Donaldson CAPITAL MANAGEMENT

This Week in the Market
7-29-19

Taking a Break

In an action-packed week, the S&P 500 retreated over 3% from last Friday's all-time high. Markets spent the week wading through the remaining Q2 earnings reports, a Fed decision, trade developments, and a monthly jobs report. Given an impressive stretch of performance over the last two months and this smorgasbord of headlines, it's not surprising to see some corrective action. This could very well continue in the coming days to weeks, but the market is operating with a good base underneath it. Decent levels of support are close by with the most prominent level roughly 4% lower around 2810. In addition, history lends a degree of confidence over the long term. The S&P has averaged 20% on an annualized basis from a rate cut to the next hike since 1982. We aren't fighting the Fed.

As expected, the Fed delivered a 25 bps rate cut at their Wednesday meeting. However, the market wasn't satisfied by Powell's comments about further rate cuts that had been priced in. When the Chairman used the phrase "mid-cycle adjustment" to describe the rate cut, he stoked fears of a one and done move. He quickly clarified that he doesn't see a prolonged cutting cycle, but rather that the Fed will continue to be data-dependent. Regardless, the bond markets continue to believe that rates will likely be cut 2 more times this year.

The case for additional rate cuts was quickly bolstered on Thursday as President Trump announced his intention to levy a 10% tariff on the remaining $300 billion of Chinese imports beginning on September 1st. The timing of this move is curious and could be taken as Trump trying to secure an additional rate hike before cutting a deal with the Chinese. However, Strategas points out that a deal before the 2020 election is increasingly unlikely. They believe the Chinese are trying to wait out President Trump and that not enough economic pain has been inflicted at this point to force the sides towards a deal. Chinese negotiators are making no further offers until the U.S. removes all tariffs. This is obviously unacceptable to the U.S. and we remain at an impasse. At the new level of tariffs, the incremental impact of fiscal stimulus for 2019 is effectively canceled out and uncertainty will only build. This is bound to slow growth and thus Strategas is in the camp of 2 additional cuts this year as well.

July's jobs report slightly missed expectations and included a downward revision of 41K jobs to prior months. This is reflective of an increasingly tight labor market with an unemployment rate of 3.7% and increasing labor force participation rate of 63%. Wages continue to rise at a good clip and came in slightly above expectations at 3.2% year over year. The consumer remains in great shape and is certainly the bright spot in the U.S. economy, but the sector is unlikely to sustain the growth it has seen over the past several years. This is particularly true as the next round of tariffs is set to hit the consumer harder.

The biggest case for stocks right now continues to come in the form of a falling discount rate and increasing relative attractiveness. Earnings played a role over recent weeks as companies generally beat the low bar. But with the season behind us, yields breaking lower perhaps offer the most compelling narrative until trade gets resolved. The low inflation expectations and growth concerns have sent 10-year treasury yields down to 1.86%. With moderate P/E levels and dividend yields well above treasuries, stocks continue to offer the only alternative in the thirst for income.

S&P 500: Standard & Poor's (S&P) 500 Index. The S&P 500 Index is an unmanaged, capitalization-weighted index designed to measure the performance of the broad U.S. economy through changes in the aggregate market value of 500 stocks representing all major industries.