Weekly Investment Strategy

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Key Takeaways

- Fed 'Poised' to Extend Economic Expansion
- Positive Earnings Growth to 'Feed' the Equity Market
- There is 'Protective Glass' Between Equities & the Sleeping Bear Market

This week, I had the pleasure of presenting our market outlook to clients at an event held at the Brookfield Zoo in Chicago, IL. As I journeyed through the park, I realized that aspects of the day-to-day operations at the zoo and several of the animals seemed applicable to the state of the economy and financial markets today.

- **It's a Zoo! |** Today, this familiar phrase is used to connote noisy, crowded, disorderly and chaotic situations. However, as I trekked through the park, I could not help but surmise that this zoo was the complete opposite of this description. The animals were beautiful, the exhibits were well maintained, and the staff was well-organized and professional. Similarly, contrary to how many pundits and even our president have described the Federal Reserve (Fed) as "behind the curve" or "out of touch," I believe the Fed has acted prudently in navigating the longest expansion in US history (123 months). In fact, just like the Brookfield Zoo, the Fed is a well organized, smooth operation that is exercising patience as it awaits further economic data from around the globe, staying true to their stated objectives, and not succumbing to pressure from the financial markets. Our base case is that the Fed will cut interest rates 25 basis points (bps) at next week's meeting. And while the debate will rage on regarding whether the Fed is done or will need to cut rates several more times, the bottom line is that the Fed will do enough to assure that the economic expansion continues for the foreseeable future.
- **The 'Bison' Bull Market |** As an optimistic CIO, my favorite animal is a bull. At this zoo, my option was to visit one of their male bison, also referred to as a bull. What makes a bison so unique is its impressive size (bulls can weigh upwards of 2,000 pounds and measure six feet tall!) and its remarkable strength (bulls have thick skulls and broad, curved horns to defend themselves). These are the same two characteristics that set this current equity bull market apart from the average bull market: size and strength. The current equity bull market is the second longest in our history (126 months) but the strongest from a total return perspective at this point of the cycle (454% since its March 9, 2009 inception).
- **Feeding Frenzy |** The 'favorite food' propelling equities higher during the current bull market has been earnings, as S&P 500 earnings have increased ~250% since the start of the bull market. With the S&P 500 less than 1% off of its all time high despite uncertainty surrounding trade and elevated global growth fears, earnings will have to accelerate in order to fuel the market to new levels. While full-year earnings have been revised down ~5% year-to-date for both 2019 and 2020, consensus earnings expect positive growth of 2% and 10% in 2019 and 2020, respectively. With depressed global sovereign yields and attractive equity valuations (19.7 LTM P/E), this positive earnings growth should support a move in the equity market to new all-time highs. From a sector perspective, stronger earnings growth within the cyclical sectors (Technology, Communication Services) support our overall preference of cyclical over defensive sectors.
- **Don't Wake the Sleeping Bear |** As a superstitious person, I made sure to keep quiet as I passed by the sleeping grizzly bear. While we expect the equity market rally to continue and for the bear to remain asleep for at least the next 12 months, it is worth noting the pounding an equity investor may have to absorb if we are incorrect and enter a recession-induced bear market sooner than expected. Over the last 50 years, market declines coinciding with a recession have seen the S&P 500 drop ~36% over ~16 months, on average. For now, we believe the protective glass between the equity market and a bear market includes a positive economic backdrop, rebounding corporate earnings, attractive valuations, favorable corporate activity (e.g., increasing dividends & buybacks) and supportive Q4 seasonality. Like a giraffe, we will continue to stretch our necks to look over the horizon in order to anticipate if, and

when, any of these favorable conditions begin to deteriorate.

- **Hefty ‘Humps’ |** As I observed the large humps on the camels’ backs, I recalled they serve the purpose of storing food for long journeys throughout the dessert. For the financial markets, the growing ‘hump’ of money market mutual fund balances, currently at the highest levels since 2009 (at ~$3.4 trillion) may serve to support the equity rally. While some of these funds are likely set aside to cover short-term liquidity needs, the elevated levels lead us to believe that cautious investors have built a sizable amount of ‘sideline’ funds that they could redeploy to sustain the rally. Given the lackluster returns afforded by money market funds, pullbacks in the equity market could be mitigated by investors redeploying some of these funds. With our favorable equity outlook, we view modest pullbacks as buying opportunities for long term investors.

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