Rochester Financial Services

Fee-Only® Financial Management Services

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Dow Jones	S&P 500	NASDAQ	Russell 2000	10 yr Treas	Earnings Yield (S&P)	Gold	Crude Oil
26,378	2,938	8,039	1,532	1.72%	5.79%	$1,518	$52.68

Investment Strategy Report

Stocks Get Hit By Hawkish Fed and Resumption of China Trade War

A lot has happened in the past few weeks, so let me start with a review of the recent events. It was only less than 2 weeks ago, on Friday July 26th, that the S&P 500 hit an all time record of 3,026. All was good in stock market land. This is when the trouble started.

On Wed. July 31st, the Federal Reserve met and agreed to lower the Fed Funds rate by ¼ of a point. While investors had been both hoping for and expecting a rate cut, they didn't expect a hawkish statement from the Fed, which essentially said that this was probably a one time cut. Investors were expecting a more accommodative Fed and a statement hinting of further rate cuts as needed. Despite the rate cut, the yield curve remained inverted (Fed funds rate at a higher yield than the 10 year Treasury note). Stocks dropped over 1% that day.

By the next day, Aug. 1st, investors had gotten over their disappointment and instead focused more on the positives, sending stocks higher by 1% by noon. However, investor resilience was again tested that afternoon when President Trump tweeted that he was toughening his stance against China and was going to implement a 10% tariff on all remaining Chinese imports on Sept. 1st. This was too much for stocks, as they plunged 2% from their midday highs. The stock slide continued that Friday with a 0.7% fall and then was followed by the collapse this past Monday, when the major averages suffered a 3% drudging. Within a span of 6 trading days, stocks dropped a substantial 6%.

The problem that investors have been faced with this year has been that after a 10 plus year bull market, no one wants to lose these gains a la 2008. So at the slightest hint of trouble, investors will sell first and ask questions later. When it gets nasty, like it did on Monday, no one knows for sure whether all of our legitimate concerns will be enough to derail the bull market, or whether we are just getting caught up in the pressure of the moment.

And of course, whenever the markets fall, there are always legitimate concerns. To begin with, I have already mentioned the unaccommodative Fed, which left the yield curve inverted. Then there is the trade war with China that seemed to shift in to high gear last Thursday. That not only caused stocks to fall, but precipitated a dramatic slide in interest rates. The yield on the 10 year Treasury, which was at 2.02% on Fed meeting day (7/31), slid to a low of 1.63% five trading days later. Lower interest rates are usually seen as being caused by a slowing economy, and so calls for an imminent recession grew louder.

But somehow, stocks have rebounded the last 3 days. The S&P 500 was up 1.3% on Tuesday, 0.07% yesterday, and 1.9% today. How could this have happened with all the concerns out there? CNBC's Jim Cramer addressed that today. He first pointed out that lower interest rates are not bad and are not necessarily due to a slowing economy. They are most likely due to the flood of international money coming in to our markets because of the extremely low interest rates abroad. Low interest rates help spur the economy and leave investors with no real alternative to stocks. He then added that while tariffs imposed on Chinese imports increase their cost to US consumers, the depreciation in the value of the Chinese Yuan has lessened the impact. And finally, he feels that those who have forecast a deterioration of US corporate earnings growth have no facts to back that up. Companies continue to report strong earnings.

Tony Dwyer agrees with Cramer that low interest rates are bullish for the economy and has a forecast of S&P 3,350 in 2020. And Louis Navellier came out with a very comforting podcast yesterday, saying that the US is experiencing strong earnings growth and remains an oasis for investors. With an S&P 500 dividend yield of 2.1% vs. a 1.72% 10 year Treasury yield, money will leave bonds and flow into stocks.

China – I finally decided to end my experiment with investing in China. While I still feel that over the long term, China will experience tremendous growth and will be a very profitable investment, over the short term, the trade war and problems in Hong Kong have caused its stock market to languish. At this point, I feel that it is more prudent to instead remain fully invested in the US, the strongest economy in the world. *Jeff Feldman*

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