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Market Commentary

WEEKLY PERSPECTIVE ON CURRENT MARKET SENTIMENT

Noise

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Scott Wren
Senior Global Equity Strategist

Last Week's S&P 500 Index:
-2.1%

Key takeaways

- *Some stock market pundits have deemed last week's labor market report as a negative for equities.*
- *Our analysis suggests the labor market remains robust and the Consumer Discretionary sector remains attractive.*

Some market prognosticators latched onto last Friday's employment report covering the month of February as something that was "scary" or "dismal" and an indication that our long upward run in the economy and stock market was coming to an end. Recall the consensus was to look for around 180,000 net new jobs to have been created last month, but the report showed the actual number to be just 20,000. That is a huge miss. Some analysts and the financial press speculated on Friday that the poor employment report combined with a horrible read on December retail sales (ex-autos and gas -1.4%) meant that the consumer was not going to be driving the economic bus any longer. Our Equity Strategy group would beg to differ.

Remember that consumer spending is responsible for close to 70% of U.S. gross domestic product (GDP). For the economy to move forward, even at a modest pace, we need confident consumers out there opening their wallets and spending money. We have had at least a favorable rating on the Consumer Discretionary sector for a number of years. Note that this sector has been, by a meaningful margin, the best-performing sector since the March 2009 financial crisis low in the S&P 500 Index. Of our many reasons for having and sticking with this guidance, perhaps the most important has been our belief that the labor market would continue to see improvement and that, indeed, American consumers would respond to this environment by doing what they do best: spend money.

The Consumer Discretionary sector continues to rank in the top half of all sectors when looked at through our Pillar analysis methodology lens. This sector's estimated earnings-per-share growth rate along with the estimated dividend growth trend over the coming 12 months rank second best among the 11 S&P 500 sectors. In addition, factors such as the trailing price-to-earnings ratio and return on equity are among the top three relative to the other sectors. These are compelling pieces of information as we look ahead and set expectations.

There are some on the "Street" who are speculating that a combination of seasonal adjustments and the effects from the recent partial government "shutdown" have resulted in reported data that are not reflective of actual conditions on the ground. Last Friday's employment report is a good example of what they are referring to. As mentioned, the number of new jobs created was well below consensus expectations. However, wage gains (average hourly earnings) were greater than expected while the unemployment rate was lower than expected. If market participants stripped away the job creation element from the February employment report, all else looked quite good. Add to that the weekly initial jobless claims number (a leading indicator reported every Thursday morning), which continues to hover near multi-decade lows and one would expect a healthy consumer outlook.

While our outlook for domestic and international economic growth has been adjusted downward, domestic GDP still appears to be on a modest-to-good pace. Our macro outlook for the labor market continues to be good, which supports our underlying equity strategy analysis—specifically our favorable stance on the Consumer Discretionary sector. We believe last week's job creation number was largely noise and not the start of a trend.

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Risks associated with the Consumer Discretionary sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players; reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment.

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