One of the more astute comments summarizing the state of the economy was delivered by US Trade Representative Robert Lighthizer on May 7th, 2019: "To paraphrase Lenin: there are decades where nothing happens and there are weeks when decades happen…and then there is a single week in the Trump Presidency. What a time to be alive."

During the last three months, the four major indices which track US Stocks (+13.66%), International Stocks (+9.55%), Commodities (+15.21%), and Fixed Income (+2.94%), have crushed it thus far this year. As we analyze the geopolitical and economic events that shaped the preceding quarter it makes more sense to examine these events month by month. The economic jubilation in April dissipated dramatically in May and whipsawed back in June.

April

Investors who believed the market's performance in the first quarter of 2019 was an aberration were clearly giddy to see US Stocks (+3.51%), International Stocks (+2.73%), Commodities (+2.29%), and Fixed Income (+0.03%) finish off April with the same exuberance seen in the first quarter.

Seemingly all of the macroeconomic news released was positive. Non-Farm Payrolls exceeded expectations and informed the world that March's release was a bad data point not a source of concern. US and Chinese inflation were 2% and 2.3% and both were in line with expectations. Russian and Chinese GDP growth were slightly larger than expected. The Fed announced they did not expect to make any changes to interest rate policy this year. US retail sales and durable goods sales were significantly higher than expected painting a beautiful picture for the state of the economy. Yet, the single best piece of financial information released in April was the US GDP growth rate, which increased by a staggering 3.2%. Even with the government shutdown, the US economy was growing at a rate that had only been expected by President Trump.

The consensus on Wall Street regarding the status of the US/China trade negotiations was that a deal was imminent. Both sides had met repeatedly and all of the news coming from Washington pointed to a finalized deal in the coming weeks which would lead to years of robust global economic growth. With all the good news, retail investor and financial advisor confidence levels accelerated during April as well.

May

On Wednesday, May 1, Treasury Secretary Mnuchin said the trade talks were productive and would continue the following week in Washington. On Friday, US Non-Farm payrolls were released showing an increase in 263,000 jobs, far exceeding the expectation of 185,000 new jobs. In addition, the US unemployment rate had dropped to a staggeringly low 3.6%.

As Warren Buffet likes to say, "Be fearful when others are greedy and greedy when others are fearful." For this reason, we shouldn't have been surprised that over the following weekend (May 4-5) Chinese officials sent the White House a redlined version of the trade agreement where they reneged on many of the previously agreed upon terms. President Trump would not allow China to beat the US in a negotiation and on Sunday, May 5th, he announced tariffs would be increasing on US$200 billion worth of Chinese goods from 10% to 25% effective Friday May 10th. He also indicated he would "shortly" impose 25% tariffs on the remaining US$325 billion worth of Chinese goods. On May 13th, China retaliated with an increase of tariffs on US$60 billion worth of US goods.

Huawei (pronounced “Wah-Way”) is the world’s number one telecom supplier and number two smartphone maker. On May 15, President Trump added Huawei to the US Department of Commerce’s Bureau of Industry and Security Entity List due to concerns about the companies’ coziness with the Chinese government and fears that its equipment could be used to help China spy on the US. Adding Huawei to this list effectively bans the company from all US communication networks.

On May 17th, Trump announced that his administration would delay tariffs on cars and auto parts imports for six months while it negotiates trades deals with the European Union and Japan. On the same day, Trump announced that he would remove steel and aluminum tariffs currently placed on Canada and Mexico. This removal of tariffs was necessary in order to ensure the senate would pass the New North American Trade Deal.

On May 22nd, President Trump stormed out of a long planned and long-awaited infrastructure meeting with Democratic leaders. Trump refused to move forward on an infrastructure bill while the Democrats were investigating him, his business dealings, and his finances. This was a major blow to the market which had eagerly been anticipating the $2 trillion infrastructure bill that had been a major component of Trump’s campaign promises. In an effort to improve his news coverage, the following day, President Trump announced he would give US farmers a $16 billion bailout to help them survive during the trade war with China. He also indicated that Huawei could be included in the US/China trade deal.

On May 28th, President Trump wrapped a four-day trip to Japan with a press conference where he and Prime Minister Shinzo Abe indicated that the US and Japan were making “great progress” in trade talks and hoped they would have a deal “very soon.”

At 7:30pm on May 30th, President Trump conflated two of his key campaign promises, trade and immigration, into one item. President Trump announced that starting “June 10th, the United States will impose a 5% tariff on all goods coming into our country from Mexico.” These tariffs will gradually increase until Mexico stops illegal immigrants from entering the US. These new tariffs all but ensure the USMCA (new NAFTA) will no longer find the approval necessary for ratification.

This new tariff threat helped to further exacerbate the already dismal market performance witnessed in May. While the US market dropped 6.36%, international stocks fell 5.86% and commodities declined 7.90%. The 10-year US Treasury bond seen as a barometer of future expectations of the market, declined from 2.55% to 2.11%, a drop of 17.25%. The 3-month US Treasury Bill meanwhile finished the quarter at 2.35%. This represents a significant and growing inversion in the yield curve.

June

On June 2nd, Chinese officials released a 5,000-word white paper in 23 languages asserting their official position on the trade conflict between China and the United States. China explained that the US government “should bear the sole and entire responsibility” for the current stalemate because, “the more the US government is offered, the more it wants.” While China indicated it wants a trade deal and the removal of tariffs, in response to sanctions taken on Huawei, China also said it planned to publish a list of “unreliable” foreign entities. These foreign entities are said to have damaged the interest of Chinese firms, based on anti-monopoly and national security grounds.

Typically, republicans are pro-business, so it came as a large shock when the federal government announced on June 3rd it would be stepping up its scrutiny of the world’s biggest tech companies. The

Justice Department will look into antitrust investigations related to Apple and Google while the Federal Trade Commission will look into Amazon and Facebook. While Apple only dropped 1.5% on the news, Amazon, Google, and Facebook dropped 5-7%.

On June 4th, Federal Reserve Chairman Jerome Powell indicated that he was closely monitoring developments involving trade negotiations and that the Fed will "act as appropriate to sustain the expansion." Upon the culmination of this speech the percentage chance of a rate cut in July increased to nearly 70%.

On Friday, June 7th, the May Non-Farm jobs number was released, showing 75,000 new jobs created in May 2019 against a consensus estimate of 185,000 created. This huge miss was coupled with the US 10-Year Treasury Note falling as low as 2.06% approximately 0.20% below the US 3 Month Treasury Bill. These two events exacerbated the view that the US economy was slowing down, further indicating to the financial markets that one if not two or three rate cuts were likely.

The Republican Senate spent a week debating whether to block President Trump's "deadly serious" tariff threat against Mexico. However, on Friday June 7th, three days before the implementation of the Mexico tariffs, President Trump announced an immigration deal had been reached and the tariffs would no longer go into effect.

On June 13th, two oil tankers were simultaneously attacked in international waters in the Gulf of Oman. These two attacks are in addition to the four earlier attacks in the Gulf of Oman on May 12th. It is widely believed that Iran is responsible for all six attacks. While no one was hurt in the explosions, the price of oil skyrocketed in response to the potential for yet another conflict in the Middle East.

On Friday, June 14th, China released two important data points showing the negative effect the US/China trade war is having on its economy. Inflation is now sitting at 2.7% an increase of more than 1% since the beginning of the year. Additionally, the May 2019 reading for China's industrial production was considerably lower than forecasted, marking China's weakest annual growth in factory output since 2002. Both US May retail sales and US inflation came in slightly below expectations which furthered the expectation that the Fed would be more dovish in their upcoming statement.

In conjunction with the dramatic appreciation in the price of almost all cryptocurrencies in the second quarter of 2019, on Tuesday, June 18th, Facebook announced it would be launching its own cryptocurrency, Libra, in 2020. Libra and Facebook's digital wallet, Calibra, will allow Facebook users to buy and sell items on Facebook or to send people money with nearly zero fees.

As expected, on Wednesday, June 19th, Chairman Powell held interest rates steady but explained possible rate cuts could be in order to sustain the expansion. While not mentioned, it is possible that instead of or in addition to cutting rates the Fed might end its ongoing quantitative tightening measures. On Wednesday afternoon, Mexico became the first country to ratify the new NAFTA, the USMCA. These two events helped the US and global stock markets record massive gains, while also dropping the interest rate on the US 10-Year Bond below 2.00% to levels not seen since the summer of 2017. All of this good news helped the S&P 500 reach a new intra-day high of 2964.15 on Friday June 21st.

After three consecutive months of increases, the June consumer sentiment index fell by 10%, from 134.1 to 121.5, as consumers have begun to recognize the risks inherent with the multitude of economic and political wars the US is fighting simultaneously. New home sales also dropped 7.8% in May which was somewhat surprising given the large drop in mortgage rates. We surmise this drop was due to the perceived risks from the trade wars and the elimination of the SALT deduction that accompanied the 2017 Tax and Jobs Act.

With all eyes and ears focused on the G-20 summit in Japan, on June 26th, when speaking about the pending trade deal with China ,Treasury Secretary Steven Mnuchin said, “we were about 90% of the way there and I think there is a path to complete this.” This helped fuel an upward trajectory in the markets which continued through the close of the quarter. On the final weekend of the second quarter, President Trump and President Xi announced a tariff ceasefire while both countries meet to work on a trade deal.

Conclusion

April, May, and June were three incredibly divergent months that came together to comprise the second quarter. April was awesome! The stock market continued its triumphant first quarter performance. Everything seemed to be coming up roses. The skies grew dark and May arrived. Giddiness and glee turned into chaos as politics and tariffs reared their ugly heads. The market gave up its April gains and then some. The skies cleared and we entered June. The market brushed off the rain and malaise of May and pushed forward to record highs. The US/China trade conversations that took place at the G-20 were seen by economists as a win-win and will likely help push the global stock markets even higher as we begin the third quarter.