Bull & Bear Bulletin

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A Tale of Two Growths

It used to be said, "America sneezes and the rest of the world catches a cold." The meaning behind the phrase implied that what was going on economically in America was a main driver for outcomes in other parts of the world. While America clearly continues to be the global leader in regards to the size of its economy and the depth of its markets, it is also true that other parts of the world have increased their share of total output over the last several decades. Increased globalization and a multitude of other factors have made diagnosing the world markets and varying economies much less of a unitary exercise.

Developed market stock performance has diverged this year. In the U.S., the S&P 500 has seen a total return of 9.52% through mid-September, while other developed markets such as Japan and Europe have seen their stock indices run flat to down mid-single digits.

Emerging markets such as those in China, South Korea, Turkey, Brazil, South Africa and Russia have all seen their equity indices dip into negative territory this year amid trade disputes, funding concerns and internal problems. It is these types of economies which often require capital from the outside to fund internal investment. Additionally, they still require strong consumption patterns in developed markets in order to sell goods into deeper markets elsewhere. The bottom line is that if conditions are not quite right, these markets are still susceptible to catching colds much quicker.

Market watchers closely follow the industrial goods producing cycles, because their clues provide information for stock and bond markets. The manufacturing surveys provide monthly soft data that can be used to track the current activity levels in industry as well as expectations for employment, new orders and prices. The key thing to note is that levels above 50 represent expansion and levels below 50 on the purchasing manager indices indicate contraction. The positive aspect to readings right now is that across the board globally we are in expansion territory. Similar to the observed divergent market returns, trajectories in the U.S., Europe and Japan are starting to look and trend differently.

The U.S. has been a juggernaut as seen by the strong uptrend in the Institute for Supply Management (ISM) Purchasing Managers' Index (PMI) for the entire year. There is, however, a marked inflection downward in the industrial manufacturing sectors of Europe and Japan since the beginning of this year. The levels are still clearly reading expansion, though they are trending down, indicating a cooling off. Certainly, by itself, this is not a major cause of concern, but it raises the question of where exactly are the cycles heading.

The bullish case is that deregulation, fiscal and tax reform stimulus and a positive North American Free Trade Agreement (NAFTA) renegotiation outcome will keep the red hot PMI reading in the U.S. elevated for some time. The cycle will continue to drive on and therefore remain on track. It is still great to be a capital rich country with relatively stable major trading partners in Canada and Mexico. It helps to have a tremendously innovative economic history and culture. It is harder to catch that awful cold if we are healthy. Like the days of old, that will help the rest of the world stay healthy as well.

The bearish case is that the industrial cycle downturn that can be observed in Europe and Japan is a product of the emerging market woes and the trend will continue down. Reflexivity will provide negative feedback into the industrial cycle here in North America. The forceful trade posture of the U.S. and its current interest rate policy have laid bare some fragile emerging market economies. This, in turn, has impacted other developed markets whose industries are more closely tied to the developing world, which could ultimately soften conditions here as well. The circle completes and everybody gets a cold.

Time will give us the answers needed but, to leave on a positive note, consumers and businesses alike appear to have confidence level indicators at multi-year highs.