THE NORTH PIERspective

Market & Economic Commentary:

Following the Bouncing Dow

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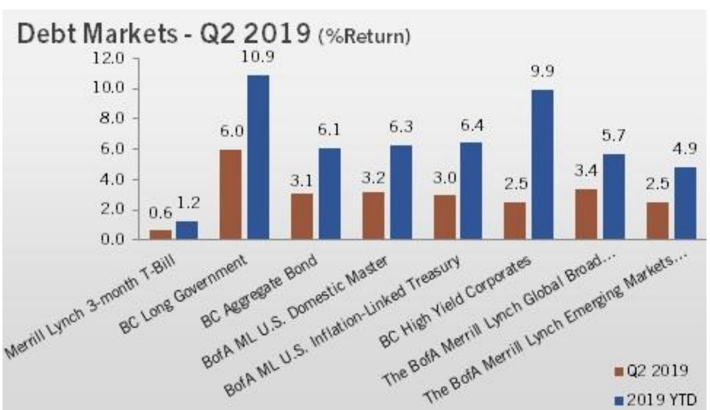
Following the Bouncing Dow

The Global equity markets continued their bouncy ride in the second quarter. Emotional jitters reversed the rebound rally of the first four months of 2019 with a dramatic pullback in May, only to see investors regain their optimism in June. Concerns over a potential of the economic slowdown in late 2018 or even 2019 have been sporadically weighing on investors' minds. Flare-ups in the trade dispute with China and conjecture about the future direction of the Fed have been the most significant reasons for the waves of occasional doubt that have gripped the markets earlier in May and then again as we began the month of August. Investors don't seem to know what they want. For much of the Spring, Wall Street was clamoring for an aggressive 50 basis point Fed funds rate cut to stave off an uncertain low down in the economy. The rancor was so high that the street might have bullied the Fed into a compromise 25 basis point cut in July (which was initially seen as not enough).

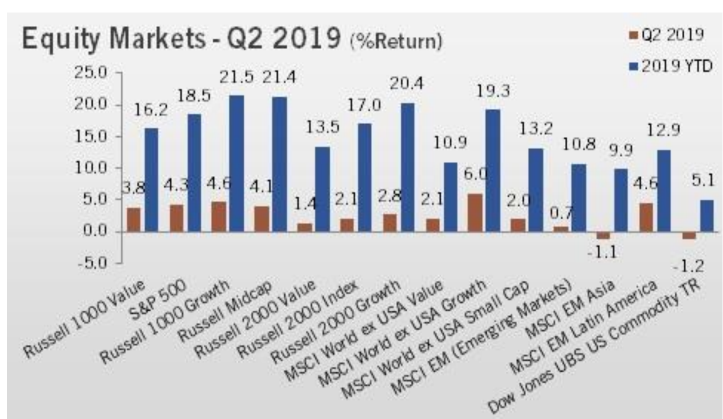
This cut and foundational fears have been largely unsupported by economic reality. Though most indicators are not showing robust growth conditions, we have certainly not seen any hard evidence that we are rolling over into a recession. We may have grown so used to a booming economy, that anything less seems intolerable. In fact, two Fed governors agreed, voting against the July cut altogether. Boston Fed President Eric Rosengren felt that "the economy is doing perfectly well without that easing." How can it be that the street thinks we are heading off a cliff without massive intervention, while two Fed governors see the economy as healthy is bewildering. Nonetheless, that is the emotionally fragile state that the capital markets presently find themselves.

How the Markets Fared



With all the fear about the near-term prospect for the economy, came buying of U.S. Treasuries across the spectrum. While futures for short-term rates were predicting the probability of a 50 basis point rate cut, yields on the long-end of the interest rate curve were dropping as well. The bellwether 10-year Treasury yield fell from 2.4% at the end of Q1, to 2.0% just one quarter later. This helped drive returns of over 3% for the most high-quality fixed income for the quarter. As the dollar was stable, international debt instruments saw similar moves during Q2. Oddly, despite concerns over the future prospect of the economy, high yield bonds largely held their ground. With credit spreads only widening modestly during the quarter, high yield also enjoyed better than 2% gains. Even emerging market fixed income was able to join the party, also posting 3%+ total returns.

While bond prices were on a steady climb, causing yields to seek lower levels, stocks were on a more adrenaline-pumping journey. Though not quite as dramatic as the nearly 10% round trip that markets took in December and January, the S&P 500 did retreat steadily over 6% in May, before rebounding fully in June. June's strength allowed many U.S. indexes to finish the second quarter at or near all-time highs. Large and mid-cap U.S. stocks netted better than 4% gains for the quarter. Small caps (which had benefited substantively from the corporate tax cuts in 2018) saw more modest returns during the quarter. Developed international market equities also saw similar gains. With European banks struggling with near-zero percent interest rates, international value stock underperformed those of the more growth-oriented industries. Here at home though, there was little dispersion between the spectrum. Emerging markets lagged mostly due to concerns over China (and trade-related spillover). However, Latin American markets avoided those concerns, advancing similarly to their peers in North America. This was despite a modest retreat in commodity prices during the quarter, which usually would have caused a headwind for Latin American equities.



PIER*ing* Ahead

The juxtaposition is confusing. How could yields on U.S. Treasuries be in rapid decline due to fear about future economic prospects while stocks are forging new highs at lofty valuations? Labor markets continue to stay strong with no signs of major layoffs and steady wage growth. Home values, while not booming, are holding their own with modest advancement on average. These two conditions have led to generational highs in consumer confidence regarding their present conditions and rosy outlooks for the future. However, we are starting to see pullbacks in the business sectors' optimism, with Purchasing Managers Indexes both domestically and abroad indicating that the economy is moderating (yet notably not in decline). Perhaps a criticism that is often leveled on the Millennial Generation applies to the modern-investor generation, we have grown intolerant of discomfort. Alternatively, perhaps our market now more closely resembles our deeply-divided political system. Maybe the investor class is two major parties of investors with vastly differing sentiments. One group that euphorically continues to gobble up equities as they rack up record earnings and forge higher and higher stock prices, while the other is nearly depressive, panicking at any negative headline or Presidential Tweet. Perhaps both groups need a gigantic dose of Prozac to even out their emotions. If so, perhaps our PIER*spective* should be… run out and buy pharmaceutical stocks. With the 2020 election season right around the corner, we may all need something to calm our nerves.