

Markets Rebound and Trade Tensions Ease as July Begins

While markets have reacted positively to G20 summit news, it's unclear what the event's long-term implications may be.

The threat of further tariffs is diminished in the near term following the much-anticipated meeting of President Trump and Chinese President Xi Jinping on Saturday at the Group of 20 (G20) summit in Osaka, Japan, reports Washington Policy Analyst Ed Mills. The pair made commitments to restart trade negotiations, resume certain shipments to Huawei, and for China to purchase a to-be-defined amount of U.S. agricultural products. Mills thinks the immediate market reaction will be positive. However, it's unclear what the long-term implications may be, and no timeline was set for the next round of talks.

On the domestic front, odds of a downturn have increased in Raymond James Chief Economist Scott Brown's view, but he still believes a recession isn't likely within the next 12 months. However, he notes the inverted yield curve does signal an expectation that short-term interest rates will fall. For now, the Federal Open Market Committee has opted to leave short-term interest rates as is after its June policy meeting, as expected. He adds that most Fed officials seem to agree that the case for a rate cut this year has strengthened.

Following the first round of presidential debates by the Democratic candidates, several leading topics emerged – including health care policy, inequity in the tax code, antitrust scrutiny, climate issues and geopolitical challenges – which are likely to make headlines over the next year and potentially impact the market, says Mills. He will be watching for ideological differences between the candidates to gauge the direction of various policy proposals and help assess market risk in the event of a presidential changeover post-2020.

According to Bloomberg, the S&P 500 closed on Friday up 6.9% for the month of June – its best performance since January. The month also ended positively for the Dow Jones Industrial Average (+7.19%), NASDAQ (+7.42%) and the Russell 2000 Index (+6.9%).

| | 12/31/18 Close | 6/28/19 Close | Change YTD | % Gain/Loss YTD |
|---|----------------|---------------|------------|-----------------|
| DJIA | 23,327.46 | 26,599.96 | +3,272.50 | +14.03% |
| NASDAQ | 6,635.28 | 8,006.25 | +1,370.97 | +20.66% |
| S&P 500 | 2,506.85 | 2,941.76 | +434.91 | +17.35% |
| MSCI EAFE | 1,719.94 | 1,922.30 | +202.36 | +11.77% |
| Russell 2000 | 1,348.56 | 1,566.57 | +218.01 | +16.17% |
| Bloomberg Barclays U.S. Aggregate Bond Index | 2,046.60 | 2,171.71 | +125.11 | +6.11% |

Performance reflects price returns as of 10:00 AM ET on July 1, 2019.

Here is a look at what's happening in the economy and capital markets, as well as key factors we are watching:

Economy

- According to Brown, May's increase in tariffs on Chinese goods weighed on the U.S. economy, with factory output in decline, alongside a slowing global economy.
- Following its decision not to change short-term interest rates, he says the FOMC promised to closely monitor the economic outlook and "act as appropriate to sustain the expansion, with a strong labor market and inflation near its symmetric 2% objective."
- In his post-FOMC press conference, Fed Chair Powell noted concerns about low inflation and a reemergence of cross-currents – principally trade policy uncertainty and worries about global growth – but indicated that officials wanted more information and to see whether the cross-currents might recede.
- Investors are anticipating a 25-basis-point cut in the federal funds target range at the July policy meeting.

Equities

- The performance of the U.S. equity market relative to the rest of the world has continued its positive trend, reports Joey Madere, senior portfolio analyst, Equity Portfolio & Technical Strategy. China's equity market, as well as U.S. companies with outsized exposure to China, was also outperforming in the several days leading up to trade talks this past weekend. This positive momentum is helping to make up for underperformance in May, and is likely to continue in the short term on optimism following the G20 summit.

- Madere points out that there has been plenty of sector rotation taking place beneath the surface. The stall in interest rates has led to some profit-taking among high-yield utilities and REITs. The technology sector is on the verge of all-time highs, and health care's trend drastically improved in June.
- The slow growth, low interest rate and narrow yield curve backdrop continues to generally favor growth over value. Madere continues to favor large-cap companies, as technical trends for small caps remain stubbornly weak.

Fixed Income

- Corporate and municipal bonds have rallied along with Treasuries, although municipal and corporate curves remain positively sloped.
- Despite many countries' efforts to stimulate their economies with accommodative monetary policies, senior fixed income strategist Doug Drabik reports that the Bloomberg Barclays Global Aggregate Negative Yielding Debt Index reflects that the world's negative debt has risen by 30% this month to a record \$13 trillion –which he feels is a clear indication of an unhealthy global economy. The negative global rates make the U.S. bond market more attractive and put a cap on our bond yields.

International

- According to European strategist Chris Bailey, global markets typically made forward progress during June, despite major global fund management surveys showing feelings of caution among investors.
- While uncertainties continue in European politics, equity markets were buoyed this month by hopes of a trade breakthrough at the G20 summit and further central bank stimulus, he explains. During June, both the European Central Bank and the Bank of Japan talked about the potential for further stimulus.
- Bailey says Chinese economic data continued to slow this month, although not enough to negatively impact markets.

Bottom Line

- Brown thinks the risk of a recession in the next 12 months is low.
- We continue to be constructive on U.S. equities, but ultimately feel that a diversified asset allocation is crucial to helping investors ensure their portfolios stay balanced over time and in various market conditions.

I will continue to watch for legislative updates as well as economic developments. Thank you for your trust in me.

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