WEIGHING THE EVIDENCE, ONCE AGAIN

Jay R. Penney *CFP ®, CFA ®, AIF ®*
Chief Investment Strategist for Ashton Thomas Private Wealth

In April of 2018, I published a white paper entitled, "*Weighing the Evidence*", wherein I compiled a list of then current capital market conditions and divided them into lists of "*Pros*" (reasons to be optimistic about market advances), or "*Cons*", (reasons to be concerned about a potential market retrenchment).

Five months later, I updated that paper with another much like it, cleverly entitled, "*Weighing the Evidence, Revisited*". In that update, I re-examined each of the "*Pros*" and "*Cons*" I'd listed in April, adding some current observations to compare to my previous comments, and I identified any "*Pros*" that had become "*Cons*", or vice versa, since the previous essay.

I've always employed a "weight of the evidence" approach to assessing market conditions in general, and while the process of making lists of "*Pros*" and "*Cons*" and determining which list carries more "weight" isn't always perfect in its ability to predict near-term market directions, I've found the benefits of preparing these lists to be exceedingly helpful.

For those of you who may have interest in reviewing these articles, they are posted to our website, and for those who are reading this in electronic format, links to both follow:

https://ashtonthomaspw.com/2018/04/20/april-2018-special-report-weighing-evidence/

https://ashtonthomaspw.com/2018/09/19/sep-2018-special-report-weighing-evidence-2/

ASHTON
THOMAS
PRIVATE WEALTH

Given the rather dramatic decline we saw the equity markets suffer in Q4 2018, and the just as dramatic rebound to new heights in calendar year 2019 through April, I thought it might be timely to update our lists of market "Pros" and "Cons". Like September's paper, I'll summarize the previous comments and make some current observations. Here is where we left our lists in mid-September of 2018:

Pros	Cons
Corporate Earnings are rising fast.	Global Synchronized Economic Expansion is over.
U.S. GDP Growth is accelerating.	Investor Sentiment is strengthening.
Unemployment is at cyclical lows.	Stock Valuations are extremely high.
Interest Rates are still cyclically low.	Federal Reserve is a "headwind" to economic growth.
$800 Billion in Stock Buybacks in 2018.	Government, Corporate, and Household Debt are high.
	Yield Curve is "flattening".
	Inflation is starting to rise.
	Geopolitical Risks are rising.
	Political Polarization.

My September comments about the change in the "balance" we saw in the list of "Pros" and "Cons" in April's essay included this warning:

"As I "re-weigh" the evidence for, and against, continued market advances, I would have to say that an honest assessment of both the "Pros" and "Cons" listed would leave the reader slightly less confident in continued advancements in stock and bond markets going forward today, than we were in April."

That mid-September warning was well-timed, as the S&P 500 Index, a proxy for the U.S. stock markets, reached an all-time closing high on Thursday, September 20th, of 2,930.75. Three months later, on Monday, December 24th, the Index closed (-19.78%) *lower*, at 2,351.10, just above the Index level that would have triggered an "official" Bear Market, defined as a closing value decline of (-20%) or greater from a previous high [(1)].

Let's "re-weigh" the evidence by updating our observations on our September lists, starting with the "Pros":

(Like the previous two versions of this white paper, this update looks at more than dozen "environmental factors" that can impact capital markets. For those would prefer to avoid all the data, and just want to check out the updated lists of "Pros" and "Cons", skip ahead to page 14. For those who want to review the data and analysis, and compare conditions in September to conditions today, read on…)

Corporate Earnings are rising fast.

What I said in September: *"'As Reported'* (corporate) *earnings in the first two calendar quarters of 2018 are 23.13% higher than were reported during the first two calendar quarters of 2018. Consensus analysts' estimates for full-year 2018 "As Reported" earnings for the* (S&P 500) *Index are that they will come in +30.15% higher than the full year "As Reported" Index earnings they delivered in 2017. A slight decline in the projected rate of growth, but still quite impressive."*

What I observe today: Full year 2018 "As Reported" earnings per S&P 500 Index Share came in at $132.39, an increase of +20.49% over 2017's "per Index Share" earnings of $109.88. With 91.2% of the Index constituents having reported their Q1 2019 "As Reported" earnings as I type this, we estimate that we'll see $35.16 per Index Share when all have reported. That would represent a +6.48% increase over the prior year's Q1 earnings, and if the full-year (2019) Analysts" Consensus Estimates of $150.96 per Index Share is delivered to shareholders, that would represent a +14.03% year-over-year gain in corporate earnings (2). Given that much of last year's increase in earnings were attributable to the tax savings corporations gleaned from the implementation of the Tax Cuts and Jobs Act of 2017, a year-over-year "cut" in marginal tax rates that won't be repeated in 2019, a mid-teens growth rate in "As Reported" earnings is *very* respectable. This "Pro" remains solidly on the "Pros" list.

U.S. GDP Growth is accelerating.

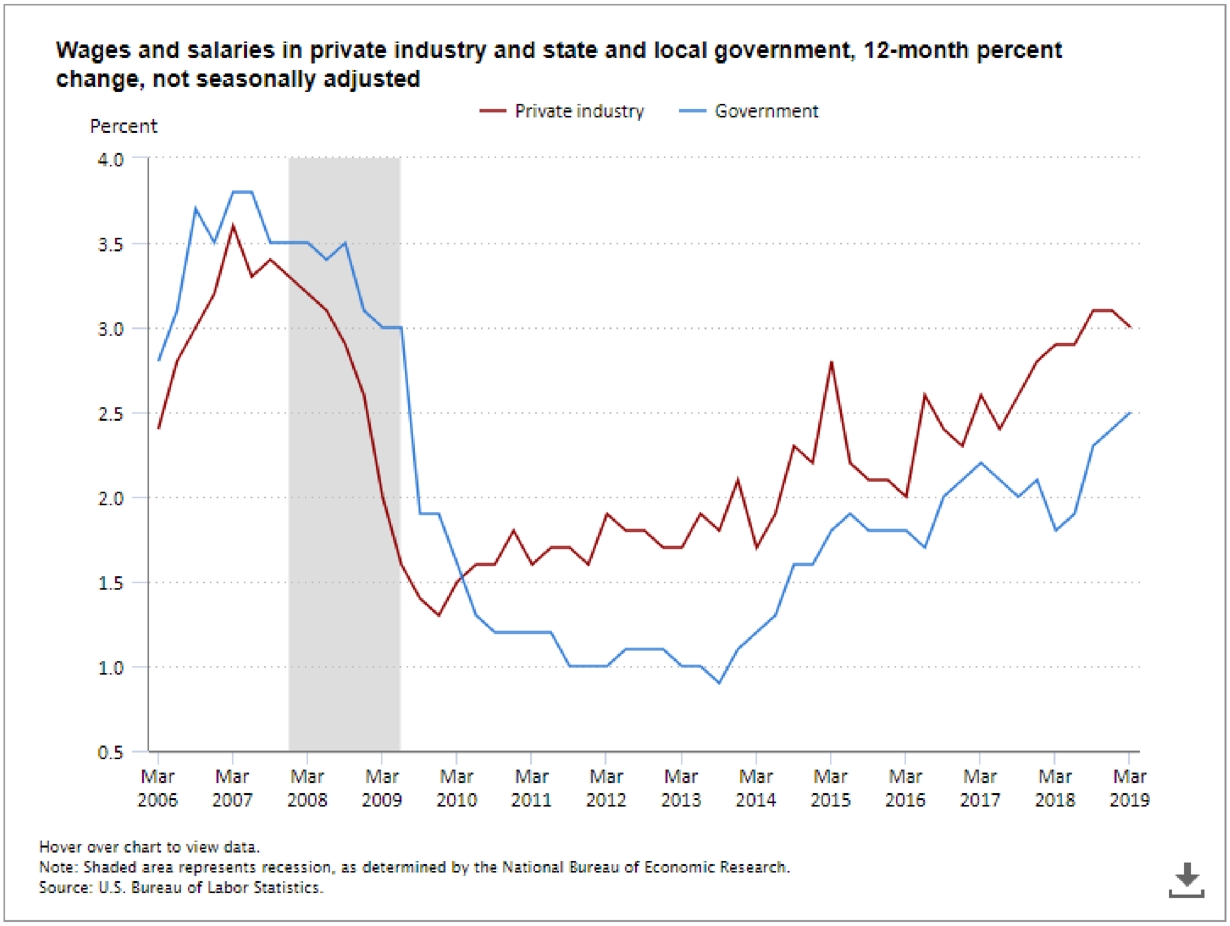
What I said in September: *"The Wall Street Journal's Economic Forecasting Survey, a monthly survey of more than 60 economists, projects Q3 GDP will come in at +3.1% and Q4 GDP will come in at +2.9%. If these next two quarterly consensus estimates are realized, the U.S. economy will have grown at an average +3.1% rate in 2018. If so, it will be the first calendar year since 2005 that the U.S. economy has grown more than 3%."*

What I observe today: Q3 2018 GDP came in at +3.4% (higher than the +3.1% estimated in September), and Q4 2018 GDP came in at +2.2% (much lower than the +2.9% estimated). Full year 2018 GDP growth was +2.9% (slightly lower than the +3.1% estimated). The U.S. Bureau of Economic Analysis' initial reading for Q1 2019 GDP growth was a robust +3.2% (3), much higher than any consensus estimates had led us to believe. While there is clearly no recession in sight, we have observed a deceleration in economic growth globally, and eventually, that must impact U.S. growth prospects. A key factor in the sustainability of U.S. GDP growth at these levels will be the successful resolution of U.S. – China Trade Negotiations, which have been underway since President Trump took office. A huge increase in tariffs went into effect a week ago Friday (10th), and if negotiations don't result in an agreement to lift those tariffs, one can reasonably expect the supply-chain disruption and increased input costs in manufacturing will have a dampening effect on corporate earnings, consumer spending, and economic growth. With a surprisingly strong Q1 GDP reading, this "Pro" remains a "Pro", but could very quickly turn to a "Con", based upon trade.

Unemployment is at cyclical lows.

What I said in September: *"August's Unemployment Rate was 3.9%, a 0.2% improvement from the March rate I reported in my April white paper.....The country has added an additional 1.009,000 jobs since March, an average increase of 201,000 per month, a slightly higher monthly average than the average* (monthly) *increase that was reported during the first 15 months (Jan. 2017 – March 2018) of the Trump Administration. That said, further improvements in the Unemployment Rate…will be challenged by a recent phenomenon, a condition called 'Structural Unemployment', which is evidenced by the fact that there are 6.7 million job openings with just 6.4 million available workers to fill them. The problem is exacerbated by the current "mismatch" of skilled jobs available, and* (a lack of) *workers with the skills to fill them.....With unemployment this low, we would expect Wage Inflation would be rising faster than it is, but with the 'skills gap' we've observed, I expect improvements in the U.S. employment situation to be challenging from here. While this 'Pro' has certainly not become a 'Con', I would suggest the current employment environment to be more of a 'Neutral' factor in the country's near-term economic health."*

What I observe today: On May 3rd, the Bureau of Labor Statistics ("BLS") declared that the Nation's Unemployment Rate had *declined* to 3.6%, *the lowest reading since December 1969* [4]. They also announced that 263,000 new jobs were created in April, bringing the total jobs created in the first four months of the calendar year to +783,000, and brings the total number of new jobs created since I wrote about this eight months ago to +1,634,000 [5]. This means we've created an average of +204,250 new jobs each month since last September. *We are still rocking and rolling economically*. More importantly, the BLS says that "*Notable job gains occurred in the professional and business services, construction, health care and social assistance*" [6] sectors, all of which require moderate-to-high skilled (read: highly paid) workers. Even better, the BLS says Wages and Salaries increased by 3.0% for the 12-month period ending March 2019 [7]. After suffering years and years of "wage stagnation" in the U.S., we are finally starting to see Wages and Salaries growing at, or above the general rate of inflation.



The only "fly in the ointment" in the employment story is the number of unfilled job openings has *increased* from the 6.7 million job openings last September, to 7.5 million unfilled positions in March [8]. And that's despite the (approx.) 1.6 million jobs we've created during that period. I'm hearing more and more in the financial press about the long-term challenges 'Structural Unemployment' presents society. In the long term, we will need to see more "targeted" job and skills training (and immigration policy) to close this growing gap between the number of job openings and the number of appropriately-skilled workers, but for now, this "Pro" has only gotten stronger in terms of its "weight" in the evidence.

Interest Rates are still cyclically low.

What I said in September: *"I would still consider current interest rates as 'accommodative' to economic growth, and thus, still a "Pro" from the capital markets' perspective. There are concerns about the yield curve however, and I'll discuss that during our review of the list of "Cons" later in the update."*

What I observe today: The "benchmark" 10-Year U.S. Treasury Bond was yielding 2.82% back when I wrote the first edition of "*Weighing the Evidence*" in mid-April of 2018, and it peaked for 2018 at 3.23% on October 5th of that year, a couple weeks after I wrote the second edition. As I type this, the 10-Year yields just 2.40% and has spent calendar-year 2019 yielding between 2.39% - 2.79% [9]. Interest rates are lower than they've been in about sixteen months. According to data released May 9th by Freddie Mac, the 30-year fixed-rate average mortgage slipped to a 4.1% interest charge. It was 4.55% one year ago [10]. Interest rates remain ultra-accommodative today, which is good for consumers as well as businesses, so this remains a very strong "Pro" today.

<u>Investor Sentiment is weakening.</u>

What I said in September: "*…the most recent survey (American Association of Individual Investors Weekly Investor Sentiment Survey) taken during the week ending September 12th (2018), showed that favorable Investor Sentiment has <u>increased</u>, with 32.1% claiming to be 'Bullish' today (as opposed to 26.1% back in April)…while the number of 'Bears' has <u>decreased</u> to 32.8%...If this survey remains a reliable contrarian indicator, the shift to a more 'Bullish' sentiment among today's investors should be a warning that trouble lies ahead. This "Pro" would now have to be considered a "Neutral" factor at best, trending toward a "Con" today.*"

What I observe today: Following that September report, and the September 12th survey results cited, the domestic stock market declined close to (-20%) from late September to late December, <u>confirming the Sentiment Survey's value as a "contrarian indicator</u>". (The higher the percentage of survey responders indicating "Bullish" sentiment, the more a correction may be in the offing.) The most recent weekly AAII Weekly Sentiment Survey, taken May 15th, showed that just 29.8% are "Bullish" today, and 39.3% are Bearish" today. From the inception of the survey in 1987, the average "Bullishness" percentage has been 38.2%, and the average "Bearishness" has been 30.3% [11]. So, investors today are less "Bullish" than the average level of "Bullish" investor sentiment observed over the last thirty-two years, and far more investors are "Bearish" today than has been the average of the past thirty-two years. Investor Sentiment has now gone from a "Pro" in April 2018, to a "Neutral" factor in September 2018, but is now back to a strong "Pro" today.

<u>$800 Billion in Stock Buybacks (projected) for 2018</u>

What I said in September: "*On August 13th, 2018, the Nasdaq market posted an article to its site entitled, 'Stock Buybacks Poised to Eclipse $1 Trillion'…..One can argue that stock buybacks are often a tool used by corporate management to 'financially engineer' better earnings going forward…but there is little doubt that $1 Trillion in additional demand for those stocks will provide upward pressure to their prices. A strong "Pro" on our list is getting stronger still.*"

What I observe today: In mid-December, CNBC confirmed that "announced buybacks" for 2018 had reached \$1.1 Trillion [12]. At the end of March, news site Axios reported: "*U.S. companies are on pace to buy back more of their shares than they did in 2018's record binge…Through March 15th, American companies had bought \$253 Billion worth of their own stock…about \$18 Billion more than at the same period last year.*" [13] The money companies are saving from tax cuts are turning into stock buybacks. Stock buybacks remain an incredibly strong tailwind to stock prices, and a strong "Pro" over the past year and a half is getting even stronger still today.

The list of "Cons" I outlined in September's paper has been stubbornly stable, although a couple have improved to more "Neutral" indicators. Here are issues to be concerned about going forward:

<u>Stock valuations are extremely high.</u>

What I said in September: "*The 'As Reported' trailing four quarters (ended June 30th, 2018) P/E Ratio for the S&P 500 Index declined to 23.71 times earnings, and Analysts' Consensus Estimates for the P/E Ratio we'll see when September 30th earnings are eventually reported, are that it will fall further still, to 22.20 times earnings. A shrinking P/E Ratio is a positive trend to be sure, but we remain 41%, and 51% above the Index' average Mean and Median P/E Ratios, historically.*"

What I observe today: With 91.2% of the S&P 500 Index having reported their earnings for the quarter ended March 31st, the trailing four-quarter "As Reported" P/E Ratio appears to have declined slightly from September's level, to 21.19 times earnings. Should the Index remain at its current level, and Index constituents' earnings grow by the +25% that the Analysts' "Consensus" estimates believe they will by year-end 2020 (12/31/2020), the P/E Ratio would be a far more "reasonable" 16.97 times earnings [14]. But it's unlikely that stock prices will remain "flat" for seven quarters, so stock prices are likely to remain quite elevated relative to their earnings. Market multiples can remain elevated for extended periods (see 1996 – 1999), but fundamentally, stock prices should be a function of their earnings. Eventually, either earnings must grow to justify high prices, or prices must fall in line with "delivered" earnings. At current levels, the higher than average valuations seen in today's market remains a "Con".

<u>The Federal Reserve is a headwind.</u>

What I said in September: *"In its annual gathering of Global Central Bankers in Jackson Hole, Wyoming, Fed Chair Jerome Powell said that the U.S. Central Bank will continue on its path of 'rate normalization' (i.e. gradually raising interest rates)….Historically, the Fed has rarely been successful in threading the needle of raising interest rates in a way that would keep an accelerating economy from 'overheating', and doing so at a pace that doesn't choke off growth entirely. We'll see if Chairman Powell's policy prescriptions are better than his predecessors in this respect, but this "Con" clearly remains on the list."*

What I observe today: Following the late-August meeting in Jackson Hole, during which Chairman Powell announced the Fed's intention to "normalize" rates, the Fed did vote to raise the Federal Funds Rate twice more in 2018, once in late September, right after I authored the September report, and again in December, bringing the Rate to a 2.25% - 2.50% "range"(15). Following its meetings on April 30th – May 1st, Chairman Powell announced they would leave the Fed Funds Rate where it was, and he said the Committee would "*remain patient*" with regard to further rate hikes. In fact, he said, "*We do think that our policy stance is appropriate right now. We don't see a strong case for moving in either direction.*" (16) The Fed also announced that they would be slowing the pace of its plan to reduce its balance sheet, built up with the massive Quantitative Easing ("QE") programs it implemented between late 2008 and 2014. Since the Fed's balance sheet capped out at $4.5 Trillion on January 14th, 2015, it has shed almost $624 Billion in assets. Starting this month, the pace of that reduction will be cut from the $30 billion per month reduction to $15 Billion per month (17). With the Fed's decision to keep the Fed Funds Rate where it is until data would provide an impetus to raise or lower the rate, the Fed's stance is now a "Neutral" one. Slowing the pace of its balance sheet reduction is also a sign that the Fed is now just as likely to implement "accommodative" monetary policy, as it is to removing accommodation going forward. What was a clear "headwind" ("Con") in September is neither a headwind nor a tailwind today. The Fed would now have to be considered a "Neutral" factor.

<u>Govt., Corp., Household Debt are high.</u>

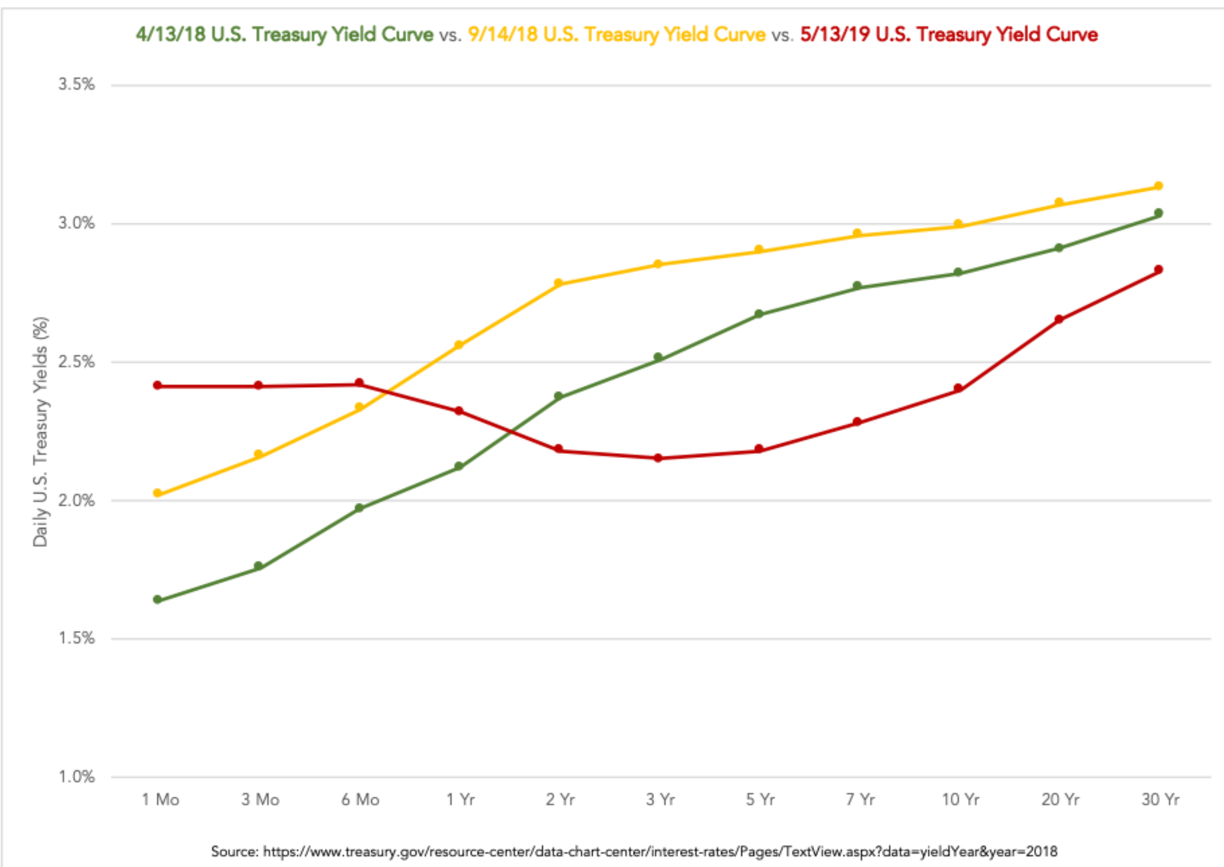
What I said in September: "*As I type this (the U.S. Debt Clock) shows U.S. National (Federal Government) Debt of $21,485,286,997,045, with U.S. GDP at $20,525,380,915,780. Dividing Debt by GDP brings me to a Federal Debt to GDP Ratio of 104.7%, just about where it was in April….the Federal Reserve's estimate for American non-financial Corporation Debt as a Percentage of GDP…has slightly increased to 73.5%...U.S. Household Debt to GDP stands at 78.7%....Given the levels of debt, and the deteriorating quality of new debt issuance, these dangerous debt levels remain a strong "Con" for market prospects going forward."*

What I observe today: As I type this, the U.S. Debt Clock shows U.S. National (Federal Government Debt of $22,297,083,253,976, and U.S. GDP of $21,144,669,879,476 (18). The U.S Debt-to-GDP Ratio has risen to 105.4%, about 0.7% *<u>higher</u>* than in September. American non-financial Corporation Debt as a Percentage of GDP has risen to 73.9% (19), +0.4% *<u>higher</u>* than last September. Bucking that trend, however, U.S. Household Debt as a Percentage of GDP has *<u>declined</u>* (-2.3%) since September to 76.4% (20). Household Debt as a Percentage of GDP peaked at 98.6% in 2009, and American households have made progress in reducing their debt loads, but they are far from the mid-40's (percentages of GDP) U.S. Households carried in the 1960's and 1970's, or the low-60's (percentages of GDP) U.S. Households carried in the 1990's (21). Debt loads continue to rise, especially government and corporate debts. When households take on too much credit card and/or consumer debt, especially when servicing that debt takes up a larger and larger share of the household's income, bankruptcy is often the result. When government and corporate debt levels rise to levels that are unsustainable, it will first crowd out discretionary spending, and ultimately lead to corporate bankruptcy, or government default. Debt levels in America remain a strong "Con" for our list.

<u>The Yield Curve is Flattening</u>

What I said in September: *"The yield curve is indeed flattening, and with one or two more rate hikes by the Fed, <u>without corresponding increases in the yields of longer-dated bonds</u>, we could see a completely 'flat' yield curve soon, and possibly, an 'inverted' yield curve. This worrisome "Con" for economic (and market) prospects remains a "Con", and it is deteriorating."*

What I observe today:



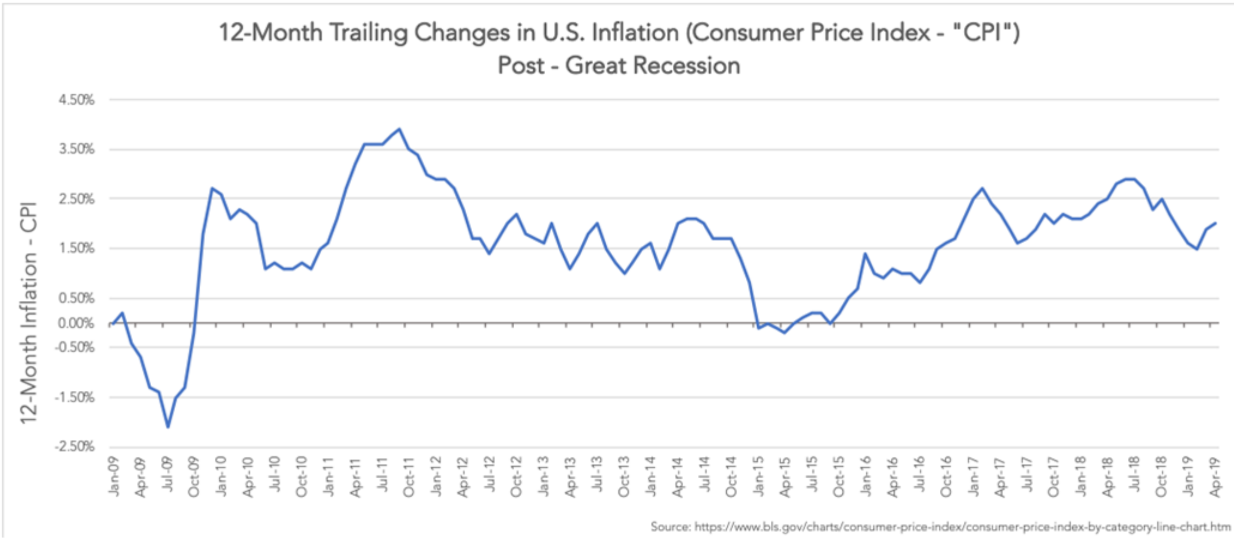
The green line is the U.S. Treasury Yield Curve on April 13th, 2018, the date I published the original "Weighing the Evidence" white paper. The yellow line is the Yield Curve for the same maturities on

September 14th, the date I wrote the second edition of this paper. The red line is May 13th's Treasury Yield curve. A casual observer would see the "flattening" of the curve over time, and most obviously, the current (red line) yield curve actually "inverts", where the 1-year, 2-year, 3-year, 5-year, and 7-year U.S. Treasury Bond Yields are _lower_ than 1-month to 3-month Treasury Bill Yields. For five trading days in March (03/22/2019 – 03/28/2019), the 10-Year Treasury Yield fell below the 3-month Treasury Bill yield, and they were inverted again at the market's close on the 13th [22]. The U.S. Yield curve has inverted before each recession in the past 50 years [23]. Investors should be wary of an inversion in yields, and with the "trend" the casual observer can see, we are "inverted" today. This remains a strong "Con" on our list.

Inflation is starting to rise.

What I said in September: "*The U.S. Inflation Rate ('CPI') has continued to rise and is now +2.7% higher for the 12 months ending August 31st* (2018). *The latest data on Employment Costs show that Wages have now risen +2.8% for the 12-months ended June 30th, the most recent data available. With 0.3% and 0.2% (annualized) increases in both CPI and Wages, respectively, since April, we are approaching some dangerous levels of growth. This remains a "Con" in terms of market conditions, and it, like the yield curve data, is a deteriorating statistic.*"

What I observe today: For the 12 months ended April 30th, 2019, the U.S. Inflation Rate, the Consumer Price Index ("CPI") has risen by +2.0%, a much more moderate pace than the +2.7% we reported for the 12 months ended August 31st, 2018, or the +2.9% we were observing at its recent "peak" in June and July of 2018. As the chart below reveals, inflation has been relatively tame for the last several years, and despite a modest, mid-2018 "spike", inflation appears to be moderating again [24]. Private Industry Compensation Costs (wages and benefits) have risen by +2.8% for the 12-months ended March 31st, 2019 [25]. With Wages growing ahead of inflation in general, and inflation safely in the 1.5% - 2.5% "range" that will keep the Federal Reserve Bank on the sidelines, I would say that this "Con" is now at least "Neutral" in terms of its impact on capital markets.



<u>Geopolitical Risks are rising.</u>

What I said in September: *"Though many in the media and in foreign affairs are rightly skeptical of* (North Korea's) *Chairman Kim's true intentions, I think it's safe to say that the President (and Secretary Pompeo) will be holding Kim's feet to the fire with the threat of continued economic sanctions, and ultimately, a pre-emptive strike on the Hermit Kingdom…We are still seeing Russian fighter jets routinely approach U.S. airspace in Alaska, and we have come very close to further 'confliction' between U.S. and Russian troops operating in Syria….The Iranians are as committed to separating the U.S. from our European allies over President Trump's decision to leave the Joint Comprehensive Plan of Action, commonly known as the 'Iran Nuclear Deal'….The Iranian Real, the country's currency, has lost about two thirds of its value this year. The country's 'official' Unemployment Rate is 12.1% (28.4% for Youth), the Inflation Rate is +18 Food), and it's getting worse. A regime on the brink of collapse, or of popular overthrow is a dangerous one…. This "Con" remains a "Con" from the perspective of capital markets, and it's getting <u>worse</u>."*

What I observe today: In the past ten days, North Korea has conducted two test launches of what appear to be five short-range ballistic missiles, a signal of their displeasure with Washington and the U.S. President's unwillingness to provide sanctions relief [26]. A North Korean cargo ship that was originally seized by Indonesian's Navy, is now in U.S. possession in a dock in American Samoa. The U.S. claims the ship was being used to skirt U.N. imposed sanctions against the sale of North Korean coal. In response to those claims, the North Koreans claim that "*the ship seizure was an illegal act that violated the spirit of (the) summit between the two countries*" [27]. They are demanding the return of the ship [28]. Over the past two-plus years of the Trump Administration, it's fair to say that the U.S. – Russian relationship continues to deteriorate. Since the last edition of this review in September, the

U.S. has added a 60th sanctions package since 2011, a blacklisting of 33 Russian nationals and three entities, all with close ties to Putin. The President has announced the United States' withdrawal from the Intermediate-Range Nuclear Forces Treaty the U.S. and the USSR agreed to in 1987. Both sides have trumpeted new missiles or missile defenses, and nobody is happy about Russia's attempts to influence our elections [(29)]. And things are particularly tense now between the U.S. and the Islamic Republic of Iran. In recent days, "specific and credible" intelligence has emerged, suggesting Iranian forces and proxies were targeting U.S. forces in Syria, Iraq, and at sea [(30)]. In a very "public" and hopefully pre-emptive response, the Pentagon deployed an entire aircraft carrier strike group, including several B-52 bombers, to the Strait of Hormuz. The Iranian response is that the U.S. is "provoking" a military conflict, and as this is typed nobody has yet fired upon the USS Abraham Lincoln as it traverses the narrow straits to the Persian Gulf. A meeting between the President's top national security aides and Acting Defense Secretary Patrick Shanahan, wherein plans to move as many as 120,000 U.S. troops to the Middle East were discussed, was "leaked" to the U.S. media on Monday, no doubt to send a not-so-subtle message to Tehran that such "plans" exist!

Though it may be hard to believe, given where we were geopolitically last September, but by all accounts, _there is more geopolitical tension in the world today than there was last fall_. Capital markets hate unexpected surprises, and geopolitical flare-ups and full-scale conflagrations are both difficult to anticipate, and to prepare for. This "Con" is still very much a "Con".

Political Polarization.

What I said in September: *"For anyone who thinks this is getting better since my last Report to you, I have two words: Judge Kavanaugh…The polarization between the two major political parties in this country continues to worsen every day the current Administration remains in power, and the political opposition to it intensifies…This remains a strong "Con" in terms of the capital markets' ability to depend upon a functioning government focused on doing the work of the people."*

What I observe today: Our country today is well beyond simply "divided". We are politically, socially, ethnically, religiously, geographically polarized. Identity politics is the name of the game, and tweets are the new weapons of choice. Amy Chua, author of "*Political Tribes: Group Instinct and the Fate of Nations*", says, "*The Left believes right-wing tribalism – bigotry, racism – is tearing the country apart. The Right believes that left-wing tribalism – identity politics, political correctness – is tearing the country apart. They are both right.*" [(31)] Every time I write about this, I say I've never seen America this badly divided, and every time I say it subsequently, its true again. Both sides are entrenched in their respective corners. It's often been said about Americans, "*What unites us is stronger than what divides us.*", but this may, or may not be the case today. The truth is, I can't point to any "market event" that was triggered by political polarization _yet_, but I can say that the capital markets will not react well to a Presidential Impeachment proceeding. This "Con" remains a strong "Con" on our list.

There is one more item that was part of the concerns I had previously addressed under "Geopolitical Risks", but has recently grown in importance enough to claim a "Con" of its own, and that is…

The Chinese - U.S. Trade War

What I observe today: Since January 22, 2018, when President Trump placed a 30% tariff on Chinese solar panels, China and the United States have been engaged in a trade war involving the mutual placement of tariffs. The U.S. has had economic and trade disputes with China both before, and since China's admission into the World Trade Organization ("WTO") in December 2001. The Chinese have been repeatedly accused of violating intellectual property rights, and of forcing technology transfers from American tech companies in exchange for access to their markets. They don't allow the U.S., or any foreign based company or individual to have a controlling interest in any Chinese company. They are alleged to use cybertechnologies to hack into sensitive U.S. private and military technology companies. Former Director of the National Security Agency Keith B. Alexander called Chinese cyber theft of intellectual property as "*the greatest transfer of wealth in history.*" [32] Presidents George H.W. Bush, Bill Clinton, George W. Bush, and Barack Obama all complained about the problem, but none of them solved the problem, which has just increased with the size of the ever-expanding trade deficit we have with China today. The U.S. Census Bureau says China sold $540 billion of goods to the U.S. in 2018, while the U.S. sold $120 billion in goods to China that year, leaving the U.S. with a (-$420 billion) trade "deficit" with China, the largest on record [33]. The U.S. tariffs on Chinese goods entering the U.S. have recently been expanded to include a 25% tariff on $250 billion in Chinese goods sold in the U.S., with threats by the Trump Administration to add another $300 billion in Chinese goods sold the U.S. to the list. China is threatening to place tariffs on $60 billion of U.S. goods sold in China in retaliation.

China is not a "good faith negotiator" in these matters. They have been sanctioned many times by the WTO, but apparently no amount of sanctions will change their behavior. They sell more and more of their goods overseas every year, all the while flouting the internationally agreed upon trade practices. The current President has decided the economy and the markets are strong enough to take the "friction" tariffs place on the free-markets, and the increased costs of goods sold tariffs bring to the consumers. His gamble is that U.S. consumer and businesses will find other countries to fill their supply chains. He also believes China has more to lose from a disruption in the U.S. Chinese trading relationship than the U.S. does. That said, the President must stand for reelection. His counterpart, President Xi Jinping, does not, and no longer must be concerned with term limits, which were eliminated in China in 2018. The "Trade War" is, by far, the "issue" the capital markets are most worried about today, and as such, it has vaulted to the top of our list of "Cons".

As we reconstitute our lists today, I'm going to add a third "Category", that being "Neutral" items, conditions that were previously cited as a "Pro" or a "Con" but can't currently be considered "favorable" or "detrimental" to market conditions.

Here are our updated "evidence" lists:

<u>Pros (or reasons to be "Bullish")</u>

1) Corporate Earnings are rising fast.
2) U.S. GDP Growth is accelerating.
3) U.S. Unemployment is at cyclical lows.
4) Interest Rates are still cyclically low.
5) Investor Sentiment is weakening.
6) Stock Buybacks of $800 billion + in 2018 expected to continue.

<u>"Neutral" (or reasons that are neither 'positive' of 'negative' for capital markets)</u>

1) The Federal Reserve is neither a "headwind", nor a "tailwind" to the markets today.
2) Inflation is currently in a moderate range.

<u>Cons (or reasons to be "Bearish")</u>

1) Stock Valuations remain extremely high.
2) Government, Corporate and Household Debts are extremely high.
3) The Yield Curve has "flattened".
4) Geopolitical Risks are rising.
5) Political Polarization is worsening.
6) An "all-out" Chinese – U.S. Trade War continues, and is worsening.

As I look at the evidence listed, it's interesting to me that the fundamental and economic data are, for the most part, <u>*favorable*</u> for the capital markets, while domestic and global political conditions are, for the most part, <u>*unfavorable*</u> for the capital markets. As I attempt to "weigh" each item on these lists, I would have to say that the "weight of the evidence" clearly indicates we still have reasons to be "cautious" in our allocations to capital markets today, just as was the case the last two times we went through this exercise in April, and then September, of last year.

My colleagues and I remain ever vigilant regarding these, and any fundamental, economic, environmental, societal, and geopolitical conditions that may impact our clients' portfolios in the future. Capital markets are far more complex than they used to be, are far more "multi-dimensional" in nature today and are subject to "shocks" previous generations of investors never had to consider. We employ tactically-defensive managers who seek to "participate" in market advances, while avoiding large losses and unnecessary surprises.

As always, we appreciate your support, and welcome any comments or questions you may have.

Until we "reweigh the evidence" next time, happy investing!

Jay R. Penney *CFP ®, CFA ®, AIF ®*
Chief Investment Strategist
Ashton Thomas Private Wealth, LLC

(1) https://us.spindices.com/indices/equity/sp-500
(2) https://us.spindices.com/indices/equity/sp-500
(3) https://www.bea.gov/news/2019/gross-domestic-product-1st-quarter-2019-advance-estimate
(4) https://www.bls.gov/news.release/pdf/empsit.pdf
(5) https://www.bls.gov/bls/news-release/empsit.htm#2019
(6) https://www.bls.gov/news.release/empsit.nr0.htm
(7) https://www.bls.gov/news.release/eci.nr0.htm
(8) https://www.bls.gov/news.release/jolts.nr0.htm
(9) https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yieldYear&year=2018
(10) https://www.washingtonpost.com/business/2019/05/09/trade-tensions-push-mortgage-rates-lower-second-week-row/?noredirect=on&utm_term=.7f0d705b5912
(11) https://www.aaii.com/sentimentsurvey
(12) https://www.cnbc.com/2018/12/18/stock-buybacks-hit-a-record-1point1-trillion-and-the-years-not-over.html
(13) https://www.axios.com/stock-buybacks-2018-2019-record-high-54f64348-bcd8-48c4-ae15-da2ef959dcb3.html
(14) https://us.spindices.com/indices/equity/sp-500
(15) https://www.macrotrends.net/2015/fed-funds-rate-historical-chart
(16) https://www.nytimes.com/2019/05/01/business/fed-leaves-rates-unchanged.html
(17) https://www.federalreserve.gov/monetarypolicy/policy-normalization.htm
(18) https://usdebtclock.org/ (May 16, 2019)
(19) https://fred.stlouisfed.org/series/QUSNAM770A
(20) https://tradingeconomics.com/united-states/households-debt-to-gdp
(21) https://tradingeconomics.com/united-states/households-debt-to-gdp
(22) https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yieldYear&year=2019
(23) https://www.reuters.com/article/us-treasury-inversion/update-1-us-yield-curve-between-3-month-and-10-year-rates-inverts-again-idUSL5N22P25S
(24) https://www.bls.gov/charts/consumer-price-index/consumer-price-index-by-category-line-chart.htm
(25) https://www.bls.gov/charts/employment-cost-index/compensation-in-private-industry-and-state-and-local-government-12-month-percent-change.htm
(26) https://www.usatoday.com/story/news/world/2019/05/09/north-korea-missile-test-nuclear-weapons-trump-kim-jong-un/1150107001/
(27) https://www.straitstimes.com/asia/east-asia/north-korea-demands-return-of-cargo-ship-seized-by-us
(28) https://www.bbc.com/news/world-asia-48263685
(29) https://www.russiamatters.org/facts/timeline-us-russia-relations-1983-march-2019
(30) https://www.cnn.com/2019/05/06/politics/pentagon-concern-iran-threat/index.html
(31) https://www.the-american-interest.com/2018/05/16/the-top-14-causes-of-political-polarization/
(32) https://en.wikipedia.org/wiki/China%E2%80%93United_States_trade_war
(33) https://www.census.gov/foreign-trade/balance/c5700.html#2018

Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Ashton Thomas Private Wealth, LLC), or any non-investment related content, made reference to directly or indirectly in this newsletter will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this newsletter serves as the receipt of, or as a substitute for, personalized investment advice from Ashton Thomas Private Wealth, LLC. To the extent that a reader has any questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. Ashton Thomas Private Wealth, LLC is neither a law firm nor a certified public accounting firm and no portion of the newsletter content should be construed as legal or accounting advice. If you are a Ashton Thomas Private Wealth, LLC client, please remember to contact Ashton Thomas Private Wealth, LLC, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or

Investment Advisory services provided by Ashton Thomas Private Wealth, LLC, (ATPW) an SEC registered investment adviser. Securities brokerage services provided by M.S. Howells & Co. Inc, a Registered Broker/Dealer, Member FINRA and SIPC. Though there are similarities among these services, the investment advisory programs and brokerage services offered by Ashton Thomas' advisors are separate and distinct, differ in material ways and are governed by different laws and separate contracts with you. A copy of Ashton Thomas Private Wealth LLC's current written disclosure statement discussing advisory services and fees is available for review upon request. The information contained in this e-mail message is intended only for the personal and confidential use of the recipient(s) named above. If the reader of this message is not the intended recipient or an agent responsible for delivering it to the intended recipient, please notify us immediately by e-mail, and delete the original message without any review/dissemination thereof.

Please remember to contact Ashton Thomas Private Wealth, LLC, in writing, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services, or if you want to impose, add, to modify any reasonable restrictions to our investment advisory services, or if you wish to direct that Ashton Thomas Private Wealth, LLC effect any specific transactions for your account. Please be advised that there can be no assurance that any email request will be reviewed and/or acted upon on the day it is received- please be guided accordingly. A copy of our current written disclosure statement discussing our advisory services and fees continues to remain available for your review upon request.