ClearPath CAPITAL PARTNERS

Thoughts on the Current Market Environment

While the expectation may have been that we as investors would be in for a boring and quiet August (these are called the Dog Days of Summer for a reason), the reality has been quite the opposite. Poor economic data out of China and Germany last week led to a bond rally, and ultimately the inversion of the U.S. yield curve which triggered a large market sell-off, as historically an inversion of the yield curve (where now the US gov. is paying less to borrow for 10 years than for two years) has been a predictor of economic recessions.

The trades in the bond market and the "risk-off" trade may have been overdone, as the bond market is now predicting an imminent US recession and possible deflation. That said, while the odds of a US Recession have now increased (new report from S&P said the risk of a US recession in the next 12 months has increased to 30-35%, up from 25-30%), we do not believe that we will see one imminently. The U.S. consumer remains a big driver of the U.S. economy, and positive retail sales in July led to a stock market bounce back last Friday. With the Fed possibly cutting rates, and the ECB planning to do the same, there could be a continuation of the growth cycle.

Like the S&P report, and other various investment strategists that we have spoken to, there is an increased possibility of a recession and that is something we are keeping a close eye on. When having conversations with teams we invest with in July, the biggest risk we heard was geopolitical risk. The tensions between China and the US provide short term volatility, and any tweets / comments from the administration are quickly priced into the market, and then subsequently priced out by different news. That said, one of the very real byproducts of the trade wars is the disruption of supply chains, which is now beginning to show in economic data. Global manufacturing and industrial production are among a few economic metrics that are starting to deteriorate and causing various asset management firms' recession monitors to move from green (low probability) to yellow (medium).

While we don't believe a recession will occur in the next 12 months, we have been positioning our portfolios to best preserve capital in case there is one. We have begun to broaden asset class exposure by introducing infrastructure and emerging market debt into our portfolios; we also have begun adding managers that seek larger cap quality companies with solid financials that could withstand any downturn. We are continually monitoring risk in our strategies and are having continuing ongoing conversations with our managers, research partners, and internally as a team about how to best modify our portfolios for the current environment. As always, while we monitor short term risks, we are not looking to make any quick reactionary movies; rather, we are looking and evaluation our strategies with a medium to longer term time frame as our objective for all of our portfolios is to help our clients meet their long term goals.

222 FRONT STREET 3RD FLOOR SAN FRANCISCO, CA 94111
SAN FRANCISCO | LOS ANGELES
t 415.682.6900 f 415.682.6899
clearpathcapital.com