Donaldson CAPITAL MANAGEMENT

The Outlook

DCM Weekly Market Brief

10-7-19 – 10-11-19

Progress at Last

After weeks of will-they-won't-they, it appears that the U.S. and China are on the cusp of a preliminary trade deal, referred to as "Phase 1." Despite a week of particularly nauseating news flow, markets have definitively applauded today's announcement. The S&P 500 closed up over 1% on the day and down less than 2% from its all-time high. Importantly, it has once again spiked above its 50 day moving average and broken above the slight roll that had been shaping up for the last several months. With Q3 earnings just around the corner, such a positive development on the trade front is most welcome. Earnings are expected to come in at their weakest level in years, but a more constructive trade environment could help steer CEO outlooks in a more positive direction. Some upside surprises to guidance could be on the way.

Today's trade announcement is light on details, but the general framework sounds encouraging. Mentioned as part of the deal are Chinese Ag purchases, intellectual property protections, financial service restrictions, and suspension of some proposed tariffs. The administration stated that the first portion of the trade deal will be written over the next 3 weeks. Still, existing tariffs are set to remain in place and there is a lot of work left to do to ensure enforcement. The market certainly appreciates the effort, but is restraining itself from going all in just yet. It was burned earlier in the year and is taking a more cautious approach this time around. However, with sentiment and valuations far from stretched, cyclicality re-emerging in pockets, and a solid technical setup, there is a lot to like about the current environment for stocks.

Around the world, there are also signs that the global economic slowdown may be finding a bottom. Sovereign bond yields have collectively held their ground for around the last 2 months. The U.S. yield curve has uninverted itself at the 3Mo 10 Year and 2 Year 10 Year spreads. This is a sign that the foreign thirst for haven assets may be easing. To further support that, gold has started to level off, the Dollar has weakened since the start of the month, and emerging market equities have turned their noses up. This has translated to performance in some U.S. sectors as well. Semiconductors remain hot and banks are catching another wind, for example. We may be setting up for another round of value outperformance vs. growth, particularly as some of the FANG names continue to lag. The combination of low P/E and steady and consistent earnings growth looks awfully attractive here.

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.