



## August Monthly Recap: Federal Reserve Embarks on a New Era of Ultra-Loose Monetary Policy

The Dow and broader U.S. stock market surged to new highs in July, as investors braced for the Federal Reserve's first interest-rate cut in over a decade. As expected, the Fed lowered its benchmark interest rate on July 31, but not without some internal dissension.

### Fed Cuts Interest Rates

On July 31, the Federal Open Market Committee (FOMC) in Washington voted to lower the benchmark interest rate by 25 basis points, marking a dramatic paradigm shift from less a year ago. Stocks plunged and the U.S. dollar surged following the rate announcement, which was delivered at 2:00 p.m. ET.

"In light of the implications of global developments for the economic outlook as well as muted inflation pressures, the Committee decided to lower the target range for the federal funds rate to 2 to 2-1/4 percent," the central bank said in its official policy statement.<sup>1</sup>

Large minorities of traders were expecting the Fed to lower interest rates by 50 basis points on Wednesday<sup>2</sup> and some may have been discouraged by the fact that two policymakers voted against cutting all together. Kansas City Fed President Esther George and Eric Rosengren of the Boston Fed both voted to leave the federal funds rate on hold.

In the official rate statement, the Fed left the door open to further downward adjustments if needed. Futures traders expect a second 25 basis-point reduction in the fall, according to CME Group's FedWatch Tool.



BMO Wealth Management is the brand name for a business group consisting of Bank of Montreal and certain of its affiliates, including BMO Nesbitt Burns Inc., in providing wealth management products and services. © "BMO (M-bar Roundel symbol)" is a registered trade-mark of Bank of Montreal, used under licence. © "Nesbitt Burns" is a registered trade-mark of BMO Nesbitt Burns Inc. BMO Nesbitt Burns Inc. is a wholly-owned subsidiary of Bank of Montreal.

BMO Nesbitt Burns Inc. is a Member - Canadian Investor Protection Fund. Member of the Investment Industry Regulatory Organization of Canada.

## Wall Street Extends Record-Setting Rally; Canadian Stocks Lag Behind

The prospect of easy monetary policy helped U.S. stocks set consecutive all-time highs in July. The Dow Jones Industrial Average, S&P 500 and Nasdaq were all up during the month. In the process, the S&P 500 Index broke above 3,000 for the first time while the Dow exceeded 27,000 for the first time in its history.

Unlike previous record rallies, volatility didn't fall in commensurate fashion. The CBOE Volatility Index, commonly known as the VIX, was little changed for the month, and that's even after we account for the sudden surge on July 31.

The major U.S. indexes are up between 16% and 25% year-to-date.

Canadian stocks were much choppier in July, with the S&P/TSX Composite Index gaining just 0.1%. The index peaked at 16,611.84 on July 24, which was just shy of a new record.

Like its U.S. counterparts, the TSX has posted strong returns in 2019. The index is up more than 15% year-to-date but has returned less than 4% over the past 12 months. In other words, most of the gains have been part of a relief rally following the fourth-quarter decline.

## Corporate Earnings Decline

Corporate earnings season was in full swing in July, with roughly half of the S&P 500 companies reporting financial results. As of July 26, 44% of S&P 500 companies had reported actual results. Seventy-seven percent of companies reported better than expected earnings and 61% posted positive revenue surprises, according to FactSet.

However, blended earnings for the S&P 500 are down 2.6%. If the trend holds, it would mark Wall Street's first back-to-back quarters of declining profitability since 2016.<sup>3</sup>

Looking at P/E ratios of S&P 500 companies, one can conclude that stocks are overvalued. As FactSet reports, the forward 12-month P/E ratio for the S&P 500 is 17.1, which is above the five-year average (16.5) and well above the 10-year trend (14.8).

## The Month Ahead

With the Federal Reserve lowering interest rates as expected in July, attention in August will shift back to U.S.-China trade talks. Face-to-face negotiations were back on this week after a two-and-a-half-month hiatus, but both sides remain far apart on a new deal. President Trump has warned that China may delay a new agreement until after the 2020 U.S. presidential election. In the meantime, investment flows between the two countries have fallen to five-year lows.<sup>4</sup>

Sincerely,

[Ferrie Petruccelli Wealth Management Group](#)

David Ferrie, Portfolio Manager, Managing Director  
T: 416-590-7667 [david.ferrie@nbpcd.com](mailto:david.ferrie@nbpcd.com)

Anthony Petruccelli, Portfolio Manager, Financial Planner  
T: 416-590-7675 [anthony.petruccelli@nbpcd.com](mailto:anthony.petruccelli@nbpcd.com)

Teresa Hoang, Administrative Assistant  
T: 416-590-7605 [teresa.hoang@nbpcd.com](mailto:teresa.hoang@nbpcd.com)

**Our Partners**

Tim Simpson, Estate & Insurance Advisor  
T: 416-359-7798 [timothy.simpson@nbpcd.com](mailto:timothy.simpson@nbpcd.com)

The opinions, estimates and projections contained herein are those of the author as of the date hereof and are subject to change without notice and may not reflect those of BMO Nesbitt Burns Inc. ("BMO NBI"). Every effort has been made to ensure that the contents have been compiled or derived from sources believed to be reliable and contain information and opinions that are accurate and complete. Information may be available to BMO NBI or its affiliates that is not reflected herein. However, neither the author nor BMO NBI makes any representation or warranty, express or implied, in respect thereof, takes any responsibility for any errors or omissions which may be contained herein or accepts any liability whatsoever for any loss arising from any use of or reliance on this report or its contents. This report is not to be construed as an offer to sell or a solicitation for or an offer to buy any securities. BMO NBI, its affiliates and/or their respective officers, directors or employees may from time to time acquire, hold or sell securities mentioned herein as principal or agent. BMO NBI will buy from or sell to customers securities of issuers mentioned herein on a principal basis. BMO NBI, its affiliates, officers, directors or employees may have a long or short position in the securities discussed herein, related securities or in options, futures or other derivative instruments based thereon. BMO NBI or its affiliates may act as financial advisor and/or underwriter for the issuers mentioned herein and may receive remuneration for same. A significant lending relationship may exist between Bank of Montreal, or its affiliates, and certain of the issuers mentioned herein. BMO NBI is a wholly owned subsidiary of Bank of Montreal. Any U.S. person wishing to effect transactions in any security discussed herein should do so through BMO Nesbitt Burns Corp. Member-Canadian Investor Protection Fund.

---

<sup>1</sup> Board of Governors of the Federal Reserve System (July 31, 2019). Federal Reserve issues FOMC statement.

<sup>2</sup> CME Group. CME FedWatch Tool.

<sup>3</sup> FactSet (July 26, 2018). Earnings Insight.

<sup>4</sup> Yen Nee Lee (August 1, 2019). "US-China investment flows fall to five-year low amid escalating trade war." CNBC.