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Manufacturing Report Sparks Recession Concerns

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After finishing down more than 1% yesterday, U.S. and global equity markets declined another 2%-3% today. Even though concerns about the trade war and the initiation of impeachment proceedings are hovering over the markets, the real catalyst for this decline was September's surprising ISM manufacturing index report. Expectations were for a number slightly higher than 50, but the actual reading was 47.8, the lowest since the 2009 financial crisis. This report has renewed fears of an imminent recession and an end to the longest expansion in U.S. economic history.

Despite the inherent strength of the U.S. consumer, businesses are reluctant to aggressively spend on capital projects due to the uncertainty of how the tariff wars may impact projected revenues. Another factor potentially impeding capital spending is the effect of the strong dollar on both top-line growth of multinational companies and in the translation of their foreign-sourced earnings back into dollars. This reluctance of corporations to spend may also be extending to company payrolls, which was reflected to some extent in ADP's preliminary September payrolls report. The figure missed analyst estimates and showed a notable downward revision for August. Payrolls are still growing but at a slower rate. We'll get another indication on Friday, October 4 when September nonfarm payrolls are released by the Bureau of Labor Statistics.

An offset to the weak ISM manufacturing survey is the accompanying survey, which comes from the competing IHS Markit group. This survey is historically more domestically focused and came in at 51.1 in December compared to the 50.3 reading in August. The IHS Markit group results tend to reflect better the positive economic indicators the U.S. has been experiencing over the last few months. Namely, retail sales have benefitted from wage growth and a high savings rate while housing statistics have been boosted by lower mortgage rates and pent up demand from the flush consumer. We will watch ongoing trade war developments and the potential impact on the employment growth statistics closely but continue to believe we are experiencing an economic slowdown. We expect the economy to grow roughly 1.5% over the coming quarters. Additionally, corporate credit spreads to same-maturity U.S. government bonds are rather contained, which is seemingly another indicator the economy remains more than a year away from an actual downturn.

The odds of recession have obviously increased considering the recent economic statistics, the protracted nature of the trade dispute with China, and the possibility that it could spill over to tariffs on European imports to the U.S. However, we believe those odds are still comfortably below 50% with Fed easing continuing to remind investors that policy is more important than politics.

Ben Pace is the Chief Investment Officer and a member of the Investment Committee. Prior to joining Cerity Partners, Benjamin Pace was Chief Investment Officer and Head of Global Investment Solutions for Deutsche Bank Private Wealth Management in the U.S. Ben has more than 25 years of experience in investment management. Prior to joining Deutsche Bank in 1994, he managed equity income funds for two investment organizations.