



Basis Points – February 21, 2019

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Above the Fold

- With the government shutdown now behind us as a source of market worry, the U.S./China trade war now takes center stage. On March 1, existing product tariffs are set to increase from 10 to 25 percent. The equity market is pricing in no escalation of tariffs, and the White House has not been subtle in its remarks suggesting its preference for a deal, and soon. U.S. Trade Representative Lighthizer has been warning that China has not put structural issues on the table yet, and this week's talks will be critical to see if enough progress is made so that a delay could be enacted to give Presidents Trump and Xi more time. China's economy has slowed materially over the past six months, so it is in the best interest of both sides to get a deal signed in the near term.

- Walmart reported fourth quarter earnings on Tuesday and posted strong sales over the winter holidays, as the world's biggest retailer lured customers from shrinking chains and ramped up its online grocery business. In the U.S., the company's comparable store sales rose a very strong 4.2 percent in the January-ended quarter, one of Walmart's biggest quarterly gains in a decade. Walmart got a boost from strong grocery sales, online orders and holiday purchases, including toys. Walmart had expected quarterly U.S. comparable sales to rise 3 percent from a year earlier, so the beat was a welcome surprise to investors.

Three Things

- 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.
- 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 United States. 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.

- The notes from the January Fed meeting confirmed that the Fed is on hold for rate increases in 2019. The notes stated that “Participants pointed to a variety of considerations that supported a patient approach to monetary policy at this juncture as an appropriate step in managing various risks and uncertainties in the outlook. A patient approach would have the added benefit of giving policymakers an opportunity to judge the response of economic activity and inflation to the recent steps taken to normalize the stance of monetary policy. Furthermore, a patient posture would allow time for a clearer picture of the international trade policy situation and the state of the global economy to emerge and, in particular, could allow policymakers to reach a firmer judgment about the extent and persistence of the economic slowdown in Europe and China.”

Did You Know

There have been no fatalities in the U.S. airline industry for the last 10 years, which is a remarkable achievement given that 90 million flights took off and landed in those 10 years. This exceptional safety record was born from tragic events in Buffalo, New York, a decade ago. On Feb. 12, 2009, Colgan Air Flight 3407 crashed while attempting to land in Buffalo. Fifty people were killed when the flight stalled and lost altitude, crashing into a home in Clarence Center, New York. But from this tragedy, airline safety changed and improved drastically. The families of the victims of the crash banded together to form a cohesive and very powerful advocacy group that doggedly pursued changes in airline regulations and training, changes that have made air travel significantly safer ever since.

The crash forever changed training regulations for airline pilots. Investigators revealed that both the pilot and the co-pilot of Flight 3407 were inadequately trained and overworked. The pilots suffered from a lack of sleep given their challenging work schedules. The pilots also lacked a proper number of flight hours and training, which contributed to the crash. Previously, pilots and co-pilots needed only 250 hours of flight experience before being allowed to fly. Now they need 1,500.

Before the crash, pilots were only trained to deal with emergency situations in the classroom. Now they are required to complete that training in a flight simulator. Pilots are also now required to have at least 10 hours of rest, including eight hours of uninterrupted sleep between their shifts. Previously, airlines only had to give pilots eight-hour breaks.

These small but crucial changes in airline regulations have resulted in an unprecedented era of commercial airline safety. The victims’ families may have lost loved ones on Colgan Air flight 3407, but their tireless work despite that grief and loss has saved countless lives over the last 10 years.

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