CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

July 3, 2019

Contradictions? Resolved.

What to make of simultaneously rising stock and bond prices? The conundrum is more apparent than real. The industry groups of stocks that have been rising are those that thrive in a recession. And recession is what the bond market predicts.

The US stock market and the US Treasury bond market appear to be telling--or foretelling--different stories. Is there a contraction between the messages or an explanation that makes sense of both? In our *Core Comments* in late May, I pointed out that the yield on the US 10 year Treasury bond--the world's benchmark bond--had fallen by a full percentage point, from 3.25% to 2.25% in the space of only seven months. This is an astonishingly swift decline of such magnitude. And, since that date, the Treasury yield has fallen all the way to 1.95% as of today. The collapse in yields (and the corresponding increase in bond prices--yields and prices move inversely) point to unfolding economic weakness and the promise that the Federal Reserve will act to mitigate economic travails by cutting the interest rates it controls.

Elsewhere in the world, the ranks of <u>negative</u> interest rates has reached some 13 trillion dollars. For example, the German 10 year *bund*, Europe's safest bond, fell as I wrote today to a record low of -0.39%, guaranteeing a loss to an investor who holds the bond to maturity. Investors are <u>paying</u> Germany to lend money to Germany. The 13 trillion dollars of outstanding negative-yielding bonds indicates alarmingly low inflation and extremely weak global economies. (That's right: more than $13,000,000,000,000 of bonds world-wide offer no return; one must pay the issuer for the privilege of lending it money!) With the US 10 year yielding a 'generous' 1.95% today, the US Treasury bond market is the cleanest shirt in the laundry bin.

US stock prices apparently tell a contrary story. In the aftermath of the Kumbaya moments over the weekend when Presidents Xi and Trump agreed to resume negotiations and Mr. Trump visited one of his beloved murderous dictators, Kim Jong Un, at the DMZ in Korea, where they also agreed to resume negotiations, stock markets around the world rallied and the S&P 500 made a nominal new intraday high. On Tuesday and today, US stocks rallied a bit further. Rallying stock markets foretell—do they not—good economic times ahead. Indeed, since our late May *Core Comments*, the S&P has rallied by more than five percent, a good showing in only a little more than one month. But….

By

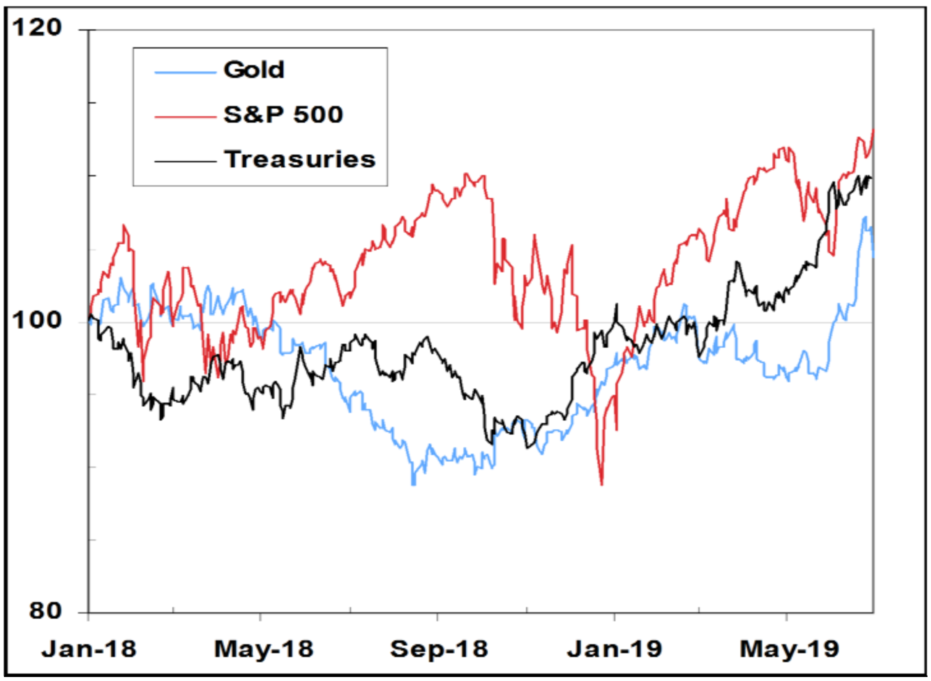
Jack Mayberry

The contradiction resolved. In the last year, the industry groups that have advanced are utilities, consumer staples (think laundry detergent, eggs, milk and gasoline), and telephone companies, while industrial stocks, auto stocks and the other cyclical sectors have lagged. What has worked are the things to own in a recession; those sectors that ride a rising economy higher lag far behind. Thus, the modest new highs in stocks are hardly telling us that the economy is strengthening. By contrast, stock market action confirms the message of the bond market, namely that the US economy is already in or heading toward a recession.

Core's investments in long-term Treasuries, in gold and in money market funds have provided a good return. And safety.

As economies weaken and the global political environment becomes more contentious, these investments offer safety and prospects for more gains.

Earning money in bonds and gold. As discussed in previous letters, we have avoided stock investments this year on the notions that the economy is heading toward a recession and that the stock market is heading to a bear market. Instead, we have invested in long-term Treasury bonds, gold and money funds. It is plain that we have been somewhat early in our call for a bear market in stocks, but we have been entirely correct in Treasury investments, which have rallied very strongly in price. Our position in gold arises from the view that geopolitical confusion and contention drives investors to safe havens--among which is gold. It too has performed well and is providing solid appreciation in our portfolios. The chart shows long-term Treasuries, US stocks and gold, all rebased to 100 at the beginning of 2018. Although we have avoided stocks during much of this period, we have not missed much, except wildly swinging prices and fear. Long-term Treasuries and gold have done just fine. I take comfort in our very substantial positions in money market funds. When the stock market finally expresses economic reality and falls in price, we have the funds available and we will be buyers.



A word about China and the United States. At the G-20 meeting over the weekend in Osaka, Messrs. Xi and Trump agreed to resume negotiations about the issues in contention. Well and good. Talking is better than angry silence. However, Mr. Trump has brought to the fore the many disputes America has with China. These are often expressed as 'tariff matters' by our president who favors tariffs as a tool in such times. However, these disputes are far broader than 'tariff disputes.' There will be no quick resolution between the rising power that is China and the defending--and perhaps declining--power of America. Accordingly, one foresees ructions in the China/America question that will roil investment markets for some time. This is the more so because Mr. Trump is impulsive, contentious and insulting. Another American administration would conduct discussions with China quietly; that is not our president's style. Hence, as it relates to investments, it makes eminently good sense to invest in the 'safe-haven' assets of cash, long-term Treasury bonds and gold. Those are Core's positions for you. In this turbulent and contentious geo-political environment and in the context of weakening global economies, your capital and ours are well placed to withstand the ill winds that threaten.

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