Markets Struggle Among Geopolitical Tensions

The trade war continued in its back-and-forth fashion this month, and Washington Policy Analyst Ed Mills expects the escalation to extend volatility through the 2020 election. With an increase to 30% tariffs on $250 billion of Chinese goods slated for October 1, there is mounting urgency surrounding the next round of negotiations. Chief Economist Scott Brown notes that tariffs raise costs for U.S. consumers and businesses, invite retaliation against U.S. exports, disrupt supply chains and undermine business investment.

Lower short-term interest rates and an increasingly inverted yield curve have caught the attention of market observers. The Federal Reserve (Fed) lowered short-term interest rates by 25 basis points on July 31, and the central bank is expected to lower them further at the September policy meeting in light of continued trade and geopolitical tensions.

The S&P 500 was down by 1.81% this month and saw its second 5% pullback of the year. The month also ended negatively for the Dow Jones Industrial Average (-1.72%), NASDAQ (-2.60%) and the Russell 2000 Index (-5.07%).

	12/31/18 Close	8/30/19 Close	Change Year to Date	% Gain/Loss Year to Date
DJIA	23,327.46	26,403.28	+3,075.82	+13.19%
NASDAQ	6,635.28	7,962.88	+1,327.6	+20.01%
S&P 500	2,506.85	2,926.46	+419.61	+16.74%
MSCI EAFE	1,719.94	1,831.36	+111.42	+6.48%
Russell 2000	1,348.56	1,494.84	+146.28	+10.85%
Bloomberg Barclays Aggregate Bond	2,046.60	2,230.85	+184.25	+9.0%

Performance reflects price returns as of 4:00 p.m. ET on August 30, 2019

Here is a look at what's happening in the markets both here and abroad, as well as key factors we are watching:

Economy

- U.S. economic data have been mixed in recent weeks, says Brown, reflecting continued strength in consumer spending and weakness in manufacturing. The

latest increase in tariffs is expected to have a further dampening impact on U.S. growth into 2020.
- Consumer spending should support overall growth in the remainder of the year, but the risks remain weighted to the downside, reflecting geopolitical concerns and trade policy.

Equities

- Raymond James Chief Investment Officer Larry Adam reports that this August saw higher-than-normal volatility, thanks to continuing trade tensions and concerns around the yield curve. Because of these factors, defensive assets outperformed while more risky assets declined.
- Michael Gibbs, managing director of Equity Portfolio & Technical Strategy, and Joey Madere, senior portfolio strategist, Equity Portfolio & Technical Strategy, believe that the market is in a normal back and forth pattern right now.
- Second quarter earnings results were generally better than expected, but guidance was relatively soft. S&P 500 companies that earn more than 50% of revenues from the U.S. continued to exhibit better fundamentals. Looking ahead, S&P 500 third quarter sales estimates have held steady, but earnings estimates have moved lower as tariff impacts continue to cut into margin assumptions.
- Senior Vice President of Equity Research Pavel Molchanov and his team are watching the energy and environmental policies of the Democratic presidential candidates, and have found that most of those proposed would require congressional approval, making Senate control a key issue.

Fixed income

- The 30-year Treasury yield fell to a record low and the 10-year Treasury yield reached its lowest level since 2016, leading equity defensive sectors that are more sensitive to interest rates, such as Utilities, Real Estate and Consumer Staples, to rally. Gold was another story as the decline in sovereign bond yields and rising expectations for future Federal Reserve rate cuts pushed the precious metal to its highest level since 2014.
- Doug Drabik, managing director for fixed income research, notes that the fall in long-term yields has contributed to further inversions of the yield curve. The spreads between the 2-year/10-year and 30-year/3-month Treasuries inverted at the end of August, while the 3-month/10-year spread has remained inverted for approximately three months. Each of these measures is widely regarded as an early indicator of a looming recession.
- Given that the U.S. remains one of the few developed markets where interest rates are positive (global negative yielding debt recently topped $16.8 trillion), U.S. yields will remain under pressure from foreign demand. Additionally, given that positive U.S. interest rates have driven a continued appreciation of the U.S. dollar (which erodes corporate profits abroad and makes dollar-denominated debts more costly to service for foreign borrowers), the Federal Reserve remains

under pressure to cut interest rates at its September meeting in an attempt to continue the U.S. economic expansion.

International

- The United Kingdom – and Parliament – remains split on Brexit, says European Strategist Chris Bailey. He thinks a soft compromise is the obvious solution, especially if assisted by some slight shifts from the European Union. However, this still leaves the day-to-day trade and diplomatic interactions between the UK and the European Union to be worked out, along with longer-term efforts and policies to boost pan-European economic growth levels.

Bottom line

- As trade negotiations and global affairs progress, we'll be keeping an eye out for movements that might particularly affect investors and their financial plans.
- The S&P 500 has buoyed in recent days, but until a decisive breakout occurs, Gibbs and Madere recommend patience with wide-scale purchases. They feel there are opportunities to be selective and accumulate individual stocks with partial positions during the market's current consolidation phase.

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