Early September 2019

MEEDER
INVESTMENT MANAGEMENT

Monthly Market Commentary

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Economic Uncertainty

The first day of August, the U.S. escalated trade talks by announcing a new round of tariffs on China. This round of tariffs impacted the remaining $300 billion of Chinese exports at a rate of 10% and commenced on September 1st. The announcement reversed positive momentum that markets were experiencing, as the S&P 500 Index tumbled almost 3% in a single day. Market volatility remained elevated as additional tariff developments transpired between the U.S. and China throughout the month.

The ISM Manufacturing Index showed a sharp contraction in August, with a disappointing result of 49.1 compared to consensus expectations of 51.3. The survey of roughly 300 manufacturing firms across the country confirms a slowing outlook for the manufacturing sector, which continues to face headwinds from tariffs between the U.S. and China. On the other hand, the outlook for the service-oriented portion of the U.S. economy painted a more positive picture. The ISM Non-Manufacturing Index continued to expand above expectations of 54.0 with a reading of 56.4, displaying strength in the portion of the economy less impacted by the China trade dispute.

August Tariff Timeline

1ST U.S. claims China not following through on promise to purchase additional U.S. agricultural products. Implements 10% tariff on remaining $300 billion of Chinese imports.

5TH China stops all purchases of U.S. agricultural products. Chinese Yuan devalued below psychologically important 7:1 ratio versus the U.S. Dollar for first time since financial crisis.

13TH U.S. delays roughly half of the products impacted by U.S. tariffs set to occur in September until December 15th to avoid distribution in U.S. holiday sales.

23RD China retaliates against U.S. tariffs implemented 8/1 with $75 billion of U.S. products being impacted with as much as a 10% tariff in addition to existing tariffs.

In response to China's action earlier in the day, the U.S. raises current tariffs from 25% to 30% and also schedules an increase in future tariffs to be implemented in September and December 2019 from 10% to 15%.

Yield Curve Inverts

On August 14th, a potential recessionary warning signal flashed as the 10-year U.S. Treasury yield briefly dipped below the 2-year U.S. Treasury yield. This sparked fear in investors and the price of the S&P 500 Index plunged nearly 3%. The yield curve quickly reverted to a positive (upward) slope, but the 2/10-year spread inverted multiple times during the next week. Investors are trying to determine if these bond market signals are a head-fake, or the beginning of new and longer-term trend. This specific inversion is important to watch, because historically it has occurred prior to each U.S. recession. The yield curve inversion is often a result of investors avoiding near-term volatility in order to lock-in the guaranteed yields of longer-term bonds. It is important to remember that bond yields move inversely with bond prices. Therefore, an increase in demand for longer-term bonds causes the price to increase and the yields to fall. This demand helped the Bloomberg Barclay's U.S. Aggregate Bond Index climb nearly 2.6% for the month, which brought its year-to-date return to +9.1%. In addition to the 2/10-year inverting, the 30-year U.S. Treasury bond yield reached an all-time low of 1.9%, falling below the yield of the 3-month Treasury. Despite the S&P 500's impressive year-to-date performance of +18.4%, this uncertainty caused the S&P 500 Index to fall -1.6% in August.

Hong Kong Protests

As the trade dispute lingers on between China and the U.S., China faces a much more violent situation close to home. Hong Kong was ruled by the British for over 150 years before transitioning back to China in 1997. The citizens continue to abide by their constitution, Hong Kong Basic Law, which is centered on freedom of speech, a free press and the right to protest. The region has maintained a capitalist system and lifestyle despite being ruled by China during this time. According to Hong Kong's constitution, the capitalist structure will remain for 50 years before it fully transitions to China. But over the last few years, Beijing has issued reinterpretations of Basic Law and now claims that it has complete control over Hong Kong. As the citizens of Hong Kong feel their identity and freedom slipping away, they have begun to protest. What started out as peaceful demonstrations more than three months ago have slowly turned violent. Protests in Hong Kong remain a fluid situation and analysts are closely watching the social and economic impact that this may have on the region and ongoing trade talks between the U.S. and China.

The Fed

At the last FOMC meeting, the committee cut short-term interest rates 0.25%, but some feel that the Fed may be moving too slowly to avoid a recession. In August, the Fed held their annual meeting in Jackson Hole and provided additional guidance to investors. Fed Chair Jerome Powell stated, "In light of these uncertainties and muted inflation pressures, the (Fed's policymaking) Committee will closely monitor the implications of incoming information for the economic outlook and will act as appropriate to sustain the expansion, with a strong labor market." At the end of the month, U.S. nonfarm payrolls reported adding just 130,000 jobs as opposed to a consensus estimate of 159,000 in August. This weakness would have been even more pronounced if the U.S. Census had not added a one-time boost of 34,000 jobs. This weak data could put additional pressure on the Fed to implement another cut in short-term rates. According the CME Group at this time of this writing, the market is predicting a 91% likelihood of a 0.25% cut at the Fed's September 18th meeting. If this occurs, it would bring the Federal Funds target range down to 1.75%–2.00%.