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A Fork in the Road

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Headlines for the month of June were dominated by talk of trade wars and tariffs as markets attempted to look forward to second quarter earnings just around the corner. With mixed economic data and worries that even without an all-out trade war, investors wondered if the perceived risk could be enough to change the momentum of the economy. This kept investors on their toes as volatility crept back up and markets struggled to find direction. There was no help from the bond market as increasing tensions in the stock market sent investors looking for safety in treasuries, causing some volatility in yields as well. After making new highs in May, oil trended lower throughout most of June, only to reverse course and end the month higher. For every piece of good news, it seemed to be met with an equal or greater reason to question the future health of financial markets it the short term. When the final bell rang to close the month and the first half of the year, markets showed some sign of fatigue. June finished with the Dow down .59%, the S&P 500 up just .48%, and the NASDAQ up .92% for the month. This closes the first half with two out of the three major indices in positive territory. Only the 30-member and price weighted index of the Dow Jones Industrial Average is down for the year, giving back 1.81%. Technology leads the way with the NASDAQ up 8.79% on the year and the S&P 500 up just 1.67%.

There appears to be at least one question investors want to know the answer to: Is the recent rhetoric about trade wars a negotiating tactic, or will it be the inevitable result from the threats of this administration? With an additional $200 billion of tariffs announced on imports from China, on top of the 50 billion already declared and the additional threat of 20% tariffs on European autos, stocks around the world had reason to retreat. There are quantifiable and unquantifiable effects that investors are trying to understand. The tariffs on the $250 billion of Chinese goods would effectively act as a .2% tax on the U.S. economy according to Cornerstone Macro. Mark Zandi, chief economist at Moody's Analytics, also points to the impact on jobs, estimating job losses at 170,000. Additionally, Head of Cornerstone Macro, Nancy Lazar, estimates that these announcements alone could offset almost half of the estimated boost from the tax cuts. It is the effect that we cannot measure that is possibly more concerning. Lingering uncertainty begins to factor into psychology. It doesn't take a lot for businesses to decide to postpone spending until they have more clarity. Consumer confidence has been helping to propel the economy in recent months, if confidence begins to slip it could have an impact on the economy.

Consumers will feel it at the registers. Rising prices across a broad category of businesses could be felt quickly. It is estimated that a six pack of beer will cost an extra 10 to 12 cents due to aluminum tariffs, while the price of an average car will rise by $144. A quarter mile of barbed wire could rise as much as 10% because of metal tariffs. The subsequent tariffs on the auto industry are potentially much more damaging than the cost per vehicle. Foreign automakers currently manufacture many of their vehicles in U.S. factories. These factories employ thousands of American workers and these jobs are at potential risk if foreign auto makers decide to leave. Its not just foreign manufacturing jobs here that are at risk. In a highly publicized decision, Harley Davidson announced its decision to move production of motorcycles shipped to the European Union from the United States to its international facilities as a way of avoiding retaliatory tariffs. It is too early to tell if the attempts to negotiate better trade will be successful or not. What is becoming clear is that investors are not comfortable with the current state of affairs and are choosing to be much more defensive with their investments.

We can see this defensive approach in several ways. Fund flows tell us where money is moving into and where it is moving out of. This month was a stark contrast to the start of the year. According to Hartnett & Co., during the first five weeks of 2018 some $103 billion of assets went into equites. During the next five months, these flows slowed to only $31 billion in assets. The last week in June

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witnessed a $50 billion outflow from equity funds. During this same time, inflows into exchange traded funds that invest in short term government securities have been attracting 33 cents out of every dollar going into ETF's among all asset categories, according to Ben Breitholtz of Bianco Research. This can be explained in part by the disappearance of T.I.N.A., there is no alternative. With yields on short term treasuries nearly the same as the yield on the S&P 500, suddenly there are options for investors to consider. In addition, to close out the month of June, utilities were the best performing sector, followed by telecommunication, during the last week of the month. Investors that are looking to position more defensively look to sectors like utilities, telecom, and staples. The consumer staples sector took the top spot for the month of June, the last time consumer staples were the best performing sector for the month was December of 2015.

This all comes during a period of time that the economic data is mixed and the bull market and economic expansion are being called into question. Look no further than the cover story of Barron's for the final week of month titled, "The Bull's Final Countdown - How to Prepare." This is one of several calls for the end of this run that started in early 2009. The article's opening paragraphs admit, "Yes, predictions of the end of this record run have been made before and have been proved wrong." There are certainly signs of a maturing economy, but one that is still growing. Weekly jobless claims unexpectedly fell at the end of the month, showing that the number of Americans filing for unemployment benefits declined again, confirming the strength of the labor market. This good news however, is one more green light for the Federal Reserve to continue raising rates this year. In the housing market, the same signs of strain are beginning to show. U.S. existing home sales fell for a second straight month, while economist had forecast an increase. The combination of higher mortgage rates and a shortage of supply have both had a negative effect on homebuyers, although, the University of Michigan's consumer sentiment index June reading hit 99.3, higher than the expected 98.3. Those who were interviewed, viewed that both their financial situation and the current buying conditions for household durables were more favorable. According to Chief Economist, Richard Curtin, "Greater certainty about future income and job prospects have become the main drivers of more favorable purchase plans".

One force not given a lot of attention but likely to become a greater part of the discussion in the next decade is our aging population. As science and technology have led to longer life expectancies and birth rates have declined, the results on the demographics of our population are startling. The average American born today can expect to live to 80, up dramatically from the 68-year life expectancy in 1950. In 1950, the average American woman had 3.5 children during her lifetime. Today, that figure has fallen below 2. What has resulted is a dramatic decrease in the current and projected number of working people for each retirement age person. In 1950, there were 8.1 working people per retiree. That has shrunk to just 5, and the U.S. Census Bureau estimates that figure to decline to just 3 by 2030. This will leave the economy struggling to find enough workers to support the population's demand for goods and services. Even with the marvels of technology we have today, this shortage of talented workers will likely slow economic growth. For decades, we have fought unemployment. What would a sustained period of full employment look like?

We have definitely entered a period of much greater challenges. There are always forces acting to stimulate and slow the economy at the same time. It is the balance that matters. As long as the benefits continue to outweigh the negatives, economic growth will continue. These forces have the potential to err in either direction. This can result in an economy that overheats and results in inflation, or a slowing that ultimately causes a recession. As of right now, neither outcome is clear. Conflicting signals can prevail for a long time before there is a definite course. The resolve of some of the uncertainty will help determine which direction the economy will head next.

Deborah DeMatteo, CFP is the Managing Director and Chief Investment Officer of 10-15 Associates. Headquartered in the Village of Goshen, NY, 10-15 Associates assists families in making a successful transition from saving for retirement to living in retirement.

Today 10-15 Associates is the leading SEC Registered Investment Advisory firm of the Hudson Valley, focused on retirement planning and wealth preservation. Over the past three decades, 10-15 has emerged as a market leader and trusted adviser for high net worth individuals in and around the New York City metro area.

10-15 currently has over $750 million in AUM, four office locations and services clients across 31 states. We proudly attribute our growth to our clients, who have created a growing sense of community by referring their family and friends over the years.

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