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The Sound and the Fury

Global economies and capital markets continued to reflect heightened economic and political uncertainties in August. The result: a "noisier" August than has seemed to be the recent late-summer norm, with many U.S. and global interest rates setting record lows and most equity markets experiencing heightened day-to-day price volatility. For example, there were 11 days in August when the U.S. market rose or fell by more than 1%, making it the most manic month since February 2018. Some monthly highlights:

- Updated government data showed that the U.S. economy (GDP) grew at an estimated +2.0% annual rate across the 3-month period ended June 30, 2019, a slower pace of expansion than during the first quarter (+3.1%). Elevated levels of consumer confidence continued to show up in rising personal consumption, particularly for durable goods (autos, household equipment and furnishings). But somewhat weaker non-residential investment (e.g., in structures and equipment) and declines in exports (reflecting slower global growth and a highly valued U.S. dollar) comparatively constrained top-line U.S. economic growth.

- Growth decelerated in other economies, with slower growth in Europe (notably, in Germany and in the United Kingdom), in Japan, and in China suggesting that the on-going U.S.-China trade imbroglio is affecting a widening swath of world economies. For the month, the U.S. dollar rose in value against all but the Japanese Yen, and the British Pound fell to a more than 20-year low in the face of continued BREXIT uncertainty.

- The second quarter *corporate earnings season* was, for the most part, wrapped up by August 31. Although a high percentage of companies (e.g., 73% of S&P 500 Index constituents) reported results that "beat" their respective quarterly earnings estimates, overall year-over-year EPS growth of roughly +3% was not particularly impressive. More broadly, trailing 12-month earnings have remained flat this year, a marked contrast to 2018's robust profit growth.

- Prices in the U.S. equity market finished the month modestly (-2.3% lower); wide swings during the month produced prices that were down as much as -4.9% at mid-month before rebounding. Non-U.S. stocks declined -3.3% in August. Prices responded dramatically to Presidential tweets on the progress/lack of progress on trade negotiations with China. Valuations remained elevated (e.g, a Price/Trailing Earnings ratio of 17.7x for the S&P 500 Index). Net of last year's late equity market corrections and this year's strong advance, global stocks have now returned just +0.3% across the last 12 months.

- Interest rates on U.S. and global bonds moved lower, reflecting growing concerns that the U.S.-China trade disputes are cutting into economic production and global trading activity. Yields on the benchmark 10-year U.S. Treasury bond fell -44 bp during the first two weeks of August, the third steepest such decline in 10 years. Yields on 30-year Treasuries (1.96%) hit an all-time low in August; yields on 3-month Treasury bills (2.00%) are now higher than the yields on all other U.S. Treasury maturities. Outside the U.S., rates fell still lower and were broadly more negative (10-year yields of -.30% in Japan, -0.70% in Germany) amid rising macro-economic concerns.

- The immediate consequence of large declines in bond market yields was rising bond prices and strong one-month returns on portfolios of fixed income securities. The taxable and tax-exempt bond markets returned +2.6% and +0.8%, respectively in August; on a trailing 12-month basis, these markets have produced "equity-like" returns in the range of 7%-10%.

The outstanding question, of course, remains whether the proverbial sound and fury being inveighed politically against a major trading partner (China) and against the world's most critically important central bank (the U.S. Federal Reserve) evolve to become more hurricane than tempest. The bond market and recent surveys of business activity (declining Purchasing Manager index reads on order activity and production) are suggesting some further erosion in economic confidence. But the equity market seems to be less convinced as to the future: investors collectively seem unwilling to bet with or against the prospects that a trade accord can be reached soon with China. Given such market unpredictability, taking balanced risks in global capital markets still seems the most prudent approach to managing investment portfolios.

Investment Strategy Team
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