

Expect more volatility ahead with every tweet and news report.

As one of our favorite strategist's said, "Investors continue to be beholden to the actions of three people – Powell, Trump, and Xi. Chair Powell is unelected, President Trump is unpredictable, and President Xi is largely unaccountable."

The S&P 500 reached new highs in June, but we have seen this movie before. In late January and again in late September of 2018, the S&P reached similar highs, leading pundits to argue that for a year and a half the market has basically gone nowhere. Between those dates, however, market action resembled a roller coaster and made investors equally nauseous.

Is it the economy, stupid?

The economy has enjoyed a similar roller coaster ride. The first half U.S. economic data are mixed, with job growth and consumer spending in the positive camp and manufacturing and capital spending decidedly negative. Despite falling interest rates, both home and auto sales have slowed. Further, business inventory levels are high, which takes away from future growth. Both the global and domestic outlook is shaded to the softer side, in part due to continued uncertainty over trade policy regarding China and USMCA (not to mention Europe). Pessimism about the US economy is reflected in the inverted yield curve where 10-year Treasury yields have fallen below 3 month yields and remained there for about 6 weeks. Historically, this inversion has signaled a likely recession in the following 6 to 18 months (and a likely cut in the fed funds rate). Recessionary bear markets last longer and go down more than other bear markets.

"...it feels like a lot of things have to go right for the S&P 500 to continue its upward trajectory."

What are the markets telling us?

We understand that markets anticipate economic activity. The US bond market shows investors think the Federal Reserve made a policy mistake by raising rates in December and now anticipate a corrective rate cut by the Fed in July, plus a likelihood of two more cuts by the end of 2019. The US stock market is anticipating rate cuts by the Federal Reserve and achieving a trade deal between the US and China. With the US stock market hitting new highs, it feels like a lot of things have to go right for the S&P 500 to continue its upward trajectory.

Fed Chair Powell

In his widely anticipated June press conference, Fed Chairman Powell notably shifted from his stance of 'patient' (rates on hold) to more 'accommodative', suggesting the Fed will cut rates if worsening trade friction and weak global growth lead to a further slowdown in the U.S. economy. Economists and market participants alike, believe an 'insurance' rate cut in July would be the best way to go, potentially preventing a recession before it happens. History has not been kind here but, similar 'insurance' cuts were done successfully two times in the 1990's, generating an improvement in the economy.

President Trump

Stocks have predicted 20 of the past 23 presidential election winners, including every winner since 1984.

Especially after losing ground in the midterm elections, presidents begin to worry about their own reelections. The most common response has been to stimulate the economy. In the post-WWII era, there has been no recession in the 3rd year of the presidency and the S&P 500 has not declined in the 12 months following a midterm election. Unlike his appearances on The Apprentice, President Trump cannot fire the Fed Chair or compel him to lower rates. Making nice on trade is within his purview, but the President doesn't want to peak too early. This argues for a trade deal with China closer to the election. Additionally, if President Trump waits, he is more likely to get both a rate cut AND a trade deal, leading to potentially greater economic growth and higher stock prices.

President Xi

President Xi has his own problems including a slowing Chinese economy and unrest in Hong Kong. A deeper global slowdown caused by a trade war will impede China's policy for growth. While President Xi has an incentive to make a deal, it is counterbalanced by strong Chinese nationalism and the cultural importance of saving face. Further, by delaying a trade deal, Xi might think if he waits until after the 2020 election there could be a new negotiator at the table. (Biden or one of the other 23 and me).

What do we expect for the rest of 2019?

For the time being, we are stuck with our three-legged stool of characters (Powell, Trump, Xi), each having their own motives and operating approach. Expect more volatility ahead with every tweet and news report.

We continue with the approach outlined in the first quarter - to rebalance with an emphasis on international markets, stable dividend growth companies with good balance sheets, and companies that get thrown out in a fit of short-termism.

We remain focused on the long term guiding your portfolio to meet your goals. Please call us with any questions, we are here to help.

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