

ECONOMY

Short-term rates on rise with expectations of waning growth

THINK STRATEGICALLY:

Hard Landing for U.S. Stock Markets

Truce Called in Trade War With China As Market Volatility Risks Having Impact on Consumer, Business Costs

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Week in the markets: Stock markets' hard landing

The U.S. stock markets have had a very “hard landing” with increased volatility as trade uncertainties retook center stage. As details of the U.S.-China tariff truce became clearer, we can note it has a 90-day expiration date; thus, the agreement between President Trump and China President Xi Jinping will be finalized in the near future. Even as both sides continue to negotiate, we fear trade concerns will remain a source of market volatility well into 2019, with the perspective that an escalation in tariffs runs the risk of having an impact on consumer and business costs, which in turn will hurt economic growth. The Dow Jones Industrial Average closed at 24,389, or a loss of 1,149 for the week and a return of minus-1.3 percent year to date (YTD). The S&P 500 closed at 2,633, a loss of 127 for the week, and a YTD return of

minus-1.5 percent, while the Nasdaq closed at 6,969, or a loss of 402 for the week and a YTD return of 1.0 percent. Finally, the 10-year Treasury yield was down to 2.85 percent.

Huawei CFO Meng Wanzhou arrested; Canada trade relations worsen

The CFO of Chinese telecom company Huawei, Meng Wanzhou, daughter of Huawei founder Ren Zhengfei, was arrested Dec. 1 while traveling through Vancouver, British Columbia, following a U.S. extradition request. According to reports, Washington is claiming the Huawei CFO deceived U.S. banks to circumvent U.S. sanctions directed at Iran. This action has created repercussions in U.S.-China relations, with China informing the U.S. ambassador in Beijing to cancel the arrest warrant for Meng Wanzhou. Huawei is an immensely successful technology company that originated in China and has

not been allowed to make inroads in the U.S. markets due to concerns from Washington that the company poses a threat to national security. The argument is that if Huawei is enabled to acquire U.S. companies to sell its technology to local networks, the company could help the Chinese military spy on the U.S. through equipment programmed to do so by unaware parties.

U.S. yield-curve concerns, Federal Reserve tightening

When short-term rates rise, that's an indicator Federal Reserve Bank policy is getting tighter (less stimulus). And

when longer-term rates fall, that can be a signal of expectations for waning future growth.

Another issue that has investors concerned is the U.S. Treasury curve, because the three-year rates are at 2.72 percent and surpass the five-year rates at 2.70 percent. This is supporting fears of an inverted yield curve. The inverted yield happens when shorter-term bonds of two years or less provide more yield in interest than older ones. This more often than not is a sign of a lack of investor confidence in longer-term bonds, and it's a good indicator that recession is looming. While we are disparaging the risks, we believe such predictions are unfounded and premature. However, if you are inclined to monitor the yield curve, a better measure is to compare the three-month rates with the 10-year notes. The three-month/10-year rate spread is currently at 0.47 percent. When the measure first breached 0.50 percent, the average return in the stock market over the next year was 12 percent in the three instances that this has occurred since 1992.

U.S. job growth continues... at a slower pace

The U.S. economy added 155,000 new jobs in November, which was below the consensus expectation and slower than the 200,000 average over the past six months. Unemployment held steady at a very low 3.7 percent. The slowdown in monthly job growth may signal that the economy is weakening. However, we continue to see a labor market that is healthy with strong consumer sentiment and an unemployment rate that is at almost a 50-year low. Healthcare employment rose by 32,000 in November. Within industry sectors, job gains over the year include healthcare adding a total of 328,000 jobs and manufacturing increasing by 288,000 over the year, mainly in durable goods industries.

Final Word: Paying gov't employees' Christmas bonus sends wrong message

December rolled in, which means it is Christmas Bonus Time again and

with it, the debate over whether the government should pay this bonus to its employees—even though the Financial Oversight & Management Board (FOMB) has advised against paying the bonus. Gov. Ricardo Rosselló told Caribbean Business that “he did not defy the island's FOMB by agreeing to pay the Christmas bonus to public employees. Rather it is not us challenging the board, it is the board challenging the government of Puerto Rico. My criterion is I am going to do what in my opinion is best for the people of Puerto Rico.”

The FOMB's executive director, Natalie Jaresko, stated: “The elimination of the Christmas bonus as part of cost reductions in payroll and related costs, as a measure to avoid more drastic measures, and the certified budget reflects that the Commonwealth would not pay a Christmas bonus. As the Commonwealth proceeds to pay a Christmas bonus to its employees this year, each agency will have to achieve an equal amount of savings within their payroll and related allocation to offset such expenditure.”

“The government of Puerto Rico is operating in default with our bondholders, and we have not paid our suppliers well, a crime wave is engulfing Puerto Rico and reaching critical levels, our roads are destroyed and driving on them is an exercise in chaos. To put it bluntly, a ‘failure.’ Yes, we have failed a country, we have abandoned this generation and the next, as we continue to think in the shorter term rather than the longer term. So, to some this \$600 bonus, if not more, it might draw the line between a good Christmas and a bad one. To most experts, it defines the very nature of our imprudent fiscal ways and why we need a Financial Oversight Board that acts aggressively to implement material changes in our fiscal and financial policy.”

Had Puerto Rico been under regular bankruptcy court, it would not have been allowed to pay the Christmas Bonus. The paying of this bonus sends the wrong message to Congress and the Trump administration that is closely observing our fiscal actions. We shall see how this evolves during the new year.”

Weekly Stock Market Change

	11/30/18	12/7/18	Change
Dow Jones Industrial Average	\$25,538.00	\$24,389.00	-4.50%
Standard & Poor's 500	\$2,760.00	\$2,633.00	-4.60%
Nasdaq	\$7,371.00	\$6,969.00	-5.45%
U.S. Treasury 10-Year Note	2.990%	2.850%	-4.91%

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