Basis Points – November 29, 2018

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Above the Fold

Stocks rallied sharply yesterday after Fed Chairman Powell spoke to the Economic Club of New York and made some highly anticipated comments. The market had been worried about the Fed raising rates too fast and too soon, so Powell noted two important things that investors cheered:

- He considers the Fed funds rate to be near a neutral level, which is a big change from remarks he made less than two months ago. He previously noted that the Fed funds rate was “a long way off” from the neutral level, which indicated that many more rate hikes would be required to get it to that level. The Fed wants the Fed funds rate to be at the neutral level, which is the level of rates that neither helps nor hinders economic growth. This change in language shows a much less urgent need for continued hikes in interest rates.

- Powell’s words also indicated that the Fed board will be data dependent with regard to future interest rate hikes, instead of sticking to a predetermined rate hike plan. Powell noted that there is no preset policy path and that they will be paying very close attention to incoming economic and financial data.

President Trump and Chinese President Xi will meet for dinner on Saturday night as part of their G20 meeting schedule in Buenos Aires. Fears of a trade war have ramped up this week as Trump has threatened to enact tariffs of 10-25 percent on Apple iPhones if China refused to sign a trade deal with the U.S. It is not in China’s interest to keep the talk of a trade war going, as the Chinese economy has softened significantly since the start of the year. And Trump must realize that U.S. citizens will not be too enthused about having to pay 20 percent more for their new iPhone, so moving rapidly toward a deal is in both countries’ best interest.

Three Things

- Salesforce.com, the largest customer relationship management (CRM) software platform, reported strong earnings yesterday and CEO Mark Benioff reiterated his positive economic outlook for the coming year. Two quarters ago, Benioff noted that the current economic environment was the best they have seen in many years. Yesterday Benioff further noted: “When we look out at next year, I’m not sure I could see it going faster than it is now because I’m not sure where we even get all of the people to hire that we need to hire. Like it’s amazing what’s happening. And not just for us, but for all, for everybody. If it’s 2 percent to 3 percent next year in the GDP, I wouldn’t be hugely surprised, but I don’t see some huge sea change in the economy.”
- It’s good to be a TV judge: Forbes magazine recently released its list of the highest-paid TV hosts, and Judith Scheindlin, a.k.a. Judge Judy, presides over the list. Scheindlin raked in $147 million in the past year, from both salary and program catalog sales. In its 23rd season, her average daily viewership of more than 10 million people consistently dwarfs even nightly cable network news shows such as Sean Hannity, who attracts only 3.3 million viewers per night. In addition to Scheindlin’s yearly salary of $47 million that she earns for hosting Judge Judy, she also sold the rights to her Judge Judy catalog of 5,200 shows, as well as future shows, to CBS for $100 million. With that cash haul, Scheindlin is now worth an estimated $400 million and is the 48th-richest self-made woman in America.

- The WSJ writes that the U.S. housing boom is coming to an end, and they look at the Dallas market as the "canary in the coal mine." The paper sees the housing market slowing markedly over the past year, as mortgage rates have risen to over the important 5 percent rate, and buyers have balked. With higher mortgage rates, homebuyers can afford less home. Buyers are not only being thrown by the new mortgage rate but giving up their very low current rate in the 3 percent range has also hindered those buyers who wanted to move up to a large house in the same geographic region. The paper specifically cites Frisco as the ground-zero for the housing market cool-down, as the number of unsold new builds in Frisco continues to rise. U.S. existing home sales have declined on an annual basis for eight straight months, the longest slump in more than four years. Although the Dallas business climate remains very strong, home prices have grown faster than wages and that imbalance may be catching up to the formerly hot DFW housing market.

Did You Know

General Motors' (GM) announcement this week concerning plant closures and the discontinuation of some products has been met with wide criticism from the White House, labor union leaders and concerned state governments. However, these were bold moves by GM CEO Mary Barra, and continue the company's transformation from the financial basket case that it was in 2009 into a company that is poised and ready for a vibrant and profitable future. During her five-year tenure as CEO, Barra has been intent on transforming GM into a more efficient company, and a business that can survive the industry's long-expected shift toward autonomous vehicles.

President Trump noted that the U.S. government "saved" GM during the Great Recession, and implied that the company now owes the American people a debt for its past largesse, and that closing plants and laying off workers is wrong and a slap in the face to its saviors. However, from a purely business sense, some have concluded that making these tough and unpopular decisions now ensures that the company will never again be in such a poor business condition that it would need to declare bankruptcy and need any future government aid. The WSJ notes some reasoned rationale for many of the moves announced this week:

- GM has closed many of its money-losing operations. For years, GM clung to its unprofitable European business, which failed to turn a full-year profit in this century. Barra sold it in 2017 and is now also exiting India and Russia.
- GM is ending production of cars that aren't selling well. GM is killing several passenger cars that simply weren't popular with consumers, including the Chevrolet Volt and Cruze. Barra did not allow GM's past bad bets on those products to sway her current plans. Instead, GM is developing new SUVs, like the Chevy Blazer, and fully battery-powered vehicles.
- GM is investing in self-driving vehicles, which is a bet on the future of the auto industry. GM bought San Francisco-based self-driving car startup Cruise Automation for $1 billion in 2016, helping the company sprint past key competitors in the race to deliver autonomous vehicles.

- GM has refused to heavily discount its products. Before Barra, it was common for GM to heavily discount vehicles to keep products moving out the door. Since Barra took the helm, she has placed GM's focus squarely on maintaining and boosting profitability, and offering steep incentives are not part of the strategy. While it may have cost some vehicle sales and market share, GM is solidly profitable and better able to weather an inevitable downturn.

Making tough decisions during good times in the economy may help GM survive and thrive in a bad economy, whenever that arrives. And while planning for an uncertain future filled with autonomous vehicles and electric cars may seem fanciful today, these plans could look like very shrewd and forward-thinking decisions down the road.