Donaldson
CAPITAL MANAGEMENT

This Week in the Market
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Breaking Out

After a month of sideways motion and relegation to the land between the 50 and 200 day moving averages, the S&P 500 has decisively broken higher. This surge came with the partial restoration of optimism for a trade deal. This week, U.S. and Chinese officials agreed to an October meeting with both parties hopeful about a positive outcome. With this move, the S&P 500 is less than 2% from a new all-time high with little resistance between here and there. We've seen time and again that stocks are inclined to go higher to the extent that trade can get out of the way. Even news of progress towards constructive talks provides a brief window for investors to see the value of equities relative to what can be found in the bond market. There is a lot of room to run upon more clarity around a deal.

The markets have perhaps been sniffing out trade progress ahead of the announcement. We've seen companies levered to China doing surprisingly well, semiconductors outperforming, and industrial metals perking up a bit. Upon this week's announcement, bond yields around the world appear to be trying to bottom out. We'll see if this persists, but for now these are positive developments.

Today's jobs report did little to sway markets one way or the other. Payroll adds missed expectations by roughly 60K jobs and prior months suffered downward revisions. Still, worker hours stabilized and the labor force participation rate rose as unemployment held constant. These are bullish developments and a sign that job growth is merely moderating as we move closer towards the bound of full employment rather than deteriorating from economic weakness. Wages are growing at a 3.2% rate and there has been a surge in small businesses reporting that labor is hard to come by. Again, these points are supportive of the tightness in the labor market. It's important, however, that we start to see productivity gains helping to offset accelerating wages going forward. Corporate profits have been flat-lining and rising wages could add further pressure. This is important because profits matter for employment which matters for consumer spending. With manufacturing weakening from trade, it's critical that the consumer continues to pull its weight. More than anything, however, today's report gave little incentive for the Fed to cut 50 bps in September. It's more likely that they remain on a slow path of 2 to 3 more cuts spread out through year-end.

The bottom line is that U.S. economy is still in pretty decent shape. Yes, manufacturing is weak and there are signs that consumer sentiment is topping out. Still, the hard data is showing consumers are providing enough economic power to give the Fed time to adjust rates and the administration to push on in its trade fight. They must be careful though. Consumer sentiment cannot roll over in a big way or we risk losing the driving force of our economy. It's a fine line to walk and a trade deal sooner rather than later is best for the extension of the cycle.

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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.