Tom McIntyre's
Weekly Commentary & Outlook

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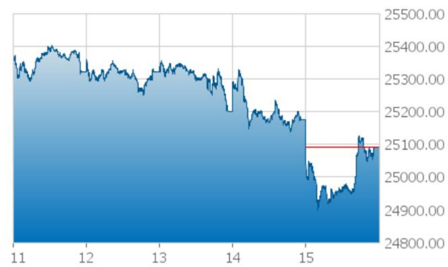
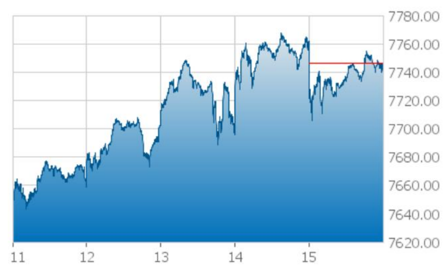
This is Tom McIntyre with another client update as of Monday June 18th, 2018.

Let's put it this way, there are many things going on which on any given day will dominate sentiment. Longer term not sure the pundits are focusing on the correct issues.



Dow 5-day



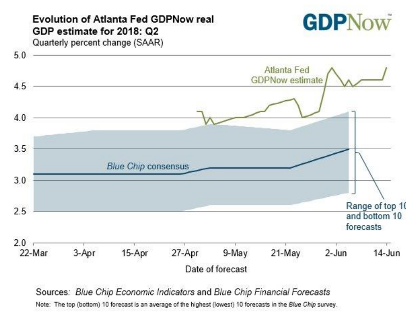
Nasdaq 5-day

Last week (see charts above) saw the **Dow Jones Industrial Average** fall less than one percent while the **NASDAQ Composite** gained 1.3% continuing the trend this year of growth/speculative names doing better than so called value plays.

Markets & Economy

There are many narratives being repeated by the media these days. Some I think are accurate while others I think will be proven way off base. Starting with the accurate ones. The economy as measured by the usual sorts of yardsticks is doing quite well. Last weekôs report on May retail sales showed a good gain. It was a nice rebound from April and wasnôt led by either housing or automobile sectors. The recent drop in oil prices bodes well for this series going forward.

Based upon this and other factors, such as a shrinking trade deficit, the current estimate for GDP growth for Q2 of this year is now ABOVE 4%. The Atlanta Fed has an estimate (shown below) of nearly 5%. Now that the quarter is almost over how wrong could these estimates be? It seems that the Trump economy, through the first six months of this year, will have eclipsed the previously unthinkable 3% growth rate. This would be quite an accomplishment for which the media takes little notice.



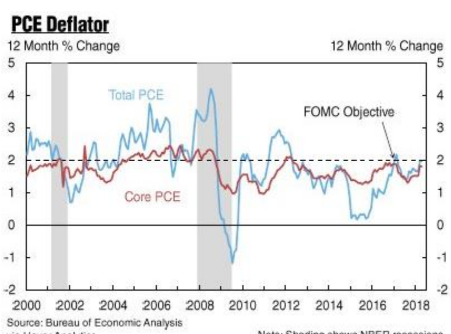
Having said all that, there are some odd things going on. While the Federal Reserve Board maintains that Trump policies are having no impact on the economy they none the less think this sudden surge needs reigning in. Last week they raised interest rates for the 7th time since President Trumpôs election after having gone all 8 years of Obamaôs with a virtual zero interest rate policy.

The question then is, why this urgency to jump rates even as the world around us flounders with their economies and are not following us when it comes to monetary policy? This variance in central bank policy has led to a much stronger dollar which would be expected but is harmful to US exports at a time when Trump is renegotiating previous harmful trade deals as he promised in the 2016 election.

Also, this strong dollar is creating havoc with emerging markets especially their currencies and bond markets. Turkey, Brazil and Argentina are just three of the more important ones to watch. In addition, Italy now has a new government which will not be led by Germanyôs ill-advised immigration policy thus setting the stage for a show down. In fact, the German government may fall soon over that countryôs disgust with Merkelôs views on the matter. These things are slowing the growth rate for the EU which is why the ECB just last week promised to keep interest rates at ZERO until at least August 2019. What are they doing wrong that Trump is doing right? Maybe our media should ask that question occasionally.

It is also an anomaly that while the Fed can raise rates on short-term money the bond market is not following. Look at the chart of the yield curve below. The gap between the 2-year and 20-year is collapsing. The Fed should know this is a huge red flag and they are embarking on a policy mistake.

While the Fed and media love to talk about rising inflation the data doesnôt agree. Look at the chart below which shows the core rate is having a hard time getting to 2%. In fact, the PCE measure of inflation, which the Fed has said is their marker, has not seen the core rate hit 2% in six years. With the recent pull back in oil that number wonôt be hit this year either. So just why is the Fed hell bent on raising rates regardless of the market feedback?



The answer could be political. Historically the FED has maintained its independence but it should be clear by now that the Trump administration is being combated on many unusual levels. The Fed is hiding behind the low unemployment rate but wages have not jumped above recent years trends so that is more anecdotal than analytical.

In my view, the biggest threat to markets and ultimately the economy is jacking interest rates up high enough to cause a recession. The Fed will blame government spending or some other global event but quite simply they have placed the global credit markets in jeopardy with their policy.

So many major global economies are struggling that the US cannot just ignore what is happening elsewhere. Of course, I wonôt even mention the various other issues of domestic politics, spy-gate, immigration problems, mid-year elections, North Korea etc. As I said at the beginning there are a lot of things going on. But the economyôs current excellent performance remains on track for now.

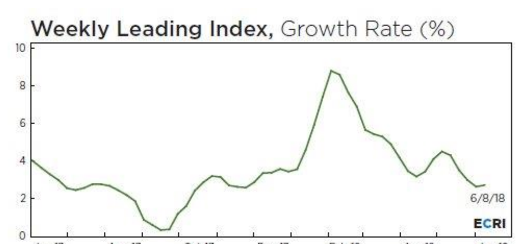
What to Expect This Week

There will be some secondary economic reports out this week which will just reinforce the things talked about above.

The biggest economic item will be OPECôs meeting on Friday. It is expected they will announce a relaxation of their quota on production but donôt be fooled. The world is no longer awash in oil. Venezuela is a basket case whose production is collapsing. Iran is now on restriction etc. If OPEC doesnôt increase their oil production then the price of oil could move quickly higher. We have seen four years of lack of investment as the worldôs usage of oil jumps every year. While the US energy industry is thriving, it cannot offset the supply/demand imbalance coming barring a global economic contraction.

Short-term oil prices might fall in sympathy with such an OPEC announcement but very quickly it will be clear that this move merely provides an offset to loss of production from many of their member states.

Finally, the chart below of the ECRIôs future economic indicators just doesnôt show this boom which some would like to think we are in the middle of. Itôs hard to imagine that the US will boom unless our major trading partners do better. That is not currently happening.



GSK 1-year chart

MSFT 1-year chart

Symbol: GSK

GLAXOSMITHKLINE's shares neared a 52-week high late last week when it was announced **GSK's** two-drug treatment for HIV, the virus that causes AIDS, met its main goal in late stage studies, scoring key points in its rivalry with GILEAD SCIENCES in the immune disease space. The combination of DOLUTEGRAVIR and LAMIVUDINE was shown to be as effective as a DOLUTEGRAVIR-based combination of three drugs from GILD.

GSK believes a two-drug regimen addresses long-term toxicity concerns of people living with HIV by reducing the number of medications needed to combat the disease. These results should help **GSK** defend its DOLUTEGRAVIR-based business from competition. **GLAXO** forecasts sales of $1.5 billion in a year for the drug combination.

GLAXO shares got a bump when the FDA announced that MYLANôs generic form of **GSK's** ADVAIR drug and inhaler for asthma suffers was not sufficient to bring to market. This is the second time MYLAN has tried and failed to produce a product to compete with ADVAIR.

Separately, it was reported this morning that COCA COLA is considering a 3-billion pound ($4.5 billion) bid to buy **GSK**ôs soft-drink brand HORLICKS. Other potential bidders include KRAFT HEINZ and NESTLE for **GLAXO's** holding.

Symbol: MSFT

Positive takeovers by **MICROSOFT** help propel the stock to new all-time highs recently. **MSFT** acquired open-source software development maker GITHUB, and announced they are stepping up activity in conversational artificial intelligence by buying SEMANTIC MACHINES. Regarding the first acquisition, GITHUB will help **MICROSOFT** in becoming more future-oriented by encouraging more developers to create services and apps. This in turn will aid **MSFT's** AZURE platform to compete more successfully against other computing giants by being more appealing to customers. The Company projects the acquisition to be accretive to operating income by fiscal 2020.

MICROSOFT helps itself in conversational Artificial Intelligence advances with its second purchase. SEMANTIC MACHINES is a company with a new cutting-edge approach for the development of conversational AI With the buyout, the Company is likely to become more competitive in the growing AI industry. Shares of **MICROSOFT** have gained a full 43 percent over the past year and paid their 42 cent quarterly-dividend to common shareholders this past Thursday.

QCOM 1-year chart

Symbol: QCOM

Shares of chip-maker **QUALCOMM** got a boost after the US government struck a deal to lift trade sanctions on China phone company, ZTE. The deal ends the sanctions by imposing a $1 billion fine on ZTE. Our government had banned American companies from selling chips to ZTE as part of sanctions. **QCOM** is a major chip supplier for ZTE phones. For weeks, **QUALCOMM** has been caught in the crosshairs of growing trade tensions, and subsequently the stock lacked direction during this period.

QCOM is still waiting on Chinese approval on its long-proposed merger with Dutch semiconductor company NXP. However, CEO Steve Mollenkopf believes the agreement with ZTE will pave the way for China clearing **QCOM's** acquisition of NXP. Hopefully this move to lift sanctions is an olive branch that will help the broader tech sector with a thawing of tensions between the USA and Asia.

MCD 1-year chart

Symbol: MCD

Shares of **McDONALD's** have been sizzling recently after it was learned the Company plans to cut some corporate jobs to lower administrative costs and put more money into digitizing its restaurants. No specific number of executive layoffs were released, but this would follow earlier moves from the number one burger chain worldwide to shrink its corporate head count. The overall goal is for **MCD** to lower administrative costs by $500 million by the end of next year.

Over the past 12 months, **McDONALD's** has expanded delivery and mobile ordering, and packed more self-service kiosks into its restaurants. CEO Steve Easterbrook said the Company will install kiosk and mobile ordering technology in 1,000 locations every quarter for the next eight to nine quarters. News of the corporate cuts and several analyst upgrades helped shares gain $7 ALONE that Wednesday! The stock at the golden arches has risen nearly 10 percent over the past 12 months.