MADISON PARK
CAPITAL ADVISORS

WEEKLY MARKET UPDATE

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More July Fireworks for the S&P 500

They keep pushing higher. What is "they" you might ask? You could easily answer: equity prices, stimulus measures, geopolitical disruptions, and investor sentiment – and you'd be correct on all fronts. All the while, you might notice one of those items doesn't necessarily fit with the others. Attempted coups, terror attacks, and British politics all hit the headlines last week – and already this week we have horrific assassinations of police and the Republican convention drawing our attention. Somehow in the face of all of these geopolitical headwinds, the markets kept pushing higher.

The S&P 500 hit all-time highs on every day last week before falling slightly on Friday to close with a 1.5% overall return. A plausible explanation for this move higher is the market's hopes for further global monetary and fiscal stimulus. To our east, somewhat surprisingly, the Bank of England did not cut rates but indicated that an easier policy is likely, perhaps as soon as next month. To our west, Japan's Prime Minister Abe called for a ¥10 trillion fiscal stimulus package to boost domestic demand.

This is the third consecutive week the S&P 500 has been positive. The index has rallied 8.2% since the drama from the Brexit vote, which initially sent it down -5.3% between Friday, June 24th and Monday, June 27th. Perhaps US markets are encouraged that Britain is facing Brexit head-on, as the country has a new Prime Minister, Theresa May, two months ahead of expectations. Ms. May quickly assembled a cabinet with the intention of moving forward with the UK's exit from the European Union.

The unofficial kick off to earnings season started Monday when Alcoa announced revenue and earnings ahead of analyst consensus estimates. Shares of the aluminum company rallied over 5% as a result. Keep in mind that, at current prices slightly under $11 per share, Alcoa trades a long way away from all-time highs above $48 per share in 2007, and $17.75 as recently as November 2014! The message is that not every sector is leading the charge as the index makes new highs. Additionally, with five straight quarters of falling earnings, markets are depending upon a strong second half of the year to justify current valuations, even in the current ultra-low interest rate environment.

There was some good news for the

beleaguered financial sector, as a number of banks announced positive earnings. JPMorgan Chase announced that profits and sales were ahead of estimates, as credit card write-offs and delinquencies came in better than expected. US Bancorp also reported earnings and revenue ahead of estimates as credit losses and their overall return on assets improved. Not all was positive, as Wells Fargo and Citigroup both saw the price of their stocks fall slightly with earnings announcements. Wells Fargo indicated a small but unexpected uptick in energy defaults and stated that the bank is deciding what to do with excess reserves. Citigroup saw a slight uptick in credit card delinquencies and reminded investors that Brexit is a headwind for the bank.

Earnings season continues in earnest this week as over 92 S&P 500 companies are expected to release their quarterly results. According to Zacks Investment Research, we now have Q2 results from 36 S&P 500 members that combined account for 10.1% of the index's total market capitalization. Total earnings for these 36 companies are down 3.9% from the same period last year on 0.1% lower revenues, with 66.7% beating EPS estimates and 41.7% coming ahead of top-line expectations.

Looking at Q2 as a whole, combining the actual results from 36 index members with estimates for the 464 companies yet to report, total S&P 500 earnings are expected to be down 5.4% on 0.5% lower revenues, with growth in negative territory for 9 of the 16 Zacks sectors. Although the Q2 growth pace has 'improved' as the banks have come out with better than expected results, if earnings do in fact fall this quarter, it would mark the 5th straight quarterly earnings drop for the widely followed index (I guess not everything is pushing higher!).

As has been the pattern in other recent periods, the energy sector remains the biggest drag on the aggregate growth picture, with total earnings for the sector expected to be down 77.1% on 5.7% lower revenues. Excluding the energy sector, earnings for the rest of the index would be down "only" 2.1% as opposed to the expected 5.4% drop cited above. While energy stands out for its very tough comparisons, there is not much positive growth coming from the other major sectors either. Finance and technology, the two biggest earnings contributors in the S&P 500 index, are also expected to see earnings decline in Q2 from reported levels a year ago.

Reflecting the global slow growth environment and ultra-low interest rates, the Walt Disney Company issued corporate debt with the lowest yields in US history last week. Mickey Mouse & friends sold 10-year debt at a 1.85% yield and 30-year debt with a 3% coupon. Expect others to follow.

Finally, and sadly, France was once again the scene of a horrific terror attack and the US saw yet another unspeakable massacre of police officers. Eighty-four people were killed and over 200 injured in Nice on Thursday as a gunman drove a truck into a crowd watching Bastille Day fireworks along the French Riviera. Three law enforcement officers in Baton Rouge were killed in an ambush by a lone gunman. It's hard to earnestly celebrate highs in the markets as we stare at these headlines, and our thoughts and prayers go out to those affected.

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