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OCTOBER 3, 2019 | 4:16 PM EDT

Weekly Market Guide

Short-Term Summary: Volatility has returned to begin October and Q4. Following a weak September ISM manufacturing number on Tuesday, the S&P 500 experienced back-to-back 80%+ declining volume days, during which the key 2940 breakout level was undercut. Selling pressure continued following the disappointing ISM non-manufacturing number this morning that pushed the S&P 500 to oversold levels in the short term. The market's ability to shake off the latest weak economic reading so far today and bounce from oversold levels is a good start, particularly as the more technology-oriented names are leading the way. Also contributing to the rally today is a view that the Fed stands by to support the economic outlook, as it has stated. The market-implied odds of a Fed rate cut on October 30th have spiked to 90% (from 40% on Monday), and the odds of two rate hikes by year-end are now up to 60%.

As for the weak manufacturing number, it is important to remember that manufacturing is just ~11% of US GDP, and services represent ~80%. The services side of the economy remains solid; and although ISM non-manufacturing did come in lower than estimates, it remains positive. Additionally, the September jobs report comes out tomorrow, which could reassure investors about employment trends. We continue to view the consumer in good shape, which remains supportive of the economy.

Over the intermediate-term, the technical backdrop remains intact, and we view the current market action as a normal pullback for now. We look to the 200 day moving average (DMA) at 2839 as technical support, followed by horizontal support in the 2822-2800 area. As a reminder, the S&P 500 has experienced two 6-7% pullbacks this year; and a similar current pullback would put the downside in this range mentioned. This level also represents a 17.4x P/E, which coincides with the average P/E seen year to date and is fair heading into trade discussions and earnings season.

Trade and earnings season will be the most influential factors for market participants to monitor in the coming weeks, with trade being the biggest item that will sway the market one way or the other. US and China officials are set to meet in DC on October 10th, where optimism has grown for momentum toward a potential mini-deal when Presidents Trump and Xi are scheduled to meet on November 16th. In the end, it is not in President Trump's best interest to come down too hard on trade a year out from his re-election campaign. He knows that he needs a good economy and good equity market in the lead up to next Fall. Our base case outlook is for the Fed to provide support to the slowing macro and trade disputes, and we expect a mini trade deal or agreement that will be market positive (although it is probably not a smooth process). (M19-2759207)

Equity Market Indices	Price Return Year to Date	Price Return 12 Months
S&P 500	15.2%	-1.2%
S&P 500 (Equal-Weight)	14.2%	-2.0%
Dow Jones Industrial Avg	11.8%	-2.6%
NASDAQ Composite	17.3%	-2.7%
Russell 2000	9.7%	-10.7%
MSCI All-Cap World	11.4%	-3.0%
MSCI Developed Markets	7.5%	-5.7%
MSCI Emerging Markets	2.4%	-4.3%
NYSE Alerian MLP	2.7%	-18.1%
MSCI U.S. REIT	21.6%	13.6%

S&P 500 Sectors	Price Return Year to Date	Sector Weighting
Information Technology	26.2%	22.0%
Real Estate	24.7%	3.3%
Utilities	20.3%	3.6%
Consumer Discretionary	18.1%	10.2%
Consumer Staples	18.0%	7.7%
Communication Svcs.	17.7%	10.4%
Industrials	15.6%	9.2%
S&P 500	***15.2%***	-
Financials	12.7%	12.8%
Materials	10.4%	2.7%
Health Care	1.6%	13.7%
Energy	-1.9%	4.4%

S&P Styles

Year to Date (Price Return)

	Growth	Blend	Value
Large Cap	16.2%	15.2%	14.0%
Mid Cap	13.7%	12.7%	11.6%
Small Cap	7.3%	8.8%	10.3%

Source: FactSet, RJ Equity Portfolio & Technical Strategy

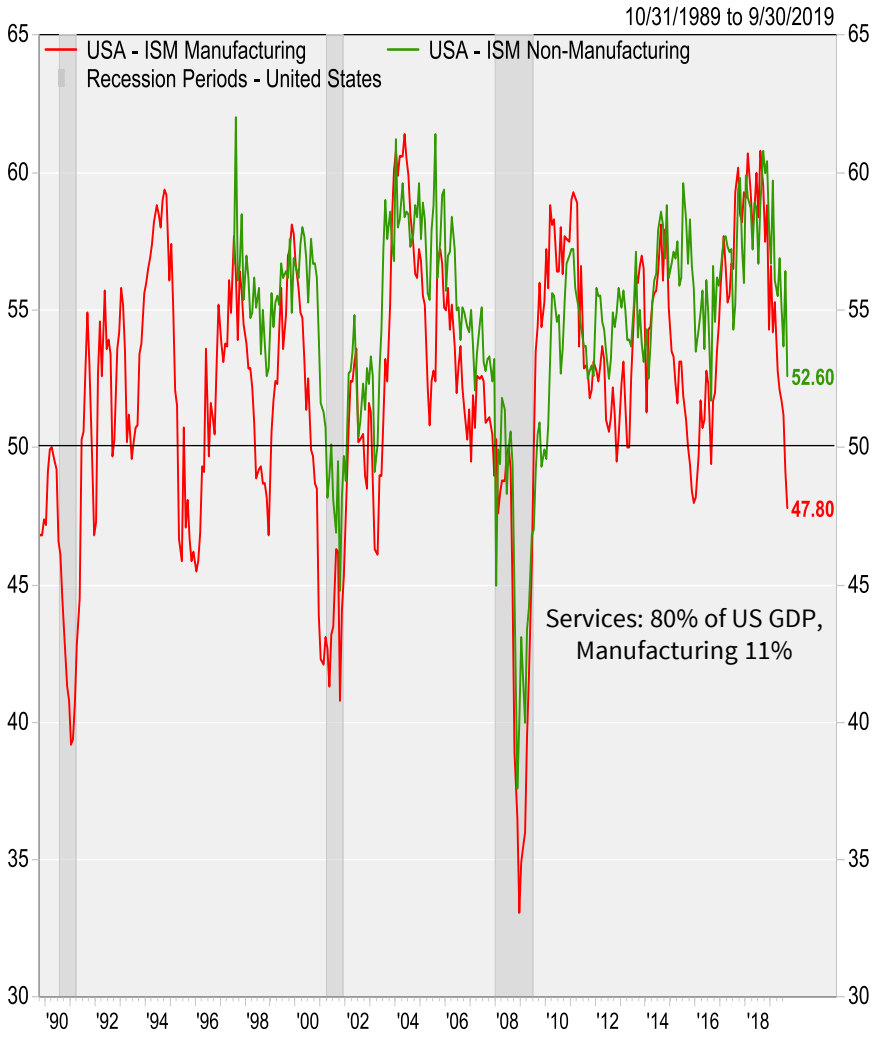
(M19-2759207)

MACRO: US

US manufacturing continued to weaken in September as ISM manufacturing came in at 47.8 the weakest in a decade. The weakness was driven by new export orders dropping to 41.0, with global trade being the largest issue. However it is important to remember that manufacturing only represents about 11% of US GDP vs services representing ~80%. Looking at the past 30 years, it is when both ISM manufacturing and non-manufacturing contract that we have experienced recessions. In the chart to the right, ISM manufacturing went negative without a recession in 2015 (manufacturing recession), 2012 (EU debt crisis), and mid-90s (Fed supported by lowering rates). Importantly, non-manufacturing ISM remained positive in these periods. It was when non-manufacturing ISM joined manufacturing in negative territory in 2001 and 2008 that the US experienced a recession.

Although September non-manufacturing ISM did come in lower than estimates, it remains positive. Additionally, employment trends have been positive and the September jobs report comes out tomorrow. We continue to view the consumer in good shape, which remains supportive to the economy. The Fed also stands by to support the economic outlook, and odds for a rate cut on October 30th have jumped to 90% (from 40% at the beginning of the week).

US economic data reported in the past week (actual vs estimate):
Personal Income (Aug): 0.4% vs 0.4%, 0.1% prior
Personal Spending (Aug): 0.1% vs 0.3%, 0.5% prior
Durable Goods Orders (Aug F): 0.2% vs -1.1%, 2.0% prior
Durables ex Transportation (Aug P): 0.5% vs 0.2%, -0.5% prior
U of Michigan Sentiment (Sep F): 93.2 vs 92.1, 92.0 prior
Markit US Manufacturing PMI (Sep F): 51.1 vs 51.0, 51.0 prior
ISM Manufacturing (Sep): 47.8 vs 50.0, 49.1 prior
Construction Spending m/m (Aug): 0.1% vs 0.5%, 0.0% prior
ADP Employment Change (Sep): 135k vs 140k, 157k prior
Initial Jobless Claims (Week): 219k vs 215k, 215k prior
Markit US Services PMI (Sep F): 50.9 vs 50.9, 50.9 prior
Markit US Composite PMI (Sep F): 51.0 vs 51.0 prior
ISM Non-Manufacturing (Sep): 52.6 vs 55.0, 56.4 prior
Factory Orders (Aug): -0.1% vs -0.2%, 1.4% prior



Source: FactSet, Bloomberg, Raymond James Equity Portfolio & Technical Strategy

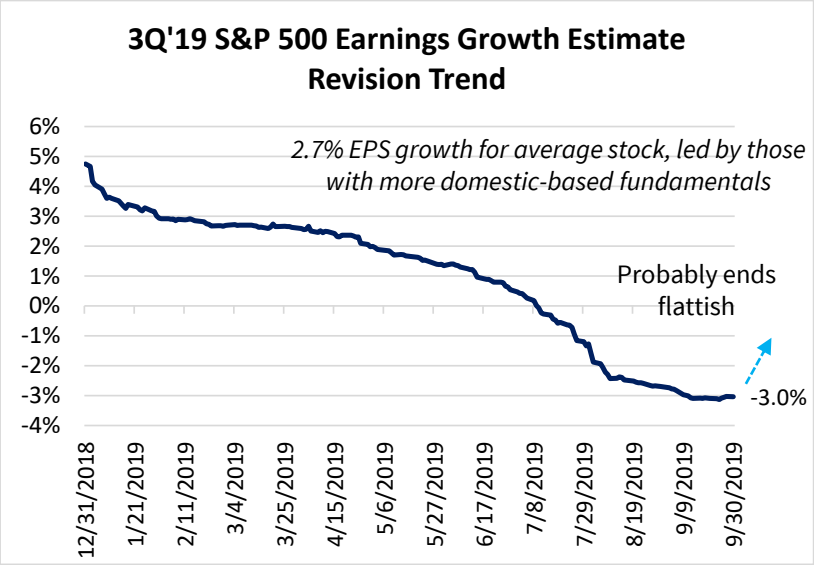
FUNDAMENTALS

Earnings: Q3 earnings season kicks off with the banks on October 15th. Sales and margin estimates for the quarter have generally trended lower since trade tensions reignited in early May, pressuring bottom line estimates. S&P 500 Q3 earnings estimates currently reflect -3.0% growth; but based on historical trends, this number is likely to finish more flattish once the results come out. Also, the average stock is expecting 2.7% earnings growth, led by those with more domestic-based fundamentals.

In our base case outlook, we use $165 in earnings for year-end 2019 (just above current consensus estimates) and $173 in earnings for 2020 (~4.5% below current bottom-up analysts).

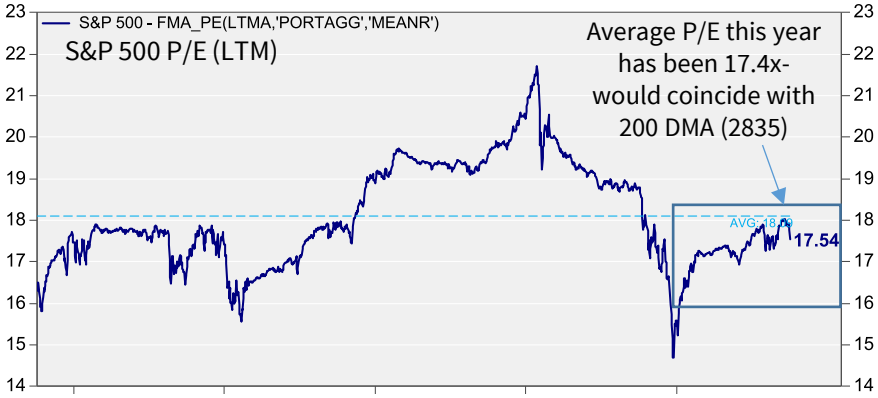
Consensus earnings estimates:

- **2019:** $164.00 (bottom-up analysts); $164.70 (top-down strategists)
- **2020:** $181.03 (bottom-up analysts); $177.67 (top-down strategists)



Source: FactSet, Bloomberg, Raymond James Equity Portfolio & Technical Strategy

Valuation: The S&P 500 P/E has moved lower to 17.5x. This is just above the average P/E seen this year of 17.4x, which would coincide with the S&P 500's 200 day moving average (nearby technical support). We view this level as fair heading into trade talks and earnings season in the coming weeks. In our base case outlook, we continue to view multiple expansion to 18.5x over the next twelve months- just below the 19.1x median P/E historically when inflation is in the 2-2.5% range.



TECHNICAL: SHORT TERM

Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

Technical:

During the weak aftermath of the disappointing manufacturing ISM reading, the S&P 500 undercut the 2940 breakout level from early September. Technical momentum grew to the downside, as declining volume was over 80% on back-to-back days. One of our technical concerns lately has been lost momentum from leadership areas (i.e. software, payments), accompanied by the former laggards (i.e. banks, industrials, small caps) failing at resistance. The net result was weaker technical momentum in the short term.

However, the S&P 500 reached oversold conditions this morning and has so far exhibited a strong bounce from oversold levels, particularly as the more technology-oriented names are leading the way today.

Over the intermediate term, the technical backdrop remains intact, and we view the current market action as a normal pullback for now. We look to the 200 day moving average (DMA) at 2839 as technical support, followed by horizontal support in the 2822-2800 area. As a reminder, the S&P 500 has experienced two 6-7% pullbacks this year; and a similar current pullback would put the downside in this range mentioned. This level also represents a 17.4x P/E, which coincides with the average P/E seen year to date and is fair heading into trade discussions and earnings season.

Trade and earnings have the ability to sway the market one way or the other, and these will be the most influential factors to monitor in the coming weeks.

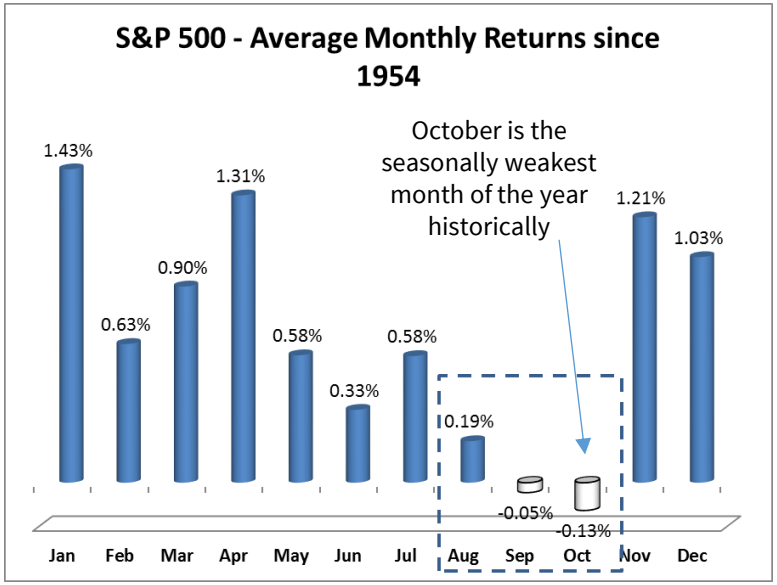
TECHNICAL: SHORT TERM

Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

The percentage of S&P 500 stocks above their 10 and 20 day moving averages reached oversold levels this morning. With technical support nearby, this suggests the market should at least see a pause to digest the pullback leading up to trade talks next week.

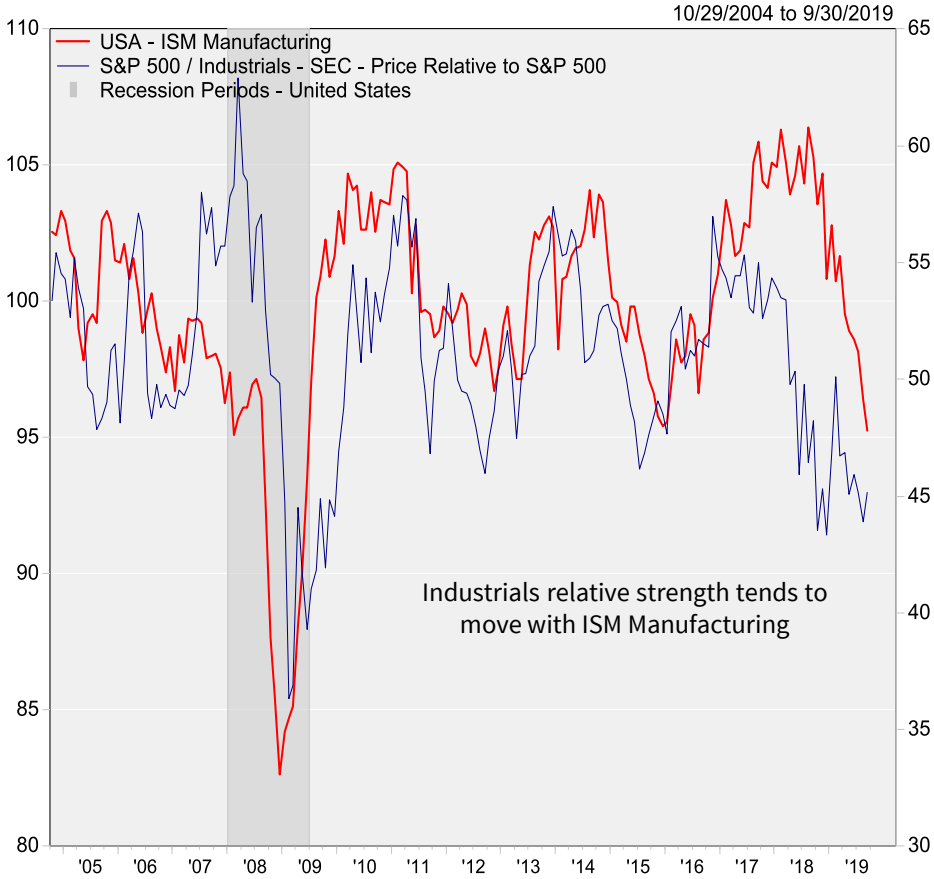
Over the intermediate term, the technical backdrop remains intact (and much more supportive than last October). As you can see, the S&P 500 is above its 200 DMA and the percentage of stocks above their 200 DMA is 54% currently. This is in contrast to the index being below its 200 DMA and under 40% of stocks being above their 200 DMA last October. This, along with a supportive Fed (remember the Fed was hiking in late 2018) support our belief that a cascade lower (like late 2018) is not in the cards for equities. For now, we believe this is a normal market pullback.

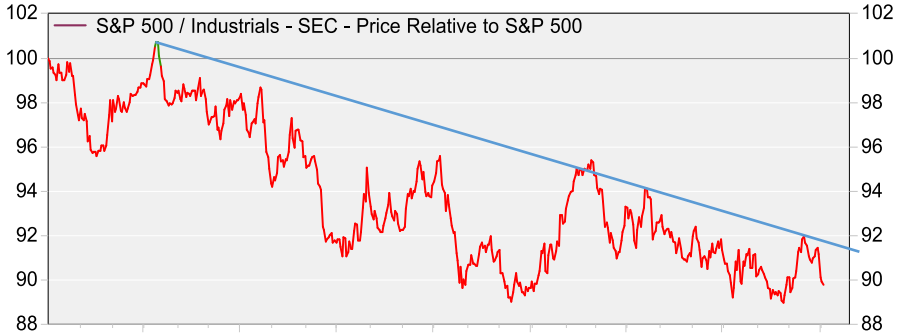
Short term oversold conditions



TECHNICAL: INDUSTRIALS

The industrials were one of the lagging sectors that found some momentum in September. We have been watching to see whether or not the group would be able to break above horizontal resistance and for relative strength to improve out of its downward trend. So far, it has not been able to. And accompanied with the weak manufacturing trend, we still think it is too early to increase allocations to the industrials sector. As you can see in the chart to the bottom left, industrials relative strength tends to trend with ISM manufacturing readings over time.

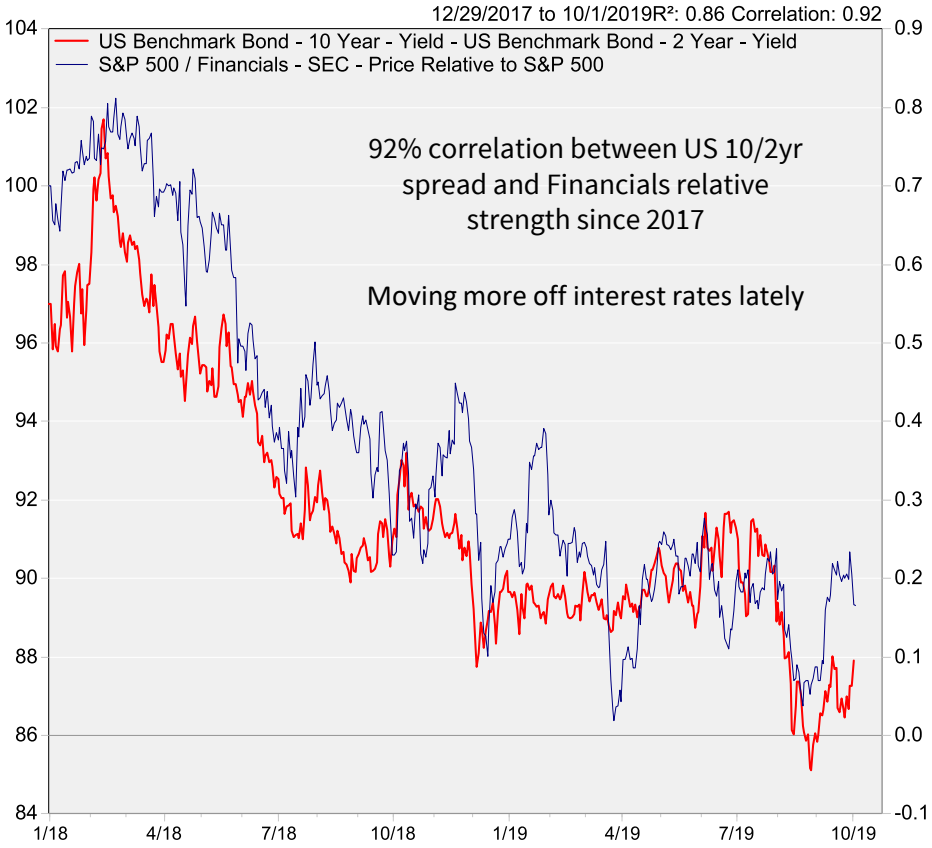


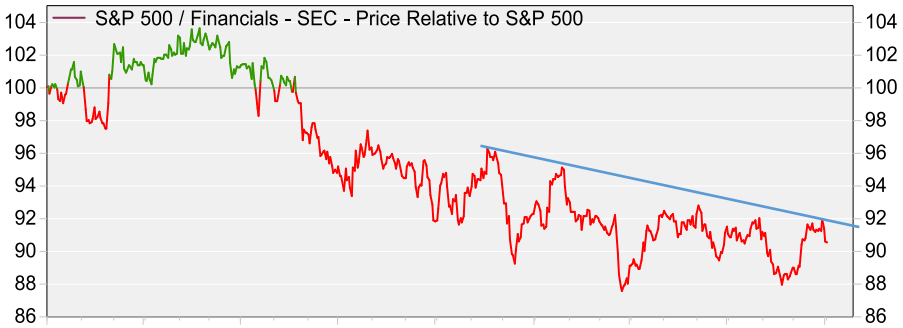


Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

TECHNICAL: FINANCIALS

The Financials were another lagging (deep cyclical) area that we were watching to see if it could break above resistance on improved relative strength trends. Like Industrials, they were not able to. The weak manufacturing ISM reading put downward pressure on interest rates as investors price in the likelihood of a sooner Fed rate cut (odds of Fed cut on October 30th rose to 90% from 40% this week). Over the past month or so, Financials relative strength has been significantly influenced by interest rate movements (more so than the yield curve that it has been correlated with for the better part of two years). Thus, the lower rates (despite wider yield curve) have the Financials stuck in a relative strength downtrend.

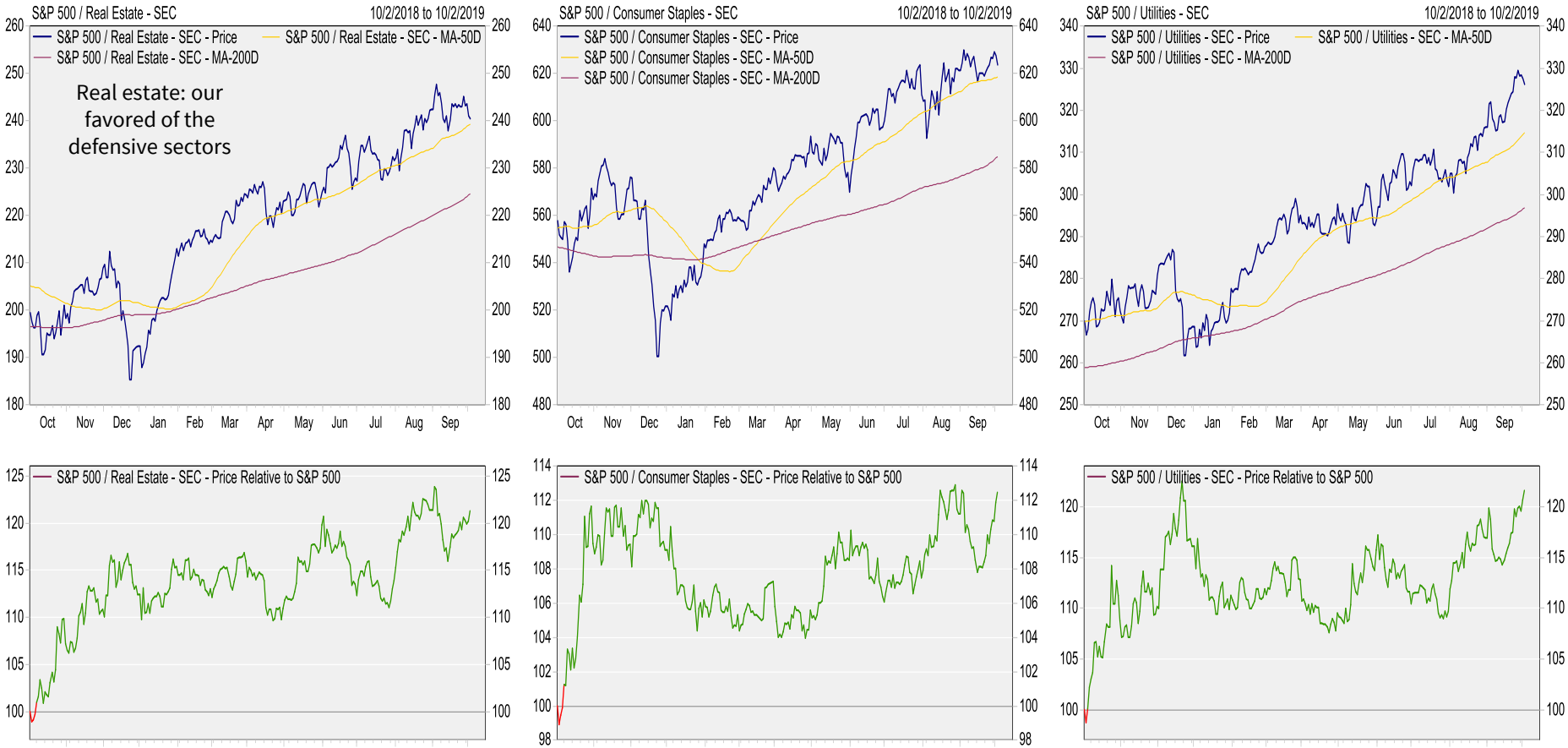




Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

TECHNICAL: DEFENSIVE SECTORS

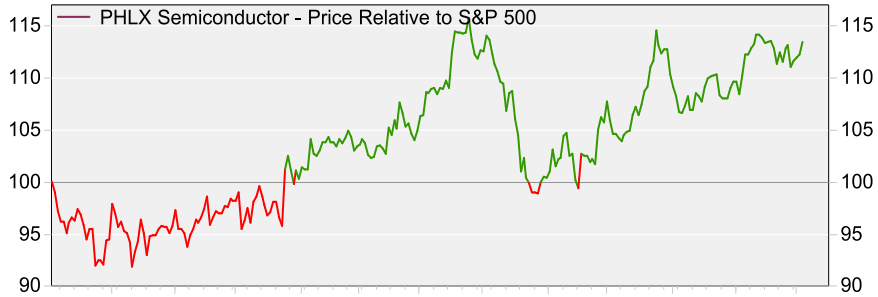
The interest rate sensitive, defensive sectors continue to have the best technical momentum within the equity market. Investors have bid up these areas over the past twelve months due to their lower betas and high yields (relative value increases as interest rates move lower). Among these, real estate is our favored group due to its leverage to the improving housing market and a relatively attractive valuation. We view both consumer staples and utilities as expensive on a valuation basis, with very low earnings growth.

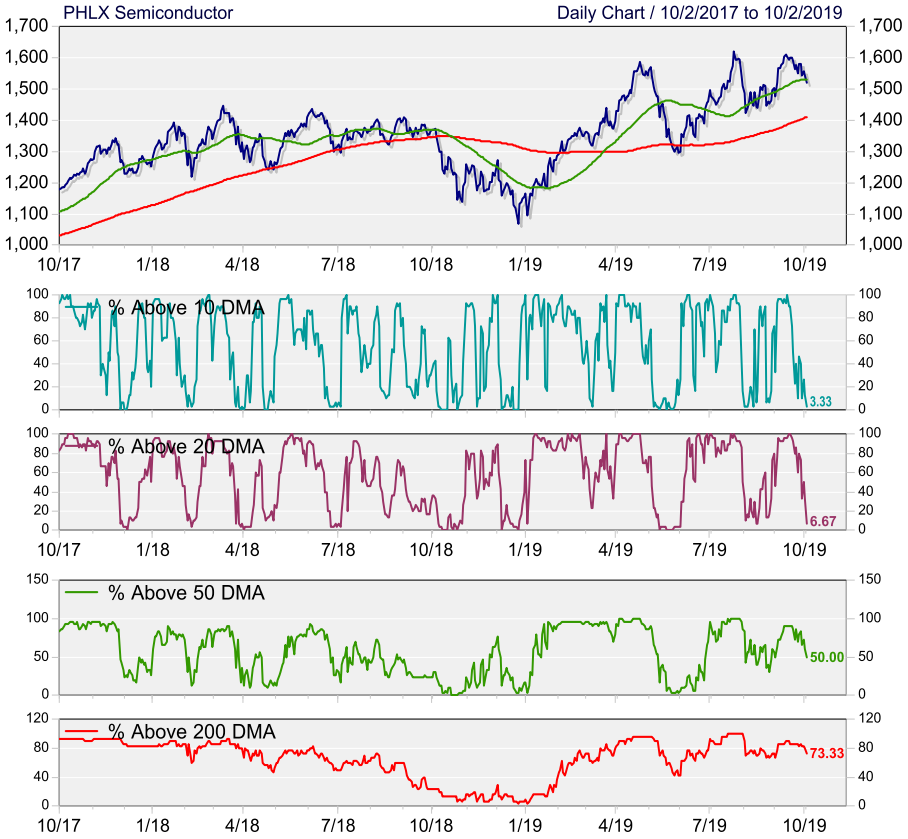


Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

TECHNICAL: SEMICONDUCTORS

One of the market leaders of late, as well as an important area when gauging underlying economic and market momentum, is the semiconductor subsector. After reaching short term oversold levels, it is bouncing from support at its 50 day moving average on relative strength. Also over the intermediate term, the semiconductor trend remains solid with 73% of stocks above their 200 day moving average. Listening to company commentary, fundamentals are not necessarily getting better but they are not necessarily getting worse either. Keep in mind that this group is significantly influenced by trade with China, so depending on how talks transpire next week this trend can change. But for now, technical momentum remains for the semiconductors.





Source: FactSet, Raymond James Equity Portfolio & Technical Strategy

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The **NASDAQ Composite** is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market.

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The **MSCI Emerging Markets Index** is designed to measure equity market performance in 23 emerging market countries. The index's three largest industries are materials, energy, and banks.

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The **NYSE Alerian MLP** is the leading gauge of energy infrastructure Master Limited Partnerships (MLPs). The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis (AMZ) and on a total-return basis (AMZX).

The **Barclays Intermediate Government/Credit Bond** index measures the performance of U.S. Dollar denominated U.S. Treasuries, government-related and investment grade U.S. corporate securities that have a remaining maturity of greater than one year and less than ten years.

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