



Basis Points August 2, 2018

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Above the Fold

In tech news, Apple reported strong earnings after the close on Tuesday, bucking the trend of selloffs in tech stocks and approaching the elusive \$1 trillion market cap milestone. It beat earnings estimates in what is considered Apple's weakest yearly quarter and provided some much needed tech optimism for the rest of the year. Facebook and Instagram announced new features that help users limit the time they spend using the apps by monitoring their daily usage and even allowing them to set daily limits. In tariff news, the Trump administration has reported that it is considering increasing the planned 10 percent tariff on \$200 billion worth of Chinese imports to 25 percent. This comes as Chinese and U.S. officials are engaged in private talks to consider resuming trade negotiations. In North Korea, new U.S. intelligence reports suggest that the Kim regime has neither slowed their ballistic missile production nor their fissile material production despite claims from the Trump administration that there is no longer a nuclear threat from North Korea.

Three Things

- The *Wall Street Journal* reports that some Treasury market traders believe that shifting demographics are a key factor set to keep long-term yields low, counteracting other forces that recently pushed the 10-year yield near 3 percent, such as a strengthening economy and increased government debt sales. The aging population is the biggest factor influencing whether investors buy 30-year Treasury bonds. Pension plans, which have seen their equity holdings rise in value as the bull market in stocks runs into its ninth year, will want to lock in their gains in safe long-term Treasuries. Demand for long-term debt is expected to be so persistent that BNP Paribas is forecasting the yield on 30-year T-bonds will fall as much as 0.2 percentage point below their 10-year counterpart by year-end. Pension funds will continue to want to lock in gains from stocks, rotating into more stable sources of income such as government debt. In addition to demographics, some companies with under-funded pension funds are rushing to add contributions to their plans this year, while a favorable tax treatment is still available. These new contributions may be invested in long-dated Treasuries as well.
- In 2004, about 95 percent of the daily trading volume for S&P 500 companies happened prior to 2:30 p.m. CST, 30 minutes before the market closes in Texas. Fifteen years later, 25 percent of the total volume occurs in the last 30 minutes of the trading day. The rise of index funds and ETFs has sharply skewed trading volume to the end of the day, as large index fund complexes like Vanguard, Spiders and Schwab receive orders during the day, and they square up their books in the last 30 minutes, with all the buy and sell information they receive during the day. This end-of-the-day volume may continue to increase, with the move to passive investment vehicles.
- At what level of low unemployment does inflation shoot higher? Economists and the Fed have no idea. There is no magic number for perfectly balanced employment, where everybody has a job, but inflation remains tame. The U.S. unemployment rate is at 4.0 percent now, and Fed Chairman Powell was asked recently what the perfect number is, and he did not have an answer. Fed Chairman Greenspan always insisted that the magic number was much lower than economists expected, and he was correct in the 1990s, as it reached 3.8 percent in 2000, without any evident flares of inflation pressure. In fact, the jobless rate has fallen below 4.5 percent only three times since 1970 — the late '90s, 2006-7, and in the last year. In none of these times was rising inflation a problem.

Did You Know

American companies are doing much more in China than the U.S. trade deficit suggests. The trade deficit, the difference between what the U.S. imports from China and what it exports there, grew to \$375 billion last year. The administration takes that number as evidence that the relationship between the U.S. and China is out of whack. But comparing imports to exports is not a full picture of American commerce with China. A closer look reveals that U.S. firms are in significantly better shape than the deficit suggests — and therefore also are more vulnerable to a

trade war. The huge missing ingredient in the trade deficit number is the business done in China by American companies. GM sells more cars in China than at home. There are more iPhones used in China than in the U.S. Overall, China subsidiaries of U.S. companies sold \$223 billion of goods in 2015. Much of that business isn't reflected in the deficit figures reported each month by the U.S. Commerce Department because the goods never actually cross a border, American firms' output is produced in China and sold in China. In the U.S., Chinese firms don't make and sell nearly as much. Corporate America is far bigger in China than the trade deficit shows, so the U.S. has a lot to lose in a trade war.

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