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Market Commentary

WEEKLY PERSPECTIVE ON CURRENT MARKET SENTIMENT

Reassurance

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Last Week's S&P 500 Index:
+4.4%

Key takeaways

» *Stock investors have been making assumptions about economic growth, inflation and an eventual easing of trade tensions for some time.*

» *There are numerous market risks but Chairman Powell reassured the market the Federal Reserve (Fed) would act if needed.*

Was the stock market expecting the Fed to cut interest rates as the S&P 500 Index climbed to new record highs in late April? In short, in this strategist's opinion, no. But we do know that the rather thinly traded fed funds futures contracts were predicting a rate cut before the end of 2019 as equities were moving higher early in the year. We think the market certainly had some degree of confidence that a U.S.-China trade deal would be struck in the nearer to intermediate term (and still does). However, at this point a deal has obviously not happened and volatility has jumped as a result. The threat of an all-out trade war is not good for economies or the equity market.

As we have stated many times over the last 18 months, global growth was stacking up to be a major concern for investors as the expansion rolled on and the economic cycle aged. The volume of global trade is the measurement piece of that puzzle, and trade frictions and uncertainties have a huge influence on the level and magnitude of worldwide economic activity. Look no further than poor earnings results from high-tech emerging market exporting countries like South Korea and Taiwan. Fourth-quarter 2018 and the first quarter of this year saw earnings declines of 25% to 35% versus the year-ago period as uncertainty over trade and global growth crimped capital expenditure (capex) spending plans in China and a number of the world's largest economies. Increased trade tensions from here would likely lead to a broadening of negative earnings results for many companies on a global basis.

Many investors were wondering if the Fed would come to the rescue if the domestic economy sputtered as a result of a trade-induced slowdown. On June 4, Fed Chair Jay Powell, in a speech addressing a conference hosted by the Federal Reserve Bank of Chicago, gave the market the answer it wanted. He stated that the U.S. central bank would "act as appropriate to sustain the expansion" should economic conditions deteriorate due to trade frictions. The Fed's dual mandate requires an attempt to reach "full employment" and "price stability," so of course, as we would expect, the Federal Open Market Committee (FOMC) is paying close attention to current trade rhetoric and its potential effect on the U.S. economy. The recent modest growth/modest inflation environment of the last handful of quarters is likely something the Fed tries to achieve.

The equity market appears to be buying into a forward outlook that includes modest growth, low inflation, and, eventually, less trade tension. Since Chair Powell's comments, the S&P 500 has rallied more than 5%. Four of the top five performing sectors since those comments have been Information Technology, Consumer Discretionary, Industrials, and Financials. We currently rate all of these sectors as either favorable or most favorable. Each of these sectors is quite sensitive to the ebb-and-flow of the economy and dependent on a continuation of the expansion. Keep in mind that on a year-to-date basis most of these sectors have been the best performers or among the best performers, even with trade uncertainties driving the headlines and markets on a day-to-day basis. Investors have been making assumptions about the economy and trade-negotiation outcomes for quite some time.

The chairman's comments earlier this month gave the stock market what it needed: reassurance.

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An index is unmanaged and not available for direct investment.

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