Global Economic Review

Eagle Eye

MARKET & ECONOMIC OUTLOOK JULY | 2019

ON THE RADAR SCREEN

1. **Monetary policy:** The Fed has signaled coming accommodation and the market is priced to hold them to it. Any back peddling might not be well-received.

2. **Trade policy:** Negotiations with China are Exhibit A, but the U.S. has skirmished with Mexico also and a potential broadside to the European Union over autos is also a possibility.

3. **Fiscal policy:** The debt ceiling needs to be raised and continuing budget resolutions agreed upon in Washington. Brinksmanship may well lead to further market stress.

4. **Households:** Thus far personal consumption has held up well amidst steady job gains and elevated confidence. But June's Conference Board survey shows that may be rolling over.

5. **Businesses:** Amidst ongoing trade disputes, CEO confidence and business capital expenditures have softened. Should the slide persist, the longevity of the current economic expansion will absolutely be threatened.

BARILOTTI WEALTH STRATEGIES, LLC IS PLEASED TO PRESENT ECONOMIC AND MARKET INSIGHTS FROM THE MULTI-ASSET SOLUTIONS TEAM.

> "What is right to be done cannot be done too soon."
> – Jane Austen

Ringfencing orange swans. In 2007, author and trader Nassim Nicholas Taleb introduced black swan theory to the finance community. Prior to the late 17th century, swans were believed within Western civilization to be invariably white. The discovery of Australia's black swans turned that idea on its head. Taleb used the black swan as a metaphor for any unforeseen event that disproves conventional thinking – a shock to the system that nobody foresaw. It remains a useful reference, even if the term itself has become trite from overuse within financial circles (we're guilty too).

A twist on the metaphor could be overheard at a recent speaker engagement at the Economic Club of NY. The phrase "orange swan" was coined as a mocking reference to unexpected political developments with potentially significant implications for the economy or capital markets. The plan announced via Twitter to impose tariffs on Mexico if steps are not taken to curb immigration is a vibrant example of an orange swan in living color. We did not originate the phrase and recognize that some may take offense, but we empathize to a degree with its creator as the edict-by-tweet style of the current administration can feel a bit impetuous on occasion. And orange swans tend not to be market-friendly beasts.

The economy has grown slowly, but relatively steadily, for the past decade with the current expansion now on the books as the longest on record (assuming NBER doesn't retroactively determine that we, in fact, are already in recession). Conditions, however, show signs of deterioration. Business capital expenditures have rolled over, CEOs confidence has soured markedly, and purchasing manager surveys have been heading steadily south for months. We are on the cusp of an industrial recession, and many observers link it to the weakness to trade policy, at least in part. The confrontation with China has bipartisan support as the rules of engagement could afford to be reset, but Trump's trade animus extends to allies also, including Mexico, Europe and Japan. The orange swan that would be a multi-theater trade war has business and markets on edge.

Insights from the Multi Asset Solutions team

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Jay Powell and his cavalry of central bankers have promised to ride to the rescue, containing restrictive trade policy swans with accommodative monetary policy fencing. The Fed chairman signaled that rate cuts are soon likely, should conditions remain downbeat. Futures pricing points to a near certain cut at the late July FOMC meeting. Given where things seem to be headed, that won't be a day too soon. The Fed may even come to regret having not taken such action in June when they had the opportunity, as they may now tacitly regret having hiked last December.

"I shop therefore I am." - Barbara Kruger. While indicators within the corporate sector have grown gloomier, households and small businesses seem to be holding up better thus far. Admittedly, the Conference Board's measure of consumer confidence fell lower in June but from an elevated level. Today, it remains relatively healthy. Similarly, perceptions of job availability have pulled back. Nevertheless, the labor market looks healthy: the unemployment rate is quite low, there are more jobs available than candidates seeking them, and new unemployment claims are hovering near historic lows. This is of critical importance as personal consumption accounts for most economic activity in the U.S. So long as Americans are feeling secure about their income and keep swiping their credit cards, it's unlikely that we will dip into recession.

"To Everything (Turn, Turn, Turn) There is a season (Turn, Turn, Turn)" – The Byrd's. There is a time to plant and a time to reap. We sense a crispness in the air that comes with the turning of the seasons and think it may now be time to begin reaping.

We have been unwavering bulls for most of the past decade, but we find the current market setup a little worrisome. We see an unusual and disturbing paradox in market pricing: the stock market is near an all-time high (investor optimism), yet it has been defensive sectors that led the way while Treasury yields have collapsed (investor pessimism). The ongoing slowdown within the industrial sector, expanding trade disputes, forthcoming Congressional battles over the debt ceiling and budget resolutions, flat growth in corporate profits, and early indications of faltering consumer confidence leave us anxious. A recession doesn't yet look near, and there remain many supports underpinning equity pricing, but a measure of caution is nevertheless sensible here. Risk assets are not priced cheaply, and there are simply too many foreseeable risks that could trigger a pullback for us to be comfortable leaning in that direction. Accordingly, we've pulled back our equity holdings to a level slightly below that of our benchmark and are likely to continue to take down our positioning in the face of further market strength. We'll sleep better camping out on higher ground for the summer.

About Risk

All investments are subject to market risk, including possible loss of principal. Stocks and bonds can decline due to adverse issuer, market, regulatory, or economic developments. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer's ability to make such payments may cause the price of that bond to decline. A bond's prices are inversely affected by interest rates. The price will go up when interest rates fall and go down as interest rates rise.

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