THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

The weeks just keep getting worse on the stock exchanges as the S&P 500 Stock Index (SPX) fell 2.62% for the week that also ended May to close at 2752.06. The Index is now down 6.8% from its recent high of 2954.13 on May Day, almost exactly one month ago. Another week like this one and we will be perilously close to what is generally considered a "correction" when the market has declined 10% from its high point. Once again, the cause of the angst was tariffs but this time it was the announcement of tariffs on imports from Mexico. At the close of the week, the one-year SPX gain had been whittled down to 0.64%. It also put the Index a hair's breadth from falling below its 52-week moving average, an often cited but not extremely reliable predictor of major market downturns.

Perhaps more critical than the stock market decline was the drop in the yield of the 10-year U.S. Treasury note to 2.130%. The 90-day U.S. Treasury bill (T-bill) yield is 2.376% so that the 10-year note's yield decline puts the Treasury bond curve into solidly "inverted" territory and confirms where it has been headed for a month. To refresh your memory, a persistently inverted yield curve historically has been a faithful harbinger of a recession arriving in about 18 months. The intermediate yields, shorter than the 10-year mark, dropped to around 2%, continuing the bond market forecast of a recession arriving in about the same time-frame late next year. The yield on the 10-year note is generally considered to be a forecast of future economic growth and it has now fallen 34.7% from its high last October of 3.263%. West Texas Intermediate Crude Oil (WTI) joined in on the trend, dropping to $53.50 per barrel, down 8.3% for the week and 16% for the month. Once again traders cited the threat of tariffs on Mexico as the cause. The dollar crept up another 0.15% for the week on the WSJ Index but had dropped over 1% from its midweek highs.

The Economy

The headline economic news is enmeshed with politics. Trade with Mexico is different from other countries as much of it is integral to U.S. manufacturing supply chains and a disruption or increase in cost will directly affect our manufacturing production. The announcement by the President that he would impose 5% tariffs on all imports from Mexico on June 10, followed by 25% tariffs if the flow of refugees to the U.S. border was not stopped by October sent shock waves through the economy. Particularly hard hit were the auto manufacturers as many American-made automobiles have parts or assembly done in Mexico in the formerly duty-free zones just across the border. That process has been credited with being a large part of why illegal immigration of Mexicans looking for work has dramatically declined. Ironically, if the full threatened tariff is imposed and U.S. manufacturers are forced to shut down production in Mexico, economically-based illegal immigration may mushroom.

In another indication that we are at the peak of an economic boom, personal-consumption expenditures increased a seasonally-adjusted 4.3% in April from a year earlier. Meanwhile, personal income rose 3.9% over the same period.

That 0.4% difference represents consumers spending about half a percent more than they earn. During recoveries households tend to focus on paying down debts and building up savings, thus are spending less than they earn. As the recovery turns into an expansion, the cycle reverses and households gradually begin to accumulate debt by spending more than they make each month. At some point, the debt starts to become uncomfortable, spending slows, and so does the economy. The tendency toward overspending is generally accompanied by peaks in consumer confidence and, according to the University of Michigan survey, we are at or near record levels of consumer confidence now. None of this suggests that a pull-back is imminent, but we do appear to be following a classic economic growth cycle and we are clearly in the "boom" part of that cycle. For better or worse, the better than good times are always followed by a decline of some kind. The issue now is when and how far the decline will be. Our estimate remains that we are due for a recession in about 18 months but that it will be relatively mild.

The Commerce Department came out with the second estimate for the first quarter of 2019's GDP growth and reduced the figure from 3.2% to 3.1%, still a robust number. A consensus is building among economic forecasters that the second quarter will come in at about 1.7%. Both numbers are annualized growth rates. The Dallas Federal Reserve Bank's underlying inflation gauge rose to 2% after being well below that number for the last several years, suggesting that inflation may be settling in at a healthy rate.

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

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