

JAMESSON

WINTER
2018

ASSOCIATES

Q *Recent Economic Events*

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The American labor market is moving from strength to strength with job growth strong, the participation rate on the upswing, and wages finally advancing faster than prices. GDP growth is maintaining positive momentum as the consumer has loosened the purse strings. Black Friday and Cyber-Monday sales portend a happy holiday season. Even so, savings rates remain elevated, suggesting potential further spending growth. With the expansion closing in on the record for longevity, there are some stresses and strains developing. These include global trade tensions, a housing market slowdown, and increasing credit spreads.

November employment gains came in below expectations, but that simply offset the better-than-expected numbers from October. The two-month average was just below 200,000 new jobs. Both months produced wage gains of 3.1% year over year, the strongest of the recovery so far. The Unemployment Rate held at a post-recovery low of 3.7%. It would have fallen to a new low if not for a nice increase in the labor participation rate, indicating that some previously sidelined workers have re-entered the job market.

Personal income, boosted by both the tax cuts and increasing wages, has kept pace with both inflation and personal spending. This has allowed the consumer to power retail sales and maintain a savings rate over 6%, which, along with elevated levels of consumer confidence, bodes well for future spending. And after all, the US economy is a consumer economy, as reflected in the components of GDP.

Third-quarter real GDP eased back to 3.5% from the second quarter's 4.2%, but the gain was enough to pull the annual growth rate up to 3%. Expectations for the fourth quarter are strong enough to suggest that 2018 will be the first calendar year during the expansion to post a growth rate of 3% or better.

While current statistics are very good, there are some concerns to note. The budding trade war with China tops the list. Tariffs collected by the customs department are booming. October totals of \$6 billion were double the level of one year ago. At the same time, our monthly trade deficit has increased to a ten-year high of over \$55 billion as importers rush to build inventories before even higher charges are levied.

Consumer inflation may be set for a temporary slowdown based on the decline in oil prices we have seen over the past few months. However, other factors have kept upward pressure on prices, pushing the annual core CPI to 2.2%. Plus, the recent OPEC/Russian agreement to limit oil production suggests that good news on that front is behind us.

PERSONAL INCOME, BOOSTED BY BOTH THE TAX CUTS AND INCREASING WAGES, HAS KEPT PACE WITH BOTH INFLATION AND PERSONAL SPENDING... ALLOWING THE CONSUMER TO MAINTAIN A SAVINGS RATE OVER 6%

Higher interest rates take their toll on those sectors of the economy which rely on credit to thrive, housing being the poster child. All of the key housing statistics have topped out — existing and new home sales, housing starts, and permits. This is not surprising given the

steady rise in home prices along with the increase in mortgage rates. The combo has boosted the average mortgage payment in the US by at least \$200 a month over the last year or so.

JAMES SON

ASSOCIATES

Recent Economic Events (continued)

Wider credit spreads on corporate bonds are another late-cycle development. The premium on investment grade bonds to Treasuries has increased by 30-50 basis points, while junk-rated credits have experienced 100 basis point or more spread widening.

Historically, increases in inflation have prompted the Federal Reserve to boost interest rates, and higher interest

rates slow housing — the canary in the coal mine for the overall economy. Couple this with credit strains and the likelihood of a recession increases. However, right now the labor market is strong, and the overall economy has positive momentum. Recession is not imminent, but the odds are shifting toward slowdown, suggesting that an increased level of caution is warranted. III

Commentary

I have been contemplating the nature of truth in the Age of Trump. By truth, I am not seeking existential or religious certitude, but a more prosaic version. A simple definition will suffice: words used to describe an action match with the action itself. The opposite, where words and actions are not in sync, must then be false. However, the real world has presented us with a recent example where this black-and-white logic can be shaded gray. I refer to the Brett Kavanaugh Supreme Court hearings.

The two principals in the process gave direct testimony that, given my proposed definition of truth, would suggest one was lying. However, listening to both parties in real time forced me to consider an alternative. While objective truth may indeed require words = actions, is the messy world of human beings and memory subject to a less absolute reading? It may be difficult to find nuance in our hyper-polarized times, but I am going to try.

The intermediate state familiar to us all admittedly imperfect individuals is that one or more of the principals testified to what they fully believe to be the actions which did or did not take place thirty-some years ago. Perhaps

Dr. Ford was assaulted by Justice Kavanaugh as she contends, but perhaps she was assaulted by someone else and over time conflated the individual with the Justice. Alternatively, perhaps Justice Kavanaugh was innocent of the assault, or perhaps he did what was alleged and has either forgotten the incident or has repressed the memory as being inconsistent with his self-image as a loving husband and father.

I believe that neither the Doctor nor the Justice was consciously lying — the stakes too high, the venue too public, and the potential of contradictory evidence too real. I suspect that one was telling the truth as I have defined it above, but as to which one, I plead uncertainty.

Doubt doesn't color my view of the President's approach to truth. Matching words with actions or with their plain meaning is hardly his goal. He also exhibits an almost laughable inability to determine truth from fiction when dealing with the leaders of other countries: Putin (I didn't meddle), Kim Jung-Il (no more missile development), Mohammed bin Salman (I know nothing about the murder). While many dismiss his comments in these cases as being Realpolitik, I believe it reflects a deeper issue of self-deception.

Commentary (continued)

Presidential Translator	
He Says	It Means
Witch Hunt	Legitimate Inquiry
Hoax	Scientific Evidence
Good Man	Liar
Liar	Cooperating Witness
Stable Genius	Erratic C Student
Made a Deal	Got Played

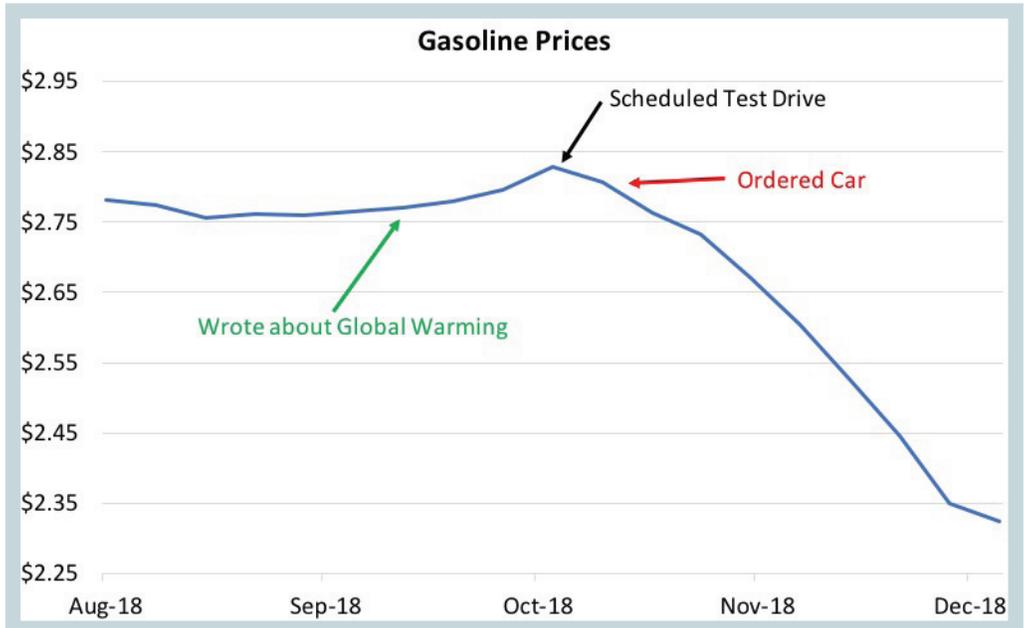
Donald Trump is good at two things: self-promotion and running up debt. In his first two years in office, he has proved adept at both. He is, however, not good at telling the truth. His reality is far more constructed than normal. While there are plenty of places in our polarized political world where we can allow for nuance in the foibles of ordinary people, Presidential tweets offer no room for nuance, only disbelief. III

Market View

Following my screed concerning global warming last quarter, I felt it was important to put my money where my mouth was. I committed to buy a Tesla, thus making an attempt to reduce my carbon footprint. You can pick out the key dates on the accompanying chart. It is unlikely that my decision crashed the oil market, but rather the universe concluded that any gasoline savings I contemplated would be fleeting.

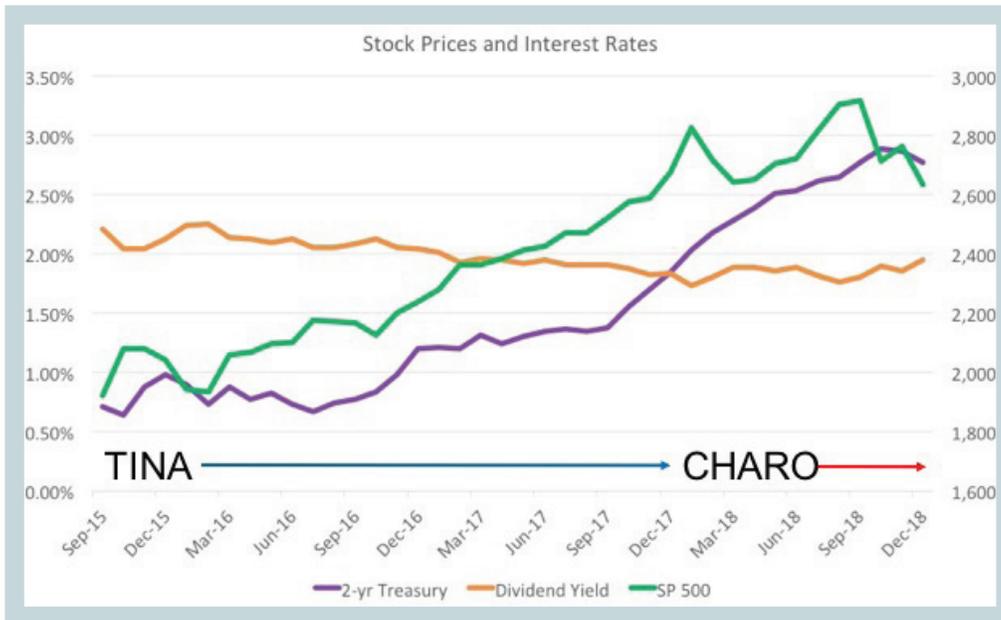
The Federal Reserve has been raising short-term interest rates for about three years now. For the first two-thirds of the period, we saw little impact on the stock market. It powered ahead because dividend returns were better than cash and appreciation was possible. We lived under the regime of TINA (either There Is No Alternative or thinking of comedian Tina Fey, cash is a joke). Since late 2017, the game has

changed, as interest rates now provide competition for stocks. The new world is characterized by CHARO.



Older readers may remember Charo as the Spanish celebrity who appeared on the Tonight Show as a foil for Johnny Carson. Her claim to fame was that she was famous, commanding attention just like cash does now. (On the other hand, the acronym is Cash Holdings Are Real Options.)

Market View (continued)



Risk off is a better strategy for 2019 than is buying the dip. The odds on a late 2019 or early 2020 recession have increased, suggesting that caution is justified. My stock advice from the fall still holds: reduce equity holdings in a measured way (1% to 3% per month), targeting a cash holding of 15% to 20%. Commodity demand is waning and unlikely to revive until after a slowdown hits and reverses. Oil is a political hot potato which I am giving up on forecasting.

It now appears that 2018 will go down as a year of little, if any, progress in the stock market. Prospects for 2019 honestly depend on events that are unknowable because they are political rather than economic. A hard Brexit (or alternatively no Brexit at all) can upend expectations. Will a trade war between the US and China escalate or dissipate? How will the Federal Reserve respond to political pressure? Even so, readers expect me to make predictions regardless of the uncertain environment. Here goes.

For the first time in a while, longer-term bonds are becoming attractive. Stay away from leveraged corporates, however, as credit issues will reduce returns.

If the ten-year Treasury refuses to exceed 3% in the next month or so, it will be a signal to re-enter the high-quality fixed income market.

Bitcoin and its cousins, along with gold, have had their day in the sun. Stay away. III

Editor's Note

Having never traveled to Italy, Susan and I decided that it was time to visit the land of pizza and pasta. Our initial destination was Venice where we dined on the former, a delicious autumnal blend of mushroom, squash, and cheese. Our pasta options were more geographically diverse. We enjoyed spaghetti with clam sauce in Trieste; tagliatelle with pesto (and with rabbit ragu) in Florence; and gnocchi on our end-of-trip return to Venice. All the pasta was made on premises, and the cheese offered was local and grated table-side. This got me thinking about domestic dining options. I must reluctantly admit that I must support President Trump on this. NO PRE-GROUND PARMESAN!! Make America Grate Again.

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