Optimism Fades as the Week Ends

It isn’t getting any easier to piece together a coherent economic narrative. Several indicators flashing signs of recovery in August subsequently retreated in September. Housing starts fell by -9.7% last month while building permits slipped -2.7%. Although the entire decline in both permits and starts was in the volatile multi-family sector, some of the shine has rubbed off the feel-good late summer housing story. On the factory side, industrial production fell by -0.4% in September after climbing +0.8% in August as manufacturing output dropped more than expected. The GM strike probably contributed to the poor showing, although the actual numbers were worse than forecast. Trade continues to weigh heavy on manufacturing and the outlook is murky as ever.

Last week’s trade announcement wasn’t so much a deal as a temporary agreement not to escalate any further, and to continue talks later this month. As the negotiations drag on, economic growth in both the U.S. and China are slowing. Chinese GDP for the third quarter appears to have fallen to the lowest level in 25 years. Both sides are under pressure, but after nearly two years of escalating tensions, neither wants to appear weak. And while the U.S./China trade war simmers, $7.5 billion in new tariffs on the EU will begin today. This includes a 25% tax on whiskey, wine and cheese, and a 10% tax on aircraft. Although $7.5 billion is a relatively small amount, EU officials have promised to retaliate. Recall that the China trade conflict began innocently enough 21 months ago with a tax on imported washing machines and solar panels.

Brexit discussions are heating up as the latest deadline looms just 12 days ahead. The three-year effort to hatch an equitable divorce, like the trade negotiations, have repeatedly shown signs of progress only to fail before reaching a resolution. U.K. Prime Minister Boris Johnson and European Union (EU) officials reportedly reached a compromise earlier this week, but the British Parliament has the last say…and they’re expected to say no. Best guess is another extension. It seems like the best of the bad choices would be to allow the British citizens to reconsider their vote to leave the EU now that the potential impact has been laid out.

The downward pressure on global yields is still very much intact, while the case for lower U.S. yields is gaining momentum with the Fed’s recent announcement that it will be purchasing short Treasuries to support the repo market. A 25 basis point rate cut is fully expected on October 30th and the relative strength of the U.S. dollar hints of more to come.
Market Indications as of 1:40 P.M. Central Time

DOW Down 201 to 26,824 (HIGH: 27,399)
NASDAQ Down 55 to 8,101 (HIGH: 8,330)
S&P 500 Down 6 to 2,992 (HIGH: 3,026)
1-Yr T-bill current yield 1.58%; opening yield 1.59%
2-Yr T-note current yield 1.57%; opening yield 1.58%
5-Yr T-note current yield 1.55%; opening yield 1.58%
10-Yr T-note current yield 1.74%; opening yield 1.75%
30-Yr T-bond current yield 2.24%; opening yield 2.24%