Towerpoint Wealth
Monthly Market Commentary

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Everybody Wants Some…
I Want Some Too!
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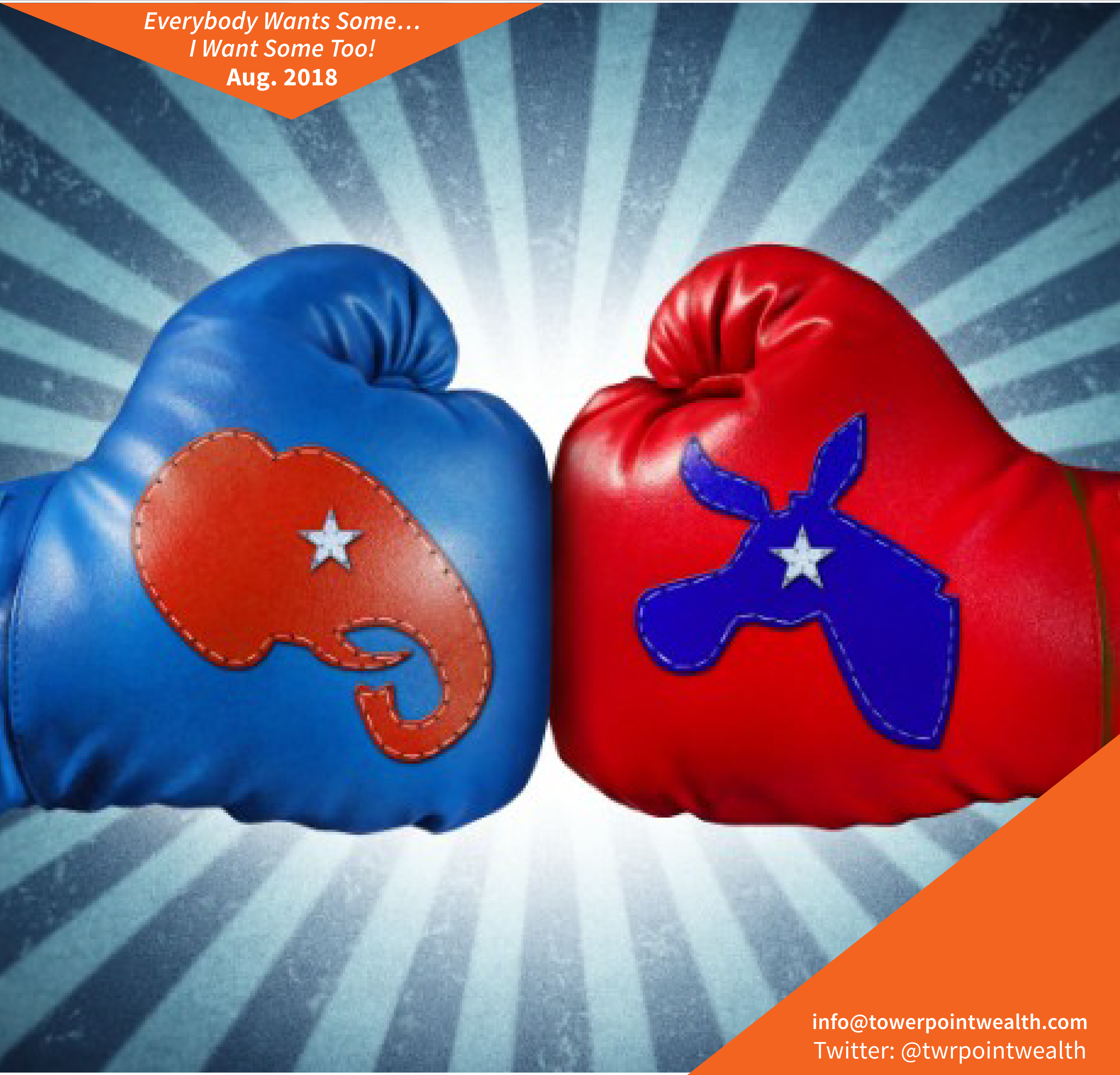

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"An Investment in Knowledge Pays the Best Interest"
(Ben Franklin)

Everybody Wants Some…I Want Some Too!

Everybody wants some
I want some too
Everybody needs some
Baby, how 'bout you?

(From "Everybody Wants Some", by Van Halen, 1980)

There is an old expression, attributed to a mid-20th century government official named Rufus E. Miles, which says, "*Where you stand depends on where you sit*". His intention was to illustrate the lack of bi-partisanship in Congress – that is, your position on any given political issue depended on which side of the political "aisle" in Congress you sat. Sound familiar?

The US economy is doing very well, as the full effects of tax and regulatory reform and fiscal stimulus come to bear. President Donald Trump is a highly polarizing figure, but anyone who suggests that the economy is not improving is either not paying attention or has a different agenda.

There are things to harp on, if you are so inclined: (1) Trump's trade agenda could curtail economic growth (though there appears to be a "thawing" on that front with Mexico and Canada); (2) personal wages are not growing as fast as the robust economic and unemployment numbers might suggest (though they are increasing – we spoke with an upstate New York truck driver recently who told us he had received 4 wage increases in the past 2 years, because of the increase in demand for qualified truck drivers, and corresponding lack of supply thereof); and (3) economic growth outside the US is most definitively slowing down, and perhaps has even peaked. China in particular is slowing down fairly rapidly which, combined with a generally strong dollar, has hurt the global commodity complex.

Some other questions remain. For example, the New York and Atlanta Federal Reserve Banks both publish "real time" economic forecasts. As of late August, these two forecasts were dramatically different – the Atlanta Fed's "Nowcast" suggests a Q3 GDP print of 4.6% (which seems very high to us), while the NY Fed's "Nowcast" suggests a mere 1.96% (which seems very low to us). This kind of disparity between the two has occurred before, but not to this level of disagreement.

The NY Fed's forecast relies more heavily on sentiment indices, while the Atlanta forecast relies more on "hard" data. So perhaps the much lower NY forecast simply reflects concern over the ongoing trade tensions, unrest in Turkey and Iran, a relative lack of progress with North Korea, or the continuing political drama playing out in Washington, DC with the Robert Mueller investigation, while the higher Atlanta forecast simply reflects the actual current economic data.

We suspect that actual Q3 GDP print will come out somewhere between these two extremes – the current *Wall Street Journal* consensus estimate is 3.1%. Which, since we live in political times, we believe will be good (or at least not bad) for the Republicans in the midterm elections occurring in November.

As a final political note, should the Democrats regain the House (the consensus view suggests this is slightly likely, but not certain) *and* the Senate (the consensus view is that this is possible, but unlikely), we still view the likelihood of Donald Trump being impeached to be, essentially, zero. A Democrat-controlled House *may* actually vote to impeach him, but the 67-vote-to-impeach requirement in the Senate seems insurmountable to us, at least based on current voter sentiment and publicly available information.

The entire discussion of impeachment seems, to us, to be an attempt to change the subject of the strong economy, or else simply tilting at windmills. A solid economy, low unemployment, growing wages, strong corporate earnings, low interest rates, and under-control inflation make those windmills even larger.

Looking out over the current economic and investment landscapes, here is what we see.

The Current Economic Landscape

The global economy continues to grow, though at different speeds across different economic regions:

- The consensus estimate for Q3 GDP growth in the US is now a solid 3.1%. That growth is then expected to decelerate slightly to 2.9% in Q4, bringing overall 2018 GDP expectations to a 3.0%; (source: *The Wall Street Journal*);
- While this GDP forecast remains sensitive to ongoing trade tensions, those appear to be lessening, as an agreement-in-principle recently was reached with Mexico (with Canada expected to follow suite in the near future), and the rhetoric with Europe has dialed back. China remains uncertain – but even there the heat seems to have lowered (though by no means gone away). At least so far, this is playing out as we expected – lots of chest-thumping and saber-rattling on all sides, but a gradual slide to agreement as everyone declares victory and moves on. It must be noted, however, that the actual impact of any agreed-upon new trade deals are completely uncertain – we won't know that until post-ratification and implementation. The Law of Unintended Consequences remains alive and well;
- Both the US manufacturing and services sectors showed slightly lower, but still expansionary, activity, with the PMI (manufacturing index) coming in at 58.1 in July, versus 60.2 in June, and the NMI (non-manufacturing index) coming in at 55.7 in July, versus 59.1 in June; any reading above 50 is considered expansionary. The manufacturing index has now been in expansionary territory for 111 consecutive months, while the non-manufacturing index notched its 102nd consecutive expansionary month (source: *Institute for Supply Management*);
- Inflation (as measured by CPI) rose 2.9% year-over-year in July, the same as in June, and its highest rate since February of 2012. This rise came despite a drop in oil prices through July (though they bounced back sharply in the back end of August). The Personal Consumption Expenditure (PCE) index – which is the Fed's preferred measure of overall inflation, increased 2.3% year-over-year in June (the most recent reading), generally in line with the Fed target rate (source: *TradingEconomics*).
- We continue to believe that inflation will increase slowly over the rest of this year, but will remain somewhat dampened by (1) continued slow (but positive) wage growth; (2) a generally strong dollar; and (3) a decelerating global economy (ex-US), which will dampen demand. As such, we continue to believe that inflation does not *yet* constitute a primary risk to economic growth. Further, we continue to believe the Fed will allow inflation to run slightly "hot" before stepping in more aggressively;
- After raising rates (as expected) in mid-June, the Fed signaled that it will almost certainly raise rates again in September, but that an additional rate hike in December is "data dependent" (we think yes).

- As we wrote last month, President Trump is now on record publicly as being against further rate hikes, and he is increasing his “Tweet Storm” against the Fed and its Chairman, Jerome Powell. As we wrote, this puts the Fed in an awkward situation. If it maintains its slow but steady rate hike plan, it may come under further withering attack from President Trump, who sees the hikes as a potential threat to continued economic expansion, but if the Fed slows down its rate hike program (for whatever reason), it will be seen as having been “politicized” by the President. To us, this is an example of Trump being his own worst enemy and “stepping on” the underlying fundamental message of an expanding economy. It is critical that the Fed remain both actually and perceived-to-be independent of the Administration;
- US interest rates essentially were flat for most of August, and the 10-year Treasury rate remains under 3%. We maintain our outlook that rates in the US generally will increase, with periodic reversals during market disruptions;
- The yield curve remains very flat as the Fed raises rates on the short-end but the long end remains “tamped down” by high demand and a lack of inflation fears. As of this writing, there is less than 25 basis points difference between the yield on the 2-year and 10-year Treasury. We repeat – *and this increasingly is a contrarian opinion* – that we do not anticipate (or fear) an inverted yield curve – should one occur, we believe it will be because of investment flows and Fed actions, not a harbinger of an imminent recession;
- The US dollar remains strong, though it stabilized somewhat through August against both the yen and the euro. Even the Chinese yuan, which had steadily and fairly dramatically weakened against the dollar (perhaps in anticipation of trade wars), stabilized slightly as August came to an end;
- The Q2 earnings season continues, and roughly 350 of the S&P 500 companies have now reported. So far, those companies posted a 24.1% increase in earnings on 10% higher revenues. Overall Q2 S&P 500 earnings are expected to increase 23.7% on 8.9% higher revenues. Earnings are expected to remain positive but decelerate as we move into Q4 (source: *Zachs Earnings Report*);
- Manufacturing across the Eurozone remains expansionary, with the Markit Manufacturing index falling slightly to 54.6 in August, versus 55.1 in July. Contrarily, the Services index rose slightly from 54.2 in July to 54.4 in August (source: *TradingEconomics*);
- Eurozone unemployment remained at 8.3% in June, unchanged from the May reading, and it remains at its lowest level since December of 2008. Annualized inflation went up 2.1% in July, a 17-month high (source: *TradingEconomics*);
- Japan’s GDP rose 1.9% (annualized) in Q2, after a decline in Q1 GDP. The expansion was driven by strong consumer and business spending. The consensus estimate for 2018 GDP growth is 1.7% (source: *TradingEconomics*);
- China’s (official) GDP growth in Q2 was 6.7% (annualized), and it is expected to post an (official) growth rate of 6.6% in Q3. Official estimates for all of 2018 are 6.5%. There are other (non-official) signs, however, that the Chinese economy is slowing faster than the official numbers indicate. For example, the Chinese Caixin Manufacturing Index fell to 50.8 in July, still expansionary but at its lowest level in eight months (source: *TradingEconomics*).

The Towerpoint Wealth Economic & Market Outlook:

- ***The global economy continues to expand, though there remains a “desynchronization” of growth. The US economy shows continued growth as the full effects of fiscal stimulus and***

regulatory and tax reform work their way through the system. At the same time, the rest of the world appears to be decelerating – still expansionary, but slowing down;

- ***US Inflation is trending higher, but we maintain our belief that it (as of yet) does not represent a problem for continued economic expansion. Wages in the US are increasing only slowly, oil prices seem to be stabilizing from previous months' increases, and overall commodity prices remain repressed by slowing demand and the strong dollar. Outside the US, inflation simply is not a problem, despite the general rise in oil prices;***
- ***In the US, tax and regulatory reform and fiscal stimulus are winning the economic tug-of-war against monetary tightening. At some point, the markets will be concerned again about massively increasing deficits and debt, but right now those issues appear to be non-events for most market participants;***
- ***Solid US GDP growth, as well as solid earnings and revenue growth, make for a generally positive market environment, and we still think stocks will end the year higher than where they began. However, decelerating earnings growth, decelerating economic growth, and generally rising interest rates will most likely combine to push valuations down and volatility up, especially now that the "Summer Doldrums" are coming to an end;***
- ***Although there appears to be positive movement, ongoing trade tensions remain by far the largest threat to the current "Goldilocks" economic regime;***
- ***EM and EAFE (Developed International) markets continue to be hurt by a strong US dollar and a "risk off" mentality driving investment outflow (though both of these markets posted positive performances in July). We still like EM and EAFE as longer-term positions, from both a valuation and economic growth perspective, but investors should expect continued volatility and perhaps negative performances for the year (in US terms);***
- ***At current interest rates and credit spreads, the public credit markets continue to look very expensive to us, and our return expectations are muted accordingly. We are nearing the end of the current credit cycle and risks are increasing;***
- ***Many investors increasingly are turning to shorter-duration bond strategies and even cash solutions, which finally have a positive real yield again due to the Fed rate hikes. The curve is so flat that investors simply are not being sufficiently compensated to take on term or duration risk;***
- ***We have muted our expectations for real assets and the overall commodity complex, due to lower than expected inflation, slowing demand, and the strong US dollar;***
- ***While we generally are constructive on the global economy and overall market performance, the public markets are not cheap. We see little reason (barring exogenous geopolitical events) why the market cannot move higher over the rest of the year, with increased volatility. We also believe, however, that clients need to have their expectations managed as to what a globally diversified portfolio can deliver over a full market cycle.***

The "dog days" of summer are ending, and September and October frequently have "re-introduced" investors to volatility. This may prove especially true as we head into what looks to be a divisive and brutal mid-term election cycle. Our economic and market dashboard still is flashing mostly green across the board, but we can "feel" increased tension and anxiety in the markets (based mostly on an increased volume of cautionary market commentaries). Stay tuned for what looks to be an "interesting" final four months of the year.

We close by offering our deepest respect and appreciation to US Naval Aviator and Senator John McCain for his lifetime of service to the United States, and by giving Ms. Aretha Franklin what she requested in her iconic song – her “propers” and our R-E-S-P-E-C-T as she heads home. God Speed to the Senator and to the Queen of Soul.

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