Donaldson
CAPITAL MANAGEMENT

This Week in the Market
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Still Waiting

Despite a significant uptick in volatility over the past month, the S&P 500 is only 3% below its all-high and has essentially moved sideways over the entire month of August. The path certainly hasn't felt that smooth with impromptu tweets moving the market over a percent in one day several times during that stretch. Still, the narrative remains the same. We are stuck in a trading range until we get more definitive information on trade or Fed rate cuts. For now, both the survey and hard economic data point to a slowing U.S. economy, but one that is still growing. With that backdrop and the ever looming possibility of a trade deal, the equity market is afraid to be too bearish.

The bond market looks entirely different. Bond yields continue to push lower and lower as investors pour into dollar backed sovereign debt. However, there is a strong possibility that the bulk of this money is foreign. Evidence is starting to show that international investors are forgoing the stability afforded by global sovereign debt in favor of a dollar backed volatility hedge. The U.S. 10 year treasury yield, after hedging for currency, offers 60 bps less than a German 10 year bund and 70 bps less than a Japanese 10 year. Despite the opportunity cost, money continues to flow into U.S. treasuries. Some may even be betting on a stronger dollar through this mechanism. Rather than a symptom of domestic economic concern, low yields are a result of global economic weakness.

Still, the low treasury yields and the inverted curve have kept defensive equity sectors in vogue. Staples are outperforming discretionary, utilities are outperforming banks, large-caps are outperforming small caps, and low beta is outperforming high beta. Equity investors haven't been able to fully shake the fear of a recession despite the relatively robust economic data. Yet, it's also possible that concern about the volatility of the upcoming election cycle is equally contributing to the defensive tone. The rules could start to look quite different a year and a half from now. Looking to safety and stability in such an environment makes sense. In these defensive names there is quality, some level of growth, higher yields than treasuries, and solid credit more often than not. TINA ("There Is No Alternative") is in full effect. Health care has yet to move and is certainly more politically risky than other defensives, but the valuations may soon be too difficult for the income crowd to ignore.

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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.