First Trust
Monday Morning OUTLOOK

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Business Uncertainty

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Analysts were very quick to pin the blame for weakness in stocks late last week on the trade war with China. We agree that uncertainty regarding the future of US-China trade relations were a drag on equities, but think it was far from the only reason for weakness. In fact, it wasn't even the most negative news of the week.

The US exported $171 billion of goods and services to China in the four quarters ending in Q1 (the latest data currently available), representing about 7% of total US exports. By contrast, about 12% of US exports went to Mexico, 14% to Canada, and 23% to the European Union. Yes, China is also a key location for production (and, therefore, profits) by US companies, but other areas are capable of picking up much of the slack, including India, Vietnam, and Mexico.

The trade war with China is costly, but unlikely to go global like it did during the Great Depression. Instead, intensifying the trade war with China would make it politically more favorable for the Trump Administration to strengthen trade ties with others, and be more inclined to relieve tariff pressure and threats on other countries. For example, the US announced Sunday that it had an agreement in principle with Japan on a new trade deal that could be signed in September.

To us, the most worrisome news of the week wasn't the trade issues or the debate about monetary policy, which is a consistent obsession of financial journalists and social media. The most worrisome news was the Business Roundtable announcing that almost all of its CEOs signed a statement saying they were no longer going to run their companies with the primary goal of serving shareholders. Instead, CEOs would lead their companies to benefit all "stakeholders," including "customers, employees, suppliers, communities, and shareholders."

This is an outright rejection of what's come to be known as the Friedman Doctrine, named after free-market icon Milton Friedman, which suggests that a firm's only objective should be to act on behalf of its shareholders. In turn, if shareholders want to use their wealth to pursue pet personal or social causes, they're free to do so themselves with their earnings from corporate profits. "Insofar as a [corporate manager's] actions, in accord with his 'social responsibility,' reduce returns to shareholders, he is spending their money," Friedman wrote.

Imagine if Tom Brady and Bill Belichick announced that their primary goal was no longer to win ballgames. We're thinking Bob Kraft would not be happy and the New England Patriots football team wouldn't be worth quite as much after the announcement as it was before. Well, that's part of what we think happened to the stock market last week.

Some analysts have argued that, in today's world, demoting the importance of the shareholder is the only way companies can hire "top talent." That crowding out of the normal corporate mission, by letting workers pursue some projects that have no apparent direct link to the company's bottom line, is, supposedly, the best way to maximize shareholder value.

But workers, just like shareholders, are always free to pursue these missions on their own time, and on their own dime. When companies decide to support a mission based on their "top talent's" conception of social responsibility, it marginalizes those at the company who think the mission is a low priority or just plain wrong. And it may undermine profitability and therefore the sustainability of those actions. Without profits, a company can't pursue any social agenda.

Part of this is political correctness, but it's also about elite business managers looking for an excuse to exploit their managerial positions (and control of corporate assets) to further their own personal goals. This is just age-old rent-seeking under the corporate umbrella. Either way, this shift in thinking is not good for the long-term value of corporate equities.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-26 / 7:30 am	Durable Goods – Jul	+1.0%	**+1.4%**	+2.1	+1.9%
7:30 am	Durable Goods (Ex-Trans) – Jul	0.0%	**-0.1%**	-0.4%	+1.0%
8-29 / 7:30 am	Initial Claims – Aug 24	215K	**213K**		209K
7:30 am	Q2 GDP Preliminary Report	2.0%	**1.9%**		2.1%
7:30 am	Q2 GDP Chain Price Index	2.4%	**2.4%**		2.4%
8-30 / 7:30 am	Personal Income – Jul	+0.3%	**+0.3%**		+0.4%
7:30 am	Personal Spending – Jul	+0.5%	**+0.5%**		+0.3%
8:45 am	Chicago PMI	47.9	**46.2**		44.4
9:00 am	U. Mich Consumer Sentiment- Aug	92.3	**92.5**		92.1