VIZIONARY WEALTH MANAGEMENT
"Perspective for the Decisions Ahead"

The Weekly Note
A Weekly Market Commentary

Monday, June 3rd, 2019

"New round of tariffs leads to losses in U.S. stocks, gains for bonds"

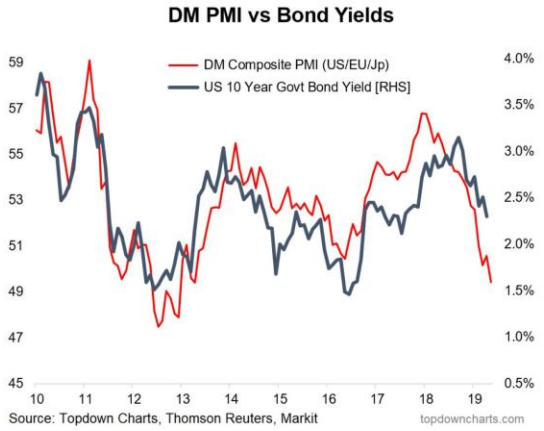
The Dow notched its sixth straight week of losses as President Trump's new threat to impose tariffs on Mexico brought a fresh round of concerns for the escalated frictions impacting global trade. We are now approaching 18 months of trade tensions, which began with the initial tariffs on washing machines and solar panels announced on January 22, 2018. The S&P 500 is once again trading below levels that preceded that first announcement.

Despite the tariffs being a global economic headwind, U.S. stocks have held up much better than international stocks since last January. Relative economic strength may have given President Trump confidence in leveraging this tactic once again, even if the rationale for last week's announcement was not based empirically on a trade deficit.

This past week, however, U.S. stocks actually stood out as the biggest loser. For the week, the S&P 500 and Dow declined 2.5% and 2.9%, respectively. The MSCI ACWI ex-U.S. index (international stocks) declined 1.1% and the MSCI Emerging Markets index gained 1.5%. It is likely that some of the impact to international stocks has been priced in earlier than the recent jump in U.S. market volatility.

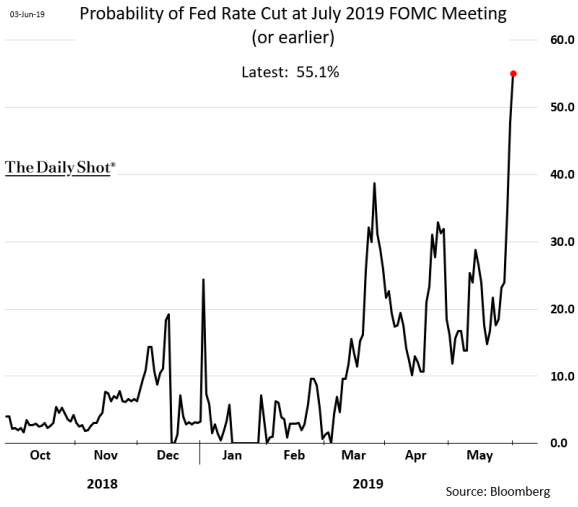
While the ultimate success of these trade initiatives is still largely unknown, the bond market has become very clear in its reading of near-term economic momentum, and the result is not very rosy. Yields of bonds in developed markets (U.S./Europe/Japan) have all trended down over the past 6 months. In fact, the 10-year U.S. Treasury bond closed Friday at a yield of 2.14%, down from the 3.24% rate as of November 8, 2018.

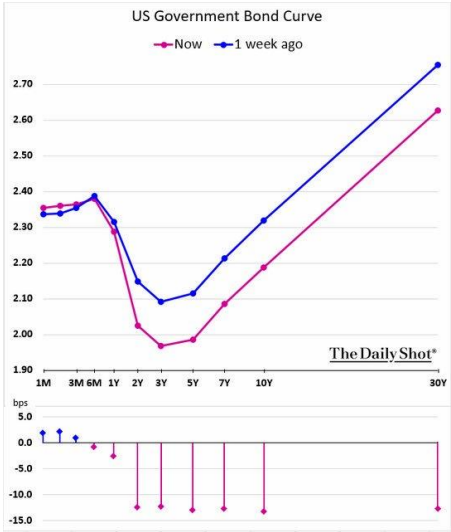
This trend down in U.S. and other developed market bonds has coincided with a slowdown in the composite purchasing manager's index (PMI), a gauge of economic momentum. The chart below shows the correlation that long-term bonds have with the composite PMI index, which appears on the surface to be very high.



The bond market has been the main beneficiary of this renewed volatility and uncertainty. As yields decline, bond prices go up. You would have found very few takers to wager that the Barclays Aggregate bond index would be up nearly 5% through the first 5 months of 2019. And those takers would likely have been overtly bearish in their natural bias.

There is now an increasing likelihood that the next Fed policy move will be a rate cut, a move that is typically reserved for boosting a weak economy. After last week's news, the fed futures market is now pricing in a nearly 50% chance of an interest rate cut at the July Fed meeting. That same implied market indicator also assumes that we will have two rate cuts by year-end[1]. Those probabilities are of course subject to change.





The static short-term rates and declining long-term rates also means that a good portion of the yield curve is once again back to being inverted. 3-month Treasury bill rates were over 20 bps higher than 10-year Treasury rates as of Friday.

Sentiment has no doubt deteriorated since the beginning of the quarter, but investors should remain mindful that many of the current headwinds could end up being transitory in retrospect. We should also not forget that the first quarter was supposed to be dire for the U.S. economy, as extrapolated by December volatility. Yet gross domestic product (GDP) ended up growing over 3%. Right now GDP estimates have once again started low for Q2, but we have seen this show before.

Wayne Wagner Jr., ChFC
Vizionary Wealth Management

Sources:

1. https://www.bloomberg.com/news/articles/2019-05-31/fed-funds-futures-now-show-two-cuts-fully-priced-in-this-year