

Delta Investment Management is a registered investment advisory firm. Delta welcomes discussions with individuals seeking investment advice and advisors seeking a new turnkey asset management solution.

Delta manages portfolios at TD Ameritrade and Schwab.

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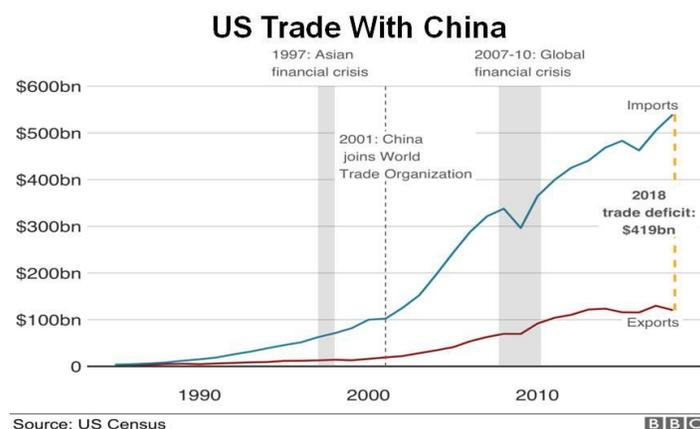
May 10, 2019

Creating a Framework for China Trade War Investing

Up until Sunday night, the U.S. economy and stock market were looking good. Last week, the S&P 500 reached new all-time closing highs. The unemployment rate was reported at 3.6%. The Leading Economic Index rebounded strongly last month up 0.4% month-over-month after five very weak months. The ten-year treasury rate, a measure of expected economic growth, was near 2.5% -- a 6% improvement off of recent lows.

Economic data measure past activity. In a status-quo environment, past activity can be used to predict future conditions. This week, the world economic environment was not status-quo as trade talks with China deteriorated substantially. Investors are now attempting to forecast the consequences of an intensified China trade war on economic activity and profits.

The chart below shows how the trade deficit with China accelerated significantly since China joined the World Trade Organization in December, 2001. The widening gap between imports and exports is one of the reasons President Trump put China trade negotiations on the front burner.



This week, the S&P 500 depreciated roughly 4% as of Thursday. After appreciating by about 17.5% year-to-date through last week, a 4% decline seems to be a measured response.

From Delta's standpoint, we ask the following questions:

1. Will an escalated trade war with China put the U.S. economy into recession in 2019?
2. Have negative expectations regarding trade negotiations been priced into stocks?
3. Could the trade negotiations have a better-than-expected outcome?

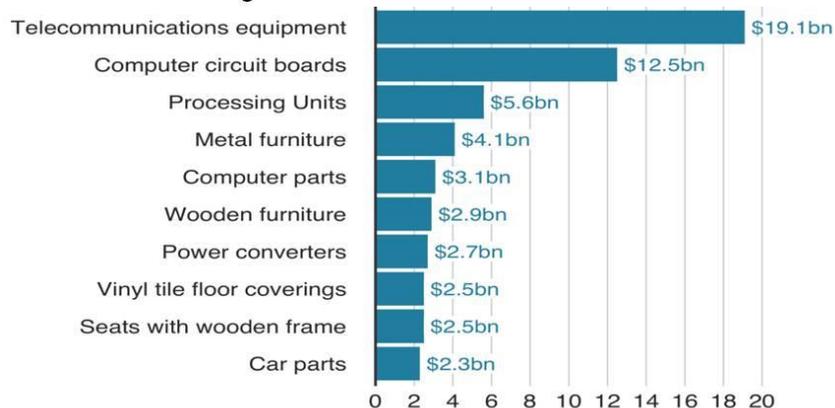
Our answers are:

1. It is unlikely that an escalated trade war with China will cause the U.S. to go into recession in 2019. The U.S. economy has significant positive momentum, particularly with full employment. U.S. exports to China are concentrated in agriculture (soybeans and cotton primarily) automobiles and aerospace. From a macro-economic standpoint, the exposure on the export side is relatively small. Bloomberg estimates that only 1.3% of U.S. GDP is tied to exports to China. The BBC estimates the U.S. exported \$120 billion to China in 2018. U.S. GDP is roughly \$19.4 trillion which makes exports to China less than 1% of GDP.

The trade chart above makes clear that we are primarily exposed to price hikes on imports from China. Higher prices caused by retaliatory Chinese tariffs may slow consumption and increase inflation.

Top 10 US Imports From China

Facing Potential Tariff Increase from 10% to 25%



Source: US International Trade Commission

BBC

2. It is difficult to tell if a failed trade negotiation has been fully priced into stocks. It is interesting that the idea of fighting for a “fair” deal seems to have bipartisan congressional support and is popular with voters. In a recent poll taken by UBS, 71% of business owners support additional tariffs on China. Popular support for a “fair” deal rather than any deal may cause the stock market to have less of a negative reaction to a failed trade deal than one might normally expect.
3. Trump’s tweets have done a good job of lowering expectations regarding a trade deal being achieved this week. It now seems the bigger surprise would be positive news rather than negative news. Stocks react most strongly to surprise news rather than yesterday’s news.

The Delta Market Sentiment Indicator is Bullish. The sell-off this week has caused the market to be “oversold” on a short-term basis. For investors looking to increase exposure to equities and willing to accept heightened levels of volatility, this may be a time to test the waters.

Give Us a Call Today

We invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com if you have questions about how we can assist you in managing your investment accounts.



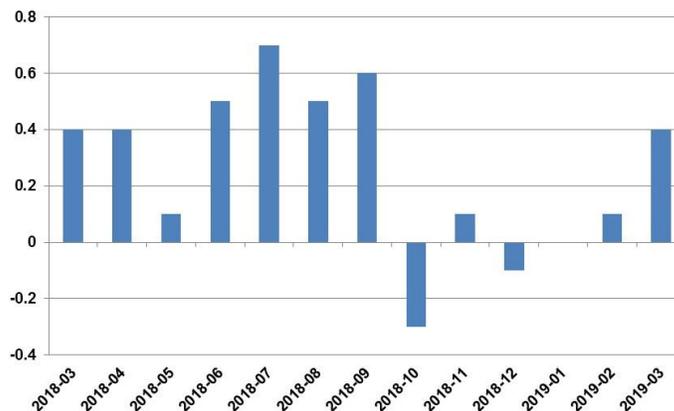
*"Thank you all for coming. Starting next year, Mother's Days
will find me at the Desert Palm Spa."*

Delta Stock Market Dashboard

Leading Economic Index % Change Monthly

March 2018 – March 2019

(Updated Monthly – last update 04/18/19)



Source: The Conference Board

INDICATOR STATISTICS

MARKET SENTIMENT IS

BULLISH

THIS WEEK'S NUMBER IS

60.7

Our technical indicator decreased this week from 65.0 to 60.7

Consecutive Bullish Weeks:	15
Cycle Inception Date:	1/31/2019
Range:	59.5 – 77.7
Mean:	70.8
Bullish Weeks YTD:	15
Bearish Weeks YTD:	4
*S&P 500	6.3%
*DJIA	3.5%
*NASDAQ	8.8%

*Percentage change during current cycle



(Delta MSI is published every week in *Barron's*)

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