THE ECONOMY
The U.S. economy started 2019 with a bang. Gross domestic product advanced at a 3.1% annual pace in the first quarter. Now with trade tensions rising, more than a few economists are wondering if the best is behind us. 3.1% is still quite good, but the underlying details, a big first quarter inventory buildup and a temporary drop in the trade deficit, suggest slower growth ahead. The first quarter’s inventory buildup is attributed to the anticipated increase in tariffs that is now expected to reverse moving ahead. That inventory liquidation might be happening now with flat retail sales being recorded. U.S. factory activity appears to be faltering as trade tensions cloud the economic outlook and global demand softens. Orders for Boeing’s 737 MAX are grinding to a halt. Auto makers Ford, General Motors and others are announcing layoffs. The auto sectors announced job cuts this year that are the highest since 2009 according to Bloomberg news. Apple could face iPhone ‘demand destruction’ in China. The weather and tariffs are hurting farmers. The weather may change for the better, but trade tensions between the world’s two largest economies seem to be getting worse. Falling interest rates are helping housing, and consumer confidence remains strong with healthy hiring reported in the last three months. The jobs reports will hopefully support consumer spending despite the announced layoffs in the auto industry and problems in the farm community.

In summary, a recession is not expected this year but a slowdown is expected with trade uncertainties taking their toll moving forward. The trade conflict between the US & China escalated this month with both sides slapping tariffs on billions of dollars of each other’s goods. China’s threat to restrict rare earth mineral sales to the U.S. came after President Trump blacklisted Chinese telecom giant Huawei, which led to many chipmakers and internet companies cutting ties with the company. The speculation about China’s payback first surfaced when Chinese President Xi Jinping visited rare earth mining and processing facilities in Jiangxi province during a domestic tour. A Chinese official warned that products made from the materials should not be used against China’s development, which was seen as a veiled threat aimed at the U.S. and its technology industry. China’s rare earth materials are crucial to the production of iPhones, electric vehicles and advanced precision weapons, although the imports are a relatively small part of the $420 billion U.S. goods deficit with China. China’s threat to restrict rare earth mineral sales to the U.S. came after President Trump blacklisted Chinese telecom giant Huawei, which led to many chipmakers and internet companies cutting ties with the company. The speculation about China’s payback first surfaced when Chinese President Xi Jinping visited rare earth mining and processing facilities in Jiangxi province during a domestic tour. A Chinese official warned that products made from the materials should not be used against China’s development, which was seen as a veiled threat aimed at the U.S. and its technology industry. China’s rare earth materials are crucial to the production of iPhones, electric vehicles and advanced precision weapons, although the imports are a relatively small part of the $420 billion U.S. goods deficit with China. The Chinese tabloid Global Times reported that China can play the “rare earths card” and that it’s “seriously considering” the move. The outlook for the rest of the year were already clouded by the threat of a slowing global economy, and trade tensions with China and Europe. Stay tuned.

MARKET PERFORMANCE – Sell In May: Second-worst May for the S&P500 since the 1960’s
U.S. and world markets posted record losses for the month as tariff talk escalated for most of the month. Bond funds were the only class of funds posting gains in May. Technology and overseas funds fared the worst with precious metals posting late month gains, but still showing losses for the year.

- S&P 500 – down 6.6% for May & 9.6% YTD
- NASDAQ Equal Weight Index – down 7.9% for May & 12.1% YTD
- All World w/o U.S. – down 7.2% for May & 5.5% YTD
- Global Bonds – up 1.6% for May & 3.6% YTD
- Balanced Index – down 3.7% for May & 5.0% YTD
RECOMMENDATIONS – Expect More Volatility and Stay Defensive Until Trade Talk Settles Down

May started in a slight uptick with news that trade talks with China were going well and that a successful agreement might be completed in a matter of weeks. Since then it has been nothing but fits and starts as talks with China have degenerated to the point that The Economist's May 24 cover issue proclaims "A New Kind of Cold War." It now appears that fighting over trade is not the half if it. The United States and China are contesting every domain, from semiconductors to blockbuster films to lunar exploration. President Nixon and Henry Kissinger started the process where the two countries would work together to seek a win-win world. President Trump's view of winning seems to require the other lot's defeat; not only with China but with Europe, Mexico, and Canada as well. Thursday's markets advanced slightly with the news that China was hinting at new trade talks. Friday's markets fell sharply with news that President Trump said that he would impose a 5 percent tariff on all imported goods from Mexico beginning June 10, a tax that would "gradually increase" until the flow of undocumented immigrants across the border stopped. So much for the renegotiated NAFTA treaty. A food fight of sorts broke out on CNBC's squawk box morning show when conservative hosts Joe Kearnan and Rick Santelli duked it out with two mainstream guest economists. One side noted that world markets had lost $5 trillion since tariffs had been deployed and that the cost to American consumers would be in the neighborhood of $93 billion. The other side stated it was time to "think outside the box" and teach our adversaries a lesson. There is now one political party that is anti-tax and pro-tariff, and another that wants to raise taxes on the rich and is anti-tariff. Go figure!

The latest tariff announcement illustrates the power of algorithmic computing in today's markets. With Thursday's upbeat news, you might have expected a rally of sorts to carry over to Friday. President Trump's Mexican tariff tweet came late Thursday night. On Friday morning, before the markets opened and I had my morning java, the futures were down over 1%, and that is where they stayed all day. Don't think that several thousand retail traders sold throughout the night. The New York Times is reporting that President Trump has issued on average 60 tweets a day. Algorithmic computers pick up on any tweet he or his staff sends that impact the market. And they sell instantly when the news is released. The S&P500 fell over 6% in May. Most if the selling came on days when adverse trade tariff news was reported. The selling was indiscriminate with no monthly gains reported in any sector. Utility and Healthcare funds fared the best with small 1-3% losses. Bond funds were the only sector that posted gains in May.

There is a feeling that the trade tariff news is now as bad as it can get. Hold onto your parachute. The next month should provide some direction one way or the other.

On the positive side:
- The U.S. economy is slowing, but employment is steady.
- No Federal Reserve rate hikes are expected in 2019.
- The Mueller report has been issued. No major legislation expected until after the election.

On the negative side:
- Geopolitical risks & tariffs between China and the U.S. are paramount.
- Other geopolitical risks are evolving. Venezuela and Iran top the list
- Corporate earnings and stock buybacks will be less for the remainder of the year.
- Annual trillion dollar deficits are expected moving forward.

We started and ended the month invested in balanced funds with small positions in technology, healthcare, retail, and utilities sector funds. We rotated out of technology funds based on failing trade negotiations with China. The major event to watch is the China trade talks. The economic slowdown is such that no aggressive moves are expected.

RELATIVE STRENGTH RANKINGS
Relative strength rankings indicate short-term (1-3 months) historical performance.

No-Load Diversified Funds
These are highly diversified, low-risk funds that should constitute the “core” holdings in a portfolio.
- BALFX American Funds Balanced
- OAKGX Oakmark Global

Industry Specific Sector Funds
- RYHIX Rydex Health Care
- RYSIX Rydex Electronics (if there is an ease in trade tensions)
- RYUIX Rydex Utilities