Donaldson
CAPITAL MANAGEMENT

This Week in the Market
4-22-19

Making a New High

The S&P 500 closed out the week at a new all-time high. After this week's action, we've completed a 7 month recovery and have begun to chart fresh territory. Better than expected earnings growth, improving economic data, low inflation, and prospects for a trade deal are contributing to a renewed sense of a goldilocks environment. Inflation is too low for the Fed to hike rates and the fundamentals are looking too good to fear a recession. As a result, stocks have room to run especially as earnings expectations for the balance of the year and 2020 hook higher. Historically, new 52-week highs after a 6+ month drought have led to outperformance over a 12 month time frame. On average, stocks have been up 13% following such conditions vs. an average of 8% for all observations.

While there is much to like in the current environment, there is still room for improvement, as well as risks that need to be balanced. Q1's GDP growth of 3.2% surprised strongly to the upside. Below the surface, however, a good portion of the momentum could be attributed to phenomenon likely to reverse in subsequent quarters (inventory build, trade rebound, and one-off highway projects). All the while, consumer spending and fixed investment are slowing their pace of growth. Consumer spending weakened at the start of the quarter, but had begun to improve by the end. Hopefully this trend will continue and will get support from lower interest rates and the wealth effect of higher asset prices. On the investment side, trade clarity is the remedy as we've said for some time. Strategas' Dan Clifton noted his surprise about the tone of Xi in a recent speech and his willingness to acknowledge issues like IP protection and fair access to markets. He believes that a trade deal is not far off and expects it to boost capital investment in the back half of the year. In other words, an opportunity for earnings to continue surprising to the upside.

On the flip side, the 2020 election is getting closer each day. Policy proposals being floated by the 20+ candidates on the left are full of tax increases and increased regulation. The market doesn't seem to be taking these proposals seriously, outside of Health Care where there is real bipartisan agreement. Should some of the more extreme candidates begin to emerge as frontrunners in the coming months however, markets may have to begin discounting for the possibility of lower growth. This is something to be mindful of as we move through the year. To navigate these waters, our focus should continue to be on companies executing on a strategy and delivering real organic growth, independent of the goings on in Washington.