# Mitch on the Markets

## 5 Key Themes for Your Summer Portfolio Review

By Mitch Zacks
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For many families and investors across America, the summer months are a time for vacations, having the kids and grandkids out of school, and less stress at work (hopefully). For the markets, the summer months tend to follow a somewhat similar path with historically low volumes – though volatility generally likes to stick around.

This summer, there's a lot to think about as it relates to the markets – particularly, how the trade wars may affect corporate earnings in Q2. But I'd encourage investors to try and take a step back from the day-to-day stories and instead think on a higher level about portfolio themes, construction, and macro strategy. For that, I have 5 investment themes for you to consider this summer.

**1. Value over Growth –** The runway left for U.S. economic growth is likely becoming more limited, in my view. Labor markets are tight and wage pressures are likely to result in rising inflation, which may trigger higher interest rates over time. Higher interest rates tend to slow investment and spending, which can lead to slower growth rates. When the economy slows, non-cyclical companies tend to perform better than cyclical companies. Value stocks are often, but not always, associated with non-cyclical companies as cyclical companies tend to trade at higher valuation multiples in periods of an economic expansion.

However, there is one issue that might give growth stocks a longer than expected boost over value stocks: With a slowdown in corporate earnings, the number of companies exhibiting strong earnings growth *decreases* while the demand for these companies by investors *increases*. Thus, it is possible for growth stocks to continue to perform well even in a period when aggregate earnings growth is slowing due to an imbalance between supply and demand. Generally speaking, an investor will perform better by focusing on revisions to earnings estimates as opposed to trying to time when value will outperform growth. That being said, growth has had a long run, trees don't grow to the sky, and it makes sense to try to be a little more biased towards value stocks if possible, at this stage of the business cycle.

**2. Large Cap as a Category –** Similar to the argument above, large cap companies tend to have the capital and cash needed to weather slowdowns, particularly if you seek out the ones with high cash balances and stable earnings. One word of caution I'd give investors, however, is to take a close look at a company's sources of income. If a high percentage of sales are derived from global sales, and exposure to China is higher than average, you may want to take that into consideration when building a thesis to own a company.

**3. U.S. over Foreign –** The United States has outperformed foreign in this cycle, for good reason – higher corporate earnings growth, better growth rates, the benefit of fiscal stimulus (tax cuts), and a comparable level of monetary policy stimulus. Even though interest rates in the U.S. have ticked up while central banks globally remain accommodative, the Fed appears committed to holding rates steady for the balance of 2019, which puts the U.S. back onto level playing ground with the rest of the world. As global economic growth rates slow, look to the U.S. for relative stability.[1]

**4. Municipals and Investment Grade Corporate Bonds –** In the first quarter, municipal bonds rallied as interest rates declined. Supply remains tight and demand remains strong as tax reform legislation passed in 2017 has further provided support for the municipal bond market. In particular, the deduction cap on state and local taxes has hurt high income earners in states such as California, New York and Connecticut, prompting demand for tax-free income.[2] On the corporate side, there's quite a bit of reporting on corporations being on a borrowing spree, which I agree is a risk at the margin. But not all corporate debt is created equal, and high-quality borrowers almost always pay better yields than offered in the risk-free market.

**5. Don't Fight Volatility –** As mentioned in the beginning of this week's column, sometimes the summer months feature heightened volatility on lower volumes. With the trade war still bubbling and geopolitical tensions rising at the margin, volatility has a breeding ground. I'd encourage investors to think about the first four themes mentioned in this piece, check your portfolio to make sure you're well diversified and positioned in accordance with your goals, and then get out and enjoy your summer. Our outlook for 2019 remains constructive, with what we see as little chance for a recession in the U.S.

**Bottom Line for Investors**

Focus on high level themes this summer and make sure your portfolio is diversified. Taking the time to review your holdings and considering how you're positioned in the current environment might take a day of work but can yield a summer of enjoyment. And that's worth your while.

**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.

[1] Yahoo Finance, May 22, 2019. https://finance.yahoo.com/
[2] Zacks Investment Management Q1 2019 Quarterly Commentary.

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