Weekly Markets Commentary

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Investors Embrace Some Good News

The bounce in U.S. equities off the Christmas Eve low now amounts to an impressive 7.7 percent, although the move has certainly been vertiginous, as a 2.5 percent down day in the S&P 500 last Thursday was followed by an almost 3.5 percent gain on Friday. But at week's end, stocks had climbed 1.9 percent. The big move on Friday came after Federal Reserve Chairman Powell said the Fed would be patient in normalizing monetary policy, temporarily relieving the anxiety of the more skittish Fed watchers.

Reports of trade talks in Beijing this week contributed to the better tone, as did the blowout jobs report that saw the creation of 312,000 new non-farm jobs, well ahead of the consensus estimate of 185,000. In addition, the previous two-month total was revised higher by 58,000 and year-over-year average hourly wages edged higher to 3.2 percent. It all added up to some good news in the three primary areas of concern currently weighing on market sentiment, namely trade, monetary policy, and economic growth. Of course, positive developments are not the same as policy breakthroughs, but investors will take good news when and where they can find it.

Not unexpectedly, the recent rally in stocks has been accompanied by a similar decline in expected volatility as measured by the VIX index of volatility. After surging to a level of 36 on Christmas Eve, just below last year's February high of 37, the VIX has since tumbled all the way back down to 21, near its prevailing average in the two months leading up to mid-December, before the Fed disappointed investors by signaling two rate hikes in 2019 at its December 19 meeting.

Other measures of market sentiment were recently at levels of extreme pessimism as well. The Investors Intelligence ratio of bulls versus bears last week fell below 1.0 for the first time in three years. Two weeks ago, the American Association of Individual Investors bull/bear ratio also fell to a three-year low but rebounded slightly last week. The S&P 500 managed to find support at its 200-week moving average at the recent low but remains more than 4 percent below its 50-day moving average at 2645 and more than 7 percent below its 200-day moving average at 2742. Last week's good news will need to be sustained for stocks to manage enough momentum to retake those levels.

Investors Prepare for Q4 Earnings Season

And we will soon add earnings to the list of immediate market concerns, beyond just the general wringing of hands over lowered full-year 2019 expectations, which currently sit at 7.4 percent (according to Factset). Fourth quarter 2018 earnings season is about to get underway, with growth of 11.4 percent expected, according to Factset, down from 15.2 percent at the start of the quarter. The firm dollar, lower oil prices, which fell 38 percent in the quarter, and the trade war with China are each expected to have taken their toll to some extent. By how much and on which companies specifically will be the question. Most prominently, Apple lowered its first quarter revenue guidance last week due, in large part, to weakness in China. Apple stock fell 10 percent in response, before rebounding somewhat at week's end. What management teams in general have to say about the expected future impact of trade will be a particular focus.

Bonds Enjoyed a Rally Last Week; Economic Reports Delayed due to the Shutdown

Stock prices weren't the only asset to enjoy a strong rally last Friday. In another sign of diminished risk aversion, at least for one day, the yield on the Bank of America Merrill Lynch High Yield index fell 25 basis points to 7.73 percent. By comparison, at the start of the fourth quarter, the yield was 6.50 percent. The Friday move pushed the spread over government yields down 39 basis points, to 505, as the yield on the ten-year Treasury climbed 12 basis points to 2.67 percent.

Lastly, several departments of the federal government remain closed, and a deal to fund them remains elusive. One result is a delay in the compilation and release of regular economic reports. One affected agency is the Bureau of Economic Analysis, which is contained within the Commerce Department, and remains unfunded. The Labor Department, on the other hand, is funded and this week's report on December consumer prices, which is compiled by the Bureau of Labor Statistics, should not be affected.

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The S&P 500 is an index containing the stocks of 500 large-cap corporations, most of which are American. The index is the most notable of the many indices owned and maintained by Standard & Poor's, a division of McGraw-Hill.

The Chicago Board Options Exchange (CBOE) Volatility Index (VIX) is a widely used measure of market risk. It shows the market's expectation of 30-day volatility. The VIX is constructed using the implied volatilities of a wide range of S&P 500 index options.

Bank of America/Merrill Lynch High Yield Master II is an index of high-yield corporate bonds which measures the broad high yield market.

Investors Intelligence is an independent provider of research and technical analysis of stocks, currencies, commodities and financial futures.

The AAII Sentiment Survey measures the percentage of individual investors who are bullish, bearish, and neutral on the stock market short term; individuals are polled from the AAII Web site on a weekly basis.

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