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TPWC Market and Economic Update

The Markets

With a dearth of good news on the trade war and a hurricane bearing down on the east coast, a person could be easily spooked into anticipating that the week that ended August would be less than happy. Instead, with the usual perverseness of the U.S. Stock Market, the Standard and Poor's 500 Stock Index (SPX) surged upward on Thursday then held its ground to close out the week at 2926.46, up nearly 2.8%. Lest we get too excited about the market's resurgence, it is only up 0.86% from one year ago and is down about 3.4% from its recent high only about five weeks ago. Once again it was the U.S. consumer to the rescue as both major-retailers and DELL's PC sales posted unexpectedly high sales figures. As important as those reports were, the market is still clearly fixated on the trade war between China and the U.S. Rumors of an easing kicked off Thursday's rally as traders and investors made bets that the trade war would come to a happy ending soon. More volatility is likely to be in the offing.

The 10-year U.S. Treasury yield stayed in its pessimistic role rather than joining the hopeful mood of the stock market, closing out the week at exactly 1.500%, down six basis points. With the 90-day U.S. T-Bill yielding 1.992%, the Treasury yield curve is even more inverted than last week. In a dire warning, the 30-year U.S. Treasury bond yield declined to 1.966%, joining its 10-year cousin below the 90-day T-Bill. Historically, there are inverted yield curves and there are severely inverted yield-curves. We are now experiencing one that is severely inverted. Crude oil followed the stock markets up to close at $55.16 up 2.2% from last week's close of $53.97 but still down about 20% from a year ago.

The Economy

The headline for the week was that the consumer is still on a spending spree. Personal consumption expenditures, one of the broader measures of household spending rose a seasonally adjusted 0.6% in July from June's level, according to the Commerce Department. At the same time, the University of Michigan announced that consumer confidence at the end of August dropped 8.6 points from July to 89.9, the biggest single-month decline in seven years. The decline appeared to reflect a fear of higher retail prices and job losses due to tariffs. The Commerce Department report followed a Quinnipiac University poll released on Wednesday indicating that for the first time since President Trump's election, more voters think the economy is getting worse than better. Economists expressed concern that the September 1 tariffs, once the price increases hit the stores, could trigger a retreat in consumer spending as pessimism grows.

The Commerce Department also released its revised estimate of second-quarter U.S. GDP, lowering the growth rate from 2.1% to 2.0%, down one-third from first quarter's annualized rate of 3.1%. The release also contained data indicating corporate profits rose 4.8% in the second quarter after dropping 1.5% in the first quarter. The new figures put corporate profits up 1.7% from the second quarter of 2018. Another item in Friday's Commerce Department report was more sobering. Business investment was falling at a 0.6% rate in the second quarter, continuing a trend that started in October of 2018.

Looking at the bigger picture, Deutsche Bank, Germany's largest lender, announced that it officially believes that the German economy is already in recession. Car production in Germany has fallen 17% in the last year. Like the U.S., Germany continues to experience record-low unemployment and on the surface appears to be going at full steam. In both countries it is good to remember that employment is a lagging indicator, often appearing in retrospect to have been in excellent shape even after a recession has started. Historically, the German economy, by far the biggest in the European Union, has led the entire EU both in and out of recessions. Again, historical records indicate that a full-blown recession in Europe has always been accompanied or followed by one in the U.S.

One more shot of stimulus appears to be in the offing as lower gas prices should put extra money in consumer's pockets as they travel over the Labor Day weekend. Average U.S gasoline prices are the cheapest in three years at $2.55 per gallon, down 30 cents from last year. To put that in perspective, oil was $140 per barrel and gas prices reached as much as $5.00 per gallon in 2008.

The bottom line has not changed much. Manufacturing, business investment, and bond yields are forecasting a recession in the next 12-18 months, but employment and consumer spending suggest the economy is on a tear. The hinge point appears to likely be the actions and effects of the trade war.

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