

Macro Commentary: The More Things Change...

This article is excerpted from a letter by MOI Global instructor Patrick Brennan, portfolio manager of [Brennan Asset Management](#).

In past letters, we've noted that a repeating set of various macroeconomic concerns (Greece indebtedness, European Union stability, and China debt levels) would periodically be magnified in a given quarter.

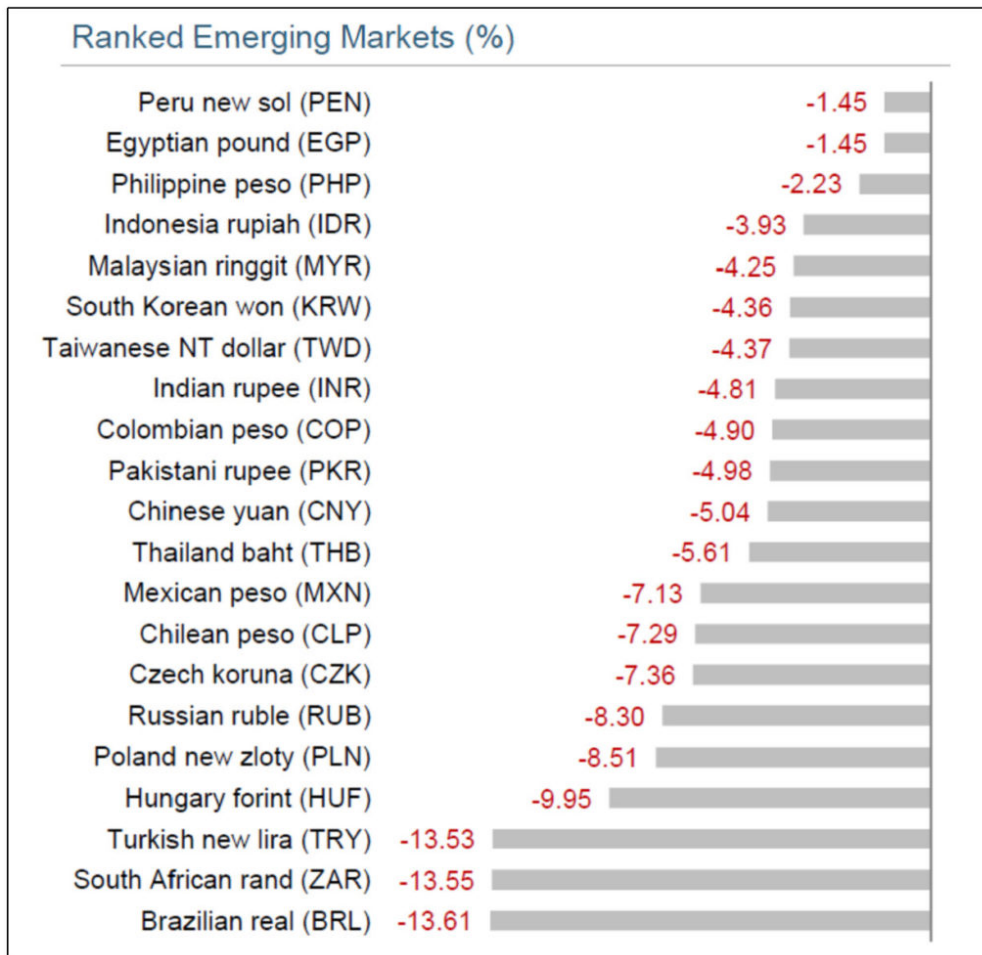
For this reason, a reader could save time by simply pulling one of our old letters and skimming the first couple of paragraphs to see a high correlation to what we are about to say. But, interestingly, while the above concerns still exist, they have been pushed to the back burner as investors are fixated on the real possibility of a worldwide trade war.

As we write this second quarter letter, the US appears to be contemplating \$200 billion of additional tariffs after initially establishing \$50 billion of tariffs on Chinese imports (\$34 billion have been implemented). China has responded with 25% tariffs on a host of different products.

Certainly, trade restrictions are not helpful for business confidence and a prolonged period of restrictions could cause real damage. That said, there is considerable uncertainty on whether all the proposed tariffs will be fully implemented and, if so, for how long.

Dollar Strong Again... Move Too Far?

The combination of a stronger US economy and possible rate hikes has reignited dollar bullishness. The dollar rose against most currencies during the second quarter and emerging market currencies were particularly hard hit.

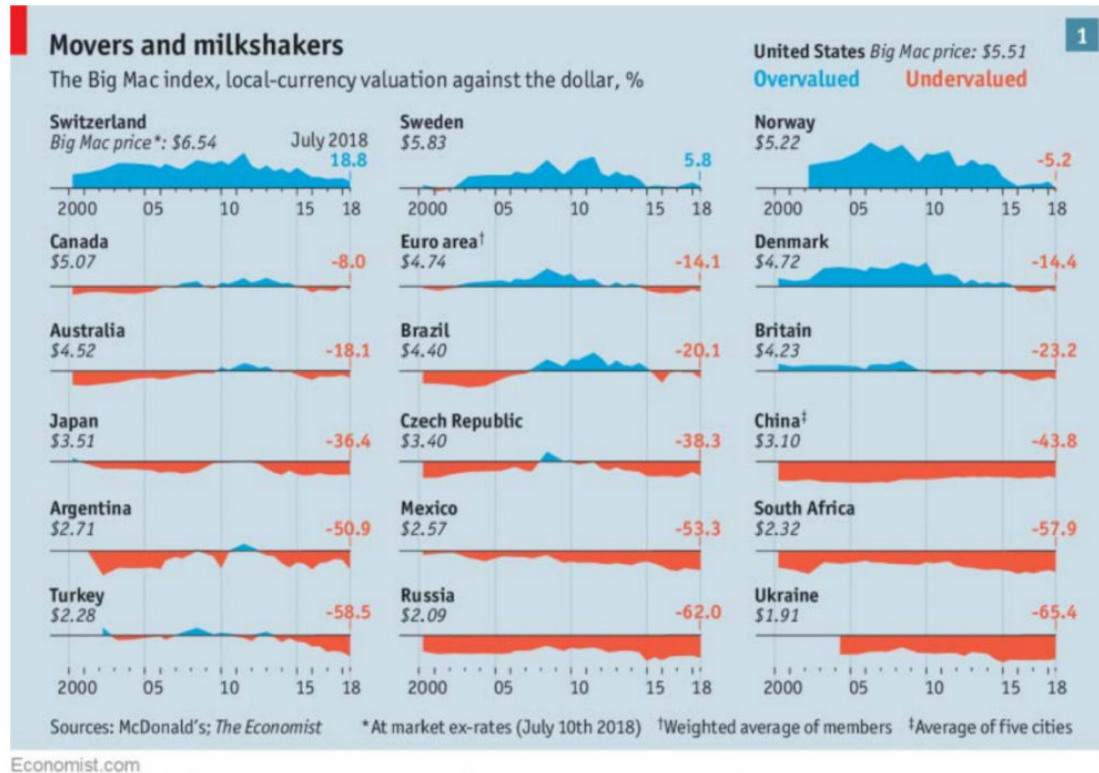


Source: MSCI Data

As we have discussed in past letters, long-term currency movements are nearly impossible to predict and uniform bullishness (in either direction) should therefore often be viewed skeptically. As luck would have it, we spent part of May in Brazil, just in time to experience a nationwide trucking strike while traveling with a four-year-old – one hasn't truly lived until experiencing this type of car fun.

Our less than official sampling of opinions on the Brazilian macroeconomic environment would be pessimistic (to be kind), and this was before Brazil's recent defeat to Belgium during the World Cup. But, this pessimism could offer some interesting investment opportunities, particularly as the trade concerns/dollar bullishness interact with elections and other geopolitical/economic events.

While far from an effective predictor of short-term results as overvalued often becomes more overvalued, the *Economist's* Big Mac Index suggests that on a purchasing power basis^[1], the dollar's move has gone too far.



High Debt, Index Buying Pressure, Expensive Stocks - The More Things Change...

As for the other concerns (trade wars, recession, cycle risk), we are reminded of a *Barron's* interview with value investing legend Seth Klarman sent to us by a close investing contact.

In the extensive interview, Klarman (with prodding from *Barron's*) spent considerable time discussing high aggregate debt levels, high deal valuation levels, the role of index investing in driving up valuations and how the overwhelming number of stocks would still be unattractive even if they dropped anywhere from 25-33 percent. Certainly, not a bullish backdrop and don't many of these issues sound familiar?

So, when was the interview? Earlier this year? 2016 or 2017? Actually in... 1991. It should be noted that the US was just coming out of recession at the time of the interview and Klarman spent a good portion of the remaining interview discussing several compelling ideas in what he thought was a tougher environment to find investments.

It is amazing to think about the number of politicians, economic cycles and geopolitical events that have occurred over the past 30 years, a period when the Dow Jones Industrial Average went from roughly 3,000 at the time of the interview in 1991 to over 25,000 today.

We are certainly not advocating that investors sport rose-colored glasses and blindly buy stocks. But, as we have stated in past letters, one of the few certainties of the investing process is constant economic uncertainty. Problems that seem unique often parallel with those from previous periods and

this should be remembered before predicting future apocalypses.

^[1] The basic idea of the Big Mac Index is that currencies should adjust until goods cost the same everywhere. If there is a variation in prices after converting Big Mac prices into dollars, one currency looks overvalued compared to another.

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