BUSINESS INTELLIGENCE BRIEF

January 4, 2019

NATIONAL AND INTERNATIONAL NEWS AFFECTING LOCAL BUSINESS

Short Items of Interest – US Economy

- **Momentum Shift –** There is more evidence that 2019 will not be the repeat of 2018 that many had been hoping for. The latest edition of the Purchasing Managers' Index fell sharply to 54.1. This was after a reading of 59.3 in November. A five-point loss is not common and comes as a result of far weaker export numbers than has been the case. It is important to remember that any reading over 50 indicates expansion and the PMI is still a long way from the low point of 47.8 set back in January of 2016. The most distressing part of this decline is that it is so connected to exports. The demand for US goods is sharply down as the global economy slows but there is also evidence that countries have been spooked by the trade and tariff wars and the strength of the US dollar. It has simply become harder to do business with the US.

- **Key Issue in Today's Labor Report –** By the time you read this the data from the Department of Labor will be out and we will know if there is a reason to remain calm or to start worrying a little more. The data from ADP suggested that private sector hiring was solid this month. If the official data shows that some 250,000 jobs have been added there is reason to think the economy is continuing to grow but if the numbers fall to 150,000 or lower this will be more proof that economic slowdown is underway and will reinforce the notion that a recession or at least a downturn is in the offing by the end of the year.

- **Why President's Stay Out of Fed Business –** The criticism that has been leveled at the Federal Reserve by President Trump is highly unusual and has been decried by economists and analysts as wholly inappropriate. One of the reasons the Fed should be left to act independently will be somewhat obvious soon. The slowdown that has been noted in the economy has prompted the investment community to opine that there will be no interest rate hikes in the coming year despite the assertion of the Fed at their last meeting that at least two more hikes were likely. If the Fed should decide that this slowdown is enough to cause a halt to the hikes it now has to deal with the assumption that the Fed bowed to pressure from Trump and that is the very last message they want to send. It is entirely likely the Fed will hike rates again even as the justification is not there as a means by which to assert their independence.

Short Items of Interest – Global Economy

- **Catholic Church Pushes for Fair Count –** The election in the Democratic Republic of the Congo is over and the vote count is scheduled for release this weekend. There is always deep concern that former President Joseph Kabila will twist the outcome to favor his hand-picked successor. After all, he has delayed that vote for over three years. The Catholic Church is very strong in the DRC and they deployed over 40,000 election monitors. They assert that they know who won the election but will not reveal this until the official count. It is their way of insuring that the official election team reports accurately.

- **Mexican Central Bank Worries About Inflation –** The central bank pushed interest rates up to the highest point since January of 2009 despite the fact that there has been some faltering in the Mexican economy the past year. The reason for the push to 8.25% is a very stubborn rate of inflation and the expectation that this rate will get even worse. The rate has now hit 5.0% again and looks to soar higher. The major factor has been a push to hike the minimum wage dramatically – 16% across the country and double the current rate along the border. This has driven costs up quickly.

- **Border Wall Fallacy –** There may be emotional reasons to build a wall and there may be reasons that relate to appeasing the base but the wall has nothing to do with border security – according to research by the Border Patrol. They urge more spending on manpower and surveillance and more attention to people who overstay their visa.

Self-Fulfilling Prophecy?

The investment community has long had a problem that stems from the "observation effect". This is a situation in which the very fact that something is observed will change behavior. Those who study people in the workforce and their productivity found that it really didn't seem to matter what innovation was tried, everything led to higher levels of productivity. More light, less light, colored lights, natural light – they all seemed to work equally well. Once the study was over the productivity levels fell back to what they had been before – no matter what light was chosen. It seems that the very fact that people were being observed was the key. Some worked harder for fear of getting in trouble and others just seemed to appreciate the attention. The investment world works much the same. As soon as the investor starts to respond to a belief or make assumptions, they tend to alter the world they have been observing and make it more likely their beliefs will prove accurate.

Analysis: Just two weeks ago the Federal Reserve statements regarding 2019 were upbeat and confident. The assessment was that there would be growth that would be close to that which had taken place in 2018. The statements suggested that unemployment would remain low, inflation would remain under control and growth would continue to stay close to that 3.0% level averaged last year. For a variety of reasons, the investment community has abruptly changed its mind and now assumes that economic progress in the coming year will be much less than in 2018 and they have further concluded that the Fed will not raise interest rates any further than they already are and perhaps will even lower them again by the end of the year. There has been nothing to suggest that the Fed shares this gloomy outlook – at least not yet.

It is not easy to pinpoint just what has investors nervous as there will be differing motivations for every kind of investor but there are four issues that seem to come up most often. Two of them have been concerns for some time and are likely behind the volatility that has beset the markets of late and two of the concerns are newer and may be motivating the emerging assertion that the Fed will not hike interest rates as they had been planning to do.

The first two concerns have been roiling the markets from the start of the Trump term – trade wars and debt/deficit. The trade and tariff wars seem to run hot and cold. One day there is a desire to impose strict tariffs on all imported steel and aluminum and the next day there is a move to give exemptions to nearly all the nations that ship these metals to the US. The Europeans are threatened with strict tariffs on cars and then the matter is dropped. The US and China do seem headed for a series of confrontations that will negatively affect both the nations as well as the rest of the world. The issue of debt and deficit doesn't seem to motivate the politicians any longer but the investment community has been affected by the staggering debt levels maintained by the US and there is ongoing concern that ever larger debts will force the sale of more treasuries and that crowds out the private sector.

The latest issue that has spooked investors and the business community as a whole is the confrontational approach that Trump and the leaders of Congress have taken thus far. There was some faint hope that President Trump would react to the new balance of power with deal making – looking for common ground in order to advance parts of his agenda. There was an equally faint hope that the incoming Democrats would decide to table some of their most ardent criticisms of President Trump in order to build a record of getting things accomplished. That faint hope has been dashed with the fight over the border wall and government shutdown. It now appears that both sides are going to fight to the death on every issue and that will result in near total gridlock. A whole host of business and economic issues will be left in limbo.

The other new issue that has made investors more than a little uneasy is geopolitical in nature. The confrontations between the US and its former allies in 2018 looks set to accelerate into the new year. The US has picked fights with Canada, UK, France, Germany and Japan. Mexico now has a very left-leaning President while Brazil has a very right-leaning one. Elections in Israel may unseat or severely weaken Prime Minister Netanyahu. Britain seems likely to undergo a hard Brexit that could have far reaching implications for the US. In short, the global economy seems to be in flux and there is little faith in President Trump's ability or even interest in what happens in these nations.

Whether these are fair assessments or not they have affected the mood of the investment community and in a negative way. This is not to say that attitudes can't change as there have been many positive developments in the US over the last few months. The retailers had a very solid Christmas and consumer confidence has remained high. The majority of the objective numbers for the economy are still strong – everything from employment to capacity usage, durable goods activity and so on. Granted, there are many of these measures that are slightly less robust than they had been but in general they remain positive. This could be enough to shift the mood of the investor but these shifts will have to come fast if the downward spiral is to be halted.

Mid-Sized Business Drives Job Growth

According to the latest data from ADP the economy added another 276,000 jobs in the private sector last month. This is higher than had been expected given the fact that qualified people are in short supply and the retail hiring season has ended. The majority of these jobs have been provided by small and medium sized business as opposed to the larger corporations.

Analysis: The majority of the hiring has been in the service sector – health, business services and education related occupations.

British Prospects for 2019 Not Good

The optimism that accompanied the initial decision to exit the EU has completely faded and been replaced with varying levels of doom and despair. Even those who still think that Brexit is a good idea have conceded that they did not expect the impasse that now exists. It looks more and more likely that there will be a hard exit – one that leaves almost the entirety of the UK isolated from the EU and leaves the fate of Ireland in limbo. Even if there is a last-minute deal of some kind the expectation is that 2019 will be a very weak economic year and if the break is as dramatic as now appears likely the country is going to sink into a full-fledged recession.

Analysis: The future for the UK economy has rarely been this uncertain. It is just 100 days before the UK leaves the EU and there is nothing approaching a real deal in sight. Theresa May negotiated the best deal available with an EU that was angry with the British and has been fully prepared to deal with a very hostile break up. It is the opinion of the EU members that Britain has far more to lose in this break-up than they do and have been unwilling to give the British any sort of economic edge.

The consensus view among economists is that the UK economy will struggle to reach 1.5% growth in 2019 and that is if there is some kind of deal on Brexit. If there is a chaotic ending the growth in the UK could well enter negative territory. The future of the economy will come down to how willing the government and the Bank of England will be to stimulate the moribund economy in a significant way. The problem is that much of the British economy remains tied to Europe – in terms of both exports and imports. It had been hoped that the US would substitute for the Europeans but the US today is an isolationist and protectionist country with no interest in sacrificing anything for the UK. There had been hope that Commonwealth nations might offer a substitute market but these nations know that the UK is in a bind and there are no good deals on offer.

Imports will rise in price as the pound falls in value but exports will not see a corresponding increase as Britain is not a consumer export nation and the demand for the industrial goods that Britain produces has been sagging as the world economy starts to slow. There will likely be an exodus of British expatriates from the various European nations now that their tax status has altered and they will be the population the British least covet – elderly and retired.

Perhaps the most worrisome issue is Ireland. If nothing is worked out it will become necessary to impose formal border controls between Ireland and Northern Ireland. This will cut straight through towns and villages as well as farms and residents. The Irish on both sides of the border are furious and Britain, as a whole, worries that this brings back all the tension and violence from past years as there will be even greater pressure to unite. At the same time the British will want that unity to stay intact so as not to invite the resumption of activity around independence for Northern Ireland or unification with the rest of Ireland.

What Happened to Macron?

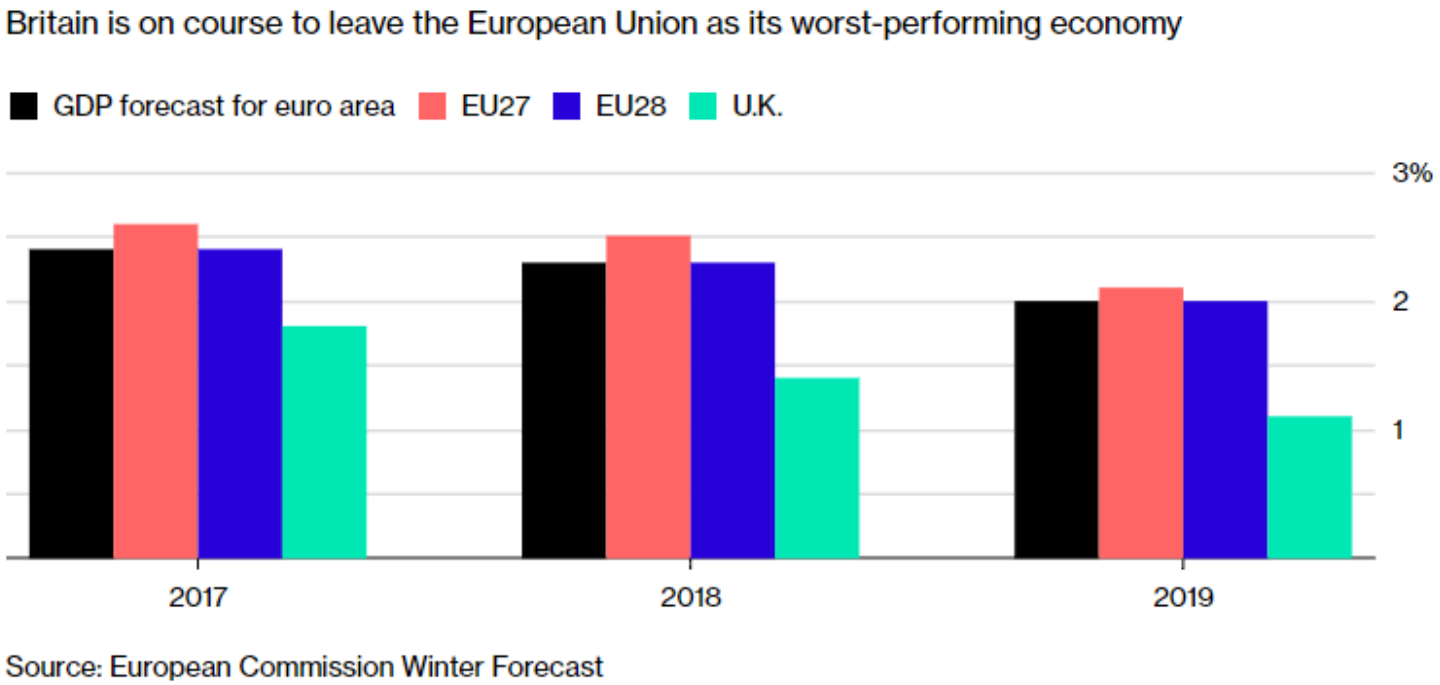
It seems like only yesterday that Emmanuel Macron of France was being hailed as the torch bearer for progressive and fair politics. His shocking victory in the Presidential race was celebrated as a victory for the thinking French over the bullies and brutes that supported the neo-fascist policies of Marine Le Pen and the National Front. Today he is the least liked leader in Europe and has half the support President Trump has. Those who seek to challenge President Trump are looking at Macron to see what went wrong and what can be learned.

Analysis: At the heart of the issue is the fact there are very few real centrists left in any electorate and appealing to that vanishing center is a largely inept policy. Macron promised everything to everybody but that is impossible to deliver. Each time he failed to provide what some faction wanted they felt betrayed and turned on him. The advantage that a President Trump has is that he never promises anything to any group other than his base and he sticks to that promise regardless of the outrage.

Those who are setting up to run against President Trump face the same pitfalls that Macron fell into. He promised steps to protect the worker and the common man so when he does anything that contradicts that promise the workers turn on him. The Macron campaign promised an emphasis on green and reduction of climate change impact so it was decided to reduce driving with higher fuel taxes. The people hurt by the higher prices are not uninterested in climate change and have been rioting in the streets for weeks.

What Else Can You Get from Armada?

As you peruse the Business Intelligence Brief you are no doubt wondering what else you might get from the authors of these reports. You are in luck as the BIB is not our sole publication. There is the Black Owl Report – published three times each week and aimed at the business executive. Keith Prather is the primary writer for the BOR and you can get a free one-month trial if you like. It is a subscription-based publication available for $84 a year. In addition to these regular reports we do longer in-depth studies, white papers and analysis of breaking economic and business stories. Beyond all that we like to be responsive to our readers and regularly answer questions posed by our readers – just e-mail chris.kuehl@armadaci.com for more details or to ask one of those questions.



At the time of the Brexit vote there was an assumption made by many in the UK that turned out to be very inaccurate. It was thought that the UK was a strong economy and one that Europe would want to stay connected to. It was assumed that the EU members would eagerly accept an arrangement that kept the UK economy in their orbit. This chart shows that Britain has the weakest economy in the region. The fact is that Britain has little leverage – it appears that Europe can get along quite well without the Brits and worst of all the Europeans seem to know this all too well.

Speaking this Month

01/10/2019	Kansas City	Heartland Heroes	Private
01/14/2018	Detroit	Automotive Plastics and Rubber	Public
01/17/2019	Kansas City	Home Builders Association Breakfast	Public
01/18/2019	Kansas City	CCIM Breakfast	Public
01/22/2019	Appleton	Fox Valley Technical School	Public
01/23/2019	Milwaukee	International Credit Executives	Public

Friendships and Legacies

I got a very nice and thought-provoking note from a reader/friend the other day. Susan Pepperdine was commenting on my resolutions and was sharing some of the things she has focused on over the years. Such as thanking strangers for what they are doing and acknowledging the work of the unsung. The one idea that struck me was making a point to make new friends and especially among the older population.

I have an opportunity to speak to several groups with older attendees and I have noticed something about the cycle of life. It has started to happen in my life as well. As we age, we start to lose people. Our parents pass away and then we start seeing our friends and colleagues pass on as well. Our friendship circle begins to contract and the older we get the smaller it becomes. I have treasured the opportunities to talk to people who have lived full lives and welcome the opportunity to share their memories and to become a new friend. I want to make a point of reaching out to those who may have seen their friendship circle diminish so that I can expand mine and theirs. I also hope that as I age there are those who still want to be a new friend. This applies to those who have left their home culture behind to start a new life in a strange land and younger people who want to share their dreams and aspirations and people with very different interests who are willing to share them with me as I share mine with them. The idea is to keep broadening that friendship circle as long as possible.

What are Your Reactions to the "NEW" Business Intelligence Brief?

The BIB format has altered a little and thus far readers seem to like the changes. What do you think? It seems that reducing the frequency of publication has made it a bit easier to keep up with and the charts and graphs at the end have been well received. We always keep tinkering with the publication so that we can stay relevant and any ideas are more than welcome. Below are some of the suggestions we have received over the last few months. Do any of these appeal to you?

1) We have been asked to consider doing podcasts or some kind of YouTube offering on a weekly basis and this seems a good idea to us. It would have to be far less detailed than what we have in the BIB now but could be something of a presentation on the "highlights" of the week.

2) It has been suggested that we do more market analysis. This is something we touch on from time to time but we have never asserted that we are stock analysts or qualified to analyze the behavior of the markets. On the other hand, we can certainly report on the economic impact of that market behavior.

3) We cover global economic news but it is a big world out there and space is limited. Right now, we tend to focus more on Europe and countries that are engaged with the US (such as China). Some would like us to spend more time on those emerging market nations in Africa, Asia and Latin America.

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