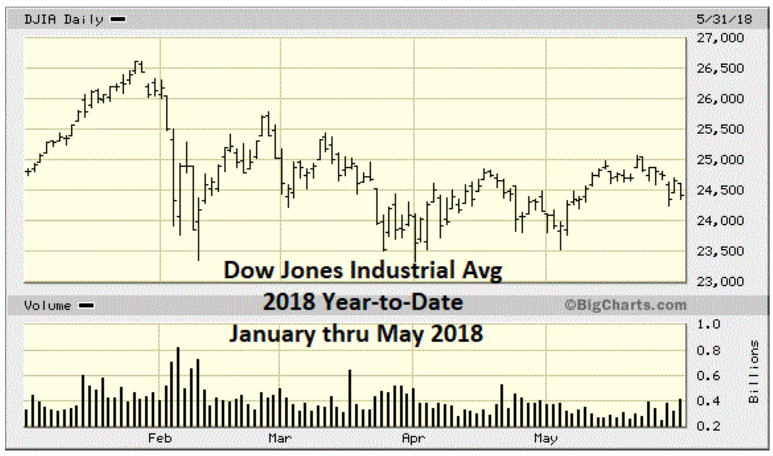
American Heritage Financial

June Update **June 1, 2018**

Managing Mayhem

If the old market axiom, "***markets climb a wall of worry***" holds true, investors in the financial markets should be feeling very positive as we begin the summer months.



In response to solid economic readings and one of the best earnings seasons on record, markets had steadily stabilized after the extreme volatility of late January/early February. Then, ***mayhem returned with a vengeance in the last days of May.*** Small cracks in the global economic picture were suddenly overwhelmed by political turmoil that startled already nervous investors and rattled markets. The list of major concerns has exploded; here are some of the most troubling:

- Interest rates have, and will continue, to increase in 2018 – unless they don't
- U.S. Treasuries yields have moved above those of other developed countries
- Two-Year Treasuries yield more than the S&P 500 dividend yield
- U.S. Dollar has surged since mid-April vs the Euro and emerging market currencies
- Euro zone if flashing warnings of softer growth
- Investors are pulling money from emerging and Euro bond funds
- Emerging country stocks have dropped about 12% since January highs
- U.S. deficit and debt outlook is about to turn much more negative
- And then there is the ***Italian drama***
- And then there is continued ***tariff/trade drama***

Of course many of these stories or concerns are not new. Some have suddenly become worse and others are being magnified by the overall chaotic environment. The stock market had managed to go for six weeks, or 31 trading days (from April 13 through May 25), with only two days where the Dow moved more than 1%. Since Memorial Day, however, volatility has exploded.

Initially, the driving force in the recent mayhem was when Italy's dysfunctional government devolved into total chaos. The short version of what is happening there is that the government was dissolved in December due to rejection of the previous Prime Minister's efforts on fiscal and immigration reform. New elections in March were inconclusive in that none of the various factions received a clear majority. Then, over the Memorial Day weekend, Italy's President rejected the newly elected Prime Minister's efforts to form his cabinet—effectively cancelling the March election and calling for new elections to be held, again, in July. Besides the problem of no government and the ongoing chaos, there is a strong possibility that a growing populist movement in Italy will prevail in any new election and such a governed might leave the European Union and/or cause major economic turmoil. As of the moment, the Italian President has backed off and the various factions are attempting to find a workable resolution.

Meanwhile, our own government has moved to the center ring of the circus. With the last day of May came the "final deadline" for renegotiating NAFTA and no resolution resulted in our President announcing he is following through with prior threats to impose tariffs on steel and aluminum imports from Canada, Mexico and the European Union. *Actual and threatened tariff and trade actions, by the U.S. or any other country, are at least as ominous for the global economy as the potential breakdown of the European Union.* The ongoing trade and tariff threats by the U.S. against its biggest trading partners (China, Canada, Mexico, Japan and Germany) have been roiling stock, bond and currency markets around the globe all year. Implementation of tariffs—as well as retaliatory responses—is a major, ongoing concern for investors.

Many of the items on our long list of concerns, above, relate to the tariff/trade tensions as well as hints of economic slippage and mounting political chaos. Some items are due to our own economic strength. The strong U.S. economy, further juiced by tax cuts, has pushed our interest rates higher and strengthened the Dollar. Flight from the Euro and wobbly Asian currencies has further strengthened the Dollar. This creates a vicious cycle for heavily indebted nations around the world as they pay interest in higher valued Dollars and feel the effect of higher rates. These increased pressures could easily push teetering economies such as Argentina and Brazil over the edge (Venezuela is already pretty well written-off by the world economy), and such worries could hit Spain, Turkey and Italy next. The strong Dollar and higher interest rates put tremendous pressure on fragile, highly indebted economies and is a major reason we are seeing weakness in the financial markets around the world.

Perhaps it has just been a bad week and all the worry will dissolve like cheap sunscreen. In spite of the recent mayhem, our economy remains in high gear, profits are supporting stock prices and the market has new and old pockets of opportunity.

The "new" category includes many "old" great blue chip companies. They are *"consumer non-durable"* and/or *"consumer staple"* stocks such as PepsiCo, P&G or Johnson & Johnson. Many of these stocks have been over-sold to ridiculous levels in 2018 and are now great bargains for patient long-term investors. Their problems resulted from changing consumer tastes, increased competition from online sources and commodity-price pressures—but the concerns are more than priced-in. The second "new" area is smaller, more domestically focused companies. While the small stock sector has been unduly ignored throughout this long bull market, it appears this broad sector is finally gaining great traction. The third major area is the great growth—mostly technology driven—companies that have been dominating the markets and economy in recent years. These stocks are not cheap and can be volatile and risky, but companies developing revolutionary, disruptive technologies are key to a growth investor's success. (We should also note that many of these companies have impacted the consumer sectors mentioned above.)

Before we disappear to the beach for summer fun, we will be working to monitor the mayhem and look for investment opportunities which always occur in this kind of volatility. Hopefully, you can take advantage of our sudden-summer, relax, and avoid all the unpleasant headlines. Please don't hesitate to contact us if you have questions or concerns.

Best regards,

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Questions or comments?

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