



Basis Points July 5, 2018

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Above the Fold

President Trump said Sunday that he wants to wait until after the midterm elections to move forward on a new NAFTA deal with Mexico and Canada. Trade tensions between the three NAFTA principals have increased recently, with the U.S. initiating import tariffs on Mexican and Canadian steel and aluminum. Both Mexico and Canada have retaliated with taxes on goods of their own, targeting yogurt, toilet paper, whiskey, apples, pork and cheese. The simmering trade disputes have made it even more difficult to strike a new North American trade deal. Trump said, “NAFTA, I could sign it tomorrow, but I’m not happy with it. I want to make it more fair. I want to wait until after the election.” With the midterms four months away, Trump wants to continue to hammer on the issues of immigration and bad trade deals through election day, in order to bring out his base to vote. It may create better publicity to settle all these trade deals right before election day, rather than in July when everyone is at the beach and not paying attention.

Three Things

- Amazon is asking small-business owners to help deliver its products, seeking to reduce its reliance on the U.S. Postal Service and other services as the number of packages it ships continues to climb. Amazon last year shipped more than 5 billion packages through its Prime program, said it is looking for hundreds of entrepreneurs “with little to no logistics experience” to set up their own delivery businesses, complete with Amazon-branded vehicles and uniforms. Amazon has been looking for ways to cut costs on the “last mile” of deliveries, which is often the most expensive part of the delivery process. Shipping costs are one of Amazon’s biggest expenses, especially with a big demand for Prime orders, with free two-day delivery. As part of the new program, each small business could have up to 40 delivery vehicles and 100 employees. By using independent contractors instead of Amazon employees to deliver packages, the company can avoid paying benefits such as overtime, workers’ compensation and unemployment insurance.
- Our friend Mark Cintolo from NEPC had interesting comments about inflation, or the persistent lack of it, in a recent musing. He notes that persistently low inflation in the face of continuing economic expansion has been confusing for most investors, but the likely culprit is the constant expansion of technology in many aspects of our economy. Disruptive technologies are propelling low-cost alternatives, creating pockets of deflation and promoting a better quality of life. For example, your smartphone is used as a phone and camera, to surf the internet, compute, listen to music and play videos. Even a \$1,000 iPhone can seem like a bargain if you consider how many devices would be needed at a higher cost 20 years ago to achieve similar functionality. It once took decades for successful corporations to establish global scale, requiring large investments in physical capital and ultimately leading to higher prices for consumers. Today, successful digital companies have achieved scale in just a few years with minimal investments in physical capital. E-commerce also has contributed to the deflationary trend, promoting price transparency, and making it more difficult for traditional retailers to sell high-margin items to consumers based on lack of pricing knowledge.
- A major change is coming to the sector members and weightings in the S&P 500. On September 28, S&P will do a major reshuffle of large Technology companies, shifting many to a new Communications Services sector, that will house companies that focus on communication and offer content and information. This new sector was formerly the Telecommunications sector, and it previously had a weight of just 2 percent of the overall index, as the only major players were AT&T and Verizon. The new sector will comprise 10 percent of the index weight, after companies like Facebook, Google, Netflix and Comcast are added to the sector. This change is more than simple housekeeping on the part of the index provider, as the sector revisions mean that funds tracking the current telecom, tech and consumer discretionary sectors will be forced to trade billions of dollars of shares to realign their holdings before the index change takes effect.

Did You Know

The resignation of Supreme Court Justice Anthony Kennedy, while a surprise to many D.C. insiders when it was announced last week, was actually the result of a 17-month full-court press on Kennedy by the Trump administration, in order to be able to appoint a new justice prior to the midterm elections this year. It began with the selection of Neil Gorsuch for the supreme court seat vacated upon Antonin Scalia's death. Gorsuch clerked for Kennedy, and considered Kennedy a mentor, so there was parental pride when Kennedy was the justice chosen to swear Gorsuch in. After the swearing in, Trump floated two more names that were former Kennedy clerks, candidates for the current empty seat, Kavanaugh and Kethledge. Trump also has nominated three of Kennedy's former clerks to high federal judicial spots. Trump also cultivated a relationship with Kennedy's son Justin, who was a key real estate liaison to the Trump organization during his time working at Deutsche Bank. All these actions gave Kennedy comfort that his replacement would secure his legacy on the court, and would be a person he could support as his replacement.

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