MarketUpdate

Global markets post solid results in July

Financial markets around the globe rose in July. In the U.S., the S&P 500 Index gained 2.06 percent, the Dow Jones Industrial Average rose 2.68 percent, and the Nasdaq Composite surged 3.42 percent. On a technical basis, all three indices remained well above their 200-day moving averages.

Fundamentals improved substantially in July. According to FactSet, of the S&P 500 companies that have reported earnings through July 28, nearly three-quarters have seen higher-than-expected results. This has brought estimated second-quarter earnings growth to 9.1 percent—with more results still to come.

On the international front, the MSCI EAFE Index rose 2.88 percent for the month, and the MSCI Emerging Markets Index posted a 6.04-percent gain. Both indices benefited from strong economic performance at the country level, as well as from continued central bank stimulus. On a technical basis, both indices remained above their 200-day moving averages for the period.

Turning to fixed income, July was solid. The Bloomberg Barclays Aggregate Bond Index gained 0.43 percent, as rates on the long end of the curve declined slightly with the Federal Reserve's decision to keep short-term rates unchanged. High-yield fixed income continued to benefit from spread compression and strong energy sector results. The Bloomberg Barclays U.S. Corporate High Yield Index rose 1.11 percent.

Economic growth heats up

The major theme for July was continued global growth. The first estimate of second-quarter U.S. gross domestic product growth rose to 2.6 percent annualized, up from 1.4 percent in the first quarter.

We also saw positive results from the eurozone, the U.K., and China. Capital Economics, an independent macroeconomic research firm, estimated that global growth rose from 3.2 percent in the first quarter to 3.7 percent in the second. We have not seen this kind of synchronized growth since the financial crisis, so it is a very positive sign.

Business sector gains strength

Strong business sentiment remains a positive factor for continued economic growth this year. The ISM Manufacturing and Nonmanufacturing indices increased more than expected for the month. The former hit a 34-month high, and the latter is nearing two-year record levels.

Durable goods orders, which are often used as a proxy for business investment, also did well. The headline number for June was up 6.5 percent on increased aircraft purchases. The core figure, which excludes volatile aircraft orders, improved by 0.2 percent.

Consumer data mixed but still mainly positive

Both major consumer sentiment measures—the Conference Board's and the University of Michigan's—beat expectations during the month. In fact, the Conference Board measure reached its second-highest level in 16 years.

Confidence has been driven largely by low gas prices, rising housing prices, and a healthy job market. The July employment report was positive, with 209,000 jobs created. In addition, the June jobs report was revised upward from 222,000 to 231,000. The underlying data was even more positive. Both the workweek and wage growth increased from May, and workers continued to return to the workforce.

Despite these results, we're still not seeing faster spending growth. Retail sales data for June dropped by 0.2 percent, against expectations for modest growth. This lack of improvement tells us this important sector of the economy bears monitoring.

Housing showing signs of potential slowdown

A surprising decline in the National Association of Home Builders industry confidence survey indicates that the housing sector may be in for a slight slowdown. The survey dropped to 64 in July, against expectations for a modest increase to 67. The index remains in expansionary territory, however.

Sales data was mixed. Existing home sales decreased slightly, while new home sales increased in line with expectations. The decline in existing home sales was due in large part to low supply. We're also seeing a decline in affordability, as price increases are outpacing wage gains, which is worrisome.

Political risks still the primary focus

Despite some areas of concern, the real economic and market risks at the moment are political. In particular, we will be watching to see whether Congress raises the debt ceiling before the government runs out of money, which is currently estimated to occur at the end of September. Failure to pass an increase has the potential to seriously disrupt markets.

Internationally, North Korean missile tests are the major concern, though at this point, they remain an outlier. Other international risks have largely receded for the time being.

Sunny skies, but watch the clouds

With synchronized global growth and positive economic news, not to mention strong corporate financial performance, the markets may well continue to rise. But keep an eye on the risks, including high valuation levels and political uncertainty. As always, a well-diversified portfolio that is in line with your desired levels of risk and return remains the best path forward.

All information according to Bloomberg, unless stated otherwise.

Certain sections of this commentary contain forward-looking statements based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets. All indices are unmanaged and investors cannot invest directly into an index. The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The Nasdaq Composite Index measures the performance of all issues listed in the Nasdaq Stock Market, except for rights, warrants, units, and convertible debentures. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin. It excludes closed markets and those shares in otherwise free markets that are not purchasable by foreigners. The Bloomberg Barclays Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Bloomberg Barclays government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities. The Bloomberg Barclays U.S. Corporate High Yield Index covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below.

Co-authored by Brad McMillan, senior vice president, chief investment officer, and Sam Millette, fixed income analyst, at Commonwealth Financial Network.