Weekly Market Flash

A Whole Lot of Nothing

October 21, 2016

It's enough to make one sort of miss those crazy Octobers when goblins and other malevolent spirits wreak havoc on asset markets. Remember 2014? A weird flash crash in U.S. Treasury yields spooked investors already jittery about the Ebola virus making sensational front page headlines. The S&P 500 fell to just short of a technical correction in intraday trading before rebounding sharply as it became clear that there was no "there" there. A vigorous Santa rally carried the U.S. bellwether index up to a then-all time high right before the end of the year.

Mario Wins the Toss, Elects to Defer

At least that gave us something to write about. October 2016 thus far is a fine month for those who value calm and serenity, but for market scribes it is notably bereft of attention-grabbing headline events. Share trading volume this month on the New York Stock Exchange is somewhat below its average daily levels back in August. August, for heaven's sake! It would appear that stock markets are catching the soporific vibes of the central banks they so assiduously follow, most recently the European Central Bank. On Thursday, ECB Chairman Mario Draghi summed up deliberations of the body's governing council thus: We'll talk again in six weeks. Ciao!

The ECB has a raft of unsolved problems, but this week was apparently not the time to provide any guidance as to their progress. Markets widely expect the bank will extend the current program of monthly €80 billion purchases beyond the current termination date of March 2017. However, the ECB's rules on asset eligibility are at odds with the actual supply of viable paper in the market. Those rules probably will have to change in order to facilitate a meaningful extension of the program. Such change in turn will require agreement from the council's German and other northern European hawks. Draghi's deference to the December meeting likely stems from a lack of consensus today as to how to remedy asset eligibility rules to facilitate an extension of QE beyond March.

Earnings: Low Bar Well Cleared

Meanwhile, the third quarter earnings season is, rather predictably, serving up a nice dollop of upside surprises. With a bit more than 20 percent of S&P 500 companies reporting to date, both top-line revenues and mid-bottom line profits are mostly outperforming analysts' expectations heading into the season. We expect that, when all is said and done, the average EPS growth number will be slightly positive as compared to the minus 2.6 percent consensus number projected a couple weeks back.

Yet, while upbeat earnings reports have helped a handful of individual names thus far, those low share volume figures and lackluster price drift for the S&P 500 overall indicate that, for the moment anyway, earnings season is not serving as much of a catalyst for a broad-based rally. Shares remain expensive by traditional valuation metrics, as we have frequently pointed out in these pages. Investors still have a more skeptical take on companies' forward guidance projections, and headwinds including the dollar and weak foreign demand haven't gone away. Until guidance announcements provide more evidence of a near-term future of double-digit EPS growth, a couple of quarters clearing a very low bar probably won't do much to shake off the lethargy.

When Nothing Becomes Something

We still have six weeks to go before that next ECB conference, and even longer to wait for the white smoke to appear from the Eccles Building in Washington D.C. signifying the Fed's next move. Six weeks is a long time for "nothing" – as reflected by sideways prices, low volatility and vanishingly thin trading – to continue. Some technical indicators including shorter term moving averages and 52-week highs vs. lows suggest some top-heaviness. While we don't see any obvious lurking threats that could move from potential to kinetic (yes, including the U.S. election which, as we have pointed out before, is largely baked into current price levels), the current quiet does strike us as too quiet.

Often it is not one thing, but rather a random confluence of several things, which gives rise to sharp price reversals. The example we provided above of the October ’14 correction illustrates this well: a sudden data point anomaly (the Treasury yield flash crash), amidst a raft of vaguely disquieting, uncorrelated event headlines and a new wave of commodity price drawdowns, converged to trigger sell signals from trading program algorithms. More often than not, these turn out to be short-lived tempests. It’s been awhile since we had one, though.

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