

November 2018

# Princesses, Trade Wars and Other Fearsome Things

by TriLake Partners' [resident pumpkin carver](#)

While their president is busy scaring the rest of the world, Americans scared each other. Not by their political views or mid-term election voting or sheer number of guns and ammo or lack of retirement savings. On Halloween night, Americans donned costumes to celebrate what once was the Celtic harvest festival of Samhain. Canadians are harvesting something else these days but we'll save that for a future newsletter.

If projections published by the National Retail Federation are correct, Americans will have spent an average of \$86.79 on costumes, candy, decorations, greeting cards and new bedsheets to replace those sacrificed as costumes this year. The expected \$9-billion total spend is the second-highest in the 14-year history of the NRF survey and highlights the elevated consumer confidence going into the holiday season.

Check out the most popular costumes this year:



Overheard at the playground:

Jessica: So George, what did you wear for Halloween this year?

George: I was a vampire statistician. You?

Jessica: I was a princess.

George: Yeah, you and 7.6% of American kids.

Jessica: Mommeeeee!!!

We could analyse the NRF poll further for more insight into the cultural Zeitgeist or for more cheap jokes but this is an investment newsletter (and a very late one, says my boss). So we take this occasion to talk about a few fearsome things that give us the creeps, lie under the bed, wait in dark alleys and compel us to check security prices every other minute. It's not your friendly neighbourhood Spider-Man in that dark alley.

**WASHINGTON GRIDLOCK.** The capital markets have never had much difficulty when the Oval Office, the Senate and the House of Representatives weren't controlled by the same party in the past. That past of course includes a more civil and bipartisan era when lawmakers made compromises to get things done. Dogmatic purity and polarised tribalism get in the way nowadays but maybe, just maybe, a man unburdened by any true dogma can broker some cooperation. Nothing under the bed, dear. Go back to sleep.

**TRADE WARS.** At the beginning year, hardly anyone thought that Trump & Co. would actually push the US-China trade skirmish to its current level. Every Economics 11 course taught the perils of tariffs and quotas and the win-win benefits of free trade which the Republicans had espoused for, like, ever. A Democratic House doesn't promise any relief; they have traditionally been more open to protectionism than the other side.

So maybe this is really about much more than unfair trade practices and intellectual property. After all, if it weren't for the messenger, the G4 may have fallen in line behind that message. Maybe this is an attempt at Chinese containment at the fabled end of the American Century. In this corner, America is the world's most [competitive country](#). Opposite, China is the world's fastest growing country both in economy and influence. In my deeply humble I-am-not-worthy opinion, it's too late to contain China, masters of the long game. They'll gladly buy more soybeans from the US and curb technology transfer requirements now while they quietly install ICBC ATMs in the South China Sea. China's ascendance over the US is a loooong way from here. China doesn't have the same depth of international alliances that the US has. America's openness to immigration keeps its working force

vibrant. And America's globalist liberal values built the current world order out of the ashes of World War II, values that many countries still admire and aspire to. Allies, immigrants, values. Yes, trust this administration to nurture those advantages. Or maybe accumulate Tencent below HKD300.

**RISING INTEREST RATES.** Yikes. Since you find interest rates somewhere in the denominator of valuations, the net present value or the price of a security should, *all else held equal*, fall when those interest rates rise. Low interest rates have buoyed security prices in an ocean of liquidity for most of the past decade. Warren Buffett has famously said, "You only find out who is swimming naked when the tide goes out." For Pete's sake, this newsletter is rated PG! Put some shorts on! Shorting however take some skill so don't DIY if a delta hedge has you reaching for the pruning shears. Nevertheless, more optionality and flexibility is a good idea for any investment portfolio now.

So far the US Fed is ahead of the other major central banks in the tightening cycle. We can't say that interest rates are not supportive of markets at their current levels. The Fed is reaching for that unknown neutral rate where inflation and real GDP growth hold steady and everyone finally quits parsing every single word in the minutes of the Open Market Committee meetings. The fear appears to be the kind of central bank policy overshoot that we've seen before.

More importantly, not all else is held equal, and the numerator of valuations – earnings growth, roughly -- can and usually does grow for good companies in a healthy market economy. So even when the interest rates in the denominator rise, asset prices can hold steady or even grow if the capitalist impulse continues to propel corporate earnings. But when investors' expectations for earnings growth get lofty—perhaps we see a potential Netflix subscriber everywhere we look or we expect Amazon's cloud-based drones to soon deliver Korean cosmetics, electric cars and legalised cannabis (same day! for free!!)—even if I struggled with fractions in the fourth grade, I know that a decreasing numerator and an increasing denominator will result in lower asset values.

**CLIMATE CHANGE.** Mommeeeee!!!

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