Stocks Fall and 30-year Treasuries Approach Record Lows as Trade Fears Increase

The stock market is taking another beating this morning and bond yields continue to fall as the drumbeat of trade war grows louder and louder. Compounding the yield drop is the notion that central banks around the world must counter-balance trade weakness in order to stop the global economy from slipping into recession. The words and actions are happening very quickly. Just this week, the White House labeled China as a currency manipulator. Although China has subsequently allowed its currency value to fall, the U.S. announcement on Monday suggests the next step could be an increase in the tariff rate. With both sides frustrated and angry, the likelihood of resuming trade talks anytime soon has dropped. As the media has pointed out, China will be celebrating the 70th anniversary of the People's Republic in October, and President Xi is expected to show only strength and unity. A trade concession isn’t likely within that space. The Wall Street Journal believes China’s strategy is now to hold out until next year’s elections.

President Trump seems to understand the negative implications of this strategy on the economy and is calling on the Fed to provide a significant counterbalance as soon as possible. This morning, Trump stepped up his attacks on Fed officials in a series of tweets labeling the FOMC as incompetent and calling for three more rate cuts…and then calling for “bigger and faster” cuts. The Fed is in a tough position because the rapidly deteriorating trade picture (and by extension the slowing economy) is being orchestrated daily by the administration. Monetary policy has become hopelessly tangled up in trade policy…which the Fed cannot control or predict.

St. Louis Fed President James Bullard, speaking in Washington yesterday, said, “the Fed cannot react to the day-to-day give-and-take of trade negotiations.” Bullard also said he continues to forecast just one more rate cut this year…in line with the committee. By contrast, the bond market is in fear mode and has priced-in roughly four cuts already, while the 30-year Treasury bond is now within a few basis points of its all-time low of 2.09%. 

Former Fed Chairman Volker, Greenspan, Bernanke, and Yellen wrote a letter to the Wall Street Journal this week arguing that Powell and the Fed “must be permitted to act independently and in the best interests of the economy, free of short-term political pressures and, in particular, without the threat of removal or demotion of Fed leaders for political reasons.” These words have mostly fallen on deaf ears, but it was a gallant effort. This morning, former Treasury Secretary Lawrence Summers told Bloomberg TV “recession risk is much higher than it needs to be and much higher than two months ago.”
The rest of the world is several steps closer to recession. Morgan Stanley recently predicted that if the U.S. implements the 25% tariff on all goods imported from China and keeps it in place for four to six months, a global recession would begin next spring. Bank of America economists warned “with no end [to the trade war] in sight, there are significant downside risks to forecast.” Industrial Production in Germany (Europe’s largest economy) is in the midst of its biggest contraction since the financial crisis, and German bond yields continue to plunge.

The German 30-year bond is now below zero, meaning the entire German yield curve is negative. Globally, an estimated $15 trillion of the world’s bonds are now in negative territory. Europe was already on shaky ground and has sustained major collateral damage in the China/U.S. trade war. Central Banks around the world have responded by slashing interest rates. Last night, New Zealand, India, and Thailand all made significant cuts. This was probably the main impetus for this morning’s series of tweets criticizing the Fed… other central banks are falling in line, why not the Fed?

Data, research, and history offer no hope in forecasting day-to-day trade threats. It’s a remarkable realization that in many ways the U.S. economy is as strong as it’s been in years, with a massive tax cut and historically low interest rates to further fuel growth, but at the same time we’re seemingly on the verge of significant decline. Traders and economists are frustrated. Many economic reports and forecasts written just weeks ago, including Fed forecasts, now appear wildly out of line.

On a side note, a bank in Denmark announced earlier this morning that it would offer 20-year fixed-rate loans at 0.00%, while another Bank in Denmark will issue 10-year mortgages at -0.50%. We believe at no time in history has a bank offered a fixed rate mortgage loan at a negative rate.

**Market Indications as of 10:50 A.M. Central Time**

- **DOW**: Down 333 to 25,696 (HIGH: 27,359)
- **NASDAQ**: Down 34 to 7,799 (HIGH 8,330)
- **S&P 500**: Down 17 to 2,864 (HIGH 3,026)
- **1-Yr T-bill**: current yield 1.76%; opening yield 1.81%
- **2-Yr T-note**: current yield 1.55%; opening yield 1.59%
- **5-Yr T-note**: current yield 1.47%; opening yield 1.52%
- **10-Yr T-note**: current yield 1.64%; opening yield 1.71%
- **30-Yr T-bond**: current yield 2.15%; opening yield 2.23%