WEEKLY MARKET COMMENTARY

THE WEEK IN REVIEW: August 4 - 10

A long time ago, in a galaxy far, far away ... Trade Wars!
In the continuing trade war saga, last week China devalued its currency and sent global markets sharply downward. Things werent much better stateside: Monday was easily the worst day of the year for U.S. equity markets. The Dow was down over 700 points and things looked pretty grim. The U.S. Treasury formally labeled China a currency manipulator.

News flash: China *does* manipulate its currency and has been doing so for a long time. Currency manipulation has enabled China to engage in unfair trade practices and helped it to become the worlds second-largest economy by undercutting prices paid by consumers and draining manufacturing jobs from developed economies. It also steals intellectual property; development costs can be significant inputs in the costs of goods, and by stealing the formula, it can price products much more cheaply, further undercutting developed economies. Finally, firms that move operations to China are greeted by a totalitarian government that makes them partner with state-sponsored (if not outright state-owned) subpar companies. Then it forces the companies to transfer know-how and technology to the state, once more circumventing the research and development cycle and making Chinese products more competitive than those of the rest of the developed world.

Heres one of those if a tree falls in the forest thoughts: When a country devalues (manipulates) its currency and then says its not a currency manipulator, what do you believe? The action or the rhetoric?

This is not a trade negotiation, its a relationship reset. For decades, China has said one thing in public and continued on its own path. Former President George W. Bush chose to ignore what was happening; he had a brief run-in with China very early in his administration when China seized a U.S. military aircraft it said was violating its airspace before President Bush was consumed by 9/11 and the war on terror. Similarly, former President Barack Obama allowed China to walk all over us when he did nothing to rein it in and actually pursued more accommodative policies such as the Trans-Pacific Partnership.

Enter President Donald J. Trump, who called China and its trade practices out for what they really are. Now here we are, with a trade war with no end in sight and a skittish market that reacts breathlessly to every twist and turn in the trade war saga.

Following Mondays drop, markets bounced back on Tuesday as China stabilized the yuan. Wednesday greeted us with our other primary worry this year: interest rates. Markets opened sharply lower on Wednesday, with the 10-year U.S. Treasury plummeting as other countries lowered rates overnight. Other contributors included fears of a broad global economic slowdown and worries that the Fed would be able to act in a significant enough manner in response to a global slowdown. Yields rebounded as bargain hunters began snapping up equities. The Dow recouped over 500 points to end virtually flat, while the S&P 500 managed a slight gain after erasing steep early losses.

The markets continued their comeback on Thursday, after China set the value of the yuan higher than analysis expected in a sign that tensions between China and the U.S. wont spiral into a currency war. In response, the Dow bounced up 371 points.

Friday was fairly quiet, as the market seemed exhausted after its previous four days of intense volatility. It drifted downward as President Trump said there was no imminent deal to be had with China. He also resumed his attacks on the Fed by saying short-term rates should come down by another 100 basis points.

Heres my take: None of this information is new. We have been bickering with China for nearly two years, there is growing evidence that the economy is slowing and President Trump is going to say whatever he wants to say. In some respects, unlike the crisis at the border, the China problem is manufactured. Our politicians are adept at kicking the can down the road and leaving it for someone else to deal with. They do it with the budget, health care, social issues, etc. -- why stop now with China?

There is some political genius here. President Trump says hes standing up for U.S. manufacturing and agricultural jobs (his base of support), and thats a good thing. He will get a deal with China, mark my words. The deal will either be real and a true game-changer with our relationship with China (which will be correctly hyped by Trump as the best deal ever which has never been done before), or we will revert to where we were before the trade spat began (which Trump will also call the best deal ever which has never been done before). Either way, markets will bounce back and yields will return to normal levels. The genius here is that President Trump can drag this out until year-end and do the deal early next year, just as the election cycle reaches a fever pitch. I dont want to sound like a conspiracist, but it has become fairly obvious where this thing is going.

Adding to the political genius, consider President Trumps master of the Fed. How else do you describe the turnaround from this time last year? We have to be careful here as we watch the two-year and 10-year U.S. Treasuries get close to inverting. The inversion of these two yield curves has predicted every recession for the past four years.

Fed Fund Futures point to a 100% chance of a 25 basis points cut in September, as well as total cuts of 1.00% by next March. If Federal Reserve Chairman Jerome Powell digs in and doesnt lower rates as the markets expect and we drift into recession, no amount of China deal hype will help President Trumps reelection bid.

Coming This Week

- Its mid-August, which means people are winding down their summer vacations and getting kids ready for school. There is very little data this week, so I am boldly going to predict that this week the markets will take their cues from -- wait for it -- China, Trump and the Fed. We are almost done with the latest earnings season; overall earnings were lackluster, which falls in line with a slowing economy.
- Retail sales and industrial productions data will be released on Thursday. Reports about housing starts and consumer sentiment scheduled for Friday will give us a look at just how much the economy may be slowing.

Have a great week!

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Index Performance Returns %					
	1 WK	YTD	1YR	3 YRS	5YRS
S&P 500	-0.47%	18.61%	4.93%	12.69%	11.01%
S&P MidCap 400	-0.40%	16.89%	-2.58%	8.95%	8.62%
Russell 2000	-1.17%	14.52%	-7.88%	9.05%	7.73%
NASDAQ	-0.89%	21.16%	1.91%	15.53%	12.96%
MSCI ACWI	-1.52%	12.51%	-1.83%	7.14%	4.22%
MSCI EAFE	-2.43%	9.69%	-4.41%	6.22%	2.52%

Source: Morningstar

Interest Rates:		
	8/9/2019	8/2/2019
UST 10-YR Government Bond Yield	1.74%	1.86%
German 10 YR	-0.58%	-0.49%
Japan 10 YR	-0.22%	-0.16%
30 YR Mortgage	3.81%	3.88%
Oil	$54.50/ppb	$55.24/ppb
Regular Gas	$2.77/ppg	$2.80/ppg

Source: Bloomberg

All data as of August 9, 2019

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