Stocks prices continued moving higher last week as if to say a somewhat disappointing July jobs report and ongoing trade-related tensions between the U.S. and China are not a serious threat, yet. The Dow Jones Industrial Average and the S&P 500 both climbed 0.5%, while the Nasdaq Composite inched up 0.1%. Second-quarter earnings were mostly above expectations and provided much of the direction for the week. The biggest market story, however, was the sharp rebound in tech stocks following a selloff the prior week. The momentum pushed Apple's market capitalization to an unprecedented $1 trillion.

Friday's jobs (non-farm) report showed that the U.S. economy generated 157,000 positions in July, well below the consensus forecast of 190,000. Moreover, the latest numbers are significantly lower than the six-month average of 219,000. The unemployment rate also ticked lower, to 3.9%, while wage growth held steady at a 2.7% annual rate. Looking under the hood, jobs were most plentiful in manufacturing, healthcare, and professional and business services. Overall, the headline jobs number, while weaker than in recent months, appears reasonable at this stage of the economic cycle. As the Federal Reserve meets this week in Jackson Hole, we are anticipating plenty of discussion about the economy's potential for employment growth. We also expect two more rate hikes in 2018.

Interest rates remain in the spotlight as the 10-year Treasury yield moved slightly lower last week to end Friday at 2.95%, versus 2.96% the prior week. The Federal Reserve highlighted the economy's strong performance and held interest rates steady following its meeting last week. In addition to strong jobs growth, we note that inflation has pushed toward the Fed's 2% target. Looking at economic growth and inflation, we believe that the Fed Funds rate (now at 1.75%-2.00%) remains 25-50 basis points below a fair value level that would no longer stimulate the economy. However, historical data tells us the Fed Funds rate typically needs to be 1%-2% above fair value before hitting a cyclical high and causing the equity markets to worry about the economic impact of rising rates.

Other economic news last week was largely favorable. Existing home sales rose 0.9% in June, after a few months of flat to lower readings. The S&P Case-Shiller home price index rose a mediocre 0.2% in May, with losses in New York City and Detroit offset by gains in Seattle, Phoenix and San Francisco. Home price gains have been muted lately. Meanwhile, the consumer confidence index remained near 20-year highs, with a 127.4 reading in July, as views about the labor market remain favorable. However, motor vehicle sales fell to an annualized 16.8 million in July, down from 17.2 million in June and the lowest rate since mid-2017. Finally, the ISM nonmanufacturing index for July came in at 55.7, down from 59.1 in June, due to a slowing of new orders, backlog orders and business activity.

The first half of 2018 is in the rear-view mirror. Looking forward across the second half, stocks remain resilient and bonds continue to lag. Focusing on valuation, large-cap stocks had a strong rally in 2017, thus pushing prices into overvalued territory based on our current P/E ratios, price/sales ratios and dividend yields. Consequently, our allocations are dynamic with varying degrees of exposure to small, mid and large-cap stocks. In terms of growth and value, growth stocks are leading in 2018 and our outlook of accelerated earnings should support this theme through 2019. Moving to the international arena, we note that U.S. stocks have outperformed global stocks over the trailing five-year period, but they lagged in 2017. Foreign equity markets account for 60%-65% of world market cap, but our allocation is much lower - investing outside the U.S.

Does it sound like we are optimistic about the direction of stocks? Well, in short, we are. Risks will always exist but that doesn't mean we are at the apex of the current cycle. Our attitude towards stocks should not be misunderstood as overconfidence. Rather, we do not see a specific catalyst which is likely to spark an imminent recession. However, trade war issues will likely remain the primary wildcard: Should protectionism grow, it could trigger broader issues. Perhaps greater clarity on these issues will become apparent following mid-term elections. Nevertheless, it is our opinion that we are in a cycle that will continue as stock prices and bond yields rise.

Best Regards,
Phillip L. Clark, RFC
President & CEO

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