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Warwick Shore Advisors LLC (WSA) is an independent investment advisor focusing on investment strategies designed to outperform the market and mitigate risk over the long-term. We employ a rules-based academic approach that incorporates top-down, macroeconomic analysis and quantitative research. Our rigorous research and portfolio construction process gives us opportunistic insight in to the investment landscape.

Our rules-based top-down macroeconomic approach differentiates us from traditional bottom-up investment management firms. We believe a global perspective driven on macroeconomics is needed to fully synthesize the current market environment. This approach is also paramount in forecasting the road ahead and building risk-controlled, goal-oriented portfolios.

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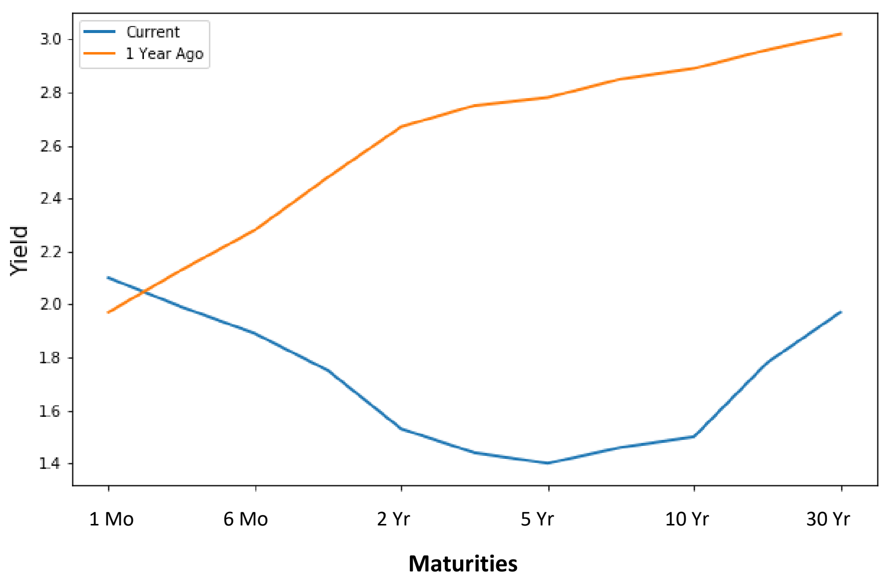
Trade War and Inverted Yield Curve

Recession Fears Rise, Trade War Escalates

In the month of August, the bond market signaled weakness in the road ahead for the U.S. Economy. In previous installations of Market Insights, we have highlighted the continued flattening of the yield curve. The short-term end of the yield curve has continued to offer higher yields than the long-term end. This has led to increased fears of a recession and an end to this aging bull market.

U.S. Treasury Yield Curve



Source: US Department of the Treasury. Rates from August 29th, 2018 – August 29th, 2019

Geopolitical Headwinds

Market volatility resurfaced over the last month as a result of the latest episodes of the trade war tennis match between the U.S. and China. Both economies have shown signs of economic fatigue, nonetheless, neither side is willing to wave the white flag. President Trump delayed some tariffs to December with the hopes of pumping more fuel into the bull. However, China announced additional tariffs against the U.S. which increased the turbulence in the financial markets. Unfortunately, the consumer will lose the most as this trade war progresses. Research from the International Monetary Fund (IMF), shows that U.S. importers bear nearly all of the cost of the tariffs. These increased costs are then passed down to the American consumer inflating the cost of common products. Behind the scenes, China has reduced tariffs to countries that represent the World Trade Organization (WTO). This has allowed China to supplement increased costs by importing substitute goods from other countries that the U.S provides.

Economic Data

U.S. treasury rates have dropped significantly over the past month and are trending in the opposite direction compared to a year ago in the chart above. In addition to the middle of the treasury rate curve inversion, the 2-year treasury note is now yielding higher rates than the 10-year. From the standpoint of an economic indicator, when the yield curve inverts, a recession is somewhere on the road ahead. Although there is no statistical evidence to forecast the time between the initial yield curve inversion and an economic recession.

In addition to the inverted yield curve, we are currently experiencing full employment in our economy and the most recent reading shows consumer sentiment has dropped significantly. The deterioration in consumer sentiment highlights a level of fear that consumers have with the potential growth aspects of the economy. A major source for the lack in consumer faith rests in the ongoing trade war and the uncertainty of a positive outcome.

Investment Implications

Our research continues to highlight the theme of slower growth as the global economy continues to decelerate. The ramifications from the trade war will continue to impact the consumer and global markets. Monetary policy has currently implemented a restrictive policy stance similar to that at the start of the great recession. Unfortunately, this time, rates are being reduced from a lower level which limits the tools the Federal Reserve has to combat an economic downturn. Therefore, maintaining a diversified portfolio that meets the objectives and goals of each individual investor is paramount in this investment landscape.

Index Descriptions

Treasury Yield Curve- Is a measure yields and maturities for current government fixed income securities. The yield curve is often used as a benchmark for lending rates. Investors inspect the shape of the yield curve for insight into the current state of the economy.

Housing Starts- Is an economic indicator that measures the amount of new housing units starting construction for a given month. These data are designed to measure living dwellings and not commercial property. The living dwellings are considered single-family units, townhomes, apartments and apartment buildings that have less than 5 units.

Gross Domestic Product- A measure of the market value of all final goods and services produced within an economy. This is measured on an annual or quarterly basis and provides insight on the growth of an economy.

Term Structure of Interest Rates – A measure of the relationship between interest rates of different term or maturities along the yield curve. A normal yield curve is upward sloping with short-term rates (1-month, 3-month, 2-year) providing a lower yield than long-term rates (7-year, 10-year, 20-year)

Consumer Sentiment – An economic indicator that measures the level of optimism that consumers have regarding their finances and the state of the economy.

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