STONEBRIDGE Capital Advisors

The Stonebridge Market Commentary

August 2, 2019

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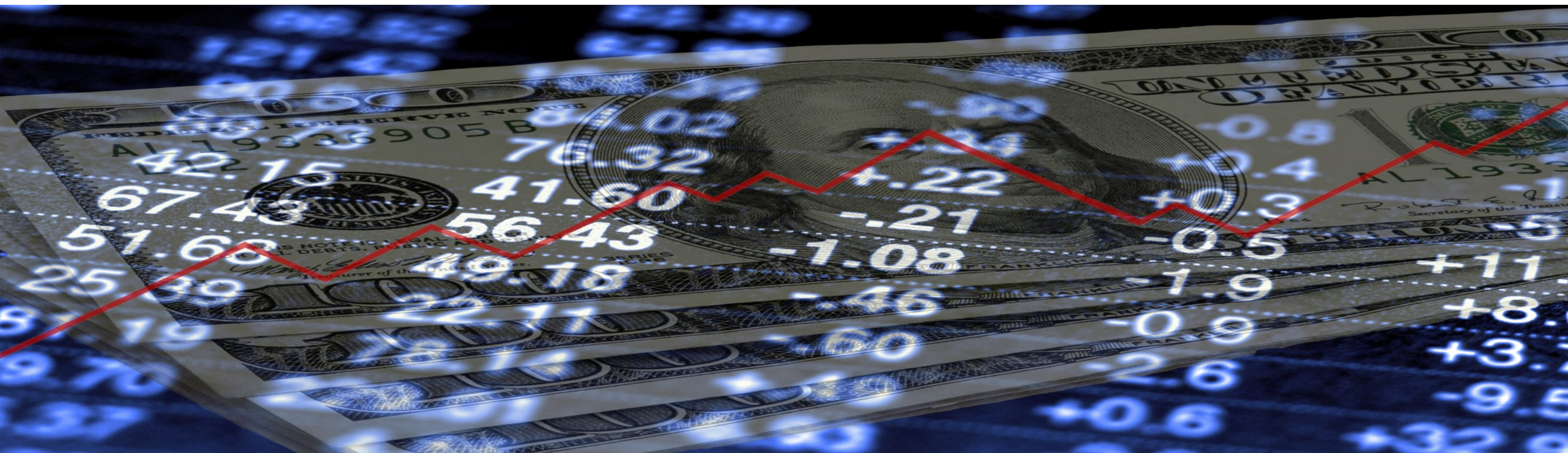
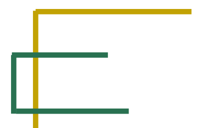
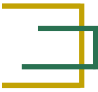






Equity Market Commentary

August is the worst month for the stock market. There I said it. It's vacation time, all of Wall Street is in the Hamptons or Martha's Vineyard. The third quarter earnings season is over. So, for all of the above reasons we should hang back and not expect too much I guess. Since most, if not all, of the forgoing is true shouldn't we alter our plans so we can time our re-entry into investing? Well no. Investing is a lifelong pursuit and trying to time your trades will cost you plenty in the long run.

From Fact Set Research:

- Earnings Scorecard: For Q2 2019 (with 44% of the companies in the S&P 500 reporting actual results), 77% of S&P 500 companies have reported a positive EPS surprise and 61% of companies have reported a positive revenue surprise.
- Earnings Growth: For Q2 2019, the blended earnings decline for the S&P 500 is -2.6%. If -2.6% is the actual decline for the quarter, it will mark the first time the index has reported two straight quarters of year-over-year declines in earnings since Q1 and Q2 of 2016.
- Earnings Revisions: On June 30, the estimated earnings decline for Q2 2019 was -2.7%. Five sectors have higher growth rates today (compared to June 30) due to positive EPS surprises.
- Earnings Guidance: For Q3 2019, 28 S&P 500 companies have issued negative EPS guidance and 10 S&P 500 companies have issued positive EPS guidance.
- Valuation: The forward 12-month P/E ratio for the S&P 500 is 17.1. This P/E ratio is above the 5-year average (16.5) and above the 10-year average (14.8)."

- The thing that stands out is the earnings decline. We know that the economy has slowed due in part to trade issues and the uncertainty they cause. Also in the mix is the trouble at Boeing over the 737 Max. We know that the consumer is doing very well. Wage growth is doing well (see chart 1). Unemployment is at 50 year lows (see chart 2).

Chart 1

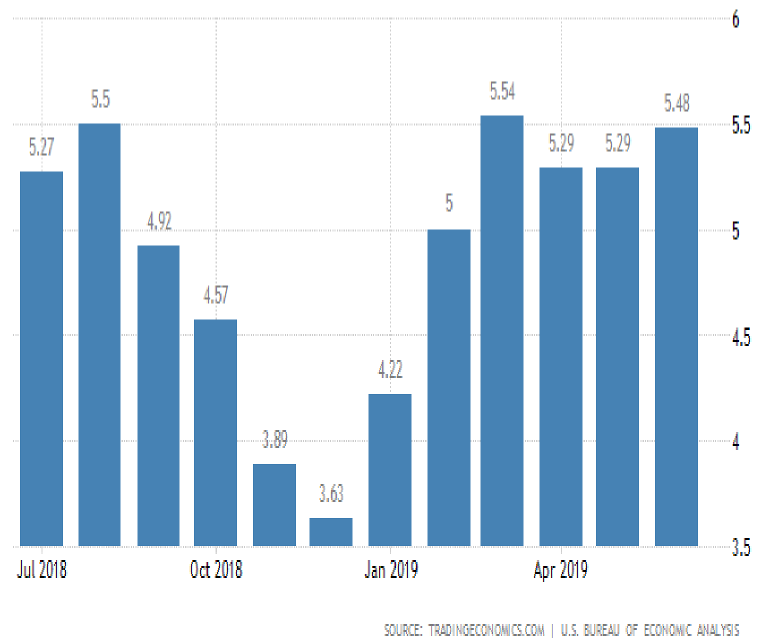
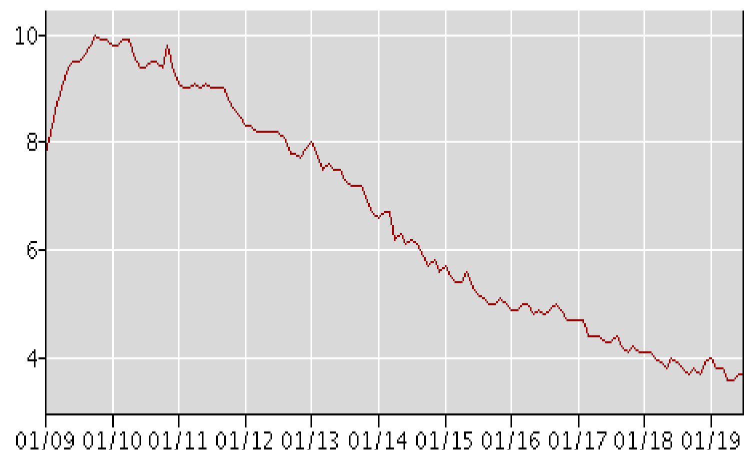


Chart 2



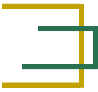
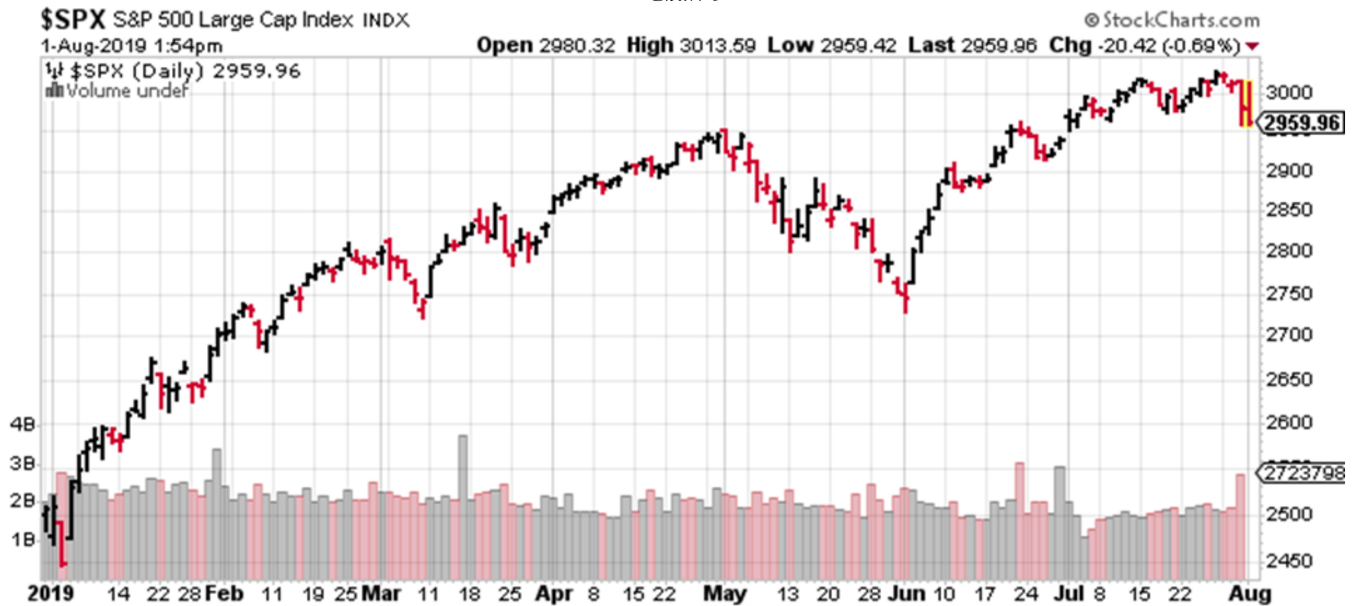
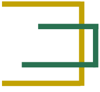


Chart 3



Since consumer spending accounts for 68% of GDP you would be forgiven if you thought this would be good for continued growth in GDP. While it pays to pay attention to such things, one should take the long view and keep on keepin' on. That said, it is worth keeping an eye to the decline in S&P earnings.

So how did the month of July shake out? After a really bad May and great June the markets returned to a kind of slow walk through earnings season (see chart 3). The S&P was up 1.31% in July and 18.89% YTD. The NASDAQ was up 2011% in July and 23.21% YTD and the Dow was up .99% in July and 15.16% YTD. So far so good for 2019, however we still have the second half to go.



Fixed Income Market Commentary

As anticipated, the Federal Reserve Board cut short-term interest rates on Wednesday, the last day of the month. It reduced its interest rate target by a quarter percentage point to 2%-2.25%. The markets had already largely priced in the cut, with short term rates falling only slightly to close out the month. In making the cut, Chairman Powell emphasized that the continuing trade tensions are a threat to its outlook. This Fed appears more eager than previous boards to be ahead of the curve in changing course and being accommodative rather than being more cautious in taking action.

Treasury yields across most of the curve ended the month slightly higher than where they began, except inside of about 1-2 years where rates dipped slightly after the rate cut. Tight supply and continued investor demand for tax-exempt paper throughout the month moved municipal yields 10-20 basis points lower inside of 10-years. The net effect of muni outperformance has made tax-exempt bonds even more expensive on a relative basis. AAA-rated benchmark yields inside 7-years are now in the low to mid 70% level on an absolute basis with Treasury yields. Given that, we continue to target tax-exempts in portfolios when we can buy good quality investment grade credits at yields of 90-100% of Treasuries. Relative bargains can still be found, it just takes a little more patience in markets like these.

Sources:
Data sourced through Bloomberg, Stockcharts.com and data.bls.gov

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