

Weekly Briefing

SKYView: Sentiment

Market volatility has been on the rise, with concurrently positive (low unemployment, high consumer confidence) and negative (declining ISM PMI, downward revisions to GDP growth estimates) economic releases. Amidst further setbacks in trade resolution, investors have become increasingly convinced that multiple rate cuts will materialize in 2019, all while the economy celebrates its 10th year of economic expansion. In this *Weekly Briefing*, we summarize implied market expectations in the aftermath of additional tariff threats, weaker manufacturing data and Federal Open Market Committee (FOMC) member speeches.

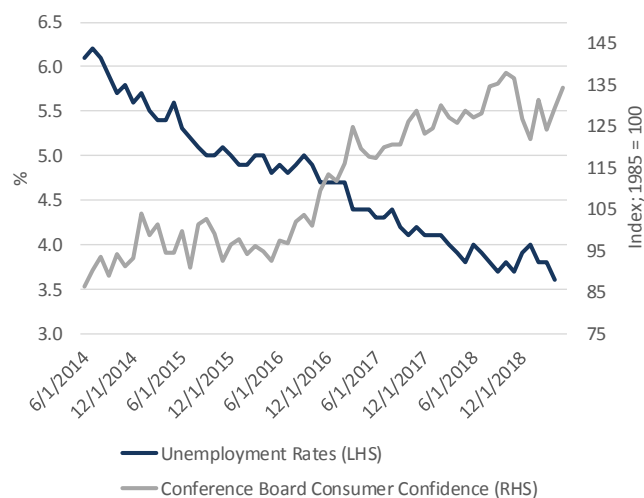
Despite a volatile month of May, the US economy is closing in on record-setting territory. By month-end, the current expansionary cycle – which, according to the National Bureau of Economic Research, began in June 2009 – will push past its 120th month, eclipsing the March '91 to March '01 stretch to become the longest expansion in history. At the same time, the unemployment rate has fallen to 3.6%, and consumer confidence over the last 12 months has hovered around territory not previously seen since late 2000.

US Business Expansion Cycles since 1900

Trough	Peak	Duration (months)
August 1904	May 1907	33
June 1908	January 1910	19
January 1912	January 1913	12
December 1914	August 1918	44
March 1919	January 1920	10
July 1921	May 1923	22
July 1924	October 1926	27
November 1927	August 1929	21
March 1933	May 1937	50
June 1938	February 1945	80
October 1945	November 1948	37
October 1949	July 1953	45
May 1954	August 1957	39
April 1958	April 1960	24
February 1961	December 1969	106
November 1970	November 1973	36
March 1975	January 1980	58
July 1980	July 1981	12
November 1982	July 1990	92
March 1991	March 2001	120
November 2001	December 2007	73
June 2009*	Present	?

Strong Employment and Consumer Confidence

monthly data, trailing 5 years



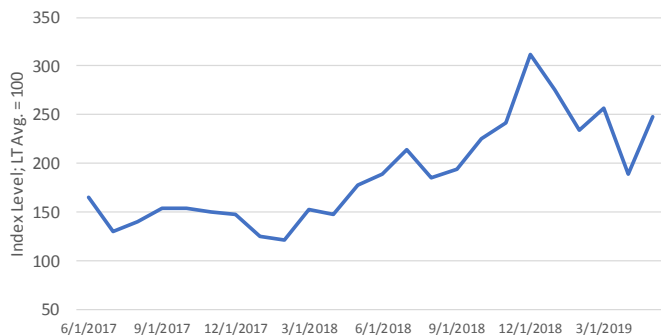
Source: SKY Harbor, National Bureau of Economic Research, Conference Board, Bureau of Labor Statistics, Bloomberg

Despite low unemployment and an upbeat consumer, market participants have grown increasingly concerned over signs that the expansion may be running out of steam. The Global Economic Policy Uncertainty Index – a GDP-weighted average of national economic policy uncertainty measures across 20 countries – remains elevated. Sluggish growth in Europe and increasingly contentious trade negotiations between the US and China are key factors contributing to heightened stress. To further complicate the situation, the Trump administration has threatened tariffs on imported Mexican goods should the flow of illegal immigrants across the US border not be stemmed by June 10, a move that surprised members of the President’s own party.

By increasing uncertainty and production costs for manufacturers, protectionism and the threat of a trade war escalation has already begun to erode manufacturing data across the globe. The US ISM Manufacturing Index declined to 52.1 in May, down from 52.8 in April and represented the lowest reading since October 2016. At the same time, China Manufacturing PMI showed contraction in May, declining to 49.4 from 50.1 in April.

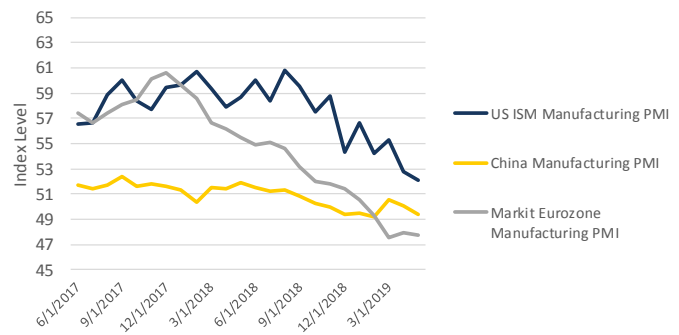
Global Economic Policy Uncertainty Index is Elevated

monthly data, trailing 2 years



Manufacturing Indices on the Decline

monthly data, trailing 2 years

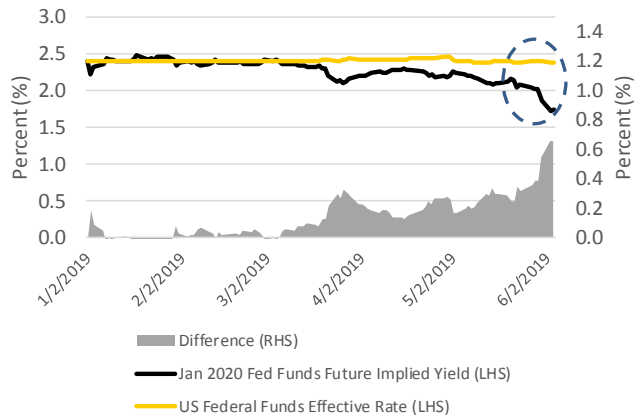


Source: SKY Harbor, Baker, Bloom & Davis, Institute for Supply Management, China Federation of Logistics and Purchasing, Markit, Bloomberg

On June 3 James Bullard, head of the St. Louis Fed, noted in remarks to the Union League Club of Chicago that “the FOMC faces an economy that is expected to grow more slowly growing forward,” and that “a downward policy rate adjustment may be warranted soon.”¹ The following day, Fed Chair Powell stated that the FOMC “will act as appropriate to sustain the expansion”² when discussing recent trade negotiation developments. These remarks helped extend the rally in federal funds futures, with the January 2020 contract now significantly diverged from the fed funds effective rate (a differential of ~ 65 bps as of June 4). The CME FedWatch Tool now implies a 69% chance of an easing of rates at the July 2019 Fed meeting, and some economists now forecast rates being cut by 75 bps this year.

Investors Are Anticipating Rate Cuts

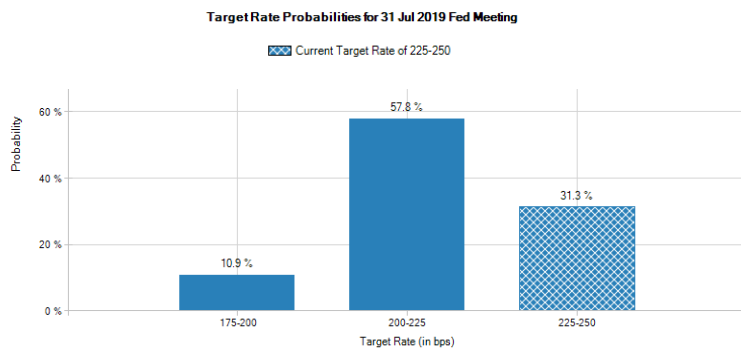
daily data



Source: SKY Harbor, Federal Reserve, CME, Bloomberg

CME FedWatch Tool Implies 69% Chance of Easing in July

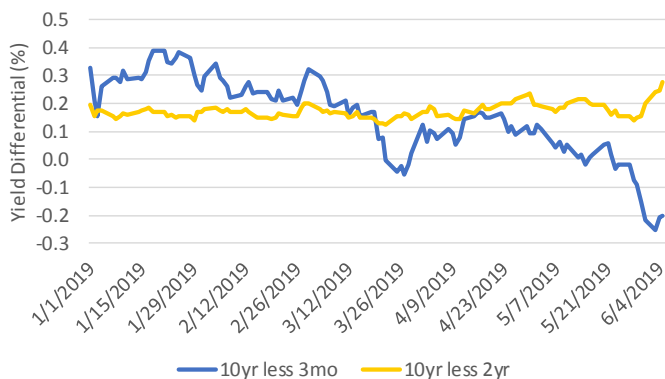
daily data



Does this mean a recession is imminent? We do not think so. While the 3m10y Treasury curve has inverted, this has historically been a long leading indicator (inversion typically occurs 14 months before the start of a recession, and the clock doesn't start until inversion is sustained). Additionally, the 2s10s Treasury curve has actually steepened as of late. Furthermore, a mid-cycle rate cut is not unique, the expansion from March '91 through March '01 having withstood two such events before a final path toward recession was embarked upon.

Curve Inversion a Long Leading Indicator w/ Past False Positives

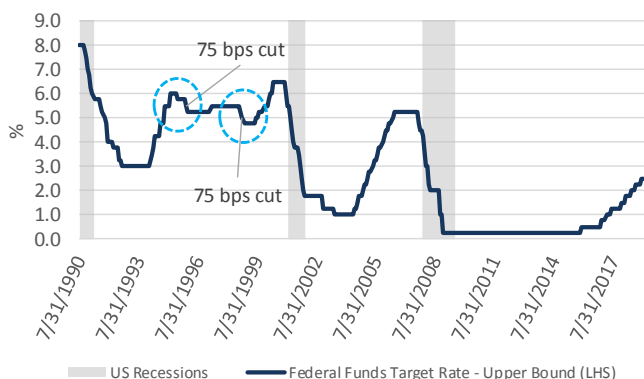
daily data, since January 1st



Source: SKY Harbor, Barclays, Federal Reserve, Bloomberg

Rate Cuts Don't Always Precede Recessions

quarterly data since July 1990



While the expansion rolls toward record-breaking territory, ongoing trade disputes have begun to chip away at projected growth – both directly, as a result of tariffs increasing certain manufacturing costs, and indirectly, through heightened uncertainty that has weakened business confidence. As a result, markets are expecting the Fed to step in and cut rates in the coming months. The motivation behind such a move – whether a precautionary measure to ensure the expansion continues, or a desperate measure to stave off a recession – will ultimately determine how markets react. For now, investors seem to be in the camp of the former (judging by equity returns during the week of June 3), in the hopes it plays out with the success of mid-cycle cuts of the '90s.

¹ 2019, June 3. St. Louis Fed's Bullard Presents Remarks on the Current Stance of US Monetary Policy. Retrieved from https://www.stlouisfed.org/news-releases/2019/06/03/bullard-remarks-on-current-stance-of-us-monetary-policy?utm_source=twitter&utm_medium=SM&utm_content=stlouisfed&utm_campaign=142dd620-0087-450f-9342-59efb5bf4666

² 2019, June 4. Opening Remarks at the Conference on Monetary Policy Strategy, Tools, and Communications Practices. Retrieved from <https://www.federalreserve.gov/newsevents/speech/powell20190604a.htm>

On the Calendar

Occurred

Event	Release Date	Period	Survey	Actual	Prior
Conf. Board Consumer Confid.	28-May-19	May	130.0	134.1	129.2
GDP Annualized QoQ	30-May-19	1Q	3.0%	3.1%	3.2%
GDP Price Index	30-May-19	1Q	0.9%	0.8%	0.9%

Source: SKY Harbor, Bloomberg

Upcoming

Event	Release Date	Period	Survey	Actual	Prior
NFIB Small Business Optimism	11-Jun-19	May	102.8		103.5
CPI MoM	12-Jun-19	May	0.1%		0.3%
Retail Sales Advance MoM	14-Jun-19	May	0.6%		-0.2%

Recommended Reading

Georgiadis, Philip (2019, June 6). UBS and Goldman Say Markets Overplaying Odds of US Rate Cuts. *Financial Times* (subs. req.), Retrieved from <https://www.ft.com/content/652baca8-8837-11e9-97ea-05ac2431f453>

Cox, Jeff (2019, June 4). Investors Want a Fed Rate Cut Before Economy Turns: 'Risk Becomes Greater the Longer You Wait.' *CNBC*, Retrieved from <https://www.cnn.com/2019/06/04/the-market-is-demanding-the-fed-cuts-interest-rates-soon.html>

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