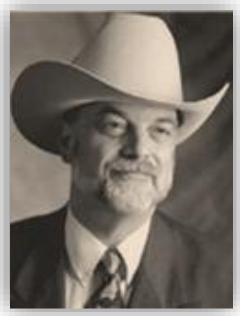

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TPWC Market and Economic Update

The Markets

The U.S. stock market, as represented by the S&P 500 Stock Index (SPX) closed out the week at 2588.26, marking the worst weekly decline since January 2016, down 5.95% for the week. From its high on January 26, the SPX is now down 9.91%, putting it within less than a tenth of a percent of the commonly-held definition of a "correction." Shares of manufacturers, steelmakers, and aluminum producers led the decline with Century Aluminum down 19% for the week. United States Steel was down 13% and Caterpillar down another 5.6%.

The culprit in this week's decline was the potential effect of tariffs. It began with the President's announcement of tariffs on tens of billions of dollars' worth of Chinese imports followed by counter-tariffs on American exports to China. Ironically, the steel and aluminum industries, those industries supposedly for which the steel and aluminum tariffs were created, now appear to be the ones that may suffer the most in the developing trade war.

Meanwhile, the benchmark 10-year U.S. Treasury note yield declined to 2.815%, a decline of 0.141 points or about 5% from its recent high of 2.956%. The decline was widely credited to a perception that the tariffs would have a negative effect on economic growth. The dollar declined against world currencies by 0.66% while gold rose 2.52% to $1,352.90 on dollar weakness and a flight to safety in the face of the potential trade wars.

The Economy

U.S. domestic factory durable goods orders rose in February 3.1% from January, the best gain in eight months and were up 9.1% since last February. Business investment was up 1.8% to $67.83 billion for the month, the highest level since 2014. The cause seems to be the new tax law that allows an immediate tax write-off for large commercial equipment purchases. There was a 2.7% increase in demand for American made primary metals in February, raising the total increase to 13.7% for the first two months of the year compared with last year.

The acceleration in the domestic industrial sectors of our economy was measured just before President Trump's announcement of steel and aluminum tariffs and should serve as a good benchmark for the tariffs' domestic economic effect. Comments by manufacturing executives since the tariff announcements suggest that the accelerating manufacturing growth could be slowed or even reversed by the metals tariffs and the emerging trade war. Take note: The combination of massive tax cuts, large increases in government spending, and trade tariffs constitutes a major experiment in macroeconomics. Over the next couple of years, we should see the results. Hopefully, we can learn from them.

The Federal Reserve Board announced another 0.25% rise in the interbank lending rate to a range between 1.5% and 1.75%. In its statement, the Fed reaffirmed its intent to continue to raise interest rates at a moderate pace to head off a spike in inflation. What was not said but widely understood was that a combination of a $1.4 trillion tax cut and a separate $1.3 trillion spending bill could easily overstimulate the economy during the next twelve to eighteen months and lead to a rise in inflation. The Fed's prime mission is to prevent things like that from happening, so it will need to take preemptive action by raising rates.

U.S. new home sales declined slightly in February, down 0.6% for the month with the median price of a new home up 9.7% from one year ago. The slowdown was generally presumed to be a result of the rise in 30-year mortgage rates to 4.45%. At the same time, existing home sales, which compose most of the home market, rose 3% in February. Existing home median values are up 5.9% from February of 2017.

Economists surveyed by the Wall Street Journal continue to expect solid economic growth this year but have lowered the annual total. They also concluded that the health of the American economy currently faces a major threat if the tariff and counter-tariff trade war continues to develop. In a worst-case scenario where the U.S. withdraws from the North American Free Trade Agreement (NAFTA) and a trade war with China escalates, the U.S. could lose 800,000 jobs and potentially enter a recession in 2019 or 2020. For the short-term, the survey reported a consensus that economic growth would continue in 2018. That view was confirmed by Thursday's release by the Conference Board of their Index of Leading Economic Indicators, all of which were positive. The Conference Board's director of economic forecasting stated that at least for the rest of 2018, a recession was extremely unlikely.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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