FVCM

U.S. MARKET REPORT

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S&P 500

The Unrelenting Bull Market

Neither an inverted yield curve, Trump's impeachment, nor a highly contagious and novel virus seems able to significantly slow the rise in stock prices. The extraordinary strength in big growth stocks remains particularly astounding. In only the past four months Tesla's stock price has increased more than three-fold. In the past year Apple is up nearly 90%. Other jumbo-cap growth names like Facebook, Alphabet and Microsoft have also continued to do very well. From a more technical perspective, very low global interest rates are causing capital to flow in search of returns, and U.S. growth stocks benefit from their persistently positive results as well as the perception that the U.S. market is relatively safe. We encourage investors to remain largely exposed to equities as they continue to offer the best return prospects. At the same time, it's a risky world out there and some cash should be on the sidelines in case the worst case scenario (recession) takes place.

Low inflation is like bright sunshine for the financial markets. Other than general economic growth, there is no single factor more important to stock returns than inflation. Low inflation allows businesses and individuals to sell long term bonds cheaply and it allows the Fed to keep short term interest rates low. There is no overstating the positive impact of friendly monetary policy thanks to low inflation, and no overstating the negative impact tightening monetary policy will have if the central bank has to start fighting inflationary pressures. Today, inflation is actually lessening and the sun is shining.

There are no obvious excesses in the real economy or the banking system. At 10 ½ years, it is true that this has been the longest economic expansion on record. But this has also been a record slow expansion as well. There has been no notable excess in any particular sector and, in fact, consumer debt has declined relative to income. There are some stresses in the corporate debt side due to borrowing by energy companies that are suffering from low oil and gas prices, but the problems don't look like they could threaten the entire economy. The U.S. banks are profitable and their balance sheets are stronger than prior to the last recession. In short, if a recession were to occur, it would likely be mild and short.

Trump's economic policies are mostly reforms that will provide strong support for long term growth. Trump's tariff war with China has caused businesses to cut the growth in capital spending to a paltry 1.6%, year over year, but with the trade hostilities temporarily on pause, capital investment could reaccelerate thanks to the ongoing incentives provided by the 2018 corporate tax cuts. Just as important, the current administration has been loosening labor regulations, cutting construction and manufacturing regulations, accelerating the approval of permits for big infrastructure projects, and generally making business decisions easier. The pro-business, deregulatory actions should not be under estimated and have the potential to keep this expansion going on for years more.

Yield curve revisited: It's against our nature to say this, but maybe this time it's different. Since the 1960s, the yield curve turned negative, or was near zero, prior to every recession. There was only one occasion when the yield curve turned negative and a recession didn't follow, and that was back in 1966. There has been recent speculation among economists that the yield curve in the U.S. is being distorted by the negative rates in Europe and Japan, since capital is flowing from those countries in search of higher returns. It has also been shown that the yield curve has not been a useful forecasting tool in Japan since interest rates approached zero. There is certainly uncertainty here. We also would note that while the yield curve remains flat, the Manufacturing PMI recently turned positive again in January (50.9) and the New Orders Index rose to 52.0. As we've said previously, we recommend keeping long term assets in equities, but keep some cash on the side as a hedge just in case this time is not different.

The biggest risk to the U.S. equity markets continues to come from overseas. China remains a major risk and not only because of the coronavirus. Many American businesses had already begun to question their heavy investment in manufacturing facilities in China because of Trump's tariffs, and the coronavirus will only amplify those concerns. American businesses from Apple to Starbucks have been closing operations and confidence in the Communist government is not high. There is risk that the coronavirus could spark a material downturn in the Chinese economy that pulls global corporate profitability down.
