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MISC. MARKET & SECTOR THOUGHTS

The Story. . .and Some Surprises. . .at 2017's Halfway Mark

President-elect Donald Trump speaks during a press conference at Trump Tower in New York on Jan. 11. (Jabin Botsford/The Washington Post)

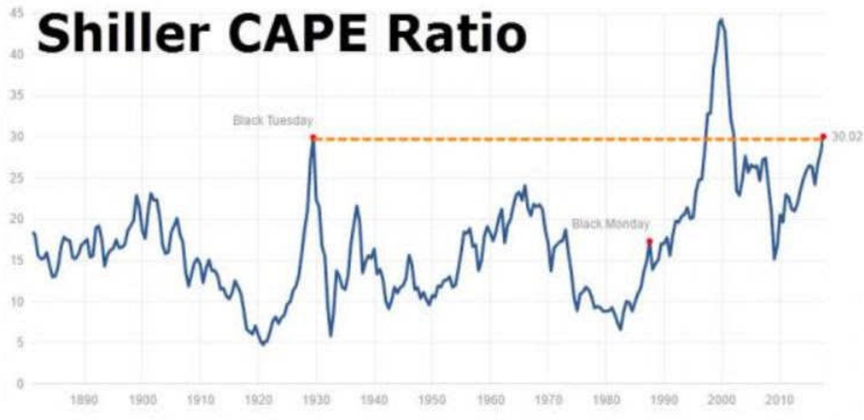
Maybe this grandfather of 12 (so far!) *really is* getting older and discovering the truth of what the generation or two ahead of me warned. And that is, time moves faster the older you get. The first half of 2017 sure fits that!

We necessarily need to spend a few minutes to ponder the first half from a market and political perspective. Much of what I expected from the first half year of the Trump Administration indeed happened (or in more cases, *didn't*.) There was no indictment of his vanquished Democrat Party opponent. No labeling of China as a "currency manipulator."

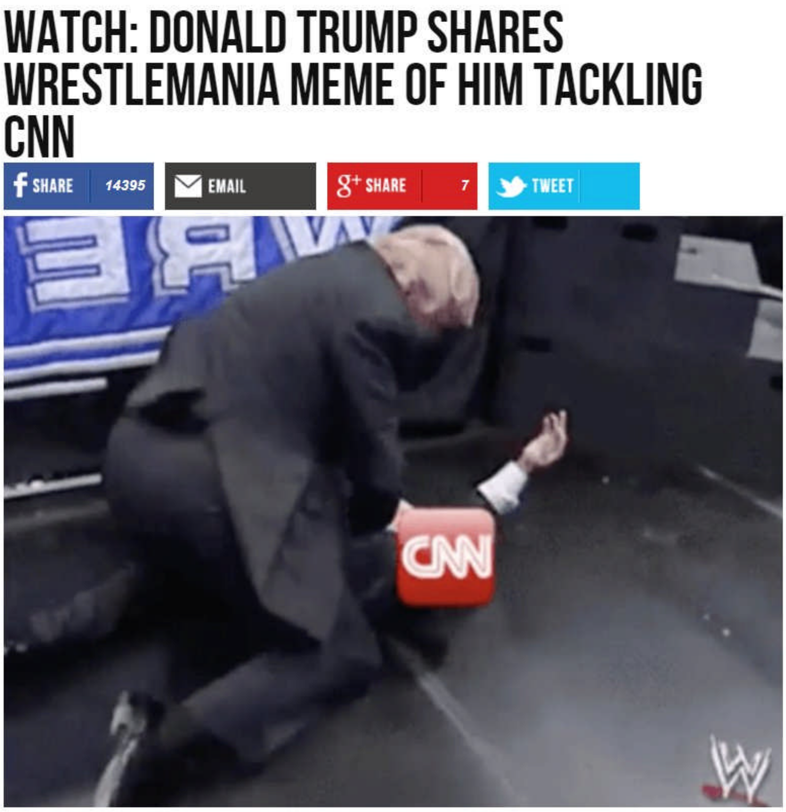
Nor did we get anything along the lines of the promises of President-elect Trump in a January 11 speech at Trump Tower where health care is concerned. As we all know (and I won't belabor the point right now) the hapless, somewhat conflicted efforts and agendas have not only *not* produced the promised "repeal and replace" of the Affordable Care Act but they have bogged down pretty much everything else too. I'm sure the president is asking himself, also, how the first six months of the year flew by so quickly with no significant part of his agenda having moved much off Square One.

To be sure, the ongoing massive liquidity in global markets that I have pointed out on numerous occasions has served to keep *most* asset classes nicely levitated despite this. That may be in the process of changing more noticeably as I write this; time will tell. But between all of the liquidity in the world and the *hope* that what is still the undelivered promises of tax, infrastructure, health care reform and other policy changes will *soon* come, markets have generally done far better than they arguably should be doing.

That there continues to be somewhat of a disconnect between Wall Street and Main Street shouldn't be a surprise in and of itself. That's more of a constant these days. So that the Shiller CAPE Ratio has recently neared the 30 level for only the third time in history isn't *totally* strange. There *have been* some substantive and business-friendly changes to those areas of the administrative and regulatory structures President Trump *can* control. That in and of itself has cheered investors. As former Sun Microsystems co-founder and C.E.O. Scott McNealy quipped a while back, in this regard Trump has turned around the growth-killing "water boarding" of the Obama years in a positive way. Getting rid of so many regulations that only existed for their own sakes is a good thing.



But it will take *much more* than that to validate the recent euphoria on Wall Street; especially if my assessment of the Federal Reserve's game plan proves correct. All else being equal, the fairly significant decline in the U.S. Dollar Index will help support earnings of U.S.-based multinationals. So far, so good there as well (though as I said recently, most of that decline is likely over, with the greenback once again in its old range of the mid-90's, give or take a little.)



With the Fed--and perhaps some other central banks now--no longer the beneficial factor to markets, something of **fundamental and fiscal substance** will need to materialize sooner rather than later. As I will discuss a bit further along, that remains a *dubious* prospect. Eventually, Republicans in Congress will realize that they (and their colleagues in state government) won't have a pleasant 2018 if they can't come up with *something* to show for their running the government. So in the end we *will* get some progress, most likely; the question is whether it will be enough to 1. ratify how much "growth" is already baked into stock prices and 2. overcome the *now-negative influence* of the Fed, et al.

Along the way, it promises to be every bit as entertaining (or exasperating, if you're not a fan of WWE-style politics!) as we watch the real estate, junk debt and reality-TV impresario inhabiting the White House. **One of the things we were able to plan on at the outset of the year was the *unpredictability* of Donald J. Trump.** Aside from the occasional raw, disrespectful give-and-take with some of those in the "fake media" (Yours truly is more entertained than exasperated, though the president should take the moral high ground and show he's *better* than these media hacks, rather than too much like them) **it is his being all over the map *on policy* that could come back to upset things.**

Further along I'll talk about a few examples where major policy is concerned that could have a substantial impact on the economy, markets *and even the world*. What makes it difficult about trying to get our heads around all of this is that **President Trump in too many areas has no settled, basic principles**. Most of all (though there are other areas) he has changed position more than once on his attitude toward China; as I write this, disturbingly *back* towards a bellicose one of wanting to challenge China both economically and militarily.

We can only hope that over the balance of the year *and beyond*, the better and wiser aspects of Donald Trump the pragmatist, negotiator and deal maker overcome the "loose cannon" president; the latter an occasional annoyance to rank-and-file Republicans and a dangerous mix of Archie Bunker and Caligula to Democrats. *Yours truly continues to keep his own expectations somewhat subdued.* And amid all of this it can never be forgotten that there has not been an American president since at least second-term Richard Nixon as *hated* by the political and media Establishments as is Trump.

So especially for those of you who are the more loyal and even religious "MAGA" groupies, realize that the odds are still against you (though never impossible) in more respects than not.

No More "Crying Wolf?" -- The Fed's Seeming, *Scary* Quest

In any case, all of the preceding and most other garden-variety political and economic issues may prove to be sideshows to the *real* main event. Yes, one development arguably THE biggest market story as we turn the corner to begin the second half of 2017.

And that is, the seeming resolve of the Federal Reserve to continue "normalizing" policy *no matter the economic data*. That this realization (together with the notion that other central banks may start to follow) hit the markets all at once this past week was hard to miss! And it has started to reverse that worrisome flattening of the yield curve I've been discussing incessantly. In some respects that could be a good thing, *at least for a while*. I'll discuss that in a bit.

I've written and spoken *a lot* recently about my own perception of just how pivotal the change in tone seemed from Fed chair Janet Yellen and Company following the last F.O.M.C. meeting. So I won't re-plow old ground. *Let me instead go back farther in time to make the central point about what I think the central bank is up to*:

More than most (though I also get caught up in all that "data dependent" subterfuge from the Fed now and then) I not only realize *but have taught for years* that modern-day central banks are all about blowing and then attempting to manage asset bubbles. That is how policy is set these days. The idea is that each of these efforts to blow/re-blow asset bubbles creates at least some "real" wealth and prosperity on Main Street so that *the economy* can better withstand the eventual next bust.

That "data dependence" has always been more of a canard and a less-adhered to mandate on the part of the Fed, at least, isn't really of recent origin when you think about it. As you may recall, it was only two or three years following the depths of the 2008 financial crisis that 1. several other central banks started to raise rates anew and 2. the inflation and employment data started to justify the same for the Fed. But to the consternation of many, the Fed under Ben Bernanke steadfastly refused to go along. And back then I understood--and explained--why: that the Fed *really* wanted to front-load the markets with LOTS of E-Z money to shore up the banks, etc. *It was back then, as some of you fondly remember, that I came up with my infamous prediction that the Fed would start raising interest rates once the Cubs won the World Series.*

Of course, technically the Cubbies won a bit *after* the Fed had started raising. Now they seem to be accelerating things.

In the end, it really shouldn't be that much of a stretch to understand that Yellen and her crew are doing nothing different today than they were for all that time they refused to act. The present is not the first time that policy seemed to actually be *counter* to the economic data. What is so confusing in a way now is that the Fed has at its helm the woman who was supposed to be a "Dove's dove" on policy; someone who isn't supposed to be raising interest rates at a time that the economy in some areas is rolling over anew.

So, as 12 of the 16 participants at the June F.O.M.C. meeting promised, the Fed indeed WILL raise the federal funds rate at least one more time in 2017 (unless some *major* outside event of some kind prohibits them.) They will continue to massage or--as necessary--explain away any economic statistic that does not comport with their game plan.

From time to time they may gently remind Wall Street, also, that a part of their motivation (and even more than they'll admit actually) REALLY IS their view that asset prices are a little "frothy." Here again, this is really not as big a mystery as it has appeared on the surface.

Provided that things do bounce favorably from the poor first quarter's economic showing--and especially if some traction comes along on the fiscal front--we will likely for a while see the environment unfold that the Fed has wanted all along: a steepening yield curve, but one that does not do *broad* damage right away to asset prices. In the end, I think Yellen and Company *really do want* much of what WE do: a return to some semblance of sanity where stock prices are concerned that is **a reflection of *value* rather than of overly-juiced passive money flows.**

The Bond Vigilantes are Starting to Stir

You know that I really do think the game has changed when--for the first time in quite a few years--I've now advocated *shorting* Treasuries as a trade! This half of the Odd Couple, at least, will not be a good place to be "long" for a while.

Even earlier this year I correctly said that the spurt higher in long-term Treasury yields wouldn't last; this as the vast majority said otherwise, as usual (see the nearby chart.) **But at long last, it seems that bond bears are going to have their day; at least until the central bankers go too far and blow things up again.**

The much-ballyhooed comments (and their subsequent walk-back) of European Central Bank president Mario Draghi this past week were *more of an excuse than an explanation* as sovereign bond yields most everywhere spurted higher. Here again, I had a lot to say about that during the week so won't repeat it here.

CNBC's Rick Santelli argued this week as we saw bonds, bunds and their comrades sell off the same thing I have been saying: **that some traders' inner "bond vigilante" is re-emerging for reasons that have little to do with the economic statistics anywhere.** With both the Bank of Canada and the Bank of England also recently making some of their strongest suggestions to date that they may now follow the Fed, the idea here really is painfully simple. If central banks will no longer be *major*, net buyers of sovereign bonds as they have been. . . if their new "experiment" is to see how much they can "normalize" before going back to *abnormal* once they break something anew. . .if in between we're going to see more in the way of price discovery and value investing rather than a broader bust. . .then who wants to be in Treasuries, bunds, gilts and the rest?

The central bankers and policymakers will continue to have to sell their claim that they have long since "saved" the system; and that it really is safe for *everyone* to get back into the water. This past week, as perhaps you heard, it was announced that all major U.S. banks had passed their Fed-administered "stress tests." Sure, it's curious that rather than loaning/investing some of their surplus dough, EVERYONE instead announced juiced dividends and stock buy-backs; but hey, this will help their share prices!

In any event, fear not. Mrs. Yellen herself just told an audience that we are unlikely to see another financial crisis "in our life times." That should seal it for you. So everyone can start *in an orderly fashion* to get back into stocks, etc. in an even heavier way.

Now, lest you think I am buying all of what will eventually prove to be *horse hockey* as old Colonel Sherman Potter would have put it, I'll remind you that our new short positions RE: Treasuries are TRADES. I pretty much have no doubt that what Doubleline's Jeff Gundlach said months ago *will happen*: the Fed will stay on an almost robotic course of incremental rate hikes and, now, simultaneous (a stupid idea) net selling of bonds on their balance sheet "until they break something."

At such a time, of course, we'd be back to being "long" Treasuries. The challenge will be to try to make money on *both* ends of this again!

My view is that we stand a very good chance of *at least* getting to the high yields of March and even a 50-50 chance of 3% on the 10-year Treasury if growth accelerates AND if we actually get passage of tax/infrastructure legislation. If this environment evolves as I expect (more on that in a bit also) we'll move our portfolios even more in that direction.

Gold Threatened Near-Term

The other half of The Odd Couple has been a bit of a marvel to me of late. It has been clinging stubbornly (but barely) to its technical up trend despite the more hawkish Fed and the resilience of the stock market. But as you know from my recent e-mails and recommendation changes, I expect continued near-term weakness for the gold price. *Indeed, as I am finishing this issue up, we finally ARE seeing it break its support around the 200-day moving average.*

I've always stressed the need to have an ability to understand the "narrative" supporting (or in the alternative, *hindering*) gold. And it changes from time to time. The biggest bullish factor over time for gold as I have reminded you countless times is **the need to have an environment of negative *real* interest rates.** And much more often than not since we entered the modern day regimen of completely unmoored fiat currencies beginning with President Nixon and his Fed chief Arthur Burns back in 1971, the gold price has benefited because the Fed (since joined by all the other central banks) *usually* keeps interest rates below the rate of inflation.

And this is why folks--going back to 1971--there has been no legitimate asset class *on the planet* that has risen in percentage terms more than has the price of gold.

Two things need to be understood right now in order to realize why gold has already weakened and is likely to weaken somewhat further in the weeks and months ahead:

1. First, the Federal Reserve is suggesting that it will continue to raise short-term interest rates even as their "official" inflation rates have turned lower. Obviously, that takes away the single most important fundamental underpinning for the yellow metal. So until either the inflation measures turn back higher (AND with expectations of more of the same) or the Fed for some reason cries "Uncle" and has to abandon its present course of action, gold will remain on the back foot; at best, a laggard as (hopefully) other commodities start to do better.

2. I have been warning for weeks that **we needed to watch the Japanese yen; and it is weakening further.** Even more so than the above--and with gold breaking down, I'm sure you'll be hearing about how it's the fault of "conspirators", "Manipulators" or some other hobgoblins--the proximate cause of gold's weakness is that of the yen. *Period*.

The two have been trading very closely in tandem for a while now. And all else being equal, it's never a good thing for gold to become too dependent *as a corollary trade* on something else. *Go back for example to 2008.* The reason gold plunged with everything else that Fall wasn't because markets were *not* scared half to death. **It was because gold had been run up as a carry trade alternative to the weak U.S. dollar.** And when everyone and their dog had to scramble at the same time to get liquid--and piled into U.S. dollars--those who "owned" gold due to borrowed/shorted dollars had no choice but to sell their gold and buy dollars for a while. Only when those *forced sales* had run their course did gold bottom; and as we remember, it was among the first of major asset classes to rally meaningfully.

Similarly, the recent past has seen gold bought by traders as a corollary to the yen. So here as well, as the yen begins to weaken anew versus the dollar, there is little choice for some but to sell their gold. *And as you'll be reading next regarding China below, the odds are very high that the renewed yen weakness is by no means over with yet.*

That said--and hearkening back to the gold chart on the previous page--it's good up to now that gold has not been *completely* routed. Indeed, as I opined in one of our podcasts right after the last F.O.M.C. meeting, I would not have been surprised if gold had dropped between $50 - $100 per ounce in one fell swoop. I think it avoided that for two reasons. First, enough uncertainty remains both geopolitically and in the markets to encourage some diversification into gold. But second--*and this may be changing*--markets clearly acted as if they did not believe the Fed would carry forward with further rate hikes. As it breaks its rising trend line support, it will be important for gold to prove that it can hold the fort at least *some place* where it previously had support, without tumbling dramatically lower. At present, I suspect that there's a better than even chance that the area around $1,200/ounce will hold up.

Thus, we'll be sticking with our recently-diminished overall exposure to the gold space. It's nice that--as a group--our various individual companies here have done FAR better than have the underperforming metals stocks *generally.* As I told you recently in my several e-mails rearranging our positions, my intention is to use this renewed period of weakness to incrementally add a few more *individual* names, even *among some majors*, let alone the BEST exploration stories.

But for now I'll be just watching; and whittling down my shopping list. If gold's decline accelerates, we'll get better bargains later. In any case, we're entering a seasonally weak time of the year for fabrication/jewelry demand for gold; this may exacerbate things for a while.

In the end, I believe it's FAR more likely that the new mantra for the central banks to try and "normalize" policy--and drain some liquidity from over-satiated markets--will run its course *more in months than in years*. During that time it's likely that gold will be a laggard as industrial commodities and even energy do relatively better; likely especially if Trump and Congress DO something about tax and infrastructure policy.

Gold will only be able to reassert itself (based on economic/market factors) once the narrative of a more skittish Fed/a move back in favor of negative real interest rates manifests itself anew. And of course the ultimate destination--a question not of if, but of *when*--is the aftermath, quite likely, of the next central bank-induced bust. If Gundlach is right, we'll see the central banks once more lurch back in panic mode into wild easing of monetary policy. The next Q.E. moves will add a zero to the last ones. And gold will fly.

Chinese "A" Shares Admitted to MSCI Index; What it Means

After the evolving Fed policy mentioned just above, perhaps the next most important development for global markets of 2017's first half was **the decision to add mainland Chinese stocks to the widely-followed MSCI Emerging Markets Index.** Initially, a bit over 200 companies will be added; reports are that more will be included later on.

Keeping in mind that most policy is geared one way or another to keeping asset bubbles from blowing up and/or finding ways to blow new ones, this is VERY big news. In the case of China, you will recall that one reason why gold stayed aloft so long was worries over debt issues in that country. Despite the *systemic* advantages of the Chinese system versus "western" countries I have explained more than once in the past, mathematics still can't be ignored forever; and the fact that China's debt-to-GDP ratio recently soared to over 300% can't be pushed off forever without consequence.

All else equal, China's badly lagging stock market will now get a boost. As estimated by HSBC

Equity Research, the MSCI inclusion should bring as much as $500 billion of equity inflows into Chinese stocks from overseas over the next decade. Together with the simultaneous broadening out of China's domestic bond market, these foreign flows will allow China to much better manage their debt load. . .**to the point of allowing the country once more to convince debt holders to accept equity.**

That, as you may remember, was going on back when Chinese stocks were having their big surge of couple years ago. If--bolstered by fresh/increased foreign capital inflows--markets become more bullish over China, that will serve to further postpone any meaningful reckoning. So plan on an environment where there is less fear over China and its debt; *a key reason, I hasten to add, why the yen is weakening anew.* Indeed, if bullishness over China gains even more traction, expect to see a prolonged period of new yen weakness, as traders put on new carry trades with shorted/borrowed yen to buy Chinese stocks, industrial commodities and the like.

Especially if a renewed appetite for Chinese stocks is accompanied by a reversal of the recent trend towards an inverted yield curve China may well lead a renewed "reflation" move globally; *even if the U.S. and our markets become relative laggards.* While gold bugs may not like the outcome, those who are long DIRT CHEAP industrial commodities and energy will enjoy it!

After all, no major country/market has been screaming "Look out below!" in the recent past as has China. As stated already and as I have covered recently, fears that the Fed might invert the yield curve at some point in the U.S. are already *reality* in China. If now we see those acute fears of deflation, if not outright bust, dissipate--a cause that will be greatly helped by the recent Morgan Stanley et al decision concerning the E.M. Index--this will buy China specifically and global markets generally more time.

Already, we have seen bounces in oil, copper, iron ore and other basic commodities; at least in part thanks to less fear over China. All of them may yet prove to be dead cat bounces; especially iron ore and crude oil, which are still in chronic oversupply. BUT if markets get a whiff of the general direction of things changing, that may be all that's needed to at least bring about some outperformance for beaten-down commodities at the same time some air comes out of the most absurdly over-priced areas of fixed income and, especially, equity markets.

Rotation? Correction? Commodity Recovery *Finally*?

I have recently been warming up more to the idea that we are going to see more of a grinding behavior for markets for the foreseeable future; what some are already calling a *rotation*. Of course, it remains fashionable among some pundits to call for something REALLY crazy and dramatic and say that any minute now we'll finally get a new crash. *Eventually*, they will be correct.

The near-term reality may be a lot more boring for those wanting fireworks. But at the same time it could be very rewarding for those who keep their heads and get out in front of the *rotation* that is likely to be the operative word for a while.

Underscoring the fact that liquidity continues to be a major tailwind for the stock market *generally*, **the major indices have recently been able to hold near their all-time highs even as the FAANG stocks have noticeably weakened.** This led to the NASDAQ just experiencing its first losing month since last October. Yet at the same time--and as some safe haven stocks like utilities have weakened--there is fresh *buying* elsewhere.

My own expectation in the near-term is for the Standard & Poor's 500 overall to work its way somewhat lower. As you see above, we could drop a good 12 - 15% from present levels and *still* be in a long-term up trend. To me, that won't be the big story. Instead--and if this new life for a "global reflation" story gets some legs--**the story will be how much money we MAKE by being in those beaten-down sectors and laggards that will benefit as "air" comes out of growth and goes into value.** For not only will there be *previous* laggards that do very well going forward due to some fundamental reasons, they will do so even more as investors are virtually forced out of over-priced stocks into those cyclical and other areas.

Indeed, one thing I may be warming up to is the idea of shorting the Nasdaq at the same time we get more "long" in some energy, commodity and other value areas. That handful of big names--FAANG, FAAMG or whatever--have accounted for roughly half of the move higher in the market cap of the Nasdaq 100 in 2017. For at least a while, I think it likely that we'll see the somewhat new, unfolding environment I've been describing cause money managers to focus less on the passive investing regimen (that had been enabled by central bank easing) **and now act more like real investors.** So those areas of the markets that have been out of favor will get renewed love; even if for little reason other than that one simple fact.

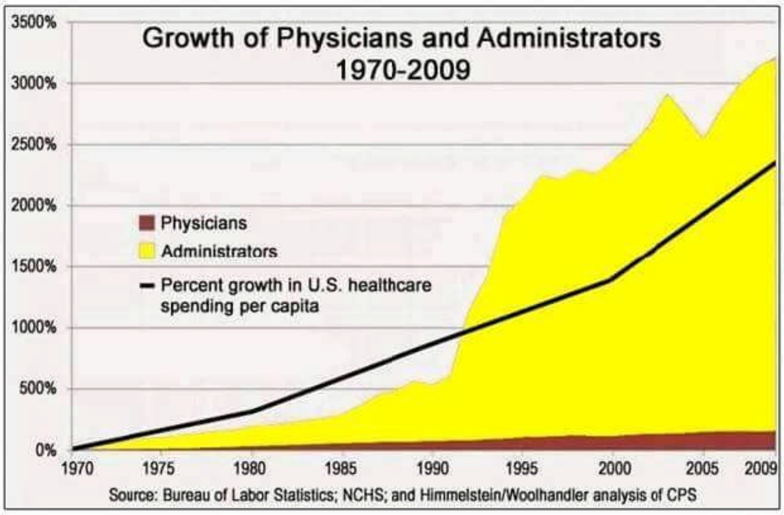
Thus, I'm seeing a LOT of commentary now concerning the notion of buying energy and even telecom stocks right now for little other reason than that they are the two worst-performing groups of 2017 at the halfway mark. That may well be foolhardy; at least right now. BOTH of those sectors are weak for a reason (and a similar one at that): oversupply of their respective products, which has led to lower prices and, especially for telecoms, cutthroat competition that is pressuring top and bottom lines alike.

But the point here is well taken; and I hope is by you as well. I do not suggest here that the Fed in the end really has much of a handle on things; by its own occasional admission, it remains in the mode of making things up as they go along. But we cannot completely dismiss the FACT that the central bank--if it gets its way--will for a while *enable* this selling of "growth" and re-embracing of cyclical areas and value. We must go along to at least some extent.

Any "wild cards" for the Second Half?

All of the preceding, for the most part, is a look at the likely course of things from, chiefly, market and economic perspectives. We cannot--and therefore, *will not*--advocate any portfolio positions based on any certainty that some outlying or "Black Swan" event *will* occur. That would be silly. If I had a crystal ball that told me with 100% certainty that the Deep State was going to push President Trump into a major new war, I would of course advocate prior that we REALLY load up on gold and maybe even oil-related positions. As it is, the *fundamentals* of both those commodities otherwise do not mandate heavy positions at this particular point in time.

None the less, I'll spend a few minutes before moving on to some other sector and company-specific comments discussing some of the big issues staring us in the face as we move into the Summer. For there are indeed some stories in front of us NOW that could have a significant impact on the broad economic/market environment, if not at least on some specific sectors.



*** Will Trump, G.O.P. run up the white flag on health care?** -- Even before the so-called Obamacare accelerated even further the chart's message you see at left, the health care *industry* had become ever more bloated. Those who in a well-meaning fashion prattle on about how health care is a "human right" have long since seen their *moral* outlook on the subject (with which I have more sympathy than you might imagine) overwhelmed by the part-capitalist and part-Big Government monstrosity that is the health care system in America.

Problem number one I.M.O. for President Trump was turning over a "fix" of Obamacare to House Speaker Ryan and Senate Leader Mitch McConnell, where the likely outcome would be a "cure" worse than the Obamacare disease. Once in a while he's seemed to understand that; and that he's been gamed by these men controlled by the corporate health care establishment who simply (as always) want more profits and less responsibility.

The smartest thing President Trump could do at this point--as he suggested last week at the White House--is simply to walk away for now. Democrats pretty much still "own" the A.C.A. If it continues to implode, Republicans can run in next year's midterm elections clamoring for reinforcements in order to truly fix things, given that Democrats (the only notable exception I've seen, to be fair, being West Virginia Senator Joe Manchin) refused to lift a finger to help.

Some including the president are now trying to suggest that a "clean" repeal bill be voted on and passed first, with the details of a replacement to come later. *Right*. Contrary to the above scenario, this would be political suicide; and enough Republicans know it. As I have mentioned previously, the Republican Party presently enjoys historic levels of control in state government. If Republican congressional leaders (and the corporations pushing them) get their way, lots of people are going to lose their present safety net. **Republicans at the state level would also pay for this.**

Not being an ideologue on this one way or the other in the first place, President Trump would be wise to wash his hands of this and move on. Treasury Secretary Mnuchin will have to go through even greater sleight-of-hand to show now how to "pay" for tax cuts/reform, infrastructure and the like without that phantom $1 trillion savings from a repeal of the A.C.A. But I think if they go this route, the markets will be forgiving; if not overjoyed that *something* is finally being *accomplished.*

*** How soon before the Fed overdoes things?** -- Being in the business even back then (see, I told you I'm getting old!) I vividly remember 1987's market action. All year long through the late Summer, stock prices roared relentlessly higher, ignoring surging interest rates along the way. Long-term Treasury yields began the year around the 7% level; *by August they were cracking double-digits.*

Finally peaking above 2700 that Summer, the Dow Industrials decided after all to pay attention to rising rates. Within two months stocks crashed, shedding 37% of their value in less than two months. Half of that infamously came on Black Monday.

Of course, we won't get anywhere near those old interest rate levels. The debate will soon become whether the relatively paltry 3% level on the bellwether 10-year Treasury note will cause the stock market's knees to buckle more noticeably.

What the Fed still has going for it right now is the massive liquidity still in markets. Further, as I also discussed earlier, as China improves (assuming it does) that will give global markets that much more time. Make no mistake: things will be getting a LOT more choppy for U.S. markets especially, as the kind of rotation now underway gathers steam. But when all is said and done, I suspect the Fed's gambit to (*they* hope) gently wring more excess out of the frothiest areas of financial markets--in part as capital is "redistributed" to value areas--without doing any major damage can go on for a while.

*** Trade war--and more nastiness with China?** -- Now it's China's turn to be apoplectic over the "loose cannon" American president who changes his views too readily. It wasn't that many weeks ago that President Trump and Chinese President Xi Jinping were all smiles at Trump's pad down in West Palm Beach. For a variety of reasons as we discussed back then, Trump had abandoned virtually every bellicose position he had previously articulated toward China.

Now he's seeming to swing back the other way. Apparently without warning to China, Trump has slapped sanctions on the Bank of Dandong, accusing it of helping North Korea launder money. Trump's administration just announced a new big arms deal with Taiwan (I guess we shouldn't have expected the military-industrial complex to do without!) There is more saber rattling over China's activity in the South China Sea; among other things, the military just sent a U.S. destroyer, the *USS Stethem*, on an excursion near disputed islands there.

What markets will most be watching as Trump and Xi reportedly are visiting by phone--and may be as well at the late week upcoming G-20 confab in Germany--is a different matter: **whether Trump will follow through with his campaign and even more recent promises to impose tariffs on imported steel, and perhaps other metals.** Unlike the similar measure by then-President George W. Bush back in 2002 that Bush was forced to retreat from, Trump (as I discussed recently following Commerce Secretary Wilbur Ross' comments to a congressional committee) will be using a "national security" finding as his basis to protect American manufacturers.

It's not as if China (and other countries) have *not* gamed America to some extent, just as candidate Trump blustered. As one steel executive (and Trump supporter)--John Ferriola, Chairman of Nucor--put it last year, China ". . .is a company disguised as a country engaged in economic warfare."

But there are a couple potential problems here, at least as *the markets* see things. First, a LOT more steel comes into the U.S. from Canada (the top source), South Korea, Brazil and many other nations than from China (see http://www.ita.doc.gov/steel/countries/pdfs/imports-us.pdf for the surprising numbers from the International Trade Association.) Thus, making China the scapegoat solves little; and any threats of trade measures against these other countries won't sit well. On that score, Trump was widely criticized a few days back for the rather ham-handed way in which he made a subtle threat in front of the cameras to visiting South Korean President Moon Jae-in (those smiles, at right, might not be lasting too much longer either!)

And beyond the potential to antagonize both foe and friend alike over an emerging trade war, **it is the likely affect it would have on fairly healthy global markets that will be most at issue.** This issue represents one of the biggest threats to the markets as we enter the Summer.

This. . .the first meeting between Trump and Russian President Vladimir Putin. . .and the *overall* tenor of things at the upcoming G-20 meeting will be closely watched. Right or wrong from a policy and even that national security perspective, any moves of substance on the part of the Trump Administration to so upset further the global neoliberal regimen by having the temerity to "start a trade war" won't sit well. So whether the bellicose, mercantilist Trump is going to re-emerge in a bigger way--and perhaps upset global markets--or not may well have some near-term bearing on the markets, and maybe even necessarily our recommendations.

*** No nasty surprises from Europe?** -- For the most part, Europe turned into a pleasant surprise for markets in the first half. Though "populist" candidates like Wilders in the Netherlands and Le Pen in France gained some ground, it was not enough to change the big picture. Indeed, in France especially, the surprising emergence of the alleged "Reagan" of that country, Emmanuel Macron (AND with far more of a contingent in Parliament than anyone expected) has investors more bullish.

Abetted by the lack of any near-term political threat to the Brussels-based plutocracy of the E.U., **the euro turned in the best performance by far among major currencies during the first half.** Going forward, we still need to keep an eye on the political environment in both Italy and Spain, where continued "populist" uprisings could lead to changes. But even in those two countries, the threats to the Establishment aren't what they were.

The European plutocrats--as I suggested in a recent issue--are now readying to mount their major "financial" counter-offensive with the hopes of forever ending any question about whether the E.U. and the euro experiment specifically will endure. **And that will be in the form of the long-sought "mutualization" of the entire continent's debt, under ONE manner of euro-denominated debt and ONE fiscal authority.**

The E.U. and the banking power of Europe now have their man installed in France. German Chancellor Merkel has, over time, softened Germany's once-persistent opposition to such an idea. (Face it: Germany lost this battle when they agreed to the euro scheme in the first place!) Even if she wins this Fall, Germany is unlikely to oppose further integration. And if her opponent Martin Schultz (once the head of the *European* Parliament, remember) is the next chancellor, one fiscal authority/debt will be on its way to realization even faster.

Indeed, it's beginning to appear as if Bundesbank President Jens Weidmann (right) is in line to take his turn to succeed current E.C.B. President Mario Draghi. In one sense, it's only fair, given that Germany foots most of the bills. After all, in its history, the E.C.B. has had at its helm a Dutchman (Wim Duisenberg), Frenchman (Jean-Claude Trichet) and the present Italian, Mario Draghi.

Already a member of the E.C.B.'s Governing Council and--for good measure--Chairman of the Board for the Bank of International Settlements, Weidmann would be loved by markets as well as be the best political "cover" to further soften German opposition. *Much more so in my opinion than where Macron is concerned, a Reagan analogy would be especially appropriate where Weidmann is concerned.* Think about this for a minute. Here in the U.S., a President Ronald Reagan--sold as a part-conservative, part-Libertarian champion of limited government, individual liberty and all the rest--was used as cover as the size of the military, the emerging police state, the national debt and government overall *exploded* higher. Who better to have now (or next) at the helm of the E.C.B. to take it and the euro experiment the rest of the way "home" than a German? Especially a fairly young, accomplished banker?

Elsewhere, the recent papering over of those shaky Italian and Spanish banks was pretty much yawned at. Here again, very liquid global markets *still* are an advantage as the deck chairs are arranged on what still might be the European *Titanic* of a banking system. The continued need for massive liquidity--punctuated by the on-again, off-again suggestions of Draghi that he might one day start to VERY slowly follow the Fed's "normalization" lead--interestingly has not been rebelled against by currency traders, as witnessed by that monster rise in the euro during the first half. Markets clearly seem to be approving of the ultimate goal; and why wouldn't they be?

* **Will a new oil bear market drag *everything* lower?** -- In the near future, I will be spending more time specifically on the energy markets. For present purposes, however, I need to at least mention **crude oil** since it will need to be followed closely *as a marker for how well the game plan of the Fed (chiefly) and others is going to play out.*

As you have already likely read--and may also be enjoying, if you are traveling during this long holiday weekend--you have to go all the way back to 2005 to find the year were gasoline on the Fourth of July was *cheaper* than at the beginning of the year. While that's great for those of us filling up our gas tanks, it has at the same time resurrected some of the fears we had early last year when gold plunged below $30 per barrel. What Mrs. Yellen and her crew definitely do NOT need right now is this renewed, systemic threat to the markets!

The irony--and all else equal, a *hopeful* sign--is that while energy *stocks* were the lousiest performers of 2017's first half, **the market value of energy debt led the way higher** (as, among other things, we enjoyed where ANGL is concerned) as debt markets' BEST sector. So perhaps even more than some of my own comments in recent months where the overall markets are concerned we especially see with energy a huge contradiction: *are debt or equity markets getting it right?*

As I will be discussing in a future issue (not too distant!) my view is that--notwithstanding the possibility of added near-term weakness--the *more likely* answer is that it is present equity valuations that are out of whack. Further, as you will be reading (or perhaps already are, if you follow some of the same energy-specific experts I do) I am increasingly being persuaded that--although still far from the previous "peak oil" scenario fears--**America at least is nearing the end of the easiest, cheapest recoveries of crude oil via fracking.** At the least, we are going to see the cost structure start to increase anew.

At this point, the Fed's reflation narrative (and that of China) will be best served if we see demand pick up further from present subdued levels (and expectations get more hopeful for more of the same.) So perhaps as much as any one asset class, the oil price will be very important to watch.

Opinions are all over the map, of course. The recent technical breakdown as oil got back to the low $40's indeed did conceivably open the door for a move even lower. In the near term, it will be *critical* for the price to regain that upward-sloping support level that was just broken.

The bullish move of the past week got some help on a few fronts. Overall--and abetted by the relatively cheap valuations of energy stocks as traders start to embrace the whole rotation theme--the recent "Energy Week" at the White House was a reason for the industry to puff out its chest a bit; and for investors to get a bit more cheer. *Late in the week we also learned that the rig count actually dropped again for the first time in some five months.* Finally--although belatedly--it seems as if the Summer gasoline demand that was a bit underwhelming around Memorial Day has picked up.

On the supply front, news presently is that recent overproduction from Iraq, Libya and Nigeria may *not* be sustained; that's bullish, of course. It is still largely *believed* as well that the Saudis will continue cracking the whip as needed in order to prevent any further price declines; and even to push prices back up to the $50 mark. *The real test will come in a couple months once we get past Labor Day and retail gasoline demand especially here flutters back down.*

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