THE PERSONAL WEALTH COACH®

An SEC Registered Investment Adviser

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TPWC Market and Economic Update

The Markets

The S&P 500 dropped a frightening 3.1% this week to close at 2932.05. That still leaves it up 3.23% from a year ago but is about where it was last September. Market participants generally agreed that the cause of the sudden sell-off that started on Thursday was the President's tweet that he was imposing a 10% tariff on an additional $300 billion of Chinese imports. The consensus view was that the tariffs constituted a tax increase on much of the commerce that drives our economy and as such could result in a slowing of the economy and a decrease in corporate earnings.

Despite a 0.25% reduction in short term rates by the Federal Reserve that drove the 90-day T-bill yield down to 2.085%, the ten-year Treasury yield declined further to 1.895% and the three-year yield dropped below 1.7%. The persistence of the yield curve inversion now strongly suggests we are likely to see a recession sometime in 2020. While the U.S. ten-year yield is at a worrisome low, we can draw cold comfort from the fact that both Germany's and Japan's ten-year treasuries have *negative* yields. Investors in both of those countries are demonstrating that they are willing to pay their governments for the right to loan those governments money and for the certainty that their money will be returned intact. West Texas Intermediate Crude Oil (WTI) joined in the pessimism with the price per barrel declining 1.67% to $55.24. Oil is now down just under 20% from this time last year.

The Economy

In a balanced economy, the quarter-point interest rate cut by the Federal Reserve on Thursday would have sent the stock market higher and probably eliminated the dreaded inversion in the Treasury yield curve. Instead, Treasury yields at the longer-dated points dropped even more and the stock market declined. That decline was exacerbated by the threatened tariff on nearly all remaining Chinese imports. Ironically, since the tariffs were put in place, the U.S. balance of trade has worsened, widening 7.9% in 2019 alone. It is becoming clear that as the U.S. imposes tariffs, the net result is that our exports are falling faster than imports. Imports rose 1.5% in the first half of the year while exports fell 6.4%.

According to Economy.com, about half the goods subject to the new 10% tariff will be consumer goods. Given the fact that profit margins for retail goods are narrow, the price increases are likely to be passed on to consumers in the form of a price increase. A 10% increase in retail consumer prices could have a significant negative impact on consumption. As consumer purchases are about 70% of the U.S. GDP, that could be a big deal. Because of the lag between the imposition of tariffs and the resulting retail price changes, the effect may take as long as six months to appear or we could see it as soon as the Christmas shopping season.

The U.S. Department of Labor reported that the economy added a net 164,000 jobs in July, in line with the average for the last several months, as the unemployment rate held steady at 3.7%. The number of jobs created was more than enough to match new job market entrants, but well below the 223,000-monthly average of 2018. That steady-state job creation news was tempered by the report by the Institute for Supply Management (ISM) that their index of manufacturing growth fell to 51.2 in July from 51.7 in June. Readings above 50 indicate growth while those below 50 indicate contraction. July marks the fourth month in a row that the manufacturing growth rate has declined. Once again, the data suggest that the U.S. economy is still growing but at a steadily decreasing rate.

As we watch the economy to see which way it is likely to go, a striking data point has emerged. Last year we reported that the U.S. had reached saturation in the trucking industry with virtually 100% of available long-haul tractor-trailer rigs in use. This year, the situation has reversed. The average spot market price to hire a big rig was down 18.5% from June of 2018. ACT Research, a major truck-industry data supplier, reported that the U.S. added about 7% to the U.S. Class-8 (18-wheeler) market capacity in the last year but demand only grew by 1%, another indicator that growth is reducing and there is a real threat of a recession next year.

As we have stated before, the U.S. economy has the capacity to continue to grow but an increased cost resulting from both the uncertainty and expense of a trade war could easily tip us into a recession in about a year.

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

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