July Monthly Market Commentary

Time to Celebrate?

The U.S. economy is celebrating an important milestone this month, having entered the longest expansion in its history. According to the National Bureau of Economic Research - the official arbiter that identifies the beginning and end of business cycles-the Great Recession ended in June 2009, making this July the 121st. month of growth, surpassing the previous longest stretch of 120 months during the 1991 to 2000 expansion. To be sure, we won't know with certainty if the economy is still in its growth phase for a while. The NBER takes its sweet time gathering all the information needed to identify cyclical turning points.

Roughly speaking, a recession is technically underway when the economy declines for two consecutive quarters. Even allowing for revisions to earlier numbers that will become available months from now (in some cases, years), it is highly unlikely that the latest estimate showing a first quarter growth rate of 3.1 percent will be revised into a negative growth rate. But the second quarter is a different story, as it is currently tracking - according to many estimates - a growth rate of less than 2 percent, which is close enough to the zero bound that revisions could push it into negative territory. If GDP also declines in the third quarter, it's quite possible that the NBER could ultimately decide the recession began in the second quarter; that would keep the expansion out of the record books and force us to recork the champagne.

That said, it is highly unlikely that the expansion has expired. After a series of disappointing reports for March and April - which coaxed many to lower their second-quarter growth forecasts - more recent data showed that consumers are alive and kicking, highlighted by a surprisingly hefty increase in retail sales in May as well as a sharp upward revision to the April reading. Meanwhile, the job market continues to churn out more openings than there are applicants for positions and incomes are climbing at a respectable pace, comfortably outpacing inflation. With a healthy job market and strengthening purchasing power sustaining an elevated level of consumer confidence, recession fears that are priced into some sectors of the financial markets seem to be overblown. The question is, does the economy have enough muscle to plow through gathering headwinds, particularly from ongoing trade tensions and slowing global growth. With the tailwinds from the 2017 tax cuts fading, the central bank will need to lend a helping hand.

Long But Weak

Barring the unlikely event that the economy is contracting this quarter, the current expansion will be going into the record books as the longest ever. By itself, that's a laudable accomplishment, particularly since it generated other milestones along the way. Most notable is the resuscitation of the job market, which tumbled into a death-defying nosedive during the Great Recession and financial crisis. More than 8 million jobs vanished during that dispiriting episode, which lifted the unemployment rate to 10 percent from a precession low of 4.4 percent.

But like the expansion, when the job market got off its feet it too embarked on a record-long journey, generating 104 months of continuous job growth, the longest stretch ever. Not only has it been the longest, the magnitude of job gains has been among the strongest, with more than 2 million net new jobs added for eight consecutive years. That record may well end this year, as the monthly pace of payroll increases through May is

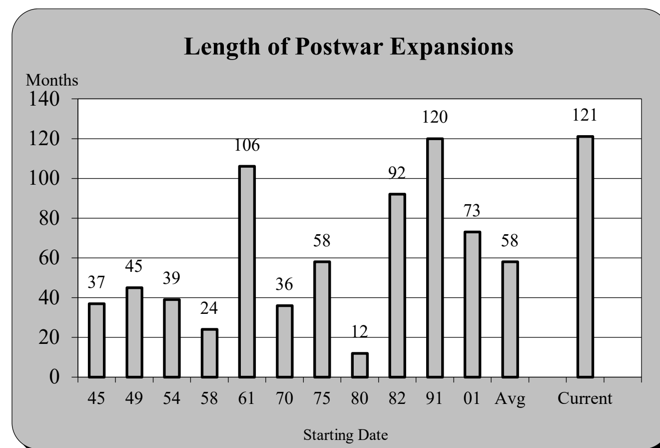
Fred Eisel
Chief Investment Officer
Email: feisel@vfccu.org
Phone: 800-622-7494 ext. 1610

Scott Wood
Portfolio Strategist
Email: swood@vfccu.org
Phone: 800-622-7494 ext. 1631

Jeffery Sengsy
Investment Analyst
Email: jsengsy@vfccu.org
Phone: 800-622-7494 ext. 1628

tracking a full-year total just shy of 2 million. But even if it falls slightly short, it may do so for the right reasons; simply put, with the unemployment rate driven down to a near 50-year low of 3.6 percent, the economy is running out of workers to fill positions.

But the tributes about the expansion come with a number of caveats. Although it has been the longest, it has also been the weakest of the postwar upturns, with GDP advancing at just over 2 percent a year. That compares to an average growth rate of 5 percent over the 11 previous cycles. The otherwise sterling performance of the job market also has its darker side; while workers found jobs at a record pace, their paychecks lagged behind. Until recently, wages grew at an exceptionally slow pace; the only reason the increase in worker earnings compares favorably with the past is because inflation has been exceptionally tame, allowing each dollar of earnings to go a longer way. That's a good thing, because nominal wage growth after jumping in 2016 has essentially stagnated since then.



Fading Fiscal Stimulus

It is unclear if the expansion would have lasted as long as it has without the jolt provided by the 2017 Tax Cut and Jobs Act. But one thing is sure: the fiscal stimulus did jump-start the economy's growth engine. In 2018, real GDP increased by 3.0 percent for the first time since 2005, almost a full percentage point higher than the average growth over the previous eight years of the expansion. The acceleration was welcome - but highly predictable.

After all, the $1.5 trillion tax cut put more money in the pockets of households and in the coffers of corporations. As expected, the windfall boosted activity for a while, as consumers, emboldened by a strengthening job market and rising incomes, increased spending on cars and other durable goods. Likewise, the additional cash flow provided by the corporate tax cuts encouraged businesses to step up investment spending: nonresidential outlays surged by an annual rate of 11.5 percent in the first quarter of 2018, the strongest since the third quarter of 2011. That was followed by another respectable increase of 8.7 percent in the second quarter of last year.

However, the impetus from the tax cuts has been fading since the middle of last year. While the bottom line of corporations has continued to benefit from a reduced tax burden, the increased cash flow has been redirected

away from investments and into share repurchases, M&A activity and dividend payouts, none of which enhances the longer-term growth prospects of the U.S. economy. Importantly, despite the ample supply of internal funds and a copious amount of borrowing at historically low interest rates, corporations have pulled back investment spending, seeing little profit opportunity in a low-growth global environment that continues to be threatened by escalating trade tensions. In the first quarter, equipment spending fell by 1.0 percent, the first decline in three years, and the declining trend in orders for nondefense capital goods points to further weakness over the foreseeable future.

Threat From Trade Wars

With the impetus from fiscal stimulus fading, many argue that the Federal Reserve made things worse by raising interest rates too far too fast in 2018. Whether that's an accurate assessment or not, the central bank is poised to lower rates as insurance against a slowdown that may snowball into a recession. To be fair the Fed, like many private economists, felt the rate hikes last year were justified to prevent the economy from overheating and stoking an undesirable increase in inflation.

In retrospect, that perception of economic strength was unduly influenced by the fiscal stimulus whose transitory effects are now waning. But it would be unfair to blame the current slowdown entirely on the Fed's actions last year. What the administration gave in the form of tax cuts and increased spending in 2018, it is now taking away with its escalating use of higher tariffs to redress perceived unfair trade practices by other nations. The drag from the government's increasingly protectionist policies became evident last year as business leaders expressed ever-more concerns over rising import costs and supply chain disruptions. It is no coincidence that business investment spending started to falter last spring as trade tensions grew.

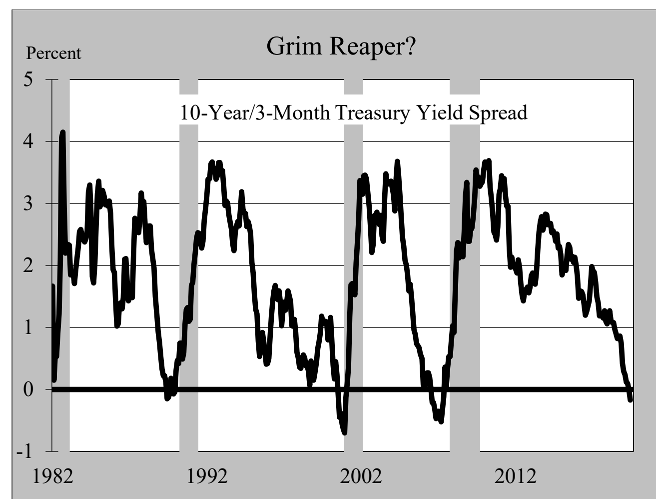
Indeed, if the administration follows through with its threat to impose stiffer tariffs on all of Chinese imports, the damage to the economy's growth rate could offset virtually the entire benefits provided by the Tax Cut and Jobs Act. In that case, the recession watch would certainly gain more eyeballs; not only would it elicit a harsh reaction from business leaders, it would also stoke heightened turbulence in the financial markets. As it is, the markets are already pricing in higher odds of a recession over the next 12 months, with bond yields tumbling below the level of short-term rates. Such a yield curve inversion is a time-honored leading indicator of a recession.

Fed Ready To Cut Rates

That said, it is important not to become too pessimistic or place too much emphasis on market developments. Trade tensions could diminish quickly if deals are struck with China and Europe and economists may be going too far in lowering their current growth estimates. While a yield curve inversion has been an infallible predictor of recessions, it is less reliable in forecasting the timing of a downturn. Historically, the record shows that there is a lag of up to two years between an inversion and a recession. Importantly, many also believe that an inverted curve has less significance in the current environment of low inflation and low interest rate than in the past.

At its latest policy meeting that concluded on June 19, the Fed kept interest rates unchanged, noting that the case for an immediate cut is not justified by incoming data. Although growth is slowing, the fundamental underpinnings remain sound. The job market, as noted, is solid with unemployment at 50-year lows and consumers are still spending at a healthy clip. In all likelihood, the expansion has enough legs to carry it through at least the rest of the year, and probably beyond.

But the best days of the upturn are behind us, and the near-term outlook is fraught with risks, highlighted by the potential spreading of trade wars that would exacerbate an already-slowing global economy. At its policy meeting, the Fed also noted that the case for more monetary accommodation has strengthened because of growing uncertainty over global developments and, importantly, the continued weakening in inflation and inflation expectations. Odds are, the risks to the outlook have tilted to the downside and the Fed will need to reduce interest rates either in July or sometime in the fall to help sustain the economy's growth engine through the gathering headwinds.



Vizo financial

Monthly Market Commentary

Key Economic and Financial Indicators

	May	April	March	February	January	December	November	12-Month Range High	Low
Prime Rate	5.50	5.50	5.50	5.5	5.5	5.35	5.25	5.50	4.89
3-Month Treasury Bill Rate	2.35	2.38	2.40	2.39	2.37	2.37	2.33	2.40	1.90
5-Year Treasury Note Rate	2.19	2.33	2.37	2.49	2.54	2.68	2.95	3.00	2.19
10-Year Treasury Note Rate	2.40	2.53	2.57	2.68	2.71	2.83	3.12	3.15	2.40
30-Year Treasury Bond Rate	2.82	2.94	2.98	3.02	3.04	3.10	3.36	3.36	2.82
Tax-Exempt Bond Yield	3.57	3.82	3.96	4.22	4.21	4.13	4.30	4.32	3.57
Corporate Bond Yield (AAA)	3.67	3.69	3.77	3.79	3.93	4.02	4.22	4.22	3.67
Conventional 30-Year Mortgage Rate	4.07	4.14	4.27	4.37	4.46	4.64	4.87	4.87	4.07
Dow Jones Industrial average	25745	26402	25723	25606	24158	23806	25252	26402	23806
S&P 500 Index	2855	2904	2804	2755	2607	2567	2723	2904	2567
Dividend Yield (S&P)	2.10	1.95	2.01	2.04	2.08	2.22	1.99	2.22	1.87
P/E Ratio (S&P)	18.0	19.3	18.7	18.3	17.8	16.6	18.9	21.0	16.6
Dollar Exchange Rate (vs. Major Currencies)	92.6	92.3	91.9	91.4	91.8	92.1	91.7	92.6	89.7

* Monthly Averages

	May	April	March	February	January	December	November	12-Month Range High	Low
Housing Starts (In Thousands)	1269	1281	1199	1149	1291	1142	1202	1291	1142
New Home Sales (Thousands of Units)		673	723	669	644	564	615	723	557
New Home Prices (Thousands of Dollars)		342	306	316	305	330	309	342	305
Retail Sales (% Change Year Ago)	3	3.7	3.8	2.1	2.9	1.6	4	6.6	1.6
Industrial Production (% Change Year Ago)	2.0	0.9	2.2	2.7	3.6	3.8	4.1	5.4	0.9
Operating Rate (% of Capacity)	78.1	77.9	78.4	78.4	79.0	79.5	79.6	79.6	77.9
Inventory Sales Ratio (Months)		1.36	1.37	1.39	1.39	1.38	1.36	1.39	1.33
Real Gross Domestic Product (Annual % Change)		3.1				2.2		4.2	2.2
Unemployment Rate (Percent)	3.6	3.6	3.8	3.8	4.0	3.9	3.7	4.0	3.6
Payroll Employment (Change in Thousands)	75	224	153	56	312	227	196	312	56
Hourly Earnings (% Change Year Ago)	3.1	3.2	3.2	3.4	3.2	3.3	3.3	3.4	2.9
Personal Income (% Change Year Ago)		3.9	3.6	3.9	4.0	4.6	4	4.6	3.6
Savings Rate (Percent of Disposable Income)		6.2	6.1	7.0	6.9	7.4	6.0	7.4	6.0
Consumer Credit (Change in Mil. Of Dollars)		17.5	11	16	17	12	21.7	25	9
Consumer Prices (% Change Year Ago)	1.8	2	1.9	1.5	1.6	1.9	2.2	2.9	1.5
CPI Less Food & Energy (% Change Year Ago)	2.0	2.1	2.0	2.1	2.2	2.2	2.2	2.4	2.0
Wholesale Prices (% Change Year Ago)	1.8	2.3	2.2	1.8	2.0	2.5	2.6	3.4	1.8

Fred Eisel
Chief Investment Officer
Email: feisel@vfccu.org
Phone: 800-622-7494 ext. 1610

Scott Wood
Portfolio Strategist
Email: swood@vfccu.org
Phone: 800-622-7494 ext. 1631

Jeffery Sengsy
Investment Analyst
Email: jsengsy@vfccu.org
Phone: 800-622-7494 ext. 1628