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Market Update: October 2019

Global stock markets not only survived the dreaded month of October but delivered solid gains for investors. The month got off to a rough start over concerns about U.S/China trade, Brexit, impeachment, the Middle East, and protests in Hong Kong. But markets rebounded, as corporate earnings beat expectations and the Federal Reserve cut interest rates for a third time this year.

Domestic and foreign stocks returned 2.15% and 3.49% during the month, respectively. U.S. stocks have registered gains of about 22% for the year, while foreign stocks have delivered returns in excess of 15 percent. Declining interest rates have also propelled bond markets to strong returns for the year.

> **The U.S. economy is in a good place. Growth has been supported by the continued strength of household consumption, underpinned, in turn, by a thriving labor market.**
>
> **Richard Clarida, Federal Reserve Vice Chairman – WSJ 11/1/19**

The U.S. economy has been bolstered by an expanding service economy which has been supported by healthy consumer spending. On the other hand, the manufacturing sector continues to struggle and business investment has been weak … a byproduct of tariffs and trade uncertainty. Keep in mind that manufacturing is less than 12% of U.S. GDP, while consumer spending represents nearly 70% of our economy.

Are we coming out of a mid-cycle slowdown or are we on the brink of recession? Back in January of 2008, the Fed projected that the economy would avoid a recession. At that time, they forecasted a 45% probability of recession within the next 6 months. In fact, the recession had begun the previous month … as determined almost a full year later by the National Bureau of Economic Research.

> **Two of the biggest challenges of fighting a recession are knowing when you're in one and deciding what to do next. When economic data weaken, it's impossible to know in real time whether it's a blip or something more prolonged. The official declaration usually comes a year or more after a recession starts.**
>
> **Kate Davidson – WSJ 11/3/19**

Fed officials have now cut rates three times since July. These cuts have been touted as a type of "flu shot" to guard against the slowdown in business investment that has been amplified by the U.S./China trade conflict. Going forward, the Fed has signaled it will stand pat. That's good news … since further cuts would historically foretell imminent recession.

> **If more rate cuts are needed, then something is very wrong with the economic backdrop, which will eventually weigh on equity performance.**

Todd Sohn, Strategas – WSJ 11/1/19

Monetary policy has helped to prop up asset values, but it can't do anything to alleviate concerns over a trade deal. And, without question, the immediate economic concern is that a trade war will eventually lead to recession.

> **The Fed went from going up (rate hikes) to going down (rate cuts), and investors are thinking central bankers are *guardians of the economy*. But central bankers have one super power, and that's to lower rates. Look at Germany, where rates are negative and their economy is almost in recession.**

Jeffrey Kleintop, Schwab's Chief Global Strategist – IMPACT® 11/4/19

At the Schwab IMPACT® Conference in San Diego, Mr. Kleintop also asserted that we are potentially in the beginning stages of a change in momentum that will favor value-style stocks over growth-style stocks, as well as international equities over U.S. equities. He noted that in each of the last four incidents when the yield curve has inverted – 1989, 2001, 2007 and 2019 – significant changes in momentum have occurred. (Remember an inverted yield curve happens when rates on short-term bonds exceed those of longer-term maturities.)

> **A yield curve inversion says something about the long term, because the market is reassessing its growth aspects. The last few months we've started to see value outperform growth, and I think it's for real. This is important because it will remind your clients why you diversify and why you rebalance. This is part of a longer-term trend that most investors are going to miss.**

Jeffrey Kleintop, Schwab's Chief Global Strategist – IMPACT® 11/4/19

The Commerce Department just reported that GDP rose at an annual rate of 1.9% during the third quarter, as consumer spending and housing investment increases offset a decline in business investment. Since the Great Recession of a decade ago, the U.S. economy has grown at a 2.3% annual rate. That compares with 3% GDP growth in the 10 years prior, and 3.3% GDP growth in the 1990s.

> **Forecasters talk about the economy the way frustrated parents might about an adult son living in the basement and working at a dead end job. Barring a wave of skilled immigration or technological breakthroughs, the economy's potential growth just isn't what it used to be.**

Justin Lahart – WSJ 9/20/19

The U.S. economy added 128,000 jobs in October, well ahead of expectations. The jobless rate ticked up slightly to 3.6%, while participation rates among those in prime working years (ages 25 to 54) reached a ten-year high. Payrolls have been expanding for 109 straight months, by far the longest stretch on record.

The economy is clearly downshifting. While employers have added an average of 167,000 jobs each month this year, the monthly average last year was 223,000 jobs. Also, the International Monetary Fund expects global economic growth to slow to 3% this year … the slowest pace since the 2009 recession.

> **A crash is coming. Relax, it probably isn't imminent. For something so infrequent, though, the "c" word is awfully good at grabbing investors' attention. The best way for less-sophisticated investors to prepare – which includes virtually everyone – is to accept that a crash could happen tomorrow.**

Spencer Jakab – WSJ 10/25/19

Modest growth, low inflation, and a strong job market … it appears that we are once again in a *Goldilocks* setting. The "plow horse" economy continues to move at a manageable pace, *not too hot but not too cold*, easing the fears of recession, but not strong enough for the Fed to consider raising rates. Let's hope this lasts through the quarter, and we all have a happy and healthy Thanksgiving holiday.

Daniel G. Corrigan, CPA/PFS, CFP®