Donaldson
CAPITAL MANAGEMENT

This Week in the Market
7-8-19

Powell Delivers

The S&P 500 closed at another all-time high after successfully navigating a week full of potential landmines. Jerome Powell gave two days of testimony in front of Congress and managed to convince the market that a rate cut remains the most likely outcome at July's meeting. This comes in the wake of a much stronger than expected jobs report last week and inflation reports above expectation on both the consumer and producer sides this week. Rather than seeing good news as bad news, Powell's insistence that the Fed would act accordingly to extend the cycle ruled the day and powered the equity market higher. Trade remains on the backburner with the market continuing to find the Fed supportive.

In testimony before both chambers of congress, Powell noted trade disputes are creating crosscurrents that are weighing on the economy. In particular, business investment has slowed substantially as uncertainty has pushed projects to the sidelines. In addition, Powell testified that low global inflation is in fact being imported into the US. The relationship between inflation and unemployment has significantly weakened over the last several decades and the natural rate of unemployment and the neutral interest rate may be much lower than previously thought. With these comments, the market stood firm in its belief that rates will be cut in July and once more by the end of the year. Strategas finds themselves in this camp as well. Their base case is that rates will be cut twice. One to take back the ill-advised December hike and another to provide insurance through the turbulent trade negotiations.

On the trade front, little has surfaced since the G-20 in terms of progress and negotiators are still in search of a face-to-face meeting. In an otherwise quiet week for developments, Trump did revisit the European front in the trade war by launching an investigation into a proposed French tax on US technology companies. We'll have to continue to monitor trade developments, but it is notable that Strategas' China trade and Euro & Auto baskets are underperforming. The Fed may be providing support for the broader market, but we should be mindful of individual pockets still hampered by trade.

In Health Care, there were big developments in the pharma pricing saga. President Trump announced that he would not implement a rule banning PBMs from being paid rebates. Rather, sentiment is building that Trump is planning to take on pharma more directly. The administration is working with Nancy Pelosi on a bill that would negotiate prices on 150 drugs in Medicare Part D and another 100 Drugs in Part B. Running parallel to this is the notion that Trump could adopt an International Pricing Index that would tie reimbursement for drugs in Part B to the price paid in other countries. One of these plans could win out and that will be bad news for pharma. As such, the big pharma names continue sell off. PBMs may have caught a brief reprieve, but the space remains pressured. Health Care is a chronic underperformer in an otherwise broad market.