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Stocks recorded solid gains in the second quarter thanks to a shift in perceptions that the Federal Reserve will cut interest rates, extending a rally that propelled the S&P 500 to record highs. The benchmark overcame an escalation in the U.S.-China trade dispute to close the quarter up 18.5% for the year, according to Morningstar.

The sharp rise in stocks also defied mounting fears of an economic slowdown that have pushed bond yields down globally. The yield on the 10-year U.S. Treasury closed the quarter at 2.00%, nearly a half-percentage point drop from the end of March. As a result, bonds fared well, as the Barclay's US Aggregate Bond index returned 6.1% in the first half of the year.

In early June, Federal Reserve Chairman Powell addressed concerns of how the continuing trade spat could hurt the economy and indicated that it could respond by cutting rates if conditions worsen. Investors embraced the news and set the stock market up for its latest climb. Markets now seem priced for at least one Federal Reserve rate cut in July.

The positive momentum could turn in the early days of July when we will know the results of the much-anticipated group of 20 meeting of major economic powers in Japan. More important, we'll also know the outcome of the crucial talks between President Trump and President Xi Jinping of China over the trade wars. The expectation is that the U.S. and China will at least make progress in resuming talks that had broken down in May. That could determine whether Trump goes ahead with his threat to place tariffs on an additional $300 billion of Chinese goods or not.

At the midpoint of the year, nearly every equity class posted gains over 10%. Although domestic large cap stocks continued to lead the way, international equities recorded very good returns with the FTSE Developed ex-US index gaining 13.8% and the FTSE Emerging Markets up 12.2%. Alternative assets classes like real estate and global natural resources rallied 18.7% and 14.9%, respectively.

We believe a trade deal will eventually be agreed upon, but we have no idea when or what it will look like. We remain positive about the prospects for global markets given the accommodative stance that the Fed has taken in recent weeks.

While we closely watch for factors that could suddenly impact the markets, we focus on reasonable longer-term assumptions that drive risk and returns. Despite the market pricing in an interest rate cut in July, the economic data shows evidence of a strong and steady economy.

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Sources:
Stocks Cap Best First Half Since '97, WSJ, June 29-30, 2019
Great Half But What's Ahead, Barron's, July 1, 2019
Valmark's TOPS Member Forum, July 11, 2019