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Midland
Wealth Management

Market Update

Volatility and fear have returned to the stock market with a vengeance. The up and down daily moves we have been experiencing in the equity markets since the beginning of August are anything but normal. The Dow Jones Industrial Average has seen swings greater than 100 points a majority of these days. While volatility and negative markets are not comfortable, we have anticipated a correction in the markets following the strength we have seen during the first seven months of the year. At the time of this writing, the major indices, which were up about 20% for the year, have declined approximately 6 to 7% from their recent highs. Some retracement of those previous gains is not unusual. At this time, we don't believe this is the beginning of a bear market in equities.

What is causing this volatility? There are several concerns facing investors.

1) Trade discussions (war) are ongoing, and there has been no resolution. Currently, it doesn't appear that there will be a deal in the next few months. Continued bantering and threatening tariffs have been a drag on business spending. This environment, along with an upcoming U.S. election, does not give businesses confidence to invest in new equipment due to the uncertainty of the future landscape of global trade.
2) Global economic growth has slowed dramatically. Germany posted negative GDP growth in the second quarter. China continues to slow and was on this path prior to any trade discussions. Stimulus across the globe has failed to spur much in the way of economic growth. While the services side of these economies remain in growth territory, the manufacturing component has declined dramatically.
3) Brexit appears to be going forward with no deal. What impact will this have on growth in the United Kingdom and the overall international markets? This situation just adds to the global uncertainties.
4) Almost $16 trillion in global bonds have negative interest rates. U.S. Treasury yields in the intermediate and longer end of the curve have declined leading to an inversion between the 3 month and 10 year and most recently, the 2 year and 10 year. Is this move in yields due to large demand from global investors or is there a recession on the horizon in the U.S.? An inverted curve has preceded every recession, but every inversion has not led to a recession. We will need to see how long the curve remains inverted for it to be predictive of recession.

While we have addressed the global slowing in previous communications, the domestic economy continues to exhibit signs of growth albeit at a slower pace than in 2018. Trend growth has been about 2% during this extended expansionary period, and we believe we are back to trend growth. While we do not believe a recession is imminent, there are more risks today than exhibited during the last three to four years.

This year we have maintained a neutral asset allocation in our portfolios with a slightly higher exposure to money markets. With the current interest rate structure and a Federal Reserve that will more than likely continue to lower short-term rates, we are lowering our money market position and investing those funds into bonds. We remain cautiously optimistic on the equity markets at this time and believe this is a correction in a continued bull market. We intend to remain at a neutral allocation to equities. Recognizing that risks of a recession have increased, we will continue to monitor the current business environment.