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WEALTH MANAGEMENT

Connecting the Dots

June 2019

The VIX spiked 32 percent as volatility returned in May after a four-month hiatus. U.S.-China trade tensions grabbed headlines in early May, and economic data pointed to slowing global growth and a lackluster growth outlook.

The U.S. ratcheted up tariffs on China and, according to the White House, will initiate 5 percent graduated tariffs on imports from Mexico beginning the week of June 10. While China announced plans to implement retaliatory tariffs, specifics are unknown at this time. Please see Trade Winds for more information on the latest round of tariffs imposed on China.

Timing of tariffs on Mexico confused several market participants because the motivation seems at odds with objectives for a firm stance against China. Namely, a central tenant of the revised NAFTA ("USMCA") was moving corporate production from Asia to Mexico. Amid global trade uncertainty, time-tested economic growth indicators offered little solace for market participants. Weakness in U.S. composite Purchasing Managers' Index (PMI) indicates the pace of economic expansion in the manufacturing and services sectors slowing to levels not observed since early 2016. Durable goods orders and consumer confidence fell slightly more than consensus estimates.

Global yields moved lower in May with negative yield curves out to ten years in Europe and Japan. In contrast, U.S. Treasury yields continue to offer positive yields but the yield curve inverted to levels not observed since 2007. By the end of May, the spread between the 30-year bond and the effective federal funds rate was just 18 basis points. The shape of the yield curve still signals that monetary policy is too tight relative to economic conditions, however, policymakers remain steadfast in maintaining the target federal funds rate at 2.25 – 2.50 percent.

In May, Fed policymakers justified no change to the federal funds rate citing "muted inflation pressures" and strong labor market conditions, however, Fed Officials are likely to revisit that narrative as forward-looking inflation expectations fall, in step with recent declines in commodity prices, and equity volatility rises.While the Fed's preferred inflation gauge (Core PCE) is just 1.7 percent, Federal funds futures had fully priced just over two 25 basis point rate cuts by the calendar year-end and as outlined in Stirred, Not Shaken the futures market had priced in just an 80 percent chance of a single 25 basis point cut in early May. While we do not believe the global growth outlook deteriorated enough in May to warrant such a move, it indicated a clear shift in investor sentiment. High yield credit spreads widened 60 basis points and is back to levels observed in mid-December. Although equity volatility makes headlines, credit markets more accurately reflect financial market conditions and will be key to discerning financial asset vulnerability to subsequent shocks. As such, Fed policymakers may reassess the appropriate federal fund's target range should credit spreads continue to widen and equity volatility intensify. Investors will also look for indications of a shift in monetary policy tools or process following the Federal Reserve's Conference on Monetary Policy Strategy in early June.

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The S&P 500 Index fell 2.6 percent in May as global slowing within the manufacturing and retail sectors point to deepening fractures in the reflation outlook in place since 2016. After the markets closed Friday, May 31, news broke that Google could face an antitrust investigation from the Department of Justice. Implications of the investigation are speculative at best at this point, but investors may worry the investigation may spread to other FAANG stocks (Facebook, Apple, Amazon, Netflix and Google).

Europe has largely avoided making front-page headlines with escalating U.S.-China trade tensions, but several key developments in the region warrant consideration. On May 24, British Prime Minister Theresa May announced that she would resign on June 7. She is expected to remain prime minister for approximately six weeks until the conservative party selects her successor. It's still too early to tell what the implications this development will have on ongoing Brexit negotiations. Persistently sluggish growth in the Euro Area renewed concerns that Italy can manage its growing debt burden. The five-year spread between Italian and German debt increased 42 basis points over the past month and bears monitoring going forward.

Conflicting signals on economic growth in China prompted investors to favor financial assets in developed markets; particularly sovereign bonds. The near-term outlook for emerging market equities remains uncertain, however, sentiment could change quickly should U.S.-China negotiations improve or financial conditions ease in China. Emerging market economies are still *the largest* contributor to world GDP growth and favorable demographics (ex-China), lower debt to GDP and relatively attractive valuations warrant a strategic allocation for long-term investors committed to disciplined rebalancing process.

Apollon Wealth Management, LLC continues to believe that investors should be patient and adhere to a well-constructed, diversified investment portfolio anchored to your goals and time horizon. Despite elevated uncertainty, we do not find compelling reasons at this time that would justify overriding our asset allocation methodology.

For more information and assistance, please contact any professional at Apollon Wealth Management, LLC