STERLING CAPITAL

Weekly Market Recap
August 19, 2019

		Return	
Index	**Close**	**Week**	**YTD**
Dow Jones Industrial Average	25,886	-1.5%	11.0%
S&P 500 Index	2,889	-1.0%	15.2%
NASDAQ	7,896	-0.8%	19.0%
Russell 2000 Index	1,494	-1.3%	10.8%
MSCI EAFE Index	1,797	-2.3%	4.5%
10-yr Treasury Yield	1.56%	-0.19%	-1.13%
Oil ($/bbl)	$54.91	0.8%	20.9%
Bonds*	$113.67	0.9%	8.5%

Source: Bloomberg, 08/16/19

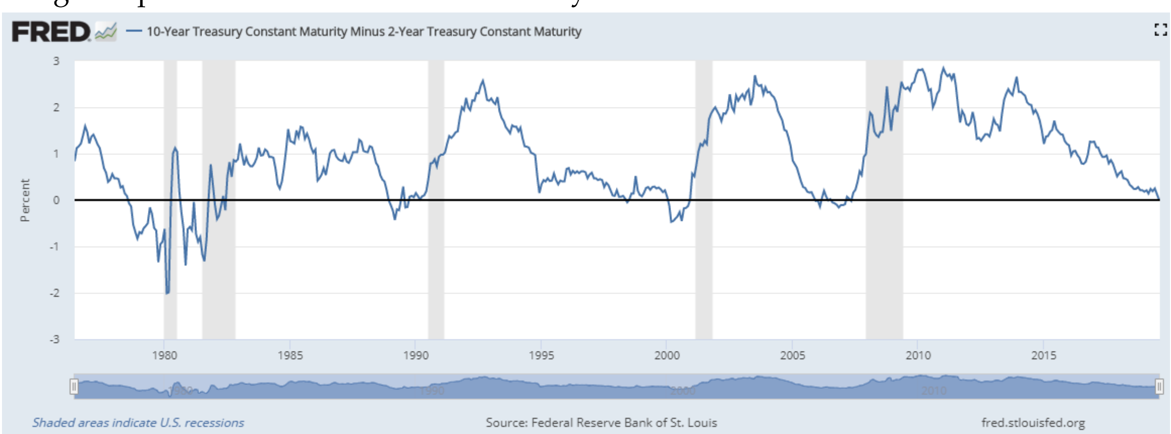
*Bonds represented by the iShares U.S. Aggregate Bond ETF

Last Week:

U.S. Equity Markets

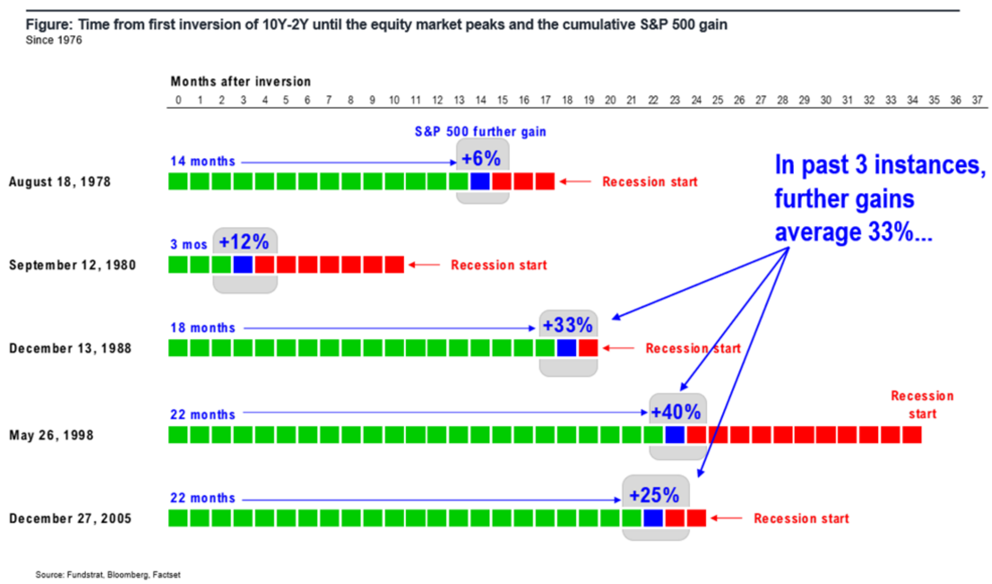
- U.S. large cap equities (S&P 500 Index) finished lower for a third straight week with a decline of -1.0% as growth and recession concerns increased with the 2-year Treasury yield briefly exceeding the 10-year Treasury yield (2-10 spread inverted), China July credit and activity data disappointed, tensions in Hong Kong increased, and German economic sentiment deteriorated sharply. The White House announced partial tariff relief for China; though there was skepticism the trade narrative has changed much at all, while more signs of consumer-driven U.S. economic resilience occurred.
  - Consumer staples (+1.6%), utilities (+0.5%), and REITs (+0.4%) outperformed as investors favored defensive sectors. Consumer staples benefitted from strength in Walmart earnings and select beverage and tobacco stocks
  - Information technology (-0.3%) outperformed with help from Apple (+2.7%) on reduced tariff concerns, and semiconductor stocks
  - Communication services (-1.0%) performed in-line as **Alphabet (-0.8%)** outperformed, while **CBS (-10.5%)** fell on the all-stock Viacom merger announcement
  - Healthcare (-1.1%) performed in-line with the broad market
  - Industrials (-1.6%) underperformed with weakness from General Electric (-3.9%) on accounting fraud accusations, as well as machinery, airlines and aerospace and defense
  - Consumer discretionary (-1.9%) underperformed with no meaningful tariff reprieve and soft earnings reports for retail and apparel (Macy's -17.8%)
  - Materials (-2.0%) underperformed on outsized weakness in most industrial metals and chemicals
  - Financials (-2.2%) underperformed as banks fell on interest rate concerns
  - Energy (-3.9%) underperformed despite the price of oil rising 0.8%

- As of Monday afternoon, the Dow Industrials had fallen in eight of 10 sessions, while Dow Transports had entered official "correction" territory (down 10%+ from previous highs). We noticed a lack of stock market tweets from the Tweeter in Chief over the same time period; coincidence?
- That streak was on the verge of becoming 9 out of 11 sessions, until President Trump indicated he is delaying the implementation of certain tariffs, "for the Christmas season, just in case some of the tariffs would have an impact on U.S. consumers." But wait – didn't President Trump previously indicate China was paying all of the tariffs, and not American consumers? Which is it?
- That trade tweet helped the markets for one day, before a sharp sell-off resumed Wednesday. The VIX volatility index jumped 26% on Wednesday alone. To say the sell-off was broad-based would be an understatement: All 11 sectors and 494 of the S&P 500 constituents had fallen in value for the day; of the six S&P stocks that had risen, only one (Newmont Goldcorp) was up more than 0.5%. The Dow's 800 point loss Wednesday was its worst of the year
- The 2 year/10-year yield curve officially inverted Wednesday for a few brief hours, marking the first time that's occurred in more than 12 years. The inversion caused the St. Louis Federal Reserve website tracking the spread between those two Treasury maturities to crash.



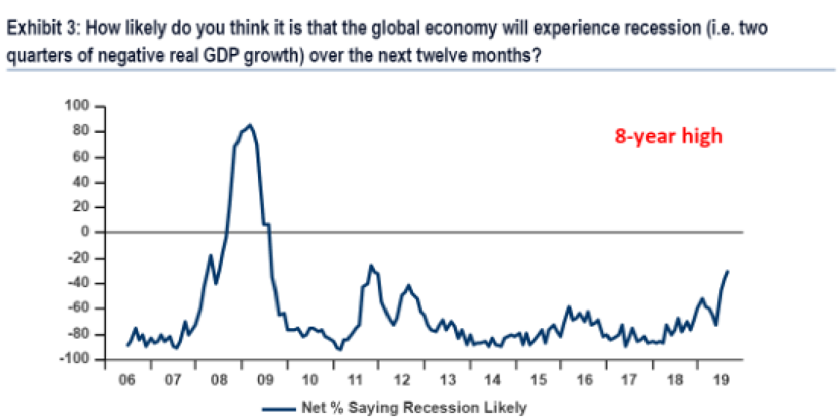
Source: Federal Reserve Bank of St. Louis

- In all five yield curve inversion occurrences since 1976, stocks went on to make fresh all-time highs after the inversion (See page 3). As shown by the St. Louis "FRED" chart, however, recessions did follow with a variable lag, within 7-24 months. Those are the conflicting *facts*. The open *question* is what may be "different this time," given so much involvement by the world's central bankers, and approximately $15 trillion in negative interest rates globally which are almost certainly distorting U.S. Treasury yields.



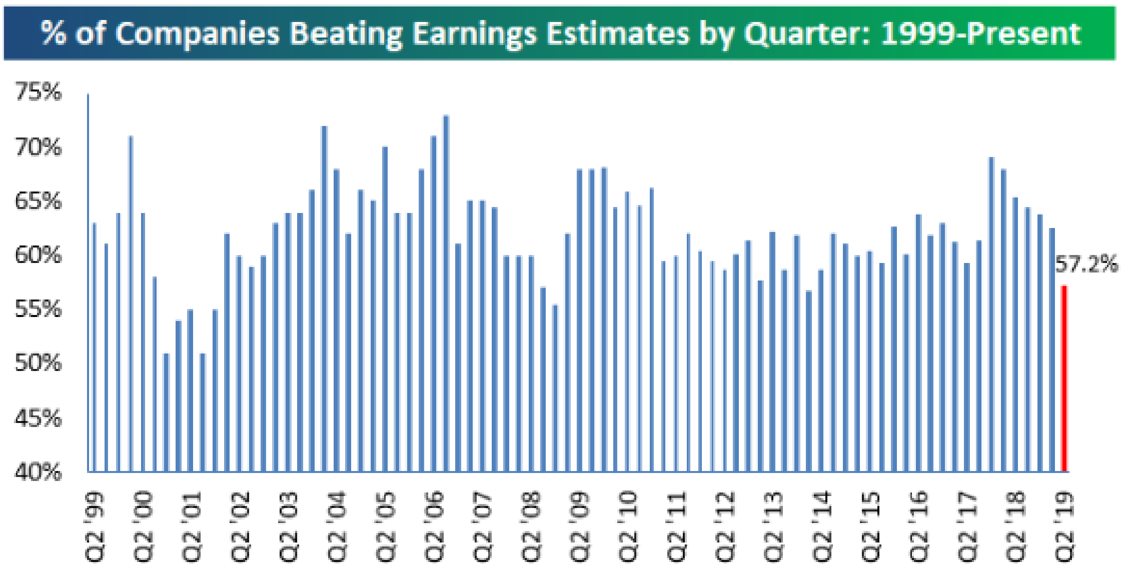
Source: Fundstrat

- Fed Funds Futures now predict a 100% probability of another interest rate cut at the Fed's September 18 meeting, and a 19% chance of a 50 basis point cut at that meeting
  - Fed Governor James Bullard said that the Federal Reserve doesn't need to take interest rate action between scheduled meetings, dashing any hopes that the Fed may rush to the stock market's rescue in the near term
- Mexico's central bank cut its benchmark interest rate 25 basis points to 8.0%, a remarkably high yield in a world that's awash in negative yields
- Japan overtook China as the largest owner of U.S. Treasury debt
- According to a Merrill Lynch survey conducted a week ago, roughly 64% of institutional investors anticipate the global economy will avoid a recession during the next year, while 34% are less sanguine (marking an eight year high); we can't account for the missing 2%! Surveyed investors were also the most bullish on bonds since November 2008, while also acknowledging U.S. Treasuries represent "the most crowded trade"



Source: BofA Merrill Lynch Global Fund Manager Survey

- While earnings season generally was considered a success, insofar as many companies exceeded expectations, the percentage that did so this past quarter was markedly lower than the prior seven quarters



Source: Bespoke

U.S. Economic and Political News

- The Philadelphia Fed index shot up to 16.8 in August, well above the 10.0 consensus forecast
- The Empire State index rose to 4.8 in August, above the 1.1 expectation
- July Retail Sales jumped 0.7%, well above the 0.3% consensus estimate
- Industrial Production dipped -0.2% in July, missing the +0.2% consensus forecast
- Weekly Jobless Claims printed 220,000
- Housing Starts came in at 1.191 million annualized units, missing the 1.259 million consensus estimate, while Building Permits of 1.336 million topped the 1.27 million forecast
- The University of Michigan's Consumer Sentiment index fell to 92.1 in August, well shy of the 97.4 consensus estimate
- ISM Manufacturing printed 51.2 in July
- Former Georgia politician Stacey Abrams announced she is NOT running for the presidency, apparently making her one of the only Democrats who isn't! But, she said she is open to the vice presidential spot for any Democratic nominee
- Meanwhile, former Colorado Governor John Hickenlooper dropped out of the Democratic race for the presidency

International Markets and News

- European equities (STOXX Europe 600) fell -0.5% as the U.S. yield curve inversion concerns, global recession fears, weak German GDP data, and political risk weighed on equity markets. Recession concerns also increased expectations the European Central Bank (ECB) would provide a greater stimulus package next month.
  - German Q2 GDP growth contracted -0.1% for the first time since Q3'2018 as activity has been undermined by ongoing weakness in manufacturing, trade tensions and Brexit uncertainty
  - Futures markets are pricing in a 10bps interest rate cut for the ECB to -0.50% next month, but weakening economic data and recent commentary from the ECB's Rehn saying that it is better to exceed investor's expectations suggests that the ECB may improve the terms of banks loans, change QE rules to give space for more purchases and Rehn did not rule out equity purchases
- Chinese markets (Shanghai Composite Index) rose 1.8% as Beijing pledged to roll out measures to boost disposable incomes for the next two years to offset the slowing economy
  - Beijing's consumption increase plan helped to offset rising concerns regarding the U.S.-China trade tensions as July industrial output and retail sales rose less than forecast, with industrial output recording its weakest monthly growth since 2002
  - Chinese officials are sticking to their plan to visit Washington for face-to-face meetings in September, though they are not optimistic of any imminent progress, according to Bloomberg
- Japanese equities (Nikkei 225 Index) fell -1.3% as global equities fell, and Japan's 10-year bond yield dropped further out of the central bank's targeted range of plus or minus 0.20% at -0.23%
  - FT.com reported that Japanese holdings of U.S. Treasuries (16.9% of outstanding Treasuries) at the end of June exceeded China's holdings, making Japan the largest holder of U.S. government bonds

Commodities

- The price of gold rose 1.0% for the week
- The price of crude oil increased 0.8%, and oil remains up 20.9% in 2019 after collapsing in the 2nd half of 2018

<u>This Week:</u>

- This week will see several retail earnings reports, but fewer reports from other industries. Notable releases include, but are not limited to: Kohl's, TJX Companies, Target, L Brands, Gap, **Medtronic**, **Lowe's**, and **Home Depot**
- The macro-economic calendar will be focused on the FOMC meeting minutes out on Wednesday, U.S. PMIs on Thursday, and the Kansas City Fed Symposium starting Thursday through Saturday in Jackson, WY with Chairman Powell set to speak on Friday morning
- U.S. economic data:
    - Monday: Commerce Department's decision on Huawei waivers (decision expected by Monday 19-Aug)
    - Tuesday: Retail Economist/Goldman Chain Store, Redbook Chain Store, API Crude Inventories, Fed speakers: Quarles (6PM E)
    - Wednesday: FOMC minutes and policy decision (2PM ET), MBA Mortgage Purchase Applications, Existing Home Sales, DOE Crude Inventories
    - Thursday: Initial Jobless Claims, Continuing Claims, Flash Manufacturing PMI, Flash Services PMI, Leading Indicators, EIA Natural Gas Inventories
    - Friday: Jackson Hole, WY speakers, Powell set to speak at 10AM ET, New Home Sales

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