BankFinancial[SM]

Trust and Investment Services
630-242-7635
bankfinancial.com

OUTLOOKS

November 2019

ECONOMIC OUTLOOK

Summary

There is a seemingly endless stream of geopolitical variables weighing on the economy and financial markets. The stark contrast between market friendly and unfriendly outcomes is palpable, yet the S&P 500 and DJIA go on to close at record highs. This brings to mind the old market adage that states, "the Market climbs a wall of worry." That seems very appropriate in our current environment, and the manner in which these "worries" are resolved will have a large bearing on the overall evolution of the U.S. economy.

With geopolitical uncertainty at a fever pitch, investors and business owners are becoming all too familiar with the "Trade War" and the various phases of a potential agreement with China, the U.K./European divorce (Brexit), the turmoil in the Middle East, the 2020 Presidential Election and the impeachment inquiry of President Trump. These issues are not going away anytime soon but there are still concrete economic data releases being published. One such release, Q3 GDP results, showed growth of 1.9% quarter over quarter and beat the consensus estimate of 1.6%. Considering the narrative for much of 2019 has been about an impending recession and all the fallout from that outcome, trend-like growth is a welcome development. Personal consumption was once again the stalwart, rising 2.9% during the quarter and contributing 1.93% to GDP growth. While government expenditures added modestly to GDP, business fixed investment and net exports both detracted to overall GDP growth.

This leads us back to those unresolved "worries." Domestically, the economy craves some clarity on trade relations since the consumer cannot singlehandedly carry economic growth in perpetuity. For balanced economic growth, an increase in business investment is essential. Additionally, the hyper-partisan political environment and very divergent policy initiatives only add more layers of uncertainty. Fortunately, the American electorate will have their say on things in less than a year.

In the meantime, the economy continues to grow near trend levels, but in an unbalanced manner. Only time will bring the clarity investors and business owners require, but for now, the domestic economy is on relatively solid footing. However, it wouldn't take much upheaval to alter the spending plans of both consumers and businesses alike.

Positives

Core personal consumption advanced 2.9%, 2.6% was expected

Consumer confidence surveys remain elevated but off the highs of the year

Pending home sales were up 6.3% month-over-month, 3.6% increase was expected

Negatives

ISM Manufacturing Index near the lowest level since 2009, contacting three months in a row

Capacity utilization was lower last month at 77.5%, 77.7% was expected

Leading Economic Index lower two months in a row, unchanged was expected

BankFinancial℠
Trust and Investment Services
630-242-7635
bankfinancial.com

OUTLOOKS

November 2019

EQUITY OUTLOOK

Summary

Equity markets continued to rally in October despite mounting uncertainty surrounding the House impeachment investigation. More impactful on the markets were positive developments regarding the U.S.-China trade dispute. Both sides seem to be willing to deescalate tariffs and are working toward a “phase one” agreement. The first phase of the agreement is unlikely to include progress on major sticking points such as intellectual property rights but the stock markets still see any hint of advancement as an encouraging signal for risk assets.

The S&P 500 rose 2.2% for the month bringing the total return to date up to a whopping 23.2%. Growth stocks once again outpaced value stocks for the month and small cap stocks, which had been lagging for the year, outperformed large peers. With trade being a key driver, international markets were among the best performers during the rally. The developed MSCI EAFE Index rose 3.6% and MSCI Emerging Markets Index jumped 4.2%.

Health care was the top performing sector in September adding 5.1% in part because Democratic presidential candidate Elizabeth Warren’s polling numbers slipped throughout the month. Many polls had her leading democratic hopefuls in recent months. One of Warren’s keystone policies has been Medicare for all, which has the potential to create significant disruption in the health care industry. The sector overall remains a laggard for the year-to-date period. The information technology sector continues to impress (+3.9%) while energy (-2.3%) and utilities (-0.8%) were the worst performing sectors’ bottom contributors.

Equity investors have plenty of reason to be cautious. However, impeachment proceedings are just a side show that will likely fail to yield Democrats an impeachment vote in the Senate. Meaningful trade progress will be tabled for 2020 or perhaps beyond the presidential election. The resulting backdrop for equity markets will likely lead to the same environment we’ve been locked in for some time. With fixed rates so low, stocks appear to be the only reasonable place to invest. Market fundamentals look encouraging and economic conditions have stabilized. With corporate earnings season mostly in the books, 74% of companies have reported ahead of estimates, there appears to be little to disrupt the momentum of the equity market at this time.

Positives

Resilient U.S. consumer and labor markets

TINA – There Is No Alternative (to equities)

Negatives

Stocks are close to becoming expensive

Unknowns

Signs of trade progress but a very long way to go

Brexit path and impact

BankFinancial[SM]

Trust and Investment Services
630-242-7635
bankfinancial.com

OUTLOOKS

November 2019

FIXED INCOME OUTLOOK

Summary

Yields declined sharply during the first few days of October as the weakest manufacturing survey data in 10 years was followed by a similarly soft non-manufacturing survey report. Investors are often willing to look past the manufacturing data as it only represents a small portion of economy but weakness in the service sector sends alarms ringing. The 2-year Treasury note hit a low of 1.36% on October 4th, the lowest level in over two years. The 10-year reached 1.50%, which was 40 bps lower than mid-September but still about 5 bps away from the lows earlier that month.

Sentiment changed after a stronger-than-expected payroll report and news that “phase one” of a trade deal with China may be reachable and presented for signatures at a mid-November summit in Chile. A decisive risk-on tone was pervasive in all markets with treasury bonds taking the brunt of selling. By late in the month, yields had moved back up to near where they began.

Even with the recovery in some key economic data and signs of progress in the Chinese trade dispute, on October 30th, the Federal Reserve’s Open Market Committee lowered the overnight lending rate by 25 basis points (bps) for the third consecutive time. The new target range for the overnight rate is 1.50 percent to 1.75 percent, which is slightly below their asymmetric inflation target of 2.0%. We believe this was the right action for the Fed to take as inflation continues to trend below their target and there are enough risks to the economy that it is prudent to take out some insurance against the downside. In the ensuing press conference, Fed Chairman Powell made it abundantly clear that they see little chance of needing to hike the Fed Funds rate anytime in the next few years as they see little chance of inflation rising consistently above their target.

We believe that the Fed will likely be on hold for the remainder of the year unless incoming data suggests that the economic momentum is slowing significantly. That said, an escalation of the trade dispute along with increasing tariffs could easily be enough to derail the trend line of around 2% growth that we expect to see. The 2-year rate should stay near the low-end of the Fed Funds target range since there is a chance for additional cuts and little to no chance for rate increases. In a sign of optimism, longer yields could increase modestly as the curve moves to restore some slope.

Credit spreads moved tighter as economic concerns diminished and equity markets rallied. We still believe that corporate bonds represent an attractive opportunity but the identification of specific issues will become increasingly important in this late cycle environment.

Positives

Still upwards of $15 billion in negative yielding bonds around the world

U.S. rates continue to be much higher than other high-quality, safe markets

Negatives

Modest growth has returned to some parts of Europe, particularly Germany

Modern Monetary Theory narrative; unlimited deficits

Unknowns

Tariffs and trade negotiations with China

Trump impeachment proceedings