Donaldson CAPITAL MANAGEMENT

This Week in the Market
3-25-19

2019 Recap Thus Far

For this week's "This Week in the Market," we've stepped back and provided a summary of our most recent 4 Stories. This is a broader picture of where we are in the market and where we think we are going.

In late 2018, the market grew concerned that the Fed was raising rates too quickly. At the same time, trade fights, slowing global economic growth, and a government shutdown added to the fear. When the dust settled, the market had fallen just shy of 20% from its high.

Since then, the Fed has pivoted away from its planned rate hikes, progress has been made on the trade front, and the government has been reopened. Global growth is still slowing and the US looks to be joining in, but the pace of the slowdown appears manageable. The US consumer has remained strong despite market volatility and offers a solid foundation to build on. The market has found this to be a supportive backdrop and has recovered most of its losses from 2018.

From a fundamental standpoint, last year was a great year that was not rewarded by the market. So while sales and earnings growth will dramatically slow on a year over year basis, the market is still playing catch up as worries have eased. Earnings growth, while slower, is projected to remain positive and add to the fundamental value of the market. Based on current projections, the S&P is trading approximately 5% below its fair value.

A trade deal also has the potential to unleash pent up demand for capital investment. Companies have kept a good chunk of their tax cut savings on the sidelines as trade fights complicated future plans. A greater sense of clarity would allow companies to put some of this money to work. With this catalyst, earnings could actually surprise to the upside.

A more dovish Fed should ease financial conditions as well. The US yield curve went incredibly flat as the Fed continued to tighten and inflation remained tame. With the Fed backing off, the curve has a chance to re-steepen as the committee pursues their goal of moving inflation towards their target. This should allow credit to flow more freely and offer a potential spur to the economy as well.

While we are optimistic about the market's prospects for the balance of the year, we acknowledge two key risks. One is that a trade deal does not come to fruition. Under this scenario, tariffs would put further pressure on economic growth and risk a downside surprise to earnings. The other is that global weakness infects the US leading to pressure on earnings as well. These risks are not our base case. We believe both sides of the trade negotiations need a deal and that US consumers, who make up 70% of the economy, will provide a buffer from global weakness.