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Did we really have a 1,000 point day on the Dow Jones Industrial Average?

It all began in October when investors grew cautious, or more accurately, algorithm trading programs detected data that caused them to move like a school of fish in the Caribbean. Those fish do not follow any leadership but swim very much as one, where an outside fish has as much or more influence on the direction of the school than one in the center.

Influence & short-term obstacles

1. Federal Reserve raising rates
2. Increased money flowing out of the equity market
3. Trade negotiations still unsettled
4. Political uncertainty at a very high level (i.e. Government shutdown)
5. Systemic risk \$21 trillion of debt

Let's look at all these influences and make some kind of risk assessment of each item — some are short-term obstacles. Others more permanent.

Federal Reserve: It seems as if the Fed and the President are at war. President Trump is upset because for the past 8 years the previous administration had historically low interest rates and easy money conditions. During the last crisis literally trillions of dollars in resources were created to take over illiquid investments from Wall Street which the Fed hid from the daylight.

Could the President remove the Fed chairman? Could the President strip the Fed of its powers or its chairman? Will the Fed keep their promise to continue to raise interest rates? Should our Congress take back the responsibility to both issue our own currency and take back some of its designated power from the Fed which flies in the face of the Constitution? There is quite a tug of war going on and this is one of the battle grounds. Since 1913 when Congress turned over its financial responsibilities to private bankers we have watched as the bankers have continued to shove money into their own pockets while allowing the national debt to skyrocket. By raising interest rates the cost of interest on that national debt wipes out any chance of financial responsibility.

This is risk number one in our book. Will the system remain in place? Will the US dollar remain the world's reserve currency? We don't have the answer — but the Fed structure and power is at the center of the struggle between Main Street and Wall Street. The results of this power struggle will reveal who is going to take the spoils.

	1st Qtr	12-Mo
DOW	-11.83%	-3.48%
S & P	-13.52%	-4.39%
NASDAQ	-17.28%	-2.81%
10-Yr Treasury		2.68%
10-Yr Municipals		2.32%
Fed Funds Rate		2.5%
Gold		\$1,281
Silver		\$15.49

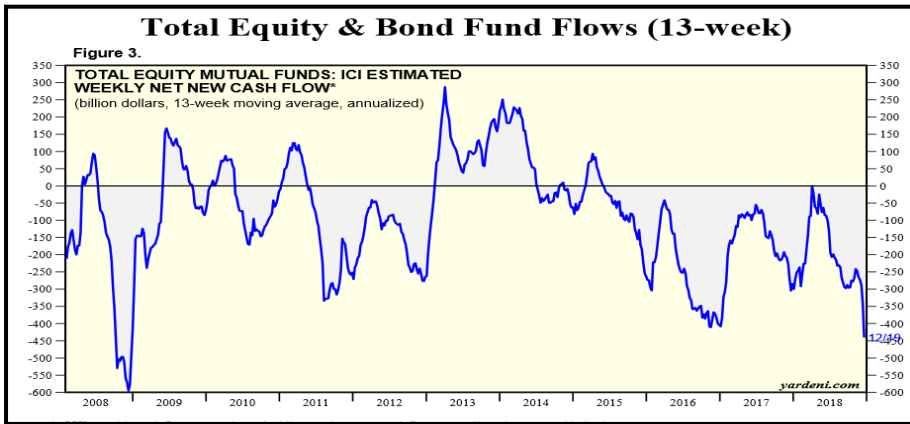
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"I predict future happiness for Americans, if they can prevent the government from wasting the labors of the people under the pretense of taking care of them."

Thomas Jefferson

Total Equity & Bond Fund Flows (13-week)



	12/26/2018	12/19/2018	12/12/2018	12/4/2018	11/28/2018
Equity	-21,048	-9,724	-17,469	4,585	-6,348
Domestic	-11,731	-2,504	-11,949	5,392	-4,614
World	-9,317	-7,220	-5,519	-807	-1,734
Hybrid	-8,268	-9,545	-5,497	-3,457	-3,391
Bond	-9,230	-12,221	-12,021	-5,244	-3,535
Taxable	-10,143	-11,710	-12,199	-4,608	-2,639
Municipal	913	- 512	178	-635	-896
Commodity	707	390	155	-321	4
Total	-37,839	-31,101	-34,832	-4,436	-13,270

Money Flows: You would think negative money flows in mutual funds would depress the market, but until this October, there has been little concern.

Markets have been up since the last crisis in 2008 when we had a debt crisis and the Fed decided to make the banks whole by transferring money from the taxpayer to the bankers. Much of the success of the markets can be linked to tech stocks. Five major tech companies make up 11% of the S&P 500 index. Facebook, Amazon, Apple, Netflix and Google. These companies have come under political pressure because of the perceived impact they might have both in Washington and internationally.

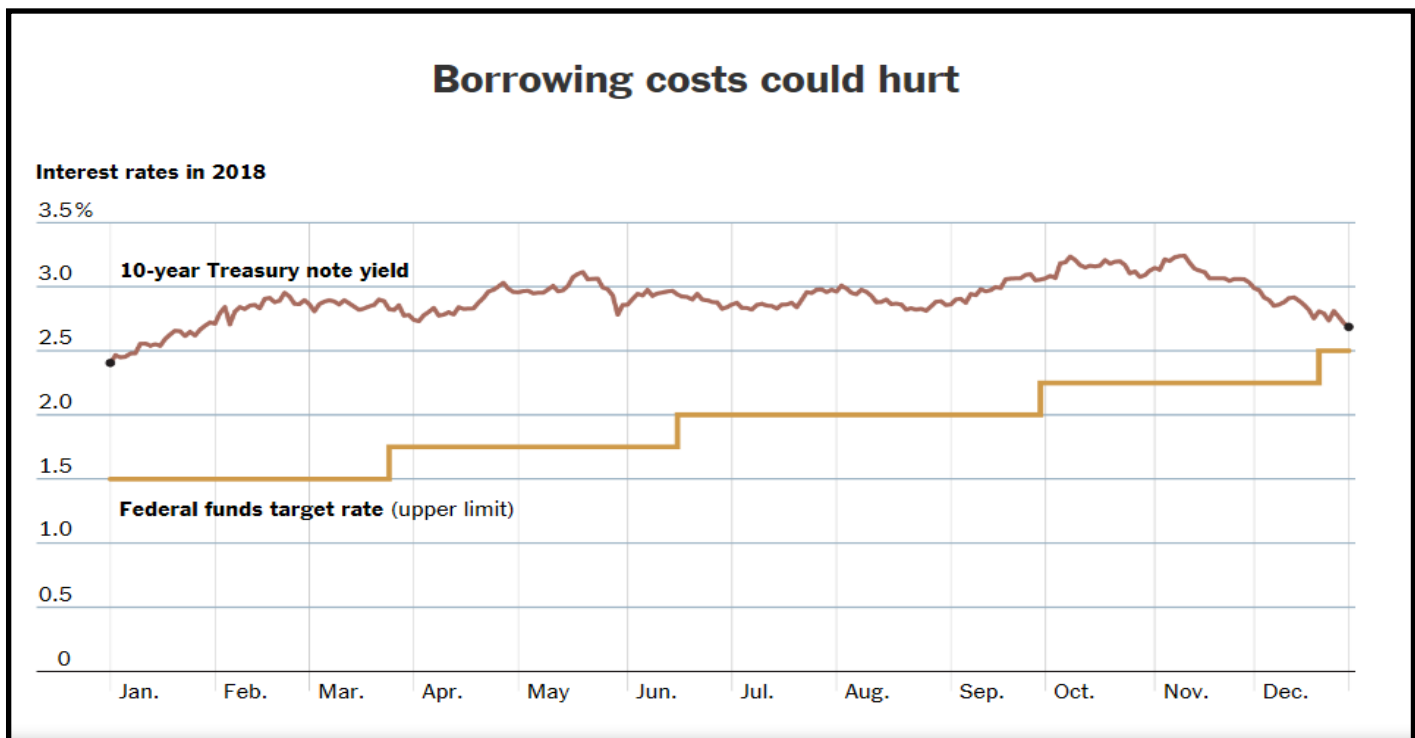


Trade Negotiations: International trade drives economic growth, enhanced **efficiency**, increased innovation, and the greater fairness that accompanies a rules-based system. These benefits increase as overall trade (exports and imports) increase. While we continue to run a negative trade balance, our President is negotiating with China, Europe and Britain to renegotiate our current policies to the benefit of our US enterprises. The equity market has been nervous that a trade war might be to our disadvantage. This can impact certain sectors of our economy without hurting others. Currently under pressure from these trade trends is agriculture, autos, steel, and technology. The current news concerning trade is Apple and the impact of slowing demand in China for Apple products. How quickly we forget that Apple's success has been driven by low cost Chinese labor at the expense of American jobs. We currently are running a \$55 billion dollar trade deficit. A resolution of trade policy (which looks more likely than resolving the wall) will go a long way in resolving market tensions.

Political Uncertainty: President Trump has added to the uncertainty with his presidential platform. While he offered to clean up the swamp, I don't believe we thought he would make just a token run at the power structure. We also didn't think the imbedded Republicans would be as significant in opposition as they have been. Now that mid-terms have elected Nancy as their Speaker, President Trump will have to adjust his sights on areas not controlled by Congress.

One of the most uncertain aspects is the governmental budgeting process. With the return of Congress into the Democrats hands, this government shutdown may threaten to impact more than Coast Guard paychecks. Most in Congress only want to see Trump fail, even at the expense of economic output. Historically, both parties have been able to bring these types of stalemates to an end. We do believe this too will pass, but there is a new sheriff in town, so predicting successful negotiations remain questionable. Risk assessment is somewhat less than the Fed, but still on the high side.

Unsustainable Debt Levels: While the topic is not new, the risk is uncertain and remains central both to our political and economic success. Will our children wake up one day and discover our generation allowed our political representatives and processes to create such a debt load that cannot be satisfied?



Along with the Federal Reserve, this debt-based system has got to go, otherwise we will just be passing money around and not creating wealth. Any child born to two working parents, educated in public (government) schools, borrows money to get through college, and ends up living with parents until their cash flow can pay for a wedding, borrowing for a house, car, etc. They face tremendous financial challenges. This second generation of workers strive to pay off their college loans, raise children, save for retirement and hopefully paying off their home. Our labor goes to the lending industry that creates debt out of nothing. This is neither a good life or freedom.

When Adam was first created he did have a job, not to pay off God — but to work the garden. There are many who have used the system to create wealth — but when God gave breath to Adam it was not so he would slave. Our leadership during the past 100 years has allowed this system of debt to overtake banking and capitalism.

Summary: If we see a movement to remove the artificial shackles put on us by corrupt leaders, we believe the best is yet to come. Brexit is a cry from the British to throw off corrupt policies. So also is fighting in the streets of Paris. No European got to vote to join the EU. We did not vote to overturn the constitution – yet our leaders gave away the controls of their own debt and money supply.

We are responsible to hand off healthy market and money systems, as well as a balanced budget with a debt free national system. Then we must teach our grandchildren the responsibility that goes along with this system and the possibility of a good life and freedom.

Herbert R. Smith & Company has been providing investment advice to institutional and wealth-management clients for almost 50 years. Our expertise in managing assets has assisted our clients in meeting their financial goals without moving beyond reasonable risk guidelines. Our mission statement is:

To provide professional investment advisory services helping clients accumulate and maintain financial wealth through conservative long-term investment strategies.

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