October 7, 2019

Weekly Viewpoint

Price Discovery Continues

Performance for Week Ending 10.04.19

The Dow Jones Industrial Average (Dow) lost 0.92%, the Wilshire 5000 Total Market Index[SM] (Wilshire 5000[SM]) fell 0.38%, the Standard & Poor's 500 Index (S&P 500) fell 0.33% and the Nasdaq Composite Index (NASDAQ) gained 0.54%. Sector breadth was mixed with 6 of the S&P sector groups finishing higher and 5 closing lower. The Technology sector (+1.11%) was the best performer while Energy (-3.79%) was the worst.

Index*	Closing Price 10/4/2019	Percentage Change for Week Ending 10/4/2019	Year-to-Date Percentage Change Through 10/4/2019
Dow	26573.72	-0.92%	+13.92%
Wilshire 5000	30089.99	-0.38%	+16.86%
S&P 500	2952.01	-0.33%	+17.76%
Nasdaq	7982.47	+0.54%	+20.30%

Market Observations: 9/30/19–10/04/19

The S&P 500 finished lower for the third consecutive week as the 'price discovery' process continues to play out. With mixed signals on the economy, rising political uncertainty, and a lack of progress in the US/China trade war – investors appear to be trying to gauge what is already discounted in market prices and what is likely to come to fruition in the weeks and months ahead. In terms of the economy, the manufacturing sector remains in a slump mostly due to trade uncertainty while the services side of the economy has been showing signs of slowing. On the other hand, the consumer—which drives the bulk of domestic growth—remains in relatively good shape. The unemployment rate stands at 3.5 percent, the lowest level in nearly 50 years, jobless claims also continue to hover near 50-year lows, wages are growing, and confidence levels remain elevated. In addition, the housing sector, likely driven by the plunge in interest rates, has been perking up with new home sales in August just off the highest levels in over a decade.

Monthly Payroll Report: The September payroll report was a mixed bag, but still good enough to help ease recent investor anxieties about the US economy's growth trajectory. The Labor Department reported that nonfarm payrolls expanded by 136K in September, mildly below the 145K expected by economists. Offsetting the shortfall was a 38K upward revision to the August payrolls. The unemployment rate dipped to 3.5% (from 3.7%), the lowest level in 50 years. Average hourly earnings were unchanged (0.0%) during the month and are now up 2.9% on a year-over-year basis. In some ways, the mixed outcome was likely the best-case scenario for the equity markets as the report wasn't so bad that it exacerbates already-existing growth concerns, but also not so strong that it will have any major impact on Fed policy.

Cracks Appear in the Manufacturing Sector … Renewed worries that the US economy is heading toward recession pummeled the market during the middle of the week with the catalyst being a report from the Institute for Supply Management (ISM) that showed manufacturing activity fell to a 10-year low. The ISM Purchasing Managers' Index fell to 47.8 in September from 49.1 during the prior month (note- readings below 50 signal contraction). These back-to-back readings were the first to fall below 50.0 since 2016, although the ISM was quick to point out that the latest readings don't signal a recession: "*A PMI above 42.9 percent, over a period of time, generally indicates an expansion of the overall economy. Therefore, the September PMI indicates growth for the 125th consecutive month in the overall economy. The past relationship between the PMI and the overall economy indicates that the PMI for September corresponds to a 1.5-percent increase in real gross domestic product (GDP) on an annualized basis.*"

… But Consumer is King: The trend in the ISM Manufacturing Index is certainly not encouraging, however, it seems a bit premature to get overly concerned about a looming recessionary environment. The manufacturing sector only represents approximately 10% of the US economy, a mere fraction of the nearly 70% of the economy that is driven by consumer spending. Importantly, the US consumer remains in good shape: Initial Jobless Claims remain near their lowest level in 50-years – signaling that the Job market remains healthy; Not only are people working, but wages are also rising. According to the Atlanta Fed, median wage growth has gone from about 1.5% growth in 2010 to the current reading of just under 4% growth; the Census Bureau recently reported that median household income has surpassed $63K for the first time ever -- so people are working, and they are taking home more money. Bottomline – While overall economic growth is slowing, we appear to be entering into more of a "muddle through" environment than an outright contraction.

Market View: While markets have rebounded from the August lows, we maintain our cautious view on the near-term outlook. Gains over the course of the year have been solely from the expansion in the market's valuation multiple, which in turn, has pushed the P/E multiple to above average levels. This scenario potentially leaves the market vulnerable to negative headline risk, especially related to developments around trade and earnings. Expectations heading into third quarter earnings season are very muted and investors will put extra weight on management's forward outlooks. Based on the recent announcement from the Business Roundtable, CEO confidence now stands at the lowest level in 3 years. The lobbying group said increased geopolitical tensions, and specifically the trade war, were to blame for the plunge in confidence. With CEO confidence at such depressed levels, it hardly bodes well for upbeat forward guidance. As we look ahead, earnings growth will need to be the key driver of forward performance and until revisions begin to move higher, upside from current levels will likely be limited.

The Week Ahead: It will be the calm before the pending earnings storm with only two members of the S&P 500 index scheduled to release third-quarter earnings. However, over the following two weeks (10/14 – 10/25) nearly 200 members of the S&P are scheduled to report results, including 19 components of the Dow Jones Industrial Average. Inflation will be the focus of the data calendar with both the September producer price index (PPI) and consumer price index (CPI) due out. Other reports of interest include; Initial Jobless Claims, The University of Michigan's preliminary October customer sentiment survey and September import and export prices will be released on Friday. Also of note will be Wednesday's release of the minutes from the September Federal Open Market Committee meeting. The Fed speaking calendar will be busy with ten speeches on the docket including Fed Chairman Powell on Tuesday and Wednesday.

Definitions

The Dow Jones Industrial Average is a price-weighted average of 30 blue-chip stocks that are generally defined as the leaders in their industry. It has been a widely followed indicator of the stock market since October 1, 1928.

Wilshire 5000 Total Market IndexSM represents the broadest index for the U.S. equity market, measuring the performance of all U.S. equity securities with readily available price data. The index is comprised of virtually every stock that: the firm's headquarters are based in the U.S.; the stock is actively traded on a U.S. exchange; the stock has widely available pricing information (this disqualifies bulletin board or over-the-counter stocks). The index is market cap weighted, meaning that the firms with the highest market value account for a larger portion of the index.

Standard and Poor's 500 Index is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The Nasdaq Composite Index is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market. The index was developed with a base level of 100 as of February 5, 1971.

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