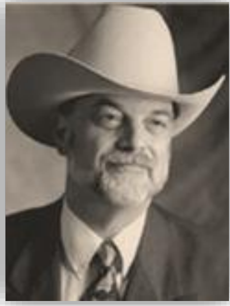

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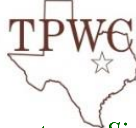

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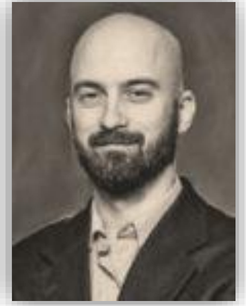

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TPWC Market and Economic Update

The Markets

The U.S. stock market, as represented by the S&P 500 Stock Index (SPX) continued its trade-war related decline for the week ending 5/24, dropping another 1.17% to 2826.06. The SPX is now 128 points or 4.3% below the high mark it hit in late April as well as below the highs of 2018. Investors concluded that the tariffs are not likely to go away soon early Thursday morning and the Index reversed course from a nascent recovery to a minor sell-off. The market is still up 3.85% from a year ago but most of the stock indicators are not particularly optimistic at the moment.

The bond-market benchmark 10-yr. U.S. Treasury note yield followed suit, dropping 6.7 basis points to 2.326% continuing last week's yield inversion as the 10-year note yield was below the 2.363% 90-day T-bill rate. The intermediate notes from 1 to 5 years were even more depressed, yielding as low as 2.09%. The bond market consensus of buyers and sellers continue to see a significant economic slowdown beginning in 2020. Oil, joining in the pessimistic chorus, declined in price over 5% for the week to close at $58.63. Gold declined 0.23% for the week to $1,284.10 while the dollar slipped 0.41% to 97.59 on the WSJ Dollar Index. The dollar remained up about 8% for one year against the Chinese Yuan.

The Economy

Economists expected the first quarter of 2019 to be one of slow growth for the American economy but, instead, the annualized GDP growth came in at about 3.2%. As the dust settled it became apparent that the unexpected growth was a rush to both export and import before higher tariffs hit. In doing so, manufacturers and businesses stockpiled inventory at a near-record pace. That predicted slowdown now appears to be coming in the second quarter as durable-goods orders fell 2.1% from March to April. The decline confirms the slowdown in manufacturing that was signaled last week as factory output slowed. At the same time, spending at retailers dropped 0.2% in April, which may be a signal of things to come or just a blip. Where it slowed was significant though; it was on big-ticket durable items.

Surveys, as well as anecdotal interviews, consistently indicate that the slowdowns and economic turbulence we are seeing are a result of the news on tariffs, real and threatened. Despite the negatives, it is also clear that the American economy is running at or near full steam and is likely to do so for some time to come. The New York Federal Reserve Bank reported that the combined effect of the recently announced tariffs will cost the average American household about $831 per year on top of the existing tariff cost of about $414 per year. While an increase in household costs of about $1,250 per year is nothing to dismiss, that equates to around $100 per month, and $100 per month will not generate a recession.

At the same time, no economic boom like the one we are seeing today lasts forever, so we are continually searching the economic indicators for signs of when this one will end. One of the things economists watch closely is a figure called "capacity utilization," meaning just what percentage of the total available manufacturing capacity we are using nationwide. Historically, as we have approached 80% capacity utilization, somewhere, something is maxed out and

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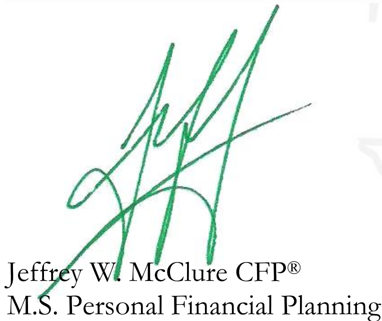
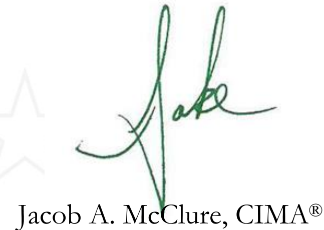
our economy starts to slow down. Industrial capacity utilization topped out at 79.6% in November of 2018 and, as of April, it had dropped to 77.9% in a gradual but very consistent monthly decline. The nagging question is whether this is a marker of the beginning of a cyclical decline or is simply the effect of trade-war related economic uncertainty. Six months more and we should know. What we have not seen so far are the layoffs that suggest manufacturing companies are taking the slowdown seriously.

Economic history and theory tell us that the next recession is likely to be generated when retail companies and manufacturers have seen an economic boom and, as a result, run low on products while demand is high. That causes the companies to increase their orders to have inventory to meet demand. At some point, the consumer will start to be sated and the monthly credit card bills start to rise uncomfortably and will start to slow their spending even as the selling companies have built up their inventory. The selling companies must then sell excess inventory at a loss and, as a result, begin to lay off employees. Those now laid off employees have less money to spend, causing a further drop in consumer spending. We don't think that cycle has started yet, but you can see why we pay attention to a decline in consumer spending on big-ticket, durable goods.

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





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