BCWM
PROVIDING PEACE OF MIND

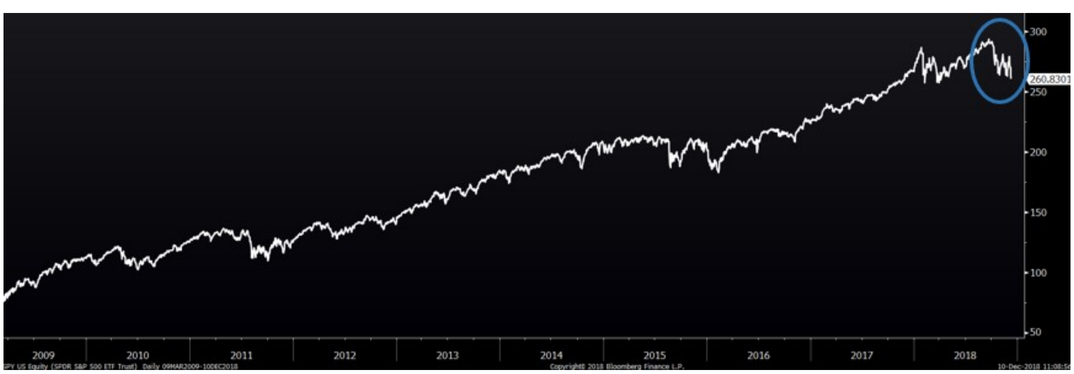
What Did You Expect?

U.S. stocks are down almost 10% since they peaked September 20th and some investors are starting to act disappointed and concerned. To them we say, "What did you expect? Stocks have increased in value almost nonstop for over nine years. Were you expecting that to just continue and continue?"

Did you honestly think that a compound annual rate of return of almost 17% indefinitely is a realistic expectation? Here is a picture of the nasty period since September 20th.

And below is that same period incorporated into a graph of market performance for the last ten years, since March 6, 2009. The latest 10% decline is barely even noticeable.

There was an uncomfortable hiccup in 2011, and a couple more in 2015. And then this one. You've got to live with months like this if you want to be in the market.



Portfolio Management
Richard W. Boyer, CFP®, CFA
Laura Carley, CFP®, CFA
Cory Bloodgood, CFA

BCWM, LLC
14221 Metcalf Avenue
Suite 201
Overland Park, KS 66223

Phone: 913-685-2300
Email: info@bcwm.com

The recent market volatility began in early October after Federal Reserve Chairman Jerome Powell hinted at higher-than-expected future interest rates. We wrote about this in "Could Amazon Go Bankrupt? Ever?" last month. When Powell backed away from those statements at the end of November, the market breathed a sigh of relief for a few days.

Then volatility returned. The primary reason volatility abruptly returned was . . .

Trade Tensions with China

If it's not one thing, it's another. There was much hope for a ceasefire in U.S.-China trade conflict leading up to the G-20 Summit earlier this month. As we mentioned in July in "World Trade and the World Cup," China stands to lose more than the U.S. in any prolonged trade war, but consumers in both countries suffer with increasing tariffs.

At the summit, President Trump and President Xi Jinping met at a dinner to discuss matters. As a result of the meeting, the U.S. agreed to delay the implementation of tariffs for ninety days. It was essentially a negotiation to have more negotiations. And in the interim, until we have more clarity, the markets are left in confusion.

But *while* the two presidents were eating dinner . . . hadn't even gotten to the dessert yet . . . Meng Wanzhou, CFO of prominent Chinese phone manufacturer (and Apple competitor) Huawei (pronounced WAH-way), was arrested in Canada and is currently facing extradition to the U.S., where she has been accused of helping Huawei dodge U.S. sanctions on Iran. Meng is the daughter of Huawei's founder and appears to be a pawn in U.S.-China trade negotiations (soap operas for global corporations).

It's kind of like if Steve Jobs' daughter was the CFO of Apple and was detained in Taiwan while boarding a flight, and then faced extradition to China. Can you even imagine how the media would handle that?

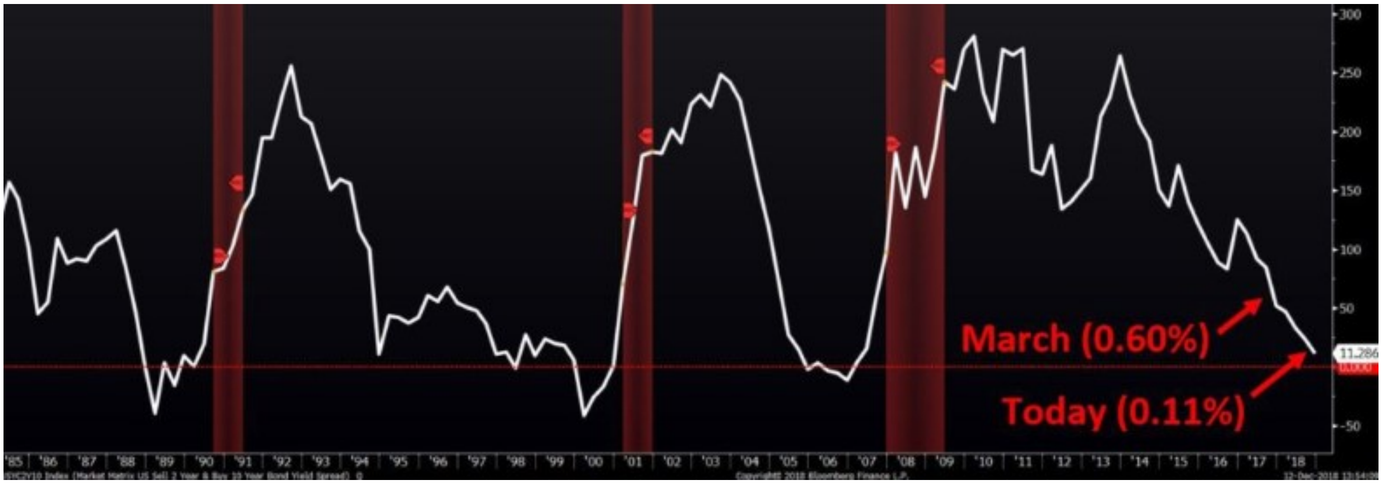
Some Canaries in the Coal Mine

U.S. Treasury Yields Acting Up

When the interest rate on long-term Treasury bonds becomes *less* than the interest rate on short-term Treasury bonds, we get nervous. Not about bonds. We get nervous about stocks (although it's typically not great for bonds either). Almost every time this "yield curve" becomes inverted, it doesn't bode well for our economy. Those of you that are old enough can remember 1981, when short-term bonds (money market funds) were paying 18% and long-term bonds were much lower.

We wrote about this back in March when the ten-year Treasury yield was 2.8% and the two-year yield was 2.2%. The graph below illustrates how the spread between the two is narrowing. In March, the difference was 0.60%. Today it is 0.11%, which is getting really close to ZERO.

In the three prior periods when the white line dipped below ZERO, it was soon followed by a recession (periods shaded in red).



Understand that the inverted yield curve doesn't necessarily *cause* a recession. It might actually be caused *by* the impending recession. It doesn't matter. All that matters is that we be aware that this canary may soon stop breathing.

Bonds Perceived as Riskier

As investors sense trouble in the economy, they demand a higher return from "risky" assets such as stocks or corporate bonds. For example, investors expect a higher interest rate from a corporate bond than from a Treasury bond. Treasury bonds are guaranteed. Corporate bonds are not.

The amount of additional return investors demand (called a risk premium) can vary over time but is usually a very small premium when the economy is good (2017) and can be HUGE when the economy is ugly (2008).

Recently we have been watching that risk premium slowly increase. Not enough to get us worried yet but enough to get our attention. This canary is breathing but nervous.

New Home Sales Waning

Even the most bullish investors are disappointed by the recent reports on New Home Sales (NHS). This indicator is important because of all the things that go into a new home (lumber, tile, carpet, paint, washers and dryers, furnaces, yadda yadda yadda). Consumers send a strong signal when they are willing to make such a big purchase, and therefore we pay close attention to housing-market data.

What was once steady growth in new homes turned to *slowing* growth this year. And the most recent numbers show that growth in NHS was the slowest since early 2016. It could be that higher mortgage rates are deterring some buyers, *or* that demand is waning.

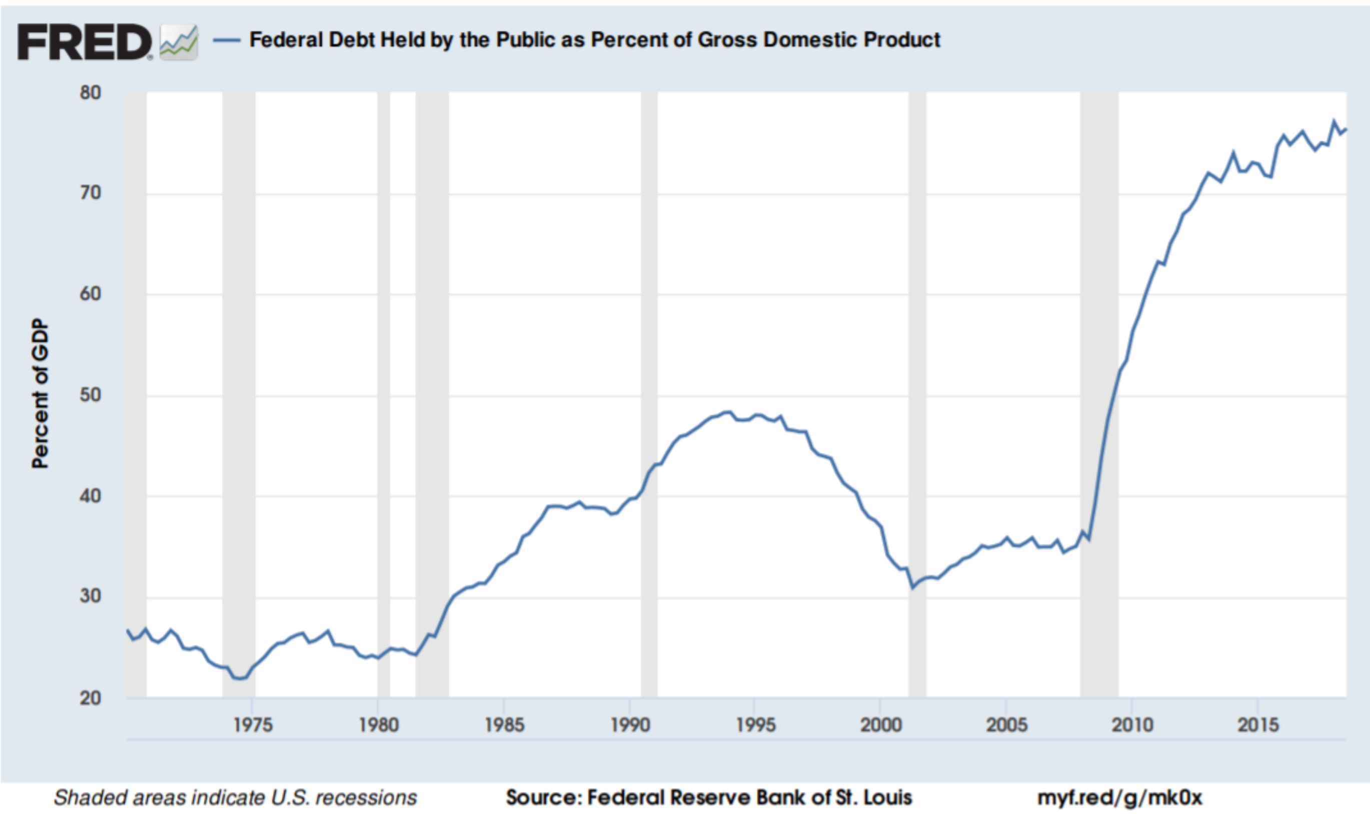
The consumer is responsible for about 70% of the U.S. economy. If they are tapped out, so is economic growth.

This canary is alive but not happy.

It is rare for the stock market to be closed mid-week as it was last Wednesday on the National Day of Mourning to honor President George H.W. Bush. The market hasn't closed for an unplanned reason since Hurricane Sandy in 2012, and before that, the September 11 attacks.

President Bush (the first) is being remembered as a president who was able to balance the national budget by raising gas and excise taxes. This ultimately cost him a second term. Never mind that he was able to reduce spending. The words "Read my lips, no new taxes" came back to haunt him in the ensuing election. He probably doesn't get the credit he deserves.

Balancing the budget has no longer become politically popular and annual budget deficits approaching $1 trillion are becoming the new normal. $1 trillion! This is frightening. The public debt has tripled in the last decade to nearly $16 trillion and has ballooned to 78% of the United States' Gross Domestic Product (GDP).



We are on track to a debt level representing 96% of GDP by 2028. By 2025, we will be spending more on the interest on our debt than on all other non-defense categories (more than Medicaid and the Pentagon). And rising short-term interest rates are not helping our debt problem.

Yikes!

At BCWM, we feel the stock market is still not extremely cheap and that interest rates will continue to remain low and possibly decline further.