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Greetings,

In my previous investment letter, I stated that we should not expect this year's returns to resemble last years in any way shape or form. Check. I also stated that I expected at least one pull back of 3% and most likely, a 10% correction in addition to the pull back. Double check. I say double check because the market had its' 10% correction back in February. It appeared to be in total recovery mode in early March after a superb jobs report. More on that later. Then, two weeks ago the broad market had its worst week in over two years (The S&P 500 dropped nearly 6%) and the market averages came close to testing the recent lows. This does happen on occasion. It seemed (at least to me) that we had two corrections for the price of one. I don't know about you but one correction is enough for me. Yes, volatility is back.

To briefly recap the causes for the market correction, the market overreacted (as my late uncle used to say, "What else is new"?) to the February jobs report as the average hourly earnings increased more than what was expected, creating fears of inflation. In addition, the yield on the 10 year Treasury bond rose too fast, peaking at just over 2.9%. The fact that this is still a low yield was not relevant to the market. What was relevant was the velocity of the rise. We know that rates are going up but the market gets spooked when the yield goes up too quickly. Short term traders as well as many large institutions (such as hedge funds and public pension plans) tend to rely on quantitative analysis, as opposed to fundamentals as I do. These quantitative models showed the market technicals breaking down in the short term, so selling led to more selling. Instead of buying good companies at cheap prices, since the charts and computers said to sell, large pension and hedge funds which control a lot of money sold companies instead of buying, which is what intelligent human beings tend to do. Just try reasoning with a computer.

The recent sell off of two weeks ago was mostly because of political reasons. President Trump became the first President (as opposed to other politicians) that I can remember to actually keep a campaign promise by ordering tariffs on imported steel and aluminum. Subsequent to April 1 (while editing this letter), the President proposed $ 50 billion worth of Chinese goods on which it plans to slap a 25% tariff unless China makes changes in its trade and investment policies. I am not sure if you have ever heard of Grover Norquist. He is an extraordinarily conservative leader of the influential Club for Growth. Among other things, he believes that a tax increase for any reason is a terrible thing. Mr. Norquist immediately said that a tariff is nothing but a tax which could also lead to an increase in inflation. Congress (including people in his own party) was also against it, so for the rare time in recent history (the last time being 9/11 as I recall), both parties were in agreement that these tariffs were a bad thing. In of itself, these specific tariffs are not a big deal. The concerns were of unintended consequences, one of which will be reprisals from other countries, especially China. China in fact did put tariffs on dozens of products that our country exports. For now, this is a tempest in a tea pot. As long as things don't escalate, this will have a meaningless effect on the domestic economy.

A problem now is the toxic political environment. While I am the last person (ok, maybe not the last, my Dad will be the last, but I should be in the top 100) to defend the President, I must admit that whatever the President does, it will be looked upon as unfavorable by the majority of the population and the media. Someone said last year on TV that if President Trump saved a puppy from drowning, he would not receive any credit for doing so. When I told this to a client of mine (a Trump supporter), his response was that Trump would not only not receive credit but would be blamed for drowning the puppy in the first place. These tariffs are a tactic to bring China to the negotiating table to improve the trade deal we have with them, so that they would be more in our countries favor. It is nearly certain that without the threat of tariffs, China would have zero incentive to negotiate any change to the trade deal in place. As it stands now, our country is at a huge disadvantage as far as our imports to China. While my preference is that the President go about this in a different way (such as doing this with a coalition along with other countries), I give him credit for fulfilling a campaign promise (something that other Presidents rarely if ever do) by re-opening our lousy trade deals with the goal of improving them in our countries favor. If things do escalate into a full-fledged trade war, it will be a terrible thing, even if it hurts China more than our country. If the President succeeds in opening China's markets to our products more than they already are, then our economy will be even better than it is now.

The economy continues to improve. As much as the February jobs report spooked the markets, the March jobs report was possibly the best in ten years. The reason isn't so much that so many new jobs were created but that so many people came into the work force. One of the things that has been so bad about this anemic economic recovery (at least until recently) has been that the labor participation rate has been so low. In many people's opinions the labor participation rate is just as important if not more so as the unemployment rate. The reason it is so important is that for an economy to continue to improve, productivity must improve. While tax cuts are good, they alone are not enough for sustainable economic growth. This was proven in 2003 with the Bush tax cuts and to a lesser extent in the 1980's. One reason that economic growth was sustainable in the 1990's was because of increases in productivity. When the workforce expands, productivity increases. During the anemic economy of the past 8-9 years, the labor market contracted even as jobs were created so the low unemployment rate was phony as discouraged workers left the workforce. These workers (at least for now) are reentering the work force.

Please either email or call me if you have any questions of anything that you want to discuss.