1919 INVESTMENT COUNSEL
Complexity to Clarity

Weekly Market Insights

Dow Jones: 25520 YTD +3.34% | **S&P 500:** 2762 YTD +3.44% | **NASDAQ:** 7240 YTD +4.93%

February 5, 2018

Finally!

The U.S. financial markets had a big down week. The Dow was down 4.12%, the S&P 500 down 3.05% and NASDAQ down 3.53%. That's enough to catch anyone's attention and, predictably, the news services were filled with concern about whether this was the start of a bear market. No one knows, but we can certainly look at the state of the market and economy and make an educated guess. Although it can be distressing to watch the Dow fall over six hundred points in a day, it is important to have perspective. Yes, six hundred points is a lot but by the end of the week the S&P was at 2762.13. How far back did that put investors? All the way back to January 11th, 2018! Not exactly the end of the world. Analysts and investors have been calling for a correction for quite some time and this appears to be the start of one. This is a good thing. The market has been ahead of itself for some time and it would be no surprise for us to see more down side.

There are a lot of positives in the economy and a number of negatives. It is important for investors to balance the two. The economy is growing and earnings reports are encouraging. Two of the most important statistics are employment and wages. As we all know, the consumer is between 65 and 70% of the U.S. economy. Job creation is quite good and the here-to-fore moribund wage growth has picked up. The nascent wage growth, although important, needs confirmation from the next few reports. Two factors deserve attention when analyzing the wage growth. Eighteen states raised minimum wages starting January 1, 2018, so part of the wage growth has nothing to do with economic growth and a significant portion of the wage gains went to upper level supervisors and executives. Our concern is not based on social equity but high salaried individuals are not inclined to spend as much of their income gains as others. Tax reform is a positive at least in the short run. It has caused a lot of investor excitement. Companies have given bonuses and some have given raises. The promise of a surge in corporate investment is great but hasn't occurred on a significant scale yet. Mr. Trump says he is about to announce an infrastructure program which, if it comes to fruition, should be a boost to the economy. But none of this comes without a cost. We already see it reflected in the cost of capital. Interest rates have started to move up at a more rapid pace and analysts suggest the Federal Reserve may move more quickly in raising rates. We believe the economy and the markets can stand higher rates. The question of course is how much higher. The Tax Reform Act, by most analysts reckoning, will increase the budget deficit. The amount differs, by analyst, but none of it is good. The administration says the increased economic activity will pay for the tax reduction. This is unlikely, according to almost all experts on tax policy. Then there is the infrastructure problem. Surely, the country desperately needs a major infrastructure program. How to pay for it? It seems unlikely that municipal governments can raise the huge amount and private dollars are also unlikely to flow. The only other source is the federal government. This will dramatically add to the deficit. This will put the United States in the very unfortunate and unusual position of dramatically raising the government debt and borrowing without a recession. So, what happens when a recession hits? It is important to remember that the tax reform directed at individuals and families can be rescinded if the deficit grows too much. None of this is in the immediate future, but it is lurking in the out years. Investors must be alert to these dangers. We think what is happening now is a correction, but growing economies and bull markets don't last forever. At the moment, investors must keep their asset allocation under control.

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The Week Ahead:

- **MONDAY:** US Markit Services PMI expected at 53.3; EC Markit Eurozone Services PMI expected at 57.6; EC Retail Sales m/m expected at -1.00%
- **TUESDAY:** US JOLTS Job Openings expected; Germany Factory Orders m/m expected at 0.80%; US Trade Balance expected at -$52.0b
- **WEDNESDAY:** China Trade Balance expected at $54.70b; Germany Industrial Production SA m/m expected at -0.60%; US Consumer Credit expected at $19.975b
- **THURSDAY:** UK Bank of England Bank Rate expected at 0.50%; Canada Housing Starts expected at 210.0k
- **FRIDAY:** UK Industrial Production m/m expected ate -0.90%; US Wholesale Inventories m/m expected at 0.20%; Canada Unemployment Rate expected at 5.80%