

The Invincible S&P 500

Bombs and tweets are flying! Ballooning Federal debt, a trade war with China, disruptions in the repo market, impeachment proceedings... no problem. The Federal Reserve has our back. President Trump no longer has unkind words for Fed Chairman Jay Powell, nor should he. With the way the Fed is pumping liquidity into this market, both lowering interest rates and buying Treasury bills, President Trump should give him a medal! Rapidly rising stock prices coincided with the increased liquidity.

Despite flat earnings for S&P 500 companies, the index was up almost 30% last year. Is this never-never land? No Peter Pan, not exactly. With lower interest rates, investors are willing to pay more for a given level of earnings. So, as interest rates fell last year, the multiple or P/E (price earnings ratio) of the market went up. On January 1, the forward P/E of the S &P 500 was 19.6 versus 13.6 at the end of 2018. Long term averages hover around 16, typically higher when rates are lower and vice versa.

If we agree that multiple expansion drove the market in 2019, what can move the market in 2020?

We have a couple of choices - continued multiple expansion or earnings growth.

Continued Multiple Expansion - Although the Fed is increasing reserves to the tune of \$60 billion a month, they appear to be done with interest rate cuts for the time being. If rates don't continue to go down, further multiple expansion seems unlikely given current high levels.

Earnings Growth - The US manufacturing sector remains in a downturn, but consumer spending, which drives 70% of GDP appears to be going strong. Consensus earnings growth for 2020 ranges from 2% to 3%. We will be listening to company earnings calls with more than the usual interest as the most likely catalyst for market growth will come from earnings.

Opportunities for 2020

- **Tech and Communications** - The place to find growth in a generally slow growth environment, with cloud computing, AI, and 5G coming as a driver.
- **Healthcare** - Historically low P/Es and aging population demographics make this sector look interesting. Threats to reform pricing have thus far been idle, but a Democratic President could negatively impact pharmaceuticals and managed care stocks.
- **Financials** - Likely to be the beneficiary of a steeping yield curve.
- **Gold** - Provides insurance against global disruptions and could be the beneficiary of a weakening dollar.
- **Energy** - We know it is a dirty word, but we don't think the conflict in the Middle East is over and the risk premium in this group is too low. Prices may surprise to the upside.

- **Outside the US** – With the global economy recovering, the dollar falling, and fewer negative yielding bonds the world over, overseas markets look less expensive than the US and therefore more appealing.

Debbie Downers

- **A black swan event** – uncontrolled escalation in the Middle East that erodes confidence could stall the market rally.
- **An unexpected rise in inflation** – would hurt both the bond and stock markets (a reprise of 4th quarter 2018).
- **If earnings do not grow** – with PEs at historical highs, the market would contract.
- **We may all feel the Bern** – Whatever your politics, despite Bernie's sincerity and the real problems he identifies, President Sanders would not be good for the US stock market near term.

For now, the market's partying like its 2019! But, in the event of a reversal, we have defensive investments in place to help stabilize portfolios.

We are here to help. Please give us a call if you have any questions.

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