Financial Wanderings

January 2019

A masterful examination of the previous month's financial events, written by Brad Blackburn, CFP ®
(and made even awesomer by Andrea Dickerson)

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Although the commentary in this newsletter has been thoroughly researched, well-reasoned and contains many impressive multi-syllabled words, please enjoy it responsibly. There are many economic minds that are far smarter than mine—and even they can't agree on even the simplest economic questions. In other words, please enjoy this newsletter with the full understanding that it may be entirely wrong.

This is why good news didn't help the stock market

A little more than a month ago, the two biggest worries for the stock market were the trade war with China, and rapidly rising interest rates. Both of those fears have faded significantly, and yet stocks continue to struggle. What's it going to take to please the stock market, and why hasn't it reacted better to those two pieces of good news?

On the trade war front, tempers have cooled. We are officially negotiating again with China, and our threatened 25% tariffs on nearly every Chinese import have been postponed for at least 90 days. It was telling that our mini-agreement with China came nearly a month before the new tariffs were set to begin. In a typical negotiation, a deadline is valuable leverage. But, in this case, we didn't get anywhere near the deadline. That is solid evidence that neither side has much fight left in them.

We've already seen recent negotiations bear fruit. China recently lowered their tariffs on American made cars and committed to buying our soybeans again. Although we're only back to where we were earlier this year, both sides are posturing down, and progress is being made.

This looks like the beginning of the end of the trade war. However, that doesn't mean we'll have a final resolution anytime soon – so the uncertainty for the global economy will continue. Perhaps that's why the stock market hasn't celebrated yet.

There was also good news from the Fed. Although the Fed raised interest rates in December, Chairman Powell said that rates

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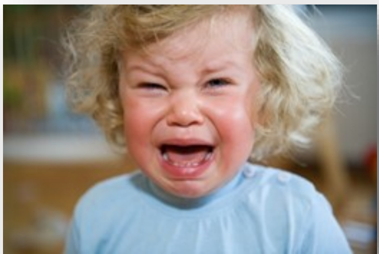
were "just below neutral." That is code for "if we raise rates much more, it might tank the economy." The Fed also lowered its forecasted number of rate increases in 2019 from three down to two. Those developments may not sound like much, but they show that the Fed is slowing down on raising rates and is open to slowing further. That takes a big worry away for the stock market.

So why isn't the stock market celebrating? The answer is that the Fed is in a no-win situation. If they continue to raise rates, it will hurt the economy. If they don't, it's a vote of "no confidence" to an already slowing economy. After all, interest rates are still very low historically. If we can't handle these low rates, perhaps the economy isn't so strong after all.

At this point, it's hard to see what could move the stock market upward in any significant way. However, it's also hard to imagine stocks falling much more than they already have – especially given our still solid economy. The coming months will bring us some important answers: Will the trade war be put to bed? Will the Fed continue to back down? Will the economy stay strong enough to support stock prices? I can't wait to find out.

One year after the tax cut

On December 22nd, 2017, the "Tax Cut and Jobs Act of 2017" was signed into law. Exactly 12 months later, the S&P 500 was down nearly 10%.



In fairness, much of the benefit to the stock market was already baked into stock prices before the tax bill was passed. However, even if we go back another 6 months (to June 22, 2017), the S&P 500 is essentially flat.

It's not just the stock market that hasn't been impressed with the tax cut; our economy hasn't responded much either. In the 4th quarter of 2017, our GDP was 2.9%. However, a year later, estimates for the 4th quarter of 2018 are closer to 2.7%. That is still a strong economy, but where's the payoff for "the biggest tax cut in history?" In directly related news, our annual budget deficit is up 17% over the last year. That's not a typo.

So, the stock market is down, our economy is slower, and we're going deeper into debt every day. It's becoming clear that the tax cut was little more than a year-long party – and now it's the morning after.

Instead of cutting taxes, we should have been paying down the debt or making long-term investments. We picked exactly the wrong time to try to stimulate the economy.

Oops!

All of this was predictable. Here's how I explained it last March:

When an economy is in a reces-

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sion, there's slack in the "economic rope." That means there are plenty of people who don't have jobs, lots of empty office buildings to fill, and lots of idle manufacturing equipment to ramp back up. At times like that, you can stimulate the economy without causing inflation and interest rates to rise. But that's not where our economy is. At this point, our economic rope is tight – if you pull on it, the whole thing will move.

There's another aspect to this as well. Nearly everyone agrees that the tax bill and increased budget will leave us with a higher national debt. If you go to the bank for a loan when you already have a lot of debt, and you'll want even more debt in the future – that bank is going to charge you a really high interest rate. We are already seeing that effect here in America. Since the start of the year, the 10-year US Treasury Bond yield has risen more than 15%, which means higher interest rates for everyone.

So, although we might all be saving money on our tax bills, we're already paying more for credit cards, auto loans, and mortgages. Similarly, if the tax bill allows your employer to give you a 3% increase in your salary, but also causes inflation to pick up to 3% - there's no net benefit to you. In other words, every bit the economy improves from this point will likely be matched by higher interest rates and higher inflation.

This just wasn't the right time for economic stimulus. If you are fat and happy, that's not the time to stuff your face with even more cake. Unfortunately, that's exactly what America is doing. In fact, if we keep eating cake, we might get a stomach ache. The markets are starting to realize that.

Unfortunately, we are now in a very difficult spot. I think nearly everyone expects a recession sometime over the next few years. Unless something dramatic happens before then, we will head into that recession with already low taxes, already low interest rates – and a massive amount of debt. That's not a good place to be.

Alan Greenspan says "prepare for the worst"

Former Fed chairman Alan Greenspan recently told investors to "prepare for the worst." It sure was nice of him to warn us AFTER stocks had already fallen almost 20%.

Greenspan has a history of saying the right thing, but with questionable timing. He famously predicted the dotcom crash by using the term "irrational exuberance." Unfortunately, he was 4 years too early. The financial world loves to argue over how much credit to give him for that prediction.

In this case, he's not only late to the game, but also overdramatic. "Prepare for the worst" makes it sound like the next Great Depression is coming. But unemployment is near all-time lows and con-

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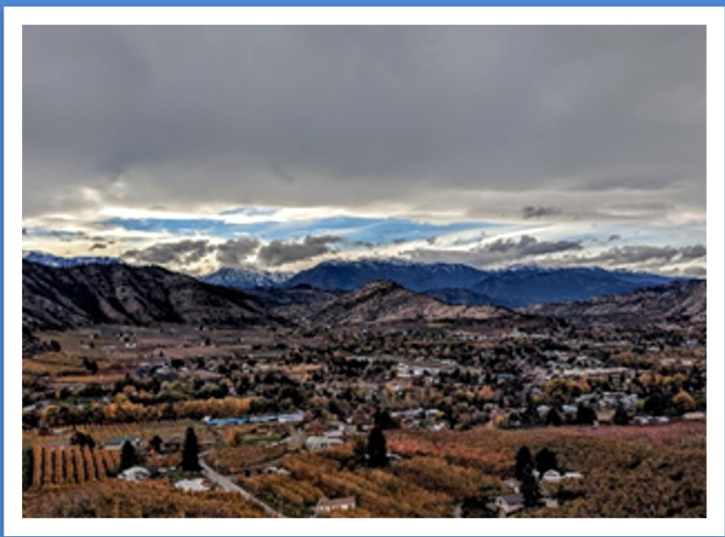
sumers are still spending strongly. Things are going to have to get a lot worse for his words not to be mocked a year from now.

To me, this is just more evidence that many investors have developed a "crisis mentality." The last 20 years have taught us that markets go straight up, then straight down, then straight back up... It's either feast or famine – a raging bull market – or a crash.

I worry that this could turn into a self-fulfilling prophecy. If everyone expects a major crisis, our confidence could shatter quickly. What might normally be a mild recession or stock market correction could become the next crisis simply because we're all so spooked. For that reason, and for your own mental health, it's important to remember that not every economic slowdown turns into a crisis, and not every stock market chart looks like a mountain. Alan Greenspan, and stock market investors, should take that to heart.

Probably a mountain or a lake

Cashmere, in late Fall.



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