# talking points

*Economic Thoughts from Rudy Thomas*

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# Economics Dominate

Well…while we continue to stress that economics is the primary factor in determining our various investment decisions, the ongoing impeachment hearings are definitely a distraction. After failing to tie President Trump to Russian collusion during the 2016 election and the Mueller Report produced no harmful information against the President, Democrats have now moved to the impeachment process. This was brought about by a so-called “whistleblower” coming forward with no direct information on a July phone call between President Trump and the new President of Ukraine. The individual has alleged a quid-pro-quo agreement regarding a request by Trump to look into a financial deal concerning former Vice-President Joe Biden and his son. We now know this “whistleblower” coordinated with House Intelligence Chairman Adam Schiff’s staff. We know Schiff and Nancy Pelosi will push this process to a House vote of impeachment, despite the lack of evidence of the President requesting such a probe for his personal gain. As Democrat Representative Al Green of Houston, Texas said; “I’m concerned if we don’t impeach the President, he will get reelected”. The outcome from the House has been known for months. However, once this process moves to the Senate, it will not result in President Trump being removed from office unless something more is uncovered than what has been presented so far. Regardless, we have to monitor the daily news as its impact on the financial markets is understood.

As we began this letter, we put our primary focus on economics when making investment decisions. While politics can move financial markets in the short-term, the economy will generally determine the longer-term direction and be the dominating influence. Since Trump became President, we have seen a strong economy, resulting in continued elevated job growth and record low unemployment levels. Also, wage growth has accelerated during this period. The Trump tax cuts have been the primary reason for this positive trajectory. Corporations in the U.S. are using the tax cuts to expand domestically and increase their earnings. This has resulted in job growth and the competitive arena has forced wage increases in the hiring process. The tax cuts have also allowed most U.S. workers to keep a larger percentage of earnings in their own pocket, creating greater consumer spending and investment opportunities.

**Year-end financial checklist:**

Check your tax withholding. Recalculating your withholding using the IRS withholding calculator can help you estimate if you’re paying too much or too little.

Give your 401(k) and retirement accounts a checkup. Set it and monitor it is great, but check it at least once a year. If you’re not contributing your maximum, challenge yourself to increase by 1% annually. If you are 70 ½, have you already taken your required minimum distribution?

Flexible spending account. Use it before you lose it. There are two types of flexible spending accounts (FSAs) your employer can sponsor: medical and dependent care. FSA must either be fully depleted during the calendar year or up to $500 can be rolled over to the next year. Otherwise, your contribution will be forfeited.

Review your insurance. Check your various policies to assure you have adequate coverage. Update your beneficiaries if there have been any changes.

Check your credit records. It’s smart to review your credit reports every now and then. Order a report every year from each of the three credit bureaus at annualcreditreport.com. Also, monitor bank and credit card statements for unfamiliar transactions.

Review your financial plan. Call us to review your financial plan and portfolio.

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While Trump did inherit an economy with positive GDP numbers, the Obama recovery was one of the weakest in history. Obama was able to show economic growth primarily by initiating numerous government-sponsored programs. There was a reason the National Debt rose from $10 trillion to over $21 trillion during the Obama presidency. During those 8 years, Obama more than doubled all of the debt accumulated by every administration before him.

When Trump began his entry into politics and his campaign, he promised a more business-like approach to his handling of the economy. Economic advances and corporate entities were the initial beneficiaries after Trump won the election. Then, as we said earlier, individuals became the prime recipients of the overall benefits one would expect from such improving conditions.

As a way of demonstrating the benefits associated with a strong economy, the recently announced non-farm payroll for October is a good example. The recent workers strike at General Motors and problems associated with the Boeing 737 Max airliner have weighed heavily on the manufacturing sector domestically. Due to this, the consensus estimate for job growth last month was only 90,000. However, due to strength in other sectors, employment gains were much higher at 128,000. Even more impressive is the Unemployment Rate rose only 0.1% above the record-low level of 3.5% during September. Wage gains are up 3.0% on a year-over-year basis and the Labor Participation Rate has climbed to 63.3%.

In another way to show the current environment Consumer Sentiment rose to 95.7 in November from an already healthy 95.5 level last month. The primary reason given for this improvement was job growth, low inflation, and gains in the stock market. When asked, most surveyed said the impeachment hearings were a non-factor. Hmmm…maybe Democrats <u>should be</u> afraid of next year's election. Another consumer-related release is that Retail Sales rose last month by 0.3%.

Construction Spending rose 0.5% in September, representing the third straight monthly increase for this economic sector. This administration's business approach has created a strong economic environment but with accompanying low inflation. The result has allowed for historically low interest rates. Lower mortgage rates have been a major influence on improving construction numbers for homes and commercial properties. On a broader scale, Pending Home Sales jumped by 1.5% during September. More recently, October Housing Starts rose a sharp 4.6%. Again, the primary factors for such would be the strong consumer sector and lower mortgage rates. At the end of October, the Fed cut the Funds Rate by another 25 bs.pts., for their third cut overall. While I personally believe they have been slow to react to the falling inflation numbers, it is encouraging they are moving in a positive manner for continuing economic growth. I expect we will see mortgage rates at even lower levels in this cycle.

Earlier, I mentioned the manufacturing and production issues associated with General Motors and Boeing. Because of these two entities, primarily, Factory Orders fell 0.6% during September. While understandable, it would be concerning if this trend continued. For instance, production levels at Boeing fell by 11.8% that month. We expect to see a positive reversal in this sector. The strike at GM has been settled and Boeing announced within the past few days they expect to resume manufacturing and selling the 737 Max within the next month. This will be worth following.

The manufacturing base also held back GDP during the third quarter. While the actual number was above the consensus, the 1.9% growth in GDP is below the 2.5%+ numbers we have experienced under this administration. However, certain sectors continued to perform quite well. Residential Investment was up 5.1% and Consumer Spending grew by 2.9%. As manufacturing regains momentum, particularly if a trade-deal with China is reached, GDP in the 2.5%-3.0% range should again follow.

In terms of our investment outlook, the economic base continues to support an upward bias in the equity market. However, the coverage of the impeachment process by the media is proving to be a factor day-to-day. Although not likely, if Trump were to be impeached the equity market would likely see a significant downturn.

Another important obstacle continues to be the trade negotiations with China. Trump is taking on the previous China-favoring trade deals directly. He is by nature a free-trade supporter, but he has aggressively included tariffs against certain Chinese-produced goods to combat their non-productive tariffs against U.S.-made goods. While it is difficult to put a timetable on these negotiations, it is probably a reasonable assumption we will see some form of an agreement within six months. Politically, it would make sense by early 2020.

Our investment portfolios have benefited from various aspects of the investment process. The majority of our portfolios allow for the inclusion of both fixed-income and equity assets. While equities have generally outperformed fixed-income securities, there have been specific time periods where our bond holdings have offset the normal corrections that occur in the equity market. A recent example was last year, 2018, when the S&P 500 had a negative return of about 4.5%. Our portfolios generated a positive return due to our bond holdings and positive equity returns. We always begin our investment process and discipline with an asset allocation overview dictated by our economic outlook. We continue to view both asset classes as positive contributors to portfolio returns as we approach the new year.

We hope the upcoming Holiday and Christmas Season brings peace and joy to you and your family.