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Financial Life Dimensions

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# What's Happening Now



*Summer is here!*

As we cruise into the hottest months of the year, we hope you're all taking the time to enjoy nature's beautiful scenery – and staying hydrated while you're at it! There's nothing like summertime in the Pacific Northwest, whether you spend it splashing in the pool or hiking through the Gorge.

If you've gone on any fun trips lately or have any planned, tell us about them next time you're in the office! We'd love to hear about your summertime adventures.



by James Pafundi

The Business Cycle Dating Committee from the National Bureau of Economic Research (NBER) officially calls the peaks and troughs of business cycles. However, the committee waits until there is sufficient data available to call turns in the cycle, meaning it is many months after a peak or a trough for the referees to make an official ruling on the economy. Seeing that we invest in financial markets, we don't have that luxury of time.

When we look at real-time models that can give us a current assessment of the business cycle, similar to the St Louis Fed's "Nowcast," here is what we find:

The top five economic indicators most highly correlated with NBER's cycle calls are: initial jobless claims, auto sales, industrial production, Philly Fed Index, and aggregate hours worked. These top five indicators are usually deteriorating when heading into recessions. What is the data telling us today? There's little sign we are heading into an imminent downturn. With the exception of auto sales, these levels are well above the levels seen at the start of prior recessions.

In fact, February 2019 looks a lot like February of 2016. The slowdown in 2016 did not lead to a recession. In fact, in 2017 we got the tax cut and the markets went on a nice run for the next 18 months. Could we get the same type of thing with trade resolutions and a \$2T bipartisan infrastructure spending bill? Maybe. But there is some even better news.

While much has been written about the weakness of the ongoing recovery, research shows that it has been very durable. Past cycles have shown some flip-flop between boom and bust, whereas this one seems to be more even. That's why it may be more likely that this slowdown in the data is more of a return to trend rather than an end of the trend -- and the stock market likes the slow growth with no inflation environment.

Consumer demand is the key driver for the US economy, making up 70% of real GDP. Right now, consumer confidence is just a few points off its all time high. This could be due to the tight labor market. In the most recent labor reports, data shows there are more openings than unemployed workers. Households have also reduced debt as well; it seems that low rates have also lead to historically low debt service ratios.

Taken as a whole, the slowdown in leading economic indicators we saw in Q1 seem to have recovered. Along with a strong consumer and the possibility fiscal and even monetary stimulus, there doesn't seem to be much data to support a recession in the next twelve months.

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# A Trade War or Something Else?

by James Pafundi

A few years ago, while on a plane to Boston, I struck up a conversation with a gentleman sitting next to me. After getting the normal “plane complain” stuff out of way, the conversation drifted to “what do you do for a living?”

He was an engineer who owned a company that designed and manufactured wind turbines. As we spoke, he told me a story of a town in Massachusetts that wanted to put in a wind turbine. He had put in a bid, and a few months later, he found out he lost out to a Chinese competitor - only this Chinese competitor was using his patented technology! He had lost the contract because his bid cost more and the township had a requirement to use the lowest price product, all other things being equal. I was shocked. What did he do? He complained to his congressman, wrote letters to the state and federal agencies, but that’s about it. There was nothing more he really could do.

Almost every day since the collapse of trade talks with China a month ago, the stock market seems to be highly correlated to the positive or negative news regarding negotiations. But is this really about trade? Or is about more than just cheap furniture, handbags, and electronics?

The previous three US Administrations had chosen to use “constructive engagement” to describe their policy stance on China trade. According to Curtis Elis, former Special Advisor to the Labor Secretary, President Obama, in a good faith effort, removed over 1500 tariffs worth \$325 billion of Chinese imports with no formal written policies for accountability. Fast forward to today, and the narrative has changed to “strategic containment.” This reflects the view that China has not played by the rules of open-market economies as promised since joining the World Trade Organization in 2001.

So what’s the big deal? Doesn’t the US consumer benefit immensely from lower cost goods? The simple answer is yes. But what should be the goal of international trade? Efficiency or equality? Should we define the quality of our lives by the quantity of goods we have for the cheapest price?

State-owned or state-subsidized companies have a significant advantage compared to privately owned

companies: the latter is profit-driven and the former is not. Add the additional requirements of doing business in China, such as the technology transfer requirement, the joint venture requirement, little to no private property protection, systematic hacking of military and government, government provided money and energy to state-owned factories, the dumping of excess production in foreign markets, and you get a very unequal playing field.

So why would any company want to do business in China? Because it has a middle class the size of the US, low labor costs, and a total population of 1.7 billion! To entrepreneurs, those numbers are mind numbingly attractive. And besides, everyone knows that trade wars are good for neither of the parties, so one could reasonably expect cooperation in any trade dispute.

Except to China, this is not about trade. This is about the survival of the Chinese Communist Party.

China has publicly stated it plans to dominate the industries of the 21st century, known as “Made in China 2025.” Add to it some aggressive military moves in the South China Sea and we may actually be experiencing a war of values and ideology.

In 2012, the Chinese had a trade dispute with Japan which resulted in China taking over a lot of Japanese joint venture companies in mainland China. While not good for the Japanese, many foreign companies doing business in China saw the handwriting on the wall and took the opportunity to reduce their concentration on Chinese supply chains, which reignited regionalization of trade. For US companies, this resulted in shifting production to Vietnam and Mexico.

According to Goldman Sachs, a full blown trade war in which 25% tariffs are imposed on all Chinese imports would require a 1% increase in average prices paid. If we account for assumed product substitution and supply chain reorganization, perhaps even less of an increase. Of course, one would expect the effects will be concentrated in certain industries more acutely, such as our farmers and lumber exporters. There is never a good time for trade disputes, but waiting for China to come around and play fair has proven to not be a good strategy, either.

# 45% of Americans Pay No Federal Income Tax – Fiscal Policy

by James Pafundi

Disparity of income has been a preponderate subject for politicians and activist groups for sometime, yet in the end, it’s those that earn the higher incomes that pay for the majority of taxes.

An estimated 76.4 million Americans, identified as households, paid no federal income tax for tax 2018. The non-partisan, non-profit tax group known as The Tax Policy Center released income tax data it analyzed for 2018 and found that nearly half, about 44.4% of American households, paid no federal income tax last year. The Tax Policy Center estimates that the number of Americans that did not pay income tax for tax year 2018 increased from 72.6 million in 2016, before the Tax Cuts & Jobs Act became effective.

Generous tax credits and low tax brackets for low-income earners allow minimal to no federal tax payments. The Tax Policy Center did find that these lower income households did pay their share of state, local, property, sales, and excise taxes.

According to the data, the top 0.1% of taxpayers pay the equivalent of 39.2% of all taxes while the bottom 20% pay no taxes and receive tax refunds in the form of refundable tax credits. The ultra wealthy, also know as the top 1% of taxpayers, with annual incomes of about \$2 million, pay about 40% of all of the federal income taxes in the U.S.

Sources:  
Tax Policy Center/Washington D.C.



## Book Corner

by James Pafundi

“The Dream Machine”  
by M. Mitchell Waldrop

In 2003, a friend of mine bought an Apple iPhone. He told me, “This phone is going to change my life.” and I thought he was crazy. Cell phones had been common for over a decade by that time, and even I had a small Nokia in my pocket. “How could a phone change your life?” I thought.

Looking back now, boy, did I miss it.

In Mitchell Waldrop’s book, *The Dream Machine*, he discusses the birth of the modern digital age and the visionaries involved in the creation of our modern reality... or virtual reality. I was fascinated to learn that one of the individuals most responsible for what we experience today was not an engineer, but a psychologist.

His name was J.C.R. Licklider, or “Lick” for short. He did not design computers or software. He did not work for an early company in the computer space, but rather the Federal Government’s ARPA (Advanced Research Projects Agency). He was a visionary that saw the potential of the way man and machine could interact. He was so far ahead of his time, his ideas so influential, his passion so contagious, that the author called him “computing’s Johnny Appleseed.”

He would use terms such as “human-computer symbiosis,” “computers as communication devices,” and “Intergalactic Network.” It’s amazing to think that he had these ideas in the 1950’s when computers were not much more than really expensive tabulating machines that always broke, took days to program with punch cards, and were way out of the reach of the average person.

I am always interested to understand not only what great minds think but, more importantly, *how* great minds think. Who knows, maybe next time I won’t be so quick to dismiss the next “big thing.”

# What’s Cooking

by Gina Pafundi

When the weather warms up and the sun is out, there is nothing like a wonderful salad green or pasta! I serve these salads together as a complete

meal. You can add chicken or shrimp to the green or pasta salad if you like, or just serve them as-is. I hope you get to make one this summer!



## Strawberry Salad with Blue Cheese and Walnuts

- 1 bunch butter lettuce (or more for a bigger crowd)
- 2 cups of sliced strawberries
- 1 cup of blue cheese, crumbled
- ½ cup of white or red onion, sliced
- ½ cup of walnuts
- Olive oil
- Balsamic vinegar

Toss all the ingredients together in a big bowl.  
Drizzle olive oil and balsamic vinegar to you liking.

## Farfalle Pasta with Pesto and Green Peas

- 1 pound of farfalle pasta
- 1 bag of frozen green peas, cooked
- Pesto pasta-homemade or store bought
- ½ cup pine nuts for garnish (optional)

Toss all the ingredients together in a big bowl.  
Drizzle olive oil and balsamic vinegar to you liking.



# Ecuador Adventures, Part 1

by Gina & James Pafundi



“Gina’s cousin, Pablo, was still on the bus giving me last minute instructions and reminding me to have a good time and not to worry about a thing. The bus station in Banos was packed - I guess that’s where everyone hung out. Pablo hustled a sleeping local from my assigned seat. I think a minor argument ensued and, under protest, the groggy local found an unoccupied seat.

Now the bus was leaving. As he gave me my last minute instructions, I couldn’t help but notice that the outside world was beginning to blur as we picked up speed. The driver was shifting gears. Was Pablo going with me?

I could have very well mistaken something in our previous conversations, as my Spanish was poor and his English was no better than my Spanish. As he continued his broken English monologue, he slowly made his way toward the front of the bus and the still open door. Apparently, the driver knew Pablo was not coming, and by now it seemed like we were going an unsafe speed to disembark. Smiling and waving me a final goodbye, like some sort of superhero, he jumped out the door of the speeding bus! The driver shut the door without skipping a beat, and I sat there for a moment, stunned.

Regaining my composure, I quickly scanned the faces of the other passengers. It was getting dark, but you could still see clearly, and I felt we had just made such a scene! But no one cared at

all - not even a quick glance from anyone. Even the driver seemed unfazed by Pablo’s theatrics.

Perhaps he’d seen better exits at much faster speeds?



As I settled in to my seat, I noticed there were monitors in the headrests for watching movies - high tech for sure. As it got darker, a movie came on. I would be treated to Bruce Lee vs Chuck Norris battling it out in the Colosseum in *Way of the Dragon*. I had never seen the movie, and of course it

was in Spanish, but that was perfect for this gringo, as you really don’t need the dialogue. In a few hours I would be in El Coca, my jumping off point into the great Amazonian Jungle. From there it would be a six hour canoe ride into the isolated camp on the Peruvian/Columbian boarder.

Let the adventure begin!”



*The year was 1997, a time when almost no one carried a cell phone, texting was not a thing, and digital cameras were still not a threat to film processing labs. Gina was taking James to Ecuador for the first time to visit her mother’s family. He had never been out of the country except to visit Mexico, and she planned a big adventure for him amidst all the family gatherings and sight-seeing.*

*Just before the trip, she informed him that he would be going into the Amazon jungle for three nights and four days... on his own! She wanted him to have this adventure and all its experiences without having to rely on her for her Spanish-speaking skills and knowledge of the culture. They outfitted him with a 35mm camera and Indiana Jones attire, and off he went.*



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