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TPWC Market and Economic Update

The Markets

There is an old saying on Wall Street, “Sell in May and go away.” That old saw reflects the widely held belief that June is often a down month for stocks. As we closed out the month and the second quarter of 2019, the better wisdom seemed to be an even older saying, “Buy and Hold.” For the week ending June 28, the S&P 500 Stock Index (SPX) was indeed down 0.29% to close at 2941.76, but during the month of June, it was up a very respectable 6.89%, the best performance for the month of June since 1955. That nearly 7% monthly return was a big part of its rise of 8.22% from this time last year. For those who don’t remember, at the end of last year there was a general panic and those who heeded the fearful call of “Sell!” have missed out on a market rise of 17.35% and the best first half since 1997. It is good to remember yet another market aphorism, “Bull markets climb a wall of worry.”

As has been the case lately, the bond market had another opinion about the future. The 10-year U.S. Treasury note closed out the week with a yield of 2.004%, down about 1.3 percentage points or 38.6% from its yield early last October of 3.236%. With the 90-day T-Bill yielding 2.139% the yield curve remains inverted and even more so at three years with that note only yielding a bit above 1.7%. West Texas Crude Oil rose 0.95% to $58.13 on news that OPEC was holding down production but remains down nearly 22% from a year ago on weaker demand. Gold rose 0.73%, to $1,413.20 reflecting a decline in the dollar against a basket of world currencies.

The Economy

One of the more watched indicators in the economy, the core Price Index for Personal Consumption Expenditures (PCE), the Federal Reserve’s preferred inflation gauge, bumped upward 0.19% in May putting it on track for the Fed’s target of 2% annual inflation. It still remains up only 1.6% from a year ago and the Fed has lowered its forecast for the 2019 inflation rate from 1.8% to 1.5%.

The Commerce Department confirmed that during the first quarter of this year the U.S. GDP did indeed grow at an annualized rate of 3.1%. There is a nearly universal consensus that the second quarter will see a decline in GDP growth to a rate at or below 2%. That same consensus of economists and Federal Reserve banks also agrees that the stimulus from the $1.5 trillion tax cut is now behind us and that the lower tax rate had little positive effect on growth beyond the short spurt we saw in 2018. The Atlanta Federal Reserve Bank is forecasting 1.5% annualized GDP growth for the second quarter.

In the GDP report for the first quarter, growth in consumer spending was revised downward from 1.3% to 0.9%. Business investment in new equipment was unchanged from the earlier estimate and remains at a *negative 1%*. That report matched up well with the Kansas City Fed’s announcement that its Manufacturing Survey Index had dropped to zero, indicating that growth in manufacturing in the central part of the nation has ceased. The good news is that it has not yet declined but the decline in that survey from +17 to zero since November of last year is sobering. Meanwhile, the IHS Markit Composite U.S. Purchase Manager’s Index for manufacturing declined to 50.2 for June on a scale where numbers above 50 indicate growth and below 50 contraction in future manufacturing.

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While manufacturing and even personal services in the U.S. appear to be nearing zero growth, conversely the American consumer, the primary driver in the economy, appears to have increased spending during both April and May at an annualized rate of about 2.5%. The obvious question is if people are spending more money but domestic manufacturing and services are stagnating, where is the money going? The answer is in a single word, "imports." There is a suggestion that consumers, like businesses did earlier, are trying to beat the tariff-related price rises by buying durable goods items now before the 25% import tariffs hit. Income growth was at 0.5% in May. That equates to a 6% annualized growth, something we would expect in an extremely tight labor market but have not seen until now. Possibly, as a result, hiring seems to be tapering off.

The bottom line is that the U.S. economy remains balanced on the edge of growth or contraction with a result that will reveal itself in the GDP numbers in the second half of the year. The difference may well be seen in whether the trade war ends or escalates. The Leading Economic Indicators still give us at least six more months of growth but the yield curve is forecasting a recession within the next 12 to 18 months.

Until next week, we remain your faithful observers, analysts, and portfolio managers.

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