Market Currents

- **<u>Volatility Returns.</u>** The solid start to the year has paused, as investors' mood turned negative toward risk assets in May. A deteriorating macro outlook, owing to the trade war and related growth anxieties, drove downward pressures. The S&P 500 retreated roughly 6% during May, ending the streak of four consecutive months of positive returns that opened the year.

- **<u>Trump: "My way or the Huawei"</u>**. Trade talks between the US and Chinese delegations are at a low, with rhetoric between the nations hardening. In early May, following Chinese backtracking on deal talks, the US announced a new round of tariffs on imports, and the Chinese promptly retaliated. In addition, a new front is emerging in the trade dispute, with Chinese telecom equipment maker Huawei Technologies being banned from the US market. We would expect the Chinese government to undertake similar countermeasures against US companies and commercial interests. The prospect of a speedy conclusion to the tensions continues to recede. A protracted trade war will likely put the global economy on a substantially slower growth trajectory.

- **<u>Softening Fundamentals.</u>** Growth anxieties are on the rise both domestically and abroad. Global manufacturing activity, in particular, has been weakening, and some forward-looking surveys are beginning to suggest actual contraction. Companies worldwide are scrambling to assess and adjust their supply chains to cope with the fractious trade climate. In the US, we are concerned about the continuing auto slowdown, and its knock-on effects within the broader economy. The housing sector remains sluggish as well. Jobs and wages, on the other hand, remain on a positive trajectory, although they tend to be a coincident-to-lagging indicator.

- **<u>Yield Curve Inversion.</u>** Meanwhile, a key slice of the US Treasury yield curve just became the most inverted (meaning that the interest rate of short maturities exceeds that of longer maturities) since 2007. Historically, the yield curve is viewed as a precursor to upcoming recessions. While we ascribe this inversion instance as largely tied to the downward pull of exceptionally low, even negative, interest rates overseas, it remains a caution flag that we are keeping an eye on.

- **<u>Outlook for 2019</u>**. We are downgrading our outlook somewhat from our recent view. While the recent deterioration in economic activity is a source of concern, the ongoing trade negotiations with China, Europe and Mexico will dictate market direction in the more intermediate term. Though we believe the countries involved would want to avoid a man-made, self-inflicted economic stress, the situation is very fluid, and it remains to be seen whether a favorable trade deal can be negotiated. In the meantime, the uncertainty can weight on investor, business, and consumer behaviors for the worse. There are a few bright spots: valuation, at about 15x forward, is inexpensive. Sentiment is very cautious right now, which might lend the market some contrarian support. And with inflation pressures still subdued, we suspect that a Federal Reserve rate cut might happen sooner than most expect.

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