By Peter Boockvar
Chief Investment Officer – Bleakley Advisory Group

During the month of August, stock and bond markets were mostly dominated by tariff news, which started on August 1st when President Trump announced a 10% tariff on the remaining $300b of goods we import from China, which up to this point had not been taxed. This was quickly broken up into two tranches, the first to start on September 1st that would cover about $110b of goods, and the balance to begin on December 15th. On August 23rd China retaliated with an increase in tariffs on some of the remaining goods that the US exports to them, totaling about $75b. Then in response to that announcement, Trump said the tariff rate on the existing $250b worth of goods would go up to 30%, from 25%, while the 10% rate on the newest batch of imports from China would shift to 15%[1].

As of the close of trading on August 23rd the S&P 500 was down 3.6% for the month, while the 10 year US Treasury yield fell to 1.54% from 2.02% on the last day of July. This was due to worries that the heightened trade fight would further slow economic growth, both in the US and elsewhere[2]. Other economically sensitive markets responded negatively as well, with copper falling by 5% in the first three weeks of the month, while credit spreads widened[3].

It has since been announced that there will be a high-level meeting between US and Chinese officials in early October in DC, which will follow behind the scenes discussions taking place beginning in mid-September. We, of course, hope that these negotiations are more than just productive, but something that gets us a deal. The two biggest economies in the world should be getting along, both politically and certainly economically.

The Global Economy

The areas of the global economy that have been impacted the most by the tariffs are manufacturing and trade. US manufacturing in the month of August fell into contraction for the first time since August 2016, right before the election[4]. Manufacturing overseas has been contracting for four months now[5].

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1. Twitter
2. Bloomberg
3. Bloomberg
4. ISM Manufacturing
5. Markit Manufacturing

This weakness in manufacturing has now spilled over into services, especially transportation, which ships all the goods made by these manufacturers[6]. The US consumer has been the strongest part of the US economy, as well as for many other economies. The labor market has been strong and wage growth has been pretty good. This offset is why the US economy is still expected to grow about 1.5 – 2.0% in Q319, according to estimates from both the Atlanta Fed and NY Fed[7]. We hope this can continue, but it all depends on how employers respond to the cloudy visibility, now apparent in the economic outlook.

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Stocks

For all the worries about trade and the economy, the S&P 500 was still up about 16% this year thru August, helped mostly by strength in technology stocks[8]. By month-end the August loss narrowed to 1.8%[9]. Even the small cap Russell 2000, where many companies have less flexibility in dealing with external issues, was up about 10% year to date thru August, and rallied 2.4% in the last week of the month[10]. This all said, stocks are pretty much where they were in January 2018, which we can call one big consolidation after an impressive 2017.

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Bonds and Central Bankers

As stated, a sharp drop in market-driven interest rates was a key response to all the macro news, and it was global. The stock pile of negative yielding bonds went from $14 Trillion to nearly $17 Trillion four weeks later[11]. Central banks, via their negative rate policies, have turned these assets into liabilities for those that own them. The German 10 yr yield started the month at -.44% and ended it at -.70%[12]. The Italian 10 yr yield went from 1.54% to just 1% by month end[13]. The US 30 yr bond yield went to an all-time record low[14]. Economic worries were a main factor, but also expectations of more monetary policy easing from the ECB and the Fed was also a factor. On July 31st the Fed cut its fed funds rate by 25 bps and they are expected to do so again in September[15]. The ECB also meets in September and they have already signaled to the markets that they will be lowering rates again. The danger of negative rates is the damage done to bank profitability and that is apparent in the results and stock prices of European and Japanese banks. Hopefully, this reality is being noticed by the ECB and BOJ.

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6. ISM Non-Manufacturing
7. Atlanta Fed, NY Fed
8. – 14. Bloomberg
15. Federal Reserve

Currencies

The other notable market mover in August was the US dollar, as it rallied against most currencies, particularly those in the emerging markets[16]. While this enhances the purchasing power of US consumers in our consumer dependent economy, it does create tighter liquidity for economies overseas, as long as the dollar is the reserve currency, where most global transactions take place in dollars. Also, there is a lot of dollar denominated debt that foreign countries and companies have taken on where it makes it tougher to pay off when their own currencies weaken against the dollar. US exporters are negatively impacted by a stronger dollar, but exports make up only 10% of the US economy[17].

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Conclusion

To say we are living in interesting times is certainly an understatement. The news flow is dizzying, I know, and the headlines can be unsettling. Now, more than ever, it is important to have a long term perspective when it comes to investing. Trying to predict the short term is impossible, particularly now. We make sure with all of our clients to maintain a long-term perspective, which should help enable us to better maneuver through events in a diversified fashion that keeps us from getting distracted. Of particular importance is making sure our clients have their liquidity needs met over the coming 24-36 month period, which then makes market gyrations much less relevant during this time frame. Lastly, we also are always looking to take advantage of opportunities that markets present because in times like this, they usually do.

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Please never hesitate to reach out at any time with questions or for any discussion on the economy or markets.

16. Bloomberg
17. BLS US GDP

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Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and changes in price.

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