THE PERSONAL WEALTH COACH®

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TPWC Market and Economic Update

The Markets

After plenty of what the Germans call "Strum und Drang" this week over tariffs, and what is now officially a "trade war", one would reasonably expect to have seen a major move in the stock market for the week that ended on the ninth. Instead, the S&P 500 Stock Index declined a mere 0.46% for the week to close at 2918.65 but is now down over 3% since the latest round of tariffs were announced. As disappointing as that may be, it beats the 2823 level the Index hit on Monday, down nearly 7% from recent highs. The 12-month return is currently only 3.01% and the Index is lower than it was last September. The downside to the valuations hinged on the threatened 10% tariff on the remainder of U.S. imports from China, while the upside later in the week was credited to China's pledge to stabilize their currency relative to the dollar.

A far more ominous market indicator emerged as the yield on the ten-year U.S. Treasury note closed out the week down 3/10th of a percent at 1.748%. With the 90-day T-bill yielding over 2%, we continue to have an increasingly inverted yield curve. At the same time, the three- and five-year notes dropped to the 1.5% range. A year ago, the ten-year Treasury was yielding nearly 3%, essentially forecasting a healthy economy for the next decade, but following the imposition of tariffs the yield has now declined to just over half that number. The price of West Texas Intermediate oil declined 1.67% to $54.27, down almost 20% from a year ago, on concerns about the global economy.

The Economy

Often enough, the U.S. economy seems to run along in one universe and the various markets in another. There are times, though, when shocks hit the economy that are reflected in the markets well before they show up in the official measurements. It is good to remember that the usually very accurate news from the Bureau of Economic Analysis in the Commerce Department or the Bureau of Labor Statistics in the Department of Labor is about what happened last quarter or last month and even then, are not complete until, at a minimum, a couple of months later. The stock and bond markets, on the other hand, tend to react immediately to what investors perceive as future results of what happens on any given day.

The Presidential Tweet, first that he would be imposing a 10% tariff on nearly all the remaining U.S. imports from China, and then that there may be no negotiations soon, had a profound and immediate effect on market values. According to the Financial Times, as of the end of July, retailers are employing about 50,000 fewer people than they did a year ago. A typical, big-box retail store has a profit margin ranging from about 3% to the astonishing 25% profit reported by Walmart, with the median being about 10%. Because much of what is sold to consumers in the U.S. by retailers is imported from China, imposing a 10% tariff generally means either a price increase of about 5% or eliminating half of the profit margin. The stock market seems to have make a guess that earnings for American companies will be reduced by about 3% by that 10% tariff. The bond market seems to believe that the profit cut will lead to layoffs and a recession in about a year.

Mark Zandi, the Chief Economist at Moody's Analytics is justifiably famous for accurately predicting both the timing and the severity of the last recession. His comment was "The U.S. and global economies are headed for a downturn unless President Trump backs away from his latest tariff threat." Since the tariffs began, U.S. retailers have reduced employment by about 50,000 jobs and Moody's stated that it cost us about 0.3% of our GDP growth in the second quarter. If the 10% tariff goes into effect on September 1, Zandi warned it would subtract another 0.5% of GDP in the short term and would tip us into an economic contraction by sometime in 2020.

We may be seeing the early stages of the producer price increases economists have been predicting. The Labor Department released the Producer Price Index for July and the price change in final demand goods was up 3.0% from a year ago. That contrasts with last July's 12-month price trailing increase of only 1.7%. If the new tariffs go into effect, prices could rise as much as another 3% to 5% igniting inflation even as economic growth slows. If so, it would mark a classic end to the record ten-year expansion.

The bottom line here remains that longer-term economic indicators suggest some rough going about a year from now but with consumer spending remaining high, the short term still looks reasonably good.

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

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