

# ***The Good, the Bad and the Volatile...***

*By Bob Deitrick*

*Friday the 13<sup>th</sup> of April 2018*

*There are unintended consequences to not having sound policy in place. The combination of a soft jobs report last Friday in tandem with Treasury Secretary Mnuchin conveying to CNBC that “there was the potential for a trade war” created great uncertainty for the markets last week. The ambiguity around a prospective trade war with China, the attacks against Amazon, troops being sent to the Mexican border, in tandem with the Mueller Report, have been unnerving to the stock market. We fear this uncertainty may daunt the potential benefits the market was looking forward to from the tax cuts passed in December.*

*The good news is that the corporate tax cuts should produce a stimulus for higher GDP and greater earnings this year. Earnings should be stellar in 2018. And to further that good news on Tuesday, President Xi Jinping of China announced a pledge to open China’s markets further for trade and investment, including its automobile sector, and he indicated he would work harder to boost imports, in a conciliatory speech amid this escalating conflict. Finally, on Thursday, President Trump announced he is rejoining the Trans Pacific Partnership (TPP) which he pulled out of last year.*

*The bad news, however, remains daunting. Prospective tariffs introduced by the President have created a tit-for-tat with China since early March, a scenario which could spin out of control. Indeed, we need to castigate China for pilfering our intellectual property, but this should be done through negotiation using the leverage of our allies - not by starting a 20<sup>th</sup> century mercantilist-like trade war which no one will win. The reality is that China has great leverage over the United States. Since we pulled out of the TPP last year, we could no longer negotiate strategically with our allies as we could before; albeit, that may change as Trump is apparently reversing his position as of Thursday. This is likely due to the influence of the introduction of Larry Kudlow. Further, China holds \$1.2 trillion of U.S. debt. To the extent they decide not to buy our bonds or dump them, this could create havoc to our markets and may choke off our recovery and any chance for dynamic scoring of our GDP to take effect.*

*We are watching these events on your behalf with great scrutiny. We are concerned about the number of ubiquitous landmines appearing almost daily. The market has gone through one correction and since the tariff introduction in early-March, we have re-tested the lows again last week. Steven and I are watching this volatility closely and our strategy moving forward is as follows:*

*The market has been hovering around an important data point called the 200-day moving average. If the market sinks beneath the 200-day average (set in February at 2535 on the S&P 500), this event would be analogous to opening a trap door. If this happens, there is no telling what may happen to the markets; therefore, we will move to a more defensive investment posture if this event materializes. Our goal is to protect your accounts and this is our plan to ensure just that.*

***A More defensive equity posture includes, but is not limited to, undervalued dividend-producing stocks, consumer staples, utilities, precious metals, international small and mid-cap stocks, and treasuries. Again, it is our hope calmer heads prevail as we have seen this week, but time will tell.***

***Guggenheim's head of investing, Scott Miner, a traditional bull, sees a tough road ahead for the market and our economy with a recession and a decline in stocks looming ahead. Miner, warned his clients last week that the market is on a "collision course" and "expects the worst of the damage to start in late 2019." Along with a decline in equities, a rise in corporate bond defaults is likely as the Fed raises rates. We agree with Miner that stocks may continue to rise this year as stock buybacks and free cash flow continue. However, as Miner adds, "when the chickens come home to roost and we have a recession, we're going to see a lot of pressure on equities as defaults rise."***

***One of the paradoxes today is that Congress and Trump pushed through very accommodative fiscal policy to expand growth and GDP while the Fed is now striving to control growth with higher interest rates and less accommodating monetary policy. This paradox presents an inherent economic conflict.***



*Scott Miner, Guggenheim Partners*

***Corporate debt stands today at a record \$8.83 trillion. Higher interest rates from a trade war or aggressive Fed policy will make it harder for firms to refinance and pressure them once the tax cuts wear off. As interest rates move higher, it will become difficult for firms to repay their debt. If this happens, the FED will harken back to quantitative easing, which pulled the economy out of the Great Recession, but this was accompanied by lackluster GDP growth as well. If the targets of 4 to 5% GDP growth projected by the Trump administration fail to take root, or if a trade war ensues with China, the national deficit will become the next big talking point on Wall Street and CNBC translating into higher interest rates, and ultimately leading to a recession.***

***Everything was fine until the tariffs were introduced in early-March. Since then, the market has been volatile at best. Starting a trade war with China and picking on Amazon is perplexing. Having said that, we assure you we are watching these events and your accounts very closely. We hope the administration has a strategy and plan in place, but that remains to be seen. Please feel free to contact us, at any time, with your questions and have a terrific weekend!***

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