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How will this story end???

With negative-yielding debt at a record and climbing, we're in unchartered waters.

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The topic for this weekend's Jackson Hole, Wyo., gathering—"challenges for monetary policy"—couldn't be more timely. There's now almost $17 trillion of negative-yielding sovereign debt, and it keeps climbing as more and more central banks keep easing (25 in the past four months alone). One Danish bank is now offering the world's first *negative interest-rate mortgage*—10-year loans with a -0.5% APR. Another Danish bank is planning 20-year fixed-rate deals at 0%. (If I can get a 0% for 30 years, I can get my Florida condo on the beach!) The entire yield curve is negative in Denmark. Switzerland's 50-year bond yield went negative in July; its 30-year bond has been negative since 2016. After adopting its negative interest-rate policy in June 2014, the European Central Bank (ECB) *never* got started on the path to monetary normalization. The Bank of Japan *never* even considered leaving "*Never*land," a reference to Peter Pan used by the central bank to defend *never*-ending stimulus. Both Germany and Japan 10-year yields hit respective record lows of -0.71% and -0.25% this month. Here in the U.S., Treasury yields are positive but the 10-year is trading at 3-year lows and the 30-year briefly dipped below 2% a week ago for the first time ever. We've been talking ad nauseam about our inverted yield curve, yet the U.S. still has one of the most normal curves around. So much so that global investors keep buying our bonds, sustaining the rally and pushing U.S. yields even lower. A decade ago, the U.S. market made up 40% of the investment-grade universe; today, it's half. Experts note again and again how unprecedented and alarming this global phenomenon is, but offer few thoughts on how it will all play out.

It's obvious why this global easing cycle is likely to continue: global growth and inflation are slowing, mainly due to the intensifying U.S.-China trade war. Among developed markets, the eurozone is the biggest trade-war loser, particularly Germany where goods exports account for almost 40% of GDP. Despite all the global stimulus (with more to come; a new round of ECB rate cuts and quantitative easing are expected in September), eurozone core CPI was up just 0.9% year-over-year (y/y) in July, Germany's core PPI was up just 0.8%, U.K. industrial selling prices hit a new low and South Korea core PPI fell 0.1% y/y. We seem to be experiencing the "Japanization" of the globe. After printing money for decades, Japan has very high debt-to-GDP but can't get positive inflation. Now countries all over are struggling to lift prices. Ironically, the debate during the second half of the '70s was how to conquer inflation, when the short-run trade-off between employment and inflation was giving way to a vertical long-run Phillips curve, with inflation and unemployment running hot. Now much of the debate is exactly the reverse—how to create inflation when the Phillips curve appears to be flat, i.e., both inflation and unemployment are low! Indeed, Deutsche Bank contends, the basic inflation framework has lost much of its appeal.

So what might be the new framework? Is it Modern Monetary Theory (MMT), the in-vogue populist policy that says deficits don't matter because governments can just print all the money they need? MMT effectively puts the government, not the Fed, at the center of managing the economy. This weekend's Jackson Hole symposium is supposed to address whether and how central bankers may push back against MMT, and what it may take to get the U.S. and world out of its zero/negative interest-rate funk. A year ago, JPMorgan Chase CEO Jamie Dimon warned that 10-year yields could go to 5% and investors need to be prepared. According to Bloomberg News, he cautioned again in May that yields in the 2.4-2.5% range were "extraordinarily low." Many hedge funds and large speculators have been shorting bonds (creating the potential for a painful short squeeze if bonds don't come down soon). For a number of years, I've surveyed advisors around the country, "Who is a secular bull on government bonds?" No one. Vast consensus argued that rates were definitely going up. What happens when everyone is on the same side of the boat, I've wondered and wondered. With the most divided Fed ever as to future rate moves (*more below*) and $17 trillion (and counting) in negative-yielding global debt, perhaps the academics at Jackson Hole will shed light on how this story will end.

POSITIVES

- **I don't care for competition when shopping for shoes** Consumer spending is robust at Walmart and Target, restaurants and hotels, and online all the time—e-commerce sales surged more than 13% in the second quarter and 16% in July. Bank of America, often a good barometer of spending because of its vast consumer and small business client base, said its consumers have spent $2 trillion year-to-date, up nearly 6% y/y. This spending could keep going as the savings rate is high with personal savings at a record high.
- **Housing is not late cycle** Existing home sales rebounded in July to a 5-month high and are now running ahead of the year-ago pace for the first time since February 2018. July new home sales slipped but a huge upward revision to June—the biggest monthly increase since 1992—lifted the 3-month average to near its highest level since 2007. Mortgage rates at 3-year lows (and falling) are boosting demand. Before the last three recessions, both builder confidence and manufacturing PMIs were deteriorating. Today, builder confidence is trending higher. Refi activity also is surging, though it's not expected to reach major up-cycle levels as occurred in 2005-6 and 2012-13.
- **Might fall see a rebound?** Despite manufacturing weakness, Conference Board leading indicators rebounded, led by stronger building permits and lower jobless claims (which fell sharply in the latest week to near 1969 lows). Overall, half the leading indicator components increased and seven (out of 10) were higher than six months ago, although on a y/y trend basis, the indicators signaled moderation, not acceleration. Overseas, the eurozone flash composite PMI unexpectedly rose, taking some of the edge off trade and Brexit worries, though it remains near 6-year lows.

NEGATIVES

- **Manufacturing needs trade relief** The manufacturing component of Markit's first take on August hit a 10-year low and slipped into contraction territory as new orders and export sales shrank at their fastest pace in a decade. Manufacturing in the Kansas City Fed's district declined the most in three years, falling deeper into contraction. Citing trade deterioration, economic activity across states slowed to a 3-month low in July, according to the Philly Fed's survey of states, and y/y truck tonnage rose at its slowest pace in two years, the American Trucking Associations said.
- **The Fed can't agree on what's going on** The most important takeaway from this week's minutes from July's meeting was that very deep divisions persist among policymakers. Specifically, "a couple of participants" (Wolfe thinks it was Minneapolis Fed President Neel Kashkari and New York Fed President John Williams) wanted a 50 basis-point cut, while "several participants" favored maintaining the target range.
- **A tough act to follow** S&P 500 operating earnings rose just 0.7% y/y during Q2, down from Q1's small 2.8% increase. This represented the weakest performance since 2015 and 2016, when comparisons turned slightly negative during four consecutive quarters. The Q2 slowdown partially is attributable to tough comps as a result of the corporate tax cut that boosted earnings last year, suggesting this is more of a soft patch than earnings recession.

WHAT ELSE

Next year's an election year, so ... President Thomas Jefferson, responding to wartime aggressions by England and France, banned most trade in 1807. U.S. tax revenues plunged, the economy suffered and Jefferson and his party were castigated. Not wanting to show weakness, Jefferson procrastinated on removing the restrictions. But electoral politics being the ultimate advisor to presidential decisions, he reversed his policy shortly before his term ended, even though the underlying foreign policy problem had not been fixed.

Shout-out to dividends Ultimately, the U.S. equity story has the extra edge of quality in a no-yield world. U.S. companies are way more blue chip than those of other countries, FundStrat says, as U.S. debt and equity have real yield. If you think about it, a stock never can have a negative yield, so if rates keep falling, those stocks paying dividends could re-rate significantly higher.

We probably shouldn't get our fiscal hopes up Despite the White House's mixed messages this week on potential tax cuts, Cornerstone Macro cautions investors against expectations for more fiscal stimulus that can help support the stock market. Meaningful stimulus is likely only if the economy were to fall into recession, an unlikely scenario but one that, if it came to pass, likely would clobber risk assets beforehand anyway.

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DISCLOSURES

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Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Consumer Price Index (CPI): A measure of inflation at the retail level.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

Producer Price Index (PPI): A measure of inflation at the wholesale level.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

The Conference Board's Composite Index of Leading Economic Indicators is used to predict the direction of the economy's movements in the months to come.

The Markit PMI is a gauge of manufacturing activity in a country.

There are no guarantees that dividend-paying stocks will continue to pay dividends.

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