John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday May 22, 2019

In a recent editorial syndicated columnist Cal Thomas wrote: "Speaking of China, Trump may be the first president since the communist takeover of that country in 1949 to stand up to Beijing. The Chinese have for decades been purloining American intellectual property, sending spies to steal military secrets and benefiting from unbalanced trade agreements. Biden and other Democrats have cowered in the face of all this, not wanting to "anger" the Chinese. Trump wants equal trade policies and is willing to risk a dip in the stock market to get it. When he does, watch the market skyrocket to new highs."

Negotiating a new comprehensive trade deal with China has not been easy. Earlier this month China backtracked on commitments to change its laws to resolve core U.S. complaints about theft of intellectual property, forced technology transfers and access to Chinese markets. That infuriated president Trump. He thought a deal was about to be completed. He believed it would happen because a new trade deal would benefit both economies. China's economy has slowed. Why would Beijing first make commitments and later back away? It made no economic sense. The Trump team logically concluded that politics in Beijing was the root cause of the reversal. Trump then applied more pressure by imposing more tariffs on Chinese goods. China in turn increased the anti-US rhetoric. For example, the People's Daily, an arm of the ruling Communist Party, said: "The trade war can't bring China down. It will only harden us to grow stronger."

The tough talk makes investors nervous. But Derek Scissors, an expert on Sino-U.S. economic relations at the American Enterprise Institute think tank still puts the odds of a trade deal this year at 50/50. He said: “Both sides might need some prodding, but we’ve had a very clear opportunity for one side or the other….to say this isn’t going to work…..and neither side did.”

Trump’s tough approach to trade has had some success. The United States and Canada have reached a deal to remove tariffs on Canadian steel and aluminum in exchange for new curbs to keep dumped metals from China and other nations out of the U.S. market. Shortly after that news, Mexico said it had reached a similar deal with the United States. The Trump metals tariffs were an aggravation for the governments of Canada ad Mexico. But they worked. It will now be much more difficult for China and others to get rid of their cheap metals by dumping them in the U.S.

Arthur Laffer is a brilliant U.S. economist. He was an economic advisor to president Reagan. I got to know him after I retained his firm as advisor to the trust department I was running at the time. Recently he was interviewed on television about the ongoing negotiations between Chin and the U.S. He said he understood that many investors are nervous because the completion of the negotiations keeps getting pushed off into the future. And now there are serious concerns that it might be impossible for the U.S. and China to resolve their trade differences.

But Laffer said he has a lot of confidence in president Trump. He praised the president saying he has done a fantastic job managing the U. S. economy. He added that the president’s goal is to make a truly free trade deal with China. And if anyone can reach

such a deal, Trump is the one. Laffer said that the Dow Jones Industrial Average would jump 5,000 to 6,000 points if such a deal is accomplished.

So, Cal Thomas has some impressive support from Arthur Laffer.

The U.S. media say that apparently the trade talks between China and the U.S. have stalled and that scheduling the next round is "in flux." Beijing has invited the U.S. Treasury Secretary and he says he is inclined to accept.

China can talk tough, but the reality is that the trade war is hurting its economy. An unnamed senior member of China's Communist Party says the trade war will trim 1% off China's GDP growth. The underlying economic pressure is real and growing stronger. China needs to settle with the United States. Tariffs and trade tensions also hurt the U.S. economy. But the damage here at home seems, so far, to be much less than in China.

Buy and hold may be boring, but is still working. The S&P 500 stock index was up 13.07% in the first quarter. Keep in mind that there has been a pessimistic drum beat in the background for months. We have been warned about a looming recession as the yield curve inverted. There is supposed to be an earnings recession this year. And above all, there is risk that the trade negotiations between China and the U.S. might fail. Never-the-less the S&P 500 had the best opening quarter since 1998.

Pessimists point out that the S&P 500 is now trading at a forward one-year P/E of about 17, well above the 10-year average of 14.7. Stifel's Barry Bannister, who thinks the S&P 500 could go down 4.6% in coming months, also says if core inflation remains low and the fed funds rate has peaked, then the S&P 500 is worth a P/E of 17.5.

First quarter earnings for the S&P 500 have been better than expected, but 80% of companies reporting have issued negative forward guidance. Full year earnings are expected to grow 3.6%.

My conclusion is that we are fortunate the optimists are cautious and listening to the pessimists. There is no bubble of stock market enthusiasm and therefore little risk of a major stock market decline. And if Trump and Beijing make a good deal, Laffer and Thomas could right. On a risk/reward basis stocks still look more attractive than bonds or cash.

I will have the next market review and update for you one week from today on Wednesday, May 29, 2019.

All the best,

John Dessauer