August 16, 2019

Weekly Viewpoint

Markets Are Thrown a ‘Curve’

Performance for Week Ending 8.16.19

The Dow Jones Industrial Average (Dow) lost 1.53%, the Wilshire 5000 Total Market Index[SM] (Wilshire 5000[SM]) fell 1.15%, the Standard & Poor’s 500 Index (S&P 500) dipped 1.03% and the Nasdaq Composite Index (NASDAQ) shed 0.79%. Sector breadth was negative with 8 of the 11 S&P sector groups finishing lower. The Energy sector (-3.88%) was the worst performer followed by Financials (-2.16%) and Materials (-2.02%).

Index*	Closing Price 8/16/2019	Percentage Change for Week Ending 8/16/2019	Year-to-Date Percentage Change Through 8/16/2019
Dow	25886.01	-1.53%	+10.97%
Wilshire 5000	29599.05	-1.15%	+14.95%
S&P 500	2888.68	-1.03%	+15.23%
Nasdaq	7895.99	-0.79%	+19.00%

Market Observations: 8/12/19–8/16/19

The major market indices finished lower for a third straight week reflecting trade uncertainty and an ominous sign from the US bond market. Adding to the negative sentiment was jitters over protests in Hong Kong and worries the German economy, Europe’s largest, is on the brink of falling into recession. Trading was once again very volatile with the S&P 500 gaining or /losing at least 1% in four of the five days. On Wednesday, the Dow average fell more than 800 points, it’s biggest one day loss this year.

2/10 Yield Curve (Temporarily) Inverts: The yield curve—defined here by the difference between the yield on the 2-year and 10-year Treasury notes—temporarily inverted last week when the 2-year yield exceed the yield on the 10-year Treasury note. The inversion lasted for a very short time and the yield curve has since returned to “normal,” although at very flat levels.

St. Louis Fed President James Bullard said this week, speaking on the Fox Business Network, “any inversion that’s going to send a bear signal for the U.S. economy is going to have to be sustained over time.” Inversion is viewed as an ominous sign as it tends to occur ahead of recessions. While inversion has a very good track record of forecasting recessions, it tells very little in terms of the timing of future downturns.

The action in the bond markets seems to be more of a reflection of heightened risk aversion due to global weakness and geopolitical tensions, than a stalling of the US economic cycle. The US economy still remains relatively healthy with unemployment near 50-year lows, few signs of excess in the system, and a consumer that remains in solid shape (70% of economic growth). After growing by 3.1% and 2.1% in the first and second quarters, respectively, the Atlanta Fed GDP Now tracking model is currently forecasting 2.2% growth in Q3.

Tariff Delay: The Trump administration announced that a new 10 percent import duty on things such as cellphones, laptops, and toys, among other consumer orient goods will be delayed until Dec. 15, instead of taking effect on September 1. The items account for a very large share of the $300 billion worth of remaining Chinese imports that Trump said on August. 1 that he would be hitting with a 10 percent duty. The trade office also confirmed it would create an exclusion process for the remaining items so companies can request them to be taken off the list. While the market applauded the postponement of additional tariffs, the three-month delay appears designed to avoid a politically-damaging rise in consumer prices ahead of the holiday season and not necessarily a sign that trade tensions are easing.

Trade Taking its Toll: A trio of softer-than-expected economic data releases from China, including the weakest industrial production figures in seventeen years, underscored the impact that trade tensions are having on global economic growth. Additionally, data from Germany showed Europe's biggest economy contracted -0.1% over the three months ending in June, thanks in part to a slump in exports linked to the U.S.-China trade dispute. If the economic weakness persists through the current quarter, Germany could be in jeopardy of falling into a technical recession which would likely have broader implications for the Eurozone area.

Jackson Hole Meeting: The most anticipated event in the coming week will be the annual gathering of central bankers in Jackson Hole, WY. The symposium, 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. Fed Chair Powell will give a speech on Friday morning and will reportedly be discussing the challenges for monetary policy. Expectations heading into the meeting are very 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. According to Bloomberg’s World Interest Rates Probability function, there is near certainty of a rate cut at the September Fed meeting, with 1 in 3 odds that they will reduce rates by half a percentage point.

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 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. Better buying opportunities are expected to emerge down the road.

The Week Ahead: Second quarter earnings season continues to wind down with just 18 members of the S&P 500 scheduled to release results during the week. Data reports of interest include; July existing home sales, initial jobless claims, and July new home sales. Also released on Wednesday will be the minutes from last month's Federal Open Market Committee (FOMC) meeting. The Fed's speaking calendar will be quiet ahead of the week's end Jackson Hole meeting, which kicks off on Thursday evening.

Definitions

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.