Markets Move Beyond Two Temporary Scares – Can the Momentum Last?

A three-day losing streak, and a drop in four out of five trading days in the S&P 500® index through last Monday pulled the index lower by 2.9 percent from what had been a record high of 4,384. The drawdown, widely attributed to concerns related to the Delta variant of the coronavirus, took the index within a half percent of its 50-day moving average, a key measure of near-term support. But that support held, as it has repeatedly this year, and just as quickly the index reversed course, rallying 3.6 percent over the final four days to end the week at another record high at 4,411.

Over the past month, stocks have moved beyond two temporary scares to reach new highs. The first came in mid-June after the Fed’s unexpected more hawkish dot plot, and last week with the virus. Not that either concern has gone away. Rather, investors have concluded, rightly or wrongly, that the economic threat of either is not as worrisome as first thought, although certainly the threat from the virus is more immediate. In both cases, the market found support at its 50-day moving average.

The same pattern was seen in the Treasury market. The yield on the ten-year note fell from 1.42 percent on July 13 to 1.19 percent on the 19th, before rising again to 1.28 percent to end the week. Credit spreads followed a similar path. Between July 13 and 19 the option-adjusted spread over governments of the ICE Bank of America High Yield index ballooned from 305 basis points to 344, before retreating back to 322 by last Friday, the 23rd. Over the same interim, BBB spreads widened to 115 basis points from 110, before ending last week at 113.

A Very Busy Week Ahead For Earnings, Economic Data and the Fed

The week ahead will offer an intriguing range of insights into the economy, earnings, and both monetary and fiscal policy. On Thursday we learn how quickly the economy expanded in the second quarter. The Bloomberg consensus anticipates an annualized pace of 8.5 percent. Other surveys offer a wide range of forecasts between 7-11 percent. Either way, growth will once again be robust, following the 6.4 percent pace of the first quarter. Excluding the 33.4 percent growth of last year’s third quarter, if the economy grows by 7.0 percent it will be the first time since the third quarter of 2003. The last time it grew by 8.0 percent was in the first quarter of 1984. It grew by 9.0 percent in Q2 1983, and 10.0 and 11.0 percent (16.4 actually) in Q2, 1978.

The Conference Board’s July survey of consumer confidence is due on Tuesday. It has risen strongly since January. It will be interesting to see if the Conference Board’s report reflects any of the relative pessimism expressed in the July
preliminary sentiment survey from the University of Michigan, the final version of which arrives on Friday. Some of that pessimism is the result of rising prices. The PCE deflator report on Thursday is expected to show the year-over-year core rate at 3.7 percent, following an expected 0.6 jump in June. If June does come in at 0.6 percent, it will result in a four month average increase of 0.55 percent, as the pace is accelerating. The Fed believes it is transitory, but even that rate of acceleration is likely to catch their attention.

The Fed itself meets this week. This meeting does not include a press conference, nor the release of any updated economic projections, so the meeting statement will be relied upon for any new insight into policy. There are likely to be few changes. The July jobs report won’t be out until next Friday, and even if it ultimately shows solid growth as expected, the Fed likely has a lot further to go to achieve its goal of “substantial further progress” toward full employment.

Expectations for second quarter earnings season continues to climb. Factset now extrapolates aggregate growth of 74 percent for the quarter, as results for the one-quarter of the S&P 500 that has reported thus far, primarily financials, well exceeds expectations. The same is true for the revenue outlook. This week more than a third of the index will report results, and the focus shifts to technology, broadly defined. Scheduled reports this week include Tesla, Apple, Alphabet, Microsoft, Facebook, Amazon, among many others of note. It is worth noting that a number of earnings calls have noted rising input cost pressures, but also an ability to pass those costs through to consumers.

The Senate and White House May Agree on a $1 Trillion Infrastructure Plan

Indications are that Senate and White House negotiators may agree to a $1 trillion infrastructure spending plan that raises already planned spending by $600 billion over the next five years. Sticking points remain, however, including the level of spending for specific programs such as mass transit and broadband. There is also the question of the second spending bill the Democrats are intent on passing, a $3.5 trillion proposal focused on social programs, which would go through the reconciliation process and be accompanied by tax increases for funding. Majority Leader Schumer said last week he wants both bills passed by the summer recess, which runs from August 9 through September 10.

Important Disclosures:

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The 10 Year Treasury Rate is the yield received for investing in a US government issued treasury security that has a maturity of 10 years.

The Consumer Confidence Index (CCI) is a survey measures how optimistic or pessimistic consumers are regarding their expected financial situation. It is based on consumers perceptions of current business and employment condition, and their expectations for business, employment, and income for the next six months.

The Michigan Consumer Sentiment Index (MCSI) is a monthly survey of consumer confidence levels in the United States. It is a statistical measurement of the overall health of the economy as determined by consumer opinion. It takes into account people's feelings toward their current financial health, the health of the economy in the short-term, and the prospects for longer-term economic growth, and is widely considered to be a useful economic indicator.

The personal consumption expenditure (PCE) measures of the prices that people living in the United States pay for goods and services. The PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

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