April 23, 2021

Re: May Conference Call on Tuesday, May 4, 2021 at 6:30 PM

Dear client,

The Thucydides Trap

In Ancient Greece, Sparta was a stable city-state with a long history of governance while Athens was a young upcoming power. While Sparta wanted to have the status quo maintained, Athens felt that their city-state was not getting the due respect that they deserved. This conflict between Athens, a city-state that was rising, and Sparta which was mature, led to the Peloponnesian War. The primary cause was that Sparta feared the growing power and influence of the Athenian Empire. In the end, Athens lost the Peloponnesian War. One reason for Athens loss was the drain of resources in fighting Sparta and its allies - Corinth and Thebes. Both Athens and Sparta's military and economic power were weakened for 50 years as a result of the war.

Today, a similar situation exists between the United States and China. The United States is a mature country wanting to maintain its status and to control the world order. President Xi of China thinks that his country deserves more respect than what it is getting and wants a bigger role in world affairs. China's ambitions and insecurities are leading it to annex peripheral areas in the South China Sea, Taiwan, Hong Kong, Tibet, as well as increasing its sphere of influence in Asia. President Obama was the first U.S President to recognize China's ambitions while Presidents Trump and Biden are trying to stop it.

Throughout history, the world has witnessed the rise and decline of powers. England, prior to 1914, was able to rule a large swath of the globe because they had a superior fleet and military in comparison to France and Russia which were the great powers of the time. Germany, under Kaiser Wilhelm and Otto Von Bismarck, felt that England and France were not giving their country due respect and that Germany needed to colonize in order to secure their supply chain for industrialization. Not only is China's desire for control in the South China Sea for security purposes, but it also desires a reliable supply of inputs for industrial production. Although the English were victorious in World War I, the war expenditures in terms of money, manpower, and munitions, severely weakened the country. After World War I, England was never able to regain its status as a world power. England fell in the Thucydides Trap in which a rising power challenges the status quo of an existing and mature power. This is exactly what is happening now between the United States and China.

As an investment manager and strategist, I need to incorporate geopolitics into any investment thinking in order to prepare for a possible "Black Swan". A Black Swan is a term used in finance to explain that investors should be on the lookout not only for the probable events, but the improbable ones. Many people think that China invading Taiwan is improbable, but this flashpoint could be the next Black Swan.

Especially when market euphoria has taken over, as the S&P 500[1] has hit new highs, we have to remain vigilant about the Thucydides Trap. An easy Fed and an ultraloose fiscal policy remain the key macro drivers of this bull market.

While the economy is on track to boom in 2021, the leading economic indicators will soon be running into trouble if interest rates continue to rise swiftly. This leads me to believe that the U.S. stock market is fairly valued and leaves little wiggle room in case there is an armed conflict with China over Taiwan.

In our Coffee episodes, I have been talking about the prospects of inflation. Year-over-year headline inflation has jumped from 1.64% to 2.64%.[2] Given this 60% increase in inflation has come from a low base, but that doesn't mean much. It isn't the absolute inflation number that is important, but the rate of change. However, if inflation continues at the same clip that it registered in March, then the annualized rate would jump to 4.75%. Although I would expect that inflation will not be as severe as that, but if it is, the Federal Reserve will have to raise rates sooner than expected, something that would definitely cause a good correction in stocks which the market clearly doesn't expect. Yet, our base case remains that stocks are less risky than bonds and the market should be higher 6 to 9 months from now. Although we are past the point of buying stocks on a wholesale level, we are continuing to buy them surgically when the price is right.

Please tune into the next conference call on **Tuesday, May 4th at 6:30 p.m**. via Zoom to learn why we may be selling the drug and oil stocks, our outlook for the next couple of years, and a complete rundown on inflation. We will also be joined by a special guest, Andrew Donahue CFP®, MHA, who is a new Wealth Manager at BFSG. Prior to joining BFSG, Andrew served as a congressional aide on Capitol Hill and his credentials include a Master's Degree in Strategic Security Studies from the Department of Defense's National Defense University in Washington, D.C. Andrew will discuss with us emerging geopolitical trends and the possible "Thucydides Trap" between China and the U.S., which we think you will find very informative.

When: May 4, 2021 06:30 PM Pacific Time (US and Canada)
Topic: BFSG Conference Call Hosted By Steven Yamshon

Please join the conference call:
Telephone US Dial:1 669 900 9128
Webinar ID: 939 3985 6885
Passcode: 853029

Best regards,

Steven Yamshon
Managing Principal

1. The S&P 500 is designed to be a leading indicator of U.S. equities and is commonly used as a proxy for the U.S. stock market.
2. Source: U.S. Bureau of Labor Statistics (https://www.bls.gov/news.release/cpi.nr0.htm)