The News You Need to Know

Left to right: Andrew Woolley, Andrew Barninger, Christopher Miller, Steven Bell and Alan Loss.

As companies begin to report third quarter earnings, expectations have been for flat growth at best. The first few reports have been encouraging, which may serve to support market prices in the short term. Whatever the outcome, it's important not to depart from a long-term perspective.

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Quarterly Economic Update

In this Q3 2019 recap: the U.S. and China intensify their trade dispute, but agree to negotiate again, the Federal Reserve cuts short-term interest rates once more, and stocks ride through some volatility to end the summer higher.

THE QUARTER IN BRIEF

Summer doldrums? Not exactly. The third quarter brought a number of attention-getting events, and while investors took some cues from them in the short term, Wall Street's confidence remained – the S&P 500 rose 1.19% in Q3. Trade negotiations between the U.S. and China broke down, but as the quarter ended, it looked like they would resume in the fall.

Manufacturing was giving mixed signals, both here and abroad, breeding concerns about the health of the global economy. Both the Federal Reserve and the European Central Bank took steps to ease monetary policy.[1]

DOMESTIC ECONOMIC HEALTH

Wall Street and Main Street had plenty to think about in the quarter. Trade remained the big issue, with China and the U.S. amplifying their ongoing dispute. On August 1, the U.S. announced tariffs on an additional $300 billion of Chinese products – some would be effective September 1; others, effective by December 15. Four days later, China devalued its main currency, the yuan, to a level unseen in 11 years – a move that immediately sent U.S. stocks 3% lower. (Devaluing the yuan made Chinese goods cheaper for buyers paying for them in dollars, effectively offsetting the impact of U.S. tariffs.)[2,3]

On August 23, China unveiled a plan to put new tariffs on $75 billion of U.S. goods, threatening to place import taxes as high as 43% on cars and trucks exported from America. Just hours later, the White House announced that current and planned tariffs on Chinese goods would increase by 5%. September was less acrimonious: China stated that it would remove 16 U.S. products from its tariff list, and the White House said that it would delay the new tariffs on Chinese goods planned for October 1 until October 15. Late in the month, word came that trade representatives from both nations would resume talks on October 10.[2,4]

On August 15, traders took note of another development: the yield of the 2-year Treasury bond exceeded the yield of the 10-year Treasury bond for the first time since 2007. In past years, this has sometimes signaled an oncoming interruption in U.S. economic expansion. Longer-term Treasuries commonly have higher yields than shorter-term Treasuries; when the opposite is true, it indicates that domestic and foreign investors have less optimism in their economic outlook. (Bond yields often fall when bond prices rise, and vice versa.)[5]

The Federal Reserve lowered the country's short-term interest rate by a quarter-point on September 18, to a range of 1.75% to 2.00%. Federal Reserve Chairman Jerome Powell, speaking to the media after the decision, called the outlook for the U.S. economy "favorable." At the same time, he noted "a lot of uncertainty" surrounding the near-term economy and the Fed's monetary policy views.[6]

Fundamental indicators were a mixed bag. Employers hired 130,000 net new workers in August, according to the Department of Labor; that was a drop from July job creation levels, and it reduced the monthly average for 2019 to 158,000. In both July and August, unemployment was at 3.7%; the U-6 rate, which counts the underemployed and unemployed, was at 7.0% in July, 7.2% a month later. U.S. manufacturing activity also slowed in both August and September, according to the Institute for Supply Management; the September slowdown was the sharpest monthly contraction since June 2009.[7,8]

GLOBAL ECONOMIC HEALTH

Factory activity slowed in some of the world's larger economies. By September, the Markit factory purchasing manager indices (PMIs) for the euro area, the United Kingdom, Russia, Mexico, Germany, and Japan were all under 50, meaning the manufacturing sectors in those economies were shrinking rather than growing.[12,13]

The European Central Bank made two moves in the quarter to try and stimulate the euro area economy. Lawmakers in the United Kingdom continued to argue over the path toward Brexit; in August, new Prime Minister Boris Johnson moved to suspend Parliament for several weeks in September and October, a move ruled unconstitutional a month later by the country's highest court. Johnson refused to resign despite pressure to do so. He claimed the U.K. would make its Brexit from the European Union by October 31, as scheduled, though some analysts worried that it might be a "hard" one, with no trade deal with the E.U. in place.[14,15]

REAL ESTATE

Home buying picked up in the quarter. The National Association of Realtors noted that a 2.5% advance for existing home sales in July and a 1.3% gain for August. Its pending home sales index, down 2.5% in July, reversed course and rose 1.6% a month later. New home sales represent only a sliver of the residential real estate market by comparison, but it is worth noting that Census Bureau data showed new home buying rebounding – down 8.6% in July, then up 7.1% for August. Yearly home price appreciation slowed: the 20-city S&P/Case-Shiller home price index saw a 2.0% annualized increase through July and was flat for that month.[9]

Thirty-year home loans grew less expensive. Comparing Freddie Mac's June 27 and September 26 Primary Mortgage Market Surveys, the average interest on a 30-year, fixed-rate mortgage fell from 3.73% to 3.64%. In both of those surveys, the average interest rate for the 15-year, fixed-rate mortgage was the same: 3.16%.[21]

30-year and 15-year fixed rate mortgages are conventional home loans generally featuring a limit of $484,350 ($726,525 in high-cost areas) that meet the lending requirements of Fannie Mae and Freddie Mac, but they are not mortgages guaranteed or insured by any government agency. Private mortgage insurance, or PMI, is required for any conventional loan with less than a 20% down payment.

LOOKING BACK, LOOKING FORWARD

In a statistical coincidence, the Dow Jones Industrial Average and S&P 500 gained the same percentage in the quarter. The Dow settled at 26,916.83 on September 30; the S&P, at 2,976.74. Both indices registered their third straight quarterly advance. The Nasdaq Composite went sideways for Q3, ending September at 7,999.34.[22,23]

Investors may recall this past quarter as volatile, but that was not always the case: in September, the S&P did not have a single 1% daily loss, and it saw just two daily gains of 1% or more.[22]

MARKET INDEX	Y-T-D CHANGE	Q3 CHANGE	Q2 CHANGE
DJIA	+15.39	+1.19	+2.59
NASDAQ	+20.56	-0.09	+3.58
S&P 500	+18.74	+1.19	+3.79

BOND YIELD	9/30 RATE	3 MO AGO	1 YR AGO
10 YR TREASURY	1.68	2.03	3.09

Sources: barrons.com, barchart.com, treasury.gov - 9/30/19[22,24,25]
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends. 10-year Treasury yield = projected return at maturity given expected inflation.

The Dow, Nasdaq, and S&P each entered the fourth quarter with year-to-date gains of at least 15%. Can that kind of momentum continue? Much could depend on corporate earnings and the guidance that accompanies them. Tariffs imposed by the U.S. and China are not the only potential drag on profits; dollar strength has to be counted as well. The coming earnings season is expected to be watched closely on Wall Street, and while it might not exactly dictate what happens in the market this month or this quarter, it could set a mood that investors might retain through the end of the year.

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