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What Can Go Wrong?

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The world is in a synchronized global recovery from the Great Recession, corporate profits are growing gangbuster, technology is creating a whole new world and our US economy is looking like it will expand more than we have seen in a decade. So why worry? Well…the US is either threatening tariffs on foreign goods or actually implementing a few. A tariff is actually a tax. If you buy a TV from Germany for $100 and there is a 25% tariff, then you pay Germany $100 and the US government $25 in tariffs so it now costs $125 for a German TV, therefore you may decide to buy an American TV for $110 instead since it is cheaper because you don't have to pay a tariff on it. What good is a global recovery if we opt-out by putting tariffs on foreign trade? Granted our free trade is not absolutely fair but nothing is.

Every country has its constituents that it wants to protect from foreign competition. France wants its family farms protected from US corporate farming competition which many deem unfair and lower quality, so there are tariffs on those. Is it a bad idea? I hear the food is better there. Is it because of protectionist tariffs? Maybe the government shouldn't determine the quality of your food. Maybe we should let the consumer decide what they want to buy at what price. Then there is China. People seem to forget that China is a communist country. Profits? They don't need no stinking profits! The job of state controlled companies in China is to employ people regardless of whether they make a profit or not. Requiring companies to make a profit is called capitalism; they either make a profit or they die. This may be cruel but it is very efficient.

So how do we negotiate a trade deal with China? I don't know, but it is definitely a different ball game. The impact of a Trade War with China is hard to estimate. Goldman Sachs estimates that US corporate profits could fall by 15% if a 10% tariff were placed on all Chinese goods imported to the US. Here we are with profits again. If China doesn't care about profits then they could just lower their price by 10% and still sell stuff at the same price with the tariffs included. It will be interesting to see how things work out, but we don't sell much to China so China has more to lose than we do. I think the most important risk to our economy and the global economy is how the world's central banks will handle letting interest rates return to normal. Since WWII every recession in modern history has been preceded by the government (The Fed) raising interest rates too quickly. Simple you say; just don't raise interest rates. But the problem is if the Fed keeps interest rates too low for too long then we may have inflation. The Fed thinks 2% inflation is desirable and that is about where we are at. Are we at a tipping point? No one really knows. The Fed knows this is a tricky tightrope to walk, let's hope they are up to it. But it's not all about the Fed; interest rates are global. The 10 year German Bund yields approximately half of a percent while the 10 year US treasury yields close to 3%. So many international investors would rather buy a US Treasury for the higher yield and this helps to lower our interest rates. While there is always something to worry about, there is an old saying that a strong (Bull) market climbs a wall of worry. The stock market was essentially flat for the first half of 2018, stocks probably needed a rest after a terrific year last year, but if we include July it is up approximately 5%. And the first estimate of our second quarter economic growth (GDP) came in at a very high rate of 4.1% annualized. The economy is looking good, corporate profits are setting records, unemployment is low, housing prices are up, and even savers can now earn a decent interest rate. There are many things that can go wrong, but so far so good. Don't hesitate to call me at (503) 668-2530 if you have any questions.

Your Friend,

Bob