NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

Weekly Capital Market Comments

August 9, 2019

Big Mistake, Little Mistake

Weekly Review

What a wild week in the equity and fixed-income markets. The 10Yr Treasury touched below 1.6% for the first time since Fall of 2016, and the S&P 500 gained and lost almost $1.7 trillion of market capitalization. To really put this into perspective, this amount is about equal to the GDP of Russia, the total amount of outstanding student loan debt, the aggregate collection of federal income taxes last year, ~8% of the National Debt, and roughly 40% of the Federal Reserve's balance sheet. We continue to scratch our head regarding the sanguine, rose-colored commentary by network talking heads and overly bullish Wall Street strategist. We remember similar positions held back in 2006/07, when capital market participants were just as indifferent to the glaring warning signs of an economy about to pop.

"*At this juncture, however, the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained. In particular, mortgages to prime borrowers and fixed-rate mortgages to all classes of borrowers continue to perform well, with low rates of delinquency*." **Ben Bernanke, March 2007**

But once again, we are not calling for a cataclysmic downturn or anything resembling The Great Recession (TGR) of 2007, but we do caution investors on the potential for any significant appreciation of US equity markets through year-end. There simply remains too much political, geopolitical and global economic uncertainty to overcome. **Hence, we see no sustainable catalysts to drive equity markets higher (and keep them there),** as we are now in the longest economic expansion/equity bull market in history. Fixed-income (bond) markets may benefit in the near-term, as the Fed is likely to cut at least 0.25% at their next meeting in September (30-31st). And while some investors and commentators are calling for as much as an additional 0.50% cut, we caution investors to consider that a 0.50% cut (from 2.25% to 1.75%) would signal that the economy is in more trouble than originally thought. Therefore, we believe the Fed will only cut 0.25% in September, providing additional fodder regarding "willingness to act further" if significant geopolitical headwinds emerge.

As a result, not only are equities extremely volatile, but bonds remain a highly crowded trade. The global easing cycle that is now underway is driving investors (both equity and bond) into unchartered risk exposures. A hard BREXIT (October), Iran, N. Korea, US elections, slowing US/global growth, F/X policy manipulation (aka global central bank easing) and trade/tariff disputes (China/US as well as other countries) are all headwinds presenting an array of known-unknown risks for global capital markets and their economies that Wall Street strategists, investors and other market participants are refusing to see or acknowledge. We have yet to witness an economic soft landing, either here or abroad (China), and remain skeptical that this time is different. Economic data that we comb through daily suggest the slowdown (global) is for real, and no amount of monetary easing will help, as the availability and cost of credit is not the problem, but rather aggregate demand for goods/services is. Further, technology and globalization (trade/capital market flows) continues to temper inflation and growth.

Therefore, we believe the current investment landscape presents the Big Mistake/Little Mistake argument; given the run up in the equity market over the last 5-10 years. Is it worth risking a "Big" mistake by stretching for another 5% of potential upside? We think NOT! We believe investors should think about fading any rallies and booking profits. However, the upside risks to our view(s) include that Trump and Xi both blink, with the former realizing that the hardline position toward trade/immigration may dent equity markets/economic trends and risk his re-election hopes. With the former, Xi realizes that the Chinese economy is truly being impacted by higher tariffs, hence seeding political/human unrest. The last thing China wants is another Tiananmen Square in Hong Kong.

We'd love to hear your thoughts.

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