MarketUpdate

Positive July for U.S. markets

Markets had a solid start to the third quarter, with all three major U.S. indices showing gains for July. The S&P 500 returned 1.44 percent during the month, the Dow Jones Industrial Average rose by 1.12 percent, and the Nasdaq Composite gained 2.15 percent.

This positive performance was supported by better-than-expected earnings results. According to Bloomberg Intelligence, companies in the S&P 500 have been outperforming analyst estimates for the second quarter. As of July 31, with 60 percent of companies reporting, year-over-year earnings growth sits at 0.8 percent for the quarter. This result is much stronger than the 2.2 percent decline that was forecast at the start of earnings season in mid-July. Ultimately, fundamentals drive long-term market performance, so this positive surprise for the second quarter is encouraging.

Technicals for all three major U.S. indices were supportive during the entire month of July. All three indices stayed well above their respective 200-day moving averages.

Although U.S. markets had a positive July, international markets pulled back. The MSCI EAFE Index declined by 1.27 percent. Here, concerns surrounding a slowdown in global trade worried investors. The story was much the same for emerging markets. The MSCI Emerging Markets Index was down 1.14 percent for the month. Technicals for both developed and emerging markets remained supportive. In fact, July marks the second straight month that both indices finished the month above their respective 200-day moving averages.

Fixed income had a solid month. The Bloomberg Barclays U.S. Aggregate Bond Index returned 0.22 percent in July. Interest rates declined on the short and long ends of the curve during the month, driving this appreciation. The 1-month Treasury started the month at 2.17 percent and fell to 2.01 percent by month-end. The 10-year Treasury, on the other hand, started July at 2.03 percent and finished with a yield of 2.02 percent.

These declines were driven by the Federal Reserve's (Fed's) decision to cut the federal funds rate from a high of 2.50 percent to a high of 2.25 percent at its July meeting. This marks the first time the Fed has cut rates since December 2008. At his postmeeting press conference, Fed Chairman Jerome Powell indicated that future rate cuts are possible—but not guaranteed.

High-yield fixed income also had a positive month. The Bloomberg Barclays U.S. Corporate High Yield Index returned 0.56 percent in July. High-yield spreads declined slightly during the month. Still, they remain well above the lows we saw for much of 2018. As the Fed shifts to a more supportive role for risk assets, there is a chance that spreads could continue to decline going forward.

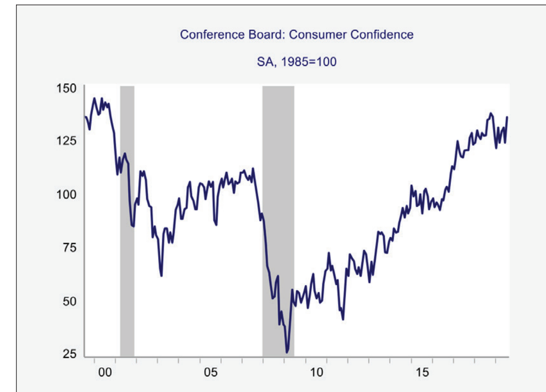
Consumer spending drives economic growth

In general, the economic data released in July came in better than expected. It showed growth picking up in key areas of the economy. Consumer spending data was especially positive, with 0.7 percent growth in June's core retail sales. This result capped off a strong quarter for consumer spending, which helped calm fears of a slowdown in economic growth.

Strong consumer spending in the second quarter led to economic growth that was better than expected. The first estimate of second-quarter gross domestic product growth came in at 2.1 percent on an annualized basis. This result is down from the 3.1 percent pace we saw in the first quarter, but it is higher than consensus estimates for a 1.8 percent growth rate. Personal consumption, which grew at a 1.1 percent annualized rate in the first quarter, jumped to a 4.3 percent growth rate in the second quarter.

Increasing consumer confidence supported consumer spending during the month. The Conference Board Consumer Confidence Index was especially impressive. It jumped from 124.3 to 135.7 in July. This is the single largest monthly increase in more than seven years. The index now sits near highs last seen in late 2018, as you can see in Figure 1.

Figure 1. Conference Board Consumer Confidence Index, 1999–2019



Source: The Conference Board, Haver Analytics

A combination of factors was behind this increase in consumer confidence, but one of the primary drivers was the strong June jobs report. There were 224,000 new jobs added in June, against expectations for 160,000. The underlying data was solid as well. Annual wage growth came in at 3.1 percent, and unemployment remained near 50-year lows.

Potential areas of concern remain

Although consumer confidence and spending growth data came in stronger than expected, it was a different story for businesses. The Institute for Supply Management Manufacturing and Nonmanufacturing indices both declined during the month. In fact, the Manufacturing index fell to two-year lows. These drops show slowing global trade is starting to affect business owner confidence. Despite the declines, both indices remain in expansionary territory. Going forward, we are unlikely to see accelerated manufacturing growth in the second half of the year, unless trade picks up notably.

Although business confidence declined during the month, business spending data was a bit more mixed. Durable goods orders rose by 2 percent in June, beating expectations for 0.7 percent growth. This surprising increase was welcome, but it follows a 1.3 percent decline in orders in May. Despite the uptick in June, business investment declined for the quarter. As such, this will be an important area of the economy to watch going forward.

Another key area of the economy to keep an eye on is housing. Existing home sales fell by 1.7 percent in June, against expectations for a more modest decline of 0.4 percent. This marks the 16th straight month of year-over-year declines in existing home sales. There had been some hope for faster sales growth due to declining mortgage rates and a surge of mortgage applications in May. Unfortunately, those hopes failed to materialize in the face of rising prices and lack of supply in some regions.

Shifting policy risks

There were many policy and political updates in July. Here in the U.S., the major story was the Fed's decision to cut the federal funds rate by 25 basis points at the end of the month. This measure, combined with the early end of the Fed's balance sheet reduction plan, indicates that the Fed is becoming more supportive of the economy. With lowered interest rates, borrowing costs should decrease for individuals and businesses. In turn, reduced costs should lead to faster growth going forward.

Another key development was the compromise reached by Congress and the White House to pass a budget increasing government spending and suspending the debt ceiling for the next two years. The passage of this bill was a positive outcome for markets as it eliminated a potential source of politically motivated uncertainty for the time being. Further, it prevented another government shutdown as we head toward the 2020 election cycle.

Internationally, the risk of the UK leaving the European Union without a trade deal increased. Theresa May stepped down as leader of the British government. She was replaced by Boris Johnson. A vocal proponent for Brexit, Prime Minister Johnson has stated that he will lead the British exit from the EU by the October 31 deadline, whether there is a trade deal in place or not. Currently, neither side is showing signs of backing down, so this could be an ongoing source of volatility for international markets over the next few months.

Steady economic growth in the face of global slowdown

Risks remain both abroad and at home, but the economic picture is positive. Better-than-expected economic data released during the month shows that American consumers are still willing and able to spend, despite a slowdown in global economic activity. With improving fundamentals, a supportive Fed, and the passage of the budget and debt limit compromise bill, markets could continue on the upward march that we've seen for much of the year.

With that being said, there are still potential areas of concern that should be watched. The slowdown in global trade is starting to affect business confidence and could have an even larger effect on markets going forward. Political risks can also pop up at any time. As always, a well-diversified portfolio that pairs an investor's goals and time horizon is the best path forward in this uncertain world.

All information according to Bloomberg, unless stated otherwise.

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Authored by Brad McMillan, CFA,® CAIA, MAI, managing principal, chief investment officer, and Sam Millette, senior investment research analyst, at Commonwealth Financial Network®

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