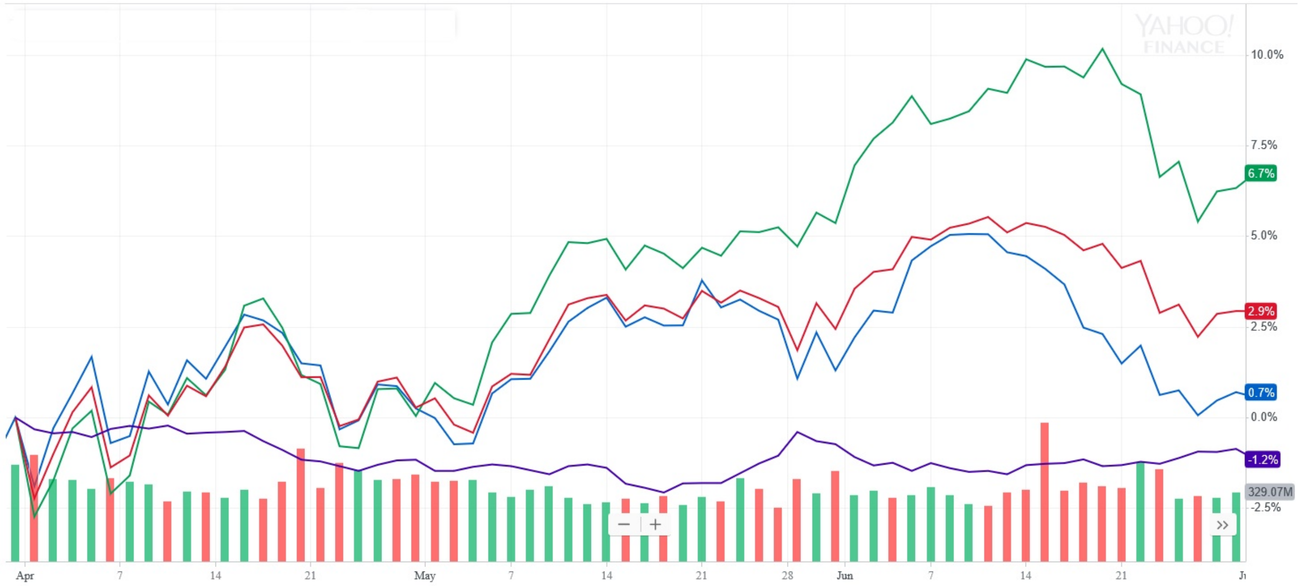
Let's not forget one more player – the Annavanian government's customs agency. For the price of passing one tariff law (I'm betting Barb paid for the lunch), overall government revenue has increased by the tariff amount ($50) times the number of foreign widgets sold (225). The Annavanian government is the true winner here. When we dig deeper, we find that the additional revenue comes almost exclusively off the backs of Annavanian consumers. One potential upside may be that if Barb and the other Annavanian widget manufactures need to hire more workers to produce the additional widgets, employment would be positively impacted. If Barb and her cohorts already had the capacity to ramp up production, there's no impact on employment.

Chances are that the major foreign producers of widgets are not going to take this tariff lying down. It turns out that Annavania is an exporter of dinglehoppers. This means that they manufacture dinglehoppers and send them out to foreign countries to be sold abroad. Guess what item foreign countries just slapped a tariff on? Ding ding ding! Dinglehoppers! And if we follow the whole process again with the glove on the other hand, Annavania ends up selling fewer dinglehoppers on the global market, hurting their revenues, foreign dinglehopper consumers either go without or pay a higher price, and some other foreign government got a little richer. And round and round she goes until all the world has slapped tariffs on all the products traded globally. Inflation ensues for you and I while the taxing governments get richer.

This is the very simplified version of tariffs on the global stage. The strength of global currencies is a factor. It doesn't take into account the fact that raw materials and components flow across borders before a final product can be made. Do you levy a tariff on a foreign company who manufacturers a product inside Annavania? And what about an Annavanian company that has manufacturing facilities outside of Annavania? It doesn't take into account the fact that Annavanian corporations faced with retaliatory tariffs may consider relocating outside of Annavania to minimize the tariff cost, resulting in a substantial negative impact on employment in Annavania? Frankly, it's a messy game that once started, every country gets sucked into and no one wins except the taxing entities.

2nd Quarter 2018 Market Performance

Index	*6/30/18 Ending Value*	*2Q 2018 Performance*
Dow Jones	**24,271.41**	**0.6%**
S&P 500	**2,718.37**	**2.9%**
NASDAQ	**7,510.30**	**6.3%**
Lehman Aggregate Bond	**106.32**	**<0.8%>**



Your Individual Investment Reports

The following reports for Year-to-Date 2018 are provided for your review:

- ***Year-to-Date 2018 Portfolio Performance*** – Compares the month-end percentage performance of the S&P 500 & Lehman Aggregate Bond Index with your portfolio performance.
- ***Year-to-Date 2018 Portfolio Performance & CPI*** – Performance of your investment portfolio compared to the rate of inflation as measured by the Consumer Price Index (CPI) for both the since inception period of your accounts and Year-to-Date 2018.
- ***Asset Summary*** – Current market value of each asset within your accounts as of 6/30/18
- ***Investment Billing Statement*** for the 3rd Quarter 2018**: Investment advisory fees for the period of 7/01/18 through 9/30/18 (based on 6/30/18 values). *This is an informational billing only.* Your account is automatically debited unless other arrangements have been made.

Please remember that this investment reporting is for informational purposes only. You should also refer to the monthly account statements you receive from TD Ameritrade Institutional.

If you happen to know anyone who might benefit from the services I provide in assisting you in managing your investment portfolio and reaching your financial goals, I would enjoy speaking with them. Don't keep me a secret! ☺ And as always, please do not hesitate to contact me if you have any questions about your reports or wish to discuss any other financial matters.

Sincerely,

Anna M. Popke, CFP®, RICP®

*Index performance is provided as a benchmark only. The performance of your individual investment portfolio will vary from that of any one index. Past performance of an index is never a guarantee of future results.

****PLEASE NOTE:*** Clients who hold "cash reserves" within their brokerage accounts will have slightly different portfolio balances depicted on the Statement of Assets Summary and the Billing Statement. This is because "cash reserves" are excluded from the advisory fee. However, cash held awaiting investment in the upcoming quarter *will* be subject to the normal quarterly fee.

Investment Advisory Fee Calculations:
Fees are paid in advance on the 7th (or prior closest business day) of the month following the end of the quarter. The amount due is calculated by applying the prorated annual fee percentage to the previous quarter-end account value(s). Fees are further prorated for accounts opened after the beginning of a new quarter. Fees may be paid directly from the investment account(s) or consolidated and paid from a specified account. Money market/cash reserves are excluded from totals. Statements have been prepared by Majestic Oak Financial from information provided by TDAmeritrade and while deemed reliable, are not guaranteed.