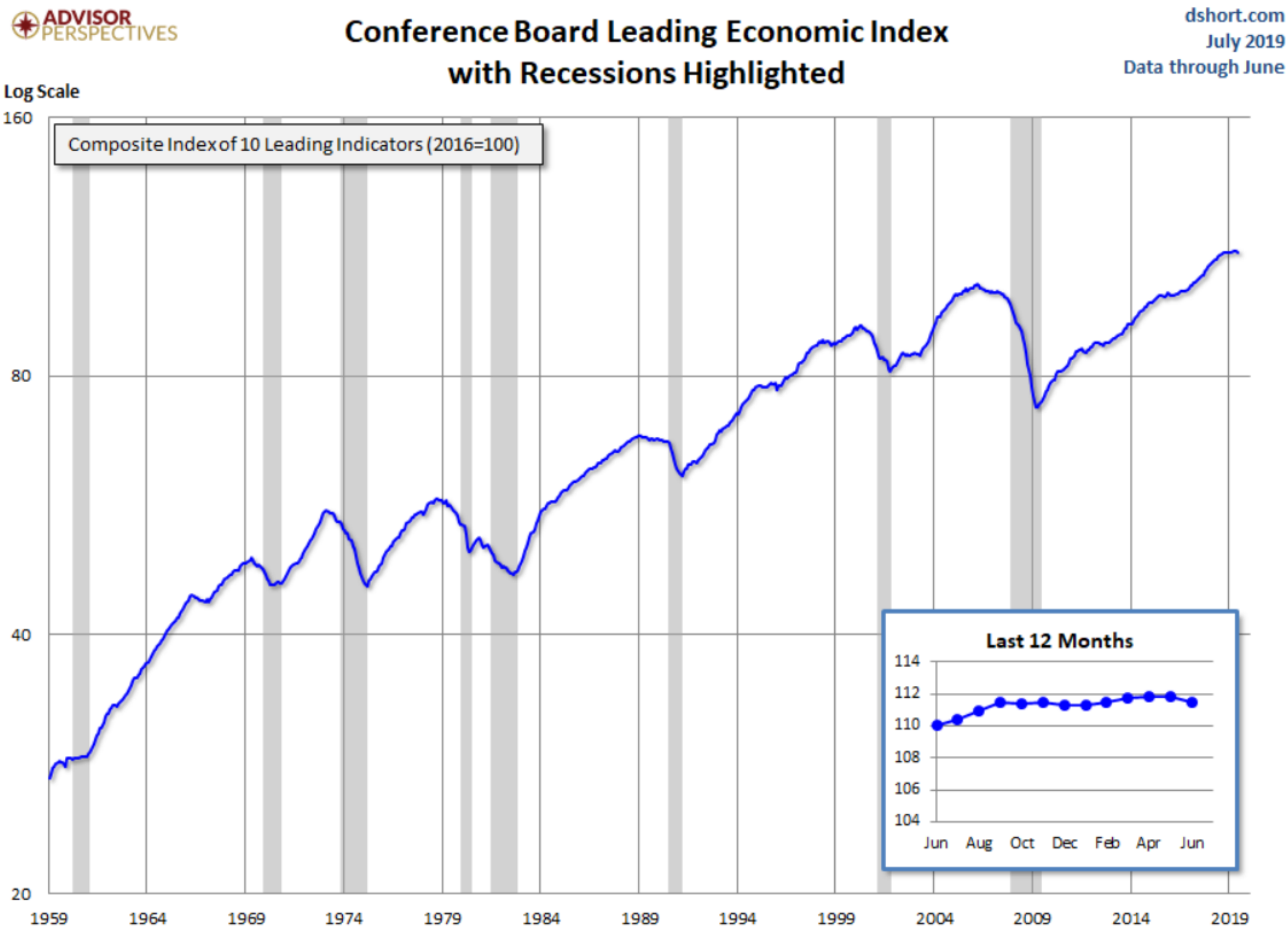
Market Recap

		Weekly Chg*	YTD Chg*
S&P 500	2,977	-1.2%	+18.7%
Russell 2000	1,548	-1.5%	+14.8%
EAFE	65.52	-0.4%	+11.5%
EM Equity	42.86	+0.1%	+9.7%
Global Stocks	75.71	-0.8%	+15.7%
Commodities	22.27	-2.3%	+5.0%
Gold	1,427	+0.7%	+10.9%
Euro	1.122	-0.5%	-2.5%
Yen	107.707	+0.1%	+1.4%
	Close	Last Week	12/31/18
Fed Funds	2.25%-2.50%	2.25%-2.50%	2.25%-2.50%
2-Year	1.81%	1.84%	2.49%
10-Year	2.05%	2.11%	2.69%
10-2 Yield Curve	24bps	27bps	20bps
German 10-Year	-0.32%	-0.21%	0.24%
Crude Oil	$56.16	$60.24	$45.84

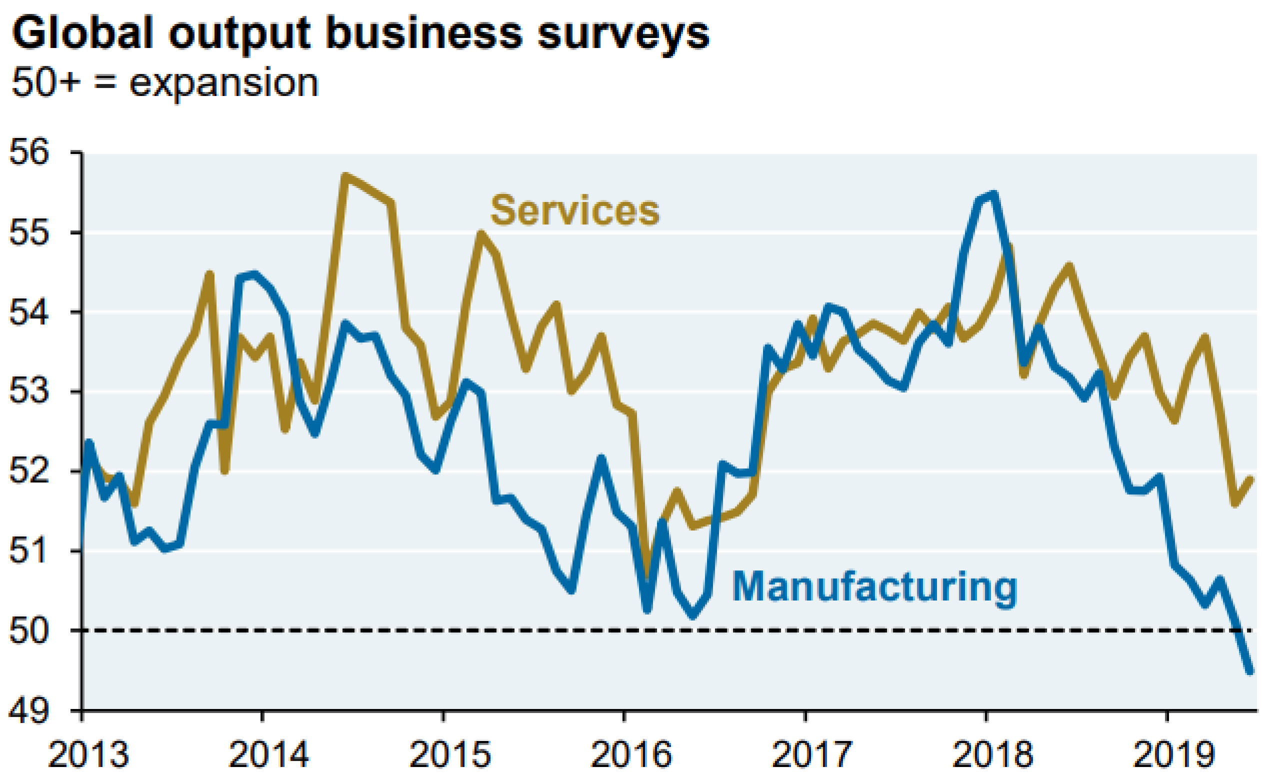
As of 7/19/19

Manufacturing Drags on Global Growth

Things were pretty quiet on the economic news front. One of the notable reports during the week was the Conference Board’s leading economic indicator (LEI). Adding to the view that second quarter growth will be soft, the LEI for June fell for the first time this year, pulled down by weak building permits, ISM numbers, and initial claims for unemployment insurance. The decline was small (you have to squint at the chart below to see it), but it supports the notion that second quarter GDP growth will fall in the mid-1% range.

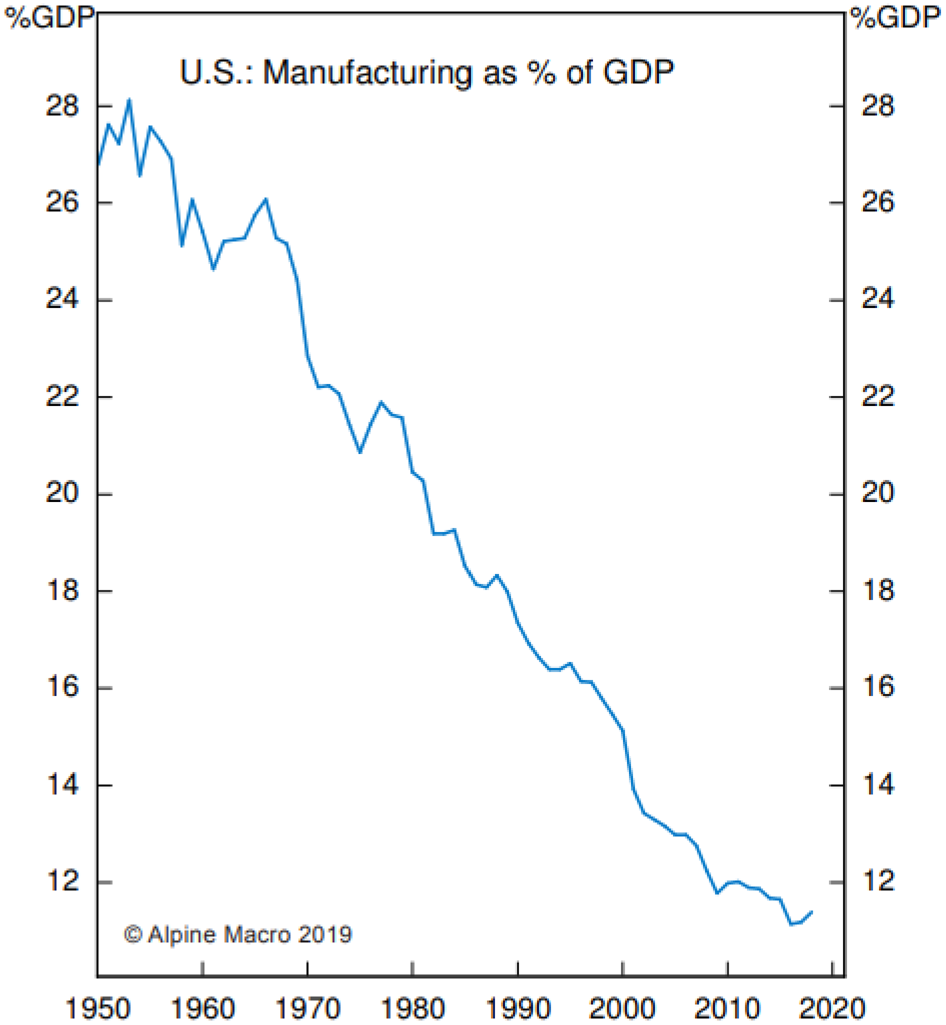


As we have talked about over the last few weeks, manufacturing in particular is a problem. Global manufacturing activity is now contracting (anything below 50 in the chart below).

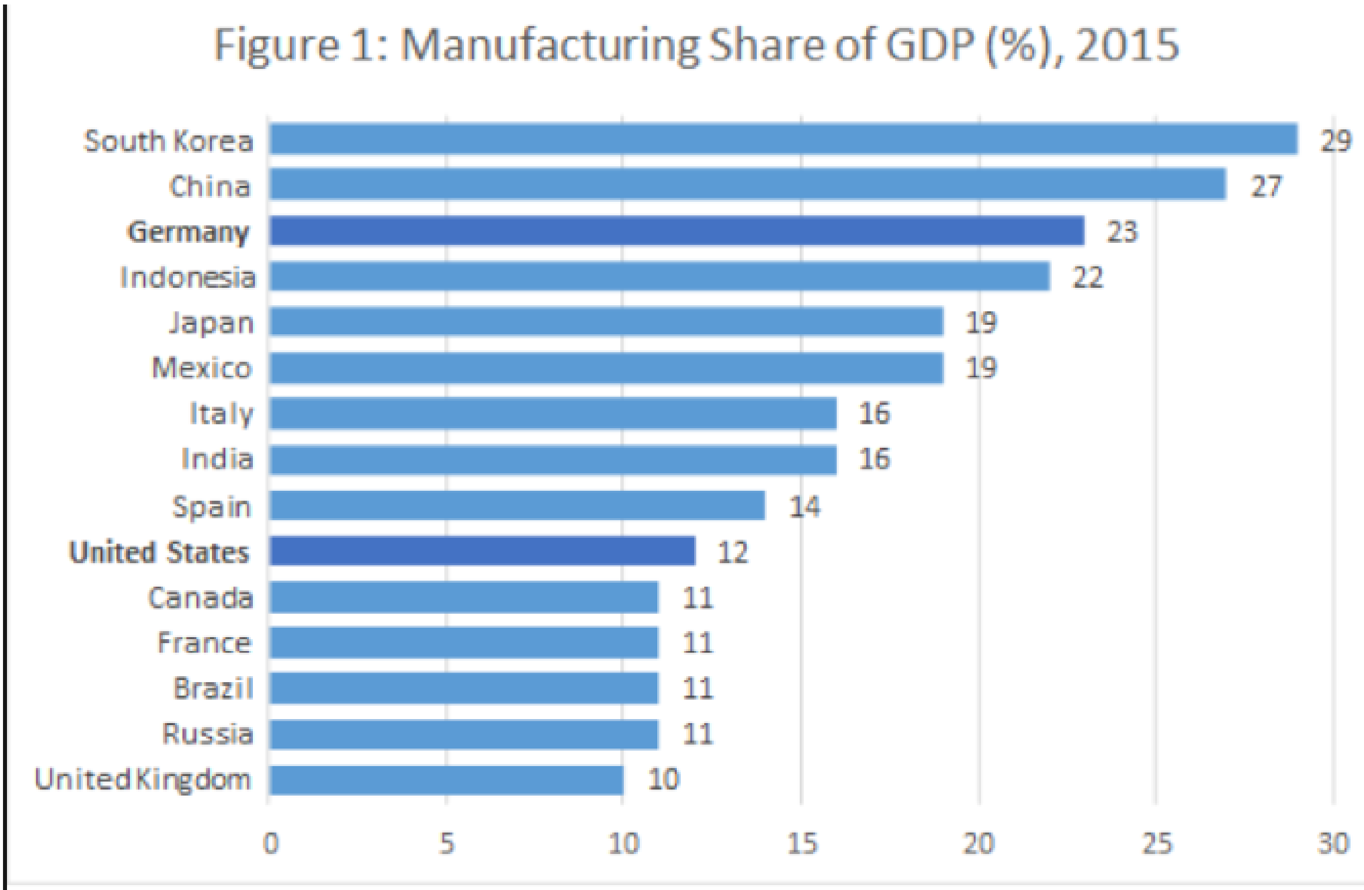


Source: Markit PMI. June 2019.

How big of a deal is this? Well it depends where you are. In the U.S. manufacturing has become much less important for the economy – down from about a quarter of GDP back in the 60’s to just 12% today.



However, other countries are much more exposed to a manufacturing downturn, as you can see below. South Korea, China, Germany, and Indonesia are particularly exposed.



Source: Congressional Research Service,

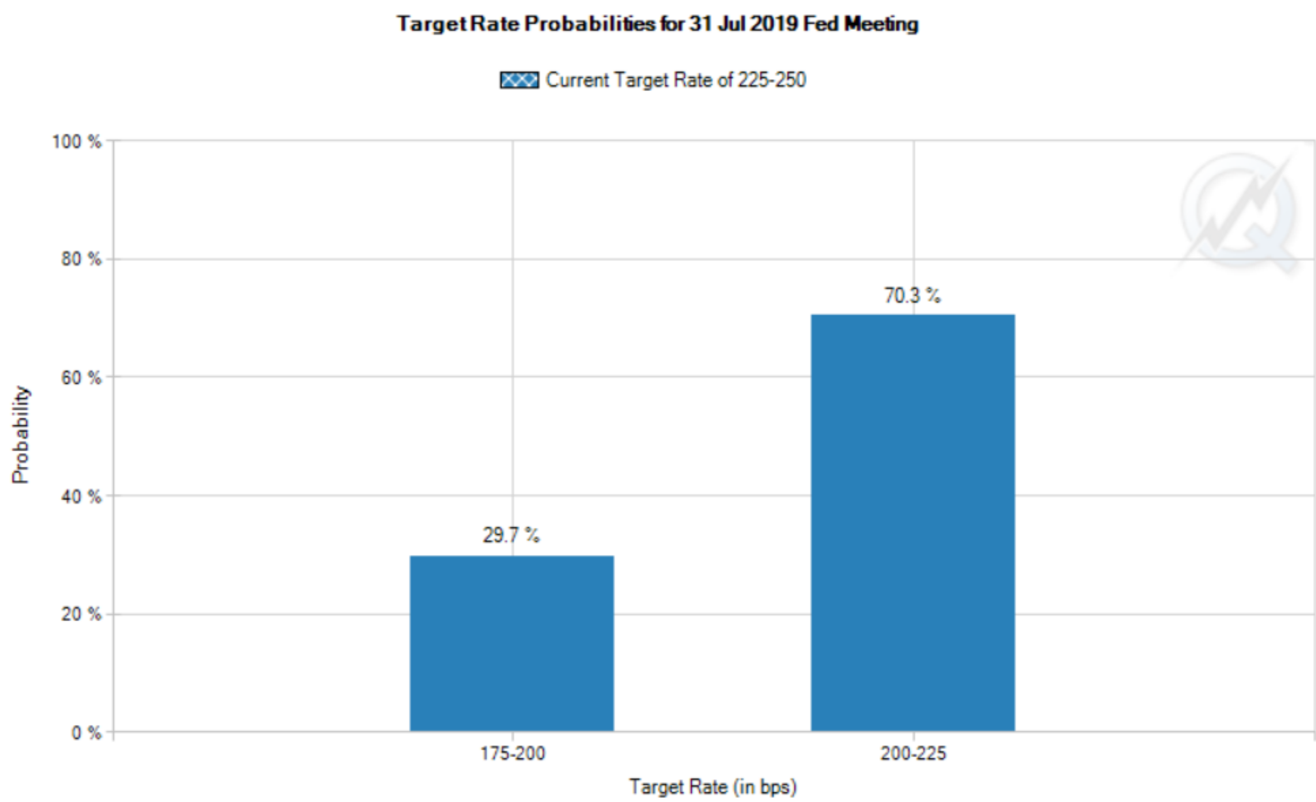
But even in the worst case, services still make up 71% of the South Korean economy. This is an important counterbalance. As we have talked about over the last few weeks, while global recession risks are low, heightened uncertainty is leading policy makers to respond. We agree with Michael Cembalest at J.P. Morgan:

> *"I don't think we're headed into a global or US recession given the resilience of the service sector in most countries, and the fact that 20 developed and emerging market central banks are expected to ease this year."*

The Fed Flip Flops on its Message

The next Fed meeting concludes July 31st. There is little doubt we see an interest rate cut – only the magnitude is being debated. On this score there was something of a whipsaw this week.

The general consensus as the week began was that the Fed would cut by quarter point, or 25bps, in twelve days. Markets were certainly priced for this, with the odds of a 25bps cut running at over 70% Wednesday afternoon.



However, on Thursday, John Williams, the president of the Federal Reserve Bank of New York, stoked expectations of an aggressive 50bps cut. During a formal speech Williams laid out the case for early monetary easing in a low interest rate environment, likening it to a vaccination for children against illness down the road. “It’s better to deal with the short-term pain of a shot than to take the risk that they’ll contract a disease later on,” he said.

The same day the Fed’s Vice Chairman Richard Clarida shared these nuggets:

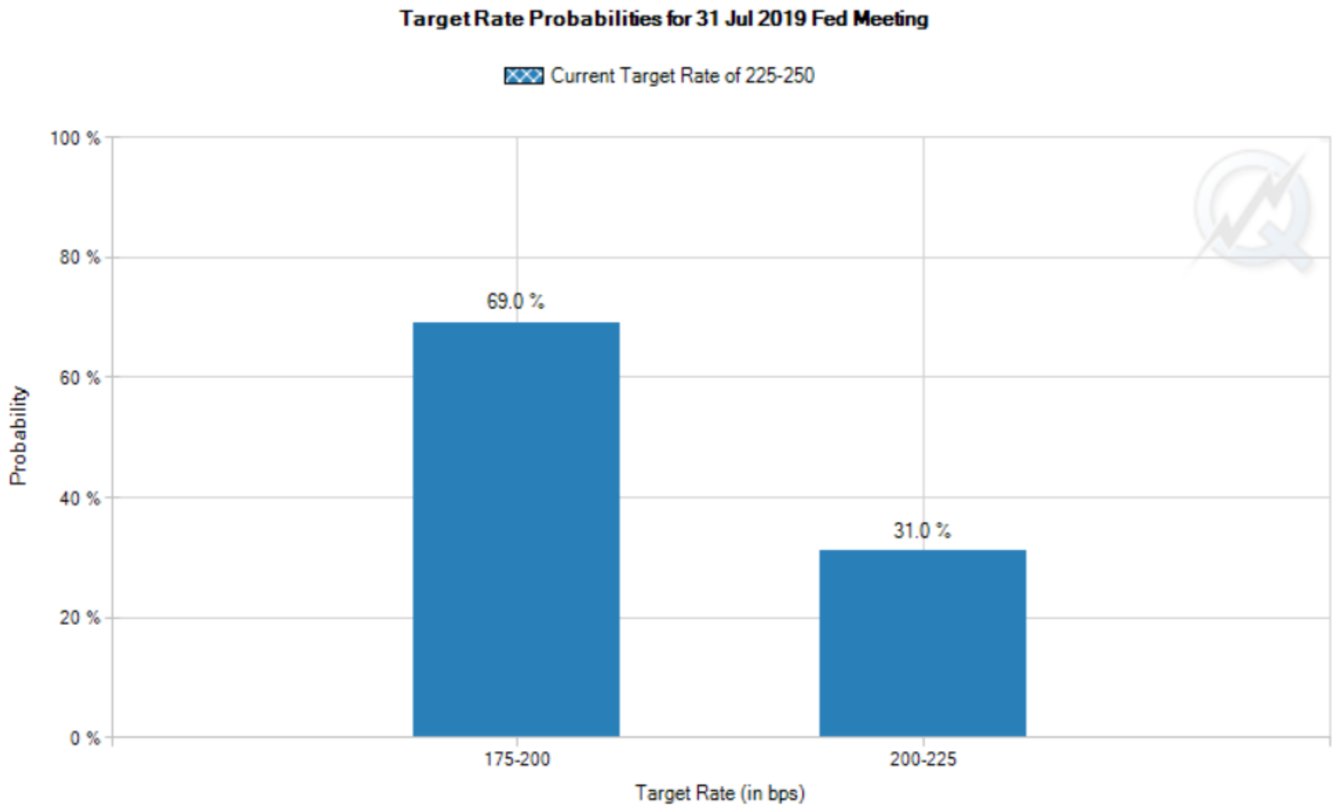
• He said policy makers shouldn’t wait until the economy has obviously stumbled before cutting interest rates in an effort to “keep the economy on an even keel.”

• While the U.S. economy is “in a good place,” he said recent global economic data have been softer than expected.

• “We’ve had mixed data, but I do think the global data has been disappointing on the downside… Disinflationary pressures, if anything, are more intense than I thought six weeks ago.”

In essence their argument is that inflation is consistently undershooting the targets around the world. Core inflation in the U.S. has underwhelmed ever since the financial crisis. In the Williams and Clarida argument, at least they know how to deal with inflation if it ever perks up. They are scared they don’t know how to tackle deflation.

In short order the market flipped, and by Thursday’s close investors placed almost a 70% chance of a half-point cut in a few days.



Yea, this is pretty nuts. Markets, like humans, are fickle creatures.

Then the Fed walked things back. On Friday we got an unusual clarification from Williams that his comments were “not about potential policy actions at the upcoming FOMC meeting.”

Really? Oh, come on now. He’s speaking shortly before one of the bigger Fed meetings in twelve months and he thought his comments would simply be taken as academic naval-gazing? He knows better than that.

Of course, all this invited comments from the President:

“I like New York Fed President John Williams first statement much better than his second…”

I’m willing to bet the Fed has no clue what they will do in twelve days. They will all gather in a room. Order lunch. Then play rock paper scissors to see what happens.

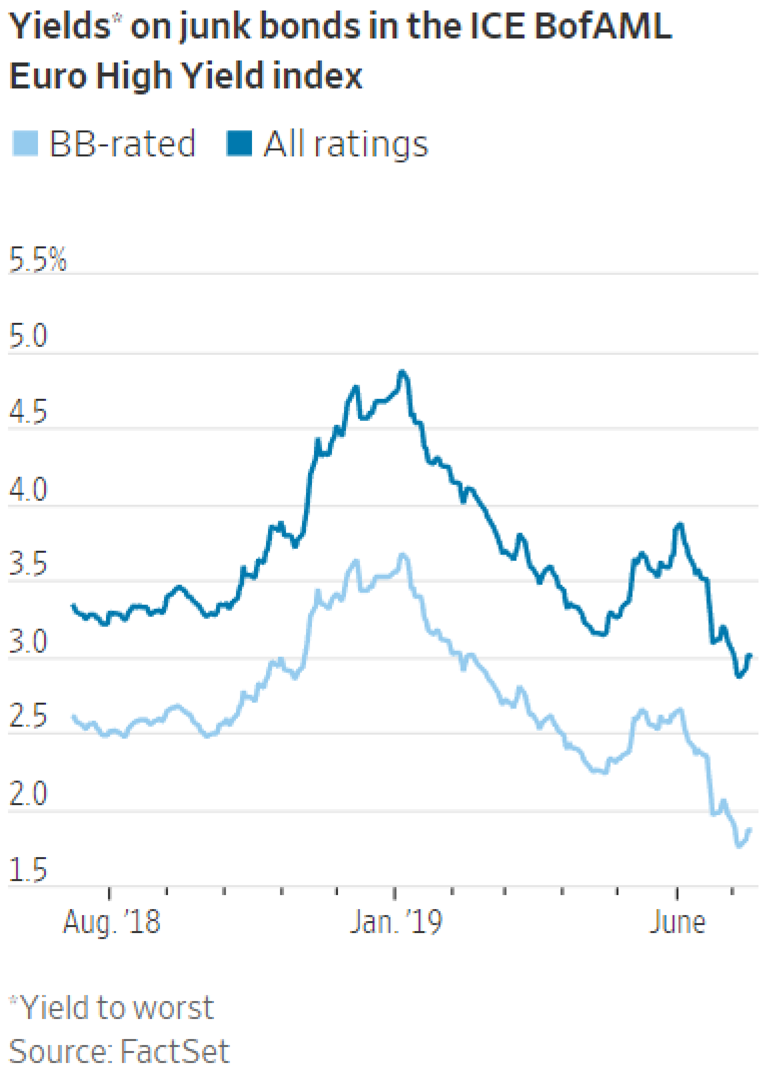
The Fed Flip Will Be Late to the Game

Regardless of the Fed’s messaging problem, more and more global central banks are starting to cut rates. The table below shows which banks have either cut or raised rates in recent months. The ‘last move’ column has a lot of green!!

@CharlieBilello	Global Central Bank Policy Rates					
Country	Rate	Central Bank Rate (Today)	CPI YoY	Real Central Bank Rate	Last Move	Last Move Date
Switzerland	Target Rate	-0.75%	0.6%	-1.4%	Cut	Jan-15
Eurozone	Deposit Rate	-0.40%	1.2%	-1.6%	Cut	Mar-16
Sweden	Repo Rate	-0.25%	1.8%	-2.1%	Hike	Dec-18
Japan	Policy Rate Bal	-0.10%	0.7%	-0.8%	Cut	Jan-16
Denmark	Discount Rate	0.00%	0.6%	-0.6%	Cut	Jan-15
UK	Bank Rate	0.75%	2.0%	-1.3%	Hike	Aug-18
Australia	Cash Rate	1.00%	1.3%	-0.3%	Cut	Jul-19
Norway	Deposit Rate	1.25%	1.9%	-0.7%	Hike	Jun-19
New Zealand	Cash Rate	1.50%	1.7%	-0.2%	Cut	May-19
Poland	Repo Rate	1.50%	2.6%	-1.1%	Cut	Oct-14
Taiwan	Discount Rate	1.50%	0.9%	0.6%	Cut	Mar-16
South Korea	Repo Rate	1.50%	0.7%	0.8%	Cut	Jul-19
Canada	Overnight	1.75%	2.0%	-0.3%	Hike	Oct-18
Czech Republic	Repo Rate	2.00%	2.7%	-0.7%	Hike	May-19
US	Fed Funds	2.38%	1.6%	0.8%	Hike	Dec-18
Chile	Base Rate	2.50%	2.8%	-0.3%	Cut	Jun-19
Hong Kong	Base Rate	2.75%	2.8%	-0.1%	Hike	Dec-18
Peru	Policy Rate	2.75%	2.3%	0.5%	Cut	Mar-18
Malaysia	Policy Rate	3.00%	0.2%	2.8%	Cut	May-19
Saudi Arabia	Reverse Repo	3.00%	-1.5%	4.5%	Hike	Dec-18
Colombia	Repo Rate	4.25%	3.4%	0.8%	Cut	Apr-18
China	Lending Rate	4.35%	2.7%	1.7%	Cut	Oct-15
Philippines	Key Policy Rate	4.50%	2.7%	1.8%	Cut	May-19
India	Repo Rate	5.75%	3.2%	2.6%	Cut	Jun-19
Indonesia	Repo Rate	5.75%	3.3%	2.5%	Cut	Jul-19
Brazil	Target Rate	6.50%	3.4%	3.1%	Cut	Mar-18
South Africa	Repo Rate	6.50%	4.5%	2.0%	Cut	Jul-19
Russia	Key Policy Rate	7.50%	4.7%	2.8%	Cut	Jun-19
Mexico	Overnight Rate	8.25%	4.0%	4.3%	Hike	Dec-18
Turkey	Repo Rate	24.00%	15.7%	8.3%	Hike	Sep-18
Argentina	Benchmark Rate	58.80%	55.8%	3.0%	Cut	Jul-19

Just this month Australia, Argentina, South Africa, Indonesia, and South Korea have cut. The ECB will probably join the Fed at the end of the month.

And this is just exacerbating the chase for yield. For example, in Europe investors are flocking into corporate debt, driving yields lower. About a third of the investment grade corporate bond market has negative yields today. However, you are starting to see such things creep into the riskier segments of the market. For example, high-yield spreads (the compensation for owning the riskiest corporate bonds) ranged between 2% and 3% over comparable government yields, as you can see below.



But shockingly, fourteen companies in Europe rated BB or less are sporting negative yields. They include telecom giant Altice Europe NV and Nokia. At the moment roughly 2% of Europe's high yield market trades below a 0% yield. This is nuts!!

It's tough being a creditor in today's market. If you believe Ray Dalio, [it's going to get worse](#).

Have a good weekend.

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