VAUGHN ASSET ADVISORY, LLC
Financial Insight + Customized Strategies + Communication
1910 Pacific Avenue Suite 18650 Dallas, TX 75201
phone: 888-691-8875 fax: 972-674-1301

May 19, 2020

Vaughn Asset Advisory Weekly Market Commentary & Update

Equities Slip on Sour Sentiment Last Week…

Equities ended the week lower last week. Emerging markets outperformed (MXEF -1.1%) due to stability in Asia, while international developed markets lagged on noticeable weakness in Europe (MXEA –3.2%). Domestic markets landed in-between the two (SPX -2.2%). But in a sign of this rebound's strength, it was the worst 1-week performance for the S&P 500 since the 3rd week of March [Figure 1].

Under the hood domestically, the recent trends of growth and large-cap leading held again last week. While this continues to be a narrow, defensive-led market, news of the Department of Justice's antitrust suit against Google may cause investors to question tech's dominance.

Caution on recovery sours sentiment

Concern from well-known investors around the valuation of equities and Chairman Jerome Powell's caution on the pace of the economic rebound coming out of lockdowns soured sentiment. The former have been bearish for years, however, and Powell's sentiments would tend to keep the Fed dovish for even longer. Bottom line? We're not reading too much into this — and the market seems to view it similarly, given the rally in equities we saw at the end of last week. And by midday Monday, the S&P 500 had climbed to new highs from the market's bottom on news of promising early results for an experimental vaccine.

Bond yields fall

On the back of weak equity sentiment, and taking a pause from their recent steepening trend, government bond yields fell last week. The 10-year and 30-year fell 4 and 6 basis points (bps), respectively, while the 2-year continues to trade in the middle of the Fed's 0-25 bps Fed Funds target.

Credit spreads widen

Focusing more on the negative sentiment backdrop than the start of Fed purchases of corporate bonds on Tuesday, both investment-grade (IG) and high-yield (HY) credit spreads widened by 5 and 52 bps, respectively, last week. With the Fed now directly involved, credit price action bears close watching moving forward. Since the announcement of the Fed program, spreads overall have tightened considerably and we remain disinclined to chase weaker segments of the credit market.

Powell's speech on Wednesday addressed negative rates, saying that they're not under consideration at this time. While his was strong language coming from a central banker, skeptics remain and the 1-year Fed Funds future contract still has a (very tiny) negative yield.

Fed addresses negative rates

Powell's speech on Wednesday addressed negative rates, saying that they're not under consideration at this time. While his was strong language coming from a central banker, skeptics remain and the 1-year Fed Funds future contract still has a (very tiny) negative yield.

U.S. dollar moves higher

The U.S. dollar (USD) rose across the board last week, and given the uncertain economic backdrop and need for dollar funding across the globe, we think this trend is likely to continue.

Oil up as inventories fall

The front month price of crude oil was up 19% last week, closing just shy of $30 per barrel. The June contract, which hit a low of $6.50 a month ago, settles on Tuesday and it's clear we won't get a repeat of the remarkable negative price action we saw in April. Inventories are finally falling and rigs have been shuttered. The 1-year West Texas Intermediate (WTI) future, a better indicator of the overall health of the oil market, remains in the low 30s.

What to watch in the future

Coronavirus newscycle – It's hard to pin down a clear picture on the global fight against coronavirus, but last week seemed more negative than positive. While former hot spots in the U.S. are clearly improved, some places opening up are seeing increased cases and overall cases have plateaued, not plummeted. Parts of Asia are back on lockdown as well. That said, stocks surged at the opening on Monday following news of potential progress on a vaccine.

Powell says Fed may do more – Powell will be in front of the Senate Banking committee on Tuesday. This following a television interview on Sunday, during which he said there's more that the Fed can do to support the economy if needed, despite the incredible amount of support already put forth. Powell also said that while he doesn't foresee a Depression, he expects GDP could fall by more than 30%.

U.S.-China rhetoric runs hotter – The relationship between the U.S. and China is another spot to read tea leaves, and the market is waking up to the idea that things are getting worse. With little to go on besides rhetoric, however, the influence of the conflict on price action is likely to ebb and flow.

China rate decision Friday – China's National People's Congress meeting is on Friday. Will they announce a growth target? Fiscal stimulus is likely to be 8-10% of GDP.

Retail sales and PMIs – Domestic economic numbers are starting to show just how bad things were in April. In a higher-than-expected drop of 16.4%, U.S. retail sales sank to their lowest point in decades [Figure 2]. In China, retail sales for April were also worse than expected despite the reopening, flagging a risk to the optimistic rebound here in the U.S.

That's why it will be important to keep an eye on the Flash PMIs for May later this week — U.S. and Japan on Thursday and Europe on Friday. Expectations are for a slight uptick from last month for both U.S. Manufacturing and Services PMIs. The Eurozone composite is also expected to be up.

Jobless claims – Weekly jobless claims are likely to fall again this week. Continuing claims may be a more relevant measure to look at now in light of the Small Business Association's PPP support and various economic restarts happening throughout the country.

All market data and economic data has been provided by Horizon Investments & Bloomberg