Weekly Markets Commentary

July 15, 2019

David Joy
Chief Market Strategist,
Ameriprise Financial

"According to Factset, expected earnings growth this quarter has slipped further to -3 percent, following a higher than typical number of negative preannouncements. And although that total is higher than usual, the depth of the downward adjustments has been relatively modest."

Stocks Surge to All-Time Highs: Is the Latest Rally Justified?

Stocks surged to an all-time high after Fed Chairman Powell's congressional testimony was overwhelmingly construed as paving the way for a rate cut at the end of the month. Citing renewed uncertainties surrounding trade, business investment and inflation, the chairman said conditions had deteriorated since the May Federal Open Market Committee (FOMC) meeting. While markets had discounted the possibility of a half point reduction this month following the strong June jobs report, those expectations re-emerged following Powell's testimony, with futures now showing 25 percent odds of a half-point cut and 100 percent odds of at least a quarter-point cut. Markets also shrugged off the stronger than anticipated June core Consumer Price Index (CPI) reading, focusing instead on the chairman's speculation that weak inflation could be more persistent than expected.

The S&P 500 ended the week at 3113, up 0.8 percent for the week. Energy stocks were among the best performers, followed by consumer discretionary, communication services and technology. Laggards included healthcare, materials and utilities. Bond markets certainly took notice of the rise in inflation. The yield on the ten-year Treasury note climbed nine basis points (a basis point is 1/100th of a percent) following the CPI release on Thursday to end the week at 2.12 percent, up from 2.03 percent the prior week. Coupled with a stronger Producer Price Index (PPI) on Friday, the move higher in yield was enough to briefly push the slope of the curve between the three-month bill and ten-year note, which had been inverted since May 23, into positive territory. It ended the week at -2 basis points, up from -19 the previous Friday. The two-year to ten-year curve widened by ten basis points to 27.

China's Economy Shows More Evidence of Slowing

The latest round of data from China offered more evidence that its economy has slowed. Year-over-year GDP in the second quarter grew at a pace of 6.2 percent, down from 6.4 percent in the first quarter. And although the pace was in-line with expectations, it was the slowest in almost thirty years. The news wasn't all bad, however. Monthly data for industrial production, retail sales and fixed-asset investment were all better than expected, indicating that the government's efforts to stabilize growth and offset the impacts of the trade war were having some effect.

If successful, a stable Chinese economy would go a long way toward arresting the overall slowdown in global growth, the trade war notwithstanding. The data follows last week's reports of better than expected industrial production in the Eurozone, with notable improvement in France, Italy and Germany.

Will Investors be Disappointed by Corporate Earnings this Quarter? Time will Tell

In the U.S., this week's economic calendar is full. Scheduled reports include retail sales, industrial production, housing starts and permits, the Beige Book, leading indicators and consumer sentiment. But it is earnings that will be the primary focus this week. According to Factset, expected earnings growth this quarter has slipped further to -3 percent, following a higher than typical number of negative pre-announcements. And although that total is higher than usual, the depth of the downward adjustments has been relatively modest. And to the extent that aggregate results typically exceed expectations, the second quarter will likely end up being relatively flat year-over-year.

The forward PE ratio of the S&P 500 is now 17.1X, up from 16.5X just a few weeks ago. Inasmuch as earnings growth has been relatively flat, that increase has come exclusively from multiple expansion, as the market discounts the expected Fed rate cut(s). With stocks at record highs, multiple expansion will only carry prices so far. Ultimately, earnings growth will have to once again start growing. That is not expected to happen until the fourth quarter and then accelerate into next year. Our economic forecast for the second half anticipates U.S. growth of roughly 2.25 percent. If China does stabilize and trade tensions do not deteriorate, earnings growth may, indeed, meet expectations. On the other hand, if those two variables do not materialize, we could be set up for disappointment.