



Basis Points – October 2, 2018

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Above the Fold

- The stock market popped on Monday after the White House signed a trade bill with Mexico and Canada, which was hailed as the new NAFTA. The details of the bill are sketchy right now, but the resolution of the trade dispute between the U.S. and its two largest trading partners takes pressure off the equity market, which has been fretting a trade war all year. These signed deals now put the focus of the global trade war squarely on China, which is where President Trump wants it. China has been slow to talk about a deal, as they could be waiting for the midterm elections to see what leverage the White House has after the elections to negotiate new trade terms. The U.S. Congress has to sign off on new trade deals, so a blue wave election may lessen Trump's Congressional support and embolden China's hand at the table.
- California has become the first state to require publicly held corporations headquartered in the state to include women on their boards. Today, women hold just 18 percent of positions on the boards of the 3,000 largest publicly traded corporations in the U.S. In 2017, 624 public companies had no women on their boards at all. California Governor Jerry Brown signed Senate Bill 826, which requires any publicly held corporation headquartered in California to have a "representative number of women on its board of directors." This directive would require hundreds of California companies to make changes to their current boards. Companies must have at least one woman on their board of directors by the end of 2019 and companies with six or more members on their boards will be required to have at least three women by the end of 2021.

Three Things

- Midterm election betting odds: Political strategy website⁵³⁸ puts the odds of the Republicans keeping their majority in the Senate at 66 percent. The site also puts the odds of the Democratic party earning enough seats in the House of Representatives to gain a majority at 78 percent. So odds are very good that a state of gridlock will exist in Congress after the new Congress is sworn in next year. Dark horses in betting odds would be a Democratic “blue wave” sweep, which would presumably be negative in the short term for the stock market, as investors may begin to worry about rollbacks in tax rate provisions in the tax reform bill that is now law. A “blue wave” could be positive for infrastructure stocks, however, as the Democrats are very interested in passing an infrastructure bill over the next year.
- Consumer confidence hit a new cycle high recently, and this high level of confidence may lead naysayers to conclude that it is a negative factor for the economy. It is true that consumer confidence does peak prior to the start of a recession, but there is no standard level of confidence at which the economy peaks, and there is no consistent time frame after which confidence peaks before a recession begins. In the past, a peak in consumer confidence has not been a good indicator of a coming recession, as the period between peak levels of confidence and a resulting recession has varied widely, from a few months to a few years. So a new high in consumer confidence is a good thing, not a bad thing.
- Strong performance in the stock market in a year’s third quarter typically bodes well for positive performance in subsequent fourth quarters. The S&P 500 rose 7.2 percent in the third quarter of 2018, which is the 14th best gain in a third quarter since 1950. In the 13 quarters on that list that were stronger than this year, subsequent fourth quarter performance averaged a gain of 5.9 percent, and the combined next-two-quarter performance averaged 10.9 percent.

Did You Know

Gross profit is the initial profit a company earns after deducting the costs associated with producing its products. Different companies earn widely different levels of gross profit on the goods they sell, but what is the reason for that? One major reason is that gross profit margins are generally higher or lower based on how much a company changes the raw materials it buys and uses prior to selling the final product. On one end of the scale, a grocery store buys a gallon of milk from a farm and sets it on its shelf for sale. The store did not change the good or

add any value to it, so its profit margin is very low. Many stores can and do sell milk, so the grocery store must keep the sales price low to keep pace with its many competitors.

At the other end of the scale, Intel Corp., the world's largest computer chip manufacturer, literally takes sand (silicon) and by using incredibly advanced technological processes, it changes the sand into advanced high-speed computer processors. Intel earns a very high gross profit margin due to the arduous and expensive process of turning sand into computer chips. Intel owns a very high share of the computer chip market as it would be extremely expensive if not impossible for a would-be competitor to duplicate its technology, manufacturing processes or expertise in this field. Not so with selling milk.

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