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TPWC Market and Economic Update

The Markets

Trade War was the dominant theme for the week ending May 10 as the S&P 500 Stock Index (SPX) lost 2.18% to close at 2881.40, about 50 points below where it was at the end of last September. The Index remains 5.63% ahead of where it was at this time last year and actually rose 0.37% on Friday on the President's tweet that tariffs "may or may not be removed" depending on future negotiations.

The yield on the benchmark 10-year U.S. Treasury note continued its recent persistent slide as it dropped another 2.8 basis points (hundredths of a percent) to yield 2.473% at the end of the week. That equates to a decline of 47.9 basis points or about 16% from a year ago. The benchmark yield is generally considered to be a harbinger of future economic growth. The good news is that the yield rose a bit from Thursday when the Treasury yield curve was negative with the 10-year yield lower than the 3-month yield. Meanwhile, the yields from 1-year through 7-years remain inverted, effectively forecasting the potential for a downturn beginning in 2020.

West Texas Intermediate Crude Oil (WTI) declined a meager 0.19% to close at $61.74 for the week but is down 3.37% for the last month and 5.5% from last year at this time. Gold put in an unusual rise of 0.51% to $1,286.60 on Friday but remains down 5.63% for one year. The WSJ Dollar Index was down 0.2% at 97.32 but the dollar rose 1.33% against the Chinese yuan to trade near a 4-month high putting it up 7.74% against the Chinese currency and largely negating the previously existing 10% tariffs.

The Economy

In an otherwise slow economic news week, the blockbuster announcement was that the U.S. will impose a 25% tariff on about $200 billion in goods imported from China. The impact will not be felt for several months as goods already in transit were excluded. Still, the new tariffs have been estimated to potentially cost the average American family about $767 over the next twelve months according to a study by Trade Partnership Worldwide.

Softening that blow was the news from the Commerce Department that U.S. consumer prices only rose 0.3% in April and an even lower 0.1% if the highly volatile elements of food and fuel were taken out of the measurement. For the 12 months ending in April, prices were only up 2%, exactly the targeted inflation level set by the Federal Reserve. A report by the Federal Reserve Bank of San Francisco forecast that the total tariffs put in place on Friday would raise prices an additional 0.4% over the next twelve months. The inflation indicator preferred by the Fed, the core Personal-Consumption Expenditure Index (CPE) only was up 1.6% from last April, indicating the economy should be able to handle the increased tariff costs without generating too much inflation.

The historically prescient Conference Board Index of Leading Economic Indicators (LEI) increased 0.4% in March following a 0.1% increase in February and no change in January. The underlying figures suggest that U.S. economic growth should continue through the rest of 2019, but at a slowing rate. While the LEI does not forecast conditions

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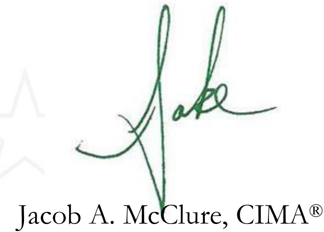
over a year out, the Conference Board's chief economist wrote that the trend lines suggest either weak growth or a mild recession in 2020. That estimate is supported by the Treasury yield curve and remains the consensus of economists surveyed by the Wall Street Journal.

The jury is still very much out on the effect the newly imposed tariffs will have on the U.S. economy. A lot depends on a couple of factors. First, how long will the tariffs be in effect and second, what level of tariffs will the Chinese impose on U.S. imports? Stock prices of major U.S. exporters like Caterpillar, Deere, and Boeing fell on the tariff news as did most electronic goods manufacturers. Three scenarios have emerged for the future. If a full trade war erupts and spreads globally, as it may, it could trigger a recession as soon as late this year or make one in 2020 more severe. The second scenario is that the U.S. tariffs remain in place but with little or no retaliation from China and little contagion around the world. In the third scenario, the U.S. tariffs are a bargaining tactic and a trade agreement will be reached soon with all tariffs removed. The second scenario leaves the U.S. market and economy having perhaps already peaked but with no catastrophic results. The third scenario, with tariffs removed, gives the markets and the economy a kick and sees both of them rising to new highs before a relatively mild downturn in 2020 or 2021.

Until next week we remain your vigilant observers and analysts of things economic and investment-related.



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