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Views From the Stream

July 15, 2025

The Monthly Letter covers two topics this month. First, we take a look at a look at Global Trade. While the Trump Administration focused on tariffs as the Big Stick to move production back to the United States, the U.S. Courts appear to have stymied the move short term by declaring the tariffs illegal under the law utilized to put them in place. While this represents a setback for the Trump Administration, there exist numerous other laws to justify tariffs and to protect U.S. Industry. Thus, multiple actions by the Administration stand ahead leveraging all the tools available to it. This will continue to put a death blow to the WTO, push the U.S. back to some form of the GATT, and lead to the Rise of Cold War II, similar to what existed during the 1950s to 1990s. Second, as always, we close with brief comments of interest to our readers on a variety of current topics relevant to the economy and the markets.

The Great Game of Power:
The End of the WTO,
The Return of the GATT,
&
The Rise of Cold War II

When I grew up in the 1960s and 1970s, there did not exist the WTO (World Trade Organization). Instead, there existed an international trade agreement called the GATT (General Agreement on Tariffs and Trade). This agreement governed how countries trade with each other. Under the GATT, if a country felt another country dumped goods into its economy or unfairly subsidized its companies, that country could take direct action to protect its domestic manufacturers with the offending country. There existed no impediment to action. This agreement, based on common sense, prevented other countries from subsidizing the build out of their industry and/or subsidizing exports outside of certain limits. In addition, due to the ongoing Cold War, it kept numerous countries out of the trading system as they were allied with Russia or China or were Communist countries. In these countries, the government owned the businesses and paid for the plant. Thus, companies located in these countries could sell goods far below the actual cost of production. Free World Countries did not want to allow the Communist countries to sell goods at a price that would drive their companies out of business.

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However, with the end of the Cold War, there came a belief that opening up to these markets would provide a large opportunity to sell goods and services to over half the globe. In addition, there existed a belief that this would bring Communist countries towards democratic forms of government by integrating their economies with the West. Thus, the World Trade Organization came into existence in 2000. There existed several unique factors specific to the WTO that radically changed how trade would occur and issues would get redressed. First, Developing Economies got State Owned Enterprises exempted from many of the anti-competitive provisions and the enforcement mechanism in trade disputes. Second, disputes no longer occurred between countries, but were adjudicated by an extraterritorial judicial system. Third, there existed no mechanism to prevent non-market economies from massively subsidizing their industry. Fourth, there existed no method to address Currency manipulation or the incentive to run Beggar Thy Neighbor policies. And Firth, the actual agreements were kept secret.

At the time, numerous critics thought that these agreements would lead to massive dumping of goods into Developed Economies. They would also incent the Developing Economy countries to depreciate their currencies ahead of entry to give their manufacturers a big advantage globally and to continue to depreciate their currencies to maintain this advantage. In addition, they criticized the loss of control over adjudication in trade disputes, as which countries controlled the appointment of judges would gain advantage in the judgments. Lastly, they expected these agreements to undermine domestic manufacturing as companies could now set up production in low labor cost countries with minimal regulatory burden. Thus, they would have an economic incentive to move production from the U.S. to a country like Indonesia or Brazil.

Fast forward to 2025, all points that critics brought to the fore in 2000 became reality over the past 25 years. First, countries such as China utilized State Owned Enterprises to build out entire industries that were exempt from the anti-competitive rules. They then pushed the goods onto global markets in such a way that they forced numerous Developed Market manufacturers out of business. The U.S. alone lost over 10,000 manufacturing companies. Second, prior to entering the WTO, Developed Economies depreciated their currencies to make their manufacturers super competitive on a global basis. From 1990 to 2000 their currencies fell a collective 68% in value against the US Dollar. Since 2000, these currencies collectively have depreciated an additional 30% to maintain their competitive advantage. In addition to these above actions, countries subsidized their manufacturers, enabling them to sell goods below cost in foreign markets, by providing cash infusions to cover the cash deficit. Or they put up protective barriers to prevent foreign manufacturers from selling their products in those markets.

With China's economic rise and demand for its Place in the Sun, Geopolitics once more rears its head in all things international. Since Chaiman Xi's ascent to power in 2012, China moved to increase its military power, project power globally, and expand its sphere of influence dramatically in Asia over the

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past decade. (Please see *Germany 1897 and Our Place in the Sun: Parallels with the Current and Future Rise of Chinese Militarism* published April 30, 2013.) All of this stands as a threat to the Global Order erected by the United States after World War II. As a result, starting with President Trump's first term in 2017, the United States began to move down the road to counter China's influence around the globe. While this was interrupted during the Biden Administration, the second Trump Administration picked up from where it left off.

Given the economic warfare waged against the US and Europe by China and other Emerging Market Economies since 2000, the WTO came under attack by the U.S. starting in 2017. The first Trump Administration imposed some tariffs on China and, through numerous official U.S. Government studies, laid the intellectual foundation to protect American companies from the policies adopted by Emerging Market Economies, which used the special provisions given to them in the WTO to grab large portion of Global Market Share for their companies and industries. As a result, the United States Share of Global Manufacturing fell from over 30% to less than 15% over the past 25 years.

The second Trump Administration, to address this trend which put U.S. National Security at risk, fired back by imposing tariffs on every country around the world. While a crude method to address particular country issues, it provided an umbrella under which to renegotiate the terms of trade with each country individually and to protect industries critical to U.S. National Security. In effect, this represents The Return of the GATT, whereby countries negotiate directly with individual countries to solve trade disputes. With the United States going down this path, which represents The End of the WTO, one can say Rest in Peace WTO. And while Emerging Market Economies continue to abide by its terms, their acceptance of the consequences of the U.S cutting off its markets from China will lead them down the same path. While Chinese exports to the U.S. fell sharply starting in May, China turned on the export spigot with its Asia neighbors. For example, Thailand's imports from China rose 30% year over year in Q2. As a result, the capacity utilization of its domestic industry collapsed. For any country under such assault, protectionist trade measures come to the fore, else it will see its industry eviscerated. As a result, it likely stands just a matter of time before other countries shut their markets to the Chinese Export assault, putting the final nails in the WTO coffin.

In addition to the above actions, the current Administration recognized that the U.S. possessed particular National Security vulnerabilities, that could prove highly detrimental in a war. For example, China flexed its dominance in Rare Earth Metals and Magnets by embargoing their shipment to the United States. These metals are critical for solar panel production and the magnets stand key components for autos and military aircraft. These actions by China sought to put some economic pressure on the U.S. as retaliation for the tariffs imposed on China. In response, the U.S. Government pulled out of the dustbin The Defense Production Act. This allows the government to stand up manufacturing production for National Security reasons. To put an end to this vulnerability, the DOD entered into a contract with MP

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Materials Inc. to expand its magnet production, separation capabilities, and mining well into the next decade. The company will receive $1 billion in financing to expand its magnet production by 10x. In addition, the company will receive $150 million loan to grow its separation capacity. In addition, the DOD made a $400 million investment into the company in a convertible preferred. Furthermore, the government provided a pricing floor to ensure the company's profitability and agreed to a 10 year offtake agreement guaranteeing the company a market for its product. Effectively, the U.S. Government created a National Champion, much the way China did over the past 25 years, and guaranteed its success.

Once the capacity comes online in the US from MP Materials, other companies in the U.S., and elsewhere in the Western world, the U.S. and the West will not need Chinese rare earth or magnet production. They will become self-sufficient. This will create a problem for China, which built capacity to supplant Western production and create economic chokepoints. With the deal with MP Materials, the U.S. created a template to remove economic chokepoints created by China over the past 25 years. And with National Security once more ascendant, it seems likely the U.S. will move systematically to remove chokepoints and economic vulnerabilities created over the past 25 years.

Coupled with the above, the Government tucked into the One Big Beautiful Bill (OBBB) a massive incentive to build manufacturing capacity in the United States. This provision allows immediate expensing of the cost to build a manufacturing structure. Instead of depreciating the structure over 39 years, 100% of the depreciation can occur in the year the plant completes and comes online. In addition, the bill restored 100% bonus depreciation for equipment and R&D. A simple example will illustrate the economic incentive this creates. Suppose a company builds a $100 million facility that produces $20 million in EBITDA per year. Using pre-OBBB rules, the plant produced a 10% IRR with a 7 year payback. Under the OBBB, the same plant produces a 15% IRR with a 5 year payback. As a result, many plants that otherwise would not hit the appropriate return hurdles will now do so. As a result, the bill will encourage more capital investment. This carrot, coupled with the stick of tariffs, will lead to capacity relocating to the U.S. given the improved economics and the protections from Emerging Market economic policy.

As the U.S. and Developed Market Economies continue to move down the road towards economic self-sufficiency, the trading regime of the past 25 years will die a slow death, leading to the end of the WTO. And with countries focused on self sufficiency for economic growth and National Security reasons, the current global trading system will come undone as the world sees The Return of the GATT. Combined with the rising Geopolitical rivalry between the U.S. and China, the globe will surely fracture into trading blocs as The Rise of Cold War II continues. With countries focused on their self-interest once more, The Great Game of Power will continue to rise and dominate the Globe and all that it entails.

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Air Traffic Control, Oh Those Mortgage Rates, and Healthy Consumer

Finally, we close with brief comments on Air Traffic Control, Those Mortgage Rates, and Healthy Consumer. First, while travel hit an air pocket in the first half due to uncertainty over the tax bill and tariffs, it appears that the passage of the One Big Beautiful Bill unleashed animal spirits. According to recent reports from Delta and UAL, air travel accelerated significantly in June and continues to do so in July, growing 6% or better. As a result, we see a busy Air Traffic Control. Second, mortgage rates have returned to their late1990s – early 2000s levels of 6.50% - 7.50%. For home buyers and sellers, this creates a crunch as they got spoilt with rates between 3.50% and 5.00% from 2010 – 2020 and even lower rates below 3.00% in 2021 as the Fed fought the Pandemic. This change in rates continues to put pressure on Housing with both buyers and sellers sighing "Oh Those Mortgage Rates". And Third, Consumer Staples companies continue to face negative unit growth as the Consumer moves towards fresher, less processed foods. In addition, the Government began to move to ban numerous substances and force companies to manufacture healthier products. With pressure on both sides, we the rise of the Healthy Consumer.

In Closing

Should you have any questions on how the above issues or the items discussed in our accompanying cover letter impact your family's financial position or your business's future as well as the potential actions you could take in response, please do not hesitate to contact us. We welcome the opportunity to discuss this with you.

Yours Truly,

Paul

Paul L. Sloate
Chief Executive Officer