Market Summary – August 7, 2017

For the week ending August 4

This summary is provided by BMT Wealth Management.

Macro Insights

The key economic reports released last week were both above and below consensus expectations, yet the market reaction was somewhat muted, as volatility continues to remain low.

On the positive side, the U.S. Bureau of Labor Statistics released its July employment report. The data exceeded consensus estimates and indicated that job creation is showing no signs of abating. Despite the U.S. economy being arguably at, or close to, full employment, 209,000 more jobs were added in July compared to June. The increase in new positions was widespread across various sectors and industries.

In addition, the unemployment rate fell from 4.4% to 4.3%, and wages rose 0.3% month-over-month and 2.5% year-over-year.

We have written in recent months about some of the robust economic activity survey reports, or "soft data." However, this past week's survey measures, such as ISM Non-Manufacturing, ISM Manufacturing, and Chicago PMI, trended lower than the previous month, and collectively fell below consensus expectations by a wide margin.

The most concerning data pertained to ISM Non-Manufacturing, given that this survey reflects the strength of the services component of the economy. While the readings disappointed to the downside, they still signified that the U.S. economy is clearly in an expansion.

Equity Markets

U.S. stocks as measured by the S&P 500 Index managed to eke out a small gain for the week last week, rising approximately 20 basis points (0.20%).

Emerging market equities as measured by the MSCI Emerging Markets Index managed to grind higher, appreciating nearly 50 basis points (0.50%). Notable global equity market outliers to the downside were U.S. small caps and international developed equities.

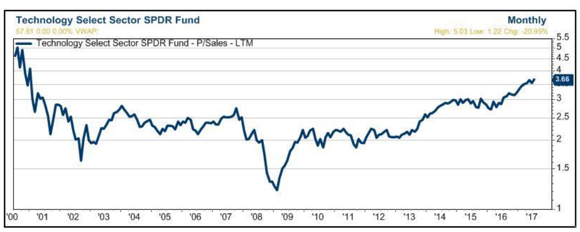
U.S. small cap equities gained significantly in 2016, but have underperformed other pockets of the global stock market by a wide margin thus far this year. In our opinion, small cap equities would arguably be the biggest beneficiary of tax reform, and they are often viewed as a leading economic indicator.

We are not too concerned about the performance of small caps at this point, given that they are still up for the year. However, a continued trend of small cap underperformance could cast doubt about the implementation of President Trump's economic agenda, which could be problematic for risk assets, given current valuation levels.

Information Technology, Financials, and Utilities registered gains for the week last week. Every other sector finished in the red, with Energy stocks being the outlier to the downside.

Technology stocks have been a market leader since the Great Recession of 2008-09. However, valuations have started to drift to levels we have not seen since the unwinding of the tech bubble in the early 2000s (see the chart below). While the Technology sector may continue to perform well on a short-term basis, we believe investors should be mindful of valuations before deploying additional capital to certain segments of the sector.

Technology Sector ETF (XLK):
Trailing 12-Month Price/Sales Ratio
17 Years Ending 7/31/2017



Source: FactSet, Inc.

Fixed Income

The 10-year U.S. Treasury yield, which has continued to trend downward since March of this year, closed out last week two basis points (0.02%) lower. Rates got a modest bounce across the yield curve on Friday (Aug. 4), after the strong employment report was released.

Credit spreads widened slightly within the investment-grade and high-yield markets. However, spreads are still tight relative to historic standards, as investors continue to prefer corporate credit.

Our View

Our views on the financial markets, both equities and fixed income, have not changed since our most recent correspondence. We continue to believe that interest rates will gradually drift higher, and the current environment of slow but steady growth should be supportive of equity valuations. However, continued weakening of the economic data could cause us to rethink our current views.

We do observe that being overweight in international equities seems to be the consensus view right now. Note that much of the year-to-date outperformance is currency-driven. The U.S. dollar is off nearly 10% year to date, relative to the basket of global currencies.

The strong outperformance of international stocks might be a little overdone on a near-term basis, but a combination of attractive relative valuations, an acceleration in corporate profits off depressed levels, and a pick-up in institutional flows to international equities could continue to provide opportunities for investors looking to diversify abroad.

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