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First Quarter was solid, but head-spinning

By Jim Flinchum

The first quarter of 2018 was head-spinning. Against a backdrop of solid economic data, improving corporate profits, decreasing regulation and a huge tax cut, the stock market rallied to record highs by late January.

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Then, the market was frightened by a jobs report showing inflation was breaking out, which encourages the Fed to raise rates faster. Then, the administration badly frightened the market with talk of tariffs and trade wars.

Then, we learned the business model of many social media companies, which have powered the stock market, is based on shredding American privacy. Lastly, winter refused to die.

THE ECONOMY

The latest Index of Leading Economic Indicators was better than expected. Consumer sentiment is the highest since The Great Recession, which is good, since consumer spending is about 66 percent of GDP.

Also, factory orders remain strong. Both the ISM Manufacturing and Non-Manufacturing Index slipped slightly, but only because supply troubles are increasing, which is a "good" problem. Demand is out there.

JOB MARKET

In the first quarter of 2009, America lost 2.3 million jobs. That was indeed a different economic world. In the first quarter of 2018, we gained 605,000 jobs. The unemployment rate is unchanged at 4.1 percent, while the U-6 level of long-term unemployment is only 8 percent.

Average hourly earnings are up 2.7 percent on a year-over-year basis, reducing inflationary worries.

The Labor Force Participation Rate is 62.9 percent, which has changed little over the last four years, as the percentage of the population over age 55 has steadily increased. Fortunately, the large number of female workers entering the workforce has stabilized the rate.

Prime age male participation has been declining for six decades but also seems to have stabilized. With a low birth rate and little immigration, the limited labor pool is holding down productivity improvements.

STOCK MARKET

The stock market was more nerve-wracking than first appearances show. The Standard & Poor's 500 index of large companies only lost 0.76 percent from Jan. 1 through March 31. Small company stocks were up about 0.57 percent. Between those dates, the index went up about 5 percent in January and then dropped almost 10 percent. There was lots of drama but little change.

Globally, emerging markets did better than developed markets, up 1.37 percent versus down 1.71 percent, respectively. The best performing region was Latin America, up 9.65 percent. The worst developed countries were Canada and Poland, both down 7.9 percent.

INTEREST RATES

The stock market first stumbled in this quarter with the January employment report, which showed average earnings up 2.9 year-over-year. This strong indicator of inflation raised the probability the Fed would increase interest rates even faster, but I doubt that. Almost all bonds dropped in value over the first quarter.

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When interest rates begin to rise, income investors start switching out of high-dividend stocks. As rates rise, the market values of utilities, real estate and telecom stocks typically decrease, and they did.

WORLD TRADE

The current stock market stumble turned into a slump, as the fears of a trade war developed. The complex international trade system was constructed over the last century but was not designed to evolve in an ever-changing world.

Into this China shop stumbled President Trump, and that may not be all bad. The system is fraying. Hopefully, we will see “The Art of the Deal.” Tell me when these disconnected negotiations conclude, and I can tell you when the stock market will go up!

Because China sends 19 percent of its exports to the U.S., while we send a mere 2 percent of our exports to China, we have the negotiating advantage, especially since their economy is more export-dependent, compared to our service-oriented economy.

There is a general fear the Chinese could hurt us by not buying our Treasury debt. Actually, they stopped increasing those purchases some years ago. But, there is scant possibility we could not sell enough Treasury bonds to keep functioning.

Don’t forget “quantitative easing” was used to lift us out of The Great Recession. That fiscal stimulus/deficit spending was financed by the Treasury selling bonds to the Fed. That tool alone will largely protect us.

The economic data has weakened slightly over the last quarter but still remains quite strong. Corporate earnings-per-share are expected to rise a healthy 15 percent. While there is always another recession ahead of us somewhere, I don’t see one on the immediate horizon. Enjoy!

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