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“By The Way”

October 2019

“Good news is good news and bad news is bad news.”

Since our last letter little has changed for the S&P 500 Index. There has been a continuation of volatility surrounding geopolitical events such as the trade negotiations with China, impeachment proceedings, mid-east hostilities, Brexit, etc.; yet no definitive market trend has been established. Nevertheless, we sit at something of a crossroads, just below the all-time highs. The bulls must press the advantage and establish a strong and meaningful breakout of those highs, or the best we can expect is a continuation of the backing and filling within the current range, or at worst a significant decline. As if everyone is waiting to be told what to do, trading volumes have been extremely light recently. It is a bit worrisome that the volume has been particularly low on days when the market is up, indicating a lack of commitment to the bullish cause.

Good news is good news and bad news is bad news. For most of the past decade that seemingly obvious supposition has proven to be incorrect when investing in the financial markets. Weak economic or earnings reports were met with increased buying in the belief that the Federal Reserve and other central banks would ease monetary policies by lowering rates and injecting liquidity into the system. For the most part that was an accurate assessment, and was reflected in higher prices. In my opinion those days are in the past, and Fed Chairman Powell no longer wields the magic wand that can make weak fundamentals disappear at his whim. We have witnessed recently that markets decline when lower GDP and PMI reports come out as the potential for a recession becomes more real. Fundamentals finally do matter.

Global estimates for GDP growth continue to contract. The International Monetary Fund's new forecast predicts growth of 3.0% this year down from earlier estimates of 3.2% in July and 3.6% at year-end 2018. The fund also cautioned that even lower numbers are possible given geopolitical uncertainties, citing trade conflicts and tensions in the middle east. In the U.S. the most recent Purchasing Managers survey showed the manufacturing index at 47.8 below the 50 level, which indicates the potential for contraction. The non-manufacturing index which is more important to the U.S. economy was still signaling growth at 52.6, but that was down from 56.4 in August. It is even more unsettling that September real retail sales came in at -0.3%, since the driving force for the U.S. economy has been consumer spending.

An incident in the so-called repo market provided another reason to question whether or not the Fed has the control of the monetary system that we all assume and count on. Banks and other financial institutions use the repo market (stands for repurchase agreement) to borrow money from the Fed to cover their overnight needs. On the night in question, funding needs were

oversubscribed and the Fed was unable to meet demand. Institutions were forced to seek funds in the private market which pushed borrowing rates to over 10% from the norm of around 2.25%. The Fed came to the rescue through open market operations that injected new liquidity into the system and brought rates back down. Ominously such open market operations had not been necessary since the crisis of 2008. The Fed has announced a 6-month program to shore up its balance sheet to protect against another occurrence, and told us not to worry; no harm, no foul. Nevertheless, I do worry. There was obviously some stress in the banking system. The Fed's balance sheet is already around \$4 trillion. To a simple soul like myself, and despite reading all the explanations, I thought that should be enough to cover emergencies. At the end of the day, there remains a concern that they are making it up as they go along.

President Trump has once again dumbfounded me with his decision to pull back troops in Syria, but why am I surprised. I'm going to abstain from long comment this month on U.S. politics other than to say the gap and antagonism between camps continues to grow. I did come across a report of a 2018 Rasmussen poll that astonished me. When asked is it "likely that the United States will experience a second civil war in the next five years", 37% of Democrats and 32% of Republicans agreed.

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