Weekly Markets Commentary

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Trade Likely to Cast a Shadow Over Investor Sentiment and Corporate Decision Making

U.S. equities fell for the second straight week, but the damage was contained. The S&P 500 fell 0.8 percent and has now shed 2.9 percent since President Trump tweeted his intention to once again raise tariffs on Chinese imports two weeks ago. But, following a sharp fall of 2.4 percent last Monday after China announced their own retaliatory round of tariff increases, stocks managed to claw their way back to limit the pain. The declines in small cap stocks were more severe. The Russell 2000 fell 2.4 percent last week and is now down almost 12 percent from its late summer peak.

Bearing the worst of last week's decline at the sector level were financials, battered by the fall in bond yields, followed by industrials, consumer discretionary and technology. The list is similar for the full two-week period, led by industrials, and followed by technology, financials and materials.

The cautious turn pushed bond yields lower, and credit spreads wider. The yield on the ten-year Treasury note fell eight basis points to 2.39 percent (a basis point is 1/100th of a percent), and the two-year note was down four basis points to 2.21 percent, after falling to a new 52-week low of 2.17 percent mid-week. The option-adjusted spread between the Bank of America Merrill Lynch High Yield index and the ten-year note widened just six basis points on the week to 407, but that was well down from Monday's wide of 420 basis points. Over the past two weeks the spread has widened by 25 basis points.

Retail Sales and Industrial Production Data Disappoints; Meanwhile Oil Spikes

The week's economic news was less than inspiring as well. In the U.S., both retail sales and industrial production, including a decline in capacity utilization disappointed, offset to some extent by stronger reports on housing starts and permits. Consumer sentiment also surprised to the upside, but the timing of the survey likely did not fully reflect the latest developments in the trade war with China. Industrial production and retail sales were weak in China as well, while in the Eurozone industrial production was weak, but first quarter GDP was in-line with expectations.

Nervousness in the oil patch pushed the price of crude higher. North Sea Brent climbed $1.59 a barrel following a drone attack on Saudi pipelines. This followed attacks on two Saudi tankers last weekend. The price of crude is edging higher in early trading this week after OPEC indicated over the weekend its intention to maintain production discipline through year-end.

Investors Embrace Some Good News on Trade; Earnings Were Better Than Expected

There was some good news on the trade front. The U.S. agreed to lift the tariffs on Canadian and Mexican steel and aluminum, and both countries announced reciprocal decisions. The renegotiated NAFTA agreement remains unratified. In addition, the U.S. said it would postpone any tariff imposition on foreign auto imports for six months. These moves allow the U.S. to focus its attention exclusively on the standoff with China. But what the next move is, and when is unclear. The two sides are expected to meet at the G-20 meeting in Japan in late June, but no talks between the negotiating teams are currently scheduled. And the rhetoric between the two has ratcheted higher.

On the U.S. economic calendar in the week ahead are durable goods, new and existing home sales, flash manufacturing and minutes from the recent Fed meeting. In the Eurozone Flash Purchasing Managers Index (PMI) are scheduled, along with Q1 GDP and business sentiment in Germany.

First quarter earnings season is winding down, and by some measures year-over-year growth has turned slightly positive. This is a far cry from the earnings recession fears that prevailed earlier in the year. Forward guidance has been generally cautious, however, given trade uncertainty and the stronger dollar. Year-to-date the DXY dollar index is higher by 1.9 percent and higher by 4.6 percent over the past year.

The trade dispute between the U.S. and China remains the elephant in the room for investors. The latest escalation in the size and scope of tariffs reduces the likelihood that an agreement will be reached anytime soon, although that could still happen. More likely, the dispute extends for longer than expected and continues to cast a pall over both corporate decision making and investor sentiment.

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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 Russell 2000® Index is a market-capitalization-weighted index made up of the 2,000 smallest US companies in the Russell 3000.

The Bank of America Merrill Lynch High-Yield Bond Master II Index is an unmanaged index that tracks the performance of below investment grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

The U.S. Dollar Index (DXY) measures the dollar's value against a trade-weighted basket of six major currencies.

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