Weekly Capital Market Comments

August 2, 2019

NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

Short And Bitter Sweet

Weekly Review

Equity markets played true to form this week (Thurs-Thurs), finishing the first week in August (which is typically the worst month for equities) in the red, after a roller-coaster of economic and geopolitical news. Following last Friday's positive surprise to 2Q GDP, markets were buoyed further by better than expected Consumer Confidence on Tuesday. But then mid-week, the Chicago PMI showed additional weakness in the US manufacturing sector. And then the Fed stepped in (as we expected) on Wednesday with a 25bps cut in rates. But disjointed communication by Chairman Powell during the subsequent press conference did more harm than good for the markets. Then, by Thursday the breakdown between the US and China trade negotiations resulted in the POTUS announcing an additional 10% tariff on up to $300bn on US imports (mostly electric and consumer-oriented products) starting in September. As a result, the S&P 500 fell by almost 1.7% from last Thursday, while the yield on the US 10yr dropped to 1.86% as of this writing. So here are a couple of our thoughts going into next week:

- **Data:** Next week will be relatively light from an economic release perspective. The JOLTS will be released on Tuesday, then you have consumer credit on Wednesday and PPI on Friday. So it will be interesting to see if markets can recover some of this week's losses, or further sink into the doldrums of Summer.
- **China:** We believe the Chinese will continue to drag their feet in working with US to resolve the current trade dispute. It is our opinion, that the Chinese government simply has no motivation before the 2020 election cycle begins to take shape, and a forerunner on both sides emerge, to do so. While nobody (even with polls) can predict an election outcome these days, we believe the Chinese will wait until at least the next democratic debate, which will be in mid-September, before they even begin to engage with the US trade delegation in any meaningfully manner.
- **The Fed:** We believe rates cuts are like Lay's Potato Chips, you can't simply have just one. While some investors are expecting a "one-and-done" insurance cut, we believe there are at least 1-2 more cuts in the offing over the next 9 months, bringing the Fed Funds rate down at least another 0.75%. As we have pointed out, a 25bps (or 0.25%) cut has virtually no impact to the economy. In addition, as we have pointed out time and time again, investors need to be careful what they wish for, as rate cutting cycles are typically a prelude to more dire economic times ahead. And if this is not enough, lower and lower rates/yields simply induce investors to take more and more risk, in search for fixed-income yields, or equity total returns.
- **Jobs:** We believe the US job market is topping out but still may post between 100,000 and 150,000 monthly jobs for the next several months. Based on the interactive tool on the Atlanta Fed's website, to reach an unemployment rate of 4%, the US would need to only add 70,000 per month over the next year. So consumer spending should remain at solid levels in the near-term and consumer confidence should remain strong for the time being.
- **Capital Gains Uncertainty**: Something that we are just starting to explore is the impact on capital gains tax, if a democrat occupies the White House in 2020. Front-runner Joe Biden (as well as others) have already vowed to roll-back the Trump tax cuts, but changes to capital gains tax could have a significant impact on investor sentiment and capital market valuations. Stay tuned for more on this topic, as we believe it will begin to garner more and more attention as we move further into election season.

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- **Markets:** We continue to look for a pullback to get more bullish, especially at heightened equity and fixed-income levels. Despite a better than expected earnings season, the S&P 500 remains close to 17x forward 12-month earnings. And with the latest round of trade rhetoric and Fed speak, the 10yr has pushed below 1.9%.

We’d love to hear your thoughts.

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