THE POWELL PUT

While the second quarter initially appeared to be a losing proposition for investors, stocks turned sharply higher in June as Chairman Powell of the Federal Reserve reversed his hawkish stance to one of accommodation. It clearly was a major change by the Fed, and reinforced the thesis that the bull market in equities is alive and well and may have several more quarters to run.

What caused Powell to reverse his view is still the subject of major debate, but in our opinion the change was justified. The U.S. and major world economies are slowing. Domestically, a leading manufacturing survey indicated that the number of new orders will be much lower in July compared to June. Though manufacturing is not a large share of the economy, orders are a leading indicator and correlate well with profit growth. We would expect, therefore, that the second quarter's S&P corporate profits will not be too exciting. The Fed can and should ease interest rates not only because of the current slowdown, but also because inflation has been consistently below its target range, parts of the yield curve are inverted, and there is global weakness as a result of trade friction to consider. China's real GDP is still slowing, Japanese exports remain challenged, and the European Central Bank would appear to be favoring further stimulus. All of these factors put upward pressure on the U.S. dollar and make it less competitive due to our higher interest rate environment.

Though there are still many unresolved domestic and international issues, progress has actually been made in addressing several former flash points. The U.S. government was not shut down and our Mexican border wasn't closed. The Federal Reserve seems to be in a holding pattern, and rate cuts are planned. China has introduced new domestic stimulus measures, and OPEC has led the way in stabilizing oil prices. The biggest stumbling block remains the absence of a U.S.—China trade deal, but there are hopeful signs that negotiations may begin again soon. It clearly is in the best economic interest of both countries that a compromise be reached.

In spite of the apparent global and domestic issues, the advance in equities has been impressive, and sometimes it pays to listen to what the markets are telling us. Importantly, the advance has broken out with more issues and sectors participating. The advance/decline line is at a new high while more cyclical and financial companies are receiving renewed bids. Perhaps the markets are telling us that reduced earnings expectations will be better than expected, that we will have renewed economic growth, and that stocks can move higher in a stable and benign interest rate environment.

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Tel: (212) 320-2000 140 Broadway, New York, NY 10005 Fax: (212) 320-3040