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TPWC Market and Economic Update

The Markets

The S&P 500 Stock Index (SPX) reflected a classic battle between the bulls and the bears for the week that closed out January 2020 and the bears appear to be winning. The SPX closed down 2.12% for the week at 3,225.52, erasing all the gains and a bit more for the month and the year to date during which it is down 0.29%. It's hard to remember, or even believe that on the 17th it was still breaking all-time records. Part of the decline was credited to the uncertainty of the economic effect of the coronavirus but outside of that worry, one of the key bellwethers of the stock market, Caterpillar, announced it was seeing a reduction in demand in the midst of global economic uncertainty. Another ring of the alarm bell was sounded as the Chicago Business Barometer fell to 42.9 on a scale where numbers below 50 indicate a current contraction is underway in general business activity.

The yield on the ten-year U.S. Treasury note fell nearly 18% to close out the week's trading at 1.5%, below the 1.562% yield of the 90-day T-bill, thereby once again inverting the Treasury yield curve and adding to the alarm bells. Last year, the Federal Reserve Board erased the inverted yield curve by cutting short-term interest rates to below that of the 10-year Treasury but the 10-yr note yield has now declined below that of the Fed's overnight lending rate. The interest rate swoon was global as Germany's 10-yr. Bund yield, which was finally climbing to nearly zero from negative territory, dropped back to -0.432%. The chorus of warning was joined by the price of West Texas Intermediate crude oil (WTI) as it declined 4.8% to close the week at $51.60. WTI is now down over 18% in the last month, putting it on the cusp of a bear market in oil prices.

The Economy

The big economic news for the week was the Commerce Department's headline 2.1% annualized GDP growth estimate for the fourth quarter of 2019. That first estimate of 2019's final quarter brings the annual growth rate for the year to 2.3%. That positive figure masks a couple of big negatives that may well show their heads more obviously in 2020. First, manufacturing has now been declining for five consecutive months. Caterpillar's announcement was echoed by 3M and DuPont, all warning that not only did orders fall in the second half of 2019 but all indications are that they will continue to decline in the first half of 2020. The 3M CEO said that the prospects for a business contraction are now bad enough that they will institute a second round of layoffs, eliminating 1,500 jobs in addition to the 2,000-worker layoff it announced last year.

The second hidden figure in the 4th quarter GDP report was a dramatic fall in imports. A decline in what American's buy from overseas creates a boost in the GDP numbers and our purchases fell a whopping 8.7% in the quarter. That decline in imports added 1.32% to the quarter's annualized GDP. Had we continued buying imports as we did in the third quarter, the 4th quarter's GDP would have come in at an annualized rate of 0.78%. At first glance it might seem that the tariffs were the cause of the decline in import purchases, but tariffs in the 4th quarter were not substantially different from the previous quarter, additionally our imports from Canada, Mexico, and the European Union all declined as well.

The big, and to us obvious, question is, if we are making fewer goods domestically and we are buying a decreasing amount of goods from overseas, how is it that consumers are reportedly buying record amounts of goods? The answer appears to be twofold. First, inventories are being sold off, and second underneath the lagging numbers of consumer spending a trend is appearing. That trend is that while the consumers bought ever more things last year, that growth in buying was tapering off by the end of the year.

Another odd fact has emerged for which we can only guess at the cause. Two weeks ago, the U.S. and China signed an agreement that Chinese merchants would buy a record $36 billion in U.S. agricultural products in 2020 and the lion's share of those purchases would be soybeans. From the date of that signing, soybean futures contracts have now fallen 7%. It is as if the commodity markets simply don't believe it is going to happen. Part of that decline could be credited to the coronavirus scare as whole sections of the Chinese economy appear to be locked down, but people (and hogs) still must eat. Adding to the conundrum was the 2% decline in corn prices over the same timeframe despite the announcement that the U.S. now has approved and signed a new trade agreement with Mexico, our biggest export corn customer.

Once again, despite the rosy lagging indicators and statistics, we are skeptical, and our gut reaction is that some choppy times are ahead in 2020.

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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