Donaldson
CAPITAL MANAGEMENT

This Week in the Market
6-17-19

Another New High

The S&P 500 put in another new high this week as the market digested dovish comments from the Federal Reserve. This marks the third new high of the year and is a sign that the equity market remains relatively unfazed by the ongoing trade dispute. With Fed support, participants continue to have confidence in the market at these levels. Curiously, equity sentiment does not look stretched on these new highs. Fund flows into SPY are near the 5th percentile and money is piling into ultrashort bond funds. At the same time, positioning on the long end of the curve is starting to look extreme as bond yields break to a new low. Flows into TLT are in the 95th percentile. This message is a bit confusing especially with stocks at new highs and gold breaking out as well. Strategas notes that this condition has only been present one time since 1974. One of these trends will probably need to reverse.

At this week's meeting, Jerome Powell indicated the case for rate cuts has strengthened and the Fed's dot plots showed committee members guiding down their forecasts in response to weaker data and a deepening trade war. The bond market is now pricing in a 100% chance of rate cut in July. While this is the probable outcome, data needs to avoid surprising to the upside between then and now. Survey data is definitively weakening, but there needs to be a continued transition into softer hard data to make a cut a certainty.

With a cut on the horizon, Donald Trump has little incentive to strike a trade at the G-20 this month. Rather, it will be an opportunity for him to set up a deal for later in the year after a rate cut has taken place. This is why the market response was so enthusiastic this week. There is a decent chance we get a rate cut and a trade deal. Under the surface, companies levered to China continue to improve and are confirming this notion. Industrials, materials, and tech continue to pick up momentum.

Geopolitical tension continued to build this week with Iran shooting down an unmanned US drone. On Friday morning, it was reported that Donald Trump called off a retaliatory strike at the last minute and tension momentarily eased. We'll see how this plays out going forward, but if the intention was to stir up oil prices, they've finally started to respond. After lying dormant for the last few weeks, oil gained over 9% this week. In other energy news, this morning's East Coast refinery explosion is likely to send gasoline prices higher as the summer driving season gets going. Refining companies should benefit, but we'll watch for additional pressure on consumers.