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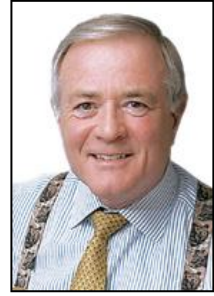
William Rutherford

Economic fundamentals trump negative news

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President Trump began his term by abandoning the Transpacific Trade Agreement, angering many of our allies. By threatening to impose steel and aluminum tariffs, he has further distanced himself from our allies when he needs them. Now he finds himself isolated in the trade talks with China, when he needs the support of other countries to come to favorable terms with them. Having determined that the U.S. is unreliable at present, our trading partners are making separate deals with China, further isolating the U.S.

Recently, Trump had to back down from his penalties on ZTE, a Chinese company that he had sought out for punishment, until President Xi Jinping retaliated with tariffs on U.S. agricultural products. Trump's interest in controlling technology transfer to China was left on the cutting room floor in order to salvage U.S. soybean exports.

In Trumpian style, he has sought to double down on his losing position. He wants more tariffs, this time on automobiles and auto parts. He is apparently unaware that auto products can and do cross borders, sometimes several times, in the manufacturing process. His strategy will disrupt global supply chains and damage the global economy. China will lose, but so will the US.

Congressmen and women are proposing legislation to limit Trump's trade authority, fearful that he has gone too far. Jamie Dimon, CEO of JPMorgan, has warned about potential negative consequences of the trade conflict. The Business Roundtable CEOs are concerned about the Trump administration's approach to trade, with a recent survey showing 95 percent see a risk that foreign retaliation could hurt U.S. exports, while 91 percent see risks that consumers will be impacted by higher costs of imports.

In a recent speech on the economy, President Xi offered nothing and hinted that Trump has an antiquated world view. China has a very clear strategy of a hard-wired economy, to the detriment of the U.S. Its emphasis is on technology with its powerful firms challenging the best in the U.S. Its "Belt and Road" strategy, which seeks to spread China's economic influence worldwide, is progressing nicely.

We, however, do not have, and have not had for decades, a coherent trade policy. Furthermore, we are now embroiled in political conflicts with China and others over North Korea and Iran. North Korea became noticeably more belligerent after Mr. Kim met with President Xi in Beijing.

If the talks get serious, expect China to demand a seat at the able. Again, we need allies for each of these conflicts, but have damaged our political as well as economic ties.

Pulling out of the Paris climate accords angered many of our historical allies. We imposed useless tariffs. We quit the Iranian agreement, leaving our cosigners to hold the bag and forcing them to choose between their own self-interest and America. They have an easy out, as India has shown, by saying they will stay with the U.N. agreements, not the U.S.

We have entered a period of a Cold War with China and isolated ourselves in the process. We have learned that trade wars are not so easy and that trade wars can lead to harder positions on both sides, which can further isolate us and dampen global economic growth. Indeed, the *Wall Street Journal* reports that the global growth story is fading, and there is an unmistakable slowdown in economic momentum in many areas.

The U.S. has often been criticized for its liberal trade policies, its free flow of capital, goods, and intellectual capital. Now we will see if a centrally planned economy can surmount such U.S. policy. History has shown that centrally planned economies don't do well in the long term. The U.S. historically championed the free flow of goods and services, which has led to a global level of prosperity far exceeding anything the world has known before.

China has myriad problems of its own, not the least of which are an ageing population, high levels of debt funding uneconomic projects and rising wage costs. The intention is to replace the country's dwindling work force with technology. The Chinese seem to be on their way.

We must figure out what our strategy is.

While trade fears hogged the spotlight, rising interest rates and uncertainty in Italy, where the ruling parties threaten to break with the EU, also upset the markets. Volatility resurfaced.

The global growth story faded, dimming market optimism, yet the U.S. showed strength – but for how long?

The May jobs report showed very strong numbers, and the market responded positively to this indication of economic growth. The unemployment rate dropped again and average hourly earnings increased 2.6 percent from a year earlier. The May factory PMI index registered 58.7 percent, an increase of 1.4 percentage points from the April reading of 57.3 percent. Comments reflected continued expanding business strength. Demand remains strong, with the New Orders Index at 60 or above for the 13th straight month and the Customers' Inventories Index remaining at very low levels.

The 10-year Treasury bond ended at 2.83 percent , a significant decline from 3.11 percent on May 17th. With the Italian situation, The European Central Bank (ECB) may be expected to go slow on tapering, its version of quantitative easing, putting pressure on the U.S. Fed to go easy on rate increases.

With 493 of the S&P 500 companies reporting for the quarter, results already show earnings up 24.3 percent year on year. Nearly 77 percent of stocks have beaten EPS estimates and 74 percent beat revenue estimates. Energy sector earnings increased 76 percent from the same period a year ago. The auto sector was the weakest of all 16 sectors in the market. For the full year 2018, earnings are expected to be up 19.6 percent. For the full year 2019, and for 2020, earnings are expected to be up 9.6 percent and 9.7 percent, respectively.

It is interesting to note that almost all of this year's market gains have come in May, a rebuff to the "sell in May and go away" crowd. The reality of stock market investing is that one must stay fully invested at all times, as market timing is extremely difficult, if not impossible, on a consistent basis.

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