Market *Perspectives*

A Glance at How the World Affects You

Tuesday, June 11

Global stock markets jumped last week, with the S&P 500 Index rising 4.5% for its biggest gain since late November 2018. Short positions were covered due to technicals that suggested stocks were oversold. This fueled some of the recent recovery, but much of the boost, in our opinion, came after hints of a more dovish turn in Federal Reserve policy. Comments earlier in the week from Federal Reserve Board members suggest interest rate cuts, a one hundred eighty-degree turn. Stocks broke out of their May slump and Friday's sluggish employment report added fuel to the fire.

Focus Points

- ***Last Friday's employment report*** for the month of May delivered evidence of a slowing economy. Expectations called for 180,000 new jobs, well above the actual results of just 75,000 new jobs. The economy is chugging along with unemployment standing at 3.6% and hourly wages making small advances.

- ***Fed rate cuts back on the table*** *as* trade risks and falling bond yields point to the need for greater accommodation. Currently, Fed futures prices suggest a high probability that some kind of rate cut could come as early as July. It has only been a few months since the Fed reiterated their position on raising rates amid improving economic trends.

- ***The U.S. and Mexico*** are working through trade tensions but not without potential risks. Still, President Trump remains steadfast on contingencies that Mexico implement tougher immigration control.

- ***China remains open to continued negotiations***. Officials of the second largest economy are asking for a "fair agreement". The Chinese Foreign Ministry spokesman Geng Shuang said "If the United States only wants to escalate trade frictions, we will resolutely respond and fight to the end." To appreciate what the Trump administration is doing, one must consider at least 20 years of history in which Beijing has manipulated currency and intellectual property. Over that period, America has shed approximately 5 million manufacturing jobs.

- ***Stocks are likely to remain volatile,*** mostly driven by trade and Fed policy uncertainty. A slowing of domestic economic growth and deterioration in bond yields are also likely to make it tough for stocks to sustain an upside move.

Using the Institute for Supply Management (ISM) as our primary metric, we can see some contraction in the economy but business strength remains strong. In other words, we don't see this as a "throw in the towel" environment. Rather, we are experiencing growth, but the pace is slowing. These conditions have led to price declines in stocks. In our opinion, pullbacks often provide opportunity.

Risks continue for equities, so do opportunities

Beginning the second quarter of 2019, financial markets have responded to growing trade optimism/fear, a more dovish Fed, and signals of slowing economic growth and weakening corporate earnings. The capriciousness of equities can quickly cause investors to forget about their long-term goals. Instead of maintaining their strategy, cash becomes the buzz. Smart money, however, is buying on the pullbacks and staying focused on time in the market.

Prior to the U.S./China trade negotiation break down, we firmly supported global economic expansion as the persistent theme. Today, the economic backdrop has new challenges that portend a less favorable outcome, in the short-term. Nevertheless, we don't believe the current cycle has run its course. Moreover, recent equity price contraction makes valuations more attractive.

Volatility can quickly erase today's relevant facts, but we think it is worth mentioning that corporate executives and directors (insiders) once again provided valuable insight during a time of stress in equity markets. Insider trading is another way to measure sentiment. In fact, insiders were cautious at the start of May (details below) and, sure enough, markets ended lower, as did most shareholders. Corporate insiders, just a few weeks later were quick to jump in and declare the selling to be overdone. With this inference of risk-on, stocks have clawed back a good deal of lost ground and insiders remain in a seemingly positive mood. We have always said that insider trading is not a primary indicator, but their track record of getting it right is hard to ignore.

Looking at the macro backdrop, trade issues remain the greatest of uncertainties. The idea of a trade war has created risk and fear, but the imbalance must be resolved. China and Mexico have benefited from free trade for decades and the current administration aims to level the playing field. However, gauging the outcome and timing of such a sinuous and onerous process is not plausible. As we await results from continued negotiations, we find some comfort in the Fed's swift move to towards a more dovish, rate-cutting bias.

From an investment perspective, the bearish case for equities and risk assets has increased year-to-date. Our outlook for corporate earnings is neutral and we anticipate that added risk should be balanced by a more accommodative Fed policy. As such, we are maintaining a fully-invested stance with reliance on our nimbleness and selectivity.