Zacks INVESTMENT MANAGEMENT

# Mitch on the Markets

## Was This Really the End of the Bull Market?

By Mitch Zacks
Portfolio Manager

With every new day of equity market selling pressure, many investors are becoming increasingly concerned that maybe this is more than just a market correction. We've seen over $7 trillion wiped from global equity market cap from the peak in January, and as it appears today, we may encounter the rare outcome of having both bonds and stocks in negative territory by the end of the year. The "cut your losses" reflex is starting to creep into the investor psyche, but I'm thinking the opposite – I'm sticking by this bull market.

The selling pressure is arguably rooted in real and valid uncertainties: trade disputes, tightening financial conditions, softening global growth. But ignored in all of these concerns, in my view, are global economic fundamentals that imply high single digit corporate earnings growth in 2019 along with a low probability of recession. Historically speaking, that's just not the stuff of bear markets.

I'm not saying the bull market will roar in 2019 with above average returns. But I also don't think it's a good time to reposition away from equities into a defensive posture. Too often investors do so at just the wrong time, and they miss what are often "v-shaped" recoveries when the selling pressure subsides. In my view, we should expect to see such a recovery soon.

The basis of our positive outlook in 2019 hinges on many factors, but here are the three most important ones, in my view.

1) **Global Economic Growth, Plain and Simple**

The Zacks Investment Management view is that 2019 U.S. GDP should settle into a growth rate that is materially higher than other developed countries, even as the effects of the corporate tax cut fade. China is the other 'wildcard' that has many investors worried, but we do not see a high risk of a substantial slowdown. At the annual Central Economic Work Conference (CEWC) in Beijing where officials set economic policy for the new year, all indications point to full support of the economy through fiscal and monetary stimulus.

Leaders pledged to cut taxes and fees "on a greater scale" and to address any financing difficulties for private and small business through liquidity measures. At the end of the day, China has levers to keep their economy growing, and I believe they're likely to pull them.

2) **Corporate Earnings Growth Slowing, But Still Nicely Positive**

The headwinds to global corporate earnings growth are palpable: slowing global economic growth, fading impact of tax cuts in the U.S., and the impact of tariffs, to name a few. But investors should not mistake *slowing* corporate earnings growth with *negative* corporate earnings growth. In my view, the latter is a major concern for stocks – the former is not. As it stands now, Zacks still expects U.S. corporate earnings growth in the high single digits in 2019, perhaps just under 10%. This growth rate is still above the global average, even as Emerging Markets are expected to notch double-digit earnings growth, led by China.

3) **Arriving at the Neutral Rate**

The market is seemingly in an uproar about rising rates, but we see them as appropriate on three counts: 1) the U.S. economy is growing firmly and unemployment is at historic lows; 2) Interest rates are still very low historically and arguably need to come up; 3) Raising interests now (when the economy is strong) gives the Fed the ability to lower them in the event of an actual crisis. In short, I think the Fed is doing the right thing, no matter what you may hear in the news.

As it stands today, U.S. rates are getting close to neutral, which is the level at which monetary policy is neither stimulative nor restrictive. Once the Fed reaches the neutral rate, which appears to be at about 3%, we believe they're likely to pause. In our estimation, that could mean one or two rate hikes in 2019, then a 'cruise control' period. Any pressure on asset valuations could ease as a result.

**Bottom Line for Investors**

The menu of market fears is extensive. Trade fears and Fed tightening dominated headlines for some time, and those fears are now being joined by calls for a global recession and a full-on tech backlash. But keen investors might notice that fears and concerns *tend to accompany market volatility*, but then those same fears also recede – like magic – when the market recovers! **Meanwhile, in my view, strong economic growth fundamentals have been there all along.**

Here's what I'd like for investors to consider: what if the U.S. and China work out a trade deal? What if the Fed raises rates as expected and then pauses in the back half of next year? What if global corporations continue to grow earnings at a slower, but still quite robust, pace in 2019? How likely is it

that the worst-case scenario *will not* actually occur? What might the markets do then?

In my view, it's fairly simple: as the fears ebb, which I believe they will, the market should be poised to rise.

**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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