Market Update

August 10, 2016

What made the markets move and what will drive it going forward?

The S&P 500 as of the close on August 9th has gone up roughly 30 more points since last month's market update.   The yield on 10yr. Treasuries has been somewhat range bound between 1.5 to 1.6 percent. Many traders are concerned that the S&P 500 has moved a bit too far too fast, as stocks in the S&P 500 are trading close to 18x forward price/earnings valuations. The concern is not that there is a looming drastic down turn coming in the markets, but rather, when the next pull back toward the short term 50 day moving average on the S&P 500 will begin. Traders are looking for buying opportunities as the recent run up in stock prices is feeling a little bit tired.

Information in this chart above was taken from sources we believe to be reliable; however we do not guarantee its accuracy or completeness.

Employment

On August 5, 2016 total nonfarm payroll employment for July rose by 255,000 jobs and the unemployment rate was unchanged at 4.9%. Job growth occurred in professional and business services, health care and financial activities. The number of unemployed persons was still around 7.8million. Labor force participation rate (those employed or actively seeking employment) was 62.8%. Average hourly earnings for all employees on private nonfarm payrolls increased $0.08 to $25.69 and the average hourly work week rose 0.1 hour to 34.5 hours. The markets cheered on these numbers and shrugged off any impact they may have on Federal Reserve monetary policy decisions as well as the fact that there are still almost 8 million Americans out of work. We must remember that if one is not actively looking for work he or she is not counted in the data. This makes the labor force participation rate important.

Will the Fed make a move?

The recovery in the employment numbers has continued but not nearly as fast as in other economic recoveries. This has made it very difficult for the Fed to raise interest rates as one of their mandates is to maximize employment through the use of monetary policy. After Brexit, many thought the Fed would be on an indefinite hold until 2017 when it comes to raising interest rates. However, Brexit seemed to have been more of a catalyst, delivering a repricing of assets (i.e. risk). This prompted a wave of buying activity that helped push the U.S. stock markets to new highs. With the development of new market highs and good economic numbers, sentiment has reversed a bit and many are looking for a 25 basis point rate increase before year end from the Fed. The question this raises is how will the market react? We can never truly know until the day comes, but the idea of a rate hike might signal that the economy is strong enough to handle higher interest rates. This signal might be the needed catalyst for money that is on the sidelines to enter the markets. One other possibility is that money will start to come out of low yielding fixed income investments to seek higher returns elsewhere.

Presidential Race

Of course we cannot deny what is going on in the U.S. political arena either. It is starting to become clearer what each of the presidential candidates might mean for the economy. Interestingly, even though their economic policies differ greatly, they both agree on the need for infrastructure spending. Trump wants to simplify the tax code down to three tax brackets and lower corporate tax rates to 15%. He also wants to provide immediate expensing for capital expenditures. Hillary Clinton wants a better tax system making sure the wealthy, Wall Street and corporations pay their fair share in taxes. She wants to help small businesses and provide tax relief to working families. Of course, these are not the only themes that both candidates are campaigning on from an economic perspective but they are some of the main themes I see at this time. Ultimately, we will need to hear a lot more from both to understand their complete economic visions for the country. We will need much more detail before the election to better assess the impact of their policies on investments and sectors.

Finally, the markets continue to trade above the 50 day and 200 day moving averages. As I mentioned in my last market update, I see the S&P 500 potentially testing the 50 day moving average as a resistance level while we grind higher into the fall.

If you have questions or would like to discuss this further with regard to your personal portfolio please contact me at 310-433-5378.

PROMINENCE CAPITAL

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