StraightTalk

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China and Trade

As I wrote in a newsletter last year, it seems as if most investors across this great land are day-trading their retirement nest eggs on the perceived likelihood of getting a trade deal done with China. As if that is not damaging enough on its own, the major financial news channels – when not exhaustively covering the parliamentary maneuvers of Congress's slow march to impeachment hearings – are complicit in exhaustive reporting on the triviality of this economic tidbit, adding fuel to the fire each day.

Since that headline is incorrectly being reported as critically important to multi decade investment portfolios – let's look at some facts about China and trade, but also some data points that are actually fundamental to your long-term plan.

China is the largest country on earth by population, but is a distant second to the U.S. in terms of gross domestic product, or GDP. If you bundle together Western Europe – as in the currently fractious European Union – China actually ranks third in GDP. However, underneath that still large measure of their economy is some significant government meddling, and a fair amount of central planning skewing their reported growth rate. In plain English, our economy is largely based on more than 300 million people producing and consuming goods throughout the course of their day – theirs is less so. The official Chinese government figures show an economy growing at 6.5%, but the actual growth rate is likely half of that. Their government owned banks continue to lend money to companies that are losing money (often referred to as "zombie companies") and their central planners routinely embark on large scale building projects for whom there are no buyers or renters (often called "ghost cities.")

An easier way to determine which card player at the table has the weak hand is to look at trade statistics immediately after negotiating setbacks. When China recently balked at the mutually agreed upon 150 page draft trade agreement, and Trump immediately moved tariffs up to 25%, some telling statistics ensued. First, China's trade surplus in April dropped 60% for the month – it was expected to be $35 billion, and came in at $13.8 billion – a huge decline. Then China reported auto sales in April down 17%, and finally, they announced for the month of May that imports had fallen 8.5%. In other words – their economy is clearly more vulnerable to tariffs and trade sanctions than the news media would lead you to believe. The narrative that Trump is erratic, and is poking at the world's largest hornet's nest to our country's detriment may be good for ratings, but the reality is that we have the much stronger economy, and therefore, the stronger negotiating position.

Will we get a deal with them this summer? I don't know, but my guess is that they will blink first, and there will be some kind of accommodation at some point in the near future. Will it solve all of the systemic intellectual property theft issues and remove all unfair tariff terms? No, but it will be seen as progress, given that no other President has successfully pushed back on China since Nixon first visited that country in 1972, effectively welcoming them to the world stage.

More importantly, whenever whatever deal is signed – this headline will exit the mainstream media, and we can all return to news stories of the greatness of our American corporations. *Just kidding!* The news media will, of course, pivot to some other existential crisis that threatens to end life as we know it.

Speaking of which, I recently read a research report that not only backs up the notion of negative news bias, but also left me stunned by the degree to which this has happened in the last few years. The research firm TS Lombard recently published their report on stock market trading patterns since January 2017. During this time, the S&P 500 has risen roughly 30%, and almost all of that gain has happened outside of U.S. trading hours. The market is up a mere 2% between Wall Street's open and close; the 28% gain occurred in overnight trading hours before the market opening. Put another way, this report illustrates quite clearly that the preponderance of negative news is reported during our business day, while the positive news that affects company prices longer-term happens when the rest of the world is listening. With the existential threats to life as we know it being reported in the hustle and bustle of the trading day, and the dispositive good things happening afterwards when the world can quietly think them over – why do we even listen to any news during the day?

So, setting aside the China trade issue for now, and establishing the negative news bias once and for all, we can review the two recent stock market price corrections in a different light. The fourth quarter's 20% decline (which had the distinction of containing the worst December since 1931, and the worst Christmas Eve ever) and the May one-month swoon of almost 7% have come and gone, as we have recovered from both. Therefore, any damage to portfolios must have been self-inflicted, by believing that *this time was different*, and acting on any bad news about China and trade as if it were truly life altering. As an aside, in sixty years of navigating markets, Warren Buffet has never gone to cash, and is wealthier than any of the highly-active, constantly-trading hedge fund managers – maybe wealthier than all of them combined, but I digress...

In case you missed some of the not widely reported *positive* news – here are a few data points just since January. The first quarter's economic growth number came in at 3.2%, blowing away the experts who had predicted almost zero growth. Growth in productivity for the first quarter was reported at 3.6%, which was almost double the consensus expectation of those same experts. The April jobs report showed 279,000 jobs added to our economy, which was 46% more than we were told to expect. And, in March, U.S. job openings surged, marking the 13th straight month where there were more job openings than unemployed people to fill them. Folks, this is not an economy in peril – far from it.

Much of this is from technology improving not only the comfort and convenience of our lives, but the work output and productivity of businesses everywhere. The fact that you can order something online and have it delivered to you the next day is wonderful as a consumer, but those productivity improvements for the company taking and delivering those goods flow directly to bottom line earnings, which is why, as investors, we own these companies in the first place.

In the energy sector of our economy alone, the improvements have been astounding. The technological improvements have driven huge productivity gains. As recently as five years ago it took 70 days to frack a well, a number that was measured in years for traditional drilling two decades ago. Today, it takes just 10 days to get oil flowing. The great state of Texas will pump more oil in 2019 than either the nations of Iraq or Iran – and last year, the Permian oil field produced more oil by itself than our entire country did a decade ago.

In the era of "the Green New Deal," with solar, wind, and renewable energy being the dominant energy news narrative – oil and gas pipeline exports have quietly doubled from 2.4 million barrels per day to 4.7 million. That number will jump to over 6 million per day by next year, and we are now the number one exporter of energy in the world. Since the OPEC oil embargo in 1973, total miles driven by Americans are up 175%, but CO_2 emissions are only up 15%. And if you include other types of pollutants, aggregate emissions are actually down double digits since 1973.

The story is, and always has been, that the quest to earn and grow profits requires constant innovation and improvement, lest the next competitor put you out of business. The great companies of our country and the world don't always do everything right, but they do it right more often than not, and have a history of growth that is undeniable, even to the mainstream negative news machine.

However, from time to time, we all collectively let this toxic narrative seep into our subconscious and affect our behavior. A statistic from MarketWatch is a very important one to combat this behavior trap. Watching flows of money is not only a way to gauge the herd's thinking, it is also a very significant contrarian indicator. Since the Great Recession, fund flows into stocks have been negative every year but 2013 and 2014. In the decade since that event, all but two years have seen individuals selling more stocks than they were buying. During this period of time, the market has more than doubled *while investors have been selling stocks.* Imagine what can happen when the public once again embraces owning great companies! I think that day is several years and many thousands of Dow points higher in the future – so, let's all ignore today's China trade headlines and stay invested.

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