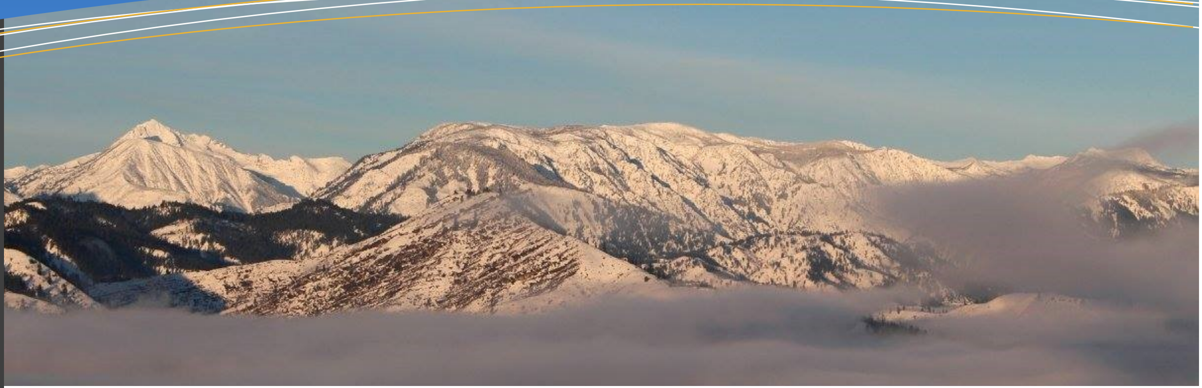
November 2018

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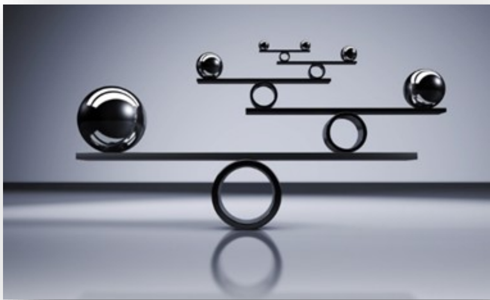
Although the commentary in this newsletter has been thoroughly researched, well-reasoned and contains many impressive multi-syllabled words, please enjoy it responsibly. There are many economic minds that are far smarter than mine—and even they can't agree on even the simplest economic questions. In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

It's not about the midterms

Although President Trump recently chalked up the weak stock market to the result of the midterms and threat of "Presidential harassment" by Democrats, I think that's old news. Had the Democrats surprisingly won both the House and the Senate, perhaps the markets would have reacted. However, for months, the expectation was that the Democrats would win the House, and we'd be dealing with at least two years of what Trump is calling "Presidential harassment." So, I don't think the stock market cares. After all, the stock market soared under Obama, who dealt with plenty of harassment himself. Even if it gets as ugly as an impeachment, I'm not sure why that would matter to the stock market in any significant way.

So, if it's not the midterms giving the stock market heartache, what is it? The answer is that it's a lot of little things: Interest rates and the dollar are rising, the trade war is lingering, and inflation has shown signs of picking up. Outside of America, Europe is still dealing with Brexit, and the Chinese economy is slowing. By themselves, none of those things are incredibly scary. However, they add up to a significant headwind for the stock market.



Another important layer to this is that our economy probably peaked in the 2nd quarter when our GDP reached 4.2%. In the 3rd quarter, it fell to 3.5%, and estimates for the 4th

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quarter are closer to 2.8%. That is still a strong economy, but the best times appear to be behind us. Whatever stimulus we got from the tax cut is fading, and for the next couple years at least, our government will probably do more damage than good. So, I think the markets are looking into the future and seeing very little to get excited about.

Of course, none of this means we're headed for a crash. The stock market is essentially flat for the year, and we are far from a recession. However, at some point the party will end. Whether it's next year, or 5 years from now, it's important to remember that not every recession becomes a disaster for the stock market. I worry that the recent experiences have trained investors that every economic slowdown becomes a major crisis. Over the last 20 years, we've seen two recessions – and both times, the stock market crashed. However, those were two of the worst stock markets in history. It won't get that bad every time. Of course, that doesn't mean you should be eager for our next recession. But take solace that it won't necessarily be a major crisis.

Is the falling price of oil good or bad?

Just a couple months ago, the financial world was all stressed out over the high price of oil. Now we have the opposite worry. Over the last 2 months, oil has fallen more than 30%. For the most part, a lower price of oil is a good thing, because less money spent on gas means more money for the important things in life.

However, there are downsides too. When the price of oil is low, oil companies make less money, and invest less in drilling and exploration. That can reverberate throughout the economy and stock market.

However, the biggest worry about the falling price of oil is what it might be an indication of. Usually, a strong global economy coincides with strong demand for oil. So, the worry is that the falling price of oil is an indication that the global economy is slowing down significantly. If that's true, it's a good thing for the stock market to be worried about.

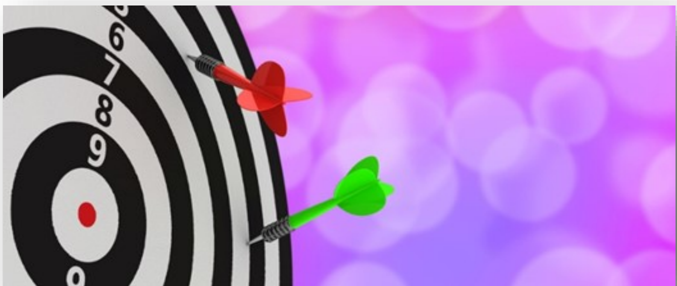
Will the trade war end soon?

On the first day of 2019, our trade war with China is set to get much bigger. The 10% tariffs we already impose on $200 million in Chinese imports will climb to 25%. If that happens, it will raise the stakes significantly.

Not coincidentally, Trump and Chinese leader Xi Xinping are planning to meet in early December. So, there's certainly the potential for a deal in the coming weeks. I think both sides would like to see that happen. China's economy has been slowing recently, and while it's not all because of the trade war, it certainly isn't helping. Similarly, here in America, the stock market is nervous and there are signs that the economy has peaked. So, a deal would be helpful to both sides. But what could a deal look like that would satisfy both sides? The simplest route for a deal would be something like this:

Over the next 5 years, China will commit to buying $200 billion more in goods from America, which will cut the trade deficit in half.

However, if Trump comes to the American people with a plan as small as "China will buy more stuff from us," will that be good enough?



Trump talks a lot about the trade deficit (which is more America's fault than China's), but nearly everyone agrees that the real problem with China is technology theft and government subsidies of certain industries. If Trump is really committed to changing those actions from China, I worry that it will take a lot more hard work and pain from both sides.

If the stock market keeps falling and the economy keeps slowing, does Trump have the fortitude to endure that pain? He doesn't seem like a delayed gratification sort of guy. However, does he have any other option? After declaring that China is "raping our country," you'd think Trump's base would revolt if he agrees to a deal that doesn't solve the biggest problems.

Clearly, the best scenario for the stock market over the short term is for a small, North Korea-style deal that doesn't accomplish much, but allows both sides to declare victory and move on. On the other hand, our problems with China are real, and now that Trump has brought those issues to a head, this might be our only chance to fix them.

It's a tough situation, and I'm genuinely unsure of which way I want this to go.

But the stakes are high, and they are about to get higher. The stock market will be watching closely.

Probably a mountain or a lake

Before the snow started falling, I hiked to the Alpine Lookout on Nason Ridge.
It was a gorgeous, fall day.

This is the fire pit for the lookout. Hwy 2 is far below.

The Little Wenatchee River far below a shadow of a massive bicep.

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