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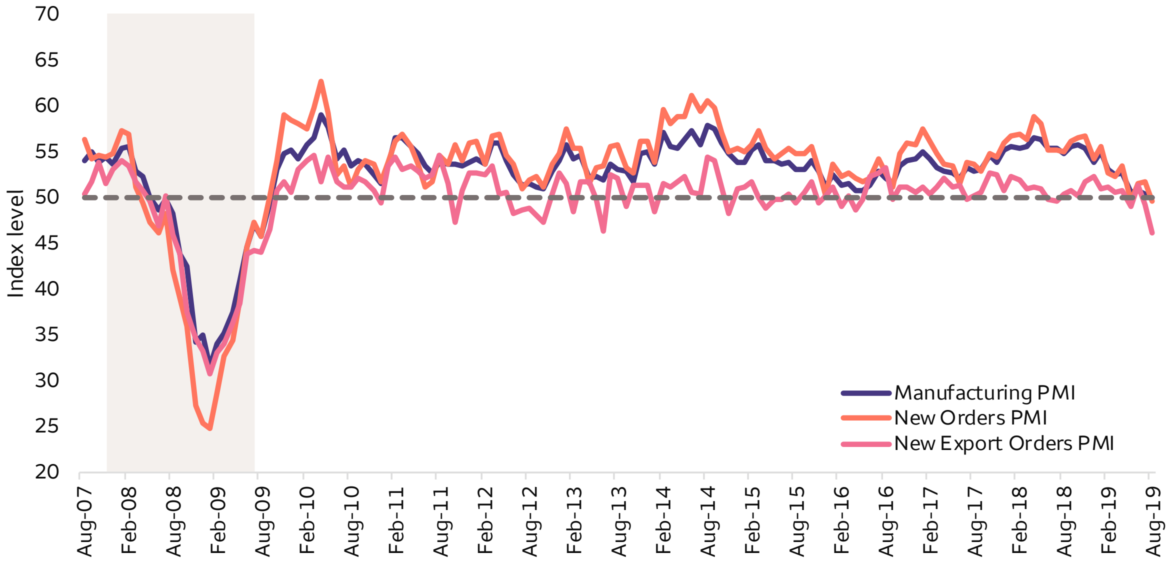
Chart of the Week

INVESTMENT TOPICS AND MARKET TRENDS USING CURRENT AND HISTORICAL ECONOMIC DATA

September 11, 2019

No Time for Complacency as Manufacturing Slumps



Sources: Wells Fargo Investment Institute, Markit; August 28, 2019. Monthly data beginning in August 2007, through August 2019. Shaded area represents a National Bureau of Economic Research (NBER) defined economic recession. A reading above the dashed line (50) is consistent with expansionary manufacturing activity. Manufacturing PMI = Markit manufacturing purchasing managers' index (PMI).

U.S. manufacturing sentiment continues to fall, led lower by domestic and foreign new orders

Growth in the U.S. economy has been upbeat in 2019, supported by resilient household spending even as business investment slowed. Our expectation of a more challenged household spending environment, combined with still-soft manufacturing activity, points to weaker growth in the second half of 2019.

As the purple line indicates, the Markit manufacturing purchasing managers' index (PMI)—a measure of business confidence and firms' future expectations—fell into contractionary territory in August. A closer look at index subcomponents showed a precipitous decline in U.S. demand (orange line) and foreign demand (pink line), which follows weaker core durable goods orders reported in July.

What it may mean for investors

While we do not expect a U.S. recession to occur in 2019, we favor reducing net risk exposure as we move further into the second half. In line with our more conservative positioning:

- We recently downgraded our guidance (to neutral) on two cyclically sensitive equity sectors, Energy and Industrials, while upgrading Real Estate and Utilities to neutral as weaker growth expectations are likely to pressure the Federal Reserve to lower interest rates.
- We favor moving up in fixed-income quality as corporate fundamentals (including earnings) are likely to be challenged in a slower growth environment, particularly for weaker credits.

Peter Donisanu, *Investment Strategy Analyst*

This chart was excerpted from the Global Perspectives report dated September 4, 2019.

Risk Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Bonds** are subject to market, interest rate, price, credit/default, liquidity, inflation and other risks. Prices tend to be inversely affected by changes in interest rates.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Real estate** investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

Definitions

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector. The PMI index is based on five major indicators: new orders, inventory levels, production, supplier deliveries and the employment environment.

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