



June 2019: Stocks, Bond Yields Plummet as U.S.-Led Trade War Expands to Mexico

Wall Street and global stocks pivoted sharply lower in May, with the Dow Jones Industrial Average posting its longest losing streak in nearly eight years as the Trump administration expanded its tariff war south of the border to Mexico. The selloff in New York exerted a gravitational pull on Canadian stocks, knocking the S&P/TSX Composite Index from record highs.

Global Stocks Plunge

All of Wall Street's major indexes declined more than 6% during the month of May, with the Dow falling more than 1,600 points over the course of its six-week skid. The CBOE VIX Volatility Index – the market's preferred measure of investor anxiety – finished the month at 18.71, just below the historic average.

The VIX exhibits an inverse relationship with the S&P 500 Index most of the time.

Canada's benchmark S&P/TSX Composite Index lost 3.3% during the month. The index's last record high came on April 23.

Asian markets were down across the board, with China's Shanghai Shenzhen CSI 300 Index falling more than 7%. Hong Kong's Hang Seng Index closed down 10.6%. Japan's benchmark Nikkei 225 fell 7.5%.

Bond Yields Fall

The combination of trade-war risks and an ailing global economy sent bond yields tumbling in May as investors cut ties to riskier assets and piled into government bonds. The yield on the benchmark 10-year U.S. Treasury bottomed at 2.13% on May 31, it's lowest since September 2017.

Yields are expected to recover in the short term because government bonds are “extremely overbought,” according to Bespoke Investment co-founder Paul Hickey. In an interview with CNBC, Hickey said yields will likely rebound in the near term now that they've breached a critical trend line.¹

A closely watched yield curve has been flashing a recessionary warning for the last few months. That warning resurfaced last month after the yield on the 10-year U.S. Treasury fell below the yield on the 3-month T-Bill. Before 2019, the last time this happened was 2007. Many investors are convinced that the inverted yield curve foretells recession.

U.S.-China Trade War Heats Up

Demand for riskier assets declined sharply in May after President Trump announced fresh tariff increases on Chinese goods, stoking fears of a prolonged trade war between the world's two largest superpowers.

In a May 5 Twitter tirade, Trump threatened to impose duties of 25% on \$325 billion worth of Chinese goods. The new tariffs came into effect later in the month.

The decision to impose higher duties came after one of Trump's top advisers complained that China had reneged on a trade agreement.² As Bloomberg reported, Beijing suddenly decided to back away from a commitment to change key industrial policy that would protect U.S. intellectual property in China.³ Beijing didn't deny the reports but said it shifted focus because the United States was planning to accept major concessions.

China retaliated to the tariff escalation by preparing a list of \$60 billion worth of U.S. imports to tax at a higher rate. Those tariffs came into force at the end of the month.⁴

The Month Ahead

The Trump administration has opened a new front in its trade war, this time targeting Mexico for its role in facilitating the free flow of illegal immigrants into the United States. Beginning June 10, the United States will impose a 5% duty on all goods coming from Mexico. The White House later confirmed that the levy will increase by 5 percentage points each month until October when it maxes out at 25%.⁵

Investors will also be keeping track of the economic data next month after consecutive reports showed a broad cooling of the U.S. economy at the start of the second quarter.

Sincerely,

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¹ Stephanie Landsman (May 31, 2019). "New chart points to 'extremely overbought' conditions in bond market, suggests yields will bounce."

² Sam Bourgi (May 15, 2019). "Dow Spikes Suddenly as Trump Team Schemes to Salvage China Deal." CCN.com.

³ Jenny Leonard, Saleha Mohsin and Jennifer Jacobs (May 6, 2019). "Trump Threatened Tariffs After Hearing of Chinese Reversal, Sources Say." Bloomberg.

⁴ DW.com (May 31, 2019). "China retaliatory tariffs on US goods come into force."

⁵ Sam Bourgi (May 31, 2019). "Dow Extends Brutal Losing Streak as 10-Year Treasury Yield Plummets Below Critical Level." Hacked.com



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