THE ECONOMIC MONTH IN REVIEW AND OUTLOOK -- SEPTEMBER

**US Markets and Economy**:

Evidence that the US economy is slowing is clear. The Atlanta Fed's "GDP Now" forecast is for third quarter US GDP growth to slow to 1.8%, below the moderate pace of 2% in the second quarter. A member of the Fed's FOMC has forecasted even slower growth of only 1.7% for the second half of 2019. The ISM's widely followed Purchasing Mangers' Index (PMI) suggests that manufacturing activity fell in both August and September. This slowdown, however, has not yet impacted the US labor market: in September, US unemployment fell to 3.5%, the lowest rate in half a century, while net job growth was a respectable +136,000. (These data were reported in early October.)

The Fed itself has now cut short-term rates twice to provide some insurance against further economic weakness. The FOMC will meet again at the end of October and could cut rates again if the economic outlook justifies it. The Fed has room to cut, since the inflation outlook is still benign, with prices rising at less than 2% a year, which is the Fed's stated target for inflation. Yields in the US Treasury bond market suggest that inflation will stay very low for a very long time: the 10-year Treasury bond is yielding about 1.5%, with the 30-year yielding 2%. These historically low yields mean that bonds are not providing strong competition for stocks, since dividends on the S+P 500 provide a current yield of 1.9%.

A new driver of stocks appeared in September, as the US House began an impeachment inquiry. Even though political analysts argue that the US Senate, which is controlled by Republicans, would never vote to convict, a new element of uncertainty has been created, on top of the growing uncertainty about the results of the US elections in 2020.

**World Markets and Economy**:

The British, famous for keeping calm and carrying on, seem to have lost that knack. Boris Johnson appears to have lost control of Parliament as the nation hurtles toward a "no-deal" Brexit at the end of October. The economic consequences of such a rupture would affect Britain's economy significantly, but the shock waves would spread through Europe and could even reach the US. Although Britain's blue-chip FTSE 100 gained for September, a selloff in the first days of October wiped out those gains and more. European blue chips were also up modestly for the month of September, but those gains also melted away at the beginning of October. The large markets of

Germany, France, and Italy followed this pattern. There were pockets of strength, though, in unlikely places: Greek stocks were relatively strong, and are now up almost 100% from their lows set a few years ago. The Greek economy is growing again, unemployment has fallen significantly, and the Greek federal budget is not far from balance. This is a far cry from a few years ago, when the depressed Greek economy was on life-support.

Japanese stocks had a strong September, rising almost 5%. The Japanese economy is growing again, although the second quarter growth rate was only 1.3%. Japan's economy does face major headwinds, however, since it is hurt by the US-China trade battle, and by the long-postponed increase in the national sales tax to 10% from 8%. Chinese stocks, as measured by the Shenzhen 300 Index, were flat for the month. China's economic growth has been hurt by the trade battle with the US, but it is likely that the Chinese will use both monetary and fiscal policy to stimulate the economy if necessary. What is not known is how the Chinese will respond to the continuing unrest in Hong Kong. An aggressive response could unsettle Asian markets.

OUTLOOK: US stocks recovered most of their August losses in September. Gains were modest, with the S+P 500 and Dow Jones both up almost 2%, while the NASDAQ gained less than 1%. Stock prices have been under the influence of two main drivers: trade battles and interest rates. Although there is no agreement with the Chinese which would settle the US-China trade dispute, stocks tend to rally when the prospects for a deal improve, and then sell off when they deteriorate. The economic impetus for a deal is getting stronger, though: both countries are being hurt by the tariffs and restrictions already in place. The Chinese economy is clearly slowing, and America's tariff walls are partly responsible. The US economy is also slowing, and Chinese barriers to our exports are part of the problem. US agriculture, which relies heavily on export markets, has been hard hit, and manufacturing activity has been slowing too, as world-wide supply chains are disrupted. Chinese leader Xi needs a strong economy to justify his authoritarian rule, and US President Trump needs a strong economy to increase his odds of reelection. Stock market bulls are thus counting on both leaders finding a way to "do the right thing" and reach an agreement.

US stocks remain in a bull market and are strongly ahead for the year. Nonetheless, it appears that volatility has returned, which could make for a choppy few months as stocks continue to climb the proverbial "wall of worry." Worries on trade, interest rates, economic growth, and US politics could again lead to increased volatility, as witnessed in the beginning of October. Long-term investors must "keep calm and carry on."