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Q1 news on economy, stocks, and impeachment

By Jim Flinchum

The Index of Leading Economic Indicators is at a record high. Factory orders are up. The ISM Manufacturing Index is up. GDP growth is positive and expected to rise. Home prices are up nationally. Even the current account deficit is decreasing.

Jim Flinchum

What else do you want? Yes, the retail sector is hurting, but both consumer confidence and sentiment are now reflecting the healthy labor market, which should help retail.

The American job market is doing better than American workers. Over the first quarter, 178,000 jobs were created each month. There are 5.6 million open jobs, which is the highest this century. Plus, 3.2 million people felt confident enough about the job market to quit their current jobs, the most since 2001.

Unemployment is only 4.5 percent, a level most economists regard as "full employment."

Getting a job today is relatively easy. Getting a raise is not. Average weekly earnings increased only 0.2 percent. There is no wage inflation, which is the primary driver of GDP price inflation. This suggests the Fed should not be so eager to raise interest rates.

The stock market

The Dow Jones Industrial Average rose 5.19 percent in Q1, compared to the broader Standard & Poor's 500, which rose 6.07 percent, easily outperforming the stock of smaller companies, which only rose 1.06 percent. Growth stocks (especially technology) easily outperformed value stocks – 8.53 percent compared to 3.29 percent. Investors are taking on more risk.

Some analysts refer to the market's robust rally since the election as the "Trump Bump." That may be, but it ignores the relief rally by breaking partisan gridlock. More importantly, it ignores the dramatic increase in corporate earnings beginning in Q3 of last year.

Global markets

Global stock markets gained 7.4 percent. Asia's markets gained 8.8 percent, driven by strong gains in India and Singapore. Europe is also coming back to life, despite BREXIT and a refugee flood. It was up 5.5 percent, helped considerably by Spain at 11.9 percent. Business sentiment in Germany just reached a five-year high.

For the past few years, a U.S.-only portfolio made good sense but no longer. Watch the April 23 election in France, which is critical.

Interest rates

As expected, the Federal Reserve raised rates in the first quarter by a quarter-point and promised more increases this year. The economy is strong enough to withstand that.

However, the Fed is also talking about reducing its balance sheet, which was increased to boost the lethargic economy over the last few years. The Fed has been vehemently criticized by the Libertarian wing of the Republican Party for this. But, reducing the balance sheet depresses the economy, just like interest rate increases. Ben Bernanke argues we should not do so. I agree!

History lessons in politics

Because political risk is so worrisome, it is important to evaluate those risks, one of which is impeachment. The conventional wisdom is that any impact on the stock market would be temporary. After all, the stock market rose 226 percent during the presidency of Bill Clinton.

History offers us little guidance. The impeachment of Andrew Johnson occurred before a "real" stock market existed. The Dow did not even exist. Also, it happened very quickly – the Senate trial began three days after the articles of impeachment were filed. The market, such as it was, actually rose 10 percent in the three months prior to impeachment but fell slightly during impeachment, before rising another 6 percent in the two months after the impeachment trial.

The impeachment of Richard Nixon was accompanied by a wild stock market. It started with a 10 percent loss in the first month of 1973, increasing to an 18 percent loss by August, when a two-month rally raised stock prices 15 percent – only 6 percent below its record high. Then, the market did nothing until Nixon's resignation in August of 1974, when the bottom fell out.

Stocks lost 27 percent in just two months. However in November, the market shot back up 16 percent, before

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turning around the next month and hitting the bottom, down 45 percent from the peak. Five months later, stocks were up an astounding 48 percent. Whew!

The Johnson impeachment tells us nothing. The Nixon impeachment tells us "nervous" investors should sit on a large cash position. The Clinton impeachment tells us not to be nervous and just wait for it to pass.

Besides, two-thirds of the Senate could never agree to remove a sitting president or anything else.

Bailing out of stocks?

I am frequently asked for a strategy to bail out of the stock market.

The vast majority of financial advisers will tell you not to market-time stocks – just buy and hold – and the vast majority of investors would be well-advised to follow that advice.

But some investors pay too great a price to do nothing. They worry and lose sleep, possibly even compromising their health and relationships. It is not worth that price. Quality of life also matters.

The necessary portfolio changes are fairly clear: Increase the percentage allocation to cash, international stocks, consumer staples and large-cap value stocks by decreasing your exposure to other sectors and asset classes. (Some investors will also increase their allocation to bonds, but I disagree.)

Here is the hard part to bailing out – timing. What is the triggering event to get out? When oil drops below $40? When China slaps a blanket import tax on U.S. imports? When mortgage interest rates hit seven percent? When impeachment charges are filed in the Senate?

Equally important, what are the triggering events to get back into the stock market? The problem with market timers is they are invariably slow to get back into the market, missing the rebound.

A trigger might be when the S&P hits 666, the low during the 2008/9 crisis. Or maybe when the Fed starts reducing interest rates? When Congress approves corporate tax cuts? When?

For good reason, advisers usually advise against getting out until you identify your trigger to get back in.

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