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Armageddon Postponed?

Global Markets and Regions

	2nd QTR	2019 YTD
US	5.00%	18.80%
Developed Europe	5.50%	16.50%
Asia	1.00%	9.60%
Emerging Markets	1.63%	10.80%

US Markets

	2nd QTR	2019 YTD
Dow 30	4.10%	15.40%
Large Cap Cos.	3.90%	18.46%
Mid. Cap Cos.	1.69%	17.96%
Small Cap Cos.	0.55%	13.73%
Bonds	2.85%	6.00%

The ongoing trade dispute between the United States and China was going to be the event that would tip the global economy into recession and bring down the markets. At least that was the expectation, until it didn't happen. The Trump and Xi administrations did not announce a grand resolution at their meeting during the G-20 Global conference. They have agreed to continue discussions without further escalation. No big resolution one way or the other. Given the depth and complexity of the disagreements, it was probably too optimistic to expect otherwise. Armageddon was postponed, though there are plenty of other potentially high consequence events to be concerned with.

The Federal Reserve Bank continues to struggle with interest rate and monetary policy. It appears they are not quite certain what their policies should be addressing. They spent 2018 raising the Fed Funds rate with the objective of "normalizing" interest rates in order to prepare for the next recession. There was an adverse market response in the Fourth Quarter based on fears of a recession. They have reversed themselves and committed to rate decreases in 2019.

Two of the Fed's mandated objectives are maximizing employment and stabilizing prices. With unemployment at record lows and no serious inflationary pressures, they seem to be trying to address problems that are not yet apparent. The markets sent them a message.

Global economies are not in great shape. Europe is struggling with the UK Brexit arrangements. Uncertainty about growth and general economic health has led European Central Banks to lower interest rates to negative yields to try to stimulate growth. They have only been marginally effective.

Iran has decided to push the limits of their nuclear weapons development. Venezuela continues to be a drag on Latin American and global economies. Politics globally seems to have entered a period of peak contention, distracting governments from effectively addressing even routine issues. There are earthquakes in California, heat waves in Europe and Climate Change will end life as we know it in twelve years. There doesn't seem to be a shortage of Armageddon events out there. Did I miss anything?

Second quarter earnings season is about to begin and the fallout from these and other events is starting to show. We're entering the second consecutive quarter of a general earnings decline. It's clear that the trade issues are adversely affecting the earnings of multinational companies. Also, the impact of the Trump administration tax cuts has faded. Company CEOs are guiding earnings expectations down. Companies are still profitable and growing, just more slowly. This is not a complete surprise, but it is happening in the context of high stock prices, hence the concern.

On the other hand, the US economy is doing well, particularly compared to the rest of the world. Gross Domestic Product growth (GDP) is solidly positive even though the rate of growth is slowing. Job availability and wage growth are strong. Unemployment is low. US household finances are in good shape. Household net worth is up and personal debt burdens are stable to down. There are no signs of the types of excess borrowing as was seen prior to the past several recessions. Federal and State debts are soaring, but they are a future problem.

The tariff disputes are a threat to our economic wellbeing and certainly to the global economy. The history of tariffs as a trade negotiation tool has not been a good one. The Great Depression of the 1930's is always cited as the example of where the use of tariffs as a trade weapon can lead. But there are two sides to trade disputes. If China can be characterized as the other side, they are not weathering this very well, despite the bluster. The economic fallout for them has been much worse. The Chinese economy is much less structurally diverse than the US. Our politics can be toxic, but the riots in Hong Kong against Chinese domestic government policies are much more threatening to general stability there. By comparison, the US is doing well. In an event driven world, there is clearly no shortage of events that have the potential to threaten markets. But for now, Armageddon has been postponed.