Financial Wanderings

March 2019

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

Brad Blackburn, CFP ®

Financial Advisor
Blackburn Financial
121 Cottage Ave
PO Box 775
Cashmere, WA 98815

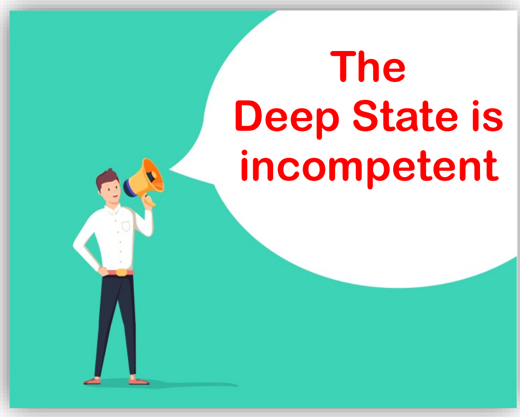
509-782-2600

brad@blackburnfinancial.net

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.

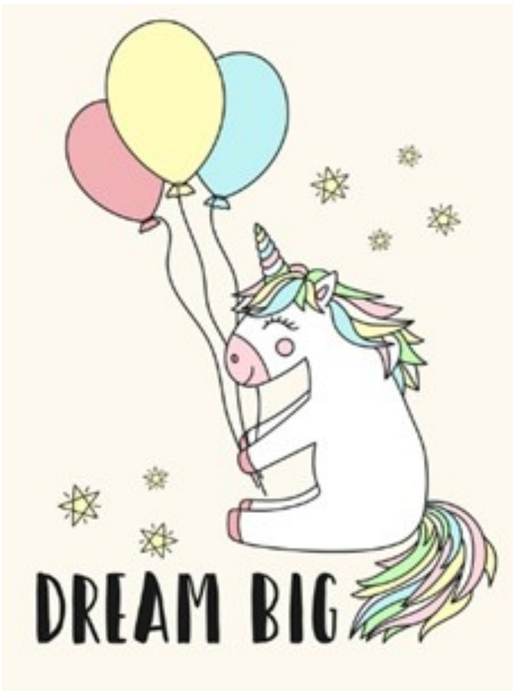
Good news for the stock market: The Mueller Report

Although the Mueller report isn't completely behind us, it appears that Trump will escape the jaws of the deep state and its 13 Angry Democrats.



For the stock market, that's a good outcome. Imagine that the Mueller Report was just bad enough to compel Democrats to impeach, but not so bad as to convince any Republicans to follow along. That would have been the worst-case scenario for the stock market. Although I don't think the stock market would have reacted much either way, it's better that most of the uncertainty has been cleared up. At this point, it appears that we will all be able to move on from this.

It seems unlikely that impeachment proceedings will begin anytime soon. In addition, the result of the Mueller report will probably discourage Democrats from investigating Trump as aggressively over the next two years. Does that mean our politicians might actually begin working together and focusing on important policy debates?



Unfortunately, that seems unlikely. The Republicans are already threatening their own investigation of the Mueller investigation. Personally, I'm looking forward to the Democrats' investigation of the investigation of the investigation.

Back to the Obama economy

Our economy added a mere 20,000 jobs in February. After averaging more than 200,000 jobs a month over the last year, that disappointing number convinced many people in the financial world that our economy was spiraling down towards an eventual recession. Fortunately, I think those people are a little bit too eager to bury our still-solid economy.

I think the weak jobs report was a fluke. On a month-to-month basis, our employment statistics are notoriously fickle. If you pay too much attention to any one month, it's likely to give you a skewed vision of reality. In this case, you only need to add the month of January, when we gained a whopping 310,000 new jobs, and the picture looks much better.

However, the overall economy is clearly slowing, which means the flukes are likely to get flukier. Recently, we've seen a slowdown in real estate, retail sales, car sales, and manufacturing. But that's no reason to panic. If a car slows down to 40 after going 65, it's not such a terrible thing. In fact, at a more manageable speed like 40, there's much less risk of a catastrophic crash.

That was deep, dude

To me, this feels a lot like the same old economy we've had since the Financial Crisis. In other words – it's the Obama economy. Perhaps the Trump tax cuts gave us a temporary boost, but now we are settling back into a very familiar routine of slow and steady growth.

That's not such a bad thing. There's still plenty of good news in the economy too: A lot of people have jobs, consumers are still consuming, and home prices are still high. Just because the economy is slowing down doesn't mean it will slow ALL the way down. If it can continue to slowly roll forward for a few more years, that would be great news for investors. After all, the Obama economy wasn't so bad for the stock market.

Wages are growing again: Woohoo and Oh No

The recent jobs report wasn't all bad news. For the first time in a long time, wages grew significantly faster than inflation. That's important, because if you get a 3% raise, but at the same time, everything you buy gets 3% more expensive, then you haven't really received a raise at all. Thankfully, over the last year, wages grew 3.4% versus 1.8% inflation. That means workers across America are legitimately better off than they were a year ago.

However, all that wonderful wage growth could turn into a problem, especially if the economy continues to slow. Wage growth is often an early warning sign of inflation. If there is more money in the pockets of consumers, that means businesses can charge more for the stuff they sell, and restaurants can raise their prices, and landlords can charge higher rents, and financial advisors can jack up their fees.

That's not necessarily bad news, but it could be. If inflation ramps up at exactly the same time our economy is slowing, it's a bad combination. That scenario is called "stagflation," which is a stagnating economy combined with high inflation. Stagflation is a notoriously tough box to escape because the standard way to fight inflation is to raise rates, but the standard way to fight a slowing economy is to lower rates. So how do you fight stagflation?

Thankfully, we aren't there yet. But this is an important risk to be aware of, and I'll be watching it closely.

Will Trump walk away from a bad China deal?

For months, the financial world was convinced that the trade war with China would be ending soon. The consensus was that a small, insignificant deal would be agreed to, and both sides would declare victory. After that, the entire global economy could gloriously move beyond all the trade uncertainty.

That's looking less likely now. Rather than a small deal, Trump seems to be going big. He's angling for a trade deal that fixes some of the biggest problems we have with China (including technological theft and government subsidizing their corporations). I will give Trump credit for trying, but a comprehensive deal won't be easy to accomplish.

Ominously, there's an obvious comparison to the North Korea situation. Trump picked a fight and successfully forced them to negotiate. While that was an accomplishment, it was only the beginning. Coming to a significant, verifiable deal is a lot more difficult, even for the world's greatest negotiator.

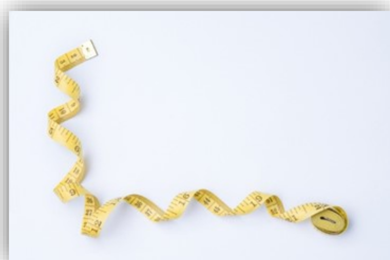
There's a lot riding on this. When Trump walked away from North Korea talks with nothing, the stock market shrugged it off. However, if Trump walks away with nothing from China, it will be a much bigger problem for the markets.

I still think the most likely scenario is that we will see a few small agreements, and all the difficult stuff will be continuously kicked down the road. While that's a lot better than any escalation of the trade war, it means that all the tariffs, and all the uncertainty of the trade war, could be with us for a long time. That's not a good outcome.

Where's the inflation?

If there was ever a perfect time for out-of-control inflation, it would be now. After the financial crisis, we saw massive government bailouts, sweeping economic stimulus programs and historically low interest rates. More recently, we've had an enormous tax cut and a very low unemployment rate. These are all things that economists say lead to high inflation – and yet our inflation rate has barely budged.

The lack of inflation has been somewhat puzzling to the financial world. Some economists argue that inflation is actually much higher than it seems, but we are simply measuring it wrong.



Others argue that it's just a matter of time until the expected inflation shows up. However, the most compelling argument is that we are living through a time where technology and globalization have changed the old rules of inflation.

Between the adoption of new technologies and access to an inexpensive global workforce, businesses can consistently find ways to cut their costs. If one business boldly tries to raise its prices, many competitors are ready and willing to undercut them. It's hard to get inflation when businesses can't raise prices.

For the most part, low inflation is a good thing because it will allow the Fed to keep interest rates low. However, inflation isn't all bad. A little bit of inflation gives

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(Where's the inflation?...................Cont. from page 3)

businesses the flexibility to raise prices, which helps them grow. Inflation also encourages people to spend their money, because when there's inflation, a dollar gets a little less valuable every day. In addition, inflation makes debt more manageable, because that debt will be paid back with less valuable money.

The financial world has been calling this a "Goldilocks" economy, which means we have found the perfect sweet spot: Our economy is strong enough to keep growing, but not so strong as to create high inflation. That's a nice place to be. However, our lack of inflation could cause problems in the future. What happens when all of our current inflationary pressures go away? The next 10 years aren't likely to bring many more massive bailouts, Fed programs, or tax cuts.

Does that mean we might start to see deflation? In many ways, deflation is a scarier scenario than inflation because it's a much more difficult problem to fight. But that's a problem for the future. For now, our low level of inflation is undoubtedly a positive factor for the stock market. Hopefully, it will continue.

Probably a mountain or a lake

My wife took this amazing photo of the recent full moon setting between The Temple and Cannon Mtn.

Blackburn Financial
Registered Investment Advisor

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