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TPWC Market and Economic Update

The Markets

The stock market as measured by the S&P 500 Stock Index (SPX) was caught on the horns of a dilemma between fear of the economic damage of the trade war and excitement about record-high corporate earnings. It weaved up and down all week but finally closed at 2801.83, up a minuscule 0.02%, and just barely hanging on to its hard-won 2800 mark. It remained up 4.8% for the calendar year and is up about 13.32% from this time last year.

The dollar slid slightly against the Euro and a basket of world currencies but remained up about 5% for the trailing three months and 2% for one year on the WSJ Dollar index. That three-month rise effectively makes imported goods less expensive and goods we want to export more expensive for others to buy, partially offsetting U.S. tariffs. The 10-year U.S. Treasury note yield eased upward to 2.898% but is still only 3/10 of 1% higher than the 1-year bill leaving the yield curve in a very flat configuration. West Texas Intermediate (WTI) oil prices eased downward 0.38% for the week to $70.31 but still remains up about 43% for one year.

The Economy

The Chinese Yuan Renminbi has declined about 7% against the dollar since the trade war began in earnest, reflecting the perceived threat of U.S. tariffs to the Chinese economy. One of the oddities in a trade war is that the nation hit the hardest by the tariffs will see its currency fall in value, thereby making its exported goods less expensive and more attractive to importers. If the whole world imposed coordinated tariffs against a single nation, it would likely create some severe pain in that country but if a single country, no matter how big, starts imposing tariffs against much of the rest of the world, it is likely to hurt that country more than its targets. An example of what historically happens when a single nation starts a trade war can be seen in what happened this week as Japan signed a free-trade agreement with the European Union. Such agreements effectively route trade and trade revenues around the nation imposing tariffs.

One of the earliest tariffs imposed in the current war was the 20% charge on Canadian lumber. That tariff has already shown up in U.S. prices as the increased cost has been reported to have added about $10,000 (5%) to the cost of a new $200,000 single-family home. That may not sound like much, but new-housing starts suddenly dropped about 12.5% last month and the anecdotal evidence suggests that at least part of the decline was the increased price of lumber and steel products.

Meanwhile, in June, the number of new jobless claims hit the lowest absolute number since 1969, when the total workforce was a fraction of what it is today. Manufacturing output too indicated a rip-roaring economy as total output increased 0.8% in June. That increase almost completely offsets a 1% drop in May as automobile manufacturers started the process of adjusting to supply chain disruptions from trucking shortages, tariff fears, and other issues.

The bottom line is that the second quarter annualized GDP growth still looks like it may come in at or above 4%. Retail sales, the 800-pound gorilla of the U.S. economy, were up 0.5% in June and May's results were revised up to a whopping 1.3%. That sounds quite impressive but it is good to remember that we have seen second and third quarter 3% to 4% annualized GDP numbers about three times in the past eight years. In each case, we saw strong growth for two quarters or even three, then a fall off as capacity constraints were hit.

Fitch Ratings issued a warning this week that commercial capital expenditures (CapEx), investments in new equipment, buildings, and the like, appeared to be slowing to about a 3% growth this year, about half of what we saw last year, and were likely to slow further in 2019. Again, the reason given by Fitch customers was uncertainty and expense associated with tariffs. Capital expenditures and investment are long-lead economic indicators. High CapEx tends to produce high growth about a year to 18 months later while slowing capital growth rates point to a potential slowdown about 24 months out.

Evidence continues to accumulate pointing to outsized economic growth in 2018 and possibly into 2019 with a potential recession in 2020.

Until next week, we remain your faithful servants,

Jeffrey W. McClure CFP®
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