Pittenger & Anderson, Inc.
REGISTERED INVESTMENT ADVISOR

The P&A Blog
August 16, 2019

What's impacting the markets?

The Dow Industrials hit an all-time high of 27,398 on July 16, 2019. Since then, the index is down 7%. Is this the beginning of the end of what many consider the longest bull market in U.S. stock market history? Or is this yet another speedbump the market will overcome? If you're curious as to what's pushing stocks down, we highlight the three main issues that investors are focused on right now.

Inverted yield curve

Picture a teeter-totter and you have a simplified version of the yield curve. In a normal relationship, short-term bond yields (the left side of the teeter-totter) are lower than longer-term bond yields (the right side). This is because investors typically demand more of a return on their money the longer it's tied up. An inverted yield curve occurs when the short side of the bond market has a higher yield than the longer end. Why does this happen? When investors grow worried about global economic growth, they head for the hills. And the "hills" are U.S. Treasury bonds, a "flight to safety" in Wall-Street-speak. This influx of demand for long-term bonds drives their prices upwards and, therefore, their yields downwards—in this case, lower than those of short-terms bonds.

Why does an inversion of the yield curve matter? It's generally considered a warning sign for the markets and economy. Since 1956, there have been 10 yield curve inversions, where the 2-year Treasury yield is above the 10-year yield. In six of these instances, "the S&P 500 topped out within approximately three months of the inversion." In the other four instances, the S&P 500 took 11 to 22 months to peak.

It should be noted that "recession" does not mean "bear market." Since the 1930s, more than half of bear markets have not had a corresponding recession. The stock market is a leading indicator, meaning it's forward-looking. Often, there is a bear market well before a recession, and recessions aren't identified until well after the fact.

Tariffs and trade wars

The world's two biggest economies are in a tit-for-tat trade war that can be summed up with tweets, tariffs, and talks. Tweets threatening additional tariffs followed by promises of talks have led to a lot of peaks and valleys in trade discussions over the last year. This one-upmanship isn't healthy for the global economy and is the primary reason for the inverted yield curve noted above. Throw in the unrest in Hong Kong and investor nervousness about how China will respond, and you have a major unknown for the market to digest. The sooner these trade issues are resolved, the better.

The Fed

On July 31st, the Federal Reserve cut interest rates for the first time since the Great Recession due to the worsening trade picture and global growth worries. Now the market is pricing in another 0.25% rate cut in September, with a 19% chance of a 0.50% cut. Additional cuts are expected before the end of 2019. The Fed is doing this to help stimulate the economy, get people spending money, and encourage businesses to invest for growth.

What's our approach?

Recently, I read a book called *Creativity, Inc.*, which is the well-written story of Pixar. I plucked the following quote from my book notes because it seems applicable here:

> *"If you're sailing across the ocean and your goal is to avoid weather and waves, then why the heck are you sailing? You have to embrace that sailing means that you can't control the elements and that there will be good days and bad days and that, whatever comes, you will deal with it because your goal is to eventually get to the other side. You will not be able to control exactly how you get across. That's the game you've decided to be in. If your goal is to make it easier and simpler, then don't get in the boat."*

Investing and sailing have a lot in common: you can't control the elements, there will be good days and bad days, and you must forge ahead to be successful.

Last July, we wrote "On bears and corrections," which details our philosophy about investing and how we react to market volatility. And even though we published "7 investing rules to remember" a month ago, there are still some good nuggets in this post as well.

We're on top of what's happening in the markets and will continue to work our process.