Weekly Markets Commentary

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Trade Negotiations Make the Path Forward for Markets Difficult

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Last week ended with investors feeling quite good about the prospects for the global economy and the possibility that corporate earnings might turn out to be better than feared. Despite some pockets of disappointment mid-week after the Fed signaled little sympathy for a rate cut, Friday's solid U.S. labor market report helped push stock prices higher and reinforced the notion that activity may, indeed, be improving. This followed reports earlier in the week that showed manufacturing activity in China had expanded for a second straight month, although just barely, and that the Eurozone economy expanded at a faster than anticipated pace in the first quarter. Capping off the positive sentiment were rumors that a trade deal between the U.S. and China could happen as early as this Friday.

Intermediate-term bond yields rose slightly on the week on the modestly better economic news. The ten-year U.S. Treasury note yield rose four basis points to 2.54 percent. But it was the shorter-end of the curve where most of the movement took place following the Fed meeting. Diminished prospects for a rate cut sent the yield on the two-year note higher by eight basis points to 2.35 percent. In the process, the two to ten-year yield curve flattened from a five-month high of 23 basis points before the Fed's rate decision back down to 19 at week's end (a basis point is 1/100th of a percent).

Corporate Earnings Growth Better than Expected

And first quarter corporate earnings growth was continuing to do its part, increasing the likelihood that aggregate results might actually turn positive, despite earlier widespread hand wringing over the possibility of an earnings recession in the first half of the year. According to Factset, with almost 80 percent of the S&P 500 now having reported results, the blended forecast now sits at -0.8 percent, a far cry from the -4.0 percent expected just a few weeks ago.

All of this resulted in a closing session on Friday in which each of the eleven sectors in the S&P 500 rose, pushing the index within shouting distance of its Tuesday record closing high, while the VIX index of implied volatility remained subdued near its lowest level of the year. The Nasdaq Composite index did end the week at a new record high.

Market Calm Came to a Halt Sunday as Trade Negotiations Took a Turn

But this general calm was rudely interrupted on Sunday when, like the proverbial skunk at the garden party, president Trump tweeted his intention to raise tariffs on Chinese goods this Friday, and soon expand the range of goods subject to tariffs. Following weeks of official comments citing the progress being made by the two sides, this announcement was a jolt to the senses. The seeming incongruity of the announcement, juxtaposed with the public impression that a deal was taking shape, called the whole process into question. The suddenly unsettled outlook for a trade deal was exacerbated by reports, since denied, that the Chinese delegation was considering cancelling its scheduled visit to Washington this week for further talks.

Asian equity markets fell across the board on Monday, with the worst of the damage being in felt in China, where the Shanghai Composite index fell 5.6 percent. The selling spilled over into European trading, where stocks are down approximately 2 percent in midday trading. And in the U.S., futures are lower by almost 2 percent as well, while the VIX has jumped from 13 on Friday to 18 on Monday, its highest reading since late January.

Until the actual status of the trade negotiations is clarified, it will be difficult for markets to identify the immediate path forward. The president’s announcement is clearly a negotiating tactic, apparently intended to spur the Chinese to accelerate the pace of talks perceived as taking too long by Washington. Whether it achieves its intended effect remains to be seen. Certainly, the Chinese do not want to be perceived as acquiescing to Washington’s demands, so it could have the opposite effect. The president’s announcement could also be viewed partly as a political ploy, intended to signal to his constituents that his resolve to negotiate a favorable deal remains firm, but with little expectation of actually following through. Whatever the strategy is, it will be difficult for any real conviction to return to markets until there is greater clarity.

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 NASDAQ composite index measures all NASDAQ domestic and international based common type stocks listed on the Nasdaq Stock Market.

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.

The Shanghai Composite Index is a capitalization-weighted index of all stocks on China’s Shanghai Stock Exchange.