Market Recap

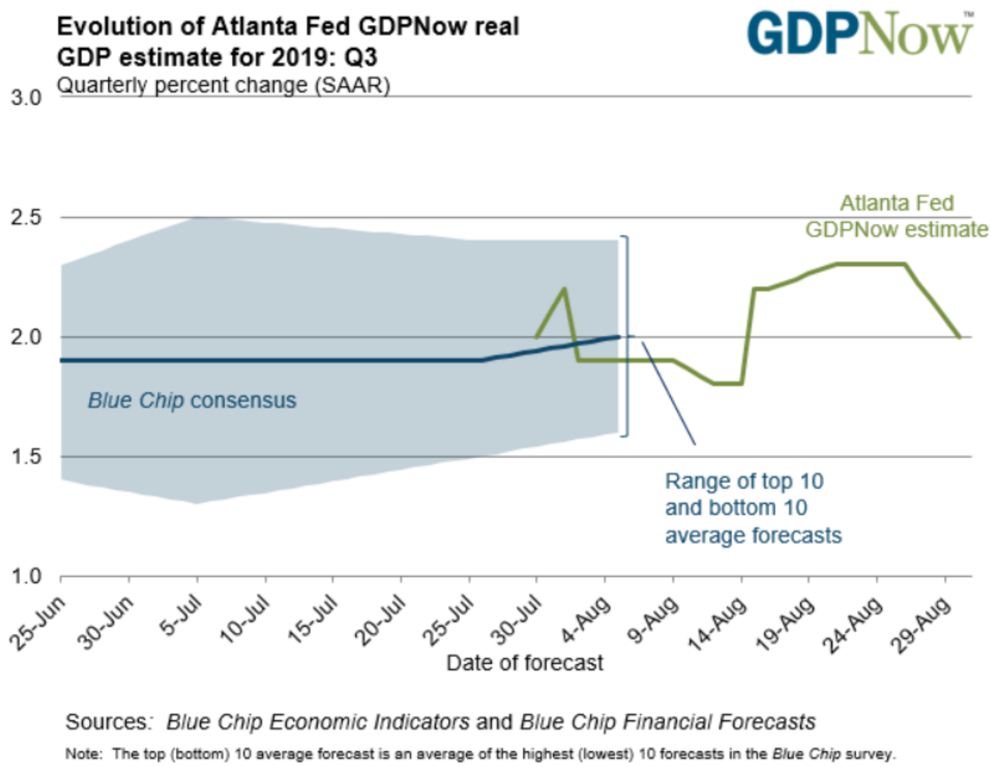
		Weekly Chg*	YTD Chg*
S&P 500	2,926	+2.8%	+16.7%
Russell 2000	1,493	+2.3%	+10.7%
EAFE	63.24	+2.1%	+7.6%
EM Equity	40.16	+2.8%	+2.8%
Global Stocks	73.57	+2.5%	+12.4%
Commodities	21.49	+1.7%	+1.3%
Gold	1,532	-0.3%	+18.6%
Euro	1.099	-1.4%	-4.6%
Yen	106.23	-0.9%	+2.8%
Pound	1.217	-0.9%	-4.6%
	Close	Last Week	12/31/18
Fed Funds	2.00%-2.25%	2.00%-2.25%	2.25%-2.50%
2-Year	1.50%	1.52%	2.49%
10-Year	1.50%	1.53%	2.69%
10-2 Yield Curve	0.00bps	0.01bps	20bps
German 10-Year	-0.70%	-0.68%	0.24%
Crude Oil	$55.08	$53.88	$45.84

As of 8/30/19

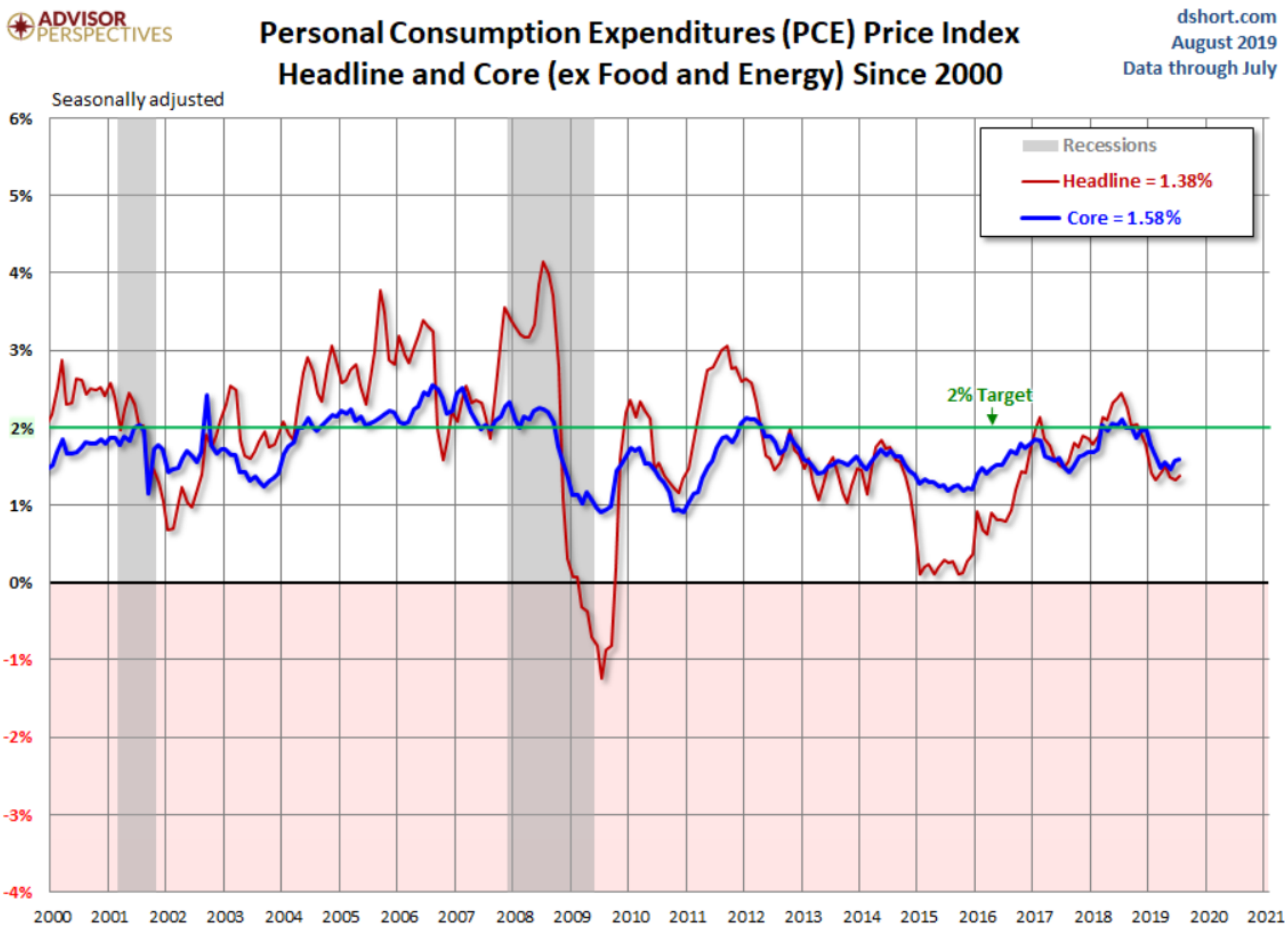
Week in Review

This was a much quieter week compared to last week. The equity indexes bounced around and bond yields continued to drift lower globally, but the palpable sense of anxiety from last week didn't carry over. Whether the hints of calm on the trade front are true or not, they were quickly embraced by investors. Now whether Lucy snatches Charlies Brown's ball away again is an open question.

There wasn't much on the economic news side of any significance. The estimate for second quarter GDP growth was lowered marginally to 2%. The estimates for third quarter growth are running at a similar pace.



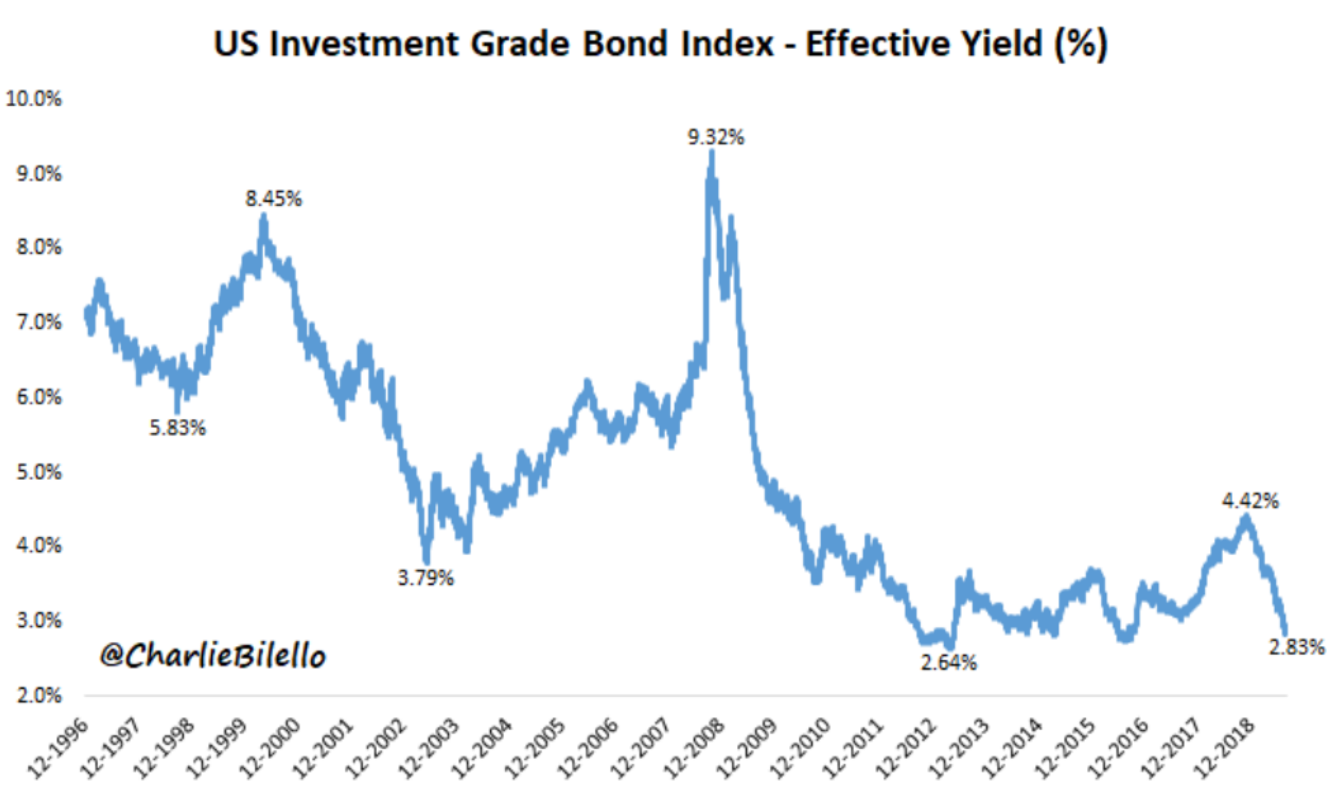
The other notable report was Friday's inflation number. The core personal consumption price index was up 1.6% in July versus the same month last year. The headline number was up 0.1% to 1.4%.



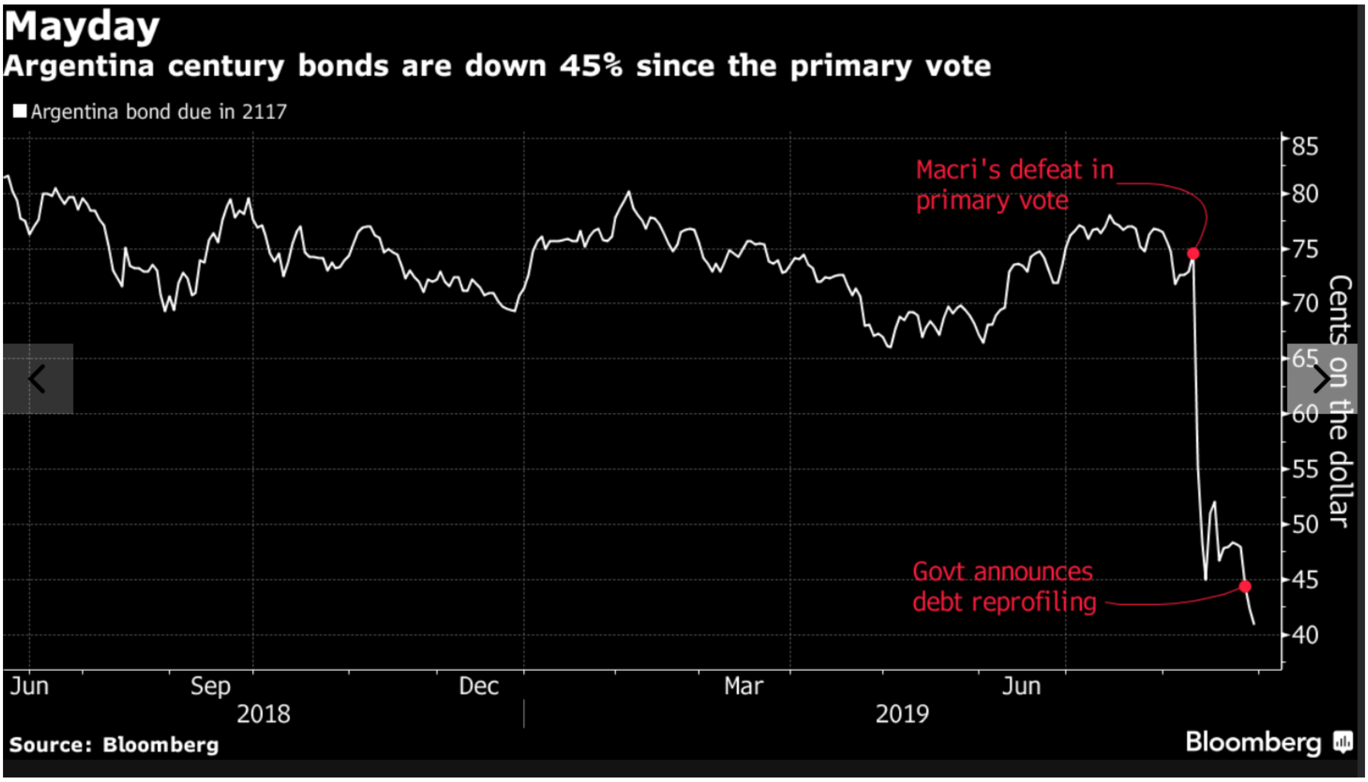
Still well below 2% and nothing here standing in the way of a Fed rate cut next month.

You Don't See This Very Often

Where do you go for yield today? U.S. 10-year government bond are paying 1.50%. 30-year bonds 1.96%. At least these are positive, but not much above inflation, if at all. Certainly not in Europe where negative yields are the norm now. Investment grade corporate bonds are giving you 2.8%, that's a bit better than inflation, but not by much.

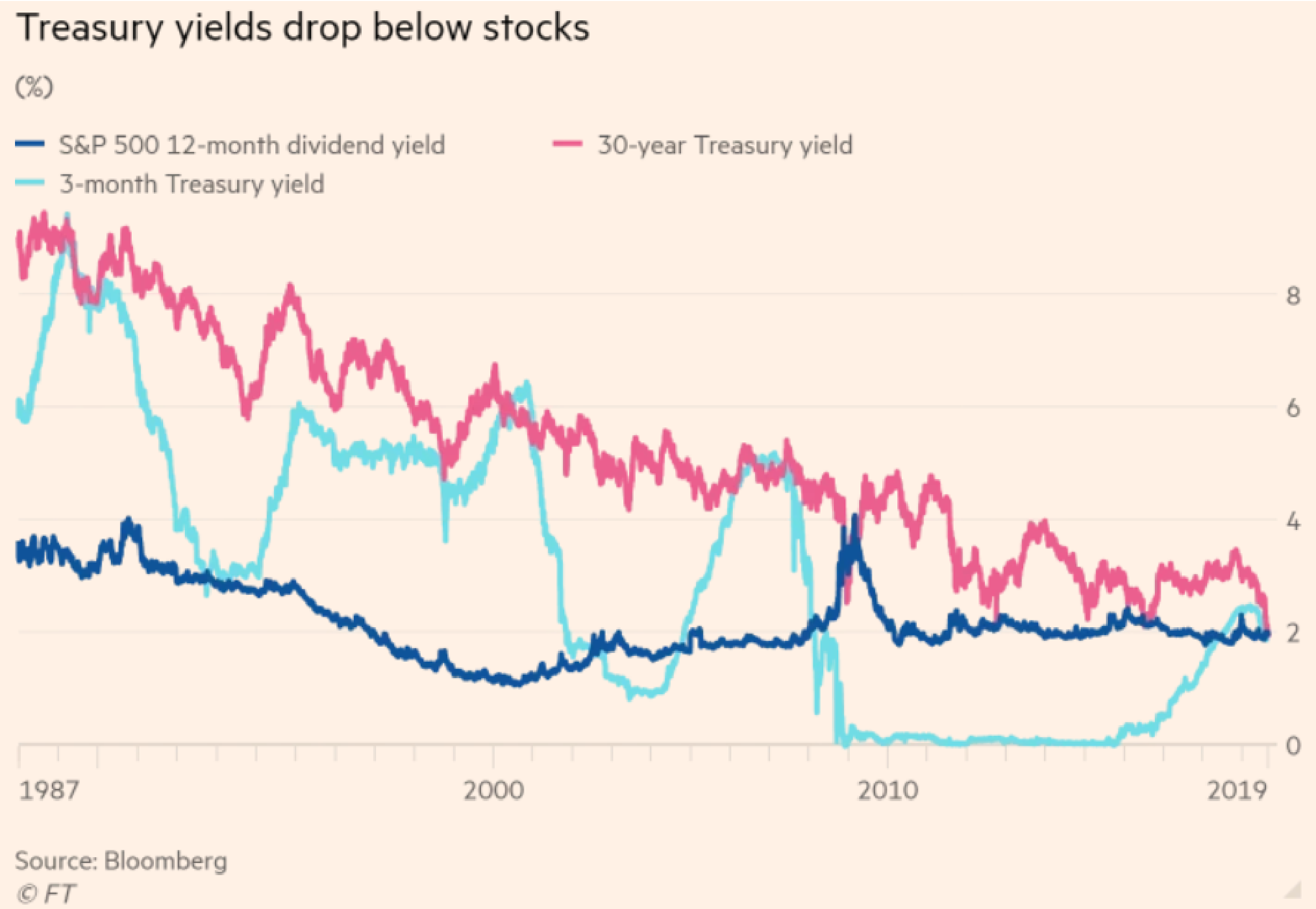


And don’t even talk to me about emerging market debt. Who needs the headache when things like Argentinian bonds can go from roughly $0.75 on the dollar to $0.40 in the matter of a few days.



Granted, Argentina is basically defaulting for the ninth time in its history. It seems an age ago, but it is only back in 2017 that Argentina floated the 100-year bond shown above and it was almost four times oversubscribed. What looked like a juicy yield of 7.9% at the time doesn't look so hot now the bond has lost 60% of its value!!!

Some investors are taking another look at equities. You can now get more income from dividends on S&P 500 than you can in 30-year Treasury bonds. This week the yield on the 30-year fell below the S&P yield. You have to squint at the chart below, but apart from brief moments earlier this year and in 2016, investors have to look back to the 2008 financial crisis to find the last time dividends brought in more cash than all of the available Treasuries.

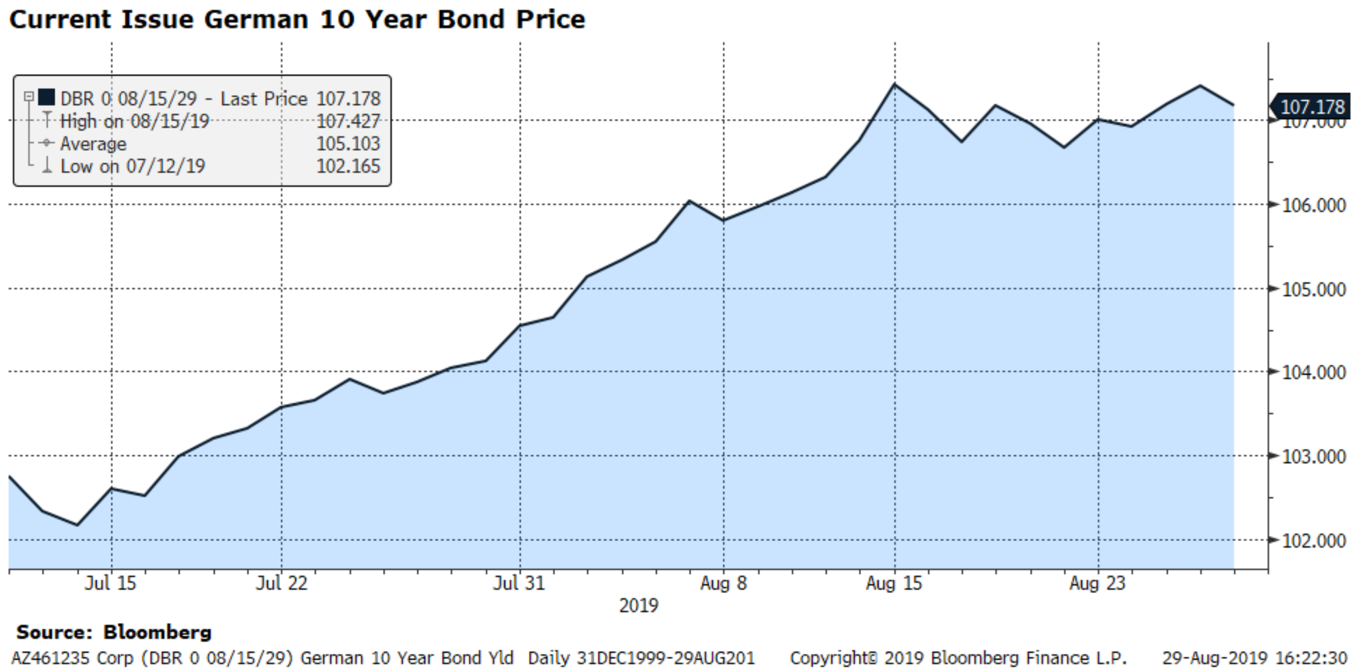


Does this mean stocks are a bond alternative? Oh heck no!! But it's fascinating how many long-term relationships are being upended by the relentless fall in rates around the world.

Is This Free Money?

The press has made a moderately big deal of various European finance ministers talking about the need for fiscal stimulus. Someone will come out calling for greater government spending (usually in Germany) and then three or four others will downplay the idea. Too soon they say. Things aren't that bad goes the argument.

They may be right, and more fiscal spending might not actually help the moribund European economy. But the math behind more borrowing is getting enticing. Take a look at the chart below. It shows that a recently issued German 10-year bond is trading at 107.178. This works out to this bond yielding -0.70%.



So, the government is getting paid to borrow. OK, but debt is bad, right? You still have to pay it back if you borrow it.

But take the following 'what if' from Alpine Macro:

> *"For example, Germany can issue 10-year zero coupon bonds worth five times of German GDP or roughly US$ 20 trillion, to the European Central Bank at a current yield of -0.7%, or at the current price of 107% of par. To make German fiscal hawks happy, the principal of the debt sales can be put in 'vault' to make sure that the money is there to repay the debt a decade later.*

> *With a 7% "bonus", the bond issuance will generate US$ 1.4 trillion in "income", or about 35% of German GDP, the government can either spend like mad on infrastructure or reduce taxes for both businesses and consumers."*

Man, this is 'through the looking glass kind of stuff.' And it doesn't even consider the return on investment from $1.4 trillion of infrastructure investment or tax cuts. What does it even mean to be a fiscal conservative in an era of negative rates??

Boris Rolls the Dice

Oh Boris Johnson. Love him or hate him, he isn't boring.

This week the UK Prime Minister initiated what could be the defining feature of his political life. He announced that in the run-up to Brexit Parliament would be suspended. As The Economist notes:

> *"His utterly cynical ploy is designed to stop MPs steering the country off the reckless course he has set to leave the EU with or without a deal on October 31st. His actions are technically legal, but they stretch the conventions of the constitution to their limits. Because he is too weak to carry Parliament in a vote, he means to silence it. In Britain's representative democracy, that sets a dangerous precedent."*

This isn't actually unprecedented – the last time it happened was back in 1945. But it is unusual and is perceived by many as an attempt to undermine Parliamentary democracy. It might also work. Opponents to either Brexit entirely or a hard Brexit must agree next week to do one of two things:

> 1) Pass a law that requires the prime minister to ask the EU for an extension. This happened in the spring, but there isn't much time to do it again.

> 2) Call for (and win) a vote of no confidence in the current government. This is a challenge because who would lead the caretaker government? Corbyn? A lot of centrists and conservatives would have to swallow hard to agree to this.

The Financial Times is openly calling for option #2 even if it means a Corbyn government before a general election:

> *"(Johnson's actions are)…an intolerable attempt to silence parliament until it can no longer halt a disastrous crash-out by the UK from the EU on October 31. The seat of British democracy, long admired worldwide, is being denied a say on the most consequential decision facing the country in more than four decades. So, too, are the British people — in whose name Mr Johnson claims to be acting. It is time for parliamentarians to bring down his government in a no-confidence vote, paving the way for an election in which the people can express their will."*

Be that as it may, he's going to take a stab at suspending Parliament for five weeks. Strange days.

Nobody told me there'd be days like these
Nobody told me there'd be days like these
Strange days indeed
most peculiar, Mama

-John Lennon

Have a good weekend.

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