AUCTUS ADVISORS

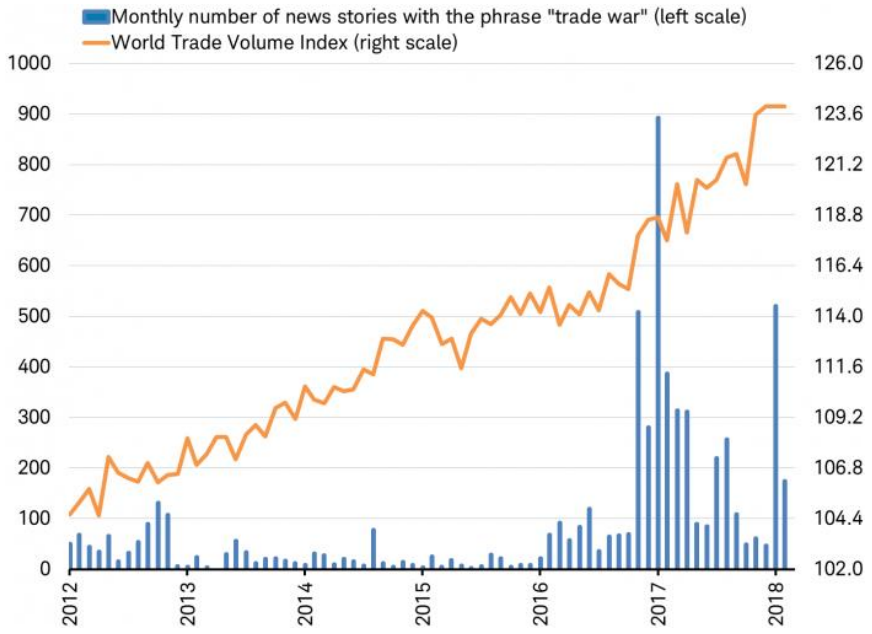
The Intelligent Investor—March 2018

Recent Developments:

Upon President Trump's announcement that he plans to impose a 25% tariff on steel and 10% on aluminum, stocks gave up about half of their recovery from the correction in early February. Although it is always unsettling to see the market go down, this does not necessarily mean we are headed for a trade war. What we do, however, anticipate is more volatility resulting from significant global trade friction.

While the steel and aluminum tariffs may be relatively insignificant from an economic standpoint, they are important on a symbolic level. The announcement caused market participants to worry that this was foreshadowing for a greater global trade war with broad negative consequences for economic growth and corporate profits.

There have been a lot of news stories over the last eighteen months that indicated a potential trade war; however, as evidenced in the chart below, trade volume growth has steadily increased. What does this tell us? The possibility of a trade war has NOT slowed trade growth…yet.

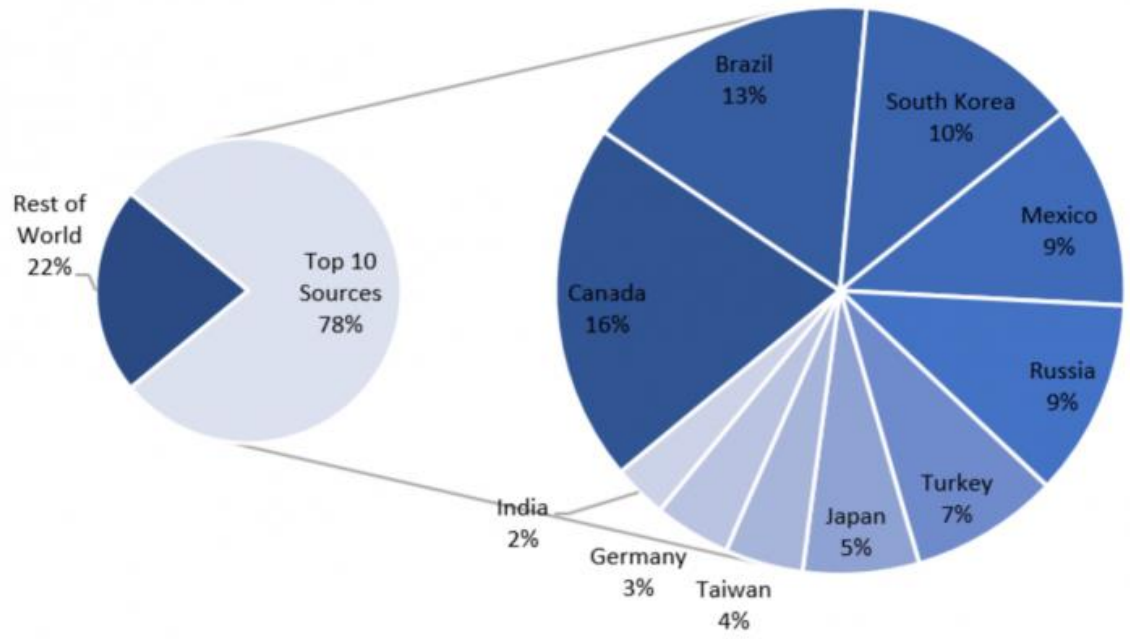


Source: Charles Schwab, Bloomberg data as of 3/3/2018.

We see this statistic as good news; however, we do want to minimize the impact of shifts in world trade. Given that total world trade is equivalent to more than half of the world's economic output, changes in the flow of the world's goods can have a large impact on the world economy and global earnings.

Retaliation

The main focus on retaliation thus far has been China, but China has made no specific promises of how (and if) they will retaliate to the metal tariffs. The US ranks 26th on the list of countries China exports steel to, but in the last several months, the Chinese press has identified measures the government could take in response to US trade tariffs. Looking at US steel imports, China does not even make the top ten here in the US. Canada tops the list at 16% followed by Brazil and South Korea. Let's take a look at some potential retaliation from a few countries that makeup the majority of the US steel imports.



Source: U.S. Commerce department. Data is year-to-date as of September 2017 (most current data available as of 3/3/3018).

Canada: With the Trump administration citing national security reasons as the catalyst for these tariffs, NAFTA does not provide any protection from the tariffs. It is possible, however, that exemptions for Canada may emerge as part of NAFTA negotiations.

Brazil: As the second largest steel supplier to the US, Brazil has signaled they may target US coal exports in retaliation. Although metal production makes up roughly 10%

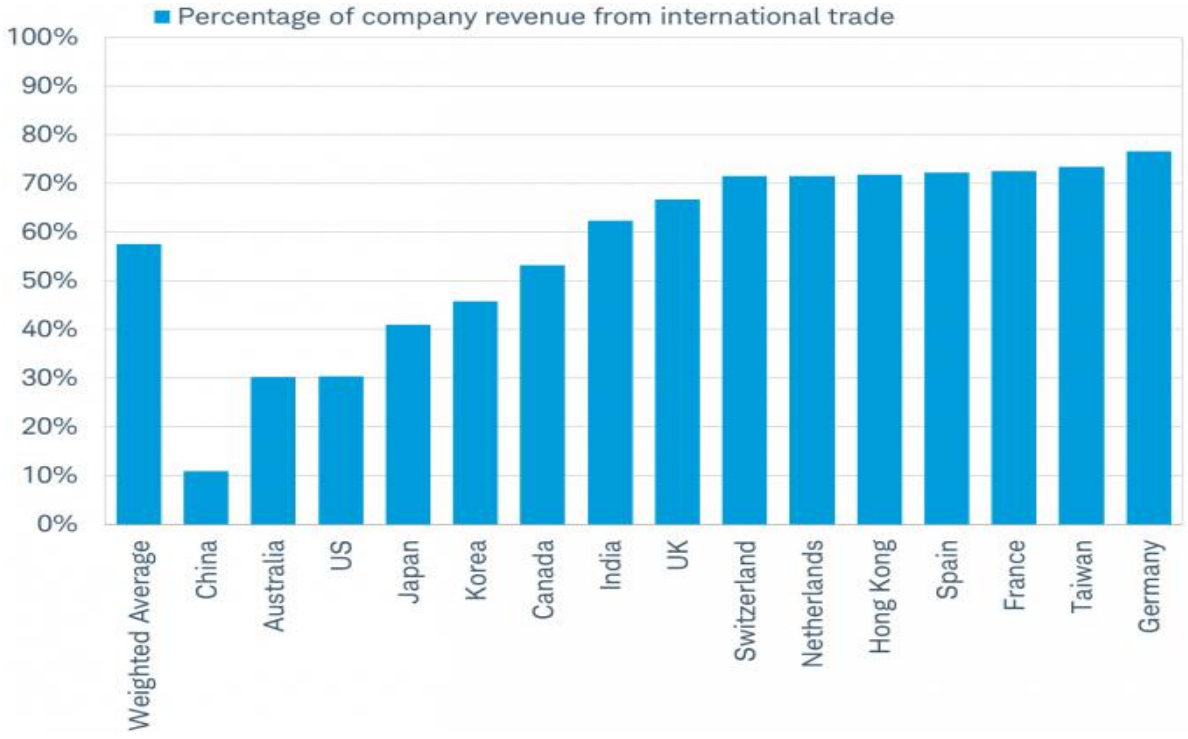
of Brazil's stock market, the Brazilian economy is in recovery and will not likely be derailed by these tariffs.

South Korea: Comprising 10% of the US steel imports, South Korea has promised to make a formal complaint to the World Trade Organization in response to these tariffs but has not made any specific retaliation plans. South Korea's economy is tied much more to technology than metal production and will, therefore, not be hugely impacted by these tariffs.

Germany: Germany is the only EU member to make the top ten list. As a part of the EU, Germany (along with other members of the EU) may get an exemption from the national security tariffs. If not, EU leaders have vowed to file a complaint with the WTO and to retaliate by focusing on US agricultural products as well as Harley Davidson, bourbon, and blue jeans.

Mexico: Of all of the top ten suppliers, Mexico may have the most riding on its trade relationship with the US. Mexican officials indicated they may retaliate but have not discussed specifics. Mexico is a large importer of US agricultural products and machinery.

While the metal tariffs are relatively limited in scope, if these tariffs do indeed lead to the start of a broader trade war, the average company in the MSCI AC World Index faces significant risks to profits given that more than half of sales come from international trade. Not all countries, however, will be impacted equally. The chart below details how stock market trade exposure varies by country.



War or Peace?

In conclusion, it is important to understand that global trade frictions can have a real impact on markets and may begin to weigh on stocks, especially on emerging market stocks. The metal tariffs alone do not constitute a trade war, but they certainly aren't calling for "trade peace" either. The uncertainty surrounding the tariffs will likely leave markets on edge and prone to volatility as we anticipate retaliation that may result.

In Conclusion

We believe the recent volatility was a healthy reminder to us all that it is imperative to have a long-term investment plan in place. This plan is complimented by short term tactical moves that can help increase return and/or lessen volatility. We were able to take advantage of a lot of this volatility and position portfolios for success.

As always, we are honored and humbled that you have given us the opportunity to serve as your trusted advisor.

Sincerely,

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