Monthly Outlook for May, 2019: "I'd Trade All Of My Tomorrow's…"

"I'd trade all of my tomorrow's for just one yesterday, for my life's no good if I can't have your love
I'd trade all of my tomorrow's, they're worth less anyway, If I can't hold the one I'm dreamin' of

Just an empty world is all I have before me, I'd give anything if you were with me now
I'd trade all of my tomorrow's for just one yesterday, For my life's no good without you anyhow"

(Merle Haggard from his album "Strangers", released in 1965).

The plaintive singing of Merle Haggard seems to neatly sum up the feelings of many an investor – especially as ***trade rhetoric*** between the good old US of A and China seems to rear its ugly head again. Many investors were caught unaware by the heating up of the trade rhetoric – which has led to ***unwelcome volatility*** in financial markets. While we still firmly believe that a ***"trade deal"*** between the two countries is possible, the chances of such a rapproachment now appear to be more remote than they were a few weeks ago.

With trade hogging much of the headlines in the past couple of weeks, we are sure that both President Trump and President Xi would prefer that cooler heads prevail over the longer term – despite what can only be termed as a ***"hardening of positions"*** on both sides of the divide currently. While attempts by various officials on either side to put a brave face on negotiations appear to have fallen flat so far, it is interesting that we are now at a stage where the world's future prosperity depends on ***two mercurial and outsized personalities!*** I would trade all my tomorrow's for just one yesterday, indeed!

Economic data released for the month of April have come in ***quite strong***: The US economy added a seasonally adjusted ***263,000*** jobs during the month. Among the sectors, Professional and Business Services (***+76k***) and Education and Health Services (***+62k***) saw the largest increase, while Mining and Logging (***-3k***) and Information (***-1k***) were the laggards during the month. The unemployment rate declined two tenths to ***3.6%*** (from 3.8% in March) while the more robust U-6 measure of underemployment increased by a similar two tenths to ***7.5%*** (from 7.3% in March).

Average Hourly Earnings gained 0.2% (m/m; y/y: 3.2%) while the Average Weekly Earnings showed a minor decline of -0.1% (m/m: y/y: 2.9%). The household survey seemed to suggest that while the labor market is still extremely strong, there are areas that are beginning to show some weakness: The ***Average Weeks Unemployed*** continued to creep higher to ***22.9*** weeks in April (from March's reading at 22.2 weeks) while the number of people in the work force who remained unemployed for a longer time (defined as remaining unemployed for over 27 weeks) actually decreased by ***75,000*** during the month. The ***Labor Force Participation Rate*** dropped two tenths of a percent to ***62.8%*** (from previous readings of 63.0% in March and 63.2% in February).

The Bureau of Economic Analysis of the Department of Commerce pegged ***Gross Domestic Product growth at 3.2%*** (q/q Seasonally Adjusted Annual Rate) ***for 1Q2019*** – clearly a larger than expected gain. However, real final domestic demand rose a mere 1.4% for the quarter (also SAAR) as ***consumer spending*** (which normally represents about two-thirds of GDP) growth disappointed at ***1.2%*** (also SAAR). The GDP data did show a large increase in inventories (of $128.4 Billion during the period) – which bears watching – especially if the inventory accumulation is ***"involuntary in nature".***

Survey data for April (of both manufacturing as well as service or non-manufacturing enterprises) showed some ***loss of momentum***: The Manufacturing PMI posted a small decline (to 52.8 from 55.3 in March), the new orders component had a larger decline (to 51.7 from 57.4 in March) and production also posted a small decline (to 52.3 from March's reading of 55.8). The Non-manufacturing Index fell slightly (to 55.5 from 56.1) led by declines in new orders (to 58.1 from 59.0) and prices (to 55.7 from 58.7). However, despite these small declines it is important to understand that the diffusion indices for both sectors ***show continued growth*** albeit at a slower pace than before.

The Federal Open Market Committee of the Federal Reserve left interest rates unchanged at their third meeting of the year. The FOMC voted unanimously to leave the Fed Funds Target at 2.25% to 2.50% with no change in their "policy concern" either. While the FOMC Statement did not have anything new in it, Chairman Powell at the press conference intimated that they felt comfortable with the level of interest rates and did not feel compelled to move in either direction.

Chairman Powell also suggested that the ***ongoing decline in inflation*** (despite a fairly tight labor market and ultra-low unemployment rates) was a result of ***"transitory factors"*** – which by their very nature are likely to be ephemeral. We do feel that the entire analyst community (as well as central bankers in general) are ***overly complacent about the outlook for inflation.*** Not that we are a card-carrying member of the hyper-inflation club mind you, but we are merely pointing out the oddity that virtually everyone seems to believe that inflation is either dead or dying.

The FOMC did lower the interest rate it pays on excess reserves ("IOER") by 5bp to 2.35% in a "technically driven move" so as to keep the IOER below the level of the effective Fed Funds Rate – as an IOER above the effective Funds Rate would make for very difficult management of the entire funds system.

Farther afield, economic data out of Europe has been mixed: Retail sales for the EU came in better than expected for March at 0.0% (m/m; y/y: 1.9%) while industrial production for Germany disappointed rising a smaller than expected 0.5% (m/m; y/y: -0.9) for the month of March. GDP rose 0.5% (q/q; y/y:1.8%) – on a seasonally adjusted annual basis – in the UK for the first quarter, as the period was obviously impacted by all the drama surrounding the multiple votes on ***Brexit.***

The trade dispute between the US and China has its roots in the latter's ascension to the World Trade Organization in late 2001. China has used its currency, the Renminbi Yuan, as a trade tool (i.e., to devalue it in 1995 and again in 2015) despite agreeing not to do so. There is no question in our mind that if China had opened up its markets like it had promised to, many of its national champions would either not be in existence today or not be in as good a shape as they currently are.

In addition, the issues of forced technology transfer, theft of intellectual property and state sponsored cyber-crime have all been major sticking points in the trade negotiations with China. The imposition of ***additional tariffs*** by the Trump Administration implies an escalation in the trade rhetoric. While it might be ***sacrilege to suggest this***, the tariffs appear to be ***a necessary evil*** to ensure that China does adhere to the same set of rules that all other countries adhere to. The road ahead is likely to be long and arduous – as the Chinese are adept at playing the ***"long game"*** – and do not have to accede to the vagaries of an ***electoral cycle*** like President Trump.

The ***irony*** is that the trade dispute comes at an ***inopportune time***: President Trump does not want to see the US economy stutter as a result of the tariffs nor do the Chinese want to see any back-sliding in their attempts to drag their economy into a domestic demand driven place (rather than one built merely on export driven chutzpah). Despite threats of "selling of US Treasuries" and counter tariffs, we hope that cooler heads will prevail and each side will not miscalculate the other side's intentions or staying power without getting a deal done!

Clearly, President Trump is a keen ***"market-watcher",*** and the recent volatility in financial markets (especially equity markets) we are sure, does not sit well with him (particularly if he is intent on getting re-elected next year). It is still early days from a political standpoint, but President Trump would need both financial markets and the US economy to continue to do well in order to boost his chances of keeping his job come November, 2020.

The Okie from Muskogee (aka Merle Haggard) had it right, "I 'd ***trade*** all my tomorrow's for just one yesterday!".

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