Weekly Markets Commentary

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Trade Uncertainty Causing Daily Volatility

Stocks fell for the second straight week, although they finished well off their lows. The S&P 500 fell 0.5 percent, but that was a relative victory after the index fell 3 percent on Monday. Fears of a debilitating currency war with China was the catalyst for the initial decline after the yuan broke through the psychologically important level of 7 to the dollar. But those fears receded after the currency stabilized.

The VIX index of implied stock market volatility spiked to 25 on Monday, before settling back to 18, the same level at the prior week's close. Bonds followed a similarly volatile pattern. After plunging 14 basis points to a yield of 1.71 percent on Monday, yields leveled off to end the week at 1.75 percent. In early trading on Monday the volatility was back, with the ten-year trading at 1.69 percent and equity futures pointing lower.

The trade war continues to dominate the headlines, and the surrounding uncertainty among investors and policy makers alike about where it is all headed is a primary source of daily market volatility. Yet the daily hand wringing over the details of how and when negotiations might proceed risks obscuring the larger issue that the global economy continues to struggle, Europe in particular. Last week, both Germany and France reported sharp declines in industrial production in June, led by weakness in manufacturing. Germany is widely expected to report a contraction in second quarter economic activity this week. That would come on the heels of last week's U.K. report of a contraction in the second quarter.

Closer to home, Canada reported a second straight month of job losses in July. Not all of last week's economic news was bad, however. Japan reported unexpected strength in second quarter GDP, and China reported an unexpected rise in exports. Overall, the latest Organization for Economic Co-operation and Development (OECD) index of leading economic indicators signaled stable growth throughout the OECD area, but did point to slowing momentum in the U.S. and Eurozone.

A Breakthrough on Trade Seems Increasingly Unlikely; Consumer Confidence Could Be Reaching a Peak

It is possible that either side in the U.S.-China trade war could surprise by making concessions that lead to a breakthrough, but that seems increasingly unlikely. And unless tariffs begin to take a noticeable toll on consumer confidence in the U.S., the economy can continue to grow at a modest pace. So far, the pullback in stocks has likely not been sharp enough to dent confidence. Despite falling as much as 6 percent from its record high after last Monday's rout, the S&P 500 currently sits just 3.5 percent off its July 26 record high of 3026 and remains higher on the year by 16 percent.

But it may be worth noting that measures of consumer confidence are near levels that have in the past represented peak readings. For example, the weekly Bloomberg Consumer Comfort index edged slightly lower last week to a level of 62.9. Prior to the financial crisis its peak reading was 51 in November 2006. And just prior to the dotcom meltdown its peak was 69 in January 2000. At a current reading of 135.7, the monthly Consumer Confidence index from the Conference Board sits just below its recovery high of 137.9 from last October. Its highest reading prior to the crisis was 112 in July 2007 although it reached 145 in January 2000. And at 98.4 the University of Michigan's Consumer Sentiment survey sits just below its expansion peak of 101.4 from March 2018, but above its pre-crisis peak of 96.9 in January 2007. Prior to the dotcom crash it peaked at 112 in January 2000.

Consumer Confidence Likely to Take a Hit if Tariffs Happen September 1

If the next round of tariffs takes effect on September 1, the impact is expected fall more heavily on consumer pocketbooks, and eroding purchasing power can certainly dent confidence. And with the savings rate currently at its highest average level in 25 years, and household debt running at historically low levels despite the length of the expansion, there may be an underlying fragility to the lofty confidence readings, as consumers remain cautiously mindful of the pain of the financial crisis. But that remains to be seen. For now, the labor market is strong, home prices continue to rise, and inflation remains low. And central banks around the world are cutting rates.

The week ahead will provide the latest insight into consumer confidence with reports on retail sales, the Bloomberg Consumer Confidence index, and the University of Michigan's preliminary August sentiment index. In addition, Walmart and Macy's are scheduled to report earnings.

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The Chicago Board Options Exchange (CBOE) Volatility Index (VIX) is a widely used measure of market risk. It shows the market's expectation of 30-day volatility. The VIX is constructed using the implied volatilities of a wide range of S&P 500 index options.

Bloomberg Consumer Comfort Index based on consumers' ratings of the economy, the buying climate and personal finances. Unlike the other indicators, it measures only current conditions with no questions about expectations.

University of Michigan Consumer Sentiment Survey is a rotating panel survey based on a nationally representative sample that gives each household in the coterminous U.S. an equal probability of being selected. Interviews are conducted throughout the month by telephone. The minimum monthly change required for significance at the 95% level in the Sentiment Index is 4.8 points; for Current and Expectations Index the minimum is 6.0 points.

The Consumer Confidence Survey® reflects prevailing business conditions and likely developments for the months ahead. This monthly report details consumer attitudes and buying intentions, with data available by age, income, and region.

Past performance is not a guarantee of future results.

The S&P 500 is an index containing the stocks of 500 large-cap corporations, most of which are American. The index is the most notable of the many indices owned and maintained by Standard & Poor's, a division of McGraw-Hill.

Indexes are unmanaged and are not available for direct investment.

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