asset management associates

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Fake, Hyped, and Not so Fake, News!

Beware! This newsletter may contain some fake news!

In recent history the media has had a bigger and bigger influence on the financial markets. There is a ton of information circulating via live feeds and internet news. With this, certain themes monopolize the chatter. Various stocks filter to the surface and get talked about and hashed more than others. When a story appears in one financial publication like Investor's Business Daily, a similar one may show up in the Wall Street Journal and other blogs and newsletters. The hype then disappears like it never happened.

In the summer of 2018 all of the financial news came out and said the economy was great. Then from out of nowhere we found ourselves in a fourth quarter market rout that wiped out a full year of stock market returns. Suddenly the perception of the economy moved from solid growth in a low interest rate environment to a phase of hyperinflation and a high interest rate scenario that would sink stocks and the economy! This is not Fake but hyped.

Then, in the early part of this year, the perception reversed and Federal Reserve policy changed with it. In a twist, the first quarter of this year ended up with lower interest rates and a stock market rebound that brought us very close to the levels we were at last summer.

So now we are left to wonder what happened. How could the information analyzed back in October by high level officials be so far off from what we are looking at today? This could be the result of some not so fake news that was so hyped up it became fake.

Interest Rates

The stock market reacts most heavily to the direction of interest rates. If investors think interest rates are

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The Tech Economy

There is no question we are rapidly moving into an economy run by technology. We are all accustomed to faster computers and more apps on our phone. There are, however, a few technologies that will transform our environment and bring us to another tech level.

The first is 5G. Although the new 5G (Fifth Generation) wireless is being heavily hyped and showing up on the new phones later this year, it may not be wise to buy them too quickly. It will take several years for the 5G access to be readily available and get the bugs out.

5G is powerful. It uses a higher frequency and can carry much more data at a much faster rate. It is slated as being some 30-40 times faster than current wireless data transmission. A movie that would now take some 6 minutes to download would take only a few seconds using 5G. The benefits are not just speeding up your text message. Driverless cars, navigation, virtual reality, remote medical procedures and the interconnection of all devices will become seamless. It won't be long before you call your dog on his cellphone. Won't work for cats - they never answer the phone.

The 5G Network will probably not replace, but greatly enhance the current 4G systems being used. This is because the distance the 5G signal can travel between antennas is much shorter. For this reason small antennas may be attached to telephone poles or small towers in various areas. It will take time to build out this infra

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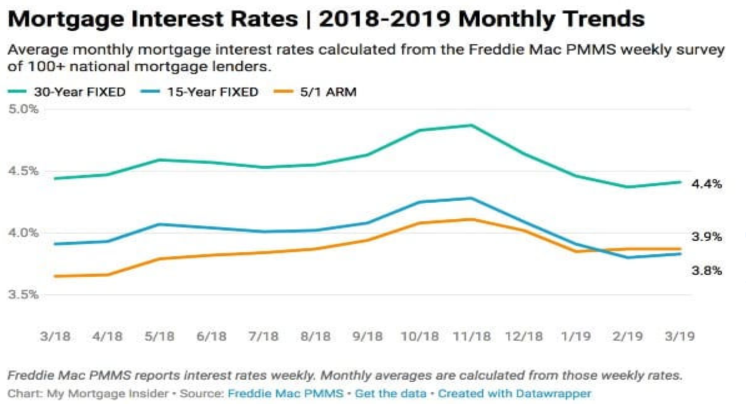

increasing, they can expect to earn higher, risk-free returns in a simple interest bearing account. For stocks to compete, they must have really good earnings to make them more attractive than cash. Some say earnings are good, others say, they are fading. Another group says it doesn't matter.

In October of 2018, the Fed increased interest rates for the 9th time in a two year period to a level it called “more normal”. Unfortunately, no one knows what is meant by “normal”. At that time, the new Federal Reserve chair indicated that the Fed would raise rates once more in December of 2018 and then possibly four more times in 2019! This aggressive statement made investors head for the hills.

The Fed ignored news on the slowing of the European and Chinese economies and the impact of the impending U.S. trade war with China. Instead, it focused on the sound and very strong U.S. economy. It strongly believed that inflation was just around the corner and it had to be stopped before it got out of control.

December came and the Fed did not raise rates but still remained firm on its stance to increase rates throughout 2019. This forecast was gradually trimmed from four rate increases all the way down to one. Then, just a few weeks ago, it became zero for 2019. But the financial news is now hyping up that theme and talking about actually reducing rates at some point. So ,in just a few months, the Fed moved from worrying about hyperinflation to concerns about potential deflation - a condition it was worried about in 2008!

The Fed Balance Sheet

While the Fed was raising rates, it was also systematically selling off pieces of the 4 trillion in bonds it purchased in the 2008 crisis. Selling these bonds in the open market causes rates to rise and puts even more downward pressure on stocks. But now the Fed has also backed off of that strategy. It indicated that it would stall those sales and push them off until later in 2019, if at all. In the most recent meeting a few weeks ago, the Fed now says it will take a very “measured” or cautious ap-

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structure and not all areas will have that kind of access. Cities will be the first target and it is being tested in NY, LA etc. Qualcomm, Nokia, Ericsson, Samsung are some of the major players in rolling out 5G platforms are Qualcomm, Nokia and Ericson. T-Mobile is heavy into 5G and of course Verizon and AT&T. It is starting to be used in South Korea parts of Japan and China.

The second revolutionary technology is what is broadly referred to as Artificial Intelligence or AI. We are already seeing this daily in our lives but it will get better ...or worse. The famous physicist Stephen Hawking once said that AI could spell the end of the human race.

AI is rapidly moving our world from a people world to a machine world. The largest user of AI today (according to theWSJ) is retail. They track everything you do and all of this information is diced and scanned and continuously analyzed to get products and ads to you.

AI falls into various segments but the most important leap comes from “machine learning” . The “simple” computers of today are programed to recognize specific situations and react to them in specific ways. AI allows the machine to “learn” from its experience. If the car “sees” a deer, it looks back at millions of photos and decides if it’s a deer or a dog, Then it records the animal and adds that experience to its “memory”. This is just what we do in our minds. We continuously record our experiences and refer to those experiences to make a decision. So with AI the machine ends up programming (learning) itself. The volume of data in AI will need 5G to make this really work and obviously these 5G networks will improve over time.

The scary part is that as this technology is absorbed into our defense systems and our personal lives, we all become vulnerable. This was the fear many countries had over a Chinese company, Huawei (the third largest cell phone provider behind Apple and Samsung). The concern is that it is imbedding spyware in its technology. China’s government passed a law that requires Chinese companies to cooperate with its national intelligence work. This is a very big problem with security.

AI is already enhancing research on drugs and other very complex studies. As it becomes more mainstream, it will revolutionize our world. It also has the ability to displace workers and replace more low income workers with kiosks. It will actually affect how the economy runs, how money is transferred and how students are educated, although they don’t need to know anything because Siri will do it all. At least that’s what it said on the internet.

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proach to raising rates and reducing its (bond) balance sheet. This is the wording Janet Yellen had used well over a year ago when she was Fed chair and was slowly raising rates. After this announcement in March, had a panic attack. Investors started to feel like something had to really be wrong if the Fed was reversing everything it talked about just a few months ago. It dropped 500 points that day. But very quickly, investors realized that low interest rates are good for stocks so it was back to the races.

It is very unusual for the highly regarded Federal Reserve to move or change direction so quickly. It was aggressive in pushing rates up and it was equally aggressive in backing off its initial strategies. As investors, we tend to think the Fed has a crystal ball that is much more reliable than the average stock guru on the street. After all, the Fed practically owns the banking system and it gets to look at information that may not be privy to the average soothsayer. But this situation makes the Fed look like it was looking at the same snowy crystal ball that was being sold for $1.00 at a JCPenney closeout sale. At the same time, Donald Trump has continued to strongly criticize the Fed for raising rates even though his crystal ball is just an old flickering lamp taken from Mar-a -Lago. But it seems as if he was right! Trump was right! The Fed was wrong! Something is amiss. This could be fake news!

The irony of this whole thing is that although the Fed has increased rates throughout 2018, the yields on the 10 year Treasury bonds are now at about 2.4%, which is significantly lower than the 3% in early 2017. So although the Fed has pushed interest rates up, investors have pushed yields on bonds, including mortgage rates, down. In just the past few weeks, new mortgage loans and refinances have increased dramatically. Consumers, along with students, governments, and everyone else, are borrowing at record levels.

Keep in mind that investor demand drives the price of bonds up and yields down. Investors are buying bonds because they still fear the future. They are willing to lock into a rate for 10 years that is equal to or lower than a rate they could get for only one year. This means they still think there will ultimately be a recession in the future and rates will have to come down. Sounds crazy, but probably not fake -that's what they are thinking.

Trade and Tariffs

The Trump trade war was also big news toward the end of 2018. 25% Tariffs on billions coming in from China! The trade war was a major factor that threw the markets into a tailspin mainly because it would drive up the cost of imports from China and, at the same time, retaliatory tariffs from China would make U.S. exports less attractive. These retaliatory export premiums have had a great impact on farmers in the U.S. Heartland. In general, both of these scenarios are inflationary. Ironically, however, the negotiations on tariffs have been delayed. The media stopped hyping the negatives on trade and are now getting optimistic that a deal "like no other deal" will be reached. But this may not be real.

Europe

Germany, the largest economy in Europe, is struggling. It is back to dealing with negative interest rates. In other words, in some cases, they have to pay the bank to take your money! This is a tough concept for most of us to understand. But people and businesses have to store their money somewhere. Along with that, the 10 year German bond tends to trade at zero or even some decimal points below that.

Negative rates are a reflection that Germany, and all of Europe, continues to be in a very slow growth mode that some say is deflationary as manufacturing output continues to decline each quarter. No one can pinpoint for certain what the problem is but it seems to be a number of factors that are stifling growth. Many countries are saddled with debt and there is a loss of confidence in the Euro and the future of the European union. A number of countries would prefer to manage their own affairs but they are tied to this common currency and, with their huge debt burden, it is difficult for them to get out.

One of the biggest factors that will make or break Europe is the impending exit of Britain (Brexit) from the Eu-

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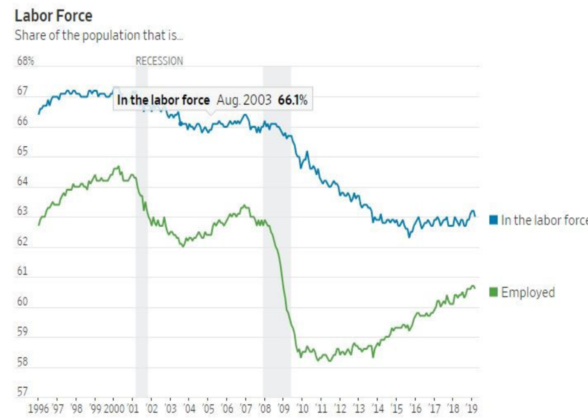
ropean Union. No one knows how this will play out. Money and commerce moves freely between London and the rest of the European Union. Since there are no definite Brexit plans, businesses are shy to invest in their own infrastructure when they do not know what the rules are going to be. So business is virtually frozen and delaying the actual Brexit does not help. So this situation has taken a relatively weak European economy and put it on the edge of a major recession.



Employment improving but a low number of participants.

At the same time, China's rate of growth has also slowed significantly and China is intertwined with Europe. So, in general, the largest economies around the world seem to be slowing and the governments and central banks of both Europe and China are stimulating their economies much like we did in 2008.

Stocks

The reversal in interest rates and the absence of the tariff hysteria have been good for stocks. We are back to where we were before the Fed spiked interest rates and possibly before Trump dropped the tariff bomb. With interest rates once again at the lower end of the spectrum, investors have a hard time justifying holding onto cash. This drives the price of stocks up. The same is happening overseas. If we really do get a solid and favorable agreement on tariffs, the markets in both the U.S. and China will continue to rally. If there is a resolution with Brexit, the European markets will be on track to pull themselves out of the dumpster. All of these positives will be very bullish for stocks. We also have a president that seems to judge his performance by the success of the stock market and the economy. The latest news is that he is trying to stack the deck at the Fed to get some voting governors appointed that are partial to his views.

Conclusions

The story of the past several months has changed dramatically and its getting harder to decipher the facts, and the fake news from the hype. Even the Federal Reserve seems to be caught in the drama. The good economy, the too good economy, the inflating economy and the deflating economy. The Fed raises rates, mortgage rates go down. One tweet and the trade war is on. Another tweet and we have a trade deal, "The best deal —EVER!". This makes it tough for investors to figure out where we are headed or what to do.

For now, we are more or less back to where we were last year. Low rates still make stocks a pretty good option. But if everyone gets too excited about buying stocks, the story may change again. The Fed will raise rates, stocks will go down. The next mania will be that elections are coming! That will be more hype and a lot of fake news. But for now, the markets is up. No faking!

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Note: First Year Fees waived for Active duty military..