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INVESTMENT MANAGEMENT

SLIMMON'S TAKE > TAKEAWAYS & KEY EXPECTATIONS

Bullish Capitulation – Real Time

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1. BULLISH CAPITULATION:

What is the market thinking? Has it gone off its rocker?

Consider:

A. A deadly virus has killed over 1,000 people, continues to spread, shuts down large portions of the second biggest economy….*and the stock market responds so far with a paltry -3.2% peak-to-trough decline.*[1]

B. An anti-capitalist who views Wall Street and the stock market as being no better than "the workings of gangsters" is now the leading Democratic nominee….*and the market ignores it.*[2]

C. President Trump is impeached, tensions with Iran escalated…. *more non-events for the stock market.*

Is the stock market just "whistling past the graveyard"?

I maintain the thesis I first presented in our January 2020 Market Outlook webcast and reiterated on our most recent Market Alert:

> *2020 is going to be a* ***<u>bullish capitulation</u>*** *year, just as 2013 and 2017 were. In each of those years, investors realized they had made a mistake by selling out the previous year (or were too bearish), and thus reversed direction and chased back into the market.*
>
> *And because everyone looking to invest wanted a pullback opportunity, <u>pullbacks became muted</u> because of the incremental buy pressure.*[3]

That is the key point. *Bad news does not cause significant declines, because investor mindset has shifted from selling on weakness, as was the case in 2019, to buying on weakness, as is the case so far in 2020.*

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2. DON'T GIVE UP ON VALUE:

Fears of a coronavirus-induced global slowdown have caused a rotation into the mega-cap, less cyclical technology stocks. *I think it's a mistake to chase that trade.* I believe ***Value stocks*** will surprise in their recovery, especially financials and industrials.

This view is based on my belief that the US economy is going to be stronger in 2020 than what this non-cyclical Growth rotation is suggesting, despite a Q1 slowdown due to the Boeing issues and now the current health scare.

To be clear, I do not recommend jettisoning Growth for Value. But Growth is overbought, and Value is extremely oversold. The last time Value was this under-owned was 2014, and over the next two months it dramatically outperformed.[4] In essence, the Growth side of the boat is too crowded right now.

3. DON'T FIGHT THE FED:

I know it's a simple saying, but if it's so easy, why were so many investors bearish last year even *after* the Fed reversed policy and moved dovish?[5] In my opinion, it is because *simplicity does not sound intellectual*. That is exactly why I have this quote taped to my monitor:

> *"The best environment for stocks is a very dull, slow economy that the Fed is trying to get going."* [6]

To me, that is exactly the environment we are in right now: a very dull, slow economy. As much as the current health scare is a tragic story, it probably keeps the Fed on hold even longer.

4. THE RISK TO THE MARKET REMAINS TOO MUCH ECONOMIC STRENGTH, NOT A LACK THEREOF.

I worry that last year's measures by the Trump administration to ensure strong voter optimism going into an election ***could*** cause the economy to heat up too much *later this year* or next.

Will the market start to anticipate the Fed reversing direction?

Time will tell, but as I said, it's not economic weakness we need to worry about, but economic strength. Consumer confidence is at a 34-year high, and 60% of Americans think they are better off financially than they were a year ago.[7,8] That's great news, but will the Fed begin to adjust its current views if the economic data begins to support the sentiment?

5. YET AGAIN, INTERNATIONAL IS UNDERPERFORMING THE US.

An overwhelming consensus call for 2020 was that international developed markets would outperform the US.[9] I believe that Asia ex-Japan *will* outperform the US, but I question the overall call.

However, I would not give up on the rest of the world right now. Assuming we get some recovery out of the tail end of the current health scare, and Value bounces back as well, I do think some of the non-US markets might outperform near-term.

However for our Global strategies in 2020, we are not currently betting on Europe and Japan over the US.

6. ANOTHER OVERRIDING CONSENSUS CALL IS THAT THE US MARKET IS EXPENSIVE. BUT IS IT?

An 18.9x forward PE for the S&P 500 is lofty compared to the market's long-term average PE.[10] However, given the recent drop in interest rates, the S&P 500's dividend yield of 1.78% is now ***above*** the 10-year Treasury's 1.62% rate. In the last 50 years, there have been 40 instances when the dividend yield moved above the 10-year interest rate. One year later, the market was higher 38 out of 40 times.[11] Those are pretty good odds.

I am not so sure the bearish argument that the market is too expensive holds water.

Andrew

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[1] On January 17th, the S&P 500 peaked at 3,330 and bottomed on January 31st at 3,225.

[2] "Brainy Quotes". Bernie Sanders.

[3] "Market Alert", February 4th.

[4] A Few Things, Michael Schaftel. February 7th.

[5] Net flows from equities remained negative in 2019 even after the Fed pivoted.
[6] *Stanley Druckenmiller.*
[7] *Calafia Beach Pundit, February 8th.*
[8] *Gallup, February 10th.*
[9] Birinyi Associates, Inc. December 19, 2019.
[10] Factset as of February 13th.
[11] SentimenTrader, October 17th, 2019.