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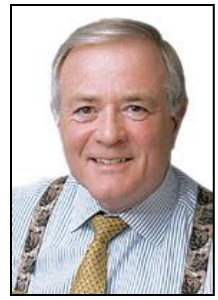

William Rutherford

Nine years of new market highs come to an end

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On March 9, 2009, the U.S. equity market touched a low, having weathered the Great Recession brought on by a financial crisis. Since that time equities have climbed a wall of worry to reach new records. Frequent corrections occurred, but the market managed to overcome many hurdles and somehow reached new highs every quarter.

A slow but steady growth in the economy carried the market quarter after quarter. It was a much-hated rally, with investors always suspicious of its reliability. Economic growth was uneven, leaving out many people, but the overall economy grew. During this time earnings and gross domestic product increased, but slowly. The tepid nature of the growth may have been one reason that the rally was so unloved.

Since the election of President Trump, headline news has dominated the airwaves. In this column, we frequently said to disregard the headline news and focus on the economic fundamentals, because the fundamentals were strong. We said our growth could continue so long as we did not have policy mistakes. Policy mistakes are frequently the reason for the end of a bull market.

The Federal Reserve is a potential source of mistakes and is frequently blamed for the demise of a bull market. “Bull markets don’t die of old age, they are murdered by the Fed” is a frequent adage. Lately, the Fed has been inching interest rates up. This is risky business, which can only be done with great care. Our rate of inflation is low, but approaching the Fed’s target rate of 2 percent. While the rate of increase is not alarming, the Fed wants to stay ahead of it. The newly constituted Fed under the Trump administration is much more inclined to be hawkish and to raise rates than the Bernanke-Yellen Fed. Lower rates are thought to stimulate the economy. But if the economy doesn’t need stimulating, then rates should be increased to ward off inflation and give the Fed some “dry powder” for the next downturn. The Fed is leaning toward three more increases this year.

The new Fed Chair, Jerome Powell, carried off his first meeting with aplomb, and it seemed that we had escaped that transition risk. But the market was unhappy, became volatile, and took several steep drops. It gave back all the gains from the tax adjustment bill that is the pride of the Republicans and fell into correction. Many well-known stocks fell into bear-market (dropped more than 20 percent) territory. Nevertheless, many analysts felt that the interest rate increase was justified, no surprise, and carried out smoothly.

But if it wasn't interest rates that caused the market dyspepsia, then what was it? One didn't have to look far to find another candidate for policy blunders. President Trump has been an advocate for tariffs on imports and exports since the campaign. He is convinced that the balance of payments between countries is bad for the United States. Almost no economist agrees with him, but he is convinced he is correct. Not only is his math bad, so is his policy. The last time the U.S. imposed tariffs on goods, the Smoot Hawley tariff, we touched off a trade war which led to the Great Depression and arguably sowed the seeds of the Second World War. President Trump argues that trade wars are good and easily won, but there is no evidence in history to support that claim. So the culprit in the policy issues may well be fear of a trade conflict.

Right on cue, the Chinese retaliated against President Trump's tariffs. The Chinese imposed tariffs on a wide range of goods, mostly agricultural. Farm states were big supporters of candidate Trump, so the Chinese targeted farm states with their tariffs. Farmers tend to be very sensitive about their pocketbooks, so we will see how that story line plays out.

Some American manufacturers already are complaining about the high price of raw materials that they formerly got from cheap imports. They warn of layoffs. Apparently, we have to learn the cost of trade wars all over again.

Money does not like uncertainty. Money runs from uncertainly. We have created a lot of uncertainty. We are reaping the rewards.

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