Trying to Make Sense of the Nonsensical

In the last 11 trading days, the DOW has been up more than 300 points three times, and down approximately 2,500 points the other eight days. This wild volatility in stocks is affecting bond yields which have been jumping up and down (mostly down) for much of the last month. Yesterday's equity rally was a direct result of the President's decision to delay more than half of the latest round of Chinese tariffs until mid-December.

Today's reversal is related to global weakness as second quarter German GDP turned negative, and Chinese industrial output was the weakest since 2002. Trade uncertainty is battering both countries, so the recent breakdown in trade talks has added to an increasingly dire global outlook.

Concern is growing that the U.S. economy will soon feel the negative effects. Recession fears are on the rise with a recent Wall Street Journal survey indicating 35% of economists now forecast an economic contraction within the next 12 months. In response, the 30-year Treasury yield reached an all-time low just above 2.01% earlier today, while the spread between the 2-year and 10-year Treasury-note turned negative for the first time in 13 years. Trivia experts will point to the 2's/10's inversion as a sign that a recession is imminent, and it may be, but there are other issues in play. Most notably, bond yields are negative along the entire curve in Germany, Switzerland, and Japan, with nearly $16 trillion in global bond yields trading below zero.

75% of the economists surveyed by the Journal expect the Fed to cut by 25 basis points at the next FOMC meeting on September 18th. In more normal times, Fed rate policy is driven by two separate mandates: maximizing employment and stabilizing inflation growth at around +2.0%. They’ve actually achieved both. Yesterday, the headline consumer price index (CPI) for July climbed by a larger-than-expected +0.3%, boosting the year-over-year pace from +1.6% to +1.8%. Core CPI, which excludes food and energy prices, also increased by +0.3%, which pushed the year-over-year core up from +2.1% to +2.2%. Core CPI has now been at, or above the Fed’s target rate for 17 consecutive months.

The average 30-year fixed rate mortgage fell below 4.0% for the first time in nearly three years last week. The Mortgage Bankers Association (MBA) 30-year loan Index for the week ending August 9 was 3.93%, the lowest since November 2016. Correspondingly, weekly mortgage applications surged +21.7% during the same period. Most of this activity was refinancing, with refi applications up a whopping +36.9%, constituting 61.4% of all home loan activity during the week.

By contrast, new purchase applications were up just +1.9%. Home sales have generally been stagnant over the past four years. So far, the drop in lending rates hasn’t sparked a revival in sales. Much of this has to do with demographics. Recent generations haven’t embraced the American Dream of owning a home to the extent baby-boomers did. Crushing student loan debt, elevated home prices, and low savings have played starring roles in this decision.
Figuring out the markets at this point is a fool's errand. With stable inflation, full employment, low lending rates and an accommodative Fed, the outlook should be decidedly positive, but trade is everything...so nothing's predictable.

Market Indications as of 12:45 P.M. Central Time

DOW Down 600 to 25,559 (HIGH: 27,359)
NASDAQ Down 224 to 7,792 (HIGH 8,330)
S&P 500 Down 72 to 2,854 (HIGH 3,026)
1-Yr T-bill current yield 1.78%; opening yield 1.86%
2-Yr T-note current yield 1.58%; opening yield 1.67%
5-Yr T-note current yield 1.49%; opening yield 1.59%
10-Yr T-note current yield 1.59%; opening yield 1.71%
30-Yr T-bond current yield 2.03%; opening yield 2.17%