

Investment Strategy Outlook: Weight of Evidence Neutral Heading Into Q4

Chart Pack

September 26, 2019



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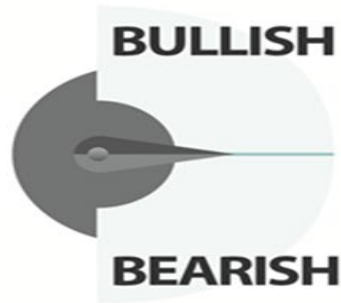
Weight of the evidence is neutral heading into the fourth quarter.

MACRO FACTORS (WHAT COULD HAPPEN):

FED POLICY



ECONOMIC FUNDAMENTALS

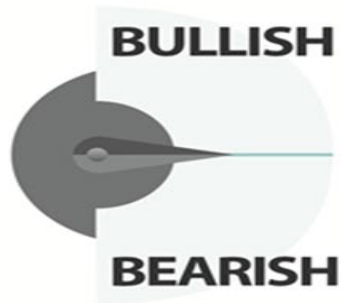


VALUATIONS

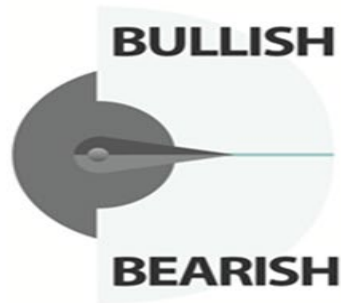


MARKET FACTORS (WHAT IS HAPPENING):

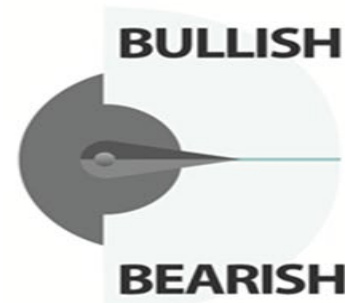
SENTIMENT



SEASONAL PATTERNS AND TRENDS



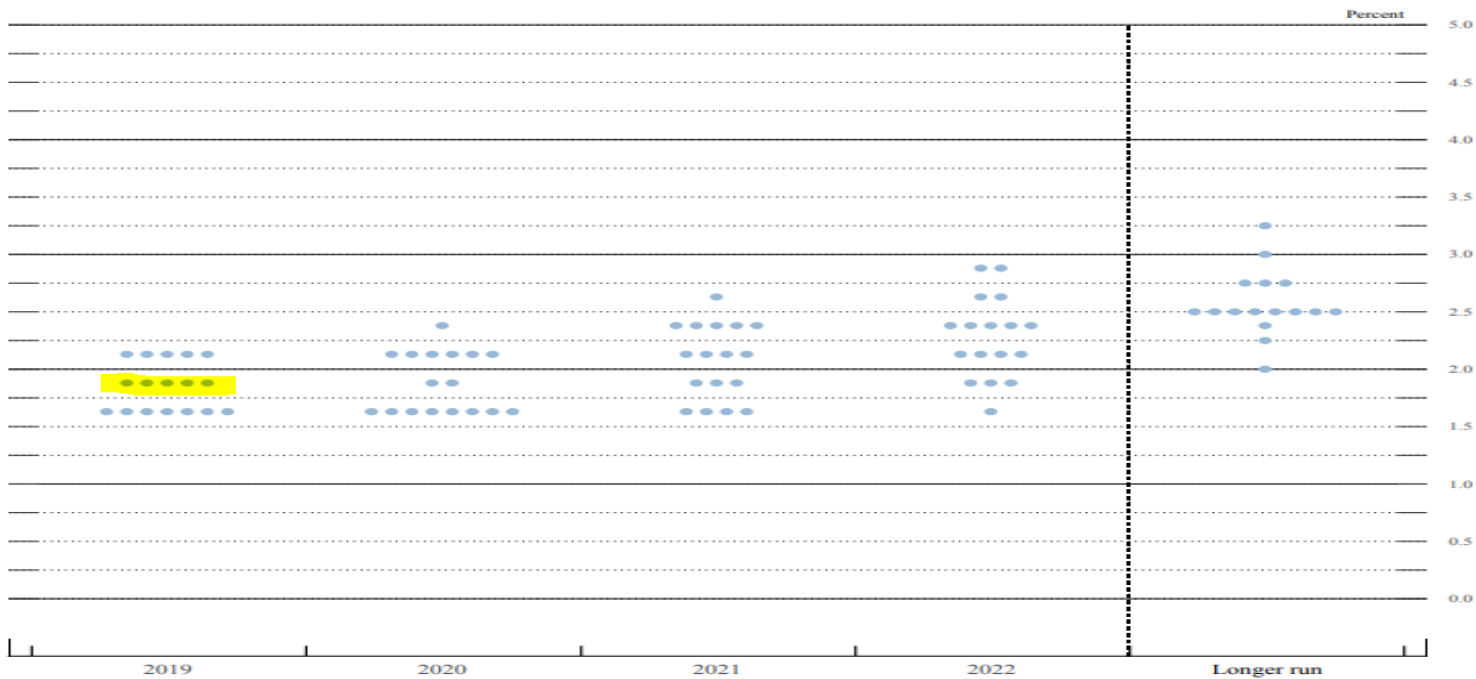
BREADTH



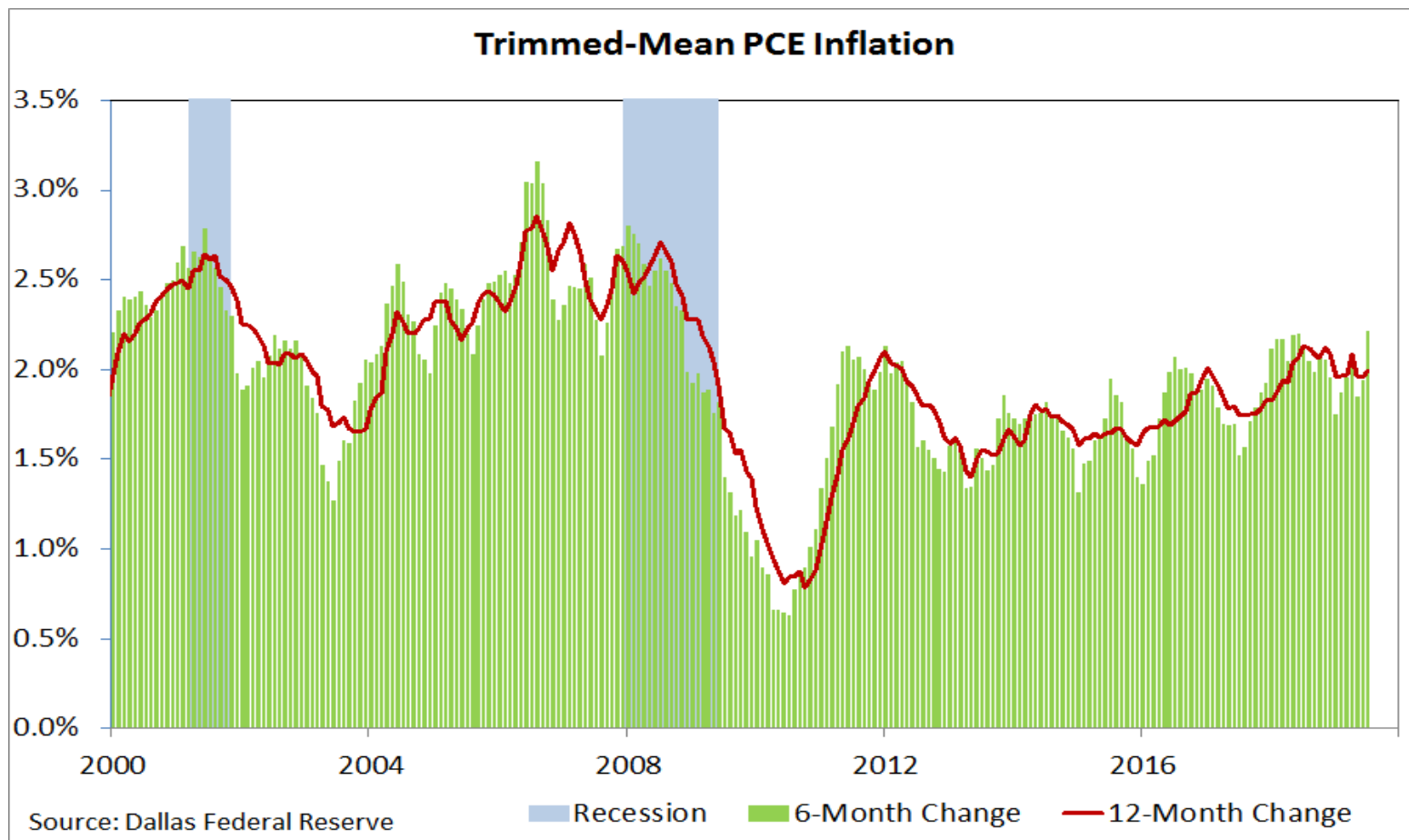
The Fed has cut rates twice in 2019 and while the market might be expecting more easing, the Fed is non-committal at this point.

For release at 2:00 p.m., EDT, September 18, 2019

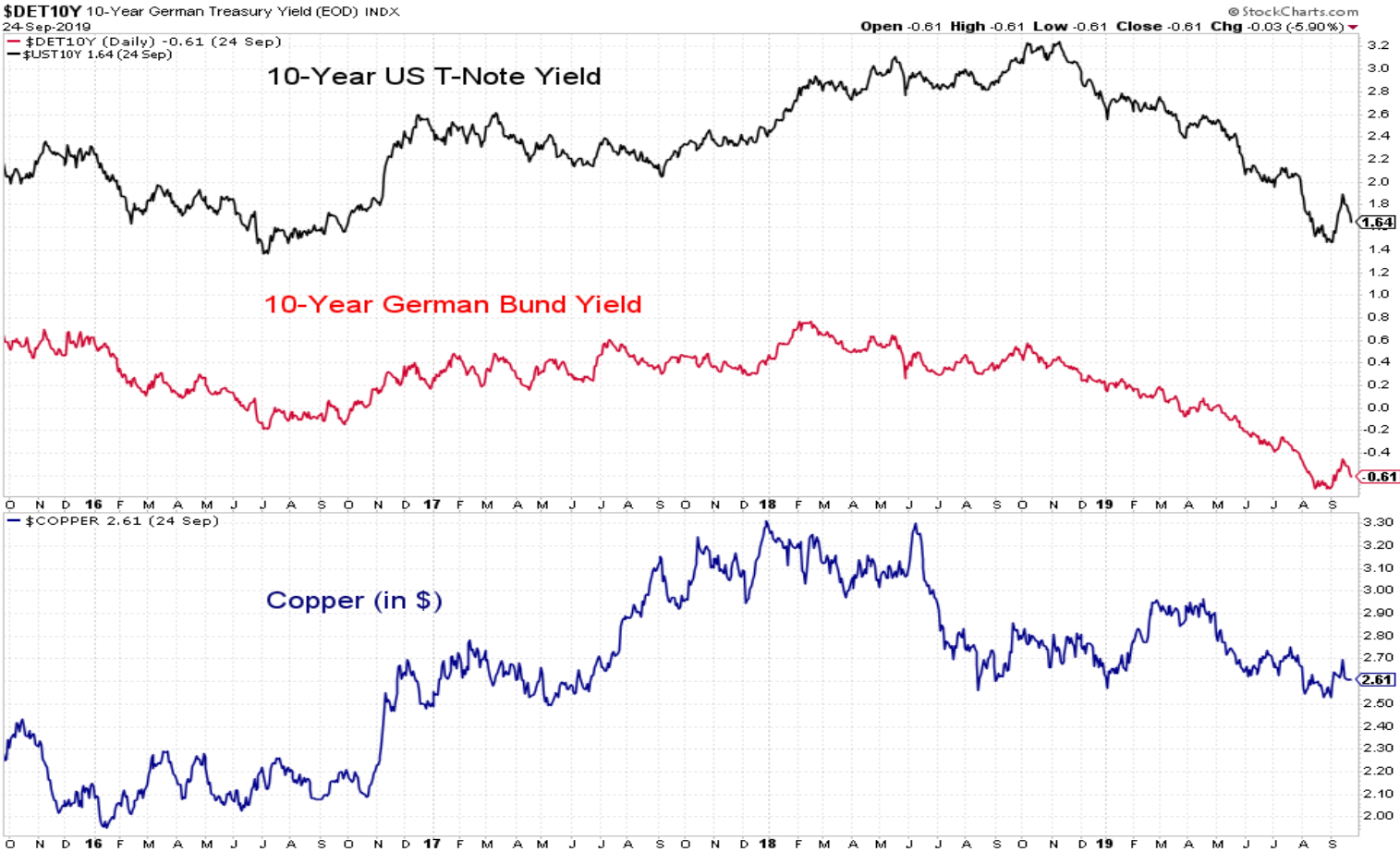
Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate



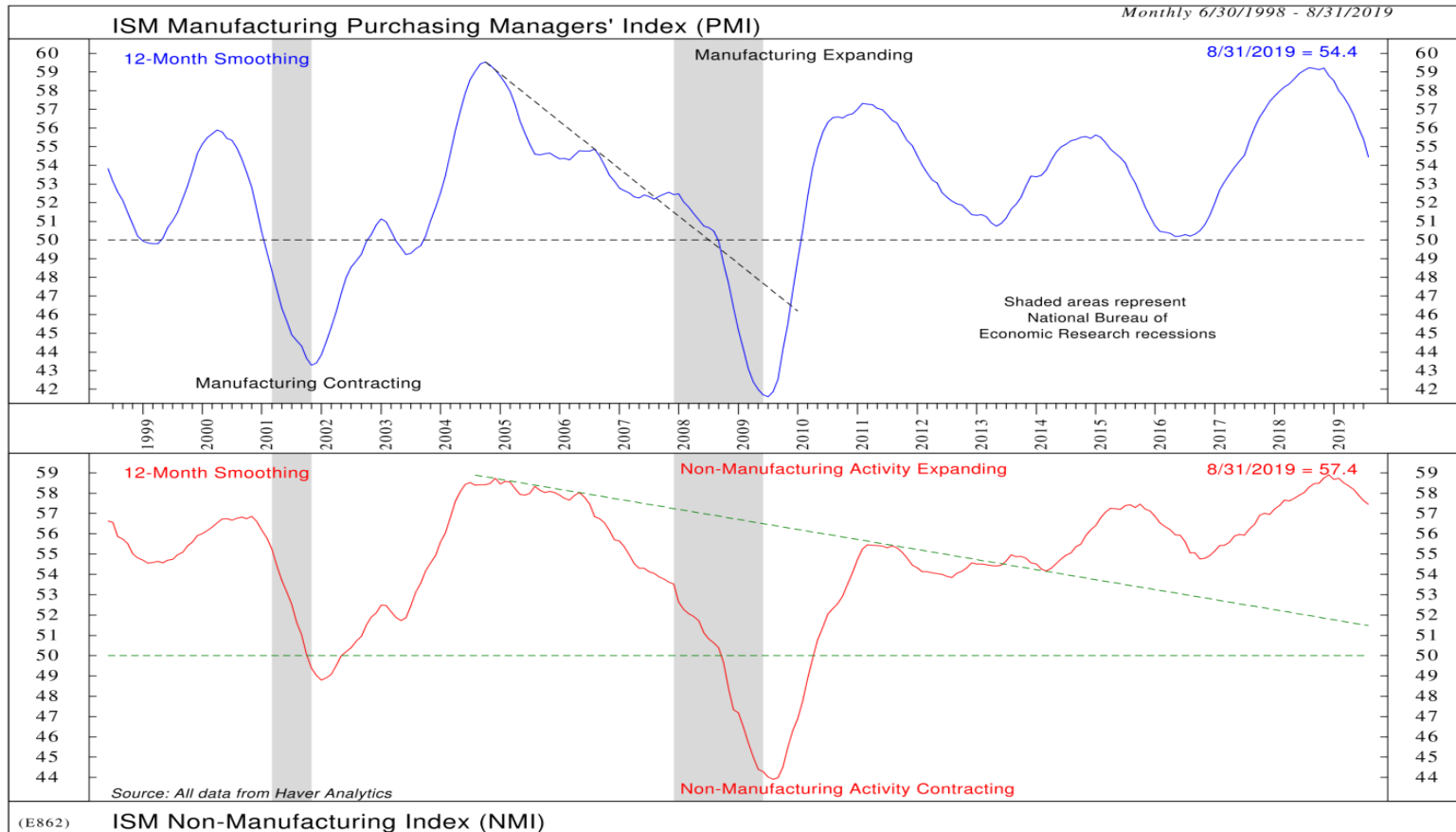
We are seeing evidence that the inflation outlook may not be totally benign – the 6-month change in this inflation measure is its highest in a decade.



US Treasury yields are being pulled lower by negative interest rates overseas. Copper, however, is not confirming the concern being expressed in the bond market.

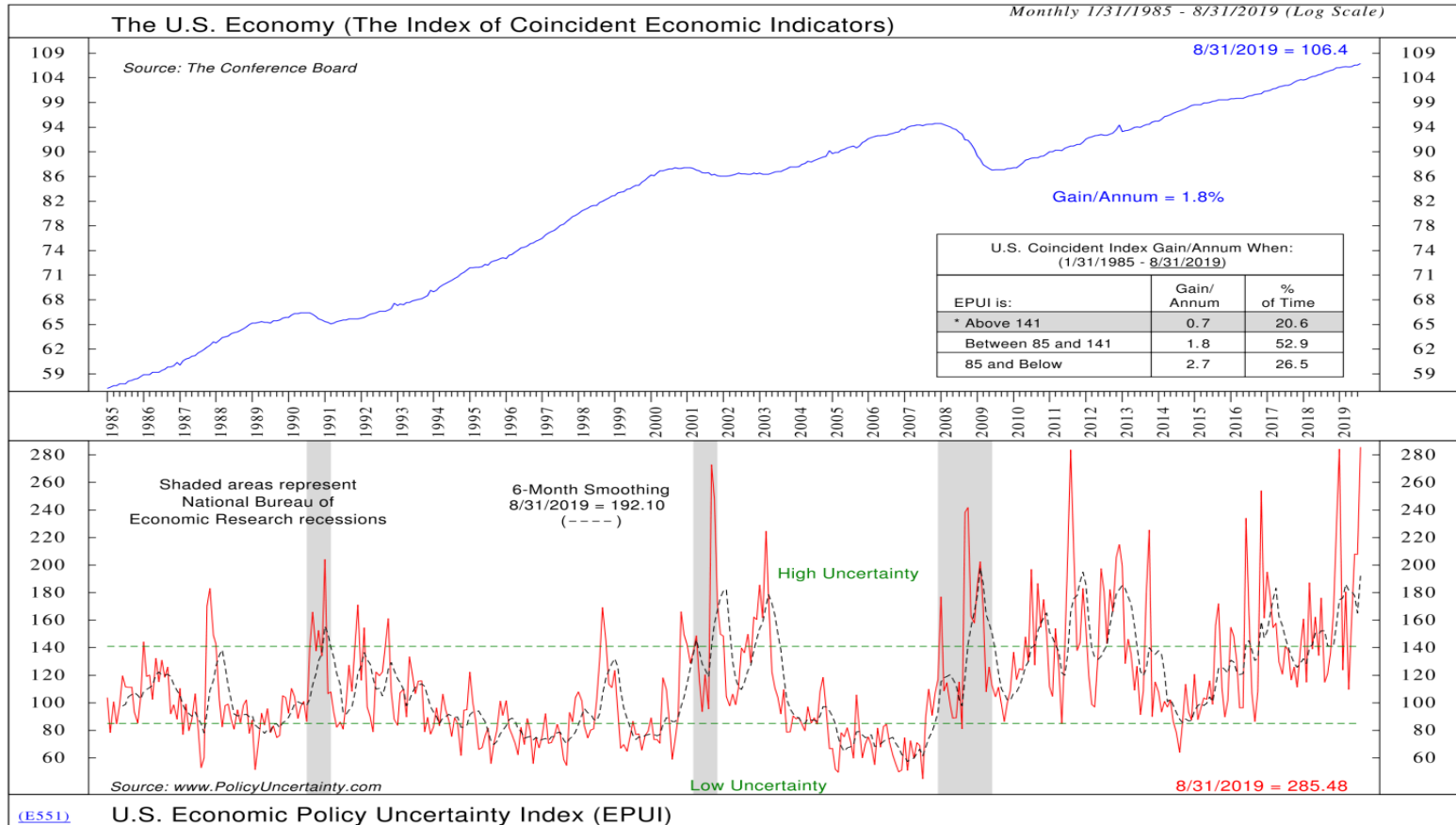


Growth has slowed across the economy, though the slowdown in the manufacturing sector has been more pronounced than elsewhere.



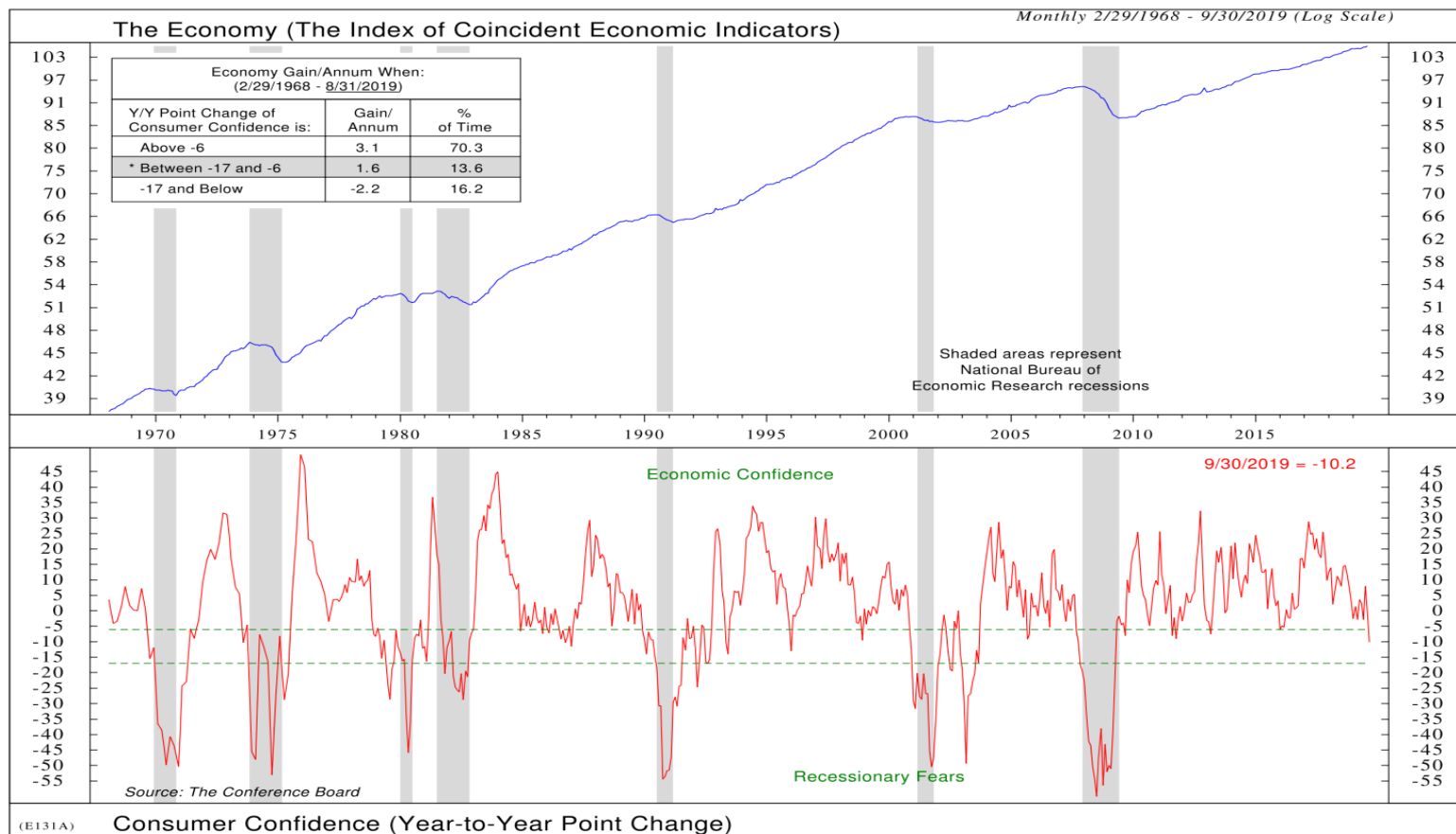
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Political headlines and overseas developments have helped contribute to an elevated level of uncertainty, which has historically been a headwind for growth.



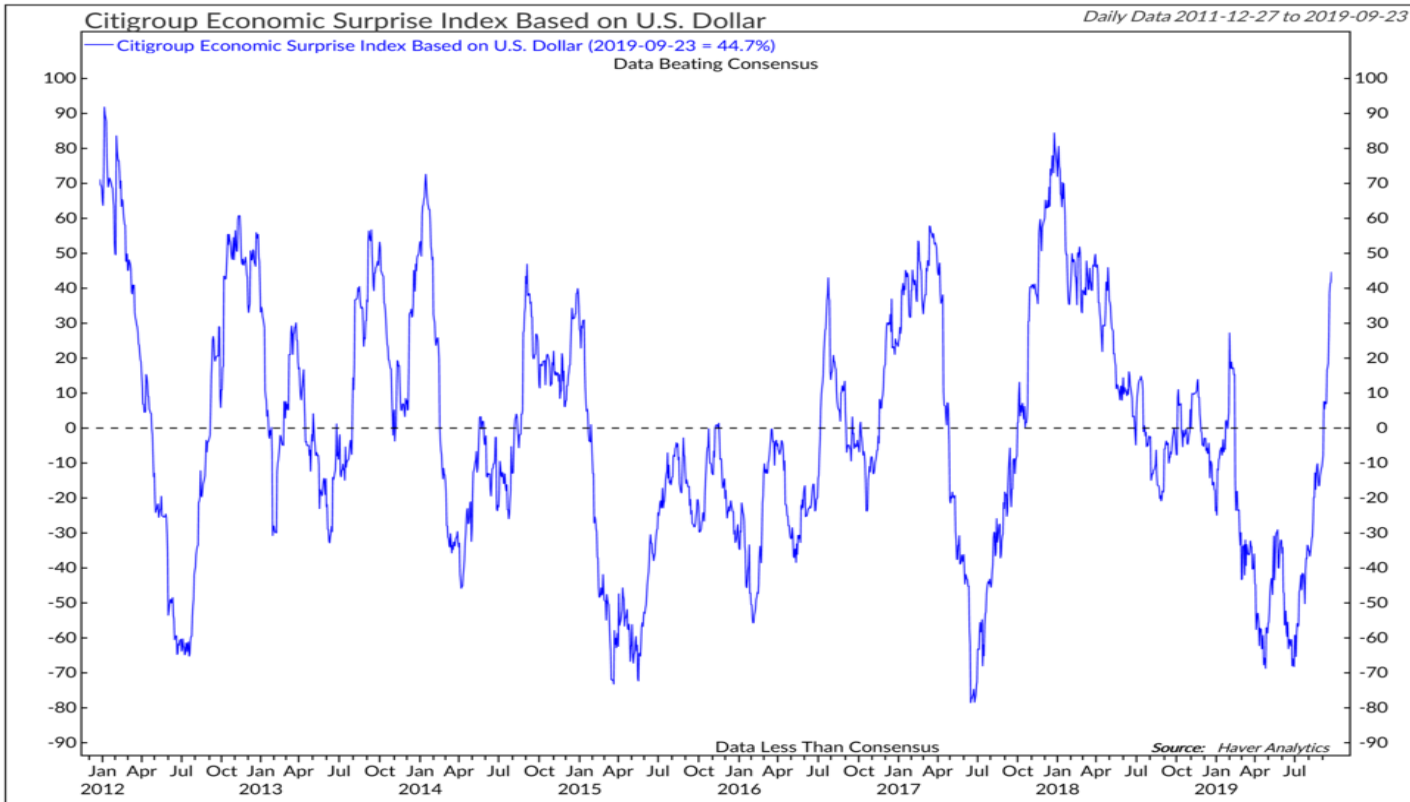
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Uncertainties are starting to weigh on consumer confidence. Further deterioration in confidence could increase downside risks for the economy.



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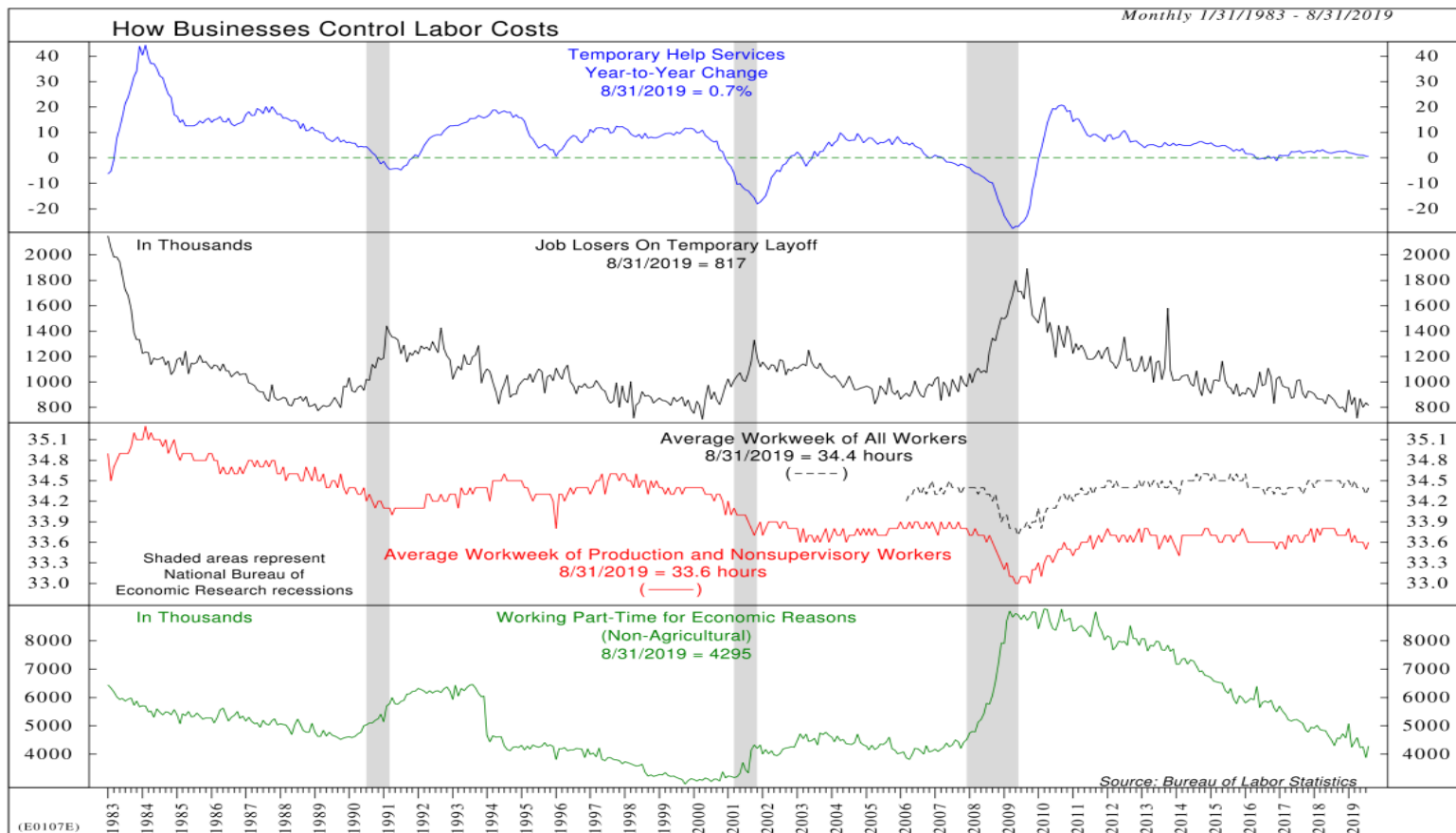
While not a measure of whether recent data has been good or bad, the surge in the Economic Surprise Index shows that incoming data has been better than expected.



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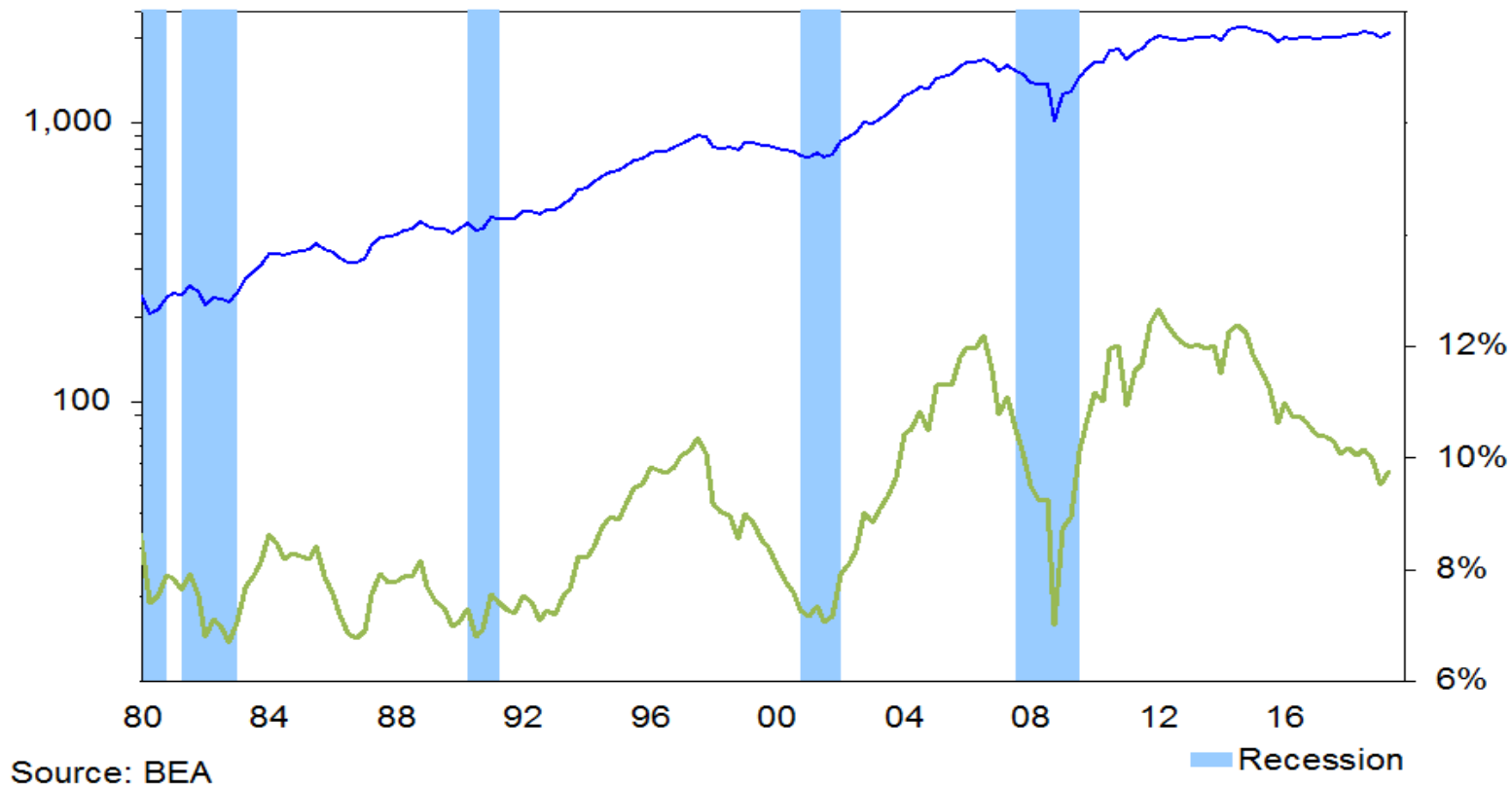
If economic conditions deteriorate from here, businesses have multiple levers they can pull to control costs – including shortening work weeks and increasing layoffs.



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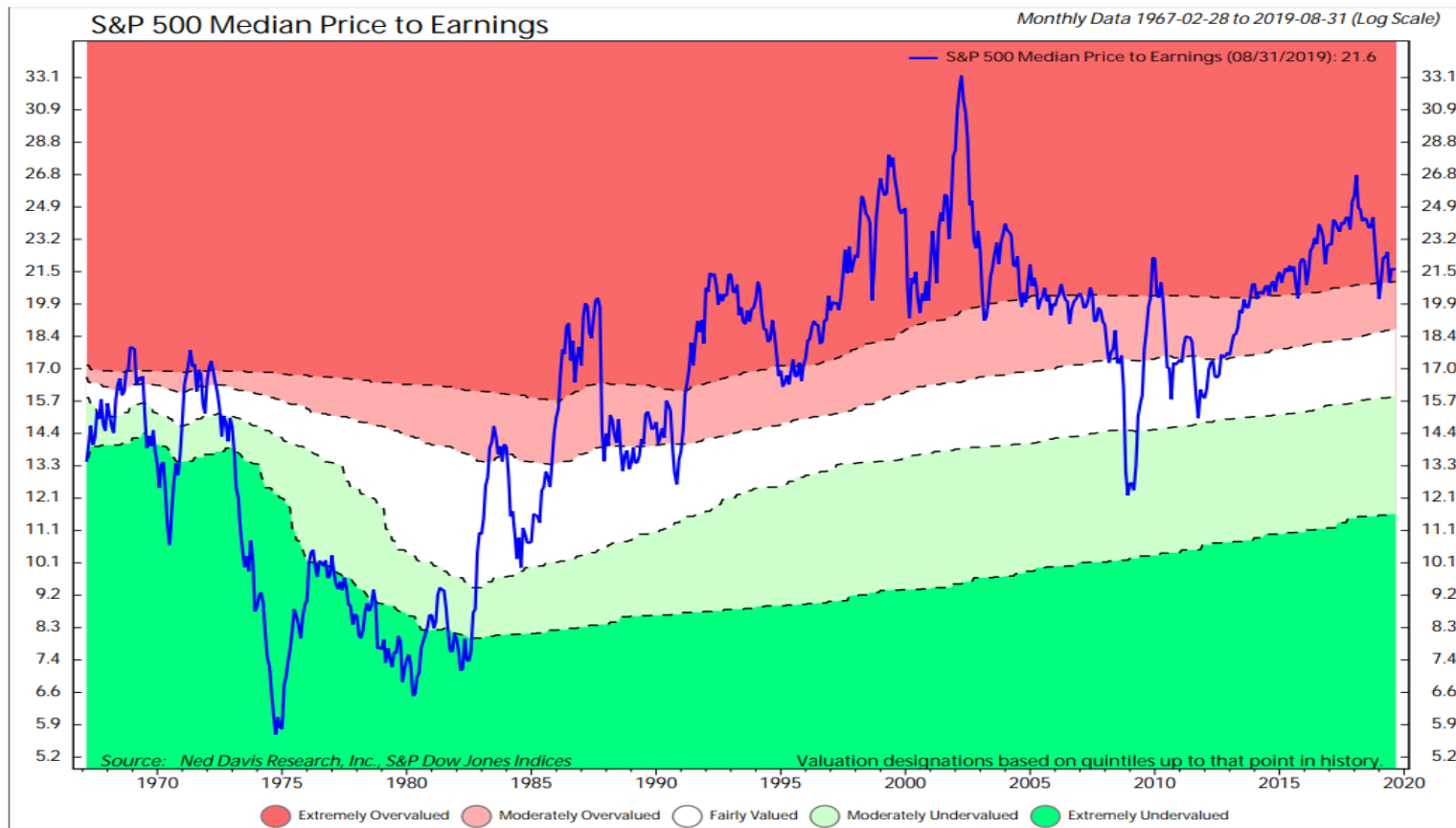
Higher costs (including higher labor costs) are weighing on profits – which peaked in 2014. As a percent of GDP, profits are at their lowest in a decade.

Corporate Profits:
Overall (left, log scale) and as percent of GDP (right)



Source: BEA

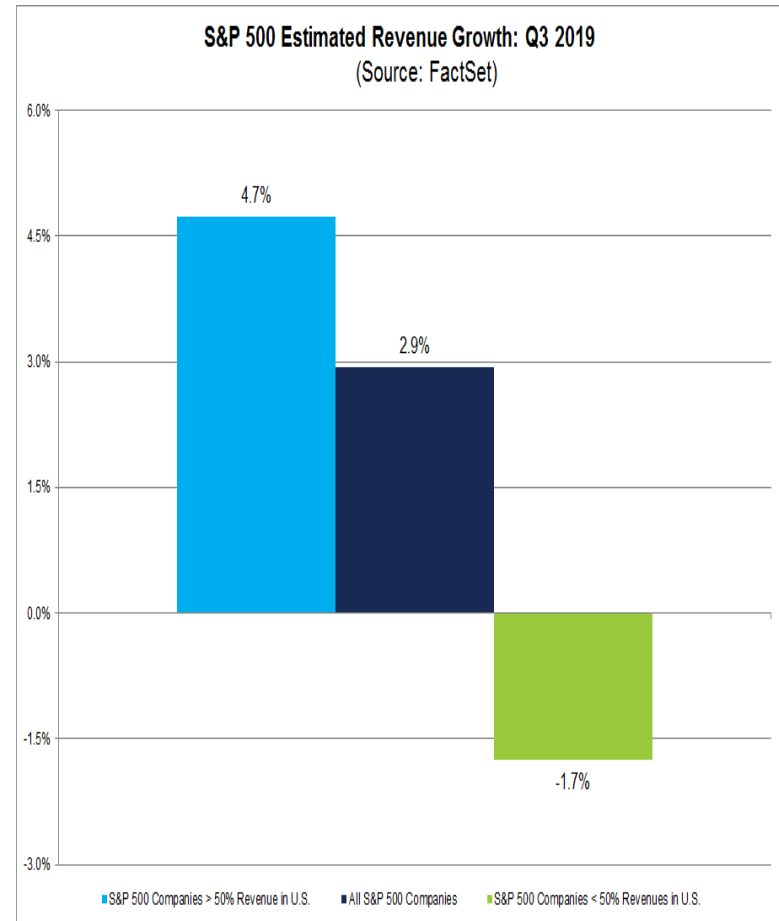
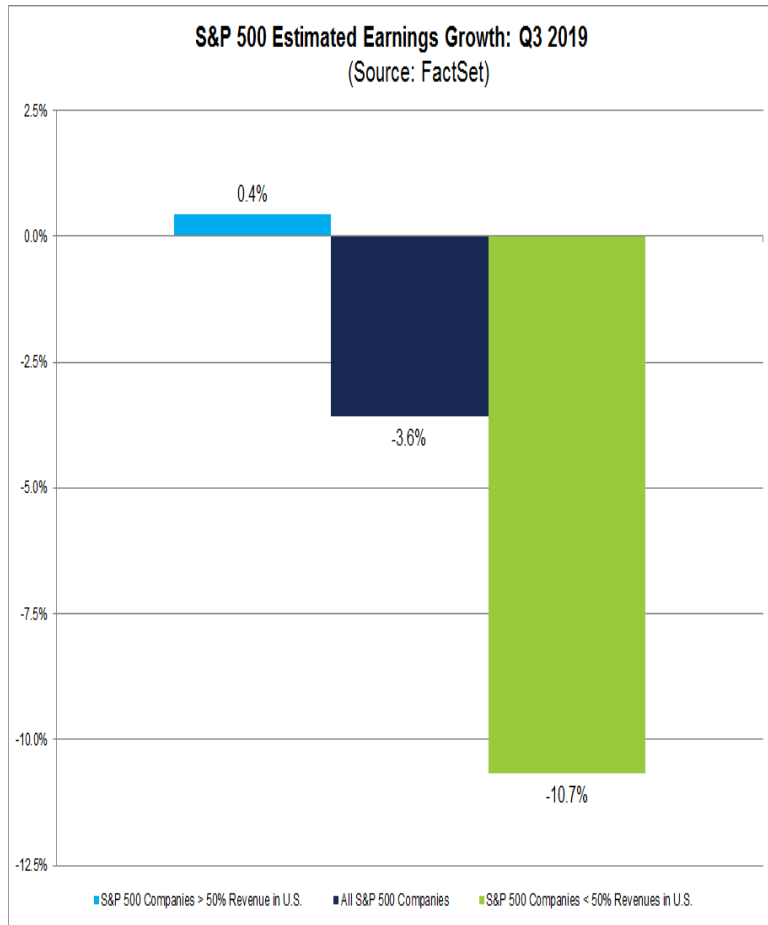
Pressure on overall profits could weigh on S&P 500 earnings growth at a time when the P/E ratio is already at an elevated level.



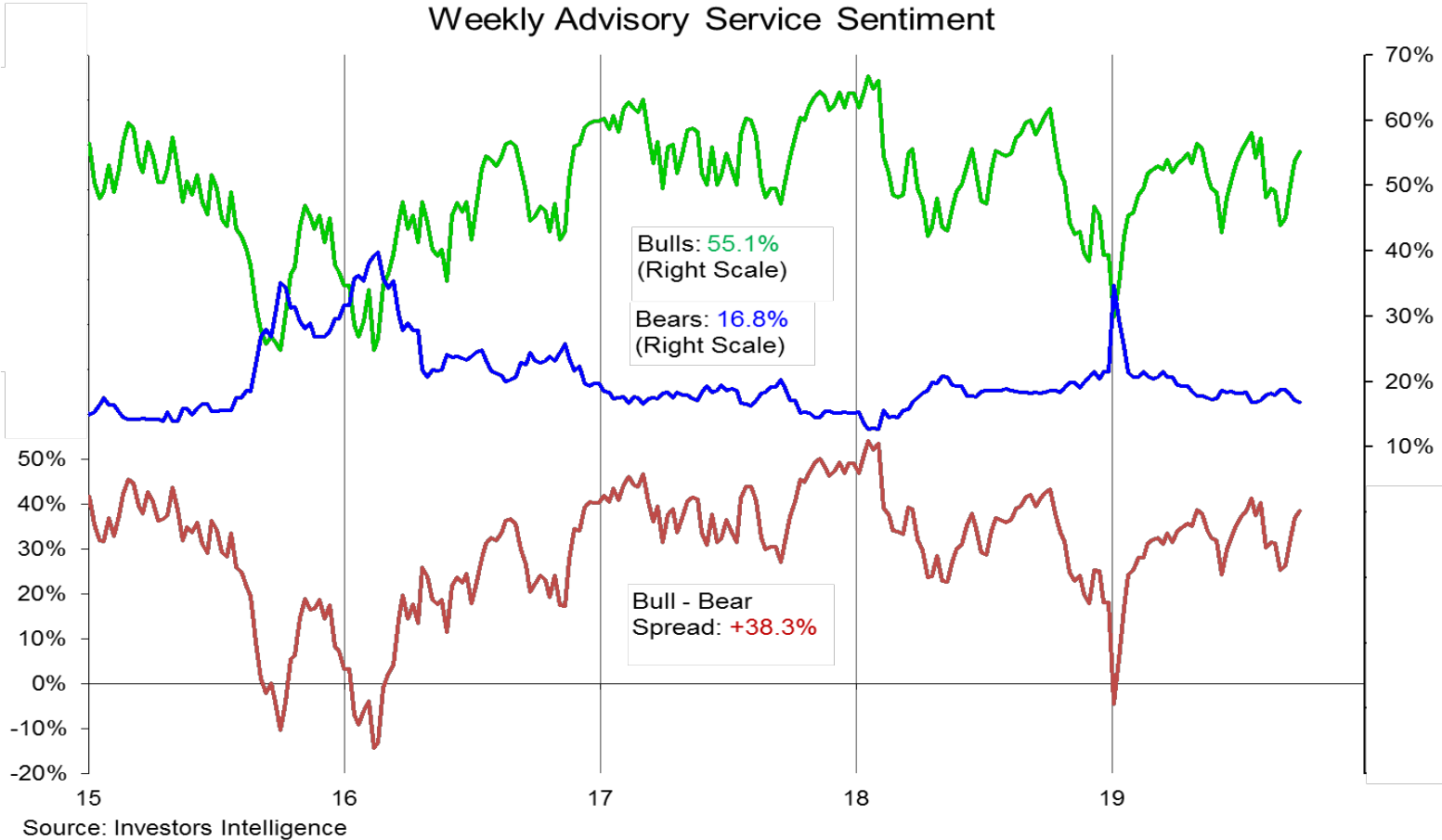
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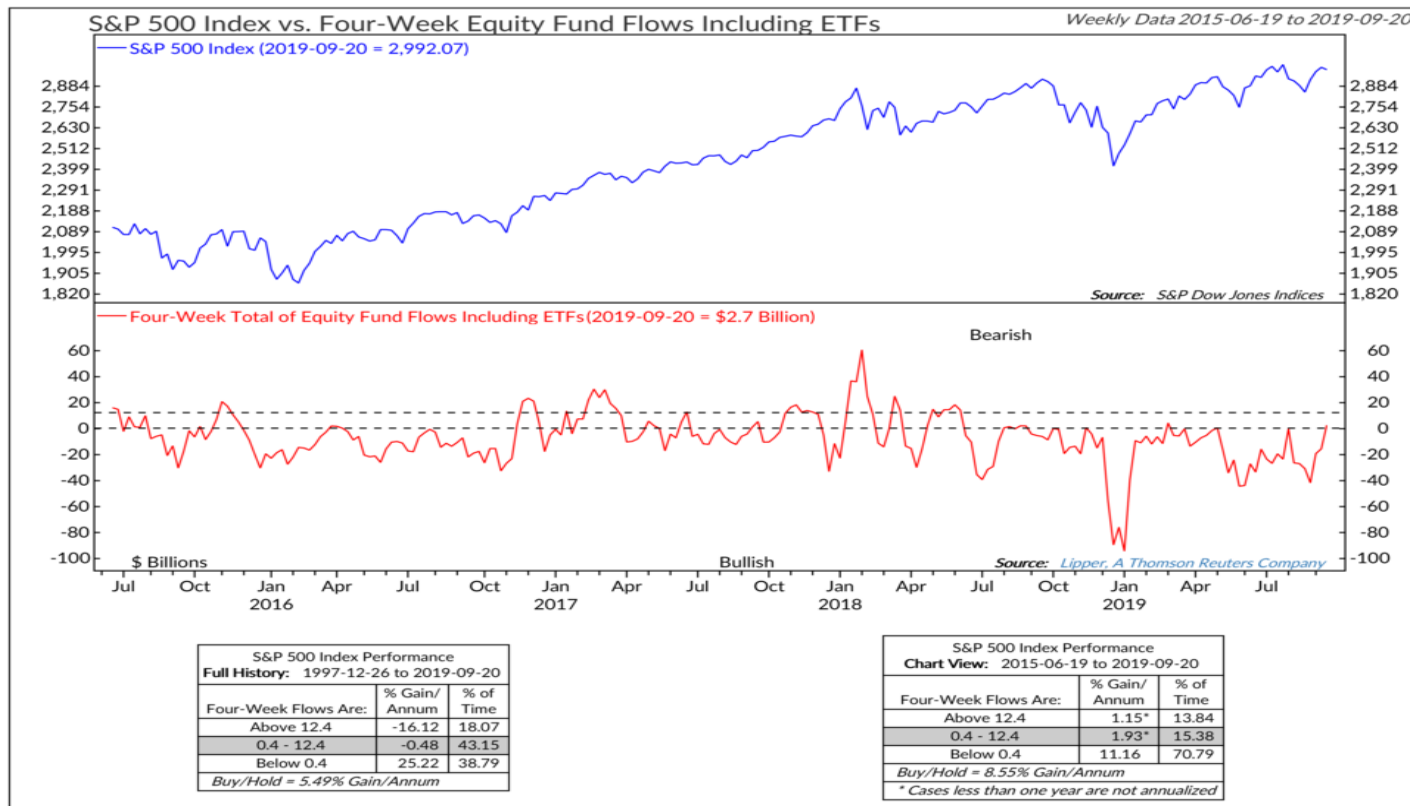
Earnings and revenue expectations for the third quarter show that weakness in the global economy remains a headwind.



Sentiment survey results vary depending on who is being polled. Advisory services continue to tilt toward optimism.



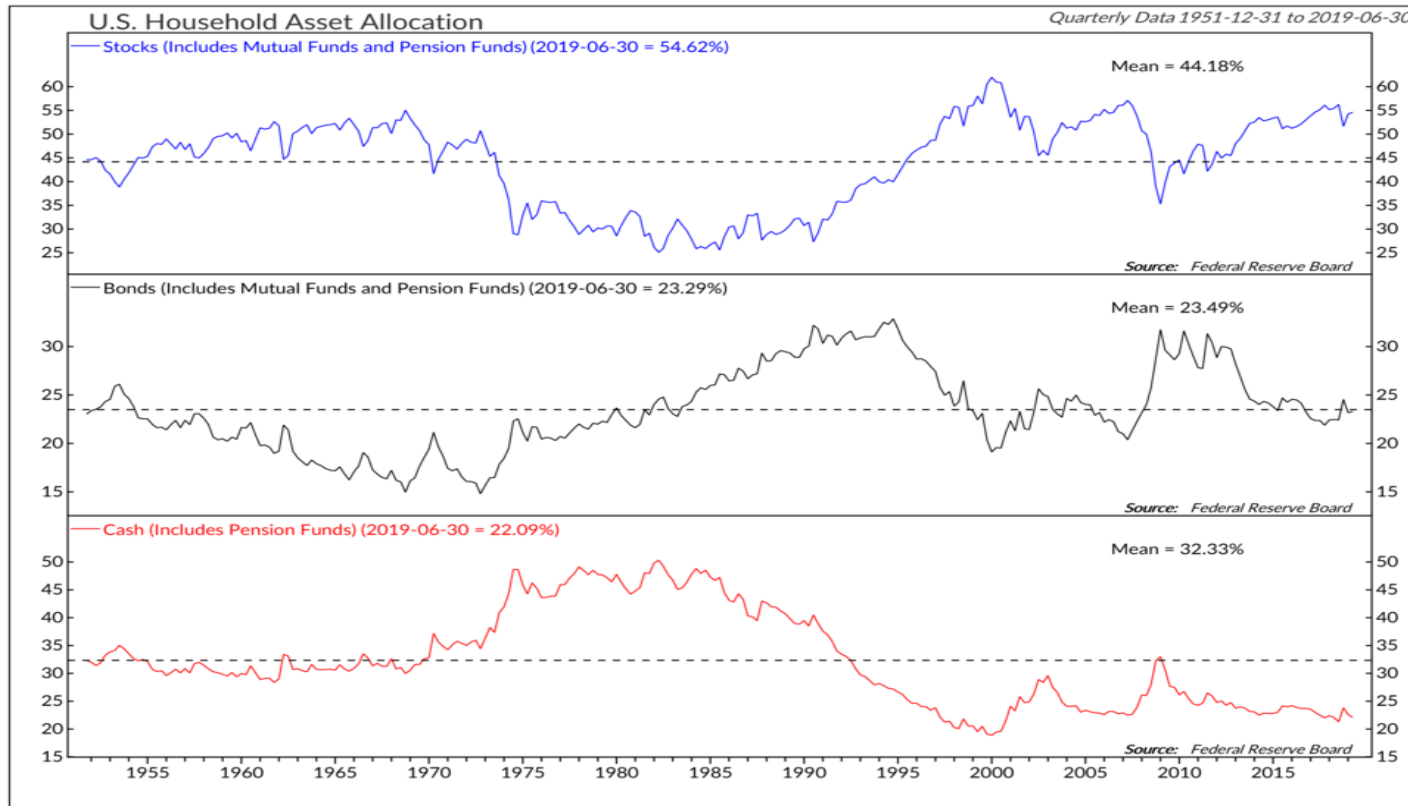
Equity funds have seen a steady pace of outflows over the past year, though the latest data suggest that could be changing.



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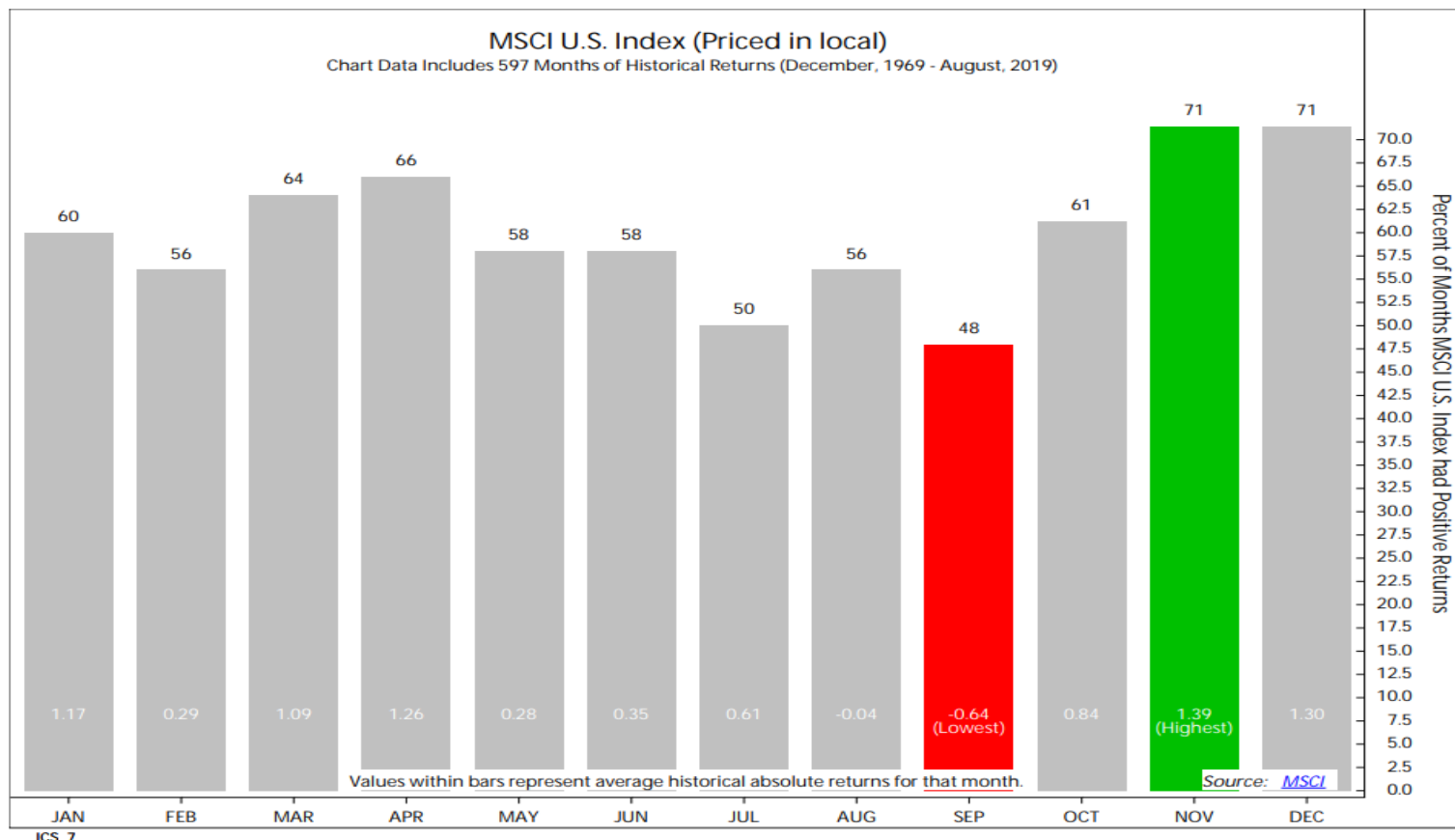
Weekly flows represent pennies on the dollar of overall assets. In terms of asset allocation, households remain overweight equities and underweight cash.



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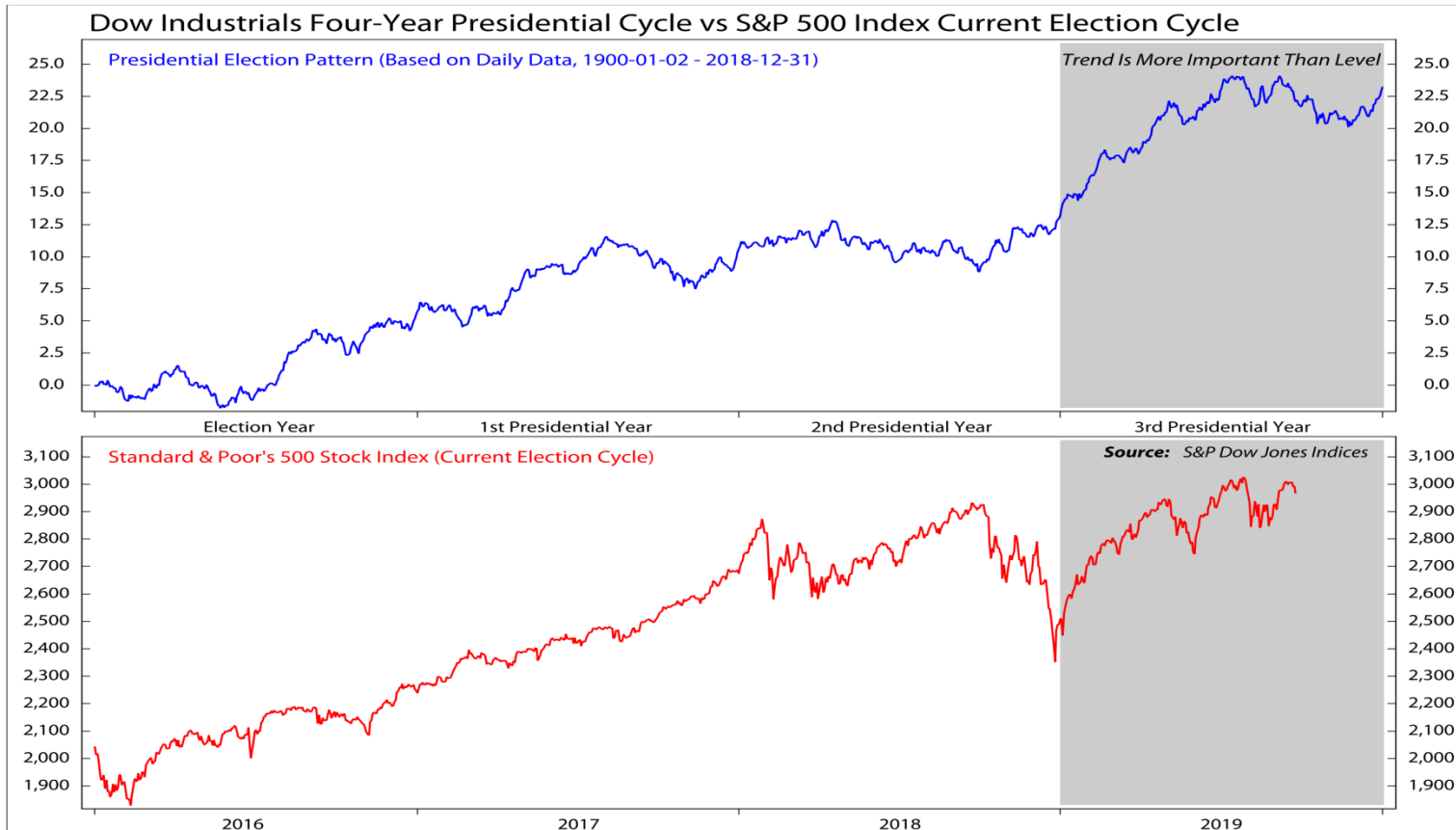
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Seasonal patterns improve as we move into the fourth quarter, with November and December historically being particularly strong months.



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With political noise crescendoing, we may be facing a full year of election-related volatility.

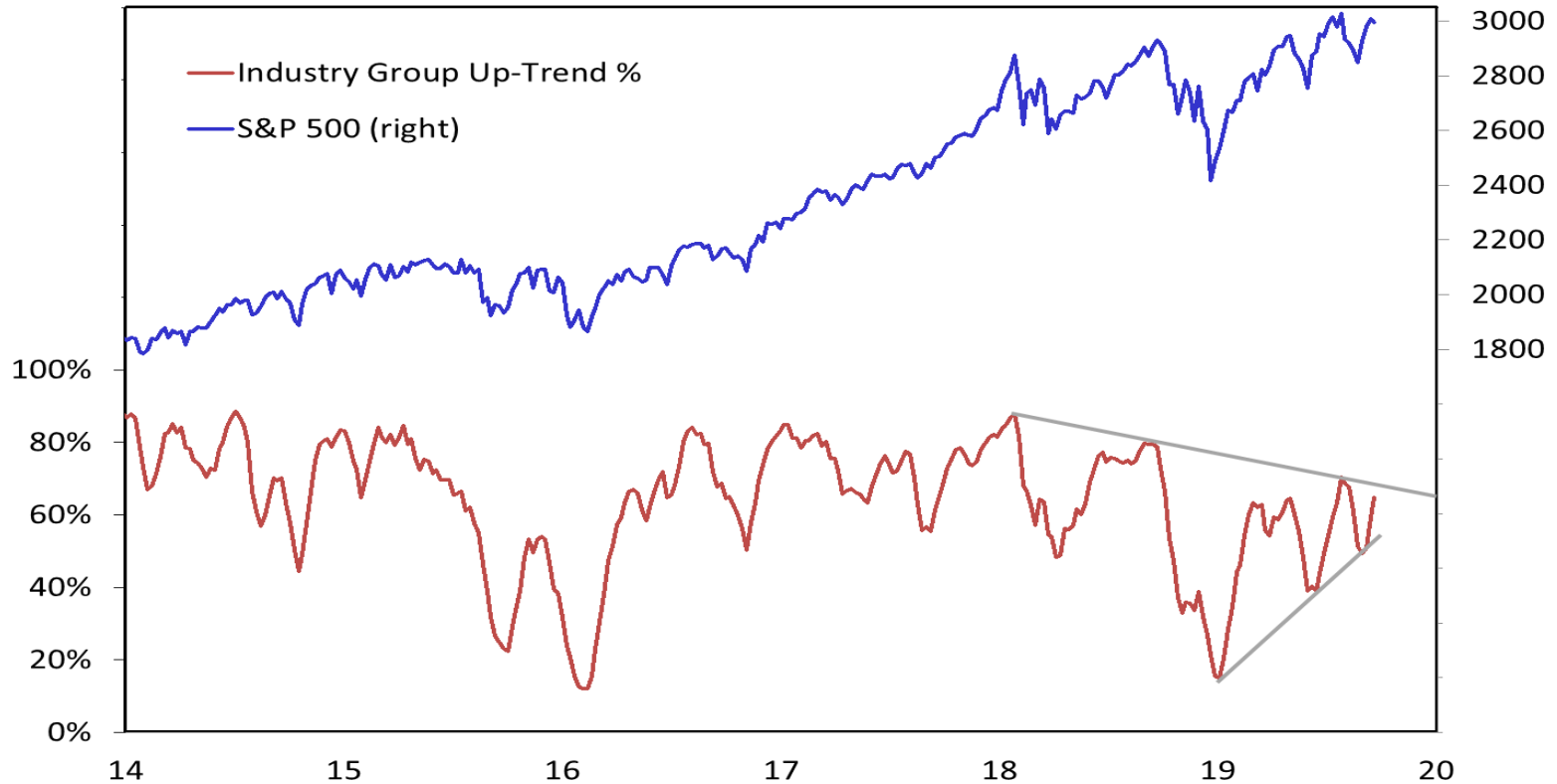


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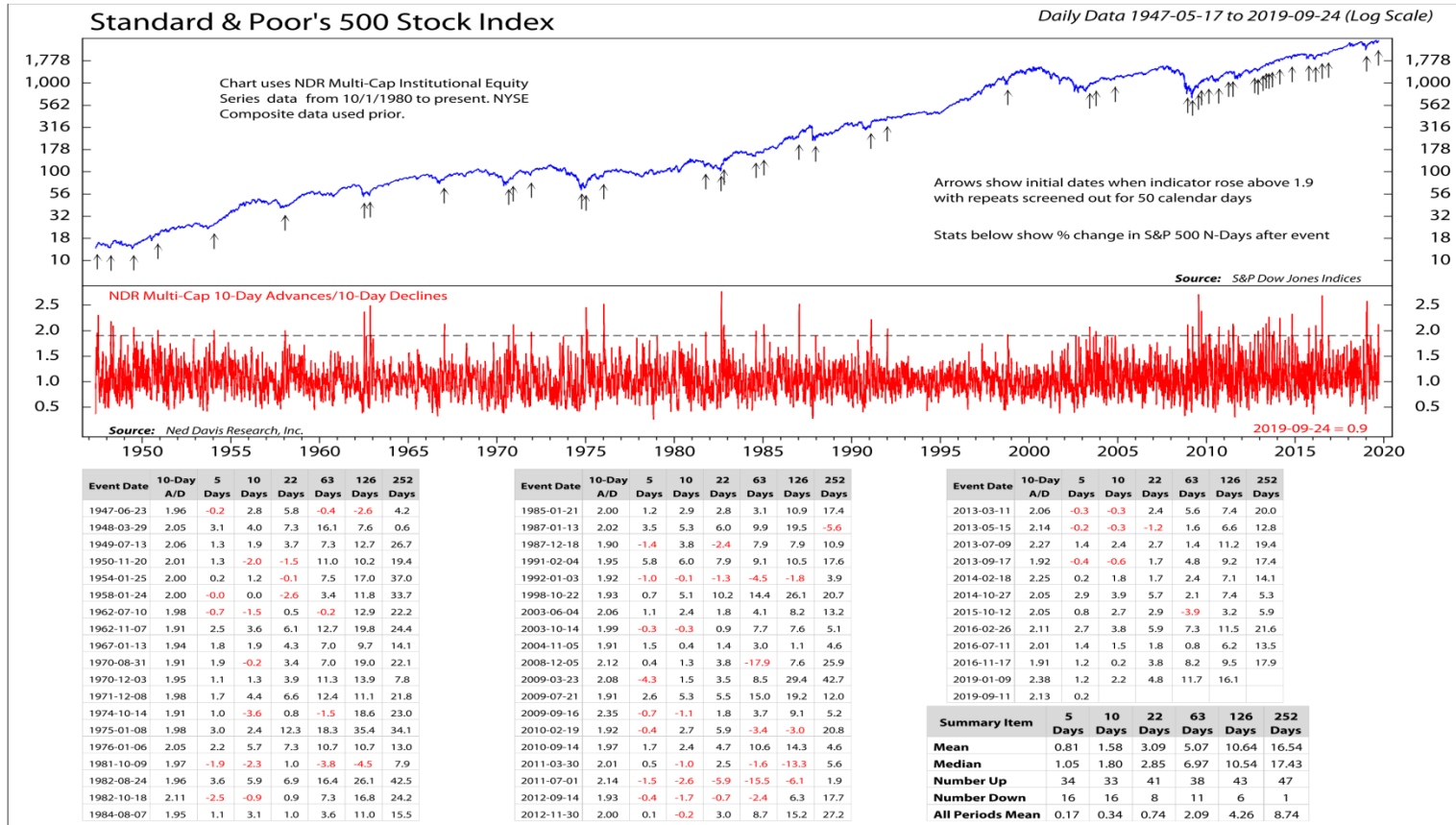
Overall stock market breadth has improved this year, though the pattern that emerged over the course of 2018 has not yet been broken.

S&P 500 and Industry Group Breadth

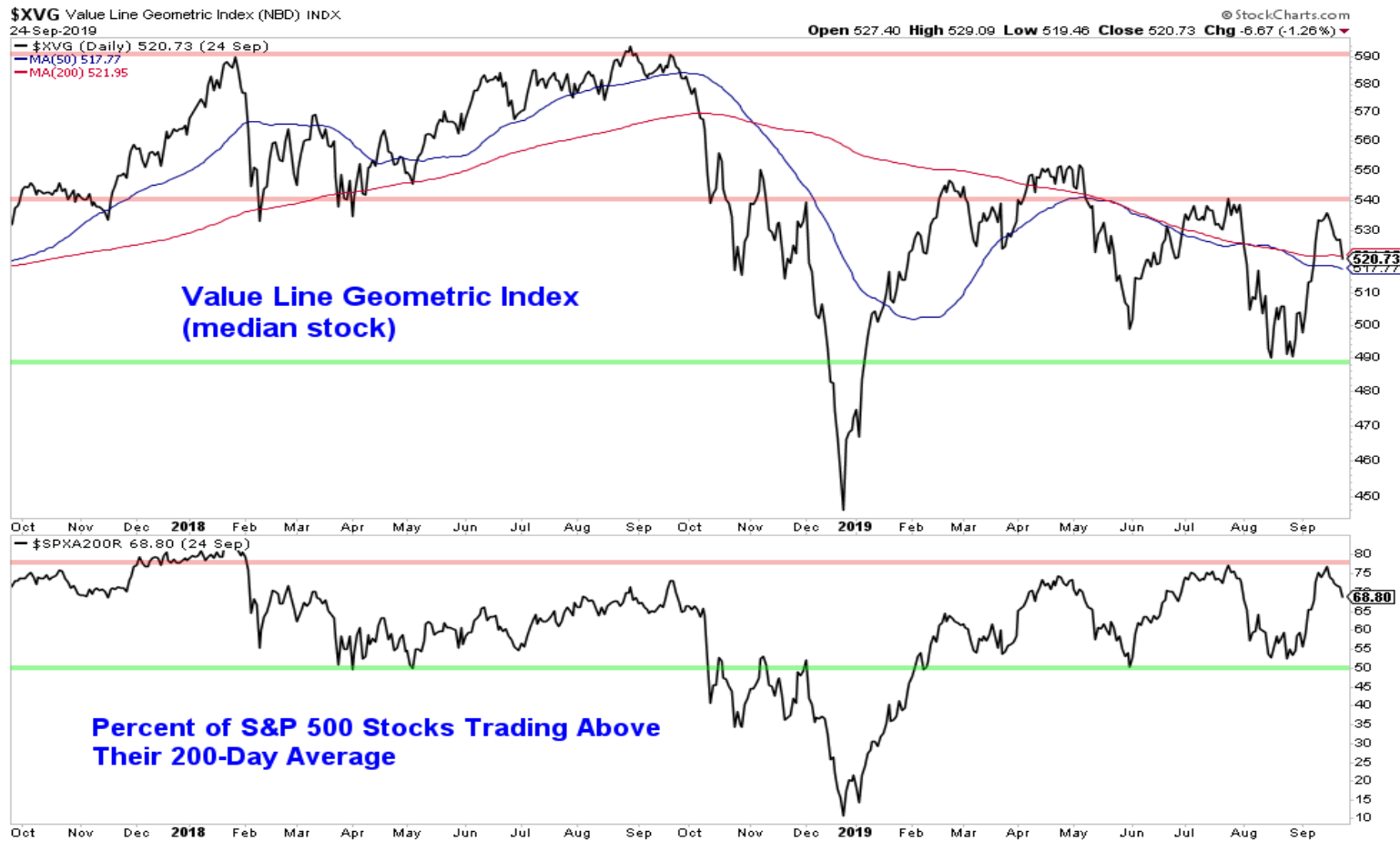


Source: FactSet, RWB Calculations

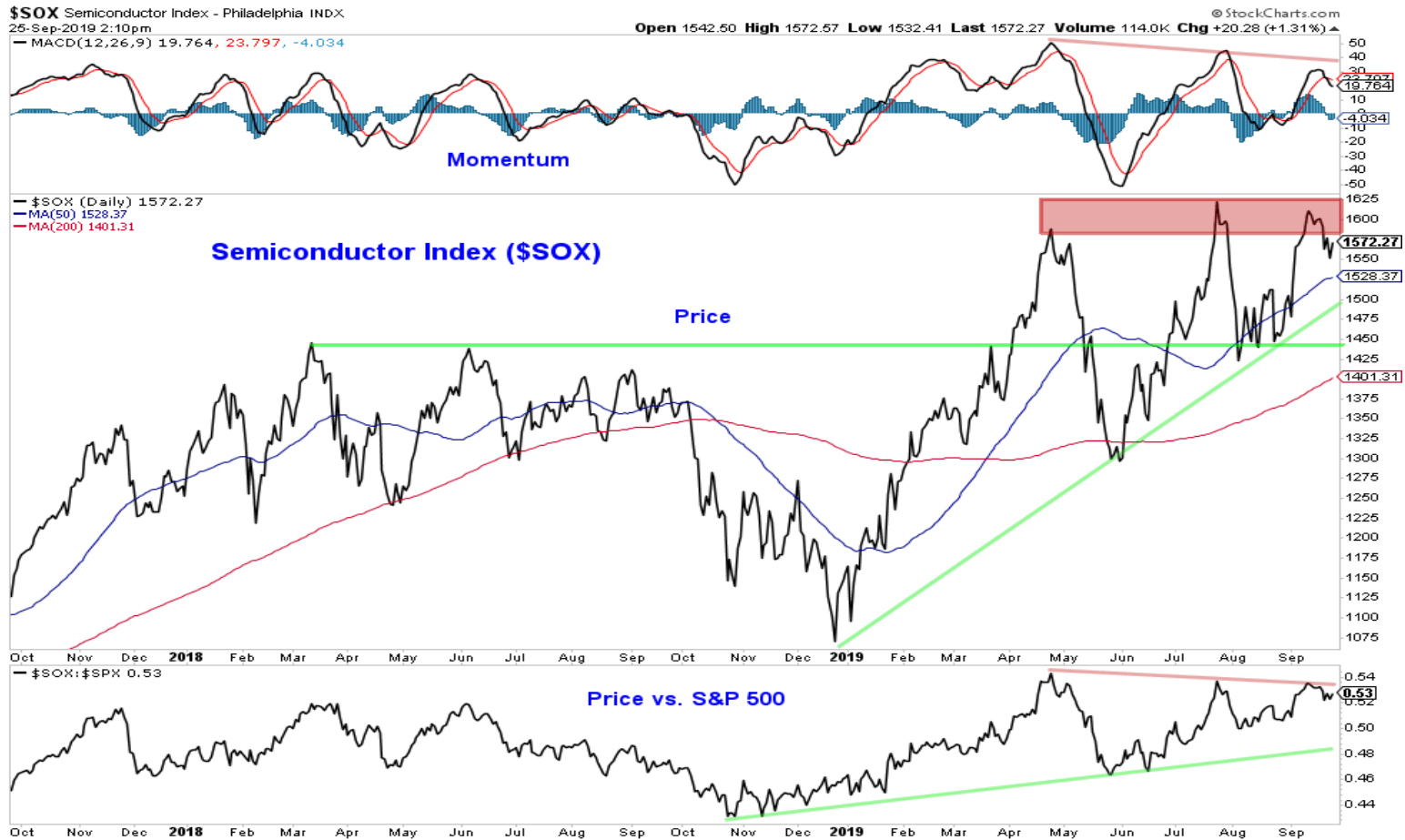
The September breadth thrust may be a signal that after two years of with little overall gain stocks could be on the cusp of a new cyclical up-trend.



If a sustainable cyclical up-trend is emerging, it will likely be signaled by an improved trend for the median stock and overall broad participation.



The semiconductor index led the move off of the late-2018 lows, but is now facing deteriorating momentum and is losing ground versus the S&P 500.



Lack of leadership from the Broker/Dealer index has weighed on the S&P 500 since early 2018. A change in that pattern would be a bullish development.



After five years of consolidation, Gold has broken out to the upside.



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