MarketUpdate

A mixed September but strong quarter for U.S. stocks

The Dow Jones Industrial Average (DJIA) led the way in September with a return of 1.97 percent, and the S&P 500 followed with a 0.57-percent return. But the Nasdaq Composite finished the month down 0.70 percent. Still, the Nasdaq ended the quarter in line with its peers; it returned 7.41 percent for the quarter compared with 7.71 percent for the S&P 500 and 9.63 percent for the DJIA.

This performance was supported by strong fundamentals. Per FactSet, as of quarter-end, the estimated third-quarter earnings growth rate for the S&P 500 was 19.3 percent. All three indices were strong from a technical standpoint as well, staying above their 200-day moving averages for the month and the quarter.

International markets were more mixed. The MSCI EAFE Index of developed markets gained 0.87 percent in September and 1.35 percent for the quarter. But the MSCI Emerging Markets Index lost 0.50 percent for the month and 0.95 percent for the quarter. Both indices remained below their 200-day moving averages.

Fixed income had a challenging month. The Bloomberg Barclays Aggregate Bond Index declined by 0.64 percent for the month and eked out a gain of just 0.02 percent for the quarter. These lackluster results were driven by rising rates, which were driven up by signs of inflation and a Federal Reserve rate hike. High-yield bonds had a stronger month and quarter, returning 0.56 percent and 2.40 percent, respectively.

Economic expansion inspires confidence

High confidence levels were matched by strong spending growth for businesses and consumers. The Conference Board Consumer Confidence Index reached an 18-year high in September.

After declining in July, the Institute for Supply Management (ISM) Manufacturing and ISM Nonmanufacturing indices bounced back in August. The rise in the ISM Manufacturing index—to a 14-year high—showed that manufacturers remain confident in the ongoing economic expansion despite headwinds (e.g., a strong dollar and trade concerns).

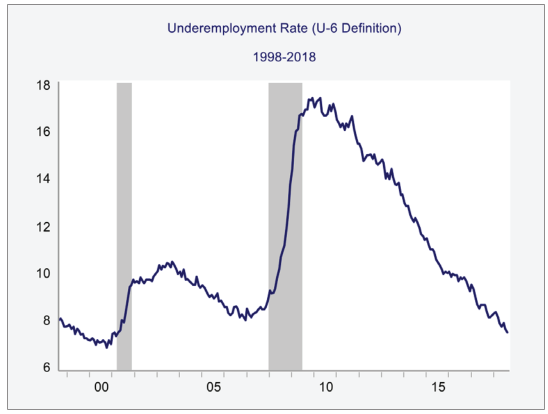
Rising confidence leads to higher spending

Stronger-than-anticipated wage growth in August took the annual rate to a nine-year high. This increase, combined with the 201,000 new jobs added in August, pushed consumer spending power and kept the labor market strong. The unemployment rate remained at 3.9 percent; the underemployment rate fell to a 17-year low (see Figure 1).

Retail sales grew in August. Personal consumption for the third quarter appears to be close to matching the 3.8-percent pace of the second quarter. This could lead to another quarter of gross domestic product growth of more than 3 percent.

Durable goods orders for August rose by 4.5 percent. This growth was driven in part by a rise in aircraft orders and is encouraging given a decline of 1.7 percent in July. Core orders growth was smaller but steadier, suggesting that even outside of transportation business, investment continues to improve.

Figure 1. U-6 Unemployment, 1998–2018



Source: Haver Analytics

We seem to be in a virtuous cycle. Higher confidence causes higher spending, which leads to faster growth and even higher confidence. This scenario is typical of a mature economic cycle.

Risks are real but not pressing

The most visible concern, economically, is the trade confrontation between the U.S. and China. Although there has been economic damage abroad, the U.S. economy and markets appear to be taking the risk in stride. The recent agreement on a revised trade deal with Mexico and Canada should help blunt the negative effects of the ongoing U.S.-China confrontation.

Another major risk factor is the November midterm elections. There may be some short-term volatility around this time but nothing that could derail the strength of the economy. There are two possible outcomes. In one, the Republicans retain control, likely to be considered positive for the economy. In the other, we have a divided government—which has also historically been considered a positive. Although politics are worth paying attention to, their direct impact on the markets should be muted.

Economic risks appear to be well contained. Although there is a housing slowdown, it may be moderating, as lower timber prices contributed to better-than-expected home builder confidence and housing starts. These results were a healthy development, as low supply in new homes has played a part in disappointing sales. Other economic indicators remain positive.

Solid start for Q4, potential headwinds ahead

Risks remain, but the economic fundamentals are strong. Confidence continues to be high and seems resilient in the face of political uncertainty.

We may see market volatility before year-end. Although consumers and businesses have been confident in the face of potential headwinds, they may not remain so. We must stay aware of risk and remember that a well-diversified portfolio that aligns financial goals and time lines remains the best option for pursuing your objectives.

All information according to Bloomberg, unless stated otherwise.

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Co-authored by Brad McMillan, CFA®, CAIA, MAI, managing principal, chief investment officer, and Sam Millette, fixed income analyst, at Commonwealth Financial Network.