October 21, 2019

Weekly Viewpoint

Cautiously Optimistic

Performance for Week Ending 10.18.19

The Dow Jones Industrial Average (Dow) lost 0.17%, the Wilshire 5000 Total Market Index[SM] (Wilshire 5000[SM]) added 0.51%, the Standard & Poor's 500 Index (S&P 500) finished up 0.54% and the Nasdaq Composite Index (NASDAQ) gained 0.40%. Sector breadth was mixed with 7 of the S&P sector groups finishing higher and 4 closing lower. The Healthcare sector (+2.03%) was the best performer while Energy (-1.72%) was the worst.

Index*	Closing Price 10/18/2019	Percentage Change for Week Ending 10/18/2019	Year-to-Date Percentage Change Through 10/18/2019
Dow	26770.20	-0.17%	+14.76%
Wilshire 5000	30432.31	+0.51%	+18.19%
S&P 500	2986.20	+0.54%	+19.12%
Nasdaq	8089.54	+0.40%	+21.92%

Market Observations: 10/14/19–10/18/19

The S&P 500 finished higher for a second straight week in volatile trading action, as a solid start to third quarter earnings season was pitted against mixed signals on the US/China trade front and a lower global growth forecast from the International Monetary Fund (IMF). The “mini” trade deal that was recently reached between the US and China was mostly downplayed as the agreement seemed too open-ended, suggesting there may be a lot of room for disappointment. Late in the week, China announced that their economy expanded by 6.0% on a year-over-year basis in the third quarter, the lowest pace of growth dating all the way back to 1992. The report suggests that economic pressure continues to build for China, potentially making Chinese policymakers more receptive to reaching a trade settlement.

Q3 Earnings – So Far, So Good: Third quarter earnings season kicked off in earnest last week, and so far the results have been better than feared. While it's still early (only 74 of the 500 companies have reported as of Friday), the initial results have been mildly encouraging. Of the companies that have released results, 84 percent have met or exceeded expectations. As expected, earnings growth has been weak (aggregate growth is down 3.1 percent), but still better than the 4.7 percent decline currently forecast by FactSet Research. Investors are expected to get a better handle on the overall quarter as 285 members of the S&P are scheduled to release results in the next two weeks.

Beige Book: The Federal Reserve released its periodic Beige Book report last week. The report, which is based on anecdotal information collected by the 12 regional Fed banks from late-August through early-October, noted the U.S. economy expanded at a "slight to modest pace" during the week. According to the report, "business contacts mostly expect the economic expansion to continue, however, many lowered their outlooks for growth in the coming 6 to 12 months." Manufacturing activity continued to edge lower, with Fed contacts reporting that "persistent trade tensions and slower global growth weighed on activity." In contrast, the report said household spending was "solid," and activity in non-financial services "increased solidly."

The Federal Reserve is scheduled to meet on October 29 and 30 to decide whether to lower interest rates for a third time this year, to a range of 1.50% to 1.75%. Investors widely anticipate such a move, with Bloomberg's World Interest Rate Probability function placing the odds of a cut at over 86 percent. Late last week, Fed Vice Chair Richard Clarida said the Fed will "act as appropriate" to sustain growth, a strong labor market, and inflation rising to its objective, adding that there are "evident risks" that include weakening global growth and a slowdown in exports, manufacturing and investment. Clarida said the FOMC continues to expect the U.S. economy to grow about 2% next year and inflation to gradually rise toward its 2% goal. He also pointed to unemployment at a 50-year low as an example of resilience in the economy.

Market View: We maintain a tactically cautious view on the near-term outlook reflecting worries that a prolonged trade war with China could continue to weigh on business sentiment and ultimately lead to belt tightening by consumers. While we are not bearish on the market, with the S&P 500 trading just shy of its all-time high, we feel the current risk/reward outlook is not particularly attractive. The strong year-to-date performance has been driven almost exclusively by the expansion in the market's P/E multiple, which in turn, leaves the market vulnerable to earnings disappointment or negative developments in trade. 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. Better buying opportunities are likely to emerge down the road, but now is not the time to be chasing the market higher.

The Week Ahead: Third-quarter earnings season will kick into high gear during the coming week with 125 members of the S&P 500 reporting. Included in this group are 12 members of the Dow Jones Industrial Average. Reports of interest on the data calendar include; September existing home sales, September durable goods orders, September new home sales, and the University of Michigan's October consumer sentiment survey. The Fed speaking calendar will be nonexistent reflecting the traditional blackout period ahead of the upcoming Federal Open Market Committee (FOMC) meeting.

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.