

QUARTER IN REVIEW

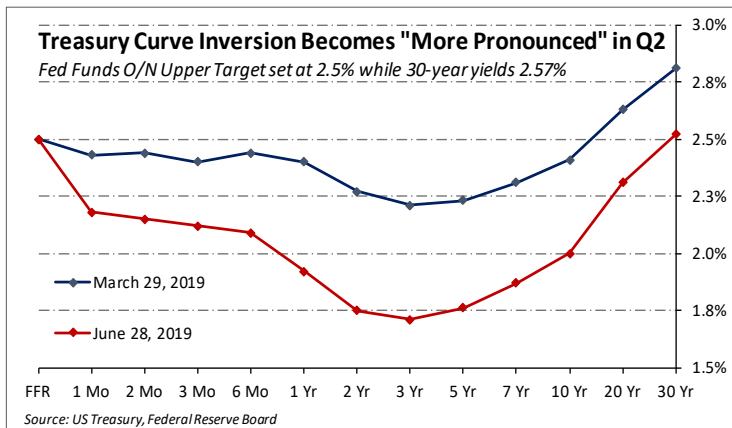
Q2 2019: CHINA SYNDROME

Global growth continued to slow as China's factory activity fell, Germany's factory orders missed expectations on weakening demand, and US manufacturing PMIs softened. All suggest global inflation remains off the table as a reason for central bank vigilance. With respect to trade, the long-anticipated US-China trade deal fell through, and President Trump surprised markets by announcing higher tariffs (suspended at the beginning of the year) would go into effect. The US accused China of renegeing on previously agreed to trade issues. China, in turn, increased tariff rates on a variety of US imported goods. FOMC guidance shifted from Q1's patient approach to FOMC members calling for rate cuts. The ECB extended the timeline for ultra-low rates to stay ultra-low. It also announced the rollout and terms of a new refinancing operation (TLTRO-III), offered markets the possibility of rate cuts later this year, and abandoned its 2% inflation ceiling.

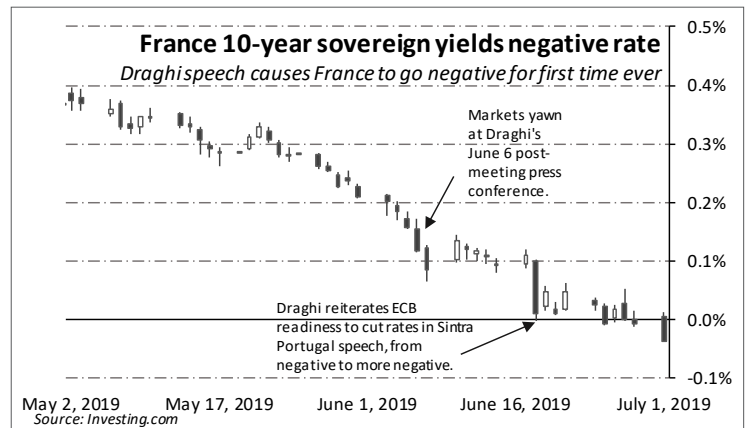
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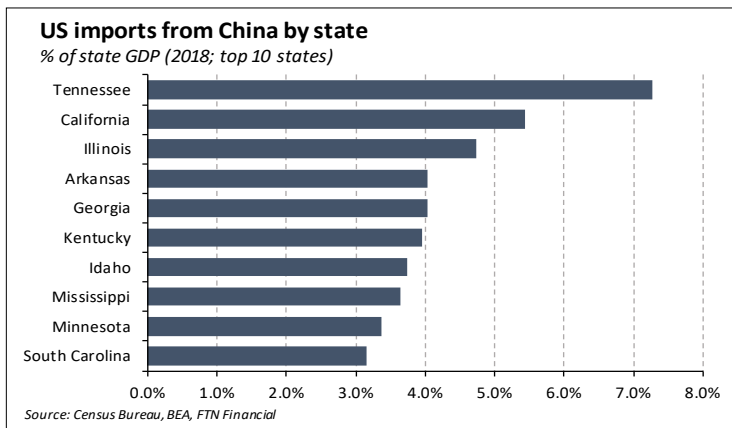
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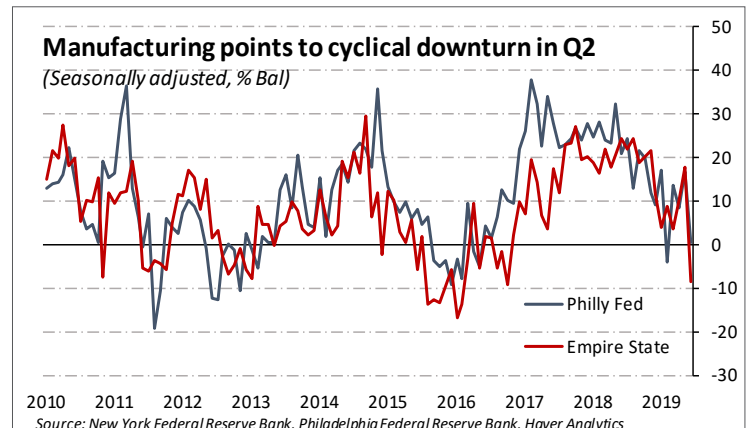
May 1, the Fed maintained its 2.5% target rate and patient approach to incoming weakening data. Saint Louis Fed President James Bullard became the first FOMC voter to say the Fed's December rate hike may have been "overdone." June 19, the FOMC signalled possible easing. Bullard dissented in favor of an immediate cut. Bullard cited a more pronounced yield curve inversion justifying rate cuts.



Mario Draghi extended accommodation, detailed another round of refinancing operations (TLTRO-III), and hinted at cuts at the ECB's June 6 press conference. Markets shrugged off the news. Draghi's June 18 Portugal speech emphasized the power of negative rates on depressing short-term yields, "automatic easing" of future rates if inflation is below the Bank's 2% target, and a flexible mandate.



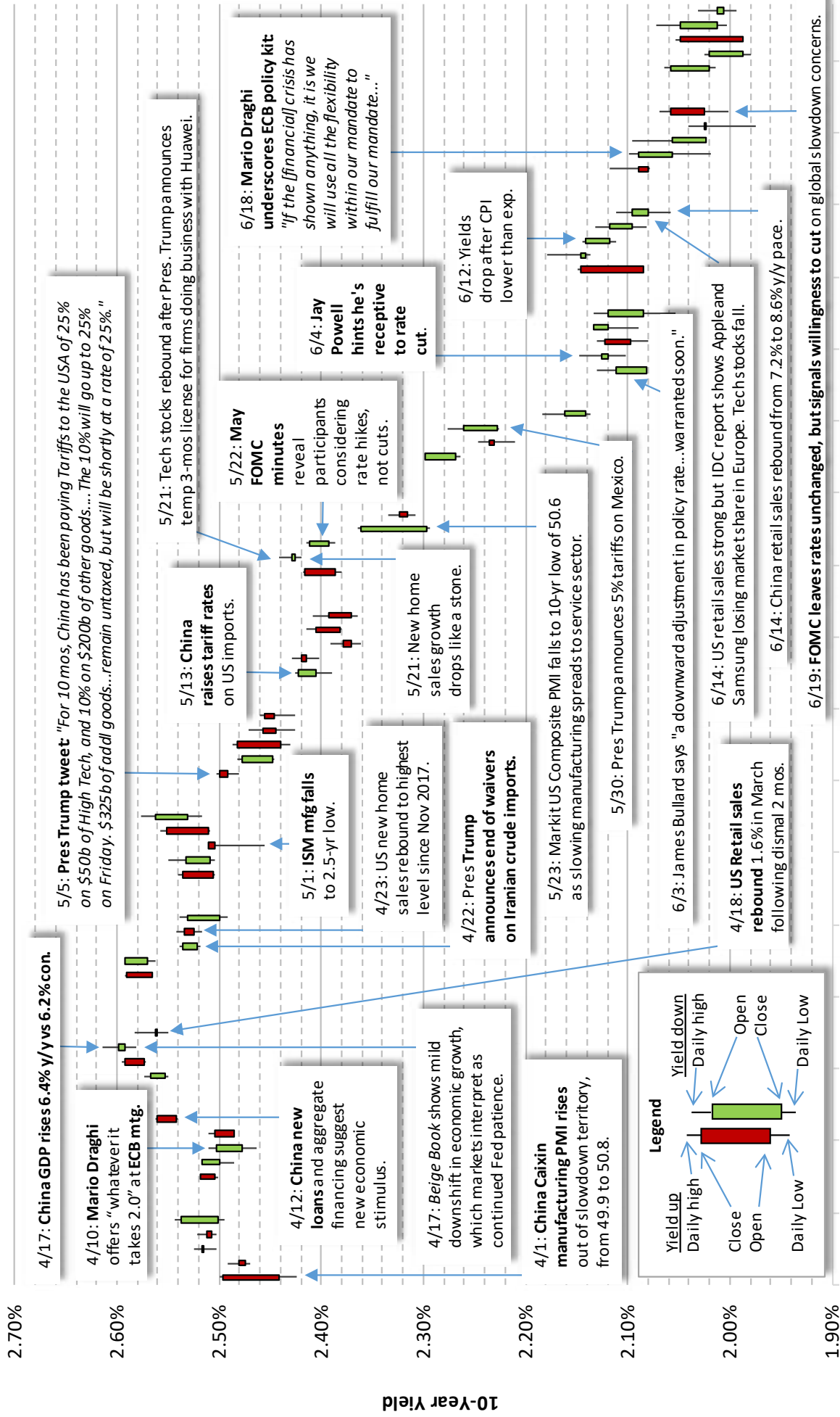
California, the largest importer of Chinese goods by state, imported \$161b of goods in 2018, while Tennessee imported \$27b. Scaled as a percentage of Chinese goods imports to annual state GDP, Tennessee actually leads California. But the scale is misleading. FedEx's Memphis Super-Hub directly links to China and the Asian Pacific, which means packages routed to Tennessee are rerouted for use elsewhere. Declines in FedEx's stock price in Q2 underscores the issue.



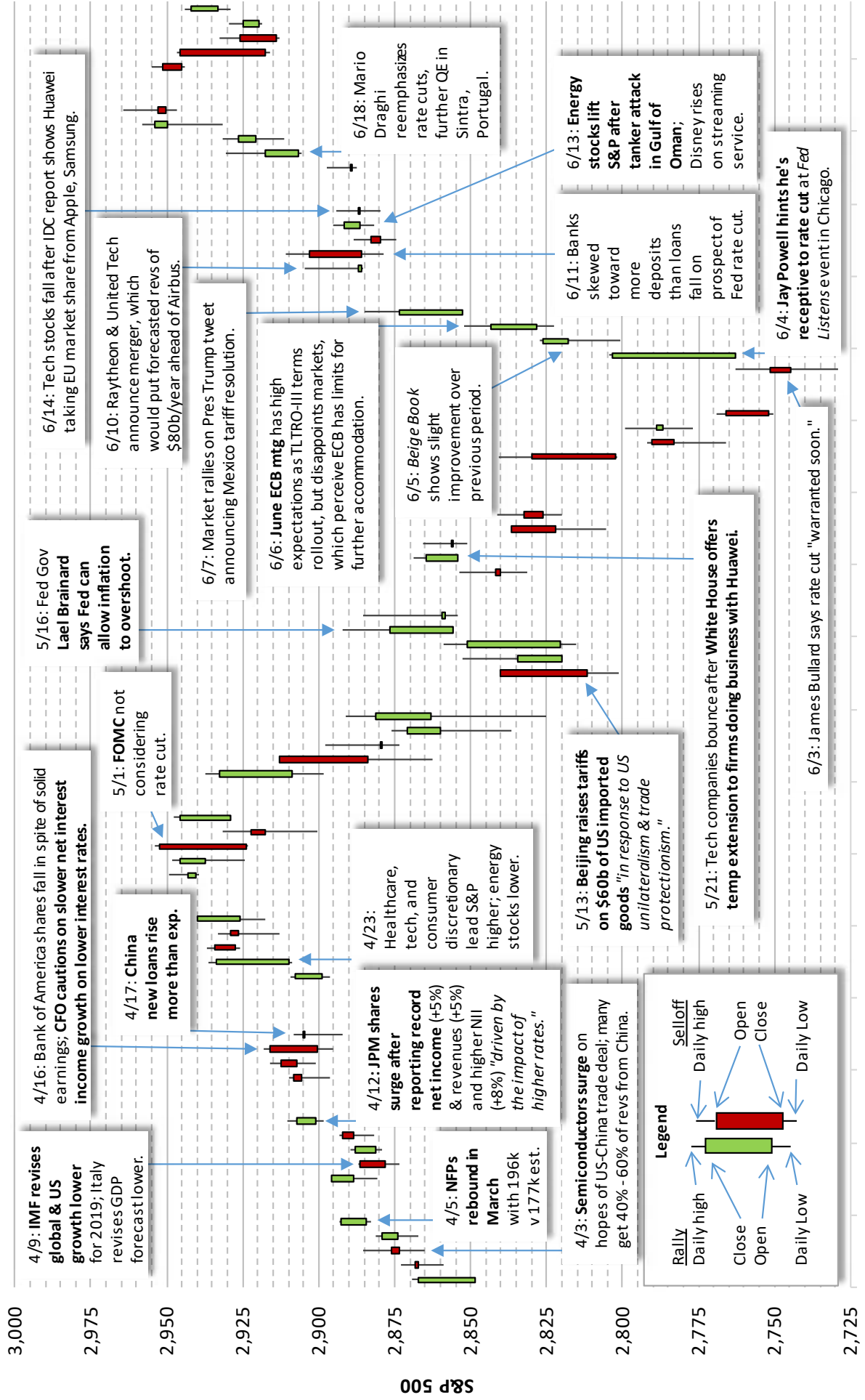
Fed manufacturing surveys plummeted over the quarter, suggesting a forthcoming cyclical downshift. The Empire State survey posted its largest decline on record, falling 26 points in June from May's 17.8 to -8.6. (It was 3.7 at Q1's end.) The Philly Fed survey fell from 13.7 at Q1's end to 0.3 in Q2.

Disclosures are on the last page of this report.

MARKET-MOVING EVENTS: 10-YEAR TREASURY



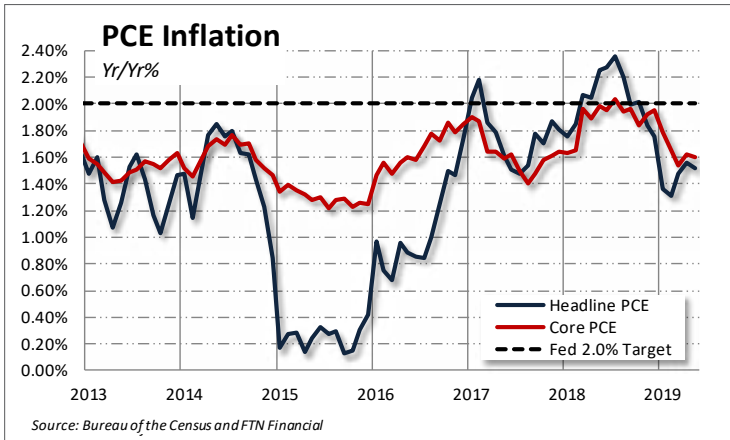
MARKET-MOVING EVENTS: S&P 500



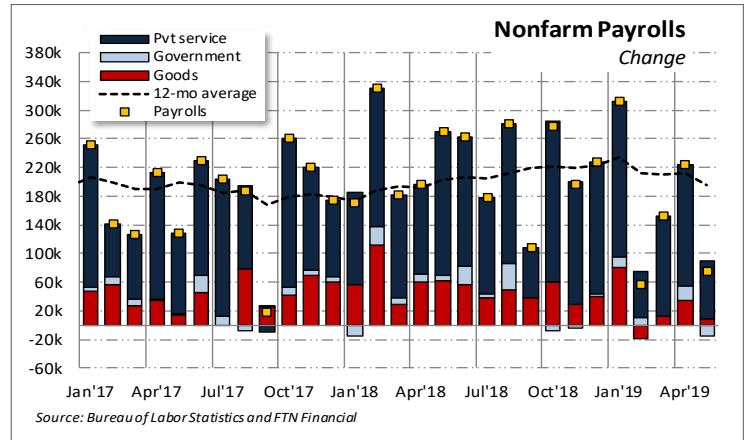
Q2 2019

1-Apr 6-Apr 11-Apr 16-Apr 21-Apr 26-Apr 1-May 6-May 11-May 16-May 21-May 26-May 31-May 5-Jun 10-Jun 15-Jun 20-Jun 25-Jun

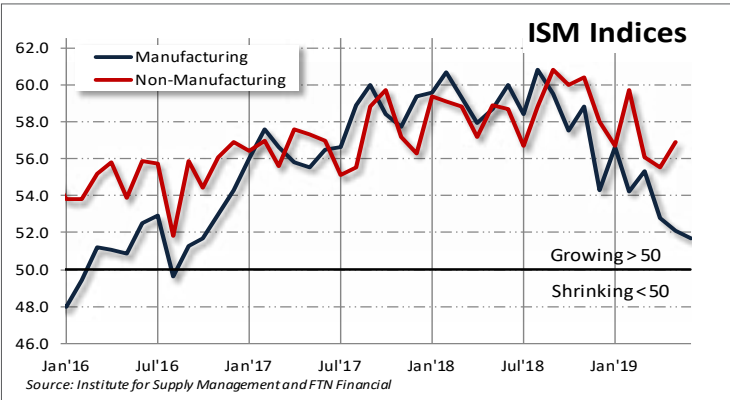
DATA WATCH: KEY ECONOMIC INDICATORS



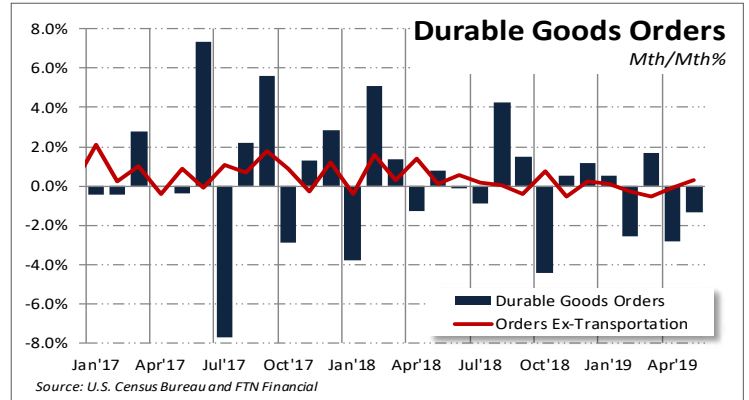
PCE inflation remains below the Fed's target, prompting James Bullard and Neel Kashkari to suggest the Fed should cut rates. In June's FOMC press conference, Chair Powell noted inflation is not returning to 2% as fast as the Fed expected.



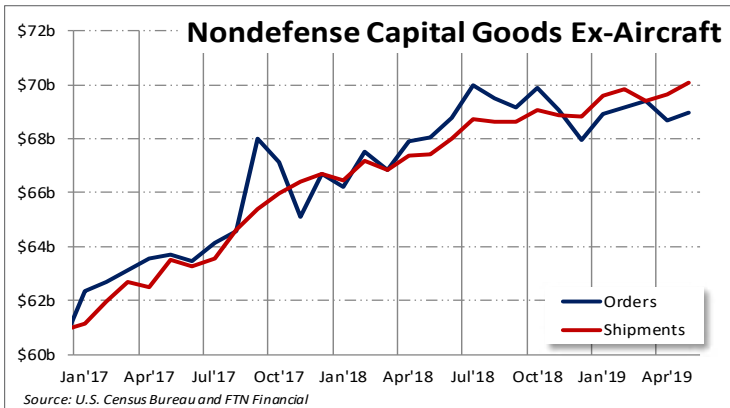
Payrolls, particularly the 3-month and 6-month averages, are of particular interest to the FOMC as Powell noted in his June press conference. The 3-month and 6-month averages at May's end was 151k and 175k, respectively, about 23k and 29k lower than the averages at the end of Q1.



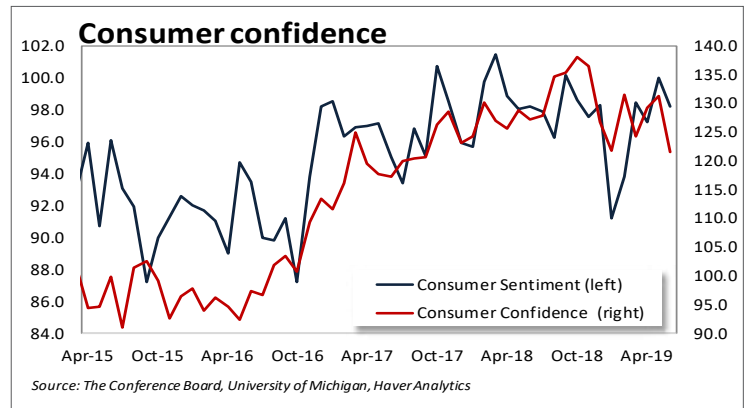
June's ISM Manufacturing PMI posted its third straight month of slowing expansion as demand fell with new orders ending the quarter recording zero expansion and new export orders weakening. Non-manufacturing turned upward, indicating faster expansion, but tariff concerns remain. Prices paid index is back below 50.



Durable goods orders fell for two straight months in Q2, primarily because Boeing orders dropped as the company continues to struggle with 737 Max issues. May dropped 1.3% (consensus called for a 0.2% dip) and April was revised down to -2.8%. Excluding transportation, orders rose 0.2% over the quarter.



May's non-defense capital goods ex-aircraft rose 0.4%, which was hardly enough to dent April's decline of 1.0%. In addition, the big gap between orders and shipments suggests a shipments slowdown is overdue.



Consumer sentiment ended the quarter flat in Q2, though consumers expressed greater pessimism over current job market conditions. Consumer Confidence fell over the quarter, led by households expecting higher unemployment and higher interest rates.

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