August 26, 2019

Weekly Viewpoint

Escalating Trade Tensions Weigh on Markets (Again)

Performance for Week Ending 8.23.19

The Dow Jones Industrial Average (Dow) lost 0.99%, the Wilshire 5000 Total Market Index^{SM} (Wilshire 5000^{SM}) fell 1.49%, the Standard & Poor's 500 Index (S&P 500) dipped 1.44% and the Nasdaq Composite Index (NASDAQ) shed 1.83%. Sector breadth was negative with 9 of the 11 S&P sector groups finishing lower. The Materials sector (-3.05%) was the worst performer followed by Communication Services (-2.00%) and Energy (-1.99%).

Index*	Closing Price 8/23/2019	Percentage Change for Week Ending 8/23/2019	Year-to-Date Percentage Change Through 8/23/2019
Dow	25628.90	-0.99%	+9.87%
Wilshire 5000	29155.08	-1.49%	+13.23%
S&P 500	2847.11	-1.44%	+13.57%
Nasdaq	7751.77	-1.83%	+16.83%

Market Observations: 8/19/19–8/23/19

The major market indices finished lower for a fourth straight week as an escalation in trade tensions between the US and China outweighed the likelihood of further monetary stimulus from the Federal Reserve. Markets were solidly in the green for the better part of the week on anticipation of Fed Chairman Powell's Jackson Hole speech on Friday morning, however, that all came to a screeching halt on Friday when tit-for-tat trade actions resurfaced.

China announced they would impose tariffs on $75B of US imports, including additional levies on soybeans and oil, in retaliation to the latest round of tariffs by the Trump administration. The inversion lasted for a very short time and the yield curve has since returned to "normal," although at very flat levels.

They also announced they would resume import duties on US auto components which have been paused since late last year. The move seemed to be aimed at the core of President Trump's political base—manufacturers and farmers across the Midwest and South, at a time when both are showing signs of stress.

In response, President Trump tweeted "We don't need China" and that the U.S. would be "better off without them." Trump added that he "hereby ordered" American companies to start looking for alternatives to making products in China, although it wasn't immediately clear if the President has the legal authority to force such action.

Powell – high expectations, low delivery: The focal event of the week was Fed Chair Powell's opening address at the Jackson Hole symposium. The conference, which is sponsored by the Kansas City Federal Reserve, is watched very closely as the meeting has been used in the past to communicate policy initiatives. Expectations heading into the meeting were elevated, with many expecting Fed Chair Powell to telegraph the likelihood of additional easing in monetary policy to ward off overseas economic weakness resulting from the ongoing trade wars. While Powell did indicate that the central bank was prepared to provide more stimulus if the weakness in the global economy begins to hurt US economic growth, he stopped short of signaling a more aggressive easing campaign.

Powell also warned that the impact that monetary policy can have on offsetting trade related weakness is currently unknown. According to his prepared remarks, Powell said "There are, however, no recent precedents to guide any policy response to the current situation. Moreover, while monetary policy is a powerful tool that works to support consumer spending, business investment and public confidence, it cannot provide a settled rulebook for international trade," he said. Instead, Mr. Powell said the Fed should try to "look through what may be passing events, focus on how trade developments are affecting the outlook, and adjust policy to promote our objectives." It generally appeared that Powell didn't want to rock the boat as he tried to thread the needle between the doves and hawks on the Fed board.

While a more 'dovish' speech from Powell (i.e. a strong bias towards lower rates) would have likely been well received by the market, we also must be cognizant that the issues plaguing the economy are related to trade tensions, and not necessarily tight policy. Elevated rates are not the problem anywhere in the world at the moment and if anything, the collapse in government bond yields seems to be undermining investor sentiment and confidence. It's uncertainty around trade that is scaring companies and making them hesitant to invest. Unfortunately, a quick resolution to the trade spat doesn't seem like the base case any longer.

Market View: In light of the ongoing uncertainty surrounding the trade spat with China and building signs the global economy is slowing, we maintain our cautious view on the near-term outlook for the market. Market gains over the course of this year have resulted solely from the expansion in the market's valuation multiple, which in turn, has pushed the market's P/E[1] multiple to above average levels. This scenario leaves the market vulnerable to negative headline risk, especially related to developments around trade. Earnings growth will need to be the key driver of forward performance and until revisions begin to move higher, upside from current levels will likely be limited.

The Week Ahead: With the exception of a few stragglers, second quarter earnings season will wrap up this week with thirteen members of the S&P 500 scheduled to release results. Reports on interest on the data calendar include; July durable goods orders, the June S&P Corelogic Case-Shiller home price index, the Conference Board's August consumer confidence survey, the first revision to second-quarter GDP, July pending home sales, July personal income and spending, and the University of Michigan's August consumer sentiment survey. The Fed speaking calendar will be limited with just two Fed Heads scheduled to speak.

Definitions

[1] **Price to Earnings (P/E)** is the standard measure for measuring the Market's valuation).

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Wilshire 5000 Total Market IndexSM represents the broadest index for the U.S. equity market, measuring the performance of all U.S. equity securities with readily available price data. The index is comprised of virtually every stock that: the firm's headquarters are based in the U.S.; the stock is actively traded on a U.S. exchange; the stock has widely available pricing information (this disqualifies bulletin board or over-the-counter stocks). The index is market cap weighted, meaning that the firms with the highest market value account for a larger portion of the index.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

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