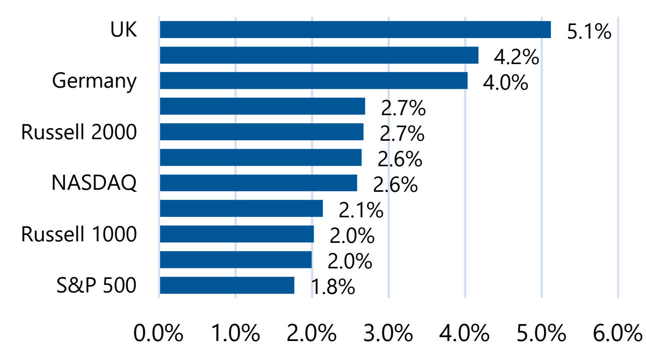
Weekly Capital Market Comments

October 18, 2019

Jeepers Creepers

Over the last week, headwinds have turned into tailwinds. A cease-fire between Turkey and the Kurds has helped temper outrage over the U.S. withdrawing from Syria; the U.S./China trade war has shown some "progress," and the U.K. and the EU have announced a "draft deal" paving the way for a potential BREXIT. Back home in the U.S., recent economic data has provided additional fodder to bond bulls in hopes of further rate cuts, as employment trends soften, inflation remains MIA and retail sales disappointed; this, on the heels of a weak manufacturing and service ISM prints from a few weeks back. All of this has helped support a bounce in equity markets, both here and abroad.

Global Equity Returns | 1 Week Returns



Source: NEPG

But with Halloween quickly approaching, investors need to ask themselves, "Is the capital market ready to serve up a trick or treat?" From our perspective, the U.S./China agreement is short on specifics, at least the ones that really matter, while China is also now mandating that any new tariffs must be canceled if a broader deal is to be finalized. Then you have the U.K./EU agreement. While both sides need to find mutual ground, PM Johnson still needs to bring the accord back home for a Parliamentary vote, which has a 50/50 chance of passing over the weekend. Finally, you have the economic data here in the U.S.; the classic bad-news is "good" argument. The continued flow of bad-news is supporting expectations for an additional 0.25% (25bps) rate cut by the Federal Reserve at the next FOMC meeting on October 29th and 30th, followed with yet another cut in December. **But what happens if Fed opts to hold rates steady, bolstering Jerome Powell's pledge of "nothing more" than a mid-cycle adjustment to borrowing rates?** What if the recent flurry of interviews from FOMC hawks, combined with the notion that the Fed needs to maintain independence from external pressures, emboldens Mr. Powell to hold steady? If this happens, we believe investors will be served up a "trick," and capital markets will sell-off.

Creeping 10Y Note

Source: NEPG

Adding to this, we believe rates may have bottomed, even if there is an additional rate cut at the December 11th/12th meeting. As we illustrate above, the 10Y UST has moved up by 20bps (or 13%) over the last 30 days, and now stands at roughly 1.80%. In our

opinion, investors need to be watchful of this "creeping" 10-year, and the implication it may have if it continues. Specifically, a higher risk-free return may attract fixed-income investors that were stretching for yield through higher-risk investments. In turn, this may also cause credit spreads to widen, pushing up interest rates on housing as well as commercial and consumer borrowing. Over the last economic cycle, the consumer has been addicted to easy credit and relatively loose financial conditions. Together with higher rates, a disjointed equity market and truly unresolved geopolitical backdrop could create a cauldron of economic uncertainty and tightening economic conditions. **So, clients should once again fade this recent rally, and continue to de-risk in the near-term.** And finally, if a 6-foot guy dressed in a bear costume rings your bell on Halloween, please make sure you have some healthy treats!