

Bad axe women

Some sectors face headwinds but earnings and the economy remain supportive.

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Ha! This is not a typo. I'll explain later. I started my week in Tampa, presenting before a welcoming group of trust advisors. A concern voiced here, as well as in Indianapolis later in the week, is sure to be a major topic of debate in the upcoming presidential election season—health-care costs. While most recent figures show costs up almost 4% in 2017, this is the lowest rate in almost every year dating back to 1970. Democratic candidates favor Medicare for All. Its huge price tag—an estimated \$32 trillion over 10 years, according to George Mason University and the Urban Institute—has crushed Health Care sector stocks in recent weeks. If it comes to fruition in some form, it not only would create chaos among insurers and providers, but also would hit as existing federal programs are running on fumes. Social Security's costs are expected to exceed its income in 2020, and by 2035, trust funds for both Social Security and Medicare are projected to run dry. Our Washington research suggests the odds of Medicare for All anytime soon are weak. Health Care stocks a bargain?

It hasn't been such a great year so far for Financials, either. Due to a variety of factors including a narrowing and briefly inverted yield curve, low market volatility and a weakening housing market, banks have lagged the S&P 500. Several money centers reported last week and the results were mixed and trendless. Still, with nearly half the sector having reported, Financials are showing a Q1 earnings gain of 6.3% year-over-

year (y/y) on a revenue gain of 5% y/y—the highest Q1 growth rate of all 11 S&P 500 sectors. Financials' weakness overdone? As for Tech, we are in a unique period of sustained Tech outperformance but low Tech net exposure, Evercore ISI says. It expects Tech exposure to capitulate, providing another tailwind for the group. And what's up with small caps? Even as the three major stock indexes hit new highs this week, small caps continued to lag, failing to offer much in terms of leadership as they historically do off market lows. Strategas Research says the criticism seems excessive—the Russell 2000 has kept pace with the S&P and its year-to-date performance ranks sixth-best in its history—and that, tactically, the index's inability to break above old highs could well be because it's domestic oriented with less exposed to the improving global growth story. It may simply be that small caps are a victim of investor FOMO (fear of missing out). When there's a rush to gain exposure during a melt-up, the biggest, juiciest and most liquid stocks—i.e., the large caps—are the beneficiaries, Third Seven says. Moreover, small caps have been in a secular bear market relative to large caps for eight years, making the current performance emblematic of this environment and not a signal of something worse, Ned Davis says. In fact, Russell 2000 breadth remains decent, seasonality is supportive and risk appetite is firm. We like small-cap growth particularly.

I finished my week in Indiana's state capital, the 16th most populous city in the U.S. May is Race Month in Indy, a full month of events, culminating with “The Greatest Spectacle in Racing”—the 103rd Running of the Indianapolis 500 on May 26. I got out of town just as 80,000 people descended upon Indianapolis for the annual NRA Convention, billed as “15 Acres of Guns and Gear.” My driver shared that his convention customers assured him, “Indianapolis is safe this weekend—everyone attending has two guns.” Speaking at a monthly luncheon exclusively for female advisors, I was told about a cool learning event they hosted which was very popular among their women clients. A laser gun training class, designed to teach safety basics for new shooters before welding a live firearm, attracted a full house. “Even our 80-year old ladies signed up!” I was told. Fierce, I love it! At May's monthly luncheon, the ladies plan to learn bad axe throwing. According to Wikipedia, a throwing axe is a weapon used during the Middle Ages by foot soldiers and occasionally knights. Usually, they are

thrown in an overhand motion (much like throwing a baseball) in a manner that causes the axe to rotate as it travels through the air. These are some bad axe women!

POSITIVES

- **The Fed could be on hold for some time** This morning's report on Q1 GDP (*more below*) showed annualized prices eking up 0.9% and core PCE rising at just 1.3%, well below Fed targets. Bank of America says persistent undershooting of central bank inflation targets across major economies the last five and 10 years has unanchored inflation expectations to the downside in most developed market economies.
- **Capex on the rise** Orders for core capital goods (nondefense ex-aircraft) surged in March, suggesting a sizable pickup in capital expenditures (capex) may be in the works following last year's tough second half. Unfilled capital goods orders rose for the month, ending a string of declines and hinting at a pending pickup in shipments. The first look at Q1 GDP included an annualized 2.7% jump in business investment.
- **Good housing news** March new home sales unexpectedly rose a third straight month, putting the 3-month average sales rate close to its best since December 2007. The trend improvement off last year's soft patch has been aided by moderating prices, lower mortgage rates and adequate supply.

NEGATIVES

- **Not-so-good housing news** March existing home sales slid the most in more than three years, dousing optimism over February's double-digit jump. March housing starts and permits also unexpectedly fell, although single-home activity improved, helping keep new-home supply in line with demand. A sharp contraction in residential investment was the biggest drag on Q1 GDP, and a concern in the otherwise good new-home sales report was that higher-priced homes are where the buying is occurring, a sign middle class buyers are struggling with affordability.
- **Can we blame the weather?** A monthly Philly Fed survey found growth slowing in an increasing number of states. Regional Kansas City and Richmond Fed surveys

reflected a slowdown in manufacturing, while the American Trucking Associations said shipments fell in March for the fourth time in five months, although it attributed some of the weakness to the wettest winter in the 124-year historical record for the contiguous 48 states.

- **Not everything about Q1 GDP was good** The underlying story behind this morning's 3.2% spurt raised questions about its sustainability. An inventory buildup that helped drive the improvement could turn around if demand doesn't pick up, while slower imports that also helped are indicative of weak, not strong, consumer spending. Indeed, spending on durable goods fell steeply and overall domestic sales rose at their slowest pace in three years.

WHAT ELSE

Low inflation is a good thing! Throughout most of the 1960s, inflation was low and the Fed was accommodative, while Presidents Kennedy and Johnson pushed through tax cuts. This virtuous combination led to U.S. real GDP growth averaging 4.8% from 1961–69. If this current cycle continues to play out in line with the 1960s, Wolfe Research says the S&P could arise another 10-15% over the next 18 to 24 months.

Minimum wage is relative Evercore says the so-called “effective” minimum wage—the average U.S. minimum hourly wage across federal, state and local ordinances—is expected to rise this year at its fastest pace since the late 1990s to an estimated \$11.25. That's 55% higher than the federal-only minimum of \$7.25.

Indianapolis has some awesome homes! A drive along historic North Meridian Street has “living” memorials—spectacular homes of the wealthy and social elite that reflect American architecture from the Roaring Twenties, when tradition returned to overtake Arts & Crafts modernism. The city's leading architects designed many of the palatial homes in a range of styles: Tudor Revival, Jacobean, Colonial Revival, Neo-Classical and Prairie.

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DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

Personal Consumption Expenditure (PCE) Index: A measure of inflation at the consumer level.

Russell 2000[®] Index: Measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. Investments cannot be made directly in an index.

Small-company stocks may be less liquid and subject to greater price volatility than large-capitalization stocks.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

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