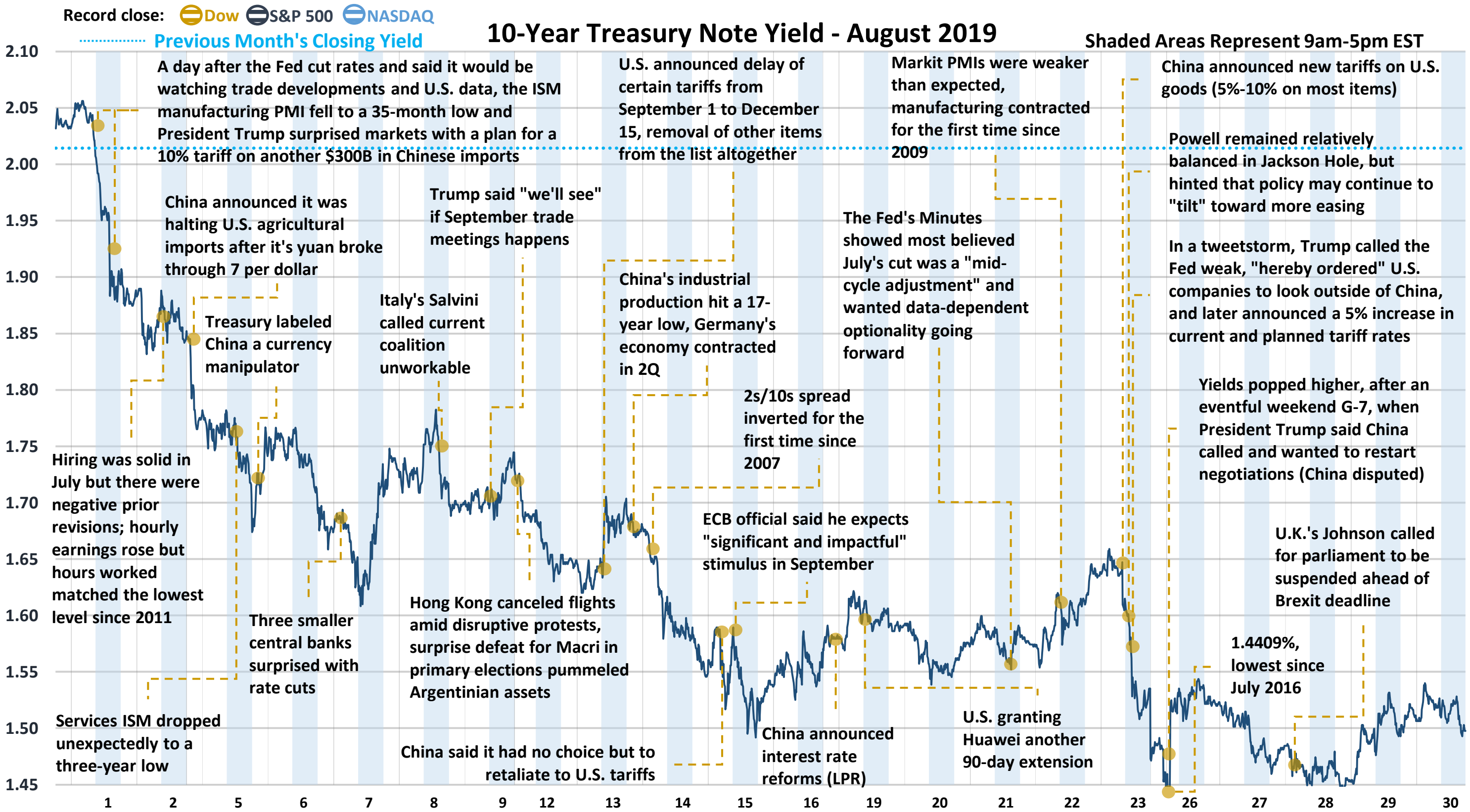
VINING SPARKS

Monthly Review

August 2019

Recession Calls Grew As Trade Tensions Boiled and Investors Feared Central-Bank Support Could Be Too Little Too Late



Recession Fears Grew in August as the U.S.-China Trade War Boiled Over and Further Data Deterioration Added to Worries Central Bank Support Could Come Too Late

Markets: Investors' anxieties about a global recession crescendoed in August as trade tensions reached new levels and continued deterioration in the global economic data fueled worries that assistance from slow-moving central bank policy might arrive too late. The trade situation turned worse early after the U.S. announced that a 10% tariff on $300B of Chinese goods would take effect on September 1. In the days that followed, the yuan weakened through a key 7-per-dollar level, leading the U.S. Treasury to label China a currency manipulator. China also halted imports of U.S. agricultural products and announced retaliatory tariffs on $75B of U.S. goods. While the U.S. had delayed the proposed tariffs on some products, and removed other goods from the list altogether, the proposed 10% rate was raised to 15% after China retaliated. As the trade situation deteriorated, so too did the picture painted by the incoming economic data. China's industrial production hit a 17-year low, Germany's economy contracted in the second quarter, and PMI data signaled the U.S. economy slowed more than expected. Markets responded volatilely, pushing the spread between the 2-year and 10-year Treasurys to its first inversion since 2007. The 10-year yield dropped 52 bps and touched its lowest level since July 2016, before closing at 1.496%. With investors expecting that an obstinate Fed may be forced to respond more aggressively, the 2-year yield dropped 37 bps to 1.504%, its biggest monthly decline since 2008.

Consumer: Revisions to GDP showed 2Q19 was the second strongest of the cycle for the consumer and July's retail sales report easily cleared expectations. However, a softer hiring report and cracks in confidence raised concerns the increasing economic uncertainty could potentially disrupt the yet-to-be-disturbed consumer. A stronger-than-expected confidence index from the Conference Board included a drop in expectations and the University of Michigan's index fell to its lowest level since 2016.

Private Investment: Small business confidence held up better than expected in July, although the report would not reflect effects of the August trade escalation, and other data kept concerns about continued weakness in business investment firmly entrenched. Capital goods data disappointed and activity surveys from the ISM and Markit reflected a slowing services sector and continued weakness for manufacturing. Markit's August manufacturing index fell to its lowest level since 2009 and its services index reflected the weakest pace of activity in several years. The ISM's manufacturing index, released on September 3, pointed to contraction for the first time since 2016.

External Trade: July's goods trade deficit narrowed unexpectedly, but the focus remained on the new tariffs put in place by the U.S. and China.

Inflation: Core inflation rose more than expected in the CPI report while the Fed's preferred PCE measure remained well below the Fed's 2% target. The former reflected firmness across most categories while the latter should give the Fed leeway to support the economy against the continued signs of slowing.

Monetary Policy: Surprise rate cuts from three smaller central banks during the month offered a glimpse of what investors believe will be a synchronized easing by central banks in response to slowing global economic activity. As for the Fed, officials' remarks during the month and the Minutes from the July meeting showed the Committee remained divided on how much additional accommodation the U.S. economy may need to protect it from a trade war and slowing foreign economies. And while Fed Chair Powell's Jackson Hole Speech was bookended and overshadowed by trade escalation, he seemed to set the stage for another cut in September. Markets ended August pricing a September cut in as a certain start to an even lower level for Fed Funds in the months ahead. With the August 2020 contract implying an average effective monthly rate of 1.14%, Fed Funds futures were pricing in roughly three additional rate cuts over the next twelve months. Additionally, a slowing European economy is expected to lead the ECB to cut rates in September, and potentially consider a restart of its quantitative easing program.

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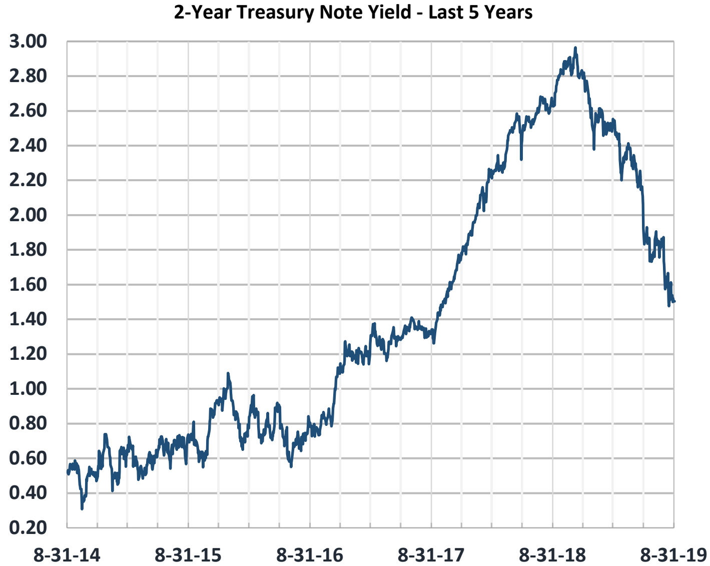
2-Year Treasury Note Yield - August 2019

5-Year Treasury Note Yield - August 2019

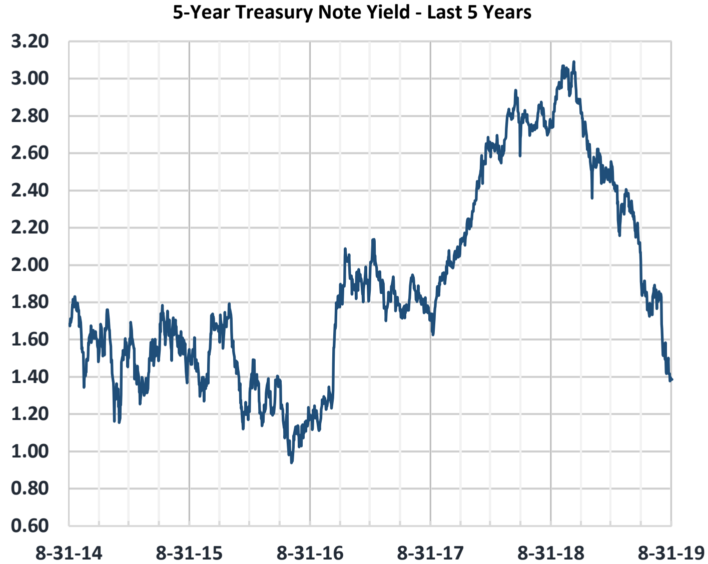
2-Year Treasury Note Yield - Last 12 Months

5-Year Treasury Note Yield - Last 12 Months

2-Year Treasury Note Yield - Last 5 Years



5-Year Treasury Note Yield - Last 5 Years



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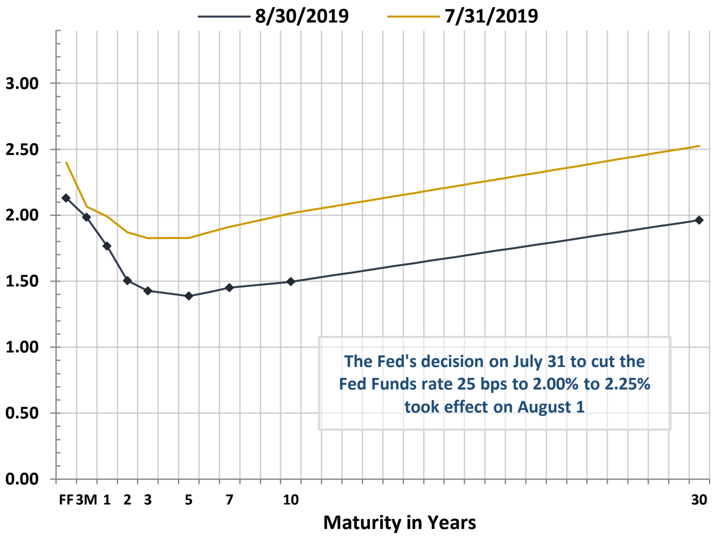
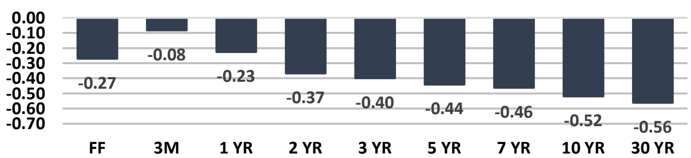
Treasury Month-Over-Month



Month-Over-Month Change in Treasury Yields



Global Stock Performance

	Value	MTD Change	QTD Change	YTD Change
Dow Jones	26,403	-1.72% ↓	-0.74% ↓	13.19% ↑
S&P 500	2,926	-1.81% ↓	-0.52% ↓	16.74% ↑
Nasdaq	7,963	-2.60% ↓	-0.54% ↓	20.01% ↑
Stoxx Europe 600	379	-1.63% ↓	-1.40% ↓	12.39% ↑
China CSI 300	3,800	-0.93% ↓	-0.68% ↓	26.20% ↑
Nikkei 225	20,704	-3.80% ↓	-2.69% ↓	3.45% ↑

Global Sovereign Debt Performance

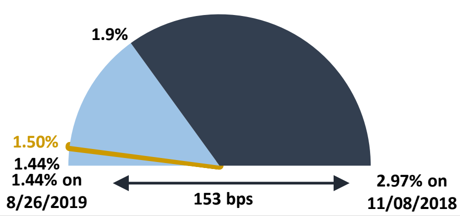
	Yield	MTD Change (in bps)	QTD Change (in bps)	YTD Change (in bps)
U.S. 2-year	1.50%	-36.8 ↓	-25.1 ↓	-98.4 ↓
U.S. 5-year	1.39%	-44.1 ↓	-38.0 ↓	-112.5 ↓
U.S. 10-year	1.50%	-51.8 ↓	-50.9 ↓	-118.8 ↓
German 10-year	-0.70%	-26.0 ↓	-37.3 ↓	-94.2 ↓
U.K. 10-year	0.48%	-13.2 ↓	-35.4 ↓	-79.8 ↓
French 10-year	-0.40%	-21.9 ↓	-39.8 ↓	-111.3 ↓
Italian 10-year	1.00%	-54.4 ↓	-110.4 ↓	-174.4 ↓
Japanese 10-year	-0.27%	-11.6 ↓	-11.1 ↓	-27.2 ↓

Commodity Performance

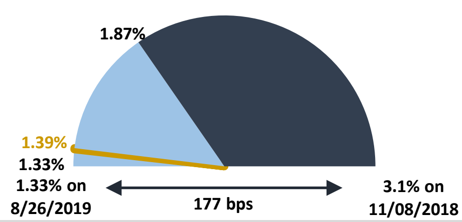
	Value	MTD Change	QTD Change	YTD Change
WTI Crude	$ 55.10	-5.94% ↓	-5.76% ↓	21.34% ↑
U.S. Dollar	98.92	0.41% ↑	2.90% ↑	2.85% ↑
Gold Spot	1,520	7.53% ↑	7.86% ↑	18.55% ↑
Commodity Index	77.00	-2.48% ↓	-3.33% ↓	0.38% ↑

Treasury Notes Intraday Ranges: 52-Week Yield Range / Monthly Yield Range / Last Traded Yield

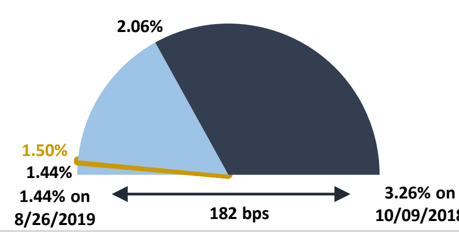
2-Year Treasury



5-Year Treasury



10-Year Treasury



Nonfarm Payrolls
July
164k

Unemployment Rate
July
3.7%
Unchanged

Hiring was essentially as expected but there were negative prior revisions

Existing Home Sales MoM
July
2.5%

New Home Sales MoM
July
-12.8%

Cushioned somewhat by large positive June revision

Core Retail Sales
July
1.0%

Expected +0.4%

Consumer Confidence
August
135.1
Down 0.7 pts

Expected 129.0

ISM Non-Manufacturing
July
53.7
-1.4 pts

ISM Manufacturing
July
51.2
-0.5 pts

Both represented the weakest readings since August 2016

Manufacturing Production
July
-0.4%

Core Capital Goods Orders
July
0.4%

Offset somewhat by prior revisions

Trade Balance
June
-55.2B
+0.2B

Core PCE YoY
July
1.6%
Up 0.01%