First Trust
Monday Morning OUTLOOK
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The Plow Horse Returns?

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We haven't been worried about a trade conflict with China, which has a long track record of pirating intellectual property and is a potential military rival in the (not too distant) future. The US has enormous leverage with China, given our trade deficit with the country and the ability of firms to shift supply chains toward alternatives, like Vietnam, Mexico, and India.

However, we are more concerned about President Trump's recent tariff threat toward Mexico if they don't cooperate to stem the flow of migrants from Central America. Using tariffs to achieve policy goals outside of foreign trade makes it much more difficult for international companies to plan ahead.

If the President imposes these tariffs, who knows what's next? Could he use tariffs to persuade NATO allies to spend more on their militaries? Could a future president use tariffs to try to get other countries to comply with stricter CO2 emissions standards? The range of outcomes quickly widens, which means businesses will have to allocate capital according to political calculations, which means less efficiently.

Before the most recent threat, we thought the odds a recession in the next year were about 10%. Now, we think they're more like 15 - 20%; still low, but higher enough to warrant some extra concern. As a result, we will be watching the data flow over the next couple of months even more closely than usual for signs of broad economic weakness. The economy grew 2.5% in 2017 and 3.0% in 2018 because of a combination of deregulation and tax cuts. Protectionism and added uncertainty could offset those positives.

So far, we don't see signs of weakness; the economy keeps humming along. No deal with China and higher tariffs on Mexico (and perhaps others), doesn't mean recession, but instead a return to roughly 2.0% Plow Horse growth. We estimate that the impact of the tariffs net of the benefits of tax cuts and deregulation roughly equal the negative effects of President Obama's tax hikes and regulation.

Some are calling for the Federal Reserve to cut interest rates to offset this damage, but we don't think rates need to be lower to boost growth. Does anyone seriously think there are firms that are not investing because the Fed has lifted short-term rates to 2.375%? In addition, there are still $1.4 trillion in excess bank reserves.

We understand the fear of a wider trade war but don't think it will happen. We continue to believe markets will push policymakers in the right direction. However, a return to the Plow Horse economy is still possible. Remember, though, even then stocks rose substantially. Investors who stay calm while others panic will continue to be rewarded.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-3 / 9:00 am	ISM Index – May	53.0	**53.3**	52.1	52.8
9:00 am	Construction Spending – Apr	+0.4%	**-0.4%**	0.0%	-0.9%
Afternoon	Total Car/Truck Sales – May	16.8 Mil	**16.9 Mil**		16.4 Mil
Afternoon	Domestic Car/Truck Sales – May	13.1 Mil	**13.1 Mil**		12.7 Mil
6-4 / 9:00 am	Factory Orders – Apr	-1.0%	**-0.3%**		+1.4%
6-5 / 9:00 am	ISM Non Mfg Index – May	55.5	**55.6**		55.5
6-6 / 7:30 am	Initial Claims – June 1	215K	**216K**		215K
7:30 am	Int'l Trade Balance – Apr	-$50.6 Bil	**-$50.7 Bil**		-$50 Bil
7:30 am	Q1 Non-Farm Productivity	+3.5%	**+3.4%**		+3.6%
7:30 am	Q1 Unit Labor Costs	-0.9%	**-1.4%**		-0.9%
6-7 / 7:30 am	Non-Farm Payrolls – May	185K	**190K**		263K
7:30 am	Private Payrolls – May	174K	**169K**		236K
7:30 am	Manufacturing Payrolls – May	5K	**4K**		4K
7:30 am	Unemployment Rate – May	3.6%	**3.6%**		3.6%
7:30 am	Average Hourly Earnings – May	+0.3%	**+0.3%**		+0.2%
7:30 am	Average Weekly Hours – May	34.5	**34.5**		34.4
2:00 pm	Consumer Credit – Apr	$13.0 Bil	**$13.8 Bil**		$10.3 Bil