

Fundamental Uncertainty

Investors always are confronted with uncertainties. Not least of which, the direction of market prices is uncertain each day. At certain times, however, uncertainties over important fundamentals can reach levels that trigger outsized market responses. Such was the case on August 5 when a convergence of fundamental uncertainties prompted a 962 point swing in the Dow Jones Industrial Average and a one-day loss of approximately -3% in global stock prices. High on the list of uncertainties were the outlook for economic growth, the direction of monetary policy and the heightened level of trade tensions. A review of these important fundamentals can provide perspective and investment implications.

Q PERSPECTIVE

A +2.1% second quarter real growth rate in the U.S. economy, representing a slowdown from +3.1% in the first quarter, generally was expected. Not expected was the pattern of growth that emerged from the periodic revision to prior quarterly growth rates. **Chart I** displays the revised pattern relative to the previous pattern. The consensus expectation had been that the rate of real economic growth was in the process of slowing in 2019. It now appears that the rate of growth generally has been slowing since the start of 2018. As a result, investor uncertainty has risen over the potential for even slower future growth.

The Federal Reserve met investor expectations with a ¼% reduction in their policy rate target. **Chart II** shows this first reduction in over ten years relative to the nine rate target increases implemented since December 2015. Investor uncertainty rose, however, when Fed Chairman Powell in press conference remarks downplayed the size and scope of future policy rate cuts. Earlier, there had been growing expectations for at least two more rate cuts. The Fed's seeming hesitancy also was more notable at a time when monetary policy easing is on the rise overseas.

The announcement of additional U.S. tariffs on goods from China and China's threat of retaliatory action added to investor uncertainty. These developments brought a full trade war closer to reality. While more favorable trade terms may be desirable, the path to their achievement may be costly in terms of slower economic growth and/or higher inflation. The relationship of these fundamentals between countries is transmitted via relative currency prices. **Chart III** shows the relationship between China's yuan and the U.S. dollar. It has received much attention as it recently has risen above 7.0, prompting U.S. labelling of China as a currency manipulator. No matter the merits of the claim, uncertainty has risen.

INVESTMENT IMPLICATIONS

Uncertainties over important fundamentals can impact market outcomes, especially if the implications are adverse. Such uncertainties must be evaluated as to their potential outcomes, even while recognizing that the range of such outcomes is quite wide and that the certainty of any outcome is relatively low. Each investor can reduce uncertainty of their personal financial outcome by being clear with their own fundamentals: objectives, time horizons, risk tolerance. Clarity here will guide portfolio construction. Portfolios properly constructed do not guarantee outcomes but they ensure that the investor is best positioned to weather the ups and downs of market cycles resulting from ever-present fundamental uncertainties.

CHART I

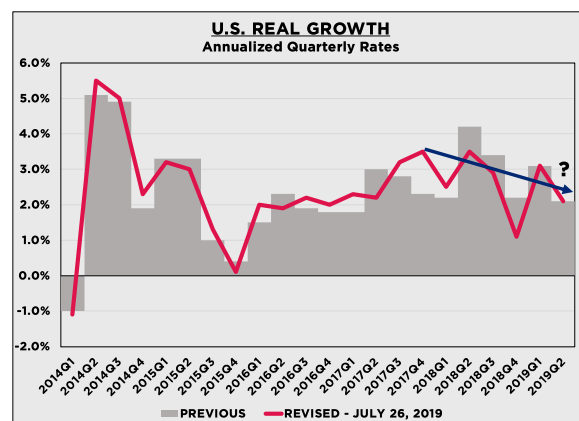


CHART II

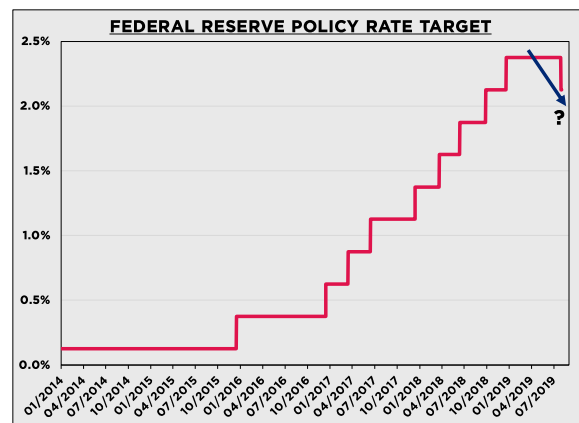


CHART III

