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CAPITAL MANAGEMENT

This Week in the Market
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Breathing Room for the Fed

The mixed bag of economic data in the US and abroad continues to support the Federal Reserve's newfound patience. With high hopes for a trade deal as a kicker, the S&P 500 is holding near a 3 month high. Momentum has continued to be strong this week with around 35% of index companies making a new 65 day high. Historically, this is another indicator that has been bullish for 6 to 12 month returns, but less meaningful in the short-term. A few of the risk-on indicators like semi-conductors and copper took a breather this week and even the S&P moved sideways from Monday to Friday. As we've said, consolidation is possible in the interim as we push against highs made in November and December. However, we remain optimistic about the balance of the year.

US economic data continues to paint the picture of an economy growing at a moderately slower pace. 4th quarter GDP came in at 2.6% and was well above expectations. This was of course lower than the 3.5% posted in Q3, but was a nice surprise given the volatility experienced in late 2018. Within the data, business investment accelerated which is key to the prolongation of the cycle and is evidence that the TCJA's investment incentives are playing out beneath the surface. Consumers contributed at a 2.8% pace which is reflective of the strength in the labor market. Housing was the weak spot in this quarter's report with residential investment contracting by 3.5%. However, more recent data shows that new home starts have begun to rebound a bit with lower long-term interest rates. Net exports were a moderate drag on the economy, but much less so than the 3rd quarter.

Today's PMI release also lent support to the growing but slowing narrative. The report shows that manufacturing is expanding, but at the slowest rate since late 2016. Generally, the report showed slack building in the system and lack of inflationary pressure. This is supported by a core PCE reading of 1.9% in Q4. Again, this is a sign that the Fed has no reason to be aggressive in the coming months. Still, the data is firmly in expansionary territory and recession remains unlikely this year. Even as growth projections have softened for the early half of the year, they have remained firm for the balance. 2019 GDP growth projections are still a healthy 2.5%. The market likes this mix.

In the bond market, the stronger than expected GDP report finally sent 10 year yields higher in the back half of the week. Strategas has called out the divergence between Copper/Gold and US 10 Year yields in recent weeks. This week's action put 10s closer in line with the risk-on signals we've been seeing and moderately steepened the curve. Still, it's hard to imagine the 10 year breaking too far to the upside. Global yields continue to weigh on our sovereigns and inflation pressures are absent as noted above. While banks, got a small shot of life towards the end of the week, the trend remains uninspiring.

Industrials and Technology continue to lead as trade optimism builds and CapEx once again materializes. Business investment surprising to the upside could be a real catalyst as 2019 goes on. Markets were largely robbed of the benefits of the TCJA last year as trade clouded the waters, but its effects are still working through the economy. The 100% expensing provision should benefit industrials and tech the most relative to other sectors. Their outperformance is noted.

Plenty of risks remain as trade deals need to be finalized and politics heat up. With that said, an economy set to grow at 2.5% or thereabouts is not to be feared.