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Mitch on the Markets

3 Investment Trends You Need to Keep an Eye On!

By Mitch Zacks
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As we rapidly approach the end of 2017, the S&P 500 is on track to notch its ninth consecutive positive year. This stretch of gains could make this bull market as long (or even longer) than the historic 1990's run. With the bull market this 'long in the tooth,' just about every investor is wondering how much fight it's got left in it.

In this column, I'll argue that the bull market has more runway at least looking out over the next 3–6 months. I think economic fundamentals support higher prices even though valuations are arguably stretched by historical standards. In my view, investors should position themselves to participate by allocating to equities *to the degree* that your risk tolerance and investment objectives allow.

But, back to the matter at hand, my near to medium-term optimism is grounded on three trends that I think could define Q4 (and beyond). Here they are.

Trend #1: Sustained Global GDP and Earnings Growth

If you exclude the post-financial crisis recovery, all major regions are posting earnings-per-share growth higher than 10% *for the first time since 2005*. We have been waiting a long time to say something like that in this expansion as economies across the world have struggled to sustain even just average growth. The global tide appears to be turning in sync, finally.

As it stands today, all 45 countries tracked by the Organization for Economic Cooperation and Development (OECD) are on pace to grow this year, and 33 of them are actually on pace to see growth rates *accelerate* from the year before. If those 33 countries manage to improve on last year's growth rates, it would mark the most number of countries experiencing accelerating growth since 2010. At the end of the day, the global economy is expected to expand by 3%–4% in 2017, which is solid especially considering that we are nine years into this expansion.

Here in the U.S., we see no interruption to the sustained "muddle-through" growth we've been observing for the last several years, which is perfectly fine by us. Growth is growth. There is even arguably some slack in the economy despite the jobless rate approaching historic lows. Many companies are reporting difficulty finding qualified workers, and we think it's possible – if not probable – that capex could increase from here.

Our growth and earnings forecasts are holding steady in the U.S. and Europe, Japan is chugging along, and emerging market (EM) earnings expectations have almost doubled this year.

Trend #2: Low Volatility: Not a Canary in a Coal Mine

Volatility in the U.S. equities market has been so low of late it may as well be classified as non-existent. This has many investors convinced that volatility is due to surge, which could in turn result in sharp declines. Truth be told, I do not necessarily disagree with this line of thinking.

However, what I would also say is that an uptick in volatility should be viewed as an opportunity, not as a signal to run for the hills. In my view, in the worst-case scenario we could see a volatility snap that resembles the 1987 equity plunge or the massive correction in 1998. Those would be scary pullbacks, but remember in both of those years that the market still finished positive for the twelve-month period. What investors tend to forget is that volatility works both ways, and sharp pullbacks are often followed by even more convincing rallies. If we see an uptick in volatility in the near term while economic fundamentals remain strong, I would see that as an opportunity.

Trend #3: The Fight over Tax Reform

Generally speaking, there is more consensus in the Republican party about the need for tax reform than, say, the need for health care reform. But that does not mean that passing a tax reform law will be easy. Just the opposite in fact.

Case in point: the original House Republican plan called for using a border adjustment tax to generate revenue needed to finance lower rates for other sectors. Enthusiasm for this approach was significant amongst many analysts and a large swath of Republicans, but it was quashed by two Senators from Arkansas, which surprise, is the home state of Walmart. The point here is that a myriad of interests and preferences for how to do tax reform could complicate the process substantially in the months ahead.

The path of least resistance—and one that would be beneficial for corporate earnings and the market—is one that lowers rates a little on the corporate side and streamlines individual taxes with fewer deductions but substantially lower effective rates. If a deal gets made that has these qualities, it could mean another brisk tailwind for stocks.

Bottom Line for Investors

Equity indexes have been on a roll, hitting new highs basically every week. Advances in the stock market are stretching valuations bit by bit, but we do not necessarily see valuations as bound to some long-term average, *especially* with interest rates this low. Plus, we think that global economic fundamentals support higher equity prices, and we remain optimistic for the months and quarters ahead.

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

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