June 7, 2019

What Happened in the Markets?

- US stocks extended their winning streak on Friday, as the S&P 500 rose 1.0% to close at 2,873. The other two major US averages also advanced on the day. The NASDAQ Composite jumped 1.7%, while the Dow Jones Industrial Average gained more than 260 points, or 1.0%.
- The market rallied to close the week, as investor optimism continued to rise surrounding the prospect for a near-term interest rate cut by the Federal Reserve. Weaker-than-forecast nonfarm payrolls numbers Friday morning further added to expectations that the central bank would be compelled to act after leaving rates unchanged since it last hiked in December. Further support came from a brighter outlook in US-Mexico trade discussions, with the White House suggesting that a deal could be reached to avoid implementing tariffs on Monday.
- Nine of the 11 S&P sectors finished higher on the session. Technology (+1.9%), Discretionary (+1.6%), and Communications (+1.5%) led the rally, while Utilities (-0.8%), Financials (-0.2%), and Real Estate (+0.3%) lagged.
- Treasuries rose with yields declining along the curve. The benchmark 10-year yield dipped to 2.08% as of the 4 p.m. equity market close. The prices of Brent and WTI Crude oil both increased nearly 3%, while the price of gold also gained around 0.4%. The US dollar depreciated by 0.5% against its major peers as measured by the US Dollar Index.

Catalysts for Market Move

The S&P 500 advanced for a fourth session, gaining 1.0% to end the week. Friday's rally capped a 4.5% weekly return for the index, its best weekly performance since November 2018. The rally was fairly broad-based, with nearly 80% of companies in the S&P 500 finishing higher on the session. The tech-heavy NASDAQ Composite was the standout among the major US benchmarks. By comparison, the Dow increased roughly in line with the S&P 500. Looking at investing styles, growth stocks outperformed value by 1.1%, as measured by the Russell 1000 Growth and Value indices. Further, large-caps edged out small-cap stocks by 0.3%, as measured by the Russell 1000 and Russell 2000 indices, while cyclical stocks led defensives by 0.9%, reflecting the day's risk-on tenor. Outside the US, European benchmarks ended their session broadly higher with the Euro Stoxx 50 Index rallying 1.2%. The Shanghai Shenzhen CSI 300 Index fell 0.9% while the Japanese Nikkei 225 rose 0.5%.

Stocks extended their winning streak on Friday to a fourth consecutive session, as the S&P 500 climbed above its 50-day moving average, a key technical indicator. The rally was mostly driven by increased investor optimism that the Federal Reserve would be open to lowering interest rates this year. Increased conviction surrounding a cut stemmed from weaker-than-expected economic data. Friday morning's closely-watched nonfarm payrolls number came in at 75,000, well below the 175,000 forecast by economists. Although unemployment remained at 3.6%, market participants believe that this latest sign of economic softness reinforces the view that the central bank will need to act by year end. The Fed will likely provide an updated outlook following its next meeting on June 18. Further optimism was driven by positive rhetoric in US-Mexico trade talks. The White House expressed optimism that a deal could be reached to avoid implementing tariffs before the Monday deadline.

The S&P 500's rally marked the eighteenth 1%+ move of 2019, and the 11th in which stocks advanced. The VIX Index, a market-based measure of future S&P 500 volatility, declined slightly to 16 as of the equity market close. US equity valuations appear to be underpricing several risks including those of higher inflation, pressures to corporate margins, and a slowdown in capital spending. The combination of high valuations, underappreciated risks to corporate profits, and escalating geopolitical uncertainty suggests to us that market volatility will remain elevated in the coming months. The S&P 500 Index is currently up 15% year to date, while the NASDAQ Composite has gained nearly 17%, and the Russell 2000 Index has risen 12%. Following this week's positive performance, the S&P 500 and NASDAQ are roughly 3% and 5% below their recent all-time highs, respectively. The S&P 500's consensus forward price-to-earnings multiple is currently above 16x, suggesting valuations remain full.

The Global Investment Committee's Outlook

The market environment in 2018 was one of the most challenging for equity investors since the Financial Crisis, with every region and most stocks delivering negative returns. Unusually, bonds and alternative investments simultaneously fared poorly, reducing the effectiveness of asset allocation in balancing out the losses with some gains. In sharp contrast with how 2018 ended, 2019 began with a sharp and broad rally across the majority of risk asset classes. Beginning in January, the dramatic pivot by the Federal Reserve to embrace a patient policy approach helped ease financial conditions and improve market sentiment. Overall, the GIC expects 2019 will be a better year than 2018 both in terms of absolute returns and the breadth of those returns. However, with significantly more good news currently priced into markets, the GIC advises caution as US equity valuations remain full and earnings forecasts may have further to fall. While the GIC remains overweight equities relative to fixed income, it believes international stocks, particularly emerging markets, may offer the most upside going forward. Within fixed income, the GIC remains underweight corporate credit, and prefers high-quality short-duration bonds as a proxy for cash, which it will look to deploy throughout 2019 as opportunities arise. It also recommends a moderate allocation to long-duration Treasuries as a defensive portfolio hedge against the risk of a future equity or credit market correction.

Market data provided by Bloomberg.
Dow Jones Industrial Average (DJIA): A price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry.
Euro STOXX 50 Index: Provides a blue-chip representation of supersector leaders in the Eurozone.
NASDAQ Composite Index: A broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market.
NIKKEI 225 Index: This price-weighted index is comprised of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange.
Russell 1000 Index: measures the performance of the 1,000 largest US companies based on total market capitalization.
Russell 2000 Index: measures the performance of the 2,000 smallest companies in the Russell 3000 Index.
Russell 1000 Growth Index: measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values.
Russell 1000 Value Index: measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.
S&P 500 Index: The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization US stocks.
Shanghai Shenzhen CSI 300 Index: A free-float weighted index that consists of 300 A-share stocks listed on the Shanghai or Shenzhen Stock Exchanges.

US Trade-Weighted Dollar Index: A weighted average of the foreign exchange value of the US dollar against a subset of the broad index currencies that circulate widely outside the US.

VIX: This is a trademarked ticker symbol for the Chicago Board Options Exchange Market Volatility Index, a popular measure of the implied volatility of S&P 500 Index options. Often referred to as the fear index or the fear gauge, it represents one measure of the market's expectation of stock market volatility over the next 30-day period.

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