February 3, 2020

Weekly Viewpoint

Virus Fears Weigh on Market

Performance for Week Ending 1.31.20

The Dow Jones Industrial Average (Dow) dipped 2.53%, the Wilshire 5000 Total Market Index^{SM} (Wilshire 5000^{SM}) lost 2.10%, the Standard & Poor's 500 Index (S&P 500) finished off 2.12% and the Nasdaq Composite Index (NASDAQ)declined by 1.76%. Sector breadth was negative with 9 of the 11 S&P sector groups finishing lower. For the week, The Energy sector (-5.65%) was the worst performer followed by Materials (-3.54%) and Healthcare (-3.29%).

Index*	Closing Price 1/31/2020	Percentage Change for Week Ending 1/31/2020	Year-to-Date Percentage Change Through 1/31/2020
Dow	28256.03	-2.53%	-0.99%
Wilshire 5000	32833.61	-2.10%	-0.16%
S&P 500	3225.52	-2.12%	-0.16%
Nasdaq	9150.94	-1.76%	+1.99%

Market Observations: 1/27/20–1/31/20

The major market indices finished the week broadly lower reflecting growing uncertainty around the severity and duration of the Wuhan coronavirus and how it may impact global growth. Late last week, the World Health Organization (WHO) declared the coronavirus, which, as of Friday morning, had killed 213 people and infected a further 9,709 others, to be a global health emergency. The United States followed the WHO announcement by issuing a level four warning - the most severe issued by the state department - and told its citizens not to travel to China. The virus threatens to further slowdown growth in China, the world's second-largest economy, as officials restrict travel and companies' close factories and take other steps to contain the virus's spread.

At a press conference following last week's Federal Open Market Committee (FOMC) meeting, Fed Chairman Powell cited the coronavirus risk when he explained that the central bank was still monitoring "increasing uncertainties" in the global economy and risks to growth from the virus. While the Fed opted to leave benchmark interest rates unchanged at the conclusion of the meeting, the probability that the Fed will ease one more time by the end of the year jumped significantly, according to the CME Fed Watch tool.

Prior to the coronavirus scare, the S&P 500 had surged by over 15 percent from early October through mid-January, a move that left the market in a technically “overbought” position, as stocks were bolstered by bets that global economic growth would pick up this year. While certainly this time could be different, a look at historical “flu epidemics,” shows that the impact on the domestic economy is usually fleeting, and market related weakness has proven to be short-lived (and more often than not, a buying opportunity), although it may be premature to draw that conclusion just yet.

Fundamentals Still Supportive: At the end of the day, it’s fundamentals that ultimately drive the equity markets and the current macro environment still appears supportive of additional market upside: 1) There are building signs the global economy is stabilizing. While there may be some near-term risk, especially in the Asian markets due to the coronavirus, overall the developing trend remains favorable; 2) The US economy grew by a year-over-year rate of 2.3% during the fourth quarter. While the pace of growth is expected to moderate in the year-ahead, the threat of an economic recession remains elusive; 3) While the broader manufacturing side of the economy has shown some cracks due to trade uncertainty, recent readings on the regional manufacturing level suggest that the worst may be behind us; 4) the Consumer side of the economy, which drives 70% of domestic economic growth, remains in good health reflecting low unemployment, rising wages, a stabilization in the housing market and the “wealth effect” associated with the markets strong performance over the past 12 months.

Market View: Despite the recent volatility, we continue to believe the Bull Market remains intact and that further upside is likely over the course of the year. While a repeat performance is not likely (the S&P 500 produced a total return of 31.5% during 2019), the macro environment should remain supportive of additional upside. The Federal Reserve is likely to keep monetary policy stable over the course of the year, inflationary pressure is likely to remain muted, and low unemployment/rising wages, should continue to support consumption – the main driver of our economy.

The rally over the past year has been driven almost exclusively by the expansion in the market’s P/E multiple, which in turn, has raised concern that valuation levels are looking a bit elevated relative to underlying earnings growth. After very little earnings growth during 2019, earnings will need to become the key driver of forward returns. According to Bloomberg earnings are expected to rebound in 2020 with current consensus expectations calling for 8.25% growth followed by 10.9% growth in 2021.

While further market consolidation cannot be ruled out, the easing threat of a recession in the coming quarters, suggests the bull market should still have some room to run.

The Week Ahead: Fourth-quarter earnings season will begin to wind down following earnings releases this week from upward of 90 members of the S&P 500. There are several reports on the data calendar that will be monitored very closely, including Friday's Payroll data. Other reports of interest include; the Institute for Supply Management's (ISM) January manufacturing index, the Markit January Purchasing Managers' Manufacturing Index (PMI), December construction spending, December factory orders, December vehicle sales, the January ADP employment report, and the ISM's January non-manufacturing index. The Fed speaking calendar will be relatively modest with just four members of the Fed scheduled to speak. Two other items of interest scheduled during the week, include; the Iowa caucuses on Monday and President Trump's State of the Union address on Tuesday evening.

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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