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"Perspective for the Decisions Ahead"

The Weekly Note

A Weekly **Market Commentary**

Tuesday, August 6th, 2019

"Stocks continue to ride the cycle of trade negotiations"

Following their worst weekly showing of 2019, stocks took another sharp leg lower on Monday with the S&P 500 dropping 3.0% and the Dow dumping 767 points, or 2.9%. The bond market reflected the sudden loss of risk appetite as the 10-year Treasury dipped under 1.80% for the first time since October 2016, a reflection of strong buyer demand.

Last week, the Fed lowered interest rates for the first time since 2008. After stocks started to recover some ground on Thursday following a "sell the news" response, President Trump announced an unexpected increase in tariffs on China sending stocks lower once again. The tennis match of trade policy continued into the weekend with China sharply devaluing their yuan currency and halting all agricultural purchases from the U.S until a trade deal is reached.

You may have a sense of déjà vu as this trade negotiation cycle has repeated itself a few times in different variations over the past 18 months. Sharp selloffs on escalations followed by gradual sentiment improvements and marginal new all-time highs.

The new wrinkle this round is the escalation of the currency war that China has explicitly targeted in response to recent U.S. "protectionism". A weak yuan makes Chinese goods appear cheaper and China's Sunday peg sent the yuan to its lowest level vs. the dollar in at least a decade.

US Dollar to Chinese Yuan

Clearly the U.S. tariffs have more than a direct impact on U.S. consumers, who foot the bill of inflated prices. China's economy has slowed to its lowest growth rate in several decades, even lower than the Financial Crisis. And even though U.S. stocks dropped sharply today, losses have been even more severe for China with the Hang Seng index 12% below its April highs.

With yesterday's selloff, the S&P 500 is still just 6% off of all-time highs set a couple weeks ago and is up ~14% for the year. Not bad considering corporate earnings are only on pace to grow low-to-mid single digits this year. In context to relative earnings growth and market returns, the U.S. remains the clear leader of major developed economies.

For investors allocating for the long-term, as they should, the relative value of stocks and bonds should still be most relevant. With the recent move in interest rates, the 10-year treasury yield is once again less than the dividend yield on the S&P 500. Which would you rather own for the next ten years: A fixed return of ~1.8% or a ~2% dividend yield plus any potential price appreciation from the earnings underlying Corporate America?

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