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August 2018 Investment Commentary

U.S. stocks experienced increased volatility in August, primarily as a result of trade and politics. Specifically, commentators and speculators focused on U.S. trade tariffs with China, renegotiation of NAFTA, upcoming midterm elections in the U.S., and the stability of the Trump administration. In this commentary we will discuss each of these issues and explain that although each of them has had and could continue to have a short-term impact on stocks or the U.S. economy, they should not result in any meaningful long-term impact for investors properly allocated.

Over the past several months, media outlets have had a feeding frenzy in discussing the potential for a trade war between the U.S., China, and other countries. In August, re-negotiation of NAFTA added to that frenzy. U.S. stocks have experienced volatility as a result of this media noise, and companies with substantial international operations have experienced the majority of the reaction. Unfortunately, almost all of the media attention has consisted of sensational headlines and speculation about what impact may result, with little attention to logical and reasoned analysis.

Rather than adding to the speculation and fear mongering, our Group prefers to look to the past to see how historical tariffs and "trade wars" have impacted the U.S. economy. International trade has always ebbed and flowed, with governments imposing and removing various tariffs and duties. In the past nearly forty years, the U.S. experienced the Reagan administration imposing significant tariffs on Japan, we've seen countries adopting stricter trade rules under the World Trade Organization in the 1990's, and we experienced steel tariffs under the Bush administration in 2002. None of these measures had a negative impact on stocks, and the U.S. in fact experienced one of its greatest bull markets through the 1980's and 90's. While stocks have experienced short-term volatility over the past few months, we do expect world leaders to ultimately act in their best interests in setting trade policy. Hence we expect, as with historical trade negotiations and tariffs, a muted long-term impact to the U.S. economy(1).

The other major topic contributing to stock market volatility in August had to do with politics. Specifically, speculation and concern regarding upcoming midterm elections, as well as the stability of the Trump administration. Just as economic trade consists of an ebb and flow pattern, so does politics, with different parties moving in and out of control of congress and the presidency. And our nation has prospered through this political ebb and flow. Or, perhaps it's more accurate to say that our nation has prospered despite foolish actions committed by both political parties. Nonetheless, many self-proclaimed experts will try to guess the economic implications of Republicans versus Democrats getting elected.

The November 2016 presidential election provided a significant example of just how clueless all the prominent investment, political, and economic pundits and "experts" are, and why you shouldn't listen to them. In the first place, their polls were vastly wrong. Some assigned Clinton a probability of election success as high as 90%. Second, after Trump won the required electoral votes, financial markets once again did not respond according to the predictions of experts. Anyone following the news knows that pundits broadly expected a meaningful decline in stocks under a Trump victory. In an article on PBS Newshour, Eric Zitzewitz, Professor of Economics at Dartmouth College, wrote the following: "Our results imply that we would expect a small global stock market rally if Clinton wins (about 2 percent) and a large decline if Trump wins (about 10 percent)". Instead of a 10% stock market decline, the S&P 500 Index increased 3% from its close on election night through the end of the month, and both the S&P 500 and Dow Jones indices reached record high levels during the month. Since then, U.S. stocks have continued to set new record high levels. Rather than trying to predict who will get elected and how the economy and stock market will react, our Group thinks investors should acknowledge that the U.S. has thrived through almost a quarter of a millennium of continuous ebb and flow of political power, and that this shows no sign of changing under current conditions. Investors should invest based on continued expected long-term economic prosperity, despite political ebb and flow(2)(3).

Even with his poor track record, Dr. Zitzewitz and two other economists appear in a recent CNN article attempting to predict how U.S. stocks would react in the event of a Trump impeachment. The general consensus among the three economists is that an impeachment wouldn't have a meaningful impact on the U.S. economy. Our Group agrees with this view as it pertains to the long-term. Over the long-term, the U.S. economy has endured economic and political shock after shock, but that hasn't held it back. Over the short-term, however, anything can and will happen with stocks. Rather than making a short-term prediction about what will happen and then investing based on our prediction, our Group follows a more intelligent approach. We invest in assets positioned to do well over the long-term, but that have a track record of overcoming a continuous stream of short-term crises over the past decades and centuries. This track record of overcoming crises gives us the confidence that these assets will prevail through future unexpected short-term crises, and carry our investors to long-term success(4).

Regarding the possibility of a presidential impeachment or resignation, the best clues we can hope to find lie in the past. Nixon resigned from the presidency in 1974. Around that time, the U.S. economy faced a series of additional shocks including the conviction of the Watergate burglars, a global oil shock, Middle East turmoil, and a sharp increase in inflation. These adverse economic conditions had a much larger impact on the U.S. economy and stock market than did Nixon's resignation. Over the time period January 1973 through August 1974, U.S. stocks fell 42%. In 1998, Clinton was impeached, but not removed from office. The technology bubble of the late 1990s had a much greater impact on the U.S economy and stock market than did Clinton's impeachment. When emerging markets began to falter in 1998, the Federal Reserve lowered interest rates, and this led to a sharp increase in U.S. stock prices. In these two historical cases of presidential resignation and impeachment, U.S. stocks moved in opposite directions, as a result of opposite economic circumstances. Although we prefer not to speculate, and are completely agnostic as to whether Trump's presidency will end in resignation or impeachment, we would expect impeachment or resignation to result in some short-term volatility, but no long-term impact. As with past presidential resignation and impeachment, economic conditions would carry far greater consequences for U.S. stocks. After all, we've had forty-four different presidents in the history of the U.S., and our economy has thrived (Trump is 45, but Cleveland is counted twice)(4)(5).

Best Regards,

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Sources:

(1) CNBC
(2) PBS Newshour
(3) S&P Dow Jones Indices LLC
(4) CNN
(5) Time