HARBOR VIEWS

HARBOR ADVISORY QUARTERLY NEWSLETTER

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HARBOR ADVISORY

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A LOOK INSIDE HARBOR VIEWS

- *Thoughts on the Economy – We believe the risk of the trade war tipping our economy into recession is high unless the President reverses course in the very near future.*
- *Our View of the Financial Markets – "I cannot remember a time when the U.S. economy was driven toward recession by a self-inflicted policy error as obvious as a unilateral trade conflict with allies as well as adversaries."*

LATEST NEWS FROM HARBOR ADVISORY

- You can visit us at: www.harboradvisory.com. Take a look and let us know your feedback.
- Jack De Gan continues to make news with his regular guest appearances on CNBC's top rated financial shows "Squawk Box", "The Call", "Closing Bell" and on Bloomberg TV, Fox Business News and National Public Radio.

THOUGHTS ON THE ECONOMY

U.S. GDP expanded at a rate of 2.1% in the second quarter after growing 3.1% in the prior quarter. Payroll growth slowed to a rate of 165,000 jobs per month, a significant reduction from the 2018 average of 220,000 per month. Wage growth is running at a rate of 3.1% year over year.

Brent crude is trading at $58 per barrel, down from $69 at the end of the prior quarter.

The Federal Reserve lowered the Federal Funds rate by .25% at the July meeting, a reversal after nine increases since December 2015. Market rates have fallen more sharply with the 10 year U.S. Treasury note falling to a yield of 1.60% from 2.25% at our last letter. This has caused the Treasury yield curve to briefly "invert". There has been much talk about the predictive ability of this event which will be discussed in detail on the next page.

We attribute most of the slowing described above to the worsening trade war. The Administration has indicated it intends to levy 10% tariffs on the remainder of our imports from China on September 1st. The U.S. Treasury designated China a currency manipulator even though China only meets one of the three objective criteria set as conditions for such a designation. China has begun retaliating by ceasing purchases of U.S. agricultural products and will certainly ratchet up the retaliation if the tariffs take effect on September 1st.

We believe the risk of the trade war tipping our economy into recession is high unless the President reverses course in the very near future.

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OUR VIEW OF THE FINANCIAL MARKETS

Much like last quarter, U.S. equity indices hit new highs in late July only to be sent 6% lower on a tweet indicating tariffs of 10% would be levied on all remaining imports from China. Following two volatile weeks in the financial markets the President walked those tariffs back by half. The continuing trade war is lowering expectations for corporate earnings in the second half of 2019. We now expect earnings growth to be very close to nil. If the trade war escalates into year-end, expect weakness in equity prices as fears of recession rise. I cannot remember a time when the U.S. economy was driven toward recession by a self-inflicted policy error as obvious as a unilateral trade conflict with allies as well as adversaries. If the oft mentioned tariffs on autos and parts imports from Europe and Asia are enacted we believe a recession as well as a return to the Christmas Eve lows in the equity indices would be likely.

The Treasury bond market has been on a tear since the August 1st tariff announcement. The 10 year U.S. Treasury note yield has fallen from 2.05% to 1.55% in two weeks. Yields are approaching the long-term low of 1.39% we saw in the summer of 2016. We expect the Federal Reserve to respond to the increased tariffs by lowering rates again in September. The bond market sees significantly increased risk of recession. The return on bonds for the remainder of 2019, like the equity markets, relies heavily on a truce in trade hostilities.

YIELD CURVE INVERSIONS

You may have heard the term in the media referring to its predictive power in anticipating recessions. A yield curve inversion takes place when the yield on shorter term treasury notes exceeds that of longer term notes. This is almost always the result of the Federal Reserve raising short-term rates while the longer term rates remain anchored by inflationary expectations. The higher short-term rates tend to make bank lending more expensive which at some point chokes off lending. This in turn leads to less capital investment by businesses which slows the economy. Indeed, many recessions have been preceded, by up to 2 years, by an inverted yield curve. But inversions have also given false signals as well. The brief inversion we are seeing now is the result of long-term rates falling dramatically as trade tensions lower expectations for growth. We think, therefore, that the predictive ability of this inversion is limited and is essentially a symptom of the trade war. We need the trade war to end.

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