Clark Capital Management Group

# Benchmark Review & Monthly Recap

## Dovish Fed Spurs June Rally

### HIGHLIGHTS:

- The S&P 500 Index achieved a new all-time high and enjoyed a strong rally (the best performance for a June since 1955) to close out the second quarter of 2019.
- Global equity markets continued to advance as well, helped in part by expectations of potential rate cuts from the Fed, which cooled the recent strength of the U.S. dollar.
- On an intraday basis, the 10-year U.S. Treasury yield slipped below the 2% level during the month, but it ultimately closed June right at the 2.0% mark. This was the first time the yield had spent time below 2% since 2016.
- As measured by the difference between 10-year U.S. Treasury and 3-month T-Bill yields, the yield curve has been inverted 26 straight trading days through the end of June.
- The current economic expansion in the U.S. is now the longest on record, and we expect ongoing growth into 2020. Economic data released in June was mixed, and investors will monitor closely incoming data as this expansion moves longer in its duration.

### EQUITY MARKETS

Coming off a tough month in May, equities showed great resilience in June and rallied sharply to close out the quarter. Trade concerns with China dominated headlines in May, and while no final resolution was made on that front, the market's focus seemed to turn to the Fed in June. Markets have become more and more convinced that a rate cut cycle is rapidly approaching and under that context, interest rates fell and stocks rallied to close out the first half of 2019.

Although all major equity indices enjoyed a strong first six months of 2019, the theme of large-cap growth stocks outperforming everything else continued in the second quarter and year-to-date. However, large-cap value stocks enjoyed modestly better gains than large-cap growth in June. Other recent trends of large-cap stocks outperforming small-caps and U.S. stocks outperforming international equities continued to hold as well.

The value/growth relationship has stretched to historic extremes and should the current situation revert to more historical norms, value-oriented stocks should benefit. At Clark Capital, we employ value-oriented measures in our investment process and believe that over a full market cycle, these value characteristics will be rewarded.

The numbers for June were as follows: The S&P 500 advanced 7.05%, the Dow Jones Industrial Average (DJIA) rose by 7.31%, the NASDAQ Composite gained 7.51%, and the Russell 2000 Index, a measure of small-cap companies, was up 7.07%. These strong gains pushed Q2 returns into positive territory after sharp declines in May as these major equity indices advanced 4.30%, 3.21%, 3.87%, and 2.10%, respectively, for the quarter.

Large-cap value stocks, as measured by the Russell 1000 Value Index, gained 7.18% in June while large-cap growth stocks, as measured by the Russell 1000 Growth Index, advanced 6.87%. Although value outperformed in June, the quarter still saw growth outperform as those two indices gained 3.84% and 4.64%, respectively.

International equity results were also strong in June. The U.S. dollar weakened during the month due in part to expectations mounting of a likely rate cut by the Fed. We continue to believe that the headwinds faced by international equities in 2018, driven in large part by U.S. dollar strength, will be less intense in 2019 as the Fed has clearly turned more dovish in 2019 compared to a more hawkish stance in 2018.

With this backdrop, emerging market equities, as measured by the MSCI Emerging Markets Index, gained 6.24% in June and the MSCI ACWI ex USA Index, a broad measure of international equities, gained 6.02% for the month. For the second quarter, those two indices advanced 0.61% and 2.98%, respectively. International stocks have enjoyed solid gains over the first half of 2019, but have not been able to match the tremendous results of U.S. equities so far this year.

## FIXED INCOME

The 10-year U.S. Treasury yield has dropped dramatically over the last few months and closed June at 2.0%—its lowest closing level since the fall of 2016. Mounting expectations of a Fed rate cut, persistent low inflation and negative global interest rates have contributed to this recent decline in yields.

The short-lived yield curve inversion at the end of March (comparing 10-year U.S. Treasury and 3-month T-bill yields) resurfaced in late May and the yield curve stayed inverted for all of June. The length of time the yield curve stays inverted has mattered historically, and we continue to monitor this data closely.

We acknowledge that an inverted yield curve has been a historically negative signal for the direction of the U.S. economy; however, at the same time, other economic data that tends to be on the front end of the economy, like the Leading Economic Indicator Index and job market data, are not showing the same cautionary signals.

In this environment, fixed income advanced across the board in June. The Bloomberg Barclays U.S. Aggregate Bond Index was up 1.26% for the month, the Bloomberg Barclays U.S. Credit Index gained 2.26%, the Bloomberg Barclays U.S. Corporate High Yield Index advanced by 2.28% and the Bloomberg Barclays U.S. 30-Year Treasury Index rose 1.37%.

For the second quarter, these indices gained 3.08%, 4.27%, 2.50% and 6.76%, respectively. Longer-dated U.S. Treasuries, among the most sensitive bonds to interest rate movements, have clearly benefitted from the significant drop in yields in 2019. TIPS and muni bonds gained in June and are positive for the quarter and year-to-date as well.

## ECONOMIC DATA AND OUTLOOK

As the length of this economic expansion moves into record territory, economic data is becoming more and more scrutinized. Information released in June, which largely covered the month of May, continued to show signs of economic growth, but with some moderation.

The widely followed Institute for Supply Management (ISM) manufacturing index for May was below expectations and dropped to its lowest level at 52.1 since October 2016. Among other factors, uncertainty in the global trade situation is likely impacting manufacturers.

However, the ISM non-manufacturing index, which represents the much larger service industries in the U.S. economy, increased to 56.9, which was ahead of expectations of 55.4 and the prior month's mark of 55.5. Recall that ISM readings above 50 indicate expansion, and both readings remain in growth territory. Most housing data was better than expected in May, likely helped in part by interest rates, and subsequently mortgage rates, dropping in recent months.

Consumer confidence slipped lower despite retail sales (ex. auto and gas station sales) showing a stronger-than-expected increase in May. The Conference Board's Leading Economic Indicators Index (the Leading Index) was flat for the month when a modest gain was anticipated.

Job market data continued its rather volatile ride in 2019 when May payroll numbers were released. Non-farm payroll additions were 100,000 below expectations when only 75,000 new workers were added to payrolls. The prior month was revised lower as well, but remained at a very robust 224,000 job gains in April.

The unemployment rate stayed at its generational low of 3.6% as expected. Average hourly earnings were just below expectations at a 3.1% year-over-year gain in May when estimates were calling for a 3.2% annual increase. The final reading of first quarter GDP was unchanged from the prior reading of 3.1% although expectations were calling for a modest increase to 3.2% annualized growth.

The dovish tone from the Fed continues to reverberate in 2019. After the FOMC meeting in June when the Fed left rates unchanged but continued its dovish stance, market expectations were at a 100% probability of a rate cut at the next FOMC meeting in July. Furthermore, the market expects almost 100 basis points of cuts over the next 12 months.

We think it is likely the Fed will cut rates in July, but trade developments (or lack thereof) with China will be an important factor. We also believe that the expectations of 100 basis points of cuts over the next year are too aggressive considering GDP is at 3.1%, the unemployment rate is at 3.6% and equity markets are near all-time highs. These market expectations could be a source of disappointment if the market and the Fed are out of step on the timing and amount of rate cuts.

We believe there will be continued economic growth through 2019 and into 2020 and anticipate further market gains over the balance of the year. However, due to uncertainty in upcoming Fed policy decisions, unknowns on the trade front, and some slowing U.S. economic activity, we also believe that the range of outcomes for the market is wider than usual, and volatility might come more to the forefront for the final six months of 2019.

| Event | Period | Estimate | Actual | Prior | Revised |
|---|---|---|---|---|---|
| ISM Manufacturing | May | 53.0 | 52.1 | 52.8 | — |
| ISM Non-Manf. Composite | May | 55.4 | 56.9 | 55.5 | — |
| Change in Nonfarm Payrolls | May | 175k | 75k | 263k | 224k |
| Unemployment Rate | May | 3.6% | 3.6% | 3.6% | — |
| Average Hourly Earnings YoY | May | 3.2% | 3.1% | 3.2% | — |
| JOLTS Job Openings | Apr | 7496k | 7449k | 7488k | 7474k |
| PPI Final Demand MoM | May | 0.1% | 0.1% | 0.2% | — |
| PPI Final Demand YoY | May | 2.0% | 1.8% | 2.2% | — |
| PPI Ex Food and Energy MoM | May | 0.2% | 0.2% | 0.1% | — |
| PPI Ex Food and Energy YoY | May | 2.3% | 2.3% | 2.4% | — |
| CPI MoM | May | 0.1% | 0.1% | 0.3% | — |
| CPI YoY | May | 1.9% | 1.8% | 2.0% | — |
| CPI Ex Food and Energy MoM | May | 0.2% | 0.1% | 0.1% | — |
| CPI Ex Food and Energy YoY | May | 2.1% | 2.0% | 2.1% | — |
| Retail Sales Ex Auto and Gas | May | 0.4% | 0.5% | -0.2% | 0.3% |
| Industrial Production MoM | May | 0.2% | 0.4% | -0.5% | -0.4% |
| Building Permits | May | 1292k | 1294k | 1296k | 1290k |
| Housing Starts | May | 1239k | 1269k | 1235k | 1281k |
| New Home Sales | May | 684k | 626k | 673k | 679k |
| Existing Home Sales | May | 5.30m | 5.34m | 5.19m | 5.21m |
| Leading Index | May | 0.1% | 0.0% | 0.2% | 0.1% |
| Durable Goods Orders | May P | -0.3% | -1.3% | -2.1% | -2.8% |
| GDP Annualized QoQ | 1Q T | 3.2% | 3.1% | 3.1% | — |
| U. of Mich. Sentiment | Jun P | 98.0 | 97.9 | 100.0 | — |
| Personal Income | May | 0.3% | 0.5% | 0.5% | — |
| Personal Spending | May | 0.5% | 0.4% | 0.3% | 0.6% |
| S&P CoreLogic CS 20-City YoY NSA | Apr | 2.50% | 2.54% | 2.68% | 2.61% |

Source: Bloomberg P=Preliminary T=Third