Uncertainty. Uneasiness. Unpredictability.

Pine Haven Investment Counsel, Inc. – Commentary –1st Quarter 2018
By Kori Allen, CFP® and Paige Johnson Roth, CFA®

Volatility in the financial markets returned in the 1st quarter. Many days saw sharp movements up or down, in a fashion described by one astute observer as a "bunny" market - a market that's hopping around all over the place. Despite the magnitude, in terms of points dropped, the percentage changes have actually returned to a normal level. The last couple of years have had an unusually low level of volatility.

The euphoria of the month of January was replaced with a fickleness which coincided with an increase of economic uncertainties. Most of the early gains, attributed to enthusiasm over the tax cut package and anticipated momentum for the economy, have been wiped out. Regardless, the US and global economies have been and continue to be strong. Emerging economies are especially robust and this includes the largest: China.

As you well know, the financial markets don't like uncertainty. Increasing global tensions have led to more doubt. The primary focus of the markets, recently, has been China and trade tariffs. The trade spat between the US and China started with US imposed tariffs on imported steel and aluminum and has been threatening to turn into a full-fledged trade war.

Free trade is important to economic fortunes because it lowers friction; enhances choice; and improves efficiency. Similar to traditional wars, trade wars have some parallels in that they are hard to predict, have collateral damage and unintended consequences. It is also important that countries play by the rules agreed upon and managed by the WTO (World Trade Organization): don't dump products, steal intellectual property and utilize an effective dispute resolution system.

President Trump's administration is not the first to attempt to help the steel industry by using tariffs. In fact, tariffs have been tried by most administrations since Nixon in 1969, yet our steel industry remains weak. Tariffs, intended to protect an industry, end up being a tax or surcharge on customers. It is likely that the current tariffs will effect industries requiring steel inputs and components which are not readily or cheaply available in the US. The impact could be seen in wide ranging sectors from carmakers, aerospace, and fuel cell technology. How much of the current discussion is posturing and politicking to appease the American public and how it will affect the economy in the long run is unclear.

One company that has been taking a different tactic with China is Starbucks. As many companies have slowed their ambitions in China, over the last 20 years Starbucks has continued to invest and even bought out its Chinese-based partner in 2017. At the annual meeting in March they devoted a lot of time to discussing the Chinese market. Starbucks is now opening a store every 15 hours in China and creating over 10,000 jobs annually. They currently have just over 600 stores in Shanghai - twice as many as in New York City.

Starbucks continues to support their employees in China, just as they have in the rest of the world. These partners are paid significantly more than average, have health benefits, and stock ownership. They also have an innovative and culturally appreciative program that allows employees to purchase critical care insurance for their parents. Since care of elders in China is so very important, this benefit along with others will allow them to attract passionate and qualified partners.

Just as they changed coffee culture in the United States, they are aiming to do so in China. Starbucks is addressing this lack of coffee culture with more education and opened their second Roastery, a 30,000 square foot emporium, in Shanghai. The Roastery concept is an experiential store focusing on coffee education in a unique environment. Many young people flock to the stores and the Roastery because American brands are seen as aspirational and Starbucks is one of the recipients.

As the trade war escalates, Starbucks, along with other American concerns, may be affected in the short term. However, in the long term, prospects look strong. Chairman Howard Shultz is among most of the world, expecting China to be their largest market in the future.

The underlying earnings and fundamentals of many businesses around the globe remain strong. We expect the markets to continue to be rocky, but hopping along. This volatility may provide some good buying opportunities. We continue to find it helpful to focus on businesses such as Starbucks, when things get wobbly. Understanding their long term focus and strategy enables us to stay the course while markets oscillate.

"The only thing that makes life possible
is permanent, intolerable uncertainty;
not knowing what comes next."
– Ursula K. Le Guin

*The mention of Starbucks is for illustrative purposes and is not a solicitation nor recommendation to purchase the stock. Every client situation is unique.