Bell Bank Wealth Management

EQUITY & FIXED INCOME OUTLOOK AUGUST 2019

Federal Reserve Monetary Policy

The Federal Reserve cut the Fed funds rate 25 basis points to 2.25% in July. The market is becoming more skittish about the growth outlook, with indications that the Fed likely will follow through with more rate cuts as soon as September.

Inflation

The most recent year-over-year inflation rate was 1.6%, which is lower than we anticipated. Look for the number released in August to be near this same level. Long-term inflation expectations remain muted. Central banks around the globe are still wondering why their easy monetary policy schemes are not working to drive inflation higher. Our take is that today's consumer is very price-conscious, and corporations have made it a point to compete on price. There seem to be fewer and fewer examples of products competing on quality instead of price for the consumer dollar. Because of this, we feel inflation will remain low in spite of global central banks' easy money policies.

Economic Activity

Last month we mentioned the brawl over future prospects for economic growth. After touching new highs in July, the stock market is now 5.5% below its peak. At the same time, interest rates continue declining, as investors remain focused on the benefits bonds provide as a shelter from the prospect of stock market volatility. It appears the declining interest rate camp is winning for now.

While the market remains uneasy about the economy's future, the consumer remains on solid ground for the time being, as suggested by employment, wages, debt-service levels and savings rates. The consumer drives about two-thirds of gross domestic product.

Concern about growth may have more to do with signs outside the United States than within. Developed-country growth has slowed to about 1% and appears to be slipping even more. Trade tensions are expected to contribute to more friction, but some of the issues in trade negotiations, such as intellectual property rights, have become so important that they appear to be non-negotiable in settlement talks. The thinking is that eventually U.S. growth will slow along with the rest of the world.

Fixed Income

Around the globe, about $14 trillion of debt has a negative yield. No, this is not a misprint. In fact, Germany's whole yield curve from 1 month all the way out to 30 years has a negative yield. Imagine investing $1,000 in a 10-year German bond with a yield of -0.58%. There is no interest, and at the end of 10 years, Germany pays the investor $943. This is a guaranteed loss of $57 if the bond is held to maturity. Can this even be called an "investment"? How long can this go on? How will it end? Now imagine taking out that next loan at a negative rate to purchase a house. Using Germany as the template, you'd pay no interest and ultimately pay back less than the initial loan balance. What a deal! We are not trying to pick on Germany. The interest rate on 10-year bonds is also negative in France (-0.32%), Sweden (-0.29%), the Netherlands (-0.48%), Switzerland (-0.99%) and Japan (-0.2%).

Many think negative rates only apply to government bonds, but that is incorrect. European yields for McDonalds, AT&T, Apple, IBM and Pepsi are all negative. Maybe that negative home loan is still a possibility.

Politicians enjoy the concept of negative rates. They can borrow as much money as they want, and the longer maturity is stretched out, the less money is payed back.

Stock Market

For the last several months, the stock market ignored tariff news in favor of prospects for Federal Reserve interest rate cuts. Now that the Fed acted to cut rates, that topic appears to be in the rearview mirror, and trade is the new market mantra. This includes resurrecting fundamentals as a driver of stock market valuation. We see this as welcome news but guess that it may be short-lived, as conversation migrates back to the prospects of a Fed rate cut in September.

Expect to see more volatility than in the recent past. The stock market will tend to benefit from further Fed developments about rate cuts and the prospect of low yields from bonds pushing investors toward stocks. Passive investing also tends to support the market with rather indiscriminate purchases into stocks as a whole.

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Tenure: 09/1992

Years of Investment Experience: 33 years

Education: Greg holds a bachelor's degree in business from the University of North Dakota and is a CFA charter holder.

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