Weekly Market Flash

When September Comes

July 15, 2016

We are heading into the dog days of summer, and this one has a distinctly retro feel to it. Just a few weeks ago we used this space to comment on the US stock market's having a distinct 1970s vibe to it. But the big socio-cultural phenomenon of the moment is Pokémon Go, an app which appeared out of nowhere to rival Twitter in popularity. What with Pikachu and friends roaming all over our virtual spaces, the S&P 500 setting new record highs, the prospect of a Clinton White House and even a new reality show for ex-'N Syncer Lance Bass, we may have to revise our cultural reference markers a couple decades ahead to the late 1990s. Of course, the silly season will eventually give way to the more purposeful back-to-school month of September. This year's ninth month could be plenty interesting and potentially tricky for investors.

Yellen and the Markets

For a first clue as to what September might have in store, we will be paying close attention to the language Janet Yellen uses to convey her sense of the state of play at the FOMC meeting later this month. The odds of any actual rate action in July are vanishingly small; at this point it would be a huge surprise, and probably not a pleasant one, for the Fed to act. But Chair Yellen and the markets need to have a little conversation. In the aftermath of Brexit, short-lived tempest though it was, market expectations on the timing of the next Fed move pushed out well into 2017. Bond yields remain near historically low levels pretty much everywhere, despite a bit of a jump this week.

Wage-Price Tango

But Brexit is oh-so three weeks ago. There is much less uncertainty around Britain's near-term future as the new Conservative government of Theresa May settles into office and the identity of the key players charged with negotiating the terms of Brexit become known. Meanwhile, a new string of macroeconomic numbers on this side of the Atlantic suggests that markets may be overly optimistic in their never-never expectations on rates. There was last week's release by the BLS with all kinds of good news about jobs and wages, of course. This week we saw a strong uptick in producer prices, suggesting that the wage-price trend of the past several months is more durable than the Fed might have thought back in the spring. Retail sales and industrial production both outperformed and capacity utilization nudged up slightly. If economic conditions suggest that the Fed's mandate of stable prices and full employment is best served by bringing rates up, if ever so slightly, can Yellen and her colleagues still make the case for staying put? Or will she use the July meeting to reset expectations towards a September move?

Earnings Finding Bottom?

By September we will also have a good sense as to how Q2 earnings will finish out and whether, as currently expected, the growth trend turns positive again for Q3 and beyond. Even as energy, industrials and materials continue to be a drag on average earnings, consensus estimates call for strong positive reversals in key sectors like consumer discretionary, healthcare and technology. The evidence from recent market trends suggests that investors are, for the moment anyway, putting oil prices and the dollar in the rear-view mirror and focusing on a potential return to double-digit earnings growth by next year.

The TINA Syndrome

Much chatter continues – including in some of our recent commentaries – about the mixed messages being sent by stocks and bonds, with the former seeing the world's metaphorical glass as half-full and the latter viewing it as half-empty. A derivation of this is the so-called TINA view on US blue-chip equities: There Is No Alternative. This view suggests that bond investors have become the new stock investors. With historically low or negative yields distorting whatever information the bond market is sending, high quality stocks with healthy total shareholder return programs have become the new safe haven, in the world according to TINA.

IF the TINA syndrome persists into the fall, we could be in for one of those Santa Claus rallies so beloved of investors as the year heads to a close. For this to happen, though, will still require a few things to go right; at the very least, a continuation of the more favorable earnings and economic trends discussed above, and a minimum of surprises as this very strange political season draws towards Election Day. And just yesterday, of course, we were sadly reminded once again of the persistent presence of terror with the Bastille Day tragedy in Nice, France.

All of which is to say that conditions continue to be supportive for stocks, but not without plausible downside catalysts. There will be plenty of things to focus on and prepare for as the dog days give way to a potentially busy and challenging fall.

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