CORRIGAN FINANCIAL, INC.

Market Update: August 2019

Global stock markets ended a turbulent month with relatively modest losses of just over 2 percent. On three separate days in August alone, U.S. stocks declined by more than 2.5 percent. This level of volatility hasn't been experienced in nearly eight years. Still, performance for global stocks remains strong at 13.8% year-to-date.

Investors continued to struggle with U.S./China trade tensions and related anxieties over the prospects for global economic growth. The domestic bond market certainly communicated its concerns, as the 10-year U.S. Treasury yield fell below the yield on the two-year issue. Yes, this is another *yield-curve inversion* milestone … and it is considered the strongest signal yet that bond investors anticipate a pending recession.

> **August saw wild swings in the U.S. markets, buffeted by the three T's: tweets, trade, and Treasuries.**
>
> **Randall W. Forsyth, Barron's 8/30/19**

Do you remember when bond yields peaked at 15% in 1981? It's hard to imagine that 10-year U.S. Treasuries now are yielding 1.5%, and 30-year Treasury bonds yield around 2 percent. But from a global standpoint, U.S. rates are quite high.

> **The proliferation of negative-yield debt around the world has helped pull down U.S. Treasury yields, which look substantial by comparison even as they sit near historic lows.**
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> **Davies/Kowsmann – WSJ 8/21/19**

Currently there are $17 trillion worth of foreign bonds trading at rates in negative territory. That is about 25% of the entire global bond market and about 43% of outstanding foreign bonds. Germany actually just sold 30-year debt at a negative yield. This means that investors holding to maturity will get back less than they paid … even after waiting patiently for three full decades!

> **There has never been such an animal in the taxonomy of bonds. Until a few years ago, traders and investors around the world would have considered negative bonds as fanciful as a children's fairytale.**
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> **John Mauldin, Mauldin Economics – Advisor Perspectives 8/31/19**

How did we find ourselves in this fairytale? It is the end result of years of deficit spending by governments (fiscal stimulus) and zero-based interest rate policies by global central banks (monetary stimulus).

Consider the implications of the *massive mountain* that is world-wide government debt. Economists used to believe that interest rates would escalate as debt levels rose. What we have come to understand is that high government debt depresses business conditions … and as economic growth declines, interest rates ultimately implode. Japan is considered the posterchild for such an economic outcome.

> **Because we're impatient, we value income today more highly than income tomorrow. The general preference for present enjoyment over deferred gratification is the reason savers got paid for saving … Still negative yields are a fact. No such deviation from normal human desires exists without cause. For the force behind the once-in-4,000-year phenomenon of negative nominal yields, this column nominates the tireless manipulations of the world's central banks.**
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> **James Grant – Barron's 8/30/19**

Since 1990, only about 17% of S&P 500 stocks offered a dividend yield in excess of the 10-year U.S. Treasury yield. According to FactSet, nearly 60% of S&P 500 stocks now have yields above the 10-year U.S. Treasury note.

> **This is a hard period for most investors to navigate through. But, stocks are supported by low bond yields as long as we don't have a recession.**
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> **Brent Schutte, Northwestern Mutual – WSJ 8/13/19**

The direct effects of tariffs are not really that material. The U.S. economy weighs in at $21 trillion, while imports from China total $500 billion and exports to China add up to about $130 billion. The bigger concerns relate to corporate behavior and investor sentiment and their overall effects on capital spending. Recent data coming from Germany and China, economic behemoths closely linked by trade and foreign investment, has helped fuel global growth concerns.

The U.S. economy continues to grow, although somewhat slower, as the economic expansion reached its 10th anniversary. U.S. GDP rose at a 2% pace in the second quarter, down from 3.1% in the first quarter and 2.9% during all of 2018. With wages trending higher and jobless claims at historical lows, consumer spending (70% of U.S. economic demand) continues at a strong pace.

At some point, investors will just focus on the underlying fundamentals. If we can look at the economy objectively, the weight of the evidence should indicate that the economy is still growing and isn't in danger of imminent recession … even with the uncertainty about trade.

Edward Yardeni, Yardeni Research – Barron's 8/30/19

Stock markets have been quite resilient in the face of softening global growth and trade uncertainties. Without question, declining interest rates have helped to prop up stock values. But, declining rates and inverted yield curves heighten recession fears. Nothing says that this "plow horse" economy needs to come to a halt anytime soon. Recession is inevitable. We just don't know when it will occur.

Bouts of market volatility are an unnerving, but normal, feature of long-term investing. They're not fun, but you can expect to see market declines periodically throughout your investing career. Our investing principles don't change when the market is down, and yours shouldn't either.

Schwab Center for Financial Research – August 2019

During times of market volatility, *smart investors* adhere to these 6 guidelines:

1. They resist the urge to sell based solely on recent market movements.
2. They take the long view … remember the average bear market lasts only 1.3 years, while the average bull market has a shelf life of 8.9 years.
3. They review their risk tolerance.
4. They make sure to have a diversified portfolio.
5. They consider including defensive assets for more stability.
6. They rebalance their portfolios as needed.

Recession may not be on the immediate horizon, but we'll be well prepared.

Daniel G. Corrigan, CPA/PFS, CFP®