Markets Don't Want to Hear Goldman's Happy Talk: Robert Burgess
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By Robert Burgess
(Bloomberg Opinion) -- In normal times, a bullish call on stocks from the chief global strategist at Goldman Sachs Group Inc. would send equities soaring. But these aren't normal times. The S&P 500 Index not only fell on Monday after Peter Oppenheimer issued a report saying investors can still expect "a reasonable relative return" by holding stocks, it declined even more on Tuesday for good measure, dropping 1.56%. This isn't an indictment of Goldman's influence, but rather proof that even Wall Street analysts can't provide the one thing markets want most.

Multiple surveys show that traders and investors see the U.S.-China trade war as the biggest risk facing markets. Bank of America Merrill Lynch's latest monthly poll of global fund managers, released in mid-September, revealed that the number of respondents who said trade tensions were the biggest danger outstripped by far those who cited ineffective monetary policy and the potential bursting of the bond bubble. In her first major address as head of the International Monetary Fund, Kristalina Georgieva said Tuesday that the global economy is ina synchronized slowdown, in part due to trade uncertainty. Also on Tuesday, the National Federation of Independent Business said its small-business sentiment index fell to near the lowest level of Donald Trump's presidency. Even more notable was that the part of the index measuring "uncertainty" plunged to its lowest since February 2016. "More owners are unable to make a statement confidently, good or bad, about the future of economic conditions," the group said, with 30% of respondents reporting "negative effects" from tariffs. To cut to the chase, if businesses can't forecast with any confidence, how can investors or strategists?

U.S. and China trade negotiators are scheduled to meet on Thursday to resume talks. What's discouraging is that instead of making conciliatory comments, each side seems to be hardening their stances. Chinese officials said Monday that what isn't on the table from China's perspective — and never will be — are changes to its laws to protect foreign intellectual property. Later that day, the U.S. placed eight of China's technology giants on a blacklist over alleged human rights violations against Muslim minorities. In response, China hinted that it might retaliate. Then the news broke that the Trump administration is moving ahead with discussions around possiblerestrictions on portfolio flows into China. None of this sounds like either side is ready to make a deal.

BOND TRADERS LAUGH AT INFLATION

It’s a big week for inflation data in the U.S., and the bond market isn’t very optimistic that the Federal Reserve can reverse the troubling slowdown in prices. The government kicked things off on Tuesday by saying producer prices fell 0.3% in September after stripping out food and energy prices. That was the biggest monthly decline since February 2015. On Thursday, the government is forecast to say that its consumer price index rose just 0.2% last month excluding food and energy, down from a 0.3% gain in August. This deceleration is happening even though the Fed has cut interest rates twice since July, a move that theoretically should boost the demand for money and spark inflation. But this shows just how much consumers are struggling despite the lowest unemployment rate in 50 years. A quarterly survey by UBS AG released Tuesday showed that an above-average percentage of consumers, or 44%, reported incomes that don’t cover their expenses, or barely cover them. It’s no wonder that breakeven rates on five-year Treasury notes, which are a measure of what traders expect the pace of inflation to be over the life of the securities, fell on Tuesday to 1.26%, the lowest since 2016, according to Bloomberg News’s Katherine Greifeld. A year ago, those rates were right at 2%, which just happens to be the Fed’s inflation target.

DOWN ON THE YUAN

When it comes to the yuan, Chinese officials are walking an extremely fine line. They are allowing the closely managed currency to weaken in an effort to offset some of the effects of the U.S. imposed tariffs, but not so much that it causes a capital flight. Already, the offshore yuan has depreciated from 6.2540 per dollar in March of 2018 to 7.1485 on Tuesday. And there’s more to come, according to the responses of 54 investors, strategists and traders around the world surveyed by Bloomberg News in late September. The results, released on Tuesday, show that it’s more likely the yuan will weaken beyond 7.25 per dollar by the end of 2019 than strengthen past 6.95 per dollar. The results are notable because the current consensus is that the yuan depreciates to 7.20 per dollar by year-end. This suggests that the official forecasts need to catch up to sentiment, which could weigh on the currency as estimates are lowered. And that’s before the downside pressure that would be exerted on the currency if the Trump administration decides to restrict U.S. portfolio flows into China, with a particular focus on investments made by government retirement funds.

CRANK UP THE HEATERS

Although the UBS report on consumers is concerning, it doesn't signal an imminent downturn, based on other data such as unemployment, jobless claims and the availability of credit, according to Bloomberg News's Claire Boston. That's good news, considering that consumer spending accounts for about two-thirds of the economy. One area where consumers may find relief in coming months is in their winter heating bills. The U.S. Energy Information Administration said Tuesday that such costs are likely to belower due to abundant supplies. Homes that rely primarily on electricity or natural gas for heating will "spend slightly less than last winter;" those burning heating oil may see their bills fall 4%, while propane costs are expected to drop 16%, the agency said in its Winter Fuels Outlook on Tuesday. Higher regional gas prices in the South mean residents there may pay 4% more, according to Bloomberg News's Naureen S. Malik. Heating costs have slid in the U.S. as the shale boom propels production of oil and gas to a record. Though gas stockpiles ended the winter more than 30% below normal for the time of year, soaring output has almost erased the deficit. The latest Old Farmer's Almanac released last month predicted a fairly harsh winter, warning readers to prepare for a "wallop."

MEDIOCRITY CELEBRATED

A report Monday from Hedge Fund Research said that hedge funds gained 4.9% on average in the first three quarters of 2019, their best performance in the period since 2013. Investors would still have been much better off putting their money in a lower-cost, plain vanilla exchange-traded fund. This is made clear by the performance of the SPDR SSgA Global Allocation ETF, which aims to track markets broadly. It was up 12% for the first three months of the year. There are two takeaways. The first is that the globalization of the world economy in recent years means that the performance of assets has also become more synchronized, with more markets moving in tandem instead of going their own ways. The second is that central banks are more directly involved in markets than ever before, helping to damp the volatility hedge funds thrive on. As of the end of September, the collective balance-sheet assets of the Fed, European Central Bank, Bank of Japan and Bank of England stood at 35.2% of their countries' total GDP, up from about 10% in 2008, according to data compiled by Bloomberg.

TEA LEAVES

What were they thinking? We'll find out Wednesday what was going through the minds of Fed policy makers when they lowered benchmark interest rates on Sept. 18 for the second time in less than two months. As a reminder, only seven participants favored one additional 25-basis-point reduction in rates by year-end, based on the so-called dot plot. The remaining 10 either favored no change or an increase, which seems pretty implausible at this point as the economic data has deteriorated meaningfully since the meeting. Still, the minutes are good for insights into the data policy makers are watching closely and where the differences lie. In his post-meeting press conference, Chair Jerome Powell noted "disparate" views among meeting participants.

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