CLARO ADVISORS

Claro Market Insights - August 2019
Should Recession Fears Have Investors Worried?

It is always bittersweet to see summer coming to end. Gone are the quiet, relaxing days where the biggest decision was deciding what to put on the BBQ. Instead the warm weather starts turning a bit colder, the kids start heading back to school (thankfully!), and investors start to refocus on what is going on in the economy, financial markets and with their investments.

The markets have been anything but quiet this summer, particularly in August, and there has been a resurgence of debate out there on whether an economic recession is looming. I will stop right here and remind you of what defines a recession just in case the summer months have dulled your macroeconomic senses. "The working definition of a recession is two consecutive quarters of negative economic growth as measured by a country's gross domestic product (GDP)."[1] It is likely we are a long way from seeing two negative, successive quarters as the expectations through 2020 are for continued annualized growth of around 2%.[2] However, there have been some signs of a slowdown in economic activity which has led economists and strategists to start the conversation.

Let's first, quickly recap the market performance from August and year-to-date.[3] We have seen markets come down from their late July highs as trade rhetoric and the debate on monetary policy have heated up. The S&P 500 was down around -6% at the start of August and bounced back and forth throughout, before finishing off -1.8%. The technology-heavy NASDAQ Composite traded even lower as regulation risk remained in the spotlight. Small company stocks as defined by the Russell 2000 continued to struggle and were down -4.9% for the month. International and Emerging Markets stocks have not fared well either as trade tensions, Brexit concerns, Italian elections and an Argentina currency crisis have weighed on global markets. Fixed income, meanwhile, is benefiting from the increased equity volatility as investors have shifted assets into bonds, despite low rates. The increased demand has subsequently pushed bond prices higher and rates even lower. Gold has also enjoyed a "flight to quality" as prices surged another 6.5% in August and have risen almost +19% since the start of the year.

Financial Market Data				
	August	August	Q3	2019
U.S Stock Markets	Closing Price	Monthly	Quarter	YTD
S&P 500 Index Price	$ 2,926.46	-1.8%	-0.5%	16.7%
Dow Jones Industrials	$ 26,403.28	-1.7%	-0.7%	13.2%
NASDAQ Composite	$ 7,962.88	-2.6%	-0.5%	20.0%
Russell 2000 Index	$ 1,494.84	-4.9%	-4.4%	11.9%
International Stock Markets	Closing Price			
MSCI EAFE Index	$ 1,842.58	-2.9%	-4.2%	7.1%
MSCI Emerging Markets Inde	$ 984.33	-5.1%	-6.7%	1.9%
U.S. Fixed Income	Yield			
90 Day T-Bill	1.99%	0.2%	0.4%	1.6%
Barclays Aggregate Index	$ 2,232.89	2.6%	2.8%	9.1%
S&P National AMT-Free Mur	$ 168.57	1.5%	2.3%	7.6%
	Closing Price			
Gold	$ 1,528.40	7.1%	8.5%	19.5%
Oil (WTI Spot)	$ 56.71	-6.4%	-5.3%	22.0%
Bitcoin	$ 9,597.50	-4.8%	-20.1%	155.3%

[1] https://www.investopedia.com/terms/r/recession.asp

[2] https://data.oecd.org/gdp/real-gdp-forecast.htm

[3] https://ycharts.com/indices

So, let's get back to what is causing this increase in volatility and prompting pundits to start throwing around the "recession" word like it is going out of style. There will always be risks to the economy looming, but some of the more recent ones are quite worrisome. For instance, the impact of a trade war is most pressing. We can debate the use of tariffs and whether or not it's a good idea to use a public forum such as twitter in trade negotiations. But we can't argue the fact that it has led to a slowdown in manufacturing activity and business sentiment as uncertainty has increased.[4] Since peaking in August 2018, the U.S. Purchasing Managers Index (PMI) has steadily decreased and recently dipped below 50 signaling a shrinking in the manufacturing economy.[5] Whether it's enough to lead to a recession depends on the duration and overall economic impact of the trade war. So far it has been tolerable, but it can certainly have lasting effects if it stifles business investment and begins to negatively affect jobs. Hopefully a resolution or positively perceived outcome to trade will, alternatively, help lift business sentiment and stave off any further slowdown in business activity.

What's going on globally is also a big factor. The ongoing "deal or no-deal Brexit" could turn more contentious with the U.K. set to leave the European Union (EU) on October 31 with or without a deal in place, which could further disrupt trade among European nations. Monetary policy in the EU is also at risk as the European Central Bank (ECB) seeks to stimulate investment through low rates and asset purchases. But will it have the desired effect? So far it has led to negative bond yields, not economic growth. Meanwhile, the currency and debt crisis in Argentina does not appear to have a positive resolution and could impair that region. And, what impact has the trade war had on China and Asia Pacific? Overall, how concerning is this for global trade?

Lastly, back in the U.S., the Federal Reserve is under the microscope as it debates which direction to take monetary policy. If the Fed were to signal more rate cuts, would it help or be too little, too late? Also, will there be a fiscal policy issue at the end of September with a government shutdown looming? These are all real questions and risks that will affect the economy and, subsequently, financial markets in the near term.

Bottom Line for Investors

As you can probably tell, there is always a lot of information to take in, digest and decide on where the economy and financial markets are headed. But what is the bottom line for investors? Should you worry so much about fluctuations in the market? Is it worthwhile to make radical decisions regarding portfolios? The evidence would suggest no, that drastic portfolio changes cannot immunize you from volatile financial markets.[6] Instead, a properly diversified portfolio, with an appropriate level of risk, monitored and rebalanced periodically can make a big difference. As long as you have a plan for your investment portfolio and stick to it, you should be able to ride out any volatility the financial markets can throw at you. And, it's important to remember that you are investing for return and growth of capital over a much longer period of time than tomorrow, next month, or even next year, and you should keep your eyes set on those goals. The short-term speedbumps along the way might be a hindrance, but over the long run the route you've planned for investing will get you where you need to go.

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[4] https://www.conference-board.org/data/bcicountry.cfm?cid=1
[5] https://ycharts.com/indicators/us_pmi
[6] https://www.fidelity.com/viewpoints/investing-ideas/guide-to-diversification