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WEEKLY PERSPECTIVE ON CURRENT MARKET SENTIMENT

Distinct Outcomes

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Last Week's S&P 500 Index:
+1.8%

Key takeaways

- *Stocks have traded in a range in recent weeks but sector performance has reflected a pattern.*
- *The direction the S&P 500 breaks out of this range will likely determine which sectors outperform.*

While the S&P 500 has been trapped in a range over the last six weeks or so and sector performance has been mixed, there are some historical patterns that often play out which have largely remained intact as stocks have bounced around during these volatile trading weeks. Over the last two weeks, the S&P 500 has made a determined run higher, trading from the bottom to the top of the range and tacking on approximately 5% without much of a stumble along the way. The catalysts are focused around possible progress when U.S. and Chinese negotiators meet next month in Washington, D.C. to reignite trade talks (we hope) as well as increasing momentum surrounding global central bank stimulus/easing plans that look more likely.

Given these potential positives and the stock market's reaction, we think it is safe to say investors have been in a "risk on" mood over the last couple of weeks. Meaningful moves higher in equities are normally led by those sectors that would benefit from a more stable economic outlook (or, historically, by potentially accelerating economic growth). Indeed, during the recent rally, the sectors that have outperformed the S&P 500 include Information Technology, Energy, Industrials, Communication Services, Consumer Discretionary, and Financials. The common characteristic for most of these sectors is that they tend to perform best with a heavy dose of economic stability, if not outright growth, with a reasonable portion being growth outside the United States.

Now, on the flip side of the coin, let's look at a period of downside within the recent range. And although it might seem like a long time ago, the S&P 500 hit an all-time record high in late July. In the four trading days starting on August 9 and ending on August 14, the S&P 500 tumbled 3.3%. It shouldn't be a surprise that investors shifted quickly to "risk off" mode as sectors less sensitive to the ebb-and-flow of the economy held in better (much better) than those more directly tied to economic activity. The best performers during that downside stint were Utilities, Real Estate, Consumer Staples, and Health Care. For the bulk of these sectors, their products and services would still be in demand whether the economy is good or bad. That is why investors frequently hide there when fear drives the stock market lower. Plus, these sectors typically pay attractive dividends in a low-rate environment.

Given what we perceive to be increased negative risks to our modest-growth macro outlook, it is likely that trade, global growth, and central bank headlines of the day will continue to drive markets in the near to intermediate term. That is the main reason we have made the conscious effort to reduce equity risk in recent months. For a number of years during this long expansion we had leaned more toward those sectors sensitive to the economy. With stocks currently trading near what we consider to be "fair value," we lowered our exposure to these cyclical sectors and increased allocations toward the more risk-off defensive sectors.

Should the S&P 500 break out of the recent range, we believe there are two distinct outcomes. The direction of the breakout will almost certainly determine sector performance over the intermediate term.

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