

Ivory's Economic Outlook

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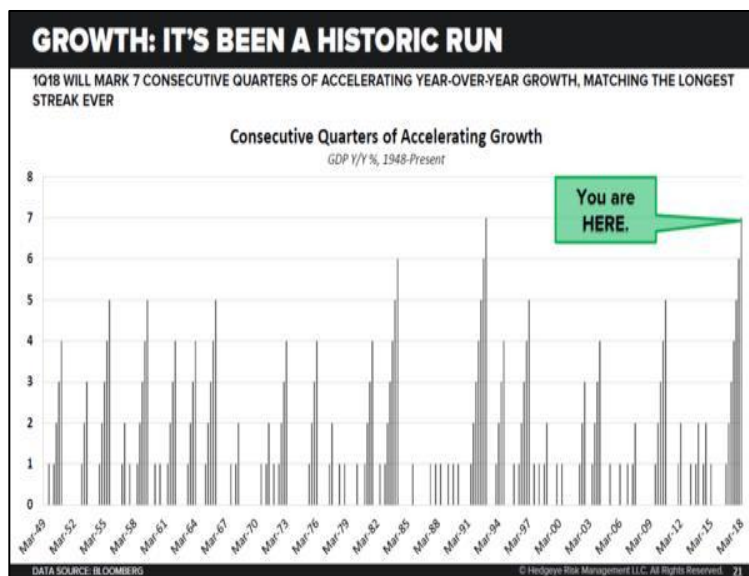
Cities are not like suburbs, only denser. They differ from towns and suburbs in basic ways, and one of these is that cities are, by definition, full of strangers.

Jane Jacobs, Author "Life and Death of Great American Cities"

My tenant in New York recently told me she went jogging in East River Park along the FDR Drive. My response was both immediate and fatherly, as I advised her in the strongest terms possible to never do that again. After all, this is a neighborhood where thieves would hide in between parked cars and stick their arm out to clothes line you as you rode by in an effort to steal your 10 speed contraption.

I'm now told that things have changed, that the Lower East Side isn't what it used to be. And like many cities around the country, Washington, D.C. is also in the throes of gentrification, albeit with glaring contradictions hiding in plain sight. Existing residents want to know why the city decided that now would be a good time to fix the leaky roofs, update the textbooks and make toilet paper available in the school bathrooms. Suffice it to say there are still sections of our city where 95 percent of the students are not proficient in English or math.

The newest arrivals counter that school board participation yields results and a higher tax base invites grocery stores into food deserts, a term used to describe neighborhoods with no access to fresh fruits and vegetables. They'll say political engagement and lobbying elected officials improves conditions and not protests that hold up traffic. As one who has lived on both sides of the same imperfect fence, and who now benefits in two different cities, I can only confirm that it is messy. These things will not be easily solved, even if all parties involved know what the final solution will be.

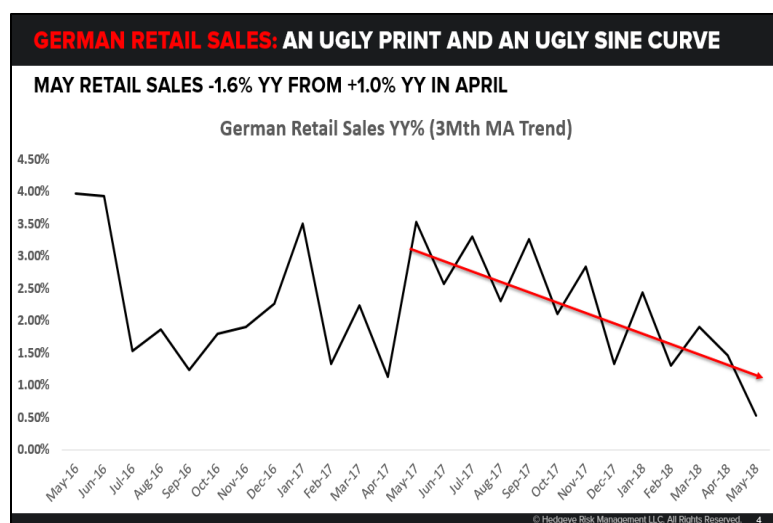


Similarly, the U.S. has seen its economy refurbished by low interest rates, stock buybacks and a wave of optimism. Uncle Sam might stagger, but he's certainly not gonna let a little adversity knock him down. In recent years, we've seen seven consecutive quarters of GDP growth on a rate of change basis. This is unusual. It also comes on the heels of corporate profits decelerating for more than two consecutive quarters. It was the first time such a thing had happened in our history without a crash. Analysts hypothesized on its meaning; the markets shrugged.

The economy, though, is likely to begin to slow in the back end of the year, and like gentrification it will bring change most find uncomfortable. The same way grandmothers must sell the family home for pennies on the dollar to pay the rising property taxes, companies must grow profits in a slowing economy with rising rates.

These are important matters. Investors are charged with deciding if they should wear a jacket or a pair of shorts – it's not so easy to decide as the seasons blend into one another. When the economy is growing, technology, industrial and consumer discretionary stocks tend to do well, especially if we correspondingly have inflation. It makes sense that people splurge and companies upgrade when the getting' is good.

Once growth slows, provided prices are still rising, energy companies, real estate and utilities have historically outperformed. The theory goes that these businesses are not expected to grow but so fast and their dividends are rewarded. Let's call it the bird in the hand theory. Should both growth and inflation decelerate, consumer staples and health care companies benefit from being a safe haven. Consumers might not buy the best toothpaste, but toothpaste will be purchased.



Europe and the emerging markets, however, are in a different situation altogether. They might be better than us at soccer, but their economies have already slowed dramatically. From the 2018 peak, world equity indices are down 10 percent from \$87 trillion in market capitalization to \$78.6 trillion. Spanish retail sales slowed to -0.4% year-over-year in May vs. +0.7% in April. German retail sales slowed to -1.6% year-over-year in May vs. +1.2% in Aprilⁱ.

Meanwhile, Chinese stocks are down 20 percent from their January highs. Emerging market equities, like Argentina and the Philippines, have been rocked by the one-two punch of a stronger dollar and slowing growth. Italian equities are down 12 percent since early May.

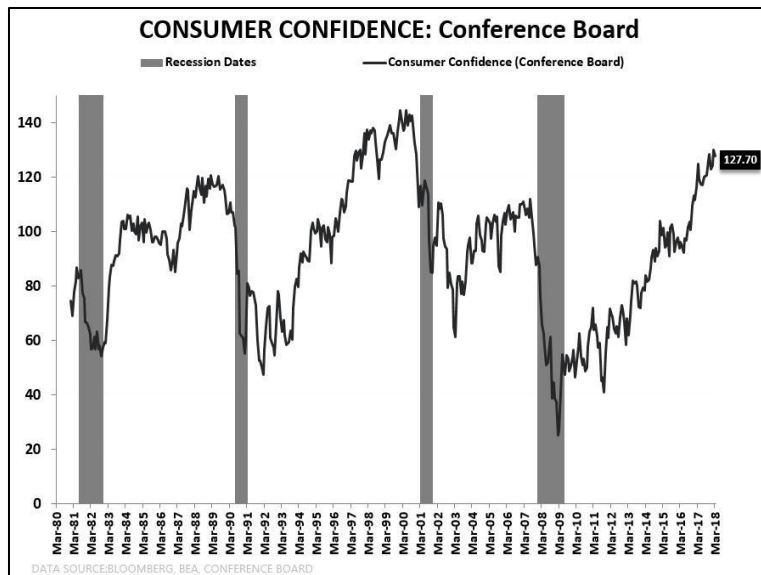
It would be easy to blame all of this on President Trump's trade war, namely the imposition of tariffs by the U.S. on \$34 billion in Chinese goods and the immediate reciprocation from Beijingⁱⁱ. It's worth noting, however, that he does have a point - China not only forces a number of foreign companies to partner with Chinese firms in order to do business in the country, but also requires those foreign companies to hand over intellectual property, including proprietary information to their Chinese colleagues.

It's not just China being affected either, the president has threatened to impose 20 percent tariffs on foreign cars and car components, which would likely have a significant impact on the America's automobile industry. The European Union has made no bones in the past that EU automakers employ 110,000 U.S. workersⁱⁱⁱ in American factories, 60 percent of whose production is exported, thus lowering the trade deficit that concerns the President. This will be interesting.

Tariffs would immediately increase the cost of imported goods, and companies will either have to sacrifice profit margins or pass that cost onto consumers, which will most likely hurt domestic sales. The retaliatory tariffs from other countries will also make U.S. goods more expensive overseas and reduce global market share.

Multinational companies didn't become multi for no reason. They'll simply import products from countries that have the lowest tariff rates such as Canada or Mexico that benefit from the North American Free Trade Agreement and claim that the products have changed enough in these countries to meet the legal requirement. Well, it seems The Donald has a problem with NAFTA too, even though 14 million U.S. jobs are tied to U.S. exports to Canada and Mexico^{iv}. The point of NAFTA was to encourage economic integration among the U.S., Mexico and Canada, and that in turn was supposed to boost economic prosperity for all three.

The effect has been what you would expect, lower skilled workers saw their job security and wages markedly decline and everyone else did well according to where they stood in the pecking order. Since NAFTA became law in 1994, exports from the U.S. to Canada and Mexico are up 280 percent over that time, while imports from the two countries have risen 313 percent^v. Also, Canada and Mexico are two of the three largest destinations for U.S. exports, making up over a third of the total exports^{vi}. The chances of this being eliminated and not renegotiated are slim, but all told that's a lot of moving pieces.



Did I say messy?

The silver lining of all of this is that the imposed tariffs have been small thus far and we're hopeful that additional ones won't be implemented any time soon. Besides, something tells me much of this is political theater for the base. If the markets really thought we were about to engage in a tariff tug of war, we'd know about it by now. The impact of a full blown trade war would favor nobody, most noticeably President Trump's supporters who include exporters of soybeans, pigs and automobiles.

A couple of months ago I went to a fundraiser for a scholarship fund. As president of a non-profit in the city, I have to make the rounds. While I was there I spoke with an attorney I knew from another affiliation who began to tell me a story about seat belts.

Whenever the big auto companies had a recall, he noticed they gave a lot of money away to various organizations. He told me that in his capacity as the general council for many of the African American affinity groups he petitioned the auto companies to give money to Black medical schools. His strategy was to finance a health and wellness report that ultimately concluded African Americans were less likely to use seatbelts and died in car accidents at higher rates.

With his study in hand, he lobbied local legislators across the country to introduce legislation and his efforts are largely responsible for the seatbelt laws that save thousands of lives each year across all demographics. One of those lives being my own, having hit a pole six feet in the air 12 years ago, with the column of the car sitting on the driver's side head rest missing my ear by a fraction of an inch.

Some things just take their own sweet time and you can't tell for certain the exact manner in which things will shake out, only that they will. One day the payroll numbers are favorable and the next wage growth is tepid. Commodity prices looked to be accelerating with inflation expectations until trade talks hurt soybeans and good weather suggested corn would have a bumper crop. Rates were supposed to spike and now the 10 year yield is moderating, impacting bond proxies like REITs and utilities.

The next few months could be unsettling because we're changing seasons and most days it's hard to tell if I should wear a sweater or a pair of flip flops. Fortunately for our purposes, one is not better than the other if your objective is to be dressed appropriately. What's apparent is consumer confidence, personal consumption and GDP growth are peaking. The trade war headlines, for what it's worth, are not the root cause of recent volatility as much as they add fuel to the fire. Likewise, the sideways road has been bumpy, the sort of thing that happens when the market is in transition. So getting to the next destination is the tricky part, and as I mentioned earlier, it's messy.

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ⁱ Bloomberg

ⁱⁱ Trade War begins: US and China exchange \$34 billion in tariffs; CNBC; 7/5/18

ⁱⁱⁱ German carmakers remind Trump they create 110,000 US jobs; Politico; 5/26/17

^{iv} Messing with NAFTA: 14 million American jobs are on the line; CNN; 4/27/17

^v US Chamber of Commerce

^{vi} US Chamber of Commerce