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A Look Back at Q3 and Forward to Q4 of 2019

Dear Investor,

Third quarter was a bit bumpy but ended with a fairly good month of September. In September, stock markets were up pretty much across the board, for both U.S. and international markets. A strong September took U.S. markets back into the black. International markets, which got hit harder, stayed in the red. Let's take a closer look.

A Look Back

Positive performance a surprise. This good performance was a bit surprising. The risks didn't subside at all and, in many cases, were actually higher at quarter-end. Notably, the drone attack on Saudi Arabian oil facilities, which reportedly took out almost half of Saudi production capacity, had minimal effect on financial markets. Even the oil price itself spiked only briefly, ending September below the price where it started the month.

Political risks continued. The trade war didn't improve. Despite hopes that the U.S. and China would come to a deal, and while negotiations continued, there was no real progress. Ditto for Brexit. Despite ongoing talks, the European Union and United Kingdom ended the month with no real prospect of a deal. Here in the U.S., domestic political risks spiked with the announcement at month-end that Congress was beginning impeachment proceedings against President Trump.

Gloomy earnings expectations. On top of all that, expectations for company earnings kept getting worse. Although the actual results will likely be better than anticipated, earnings for the third quarter are supposed to be down more than 3 percent over last year. With earnings down and all of the other risks, it hardly makes sense for stock prices to be up—but they were.

Fundamentals remain solid. So, what kept the U.S. markets in the black? The fact that the economic fundamentals continued to come in better than expected. The biggest part of the economy, consumer spending, did surprisingly well. Retail spending was up for the sixth month in a row, and the growth rate was twice what was expected. Personal income growth was up as well, which should help keep the spending spree going. Plus, wage growth accelerated over the past three months, and it is now at the highest level of the past 11 years.

Housing also continued its comeback, with home builder confidence up to an 11-month high. Sales of homes, both new and existing, were up on a year-on-year basis for the second straight month after almost two years of declines. Housing is a key economic driver, reflective of both confidence and future spending, and this improvement is a significant positive sign. Overall, between housing and spending, the consumer is doing well. The consumer is what drives the economy and, for the last month at least, the stock markets.

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A Look Ahead

Political risks on the rise. Looking forward into October, however, the news is not as good. Political risks spiked at the end of September, with the start of impeachment proceedings in the House of Representatives, and will continue to grow. Internationally, Brexit is due to come to a head by month-end, which should continue to shake developed markets. And the trade war looks likely to acquire a new front as there are now pending sanctions against Europe. Politically, risks are likely to continue to rise.

Weakening economic data. The economic news may also provide less support in October. Consumer confidence dropped materially at the end of September. Business confidence, as reported in the ISM surveys, also declined, with the manufacturing number down to the lowest level in years.

US jobless rate hits 50 – year low. Last Friday, the Labor Department reported the jobless rate dropped to 3.5%, down from the 3.7% rate reported in August. This was a sign of relief after the other weaker economic data reported earlier in the week. The falling unemployment rate has, at least temporarily, eased the fears of a pending recession.

Volatility ahead. Although September was a positive month, despite some scary headlines, the rest of the year could show much more volatility. The continued and rising political risks, combined with weakening economic data, are likely to put markets under stress. At the same time, as long as the fundamentals remain solid, they should act as support for markets. There is the real possibility that better-than-expected earnings reports could provide further support.
In other words, October is likely to be a bumpy ride. This is no surprise, as October has often been turbulent. But the good news is that despite weakening, the fundamentals still remain supportive. Any damage that we get (and we may) should be limited as long as the economy continues to grow.

If you have questions, let's talk. That's what we're here for.

Sincerely,

Mike

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President/Owner

Parts of this commentary are authored by Mike Ovshak, President and Owner at FPS Financial, Inc., and by Brad McMillan, CFA®, CAIA, MAI, managing principal, chief investment officer, at Commonwealth Financial Network®.