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TPWC Market and Economic Update

The Markets

A strong rebound from the coronavirus scare was evident in the markets for the week ending on February 7. On Wednesday, our old favorite indicator, the S&P 500 Stock Index (SPX) closed at 3,334.69, both a memorable number and a new record, while the Dow Jones Industrial Average (the Dow) crawled back above the 29,000 level to close at 29,280.85. Unfortunately, as Thursday and Friday passed, the Indexes ended the week at 3,327.66 for the SPX and 29,102.51 for the Dow. The culprit behind the end of week sag appeared to be a renewed concern over the potential for the viral epidemic to have a significant effect on the world's economy and ours as well. Still, the SPX was up 3.17% for the week, and that was nothing to sneeze at!

The yield on the ten-year U.S. Treasury note followed the same pattern having risen as high as 1.68% midweek but sagging to 1.58% by the end of the week. The rise for the week was sufficient to barely neutralize the inversion in the yield curve we saw at the end of last week; however, the one, three, and five year Treasuries all are yielding less than the 90-day T-bill creating a less than good forecast for near-term economic activity. West Texas Intermediate crude oil (WTI) failed to join the party as the price declined 2.38% for the week and is now down 17.66% year-to-date. There the reasoning was clear; China is using less petroleum and lower global demand has had its normal market impact, driving prices downward.

The Economy

The Labor Department reported on Friday that the U.S. economy added a surprising 225,000 jobs in January of this year. At the same time unemployment rose to 3.6% as more workers who were not looking for jobs a month ago started doing so. At least part of that surge in reported new jobs may have been an inaccurate seasonal adjustment. For the past decade or so there has been a severe blizzard that impacted hiring in the northeast U.S. and the Labor Department factors assumed bad weather into January's jobs report. This year there was no blizzard, so the data may be inaccurate. The average hourly wage rose 3.1% year over year. The workforce participation rate, the percentage of working-age adults who are working or actively looking for work, rose to 63.4%, the highest since 2013. As a point of reference, the participation rate was as high as 67.3% in the year 2000 but has been declining since. Notably too, the coronavirus scare hit after the jobs survey, so next month may see a marked decline.

In another breath of good news, the January 2020 Manufacturing Purchasing Managers' Index (PMI) published by the Institute for Supply Management (ISM) rose to 50.9 on an index scale where numbers above 50 indicate growth and below 50, contraction. January's number was 3.1 points above December's 47.6. If this trend continues, it well may indicate that the economy has turned a corner and may miss the traditional zero-year recession. Still, it is good to remember that in the year 2000, the first three months of the year also had numbers that strongly suggested the risk of a recession were receding but what followed was certainly not a pleasant time in the markets or in the economy.

Yet another positive indicator was reported during the week, albeit one that is highly contrarian. According to the *Wall Street Journal*, during 2019 over half a trillion dollars were invested into bond funds and ETFs by individual investors even as they pulled a net $72 billion from stock funds. Historically, major market contractions have been proceeded by large-scale inflows into stock mutual funds. If we use amateur investors' large-scale cash flow as a contrarian indicator, then we would expect to see a major market downturn in the bond market in 2020 rather than in stocks. Part of the rush to bonds can be accounted for by the record $100 billion that poured into municipal bond funds. That rush to tax-exempt bond fund in turn can be at least partially credited to the new tax law which capped interest rate deductions on home mortgages and deductions for state income taxes. High income investors in high tax states are being squeezed and have flocked to tax-exempt bond funds to take cover.

Things are definitely looking far more optimistic than even a couple of weeks ago, but there are at least two wild cards in the deck. First, the increase in average wages combined with falling imports from China could trigger a rise in inflation. That rise would drive interest rates upward causing the bond market to return to earth. Even a relatively small increase in interest rates could easily create a crisis in both heavily indebted companies and the federal budget. The second wild card is the still unknown impact of the Coronavirus epidemic. At present it appears to be very likely that it will have a significant negative impact on the Chinese economy but if it spreads to the rest of the world it could have a profound impact here as well.

As has been the case for the past several months, both the U.S. and world economies are on a thin edge. We could be looking at one or more years of continued growth or we could be on the cusp of a recession. Only time will tell.

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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