Added Noise to an Already Very Loud Room

We've seen remarkable volatility across all markets (stock, bond, commodities etc.) since the end of July. This volatility stems from investors' search for clarity and stability within the ongoing trade war with China, and the resulting impacts on GDP here at home and abroad. Additionally, our central bank and interest rates are very much in play.

The overall gist is that we have interrelated markets across the world. The trade issues between the U.S. and China not only impact those two countries but bleed over into other economies as well. Disruptions in the worldwide supply chain can have negative effects on other markets who rely on or are a part of that supply chain. However, it can also be positive in that other markets can pick up market share. We have begun seeing data here and in China that suggests economic activity is quickly deteriorating. U.S. manufacturing activity is in a recession and inventories are rising. China's exports have dropped 16% per their latest report. Thus, both ends of the world's largest conveyor belt of goods are hurting. If companies are unable to access key components of their products, or do not have a downstream market for their goods, they can't make money. If businesses can't make money, they can't pay wages and hire workers. You see how this can be a very slippery slope. Compound this with the fact that all the world's other major trading partners are in or near recessionary economic conditions.

The U.S. government is aware of everything I have described and has turned to our Federal Reserve for help. It is the expectation that the central bank will drop rates precipitously to offset the loss in earnings, which has caused bond yields to plummet over the past six weeks. This, along with the fact that we are just about the only developed country left with positive interest rates, has led to the recent inversion of our yield curve (international investors are buying our longer-dated bonds and causing rates to fall). All in all, we have precarious economic situation at hand.

We recently talked about the importance of our labor market remaining strong and real estate holding up. These important data points have allowed us all to hang on to the bull's tail, while the rest plays out.

The past two weeks have seen hints of improvement in the trade situation and a bounce in interest rates, reflecting optimism that some type of good news is in the offering. There has been a technical shift from risk-off positions into risk-on positions as this has unfolded. Whether this is a meaningful shift in sentiment related to improving data, or simply more of the same news-driven market remains to be seen.

Just to add a little noise to an already loud room, Saudi Arabia experienced a drone attack on two of its production facilities, thereby cutting 5% of world oil supply. The U.S. has indicated that Iran is responsible, and we are "locked and loaded" for a military response. This will undoubtedly impact markets further.

Last week's market commentary can be found here.

G. Chadd Mason
CEO, The Cabana Group

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