Second Quarter 2019

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Deal or No Deal!

In the first half of this year we ended at the high end of what has been a rollercoaster. The markets peaked back in January of 2018, took about a 10% dive, recovered through late last summer, then dropped another 15-20% and recently rebounded almost 20% into the end of June. We are now back at market highs.

With signs that there will be some kind of China deal, we are breaking out into new territory. There are actually a lot of deals floating around. The lead deal is China, but Korea, Mexico, Canada, and Iran are still in play. They all add to the backdrop of the instability and confusion of the markets. I find my clientele to be split in their thinking. Some think we are headed for economic collapse, while others think that we will have the greatest economy and stock market of all time! Of course, a lot of this has to do with their political affiliation.

What makes it so difficult is the entire dynamic of the world economy has changed since the big jolt of 2008. A lot of this is due to government interventions into the market and this has made some things seem upside down.

Negative Rates

The stock market rally over the past six months was due purely to interest rate declines in the U.S. The 10 year treasury was well over 3% early in the year. It is now hovering at 2% and could be headed lower. That is a 30% decline in only a few months! At the same time, the shorter term 1 and 2 year rates have remained in the 2% range. So, we may be moving into a period of time where short term rates are higher than long term rates.

The normal "yield curve" illustrates lower rates for short term maturities that get higher as maturities get longer. Today the curve is flat and teetering on what is called an "inverted" curve. So this "inversion" of inter-

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New Service for the 21st Century

You may have noticed that I updated my logo. Not that it matters much but it's a new look. Also, over the next weeks and months I will be rolling out a new service that will offer great benefits for the right situations and it is free to existing clients. There are several pieces to this. I am just setting it up so there will be more info coming but here are some of the highlights.

This utility is simply a Fidelity owned, web-based, portal designed for independent advisory firms to help service their clients. There are several products that are similar but this service is one of the better, if not the best, out there.

One of the primary features of this service is consolidation. By logging into one web page, a client can link all of their assets. As an advisor, I have clients who have investments in addition to the ones I manage. For example, I may handle a client's Schwab account and somewhere in the process they ask me to look at their 401k plan, which is through another investment firm. I have to get their statement or sometimes log in with them to review it and get back to them. With this tool, a client can link all of their Schwab or Ameritrade accounts, 401ks, IRAs, etc. to this one website and the client and the advisor can view everything at one time. There are over 40,000 institutions that are easily linked via dropdown to this site. If a company isn't there, it is possible we can set it up.

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We are approaching 14 trillion in world debt that carries a negative interest rate.

est rates is a situation that is usually a precursor to a recession and investors are seeing a bleak future. They would rather earn 2% for 10 years rather than take the risk of losing their shirt in stocks. But, because of what is happening overseas, this may no longer be the case.

Europe is struggling with a slowdown. Because of this, the European Central Bank decided last month to lower interest rates. They are already in negative territory! But they want even lower rates to help stimulate their economy. Negative rates were unheard of in the past but now seem almost normal. Pushing rates this low is an extreme example of government trying to manipulate the economy out of a recession or depression. Worldwide we now have some 12-14 trillion dollars in negative rate debt. In other words, you lend money and get just a tad less back. This may not make sense, but it is more secure to get back a little less than lose all your money because the whole economy falls off a cliff.

Back in the U.S., the Federal Reserve is feeling the pressure to lower rates. One fear is that Europe will drag us down with it. If their recession worsens, we will feel it and we could be already. With all the good that is happening in our economy, our growth has begun to slow. This could be due to all the uncertainty over tariffs and interest rates. It is difficult for businesses to make decisions when the future is so unclear. Should they shift their supply lines or wait to see what happens?

Investors around the world are also buying our treasuries because they anticipate our Fed dropping rates and because our rates are high relative to Europe. This extra European demand may be pushing U.S. treasury prices up and yields down. This may be the cause for the inversion. For this reason, lower long term rates may be justified.

For stock investors this is good. Borrow money cheap and buy stocks. The extra demand drives prices up ...at least for now. But borrowed money has to get paid back quickly when the market reverses, so the downside is also more violent. We are

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First, this makes it easy to see what you have and give us a real time update of where you stand. The site is linked to your accounts so you do not have to download stock prices or values and it is updated daily.

Second, it is a benefit in case of an emergency. If you are disabled, then your spouse, son, or daughter, etc. could log in and see where everything is. It does not allow access to any accounts but everything is available for review.

The next feature is for analysis and you can take this as far as you want. Bank accounts, credit cards, mortgages, etc. can be plugged in so cash flow can be analyzed. It is designed for an advisor to work with a client and help with financial planning issues, like projecting how investments grow or how a mortgage or debt could be paid off over the next 6 years.

The actual transactions on credit cards and banks are not visible to the advisor but some people need to get a handle on cash flow. Since it is all there - live - it is a lot easier than an Excel spreadsheet.

The last function to mention could be the most valuable. There is an online "vault" where you can upload your personal documents. By default, this is not visible to the advisor unless the client wanted to make it so. With this you can upload your will, trust documents, powers of attorney, passports or whatever. Again, if you become incapacitated, all of these important documents are in one place. Many people have family all over the country. In an emergency, someone may have to fly in and start digging through drawers to figure out which bank account you are using or who your insurance is with, etc. With this, if done properly, it is all there. Your family in Denver can start getting a handle on things without leaving town.

To view and work with the program, the advisor and the client do not have to be together. Both would be connected online. I have various types of clients with all different needs. This tool can solve some challenges.

Finally, it is a great planning tool for an investor just starting to take control of their financial lives—saving money and paying down debt. The process is no different than losing some weight or getting in shape. You need the tools, the willpower and a good coach. I have found it very rewarding to help people succeed and I am hoping this will help.

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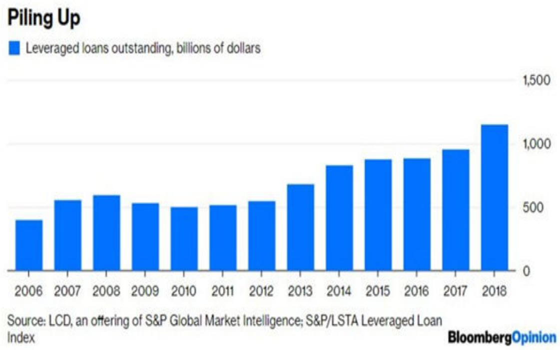

back to the same scenario we were at several years ago. There is no place to put money. Two percent is not too exciting—so buy stocks and hope for the best.

Debt levels are Rising

Our National debt is now over 21 trillion and counting. We still do not have a plan to rebuild our infrastructure (bridges, etc.) which, if put through, would require more debt. The Federal Reserve Bank still holds some 4 trillion of that debt. It is trying to get rid of it but it is getting hard to sell off. So far no one is talking about the Federal Debt and fewer are talking about municipal and state debt levels.

At this time, the markets are more focused on the growing corporate debt. In spite of all the uncertainty, corporate debt is growing. It only makes sense for a company to invest in their own technology or infrastructure and take advantage of low rates. But the corporate debt bubble is growing and it is the lowest quality of debt (junk) that is at record levels.

So we solved the problems that caused the 2008 mortgage meltdown but the solution of low interest rates has created other problems, like a potential bubble of corporate debt. It could also cause a stock market bubble, which is why the Fed was raising rates last year —to shut that down! But it got blindsided by the tariff war and Europe so it is now reversing course. To complicate the picture a little more, the Fed continues to get the evil eyeball from Donald Trump. He wants lower rates. The Fed wants to be independent. It doesn't want things out of control—but it knows tariffs and Europe could sink us. The Fed is in a tough situation.

So all of this will more than likely lead to the Fed following Europe with a rate cut in July. The market wants this one. This will reverse the course of raising rates that the Fed has been on for the past 2 years. This could be a big boom for the economy or it could backfire and make investors start to think that we really are in trouble. The investment community seems to be pricing in not one, but two or three cuts this year. That seems a bit much and another reason things could go either way. The markets could celebrate the rate declines or be upset they are not getting enough.

Tariffs

The most important and invasive way the government is providing economic interference is via tariffs. We have not seen a situation like this in modern history. The headlines are all about China but this also effects trade agreements with Mexico, Canada and other European Nations. Over several decades, the U.S. has become a country that is dependent on cheap overseas labor and low-priced imports, most of which are from China and a lot from Mexico.

In addition to using low cost labor, a good portion of corporate growth over the past decades was a result of padding profits by tapping into the 1 billion Chinese consumers. To get the opportunity to market to these consumers, we (U.S. business) had to give something up to China. In a lot of cases that was intellectual property. China developed into a technological behemoth with lessons learned from the U.S. It has now fully penetrated our markets. They are aggressive. They have their own set of rules. They take what they can't buy and now they are a world power. They have shot satellites out of orbit just to prove they could do it and landed two spacecrafts on the moon. They are building a formidable military force, part of which entails dredging tons of sand onto sandbars to build military island bases from scratch in the South China Sea. This area is of particular importance to trade throughout that region. Along with their military growth, they have gained political alliances among several third world countries by helping these needy countries build roads and infrastructure. More recently, China is trying to strengthen its alliance with India and Russia. Both China and Russia are having issues with the west—particularly the U.S.—and it makes sense for them to "commiserate".

Technology

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As China became stronger, they became the bully in the markets and gained a competitive advantage in technology. Because of that, the U.S. Government retaliated with the implementation of tariffs. We are trying to slow their growth by making it financially less desirable for American businesses to work with China. But it could be even more than that. What we have is also a race to technological superiority. Most of us cannot comprehend the transformative power of 5G networks, artificial intelligence and virtual reality. A government that controls these technologies will have power akin to the superior air and sea power of past generations. At this point everyone would agree that the next generation of warfare will probably be fought with superior computer technology and China is taking the lead.

Pressure

Tariffs are hurting businesses in China. The Chinese economy is laden with debt at multiple levels and most market experts do not understand how it works. Their economy is not transparent. The government is backing up businesses of choice. A lot of small manufacturers in China that ship to the U.S. are being crushed. We don't know the repercussions. Ultimately the Chinese economy could be hurt very badly. Japan's economy came to a standstill in the early 1990s due to the arcane government regulations and Japanese customs. Japan is now struggling with negative rates and still has not recovered. An economic collapse of China, the second largest economy, will cripple the world economy and there is a possibility that can happen. Or, they could play hard ball and force a standoff that will jeopardize our economy. Xi is President for life, Trump has a year and a half, at best, to pull this together.

Right now, the tariff war is applying substantial pressure on U.S. farmers. It is directly crushing U.S. soybean exports and several other crops. The tech industry is also feeling the crunch. Over several decades we have created a world economy. It is difficult to just turn it off without significant collateral damage. It is difficult to determine in advance who gets hurt the most when a switch is turned off. When building an airplane if there is one screw missing, the production line stops until it comes in.

Conclusion

A free market is supposed to be free from government control. In reality, government has always been involved by adding in regulations, taxes, tariffs and central banks that control our money supply and interest rates. But governments are pushing these levels to the extreme with negative rates, harsh tariffs and the restructuring of Europe via Brexit. This extreme meddling with free markets can cause disruptions and the consequences are unknown.

However, the stock market news is all good! It has a President that judges his success with the market performance. It has low interest rates which may go lower. Growth is slow, but moving in the right direction and we have so many deals in the works that it seems like any good resolutions will be just another reason to buy stocks.

At the same time, it's all about the deal. Trying to figure out if it will be a good deal or not is like choosing which suitcase to open. There are so many suitcases ,we just don't know what we will find when we open the next one. We don't need a win ..we just need a deal!

Have a Great Summer!

John R. Ruocco