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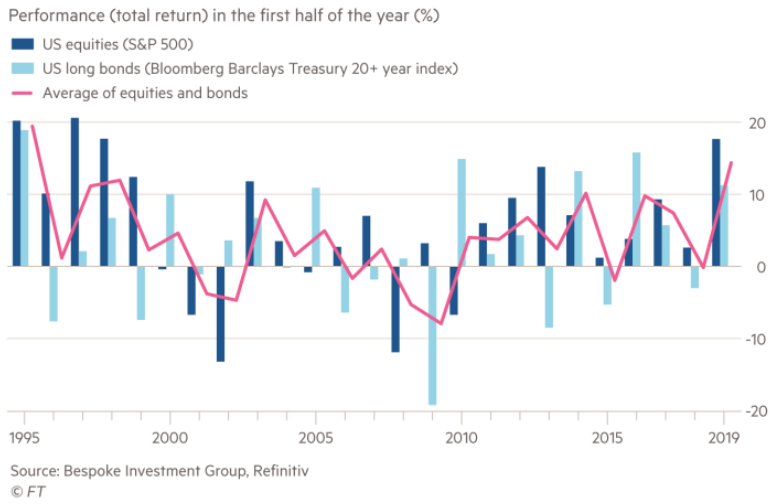
The Weekly Note

A Weekly **Market Commentary**

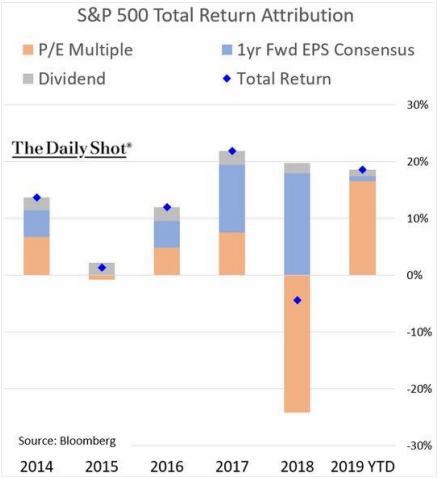
Monday, July 1st, 2019

"Best first half for stocks and bonds since 1995"

Stocks rallied 6.9% in June helping the S&P 500 post its best first half return in 22 years. Bond investors also joined the first half party as declining interest rates led to strong gains in bonds across the quality spectrum. It was a rare combination of healthy returns for both cautious and aggressive investors, all supported by a dovish Fed and a goldilocks economy.



Last year's combination of strong earnings but substantial valuation compression led to losses in stocks. This year we have seen a significant retracement of valuations despite flat earnings. The most important factor has been the shift in sentiment and the valuations investors are willing to pay for stocks given lower interest rates, a supportive Fed, and above-average economic growth in the U.S. compared to the rest of the world.



After declining 14% in the fourth quarter, the S&P 500 was able to rally back to new highs (on a total return basis) by April. Markets then took a breather in May as trade sentiment appeared to deteriorate before recovering in June when the Fed gave indications of potential rate cuts if the economy continued to weaken.

Despite the improved investor sentiment and progressive trade talks, the Federal Reserve is still widely expected to cut interest rates at the July meeting and potentially one or two more times for the duration of 2019. As we have learned in recent years, these expectations can shift from month-to-month, but that appears to be the consensus at this point as implied by the Fed futures market.

Last week we saw another mixed bag of economic data. The Chicago Purchasing Managers Index (PMI) fell below 50 (contraction territory) for the first time since January 2017. Durable goods orders declined by 1.3% in May, but that was primarily due to a 28% decline in commercial aircraft as sentiment towards Boeing wanes in the midst of their recent issues. Stripping out cars and planes, core orders actually rose 0.3% to break a string of three monthly declines in a row[1]. This week we will get the June monthly jobs report and it will interesting to see if last month's dud was just a one-off or the beginning of a softer trend for employment.

Stocks received another injection of positive sentiment this weekend from the G20 Summit meeting between Presidents Trump and Xi. The two sides agreed to restart trade talks and halt any escalation in tariffs while negotiations progress. With this positive development, the S&P 500 is now poised to hit fresh all-time highs as we kick off this holiday-shortened week.

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Sources:

1. *https://www.marketwatch.com/story/durable-goods-orders-drop-13-in-may-but-business-investment-picks-up-in-reassuring-sign-2019-06-26*