Market Update

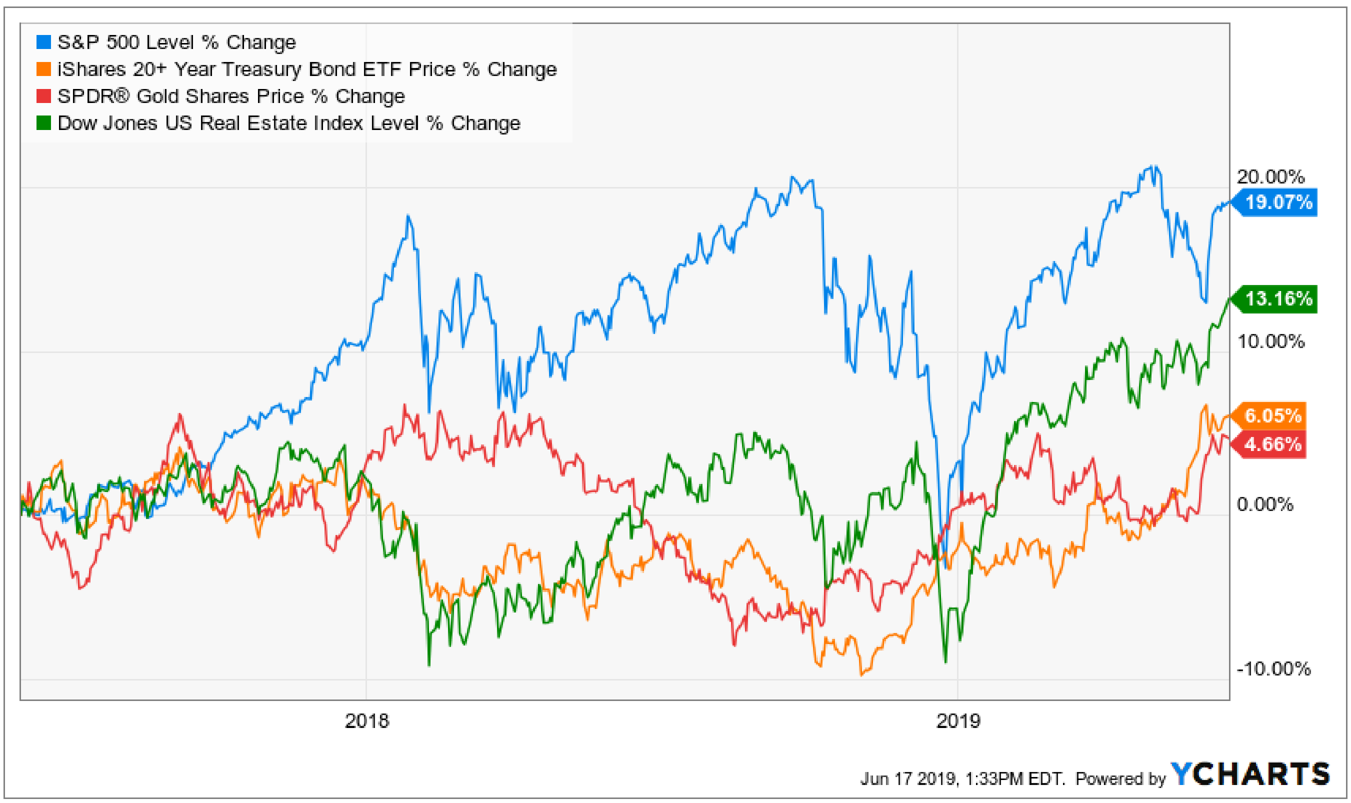
June 17, 2019

Federal Reserve, Interest Rates and China-U.S. Trade Driving Markets

Major Market Driving Theme: Federal Reserve Decisions and China Trade Negotiations

- A potential trade war between U.S. and Mexico was averted, but global trade uncertainty remains.
- Despite markets pricing in rate cuts, domestic indicators suggest that the U.S. economy is on decent footing. Inflation remains stubbornly low, however.
- The Fed rate decision this week is clouded by conflicting signals, but we believe it will likely feature an easing bias.

The U.S. equity markets have been exhibiting some volatile trading patterns, of late. There are some indications that downside risks to future growth are rising. There are other indicators that suggest the economy is doing fine. The spotlight is now on both the Federal Reserve and negotiations with China. The chart below indicates the bumpy path taken recently, as indicated by the blue line, toward the end, of the line graph period. We also see from the orange line (the proxy for long dated U.S. treasury bond prices) a significant uptick in prices. This is indicative of capital, looking for a relatively safer place to be, while trade negotiations are worked through. We also see an uptick in the value of U.S. Real Estate. Our belief is that this is due to an uptick in bond prices. As bond prices tick up, interest rates come down. Real Estate is sensitive to interest rates. When interest rates are lower, Real Estate becomes more attractive.



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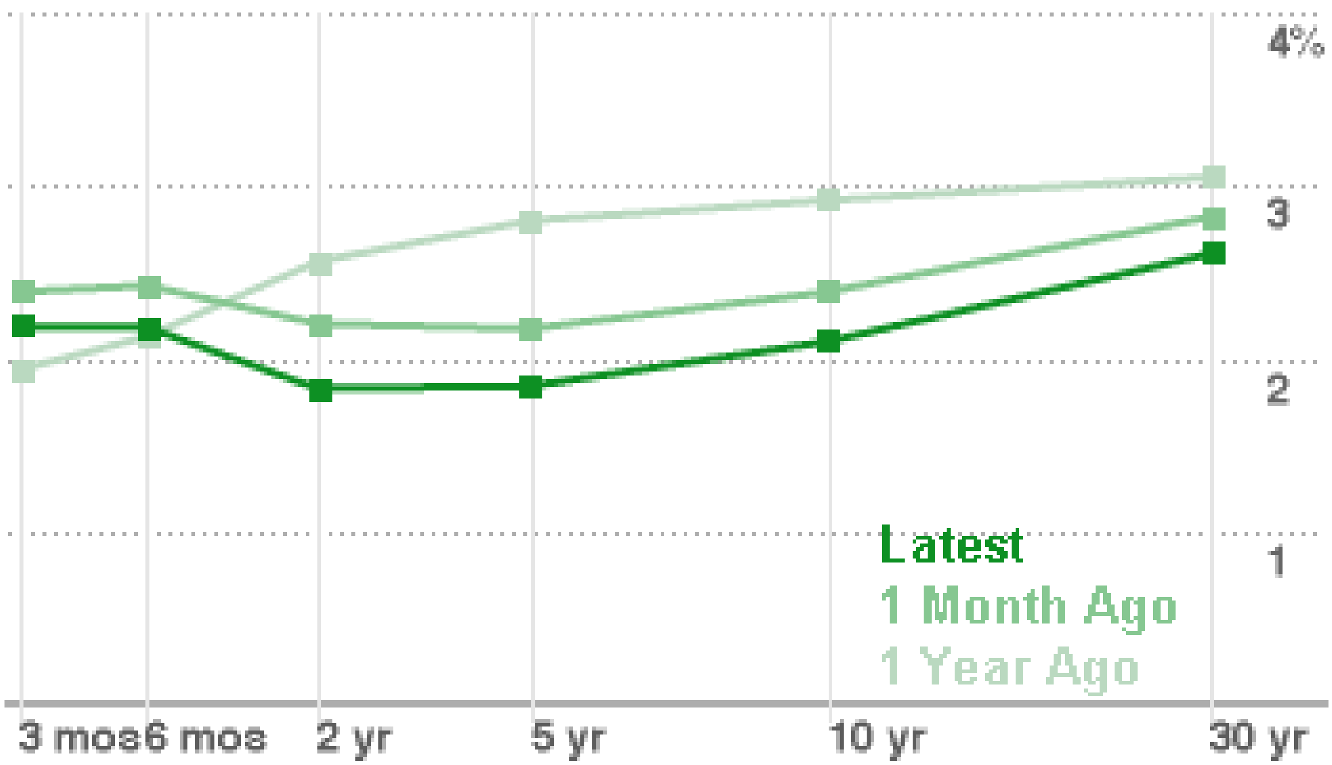
Last week President Trump indicated that if President XI did not meet with him at the upcoming G20 summit, he would immediately put on 25% tariffs on the remaining un-tariffed $300 billion of Chinese imports. Tariffs are often a very misunderstood tool in economics. One of the biggest reasons for this is tariffs are often also used politically, and many of the effects of tariffs are not completely understood by many. Tariffs and Quotas historically have played an important role in the sovereignty of nations, and building up a nation's independence. However, tariffs tend to also be an impediment to free-global trade. As a political negotiation tool, they can be effective. The recent threat to use them on Mexican imports has shown to work in getting the Mexican government to agree to do more on immigration. Protracted trade wars are not necessarily good for either country involved with them. Typically, it is more impactful on the country who is more the supplier, than the customer due to efforts to shift sourcing elsewhere. The consumer is impacted with higher prices until the products being imported can be sourced elsewhere.

Below, you will find the U.S. Treasury Yield Curve. We see the curve has steepened since last month. From the prior year, we are still experiencing some inversion between the 6-month to ten-year maturity range. Federal Reserve policy will be very important to the stability of interest rates, and the ability for the economy and the markets to shrug off concerns, over the inversion, in the yield curve. Negotiations with China are also impacting the yield curve, as some of the money coming out of the equities markets are going into the liquid treasury market.



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We continue to feel that there are signs of a later stage economic environment. The biggest concern for the economy in the next 12 months continues to be the Federal Reserve interest rate decisions. China trade tensions are front and center and could influence Fed policy. However, the Chinese trade issue could quickly turn into a positive if a deal is made. This would potentially create a reason for equities to rally.

Overall, we prefer domestic equities over international equities. We prefer more value-oriented stocks vs. growth stocks currently, in the economic cycle. As we have stated in the past, value stocks tend to move more slowly in either direction when the markets react to stimulus. In later stage economic environments, a tactical shift to overweighting value type stocks can reduce portfolio risk. This is an area we are looking at, to continue to make tactical changes, over the course of the coming months. We are currently neutral to bearish on fixed-income and interest rates. It is important to maintain discipline regarding long-term strategic asset allocation. However, as market conditions dictate, we are looking at tactical opportunities to reduce risk in portfolios, if necessary.

If you have questions or would like to discuss this further with regard to your personal portfolio, please contact me at 310-469-7254.

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