

Will this week's data confirm last week's optimism for stocks?

Weekly Market Compass: After a positive week for stocks, markets brace for news on the Fed's outlook, US-China trade negotiations, and the eurozone and Chinese economies.

Oct 28, 2019 | Kristina Hooper, Chief Global Market Strategist

Last week was a "risk on" week for the markets, with stocks rising. The MSCI All Country World Index rose during the course of the week, the S&P 500 Index came close to its all-time high, and the tech-heavy Nasdaq Composite Index surged a robust 1.9%.¹ US Treasury yields also rose as fear dissipated – the 10-year Treasury yield rose to 1.8% and the 30-year finished at 2.29%.¹ By the end of last week, there was a relatively comfortable 18-point spread between the 2-year and the 10-year Treasury yield.¹

Propelling this optimistic environment were some positive catalysts, including expectations that the Federal Reserve (Fed) will cut rates when it meets this week and positive news flow around US-China trade negotiations. These two factors were so powerful that they superseded some high-profile earnings disappointments – although in my view, earnings season in general has been relatively positive.

But while last week was a time of great expectations, this week is when the rubber meets the road. We will want to see continued signs that progress is being made toward Phase 1 of a trade deal. While all reports thus far are positive, suggesting the two sides are closing in on this first installation of a more comprehensive deal, I for one remain skeptical that even a Phase 1 deal will come to fruition quickly. I believe China will insist on tariff relief in order to agree to this phase of the deal, and that could be a big stumbling block for the US, which will want to use that bargaining chip for bigger concessions. I suspect that at some point soon – although maybe not this week – news flow will turn negative, which will likely place downward pressure on stocks.

Investors will also be focused on the Fed to see whether it decides to actually cut rates on Wednesday. Perhaps more important than the actual decision – since a rate cut seems to be a foregone conclusion – will be the press conference and Fed Chair Jay Powell's messaging about the future of Fed policy. In particular, we could see a less accommodative tone, which would undoubtedly rattle stocks.

I remain optimistic that Powell will be able to carefully craft his words and will convey the message that the Fed stands ready to continue accommodation if necessary. I believe that's all that investors need to hear to be satisfied, and so if Powell delivers, I expect stocks to have a neutral to slightly positive reaction to the actual decision and press conference. However, there is always the possibility of a communication error, and in such a case I would expect some short-term volatility.

We also have ongoing Brexit drama. In my view, news that the EU has granted an extension through January is a welcome reprieve that should provide a nice boost for UK equities in the very short term. But while this is good for the stock market, it only prolongs the uncertainty. And we have historically seen economic policy uncertainty weigh down on business investment, so I would expect that to continue. Despite this development, expect to see continued volatility for equities, gilts, and the pound as UK Prime Minister Boris Johnson attempts to hold elections in December, and other Brexit-related news flow, both positive and negative, pushes them up and down.

In addition, a lot of important economic data will be released this week. Following are just a few events we will want to follow closely:

- Purchasing Managers' Index (PMI) data will be released for China. We will want to follow this closely, as I expect it will provide signs that the Chinese economy is stabilizing in the face of stimulus.
- Key eurozone indicators around business and consumer confidence will give us insight into whether the eurozone economy could be stabilizing.

PMI data as well as business and consumer confidence gauges are all valuable leading indicators. In addition, the Bank of Japan and the Bank of Canada will also meet this week and will provide insights into the current state of their respective economies. I expect to hear both central banks express the view that the economic situation is improving in their respective countries.

Finally, we have an historic event occurring at the end of this week - after eight years at the helm of the European Central Bank (ECB), Mario Draghi will turn over the reins to Christine Lagarde. While I don't expect to see change immediately, I do believe Lagarde's tenure as head of the ECB will be a significant departure from that of Draghi - and she may be able to instill more confidence in markets than even he did in his tenure (and he was able to instill significant confidence). That is because I believe she will take the negative effects of negative rates seriously - something that Draghi was largely dismissive of, including in his last ECB press conference. I also believe she will be willing to explore more experimental monetary tools - perhaps even ones that can simulate fiscal stimulus - rather than just implore governments to increase fiscal stimulus.

I am optimistic that the ECB could be a model that other central banks such as the Bank of Japan could emulate rather than fall deeper into negative rates, or that the Fed could emulate rather than resort to negative rates (something that is becoming a growing worry in the US). In any event, I would expect to see a lift for European equities if Lagarde's messaging suggests she is open to being both accommodative and innovative.

All in all, I expect some hiccups in the next several weeks, as not all market expectations are likely to be met. However, I do believe the global stock market trajectory remains upwardly biased.

Source

¹Source: Bloomberg, L.P., as of Oct. 25, 2019

Important information

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The MSCI All Country World Index is an unmanaged index considered representative of large- and mid-cap stocks across developed and emerging markets.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

The NASDAQ Composite Index is the market capitalization-weighted index of approximately 3,000 common equities listed on the Nasdaq stock exchange.

The Purchasing Managers' Index (PMI) is a commonly cited indicator of the manufacturing sector's economic health.

Brexit refers to the scheduled exit of the UK from the European Union.

UK gilts are bonds issued by the British government.

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