Daniel Wildermuth's
MARKETCOMMENTARY

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October (and September) is Nigh – Are You Ready?

The market has been a roller-coaster in August. After the Dow dropped 767 (3.0%) points August 5th on news of China's currency devaluation, it rebounded 311 (1.21%) points the next day on news of delayed tariffs, before sinking 800 points (3.05%) eight days later when the yield curve inverted further. Since then it's been bouncing up and down with multiple days notching moves more than a percent and even two. Market gyrations like these, particularly late in an expansion cycle, often signal bigger problems. The timing on the calendar could also add to challenges.

Historically, the market has been volatile in the fall with the market's biggest losses usually occurring in October. And September is the only month that has historically generated a negative average monthly return. The more memorable crashes of 1929, 1987 both occurred in October, and the market meltdown of 2008 began in September. Just last year, the market was down about 7% in October.

Some believe the falls and historical gyrations result from emotions turning negative as summer vacations end and the sun sets earlier. Possibly a more likely reason stems from investors returning from summer breaks and catching up on economic data, which during a slowing economic cycle, can drive markets down as traders factor in negative developments.

Over the last few years, tax cuts, 50-year-low unemployment, strong corporate profits, and a GDP growth rate nearing 4% have all contributed to various U.S. markets setting new

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highs, but weakening trends in multiple areas ranging from manufacturing to trade to global growth have more recently sapped investor confidence. Against a less robust backdrop, rising tariffs and threats of more are rattling markets. China's additional $75 billion in tariffs announced on August 23rd followed by Mr. Trump's further ratcheting up various tariffs from 25% to 30% has lessened hopes for future compromise.

Beyond tariffs, many concerns also abound. The inversion of the yield-curve (short-term rates are higher than long-term rates) typically indicates falling expectations for longer-term economic growth as investors exit equity markets for the safety of long-term bonds. Since inverted yield curves have proceeded every recession since 1956 (although not every yield-curve inversion has been followed by a recession), investors pay attention.

Various negative developments are motivating the move into bonds. Numerous major economies are near, or already in, a contraction. Global interest rates are mostly negative as growth rates stall, and there's no historical precedence to weathering sovereign debt yields across the world trading at, near, or below zero.

Germany's Ifo business climate fell from 95.8 to a seven-year low 94.3, and president of the Ifo institute, Clemens Fuest noted, "The situation is becoming increasingly dire" and "The weakness which was focused on manufacturing is now spreading to other sectors." UK GDP fell 0.2% in the second quarter, the first contraction since the Brexit vote. Capital spending was one of the weakest sectors indicating concerns over the UK's future. If the UK lurches out of European Union with a "no deal Brexit" (lack of negotiated terms to ease the impact of UK's departure), further chaos within the British and EU economies would likely result. China, is also slowing appreciably with their producer price index contracting 0.3% year-on-year. The reemergence of wholesale deflation highlights Chinese manufacturing troubles.

The recent crash in Argentina's markets resulting from the loss by the pro-market presidential candidate has also added to instability within emerging markets, and mounting political, and geopolitical risks continue building in Venezuela, Iran, and North Korea. Even trade partners

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South Korea and Japan are struggling to get along.

Prices for metals used in basic industry are falling, which historically has signaled approaching harder times. Within the U.S., transportation, banking and small-cap stocks, the last of which are thought to be immune to global economic weakness, are all flashing warning signs of an impending domestic economic slowdown.

Demand for luxury items are also signaling potential problems. In 2019, shipments of recreational vehicles to dealers have fallen about 20% after a 4.1% drop last year, according to data from the RV Industry Association. Multiyear drops in shipments have preceded the last three recessions and has led many to note that the RV industry is better at calling recessions than economists.

Still, against all the negative developments, markets around the world would likely rebound quickly if a trade war is averted. Also, corporate profits turned around in the second quarter, rising 4.8% from the prior quarter, according to the Commerce Department. In addition, retail sales, a key component of the U.S. economy, rose 0.7% in July, and, not counting autos, were up 1.0%. The retail sales control group – the part that feeds into GDP – also rose 1.0%. The Atlanta Fed raised its Q3 GDPNow forecast to 2.15%. While the Wall Street Journal warned that US company earnings will be poor despite US growth because these companies see about half their business from offshore, domestic focused businesses should fair well if US growth beats expectations.

In addition, President Trump has ample motivation to push for growth given his upcoming election. Deteriorating economic sentiment, or even worse, an actual recession, would be disastrous for Trump. A combination of tariff reductions, rate decreases and other stimulus could reverse all these trends, at least in the short-term, and greatly help his re-election prospects.

Furthermore, reacting quickly to an inverted yield curve has historically been unwise given the equity market lag after the event. During the previous 10 inversions dating back to 1956, the S&P 500 topped out anywhere from two months to two years later, according to Bank of America strategists. If one is really trying to time the market, bailing immediately after the inversion can mean missing out on double-digit gains. Yet, while the S&P 500 usually peaks some considerable time after a yield curve inversion, equity markets are nearly always running on borrowed time after the event.

All this points to the importance of shoring up your investment strategy. It seems increasingly likely that equity markets will hit some rougher times in the near to medium-term future although resolution to trade tensions could extend the market rally, possibly considerably. If your timeframe is longer term, as it should be if you hold public equities, you may be comfortable riding out the storms. Or, now may be a good time to make some adjustments. Private markets and various other types of investments may offer attractive return and diversification benefits. Regardless, this fall seems likely to deliver excitement, possibly good if trade talks progress or possibly another memorable October.

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