A BULLISH VIEW AMID CHINA UNCERTAINTY

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In a week of big news, ranging from the Federal Reserve (Fed) meeting to additional Chinese tariffs to an employment report, we had two great podcasts with Professor Jeremy Siegel covering the major events with First Trust economist Brian Wesbury and Hanming Fang, professor of economics at the University of Pennsylvania and founder of the nonprofit website VoxChina.org.

Wesbury Is Bullish

To get to the most important point first, Brian Wesbury has a market call of 3,250 on the S&P 500 Index for year ending 2019 and another 10% gain for 2020, putting it at 3,575 for the end of that year. Not only does Wesbury not think we are going to have a recession, he thinks stocks are undervalued, with risks to the upside rather than the downside.

In order to make the S&P 500 hit fair value in Wesbury's model, we would need over a 3% yield on the 10-year U.S. Treasury model. But rather than rising bond yields, we've been seeing falling bond yields, which supports equity valuations.

Trade War Lessons

Wesbury believes some of the fears about trade wars stem from the Smoot-Hawley trade war of the 1930s, when the U.S. instituted a 30% tariff on *every* good imported into the U.S. from every country in the world. This sparked retaliation everywhere and led to a broad reduction in global trade, bringing down import and export companies, as well as banks.

Today's trade wars are largely targeting China, and Wesbury is not greatly worried. He believes China has abused its developing country status in the World Trade Organization, allowing it to place tariffs on goods entering the country, despite having the world's second-largest gross domestic product, roughly equal to that of the European Union.

Wesbury does believe China deserves the special developing country status that allows tariffs at higher rates compared to the rest of world, but also likes that the U.S. is pushing China to join the global marketplace on a level playing field.

Of course, Wesbury recognizes there is uncertainty in the short run, but he believes this is better for the global economy in the long run. The longer China takes in coming to a deal, the more global supply chains it will lose, in his view. In short, Wesbury is not worried about fallout from the trade war.

Why Cut Rates?

Wesbury cites Jay Powell's press conference following the Federal Open Market Committee meeting, which explained that firms are not currently coming to Fed regional banks and saying they cannot afford to invest given "high interest rates," so he is skeptical that an interest-rate reduction will really support business investment.

VoxChina

There was also an interesting discussion on China with Professor Hanming Fang from the University of Pennsylvania.

China is not just in the news on the subject of its trade with the U.S., but also as tensions are high in Hong Kong, with protests in the streets. Hong Kong was China's main port providing access to the world, but with Shanghai and China opening more broadly to the world, Hong Kong needs to redefine its identity.

Hong Kong protestors' root concerns include dissatisfaction with wage growth and local opportunities. Wage growth in Hong Kong has been almost nonexistent over the last 15 years, and stagnation in the economy is driving dissatisfaction.

Professor Fang believes very few people outside China know the Chinese economy very well. His website, VoxChina.org, is maintained by academic economists who do not have conflicts of interest. Fang's desire, with VoxChina.org, is for discussion on the economic issues between China and the U.S. to be based on facts, without bias. There is typically one new article published every week on the site.

Are Trade Deficits the Right Metric?

One recent article on VoxChina.org discussed how looking strictly at imports and exports provides an overly narrow view of the relationship between the U.S. and China. President Trump focuses primarily on the trade imbalance, the difference between exports and imports.

Professor Fang discusses Apple, which sold 310 million iPhones in China, generating $41 billion in sales. These phones were produced in China and do not show up in export statistics. These sales are profits for Apple, but not "trade" figures.

There are not many relationships in which the reverse is true, with big Chinese companies producing and selling in the U.S.

The net conclusion: the U.S.-China economic relationship is almost fairly balanced and, if anything, the overall relationship gives the U.S. a surplus if looking at sales generated by companies producing in China.

This was a great conversation and very timely, given last week's headlines. Please listen to both conversations with economist Brian Wesbury and Professor Hanming Fang below:

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DEFINITIONS

Federal Reserve : The Federal Reserve System is the central banking system of the United States.

Bullish : a position that benefits when asset prices rise.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Recession : two consecutive quarters of negative GDP growth, characterized generally by a slowing economy and higher unemploymen.

Yield : The income return on an investment. Refers to the interest or dividends received from a security that is typically expressed annually as a percentage of the market or face value.

10- Year Treasury : a debt obligation of the U.S. government with an original maturity of ten years.

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

Interest rates : The rate at which interest is paid by a borrower for the use of money.