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Vice President

“By The Way”

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““I’ve got a hundred million reasons to walk away but baby, I just need one good one to stay”

The S&P 500 broke out into new all-time high territory, and for confirmation so too did the Dow Transport and NASDAQ Indices. (The Toronto S&P Index also looks ready to challenge record levels.) A period of consolidation and possible test of the breakout level would not be a surprise but would not negate the positive outlook. I have expressed my worries and concerns in previous letters, but I won’t argue with the message this market is sending. To quote Lady Gaga, “I’ve got a hundred million reasons to walk away but baby, I just need one good one to stay”. New highs qualify as such a reason.

As I look out into 2020 and beyond, I see six factors that I believe will influence the direction of equity markets. I will make some broad-brush comments here and delve into each in future letters.

1. The economy and earnings
2. China and trade
3. Fed policy
4. Fixed income markets
5. U.S. election
6. Climate change policy

There is no argument that global economic growth is slowing. What is worthy of debate is whether this is just a slowdown which will be followed by a rebound or something that will develop into a real recession. I lean toward the latter, but strong markets are telling me something different. Recent economic releases confirm slower growth around the world and numerous forecasts are being lowered. U.S. GDP was just reported at only a 1.9% yearly rate; China is guiding its economy to a pace below 6%; and Europe is trying to stave off a recession. On the earnings side, I will simply point out that in 2018 S&P 500 earnings per share grew at 10%, but for the year just ended September 30th earnings were down 2%.

When discussing China and its future it is worth looking into its past and recognizing what an incredible story it is. In 1980 China’s GDP amounted to $90 billion measured in current dollars, today it is in excess of $12 trillion. As recently as 2011 GDP growth was 19.7% compared to today around 6%. Much of that growth was built on the back of cheap labour and technology given by, or stolen from, western corporations overly anxious to access that huge market. Which brings us to today with China now a close second to the U.S. in economic strength, and the U.S. fighting to maintain its leading position. Thus, we have the tariff/trade negotiations with each side reluctant to give ground. Bits and pieces will likely be resolved and be positive for markets, but this will remain a long-standing battle for supremacy.

After the most recent rate cut Chairman Powell indicated the Fed does not want to cut rates any further and sounded very sure that an increase in rates is not on the table for the foreseeable future. That's good news for markets as the Fed borrows from the medical profession and promises to "do no harm". Still open to question is whether central bank policies any longer have the power to materially affect the economy and markets. A lot of ammunition has already been used up and empirically we are seeing less price movement when rate changes take place. It is worth noting that U.S. GDP growth is lower today than when the Fed first began quantitative easing.

I'll say it again negative interest rates make no sense. Paying someone to take and hold your money is not a long-term viable proposition. Savers are being punished; pension funds are being forced into taking more risk to meet projections; European financial institutions have suffered and those that trade have lost 1/3 of their market value since January 2018. I don't think it is anywhere near imminent and I don't know how or when it will end, but it will not be pretty. In the meantime, the health of fixed income markets will continue to have a significant impact on equity markets. The recent increase in longer term rates and resultant decrease in bond prices is an example of the possible destabilizing effect which could spread to other markets.

The U.S. election is now only a year away and given the differences in the economic policies of the two sides, it stands to have a major influence on markets. If Elizabeth Warren were to win and is serious about her intentions it would be a negative for equity investors. I have held the belief that impeachment would die in the Senate given the Republican majority there. However, as the testimony against the President builds, those Senators might get a message from their constituents that Trump is no longer worthy of such support. My odds of a guilty verdict or resignation have increased significantly. Such an outcome would provide for uncertainty, and we know markets do not like uncertainty. I keep envisioning that some outlier we haven't paid attention to will rise up and win the election and save the world from either four more years of unpleasant craziness or the risk of much lower stock prices. I don't like my chances. However, today brings the news that Michael Bloomberg may be back in the race. Whatever his policies may be, he is a superior alternative to anyone else I see.

Finally, the debate over the consequences of and remedies for climate change has moved from just protests in the streets to boardrooms and financial summits. The recent International Monetary Fund and Bank of International Settlements annual meetings highlighted climate change as the most important topic on the agenda. The solutions are not without great cost and disruption and are certain to affect us all personally and financially. The impact is unlikely to be immediate but is still very worthy of our attention.

Forward Looking Information and Disclaimer

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