The first quarter of 2018 was a tale of two markets. They began the year with a near meteoritic rise in January, reaching all-time highs, yet a February correction, based on technical factors, retraced all the earlier gains and then some. The correction, the first meaningful one as such, in years, was followed by further negative moves on the back of fears of a damaging trade war with China. Much of the more recent selloff in the markets has been a result of President Trump's announced imposition of trade tariffs on imported goods, most of which are focused on Chinese imports. This is the first time in 18 months that the mess that is Washington politics has been a noticeable negative catalyst for the markets.

Much of the political debate and reporting on the trade issue, has been focused on the dollar amount of the $347 billion trade deficit with China. What policymakers and the press should be focused on instead, is the total volume of trade, imports plus exports, which signals how much value US consumers experience through the global economy. Looking at it from this perspective, total trade increased in February by $7.9 billion. Although the trade deficit rose to near a nine and a half year high, the total volume of trade rose to a new record all-time high in February, as well. The US finances its trade deficits with foreign capital inflows; foreign investment in the US can offset the trade deficit and foreign investors have been willing to be paid current market returns on their US investments. As long as that continues, the US can continue to run trade deficits.

The value of the US dollar also plays a significant role in the balance of payments. In spite of the Federal Reserve's tightening of monetary policy via increasing Federal Funds rate, over the last 18 months the dollar has lost 12% of its value in the world markets. This could lead to some amount of inflationary pressure within the economy.

The major increase in volatility over the last several weeks, primarily due to trade issues, appears to be significantly overdone relative to the overall strength of the US economy. Although volatility has returned to the markets after a very benign 2017, it has not yet even risen to levels considered average, over the last 20 years. Indeed, yearly 20% volatility was the norm during the previous 20 years.

The unemployment rate remains at a very strong 4.1% and monthly jobs creation is averaging better than 180,000. Wages have begun to show signs of gradual increases and consumer confidence remains very high. This strength within the US economy is starting to generate early signs of modest inflation with a prospect of inflation rising above the government's 2.0% goal for the first time in several years.

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The government's tax cuts have been reflected in payrolls and the increase in after-tax income is having the anticipated effect on consumer confidence. Housing is strong, with interest rates, although higher than in past years, still at attractive rates. We are expecting earnings to be quite good for Q1 and for the balance of the year. Analysts expect first quarter earnings for the S&P to be in the $38-$38.50 range putting them on target for $155 for the year; with forward earnings of $155, the S&P is trading at a not-at-all expensive, 17.08 price to earnings ratio.

The escalating government deficits, as a result of the tax cuts, will work to increase longer-term rates, as the government typically borrows long-term when financing large shortfalls within their budget. The government's budget deficits are the more serious issue our "leaders in Washington" should be focused on. Total government debt and the interest on that debt is growing to an unhealthy percentage of GDP. The Federal Reserve increased the Federal Funds rate 0.25% at their March meeting and we continue to expect that they will increase rates 3 more times in 2018 with the next increase at their June meeting.

Going forward we expect the most recent volatility to moderate as the economy continues to demonstrate strength across the board, indicated by the expected low unemployment, moderate wage growth, strong consumer confidence, and low inflation, figures. This should serve to bolster markets and portends a sustained positive trajectory.

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