October 2018

Financial Wanderings

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.

Will rising interest rates ruin the party?

Back in February of this year, there was fear in the stock market. The S&P 500 dropped 10% over just two weeks. The reason for that fear was the same reason for the recent fear in the stock market: Quickly rising interest rates. Thankfully, back in February, the stock market quickly remembered that although rates were rising, the economy and corporate earnings were still strong. That begs the question: Will the stock market recover again like it did in February? Or, will this be the moment the bull market finally ends?

The worry for the stock market isn't as much about short-term interest rates, which are controlled by the Fed, but rather long-term rates, which are controlled by the markets.

Over the last few years, the Fed has been consistently raising short-term rates. However, until recently, long-term rates had barely moved.

Rising interest rates worry the stock market for a couple reasons. First, rising interest rates tend to slow the economy, which isn't good for stocks. In addition, when rates rise, it creates more competition for stocks. The higher a bond or CD rate is, the more appealing it is to investors. If my clients could find a CD paying 5%, a lot of them would sell a chunk of stocks to buy that CD (with my blessing).

So, it does make sense for the stock market to worry about how far, and how quickly, rates

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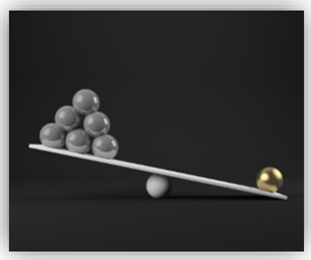
will rise. At some point, interest rates might rise enough to impact the economy and corporate earnings. That will be the moment the stock market will react for more than a few weeks. However, it's hard to know when that moment will be. Interest rates are still relatively low, and the economy is strong. But, the markets are forward looking. The stock market is trying to predict what will happen in 6 months, or in a year. Perhaps by then we'll be seeing a slower economy.

Is the Fed "loco?"

In response to the recent stock market meltdown, which was caused in part by higher interest rates, Donald Trump repeatedly attacked Fed chairman Jay Powell (whom he appointed). Trump said the Fed was "crazy," "loco," "ridiculous," and "too cute." Obviously, he's wrong, because nothing is too cute.

Having said that, Trump is at least a little bit right. The main reason for the Fed to raise rates is to fight inflation. However, we've seen very little inflation. In addition, we're starting to see the downsides of rising rates. We've seen the impact not only in our stock and bond markets, but also in the global economy, which has been thrown off balance by how much higher U.S. interest rates are than in the rest of the world.



If you look back at history, an overly aggressive Fed has been the cause of multiple recessions. So, Trump is correct to be worried about a Fed mistake. However, there are two important things to consider: The first is that Trump publicly calling out the Fed with lame elementary school insults might have exactly the wrong effect. The last thing the Fed wants is to appear to be bullied by Trump. Therefore, I think they'll be MORE likely to raise rates than they were before Trump called them out.

More importantly, Trump's own policies are a major reason rates are rising as quickly as they are. There's a very predictable result when you add a major tax cut and higher government spending to an already good economy: A juiced-up economy and a lot more debt. Both of those things lead directly to higher interest rates. In related news, our Federal budget deficit just jumped 17%.

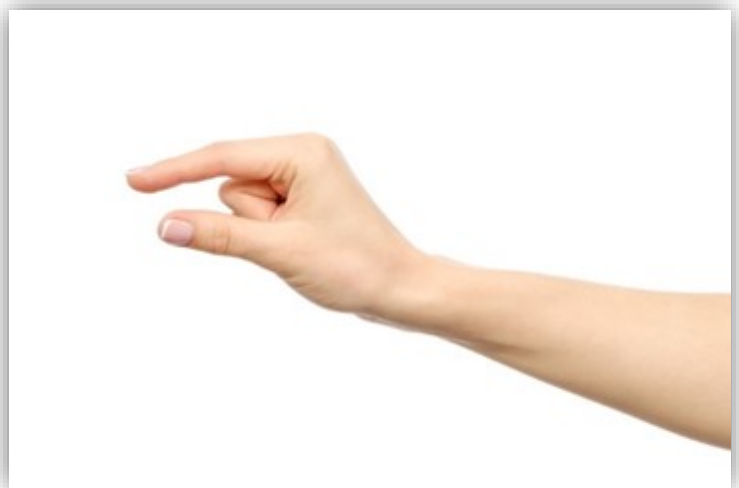
If there is ever a "right time" for a huge economic stimulus package and a massive debt increase, it's during a crisis. However, Trump did it when our economy was strong. So, the Fed isn't "loco" or "crazy." They are in a very tough position that was made even tougher by Trump's policies and public shaming.

The New NAFTA and China

Congratulations to President Trump. He recently replaced NAFTA, an agreement he called “maybe the single worst trade deal in history” with the “USMCA” (The US, Mexico and Canada trade deal), which Trump called “truly historic.” That can’t be a bad thing.

It will certainly strengthen our hand when dealing with China. I always thought it was a terrible idea to fight trade spats with many different countries, all over the world, all at the same time. Now that we aren’t fighting with our allies, we can gang up with Canada and Mexico to make China “an offer it can’t refuse.”

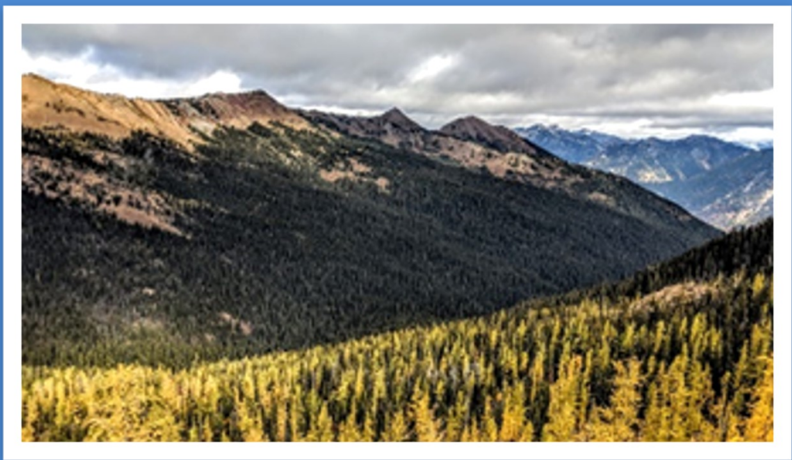
It’s also good news that, despite Trump’s bloviations, the USMCA is really just a slightly improved version of NAFTA. There are only 3 significant changes in the new deal. First, car manufacturers must buy 12.5% more of their parts from their local “region.” Also, a $16 minimum wage was agreed to for certain manufacturing jobs. At first, a minimum wage doesn’t sound like something Trump would endorse, but the idea is that forcing Mexico to pay their workers more will encourage manufacturers to employ more American workers. The last significant change in the deal is that Canada will open their market to more US dairy products. There are some other smaller aspects of the new plan. However, it’s clear that the USMCA is merely a slightly improved version of NAFTA.

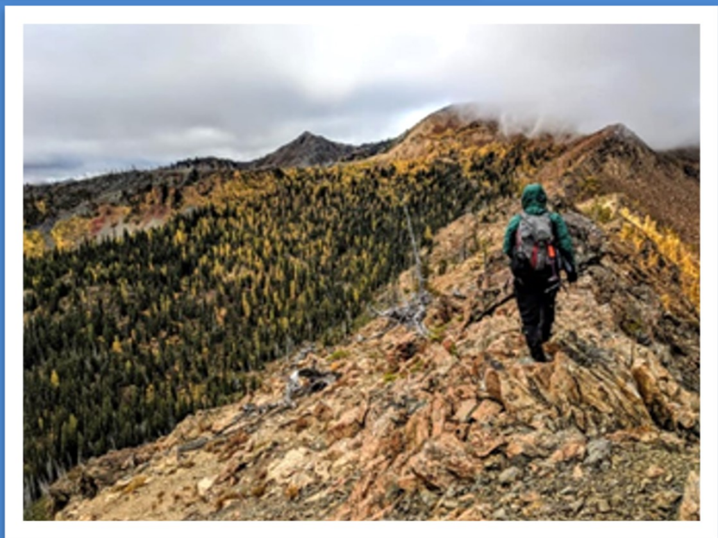


That’s great news because it shows that despite Trump’s big talk, he’s willing to make small deals (and celebrate them like they are HUGE). He did it with NAFTA, he did it with North Korea, and the hope is that he’ll do the same thing with China. If that’s the way it turns out, the stock market will be very pleased.

Probably a mountain or a lake

Without a doubt, Fall is the best season to be in the mountains. There are no bugs, the weather is cool, and the colors of dying leaves are somehow amazingly gorgeous. These photos were taken up the Icicle in a little basin below Highchair Peak.





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