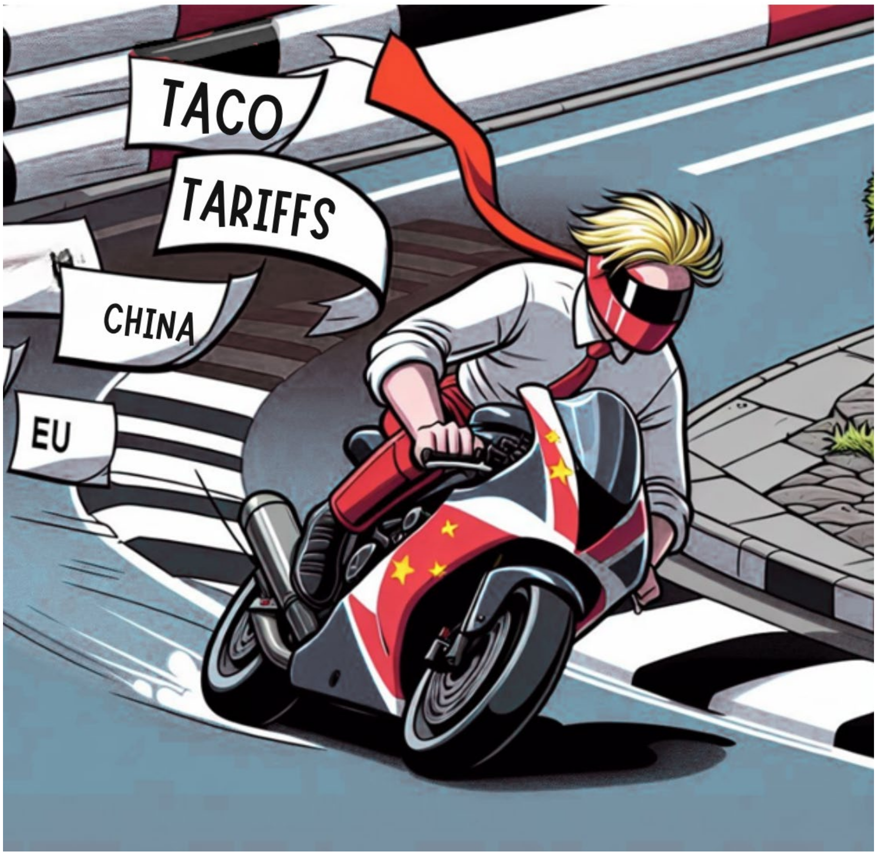
TT: The Isle of Man Tourist Trophy? Or TACO Trade, Trump Tantrums or Trade Tariffs?

This week's update comes a day earlier than normal as tomorrow is the TT Bank Holiday in the Isle of Man. As all Isle of Man residents know, TT stands for "Tourist Trophy" and is the annual 2-week festival of motorcycling that culminates with the Senior Race that takes place on Saturday. This year though it could also easily stand for "TACO Trade", or "Trump Tantrums" or "Trade Tariffs" – please feel free to send in any other suggestions you may have.



As is now commonplace., there's a lot to discuss this week. Picking up the issue we reported in last week's update, we have spent some more time understanding more about Section 899 of the "Big Beautiful Bill", which is Trump's tax cutting bill, but much more besides.

The Section 899 allows the US to levy taxes on US assets held by investors from non-US countries that are deemed to have "unfair" taxes.

It is widely interpreted that countries and territories that are deemed to have unfair taxes are the EU, UK, Canada, Australia and Japan. The potential implications are that there will be a flight of capital from the US which could cause a significant fall in the value of US assets and the value of the dollar.

Between the team members at Blythe Financial we have spent several hours looking into this issue and have sought the opinion of various experts and here is the summary of that research:

- This taxation power should be seen more as part of the trade tariffs than the tax bill and will add to the negotiation tools available in those discussions.

- Accordingly, the power as proposed has wide discretion for the US Treasury Secretary in its application

- The power as proposed applies to income from investment only. Capital gains are not taxed.
- US Treasuries and corporate bonds are exempted.

The measure therefore seems to be aimed more at private markets than public markets and will very clearly target non-US corporates with US subsidiaries. As such we are more relaxed about the implications than we were this time last week.

That is not to say however that everything is "looking rosy in the garden". The tax cutting nature of the bill is forecast to increase the budget deficit by $2.4tn, with that deficit needing to be financed by way of further debt issuance.

That prospect has kept US Treasury yields at the top end of their recent range and has raised concerns amongst some of the Republican lawmakers in the US Senate, who are currently debating the Bill.

One in particular, Kentucky Senator Rand Paul, has said over the last few days he will not support the bill if it raises the debt ceiling. Trump responded to Paul with a series of social media posts, accusing him of having "*very little understanding of the bill*" and saying that the "*people of Kentucky can't stand him*" and "*His ideas are actually crazy*". Hello Mr Kettle, it's Mr Pot here…

The timetable of events over the next 2-3 months is quite important to think about as there are a couple of potential "cliff edge" points that we have in our thinking. These are the end of the Liberation Day tariff pause on 9th July following which the threatened tariffs *may* take effect on those countries and territories that have not reached a trade agreement with the US.

The second is the expiration of the "extraordinary measures" that are being used to continue paying the government's bills, whilst the debt ceiling has been suspended. According to projections from the Congressional Budget Office and the Treasury Secretary, these measures are expected to be exhausted sometime in August.

The Big Beautiful Bill needs to pass the Senate stage and then go back to House of Representatives for the Senate's amendments to be discussed. In reality therefore this Bill needs to be ideally concluded by 9th July but certainly no later than the expiry of the "extraordinary measures" in August, so that the debt ceiling negotiations can include the requirements from the Bill.

The 9th July possible cliff edge looks difficult given the following summary of where trade negotiations stand with key countries / territories:

Country/Territory	Current Status of Trade Negotiations
United Kingdom	A limited "Economic Prosperity Deal" is in place, but no comprehensive Free Trade Agreement (FTA), although negotiations are active. The "Economic Prosperity Deal" includes graduated tariff reductions for specific sectors like US beef and UK steel, aluminium, and automotive goods. US tariffs of 10% are imposed on most UK goods.
European Union	High-level talks are ongoing over new tariffs but there are no active negotiations for a broad FTA. The EU has a temporary suspension on its retaliatory tariffs that is set to expire, also on 9th July, when reciprocal tariffs of 50% are set to be implemented.
Canada	Trade between the two countries is governed by USMCA the US-Mexico-Canada Agreement (USMCA) but the US has imposed new tariffs (25% on most Canadian imports) outside the USMCA, citing national security and emergency powers, which Canada has challenged at the WTO and responded to with billions in retaliatory tariffs.

Mexico	Trade is also governed by USMCA but the US has used the threat of new tariffs of 25% to pressure Mexico on non-trade issues. These tariffs have been temporarily suspended, with various disputes currently being managed through USMCA dispute process.
Japan	The US-Japan Trade Agreement and a Digital Trade Agreement were already in effect, but the US has imposed a 10% "reciprocal" tariff on Japanese goods (temporarily paused from a higher rate of 24%) and reimposed 25% tariffs on steel and vehicles. Japan is actively engaging in talks to reach agreement to mitigate the impact.
China	There are currently no negotiations for a comprehensive trade deal. At the meeting on 14th May in Geneva, both sides agreed on to a 90-day suspension of higher retaliatory tariffs, though significant base tariffs remain. Discussions are described as "stalled," with ongoing friction over technology controls, sanctions, and market access.

The Chinese situation is less relevant for 9th July as the suspension here runs until 12th August, also coinciding approximately with the debt ceiling issue.

The discussions with China have been subject to a couple of social media posts from Trump with the first issued last weekend proclaiming, without any hint of irony, *"China, perhaps not surprisingly to some, HAS TOTALLY VIOLATED ITS AGREEMENT WITH US. So much for being Mr. NICE GUY!"*

This was followed up on Wednesday with, *"I like President XI of China, always have, and always will, but he is VERY TOUGH, AND EXTREMELY HARD TO MAKE A DEAL WITH!!!"*

There are of course many facets to trade between the two largest economies, with each having different levers to pull in their dispute. One of the key levers that China has is fact that it mines, processes and refines around 90% of global rare earths.

These rare earths are used in a whole host of technologies but crucially for the US they are key components of the automotive and defence sectors. A group representing US motor manufacturers this week issued a letter to the White House stating, "*Without reliable access to these elements and magnets, automotive suppliers will be unable to produce critical automotive components*"

On the military side, rare earth magnets are included in the production of fighter jets and aerospace components like missile guidance systems. A lack of access to these rare earths is therefore a key priority for the US and underlines just why Trump is so keen on talking about taking Greenland as a US territory.

Trump's angry reaction to the acronym "TACO" ("Trump always chickens out") that he has attracted (and a reference to his backing down from his initial position on tariffs and other matters when the bond market yields soar) suggests that there is going to be a statement policy that he won't back down on.

That could well be his steel and aluminum (why on Earth can't they say aluminium?) tariff play where he doubled the tariff on all imports to 50% (and subsequently exempted the UK, where the tariff remains at 25% under the Economic Prosperity Deal between the two).

It could however also manifest itself on 9th July making that a hard deadline rather than something that again becomes moveable. The closer that date comes without progress the higher the potential for market disruption.

In the meantime, signs of an economic slowdown are emerging in the US economy, with 2 key data points on Wednesday being reported. Firstly, there was a downturn in sentiment amongst the non-manufacturing sector with the Purchasing Managers' Index showing a reading of 49.9, below the last reading of 51.6 and well below the expected 52.0 – a reading below 50 indicates that sentiment is in recessionary territory.

This PMI reading accompanied the AFD Non-Farms Payroll data which showed that last month the net increase in jobs in the US was virtually negligible at 37k and significantly below the 111k that had been expected. Whilst this is not the official measure, the official reading is published tomorrow (Friday) and will be closely scrutinised for how closely it matches the AFD number.

This AFD number however saw Trump renew his rhetoric against Jerome Powell, the Chair of the US Federal Reserve, with his social media post proclaiming *"ADP NUMBER OUT!!! 'Too Late' Powell must now LOWER THE RATE. He is unbelievable!!! Europe has lowered NINE TIMES!"*

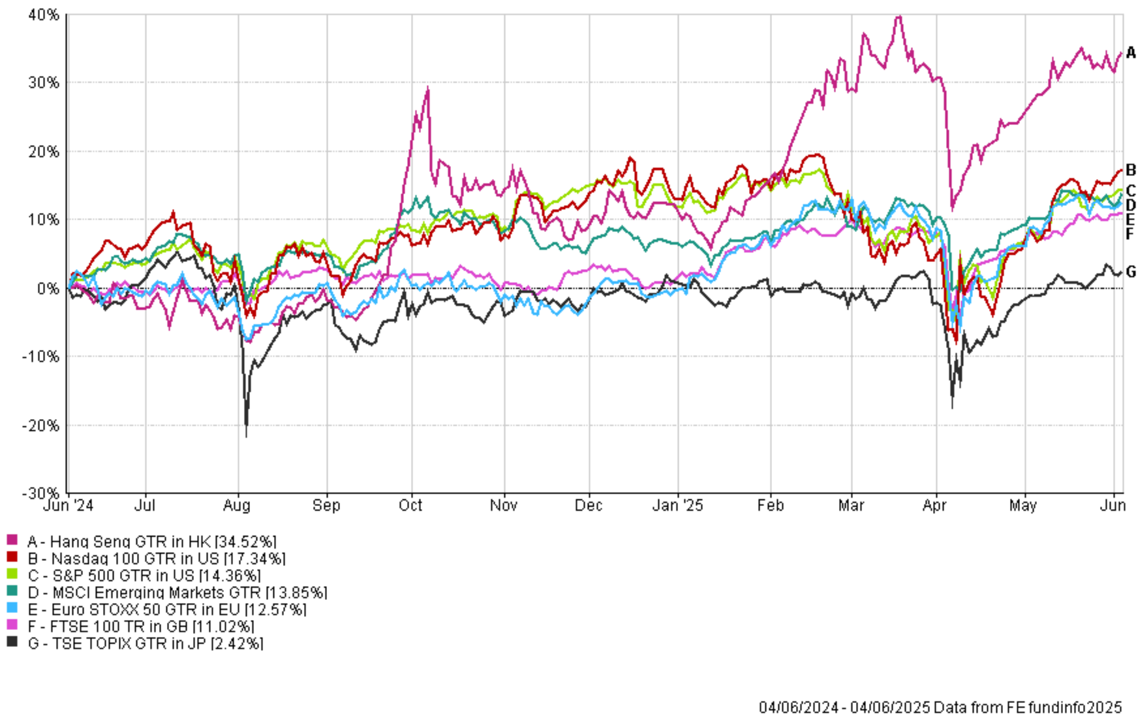
Actually, Europe had lowered its rate 7 times in the current cycle at the time of the outburst, but today made that 8 times, as it cut its rate again by 0.25%.

Whilst indicators of economic weakness should indeed make the Fed think about cutting rates, what Trump is so obviously missing is that it is his own policies, particularly on trade, that are the root cause of the economic weakness. It's a bit like deliberately setting fire to your house and then berating the fire service for not putting the fire out quickly enough.

Whilst it feels like lately every day has some drama or twist to it, the upcoming few weeks and the outcome of these issues are going to be of keen importance.

Where are markets up to?

The rolling 12 month % cumulative returns in local currency from various indices is shown in the following chart:



Where are the portfolios up to?

The portfolio performance, net of fees, to close of business on Thursday is as follows:

	1 week	1 month	3 months	12 months
Cautious	+0.58%	+1.75%	-0.58%	+2.55%
Balanced	+0.59%	+2.79%	-0.19%	+2.26%
Adventurous	+0.68%	+3.31%	+0.25%	+1.85%

As ever, if you would like to discuss any aspect of your portfolio, please do not hesitate to contact us on service@blythefinancial.com.