Boenning Morning Comment

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Stocks fell yesterday led by the energy sector. For months it has been presumed that the best drillers in the U.S. could make good money even with the oil price averaging about $45 per barrel. Earnings reports this week suggest that while they are profitable, they are not making superior returns. As a result, earnings came in well below expectations for the second quarter and the future outlook is not nearly as pretty as first believed. For the rest of the market, earnings news dominated. Bond prices rose sharply and yields fell. Today's employment report will be instrumental to the near term outlook for interest rates. But, at the moment, there are few signs of either accelerating growth or inflation. President Trump wants to take credit for record stock prices but low interest rates and a weak dollar reflect disappointing growth rates as much as anything else. While earnings are generally doing well, they are increasing because of growth overseas and the impact of a weak dollar on the translations of foreign earnings back into U.S. currency. It's hard to attach that improvement to any direct actions taken by Washington.

This week, the President and two Senators, Tom Cotton (R-Arkansa) and David Perdue (R-Georgia), introduced new immigration legislation that, when all is said and done, will reduce the number of Green Cards by about half or about 500,000 per year. New rules would score immigration applications and reward those who speak fluent English and are highly skilled. Normally, I try to avoid commenting on legislative proposals unless they have meaningful economic implications. This one does. So here goes.

One definition of GDP is to multiply population growth times the improvement in productivity. More specifically, the actual population number used should equate to the number of full-time equivalent workers. Today a bit over 127 million people in the U.S. work full time. Recent annual population growth rates peaked in 2006 at about 0.97%. In 2017, that rate had fallen to 0.69%. Simply stated, over the past decade, one can attribute an almost 0.3% annual decrease in our real rate of growth directly to slower population growth. Look at in a different way, our 2.0% growth rate average of the past 5 years would have been 2.3% if population growth had kept up to 2006 levels all other factors being equal.

I can't tell from the brief message this week how many of the 500,000 green card reductions would affect the number of people employed but my guess is that very few of those allowed in under a system that scores applicants based on skill levels would not be seeking work. But instead, let's just look at population numbers. Our net birthrate (births minus deaths) is now about 1.6 million. According to the most recent census data, however, the annual total population increase is about 3.3 million. That includes net births as well as both legal and illegal immigrants. That implies that we have about 1.7 million net immigrants per year. Subtract 500,000 to account for fewer Green Cards, and another 250,000+ because of tougher enforcement of immigration rules governing illegal immigrants. That is about 750,000 per year against a base of 3,300,000 total net population increase. That's a 23% reduction in annual population growth which works out to a 16 basis point reduction in GDP each year. That may not sound like a lot but it is worth billions of dollars. Immigration is and always has been the lifeblood of the country. I will leave it to Washington to decide how it should be done safely and fairly. But the economic answer to immigration reform is not to shut our doors to all but an elite few.

With that said, this plan probably has less chance of passing that the effort to repeal and replace Obamacare. If we have learned one thing in the first 6+ months of this administration, it is that passing broad, big and complex legislation on a purely partisan basis is virtually impossible. Thus, without getting into the social and political implications of such a major change in our immigration laws I think I can safely say that (1) the proposal, as presently constituted, would be harmful to future economic growth rates but (2) has little chance of passage. What it does do is play well to the President's base of support. If things aren't going right, Mr. Trump likes to deflect the conversation elsewhere. New immigration ideas will be well received by certain large segments of our country and will be controversial. Hopefully that will shift some of the Fox/CNN/network news debate away from healthcare, Russia and the Mooch, if only for a while.

Now we enter that period between next week, after today's employment report, and mid-late September, when the economic and corporate news flow is light. Even assuming current trends stay in place, markets are susceptible to sudden changes in rates or currencies. The political circus in Washington will take on greater importance. I am not a political scientist but when you hear different views on what to do about North Korea from the President, Vice-President and Secretary of State, it leaves everyone a bit confused. Worse, our enemies have a way of pouncing on uncertainty and escalating fears. So far, the stock market has been able to avoid the world of political turmoil but in a six week information vacuum, the risk rises that something untoward on the world stage could rattle financial markets if only for a short while.

By their very nature events capable of generating significant stock market moves are unpredictable. But what one can do is understand when market risks are elevated. That doesn't mean I would suggest any wholesale selling (or buying). But to compound by angst, market internals are a bit disturbing. At least for the moment, leadership names like the FANG stocks or the technology sector seem to have lost momentum. To a lesser extent, the same is true for healthcare and the banks, also 2017 market leaders. Conversely, the weakest sectors, energy and retailers, don't seem out of the woods yet. The few bright spots yesterday were one-off names reacting to individual company news, mostly earnings. We haven't had so much as a 4% correction yet this year. If your asset allocation is more weighted to equities than is normal, take some profits here. Otherwise, sit tight. I don't expect anything serious that will disrupt either the economy or the bull market. But a modest 5-10% correction now would be healthy and reset some stocks to bargain entry levels. It might be nice to have just a bit of dry powder for the next few weeks.

Today President Barack Obama is 56. Also on this date in 1821, Louis Vuitton Malletier was born. Of course, we have all come to know him as Louis Vuitton. He began his business in the mid-1800s making trunks, a business that still exists as part of the Louis Vuitton empire to this day. After my wife found the brand, I decided my best chance to break even would be to buy a few shares of their stock. Over the years that decision has paid for an extra pocketbook or two. But I can't say I'm at breakeven quite yet.

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