Market Commentary No. 4
September 2019

MIXED SIGNALS

Don't you hate when you get mixed signals? Like the scarecrow from the Wizard of Oz pointing both east and west when Dorothy asked where the Emerald City was, we are in a time where there is not a clear indication of which direction the economy will go next. It is clear that we are in the late cycle of an economic expansion, but there are numerous indicators used to gauge the health of the economy. These include leading indicators which are used as guides to anticipate future trends, coincident indicators which help clarify the state of the economy in real time, and lagging indicators which can confirm a pattern that is in progress. Collectively, these indicators are sending mixed signals about the state of the economy and what is next to come.

One of the most universally used leading indicators is the stock market. This is because stock prices factor in forward looking performance which can denote the economy's direction. Asset valuations have climbed to fresh highs and remained bullish since the start of the year with equities, credit spreads, and ratings performing well despite the bouts of volatility this summer. Other leading indicators are the Michigan Consumer Sentiment Index (MSCI) and the Consumer Confidence Index (CCI), which measure how optimistic consumers feel about their finances and the state of the economy. Recently, the MSCI fell from 98.4 in July to 89.8 in August (the lowest level in 2019), and the CCI increased in July but retreated slightly in August. This could be attributed to many factors, specifically heightened consumer uncertainty from the ongoing trade war with China. Suggesting that consumers spending will potentially decline, which would negatively impact economic growth.

Gross Domestic Product (GDP) is the most extensively used coincident indicator. There is currently a decreasing trend in GDP, with 2019 on path to grow at 2.3% compared to 3.0% for 2018. While GDP is still increasing year over year, it is increasing at a decreasing rate, possibly suggesting a slowing economy and a nearing end of this expansionary phase. At the same time, the U.S. current account deficit, which indicates the the value of goods and services imported exceeds the values of goods and services exported, is actually decreasing, and is most likely due to the tariffs on Chinese imports. Although this is positive, an increasing deficit is not always beneficial to consumers because the lack of imports can increase the price of goods.

A common lagging indicator is the U.S. labor market, which continues to be resilient. The unemployment rate remains at all-time lows under 4.0%, while initial claims for unemployment also remain very low. The stagnation in these numbers suggests that the economy could be hitting a peak in this cycle, possibly suggesting a trend reversal to come. Another commonly used lagging indicator are interest rates and the shape of the yield curve. Last month, the Federal Reserve cut the Fed Funds rate by 25 bps to 2.25%. Fed Chairman Jerome Powell

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emphasized the July cut was meant to protect the expansion from the risks of a global economic slowdown, slower than expected inflation and the trade war with China. Generally, however, lower interest rates are utilized to stimulate the economy as they encourage lending and the flow of capital. As mentioned in a recent RMC Market Commentary, the yield curve inversion and the Fed's pivot to a dovish sentiment are both typically associated with slowing economic growth, yet can lead to "false alarms" as well.

As Robert Kuttner cleverly said, "What do you call an economist with a prediction? Wrong." Most economists will give you differing opinions, in large part, because the vast quantity of signals they use are often piebald at best. Based on the mixed signals of today's economy, RMC is not focused on predicting what is yet to come. Instead, RMC remains focused on business fundamentals and company valuations, with an aim to construct portfolios and maintain client objectives for each stage in the economic cycle.

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