Weekly Headings

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Key Takeaways

- Equity markets entering the 'Dog Days of Summer'
- Below average trading volumes can lead to exacerbated price swings
- Remain patient and position for buying opportunities

The origin of the phrase "dog days of summer" traces back to Greek astronomy. The ancient Greeks discovered a 40-day period in which Sirius, also known as the "dog star," rose and set in conjunction with the sun. Since Sirius is the brightest star in its constellation, they believed the additional glow was responsible for the scorching summer days. Greek literature expanded the myth by linking the incredibly hot part of the summer to include drought, sudden thunderstorms, and even bad luck. Today, we add another interpretation, as the 'dog days of summer' is not only applicable to the sultry summer weather, but also the current state of the financial markets.

- **Hot, Hot, Hot |** Through July 31, the S&P 500 was off to its fastest start to a year (20%) in over 20 years and its valuation (S&P 500 NTM P/E = 17.3x) rose to its highest level since March 2018. However, as we had cautioned in previous *Weekly Headings*, the equity market may have stayed in the sun a little too long as it was priced to perfection and increasingly susceptible to disappointing monetary policy, escalating trade tensions between the US and China, and unfavorable outcomes for other geopolitical risks such as Brexit and the US-Iran conflict. The recent pullback in the equity market offered a buying opportunity as it provided more palatable risk/reward prospects (See our *Thoughts on the Market* titled "Head Fake or Head Shake?" from 8/7/19). The combination of longer-term Treasury yields falling to multi-year lows (10-year Treasury yield: 1.70%), a record $15 trillion in negative-yielding debt across the globe, and the highest level of cash on the sidelines since 2010 (money market fund balances at $3.28 trillion) and the highest percentage of 'bearish' investors (contrarian indicator) over the past eight months (according to the AAII survey) enhanced the attractiveness of equities.
- **Drought |** One of the recurring risks in the markets is that the heavy vacation season reduces the trading volume in the market. According to a recent AAA Travel survey, of the nearly 100 million Americans planning to embark on a family vacation this year, more than two-thirds booked their travel for the summer months. Therefore, it is no surprise that the month of August has the second lowest average trading volume of any month during the year (December is the lowest given the holiday season) and the longest period of days with below-average equity trading volumes. Usually, the lack of market participants is not a major problem as the mid to latter part of August does not have earnings season, major economic data, FOMC meetings (although we do have the Jackson Hole Symposium on August 22-24), and Congress is on summer recess.
- **Sudden Thunderstorms |** However, as a result of low volumes, when market moving headlines (e.g., sudden thunderstorms) hit, market moves in either direction are exacerbated by these lower volumes. Some of the thunderstorms that might pop up sporadically include President Trump tweets, US/China trade issues, and global central bank rhetoric and/or action. Our view is that investors need to ignore the 'quick changing weather' and focus on the long-term fundamentals. Our base case remains that the economy continues to be healthy and until that view changes, we have a favorable outlook for the equity market, including our favorite sectors (Technology, Consumer Discretionary, Communication Services and Health Care). For investors seeking ways to mitigate portfolios from some of these potential storms, an 'umbrella' of 'safer' investments could prove beneficial. The diversification benefit has been evident in the most recent S&P 500 decline (~6%) as gold (4.0%) and Treasuries (2.1%) significantly outperformed during this tumultuous time period (July 26 – August 5).
- **Bad Luck |** Historically, August begins a more lethargic period of time for the equity market. The August through September period has historically been the weakest rolling two-month time period for the S&P 500 (-0.6% on average) since 1980. However, that does not mean investors should flee the market. Rather, we suggest investors remain engaged with the markets as any potential pullbacks, like the one experienced over the last few days, could provide opportunities to increase exposure to riskier assets such as equities as we head into the fourth quarter, a historically strong period for equities.

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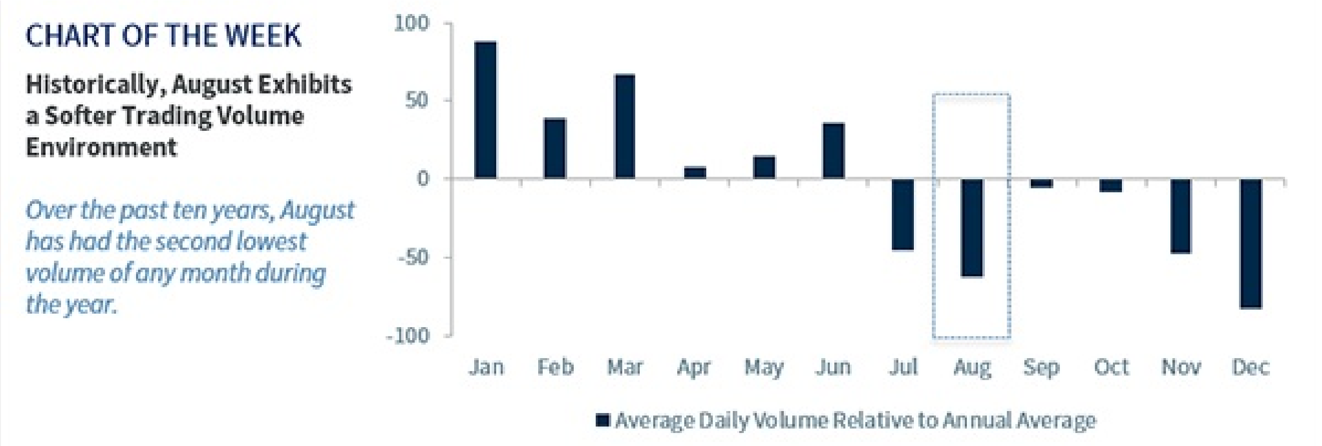

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