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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX), representing the U.S. stock market, hit an intraday record high on Thursday, November 7, but settled for a slightly lower close on Friday, the 8th at 3093.08, up 0.85% for the week and almost 6% for the trailing three months. As we do each week, it is good to put that in perspective. The SPX is up 2.2% from the end of July of this year and only up 7.7% from the end of January 2018 nearly two years ago, or about 3.35% per year. It is certainly pleasant to see new record highs, but an average gain of 3.35% over the last couple of years is not a great return. We clearly have a rally going here, but it bears cautious watching. Unfortunately, each new record is made with fewer actual stocks also hitting records. The largest 50 stocks in the SPX appear to be doing virtually all of the record-breaking, a market characteristic we last saw in the last months of the 1990s bull market.

With nearly 80% of America's largest companies now having reported for the third quarter that ended in September, the total earnings (profits) for the S&P 500 are now estimated to have contracted by 0.7% in the quarter. The recent record highs in the stock market have been primarily generated by losses that have come in less than expected and the ongoing hope for an end to the trade war. The consensus for stock market earnings growth in the fourth quarter is now just 0.8%. As in all such data, the ongoing status of the trade war is the wild card.

The yield on the 10-year U.S. Treasury note closed out the week at 1.942% up a substantial 0.226 points from last week, reacting to the announcement by Chinese trade officials that the U.S. and China would be reducing tariffs in an apparent thaw in the trade war. Late in the day, President Trump denied that the decision to cut tariffs had been made, creating some confusion. The most important reaction to the tariff good news was that the recession-predicting inversion in the Treasury yield curve instantly vanished. While the vanishing inversion was definitely good news, it is good to remember that a year ago the 10-year T-note was yielding 3.28% as it reflected an expectation of good times ahead. U.S. crude oil markets joined in the celebration as futures rose 2.05% to close at $57.37 per barrel of West Texas Intermediate.

The Economy

In not so earthshaking news, the U.S. collected a record $7 billion in tariffs in the month of September. That number sounds impressive until we consider that the Federal Reserve had to buy $62.5 billion in Treasury debt in the open market on Wednesday to offset a portion of Treasury borrowing, preventing a cash crunch in the money-center banks.

The Commerce Department announced that U.S. imports of consumer goods fell 4.4% in September and vehicles and auto parts fell 3.4%. That announcement was a good news/bad news story as it means our trade deficit may be lower for the month but at the same time means that consumer purchases must have declined from the retail outlets who didn't buy as many imports. While imports subtract from the U.S. GDP calculations, the gain from selling those imports to consumers is substantially larger than the savings from not importing the goods. Consumer purchases have been keeping the U.S. GDP in positive territory and a consumer slowdown is something to pay attention to. U.S. new-vehicle sales slowed in October by 6.5% from September and were down 4.3% from last year. Indications from dealers suggest that the contraction in car and light truck sales may continue through the year and into 2020.

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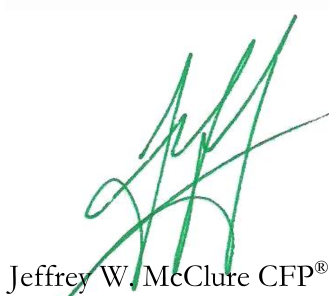
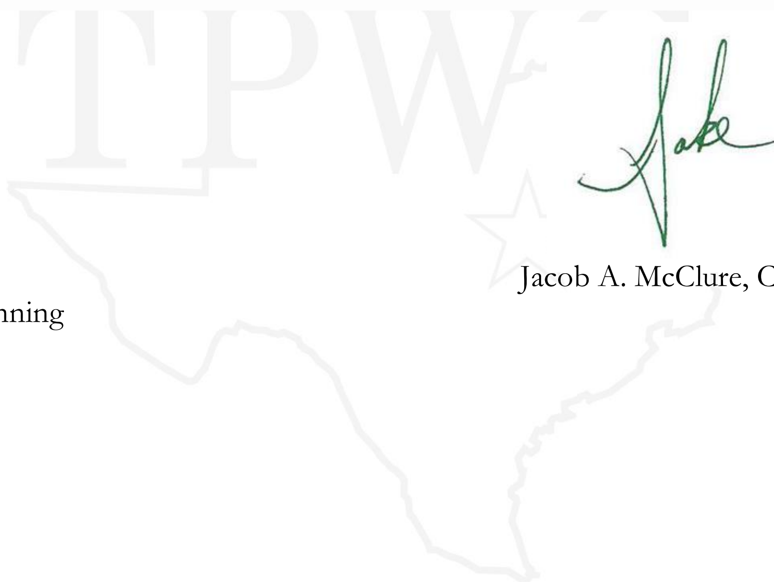
In an unambiguous piece of good news, the U.S. ISM Nonmanufacturing Index, a good measure of business activity in the service sector of our economy, produced a reading of 54.7 in October, well above the "50" break-even level and an improvement from the 52.6 reading in September. This could mark a positive turning point but is still well below the 60(+) readings of a year ago.

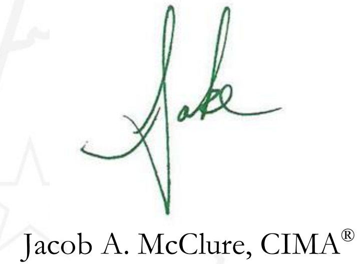
In another cautionary note for the economy, nonfarm labor productivity declined by 0.3% in the third quarter. Labor productivity tends to drop when companies have a reduction in business but are unwilling to lay off trained employees. Notably, hours worked increased by 2.4% but output only was up 2.1%. In a sudden surge, labor costs were up 3.6% for the quarter after having risen only 3.1% over the previous four quarters.

The economy remains in a balancing act with the production side contracting and the services side still growing but at a significantly lower rate than a year ago. A general consensus among business decision-makers appears to be that if the tariffs are lifted soon the expansion could resume but if the existing tariffs remain and more are added a downturn may be in the works.

Until next week, we remain at our posts, vigilantly watching the tea leaves of the economic data for signs of the future.







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