ClarkCapital MANAGEMENT GROUP

Navigator® Market Update

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From Fed Rate Cuts to Additional Tariffs

Fed Cuts Rates and Confuses Markets

In its July meeting, the FOMC reduced the fed funds target by 25 basis points to a new range of 2.00% to 2.25% as expected. The Fed also ended the balance sheet runoff two months earlier than planned and kept its options open about future rate cuts. The Fed's statement justified the rate cut based on "global developments" and "muted inflation." The statement also noted that "uncertainties remain," core and over-all inflation are "running below 2%," and that the FOMC was "contemplating" a future rate cut.

However, in the post-meeting press conference, Fed Chairman Powell didn't inspire a lot of confidence and alluded to the fact that the Fed wasn't committed to a series of rate cuts. In his statement, Powell mentioned that the Fed was viewing this cut as a "mid-cycle adjustment to policy." With this comment, Powell confounded the market, which was looking for more rate cuts than it appears the Fed is willing to give.

In our Mid-Year Market Outlook, we mentioned that the Fed's pivot to a more dovish bias was complete and that the market was discounting 100 basis points of rate cuts over the next 12 months. We also expressed our view that the Fed would cut rates, but in our opinion, believed that the market's expectation was too aggressive, and that there was a better than even chance that the market would be disappointed. If the initial reaction to the cut and press conference is any indication, the market is in fact underwhelmed by the Fed's actions.

In a typical rate cut cycle, the Fed normally cuts rates for the second time about one month after the first. Therefore, a second rate cut at the next scheduled FOMC meeting on September 18th would be consistent with historical precedent. With this in mind, the market is currently pricing in a 92% chance of a rate cut at the next FOMC meeting.

Adding on Tariffs

The day after the Fed cut rates, President Trump momentarily diverted his attention away from feuding with the Fed and turned to China. In a tweet, President Trump announced a new 10% tariff on $300 billion in Chinese goods that aren't yet subject to levies starting on September 1st.

In the tweet, Trump criticized China for not following through on purchasing additional agricultural products or stopping fentanyl shipments. This new round of tariffs will be in addition to the $250 billion of Chinese goods that already have a 25% tariff imposed and escalate current tensions following the conclusion of unproductive talks between the U.S. and China. If history is any guide, we believe this escalation may only get more heated.

Trump tweeted earlier this week that China "does not come through," and was making a mistake in delaying negotiations until after the election, as they are hoping that a newly elected Democratic president would provide more favorable terms. China also believes that prolonged negotiations will increase political pressure on Trump, which would eventually force him to reduce his demands. Trump's decision to threaten additional tariffs suggests he is trying to force China to negotiate and not wait him out.

We do find the timing of the tariff announcement interesting, with President Trump's tweets occurring the day after the Federal Reserve's decision to reduce interest rates. Fed Chairman Powell has cited trade uncertainty as an economic headwind and Trump's latest move could be interpreted as an attempt to ensure that the Federal Reserve reduces interest rates further in September (and possibly by more than a quarter of a point) if they believe these additional tariffs will go into effect. The tariff announcement also comes a day after the 2020 Democratic debates concluded — it seems clear that Trump believes that running against China is a winning political strategy on multiple fronts.