Mitch on the Markets

Bullish or Bearish? Here is My View

By Mitch Zacks
Portfolio Manager

On the surface, it looks like the bull market is hitting resistance on multiple fronts. Just when many market participants thought a trade deal with China was in the offing, talks broke down and tariffs went up – the exact opposite of a 'market friendly outcome,' in my view. Now, as corporations grapple with a new layer of uncertainty, the United States is also dealing with multiple geopolitical situations, from Venezuela to Iran to North Korea. And as if all these challenges aren't enough, earnings were flat in Q1.

If some investors are starting to feel less bullish these days, I'd understand why. But I'm not one of them.

Let's take a closer look at each of the above-referenced situations and see what's really there.

U.S. - China Trade: I've said before that I believe a trade deal is a key factor in giving stocks room to run, so seeing these talks stumble was disappointing. The market didn't like it either – on the day it became evident that talks weren't advancing the S&P 500 fell by over 2% with 90% of stocks declining.[1]

We do not know when or if a deal will get reached, and it's very difficult if not impossible to measure the impact of uncertainty. But if we forecast a 0.3% or perhaps on the high end a 0.5% hit to GDP as a result of increased tariffs, I think we're still a far cry from undoing 3.2% GDP growth (Q1 initial estimate). What's more, it's important to remember that exports only comprise around 12% of U.S. GDP, while consumption accounts for nearly 70% of our economy.[1] To the extent prices don't go up too much with the latest round of tariffs, the U.S. consumer will likely weather this storm.

The one point of caution I'd underscore, however, is that investors should not read too far into 3.2% GDP growth in Q1.[2] For one, it's just an initial estimate. But second and more importantly, the start of the trade war last year resulted in quite a bit of supply-chain padding for many corporations – which gave a one-time boost to GDP. Looking deeper into the data, an investor would find that final sales (excluding inventories and net exports) grew at a more modest rate of 1.4%—the weakest performance since 2015. It's still growth – which keeps me bullish – but it's certainly late cycle growth, which keeps me cautious.

Escalation with Iran: We learned this week that Iran may be weeks away from exceeding an internationally-agreed cap on stockpiles of low-enriched uranium.[3] It follows that this development would make them steps closer to production of nuclear weapons, which has drawn scrutiny from the international community and has led to posturing by both Iran and the United States.

Iran wants sanctions relief, while the U.S. continues to deepen sanctions and increase military prescence in the area. Statements by the U.S. National Security Advisor, John Bolton, made it appear as though the U.S. would be ready to engage militarily at any time, though President Trump has indicated he does not want war with Iran. For stock markets, an unexpected escalation or a miscalculation on either side would likely result in volatility, but I'm not convinced at this stage that either nation is doing anything more than posturing.

The Weak Earnings Picture: Looking at Q1 as a whole, earnings growth is expected to be effectively flat (down -0.1%) on +5.1% higher revenues. Investors generally do not like to see flat earnings.[3]

But there's an upshot here, too. Total earnings for the 450 S&P 500 members that have reported earnings showed 77.1% of them beating EPS estimates and 59.3% beating revenue estimates. Those are reasonable levels of earnings beats, and I think we can expect an earnings recovery in the second half of the year (assuming the trade dispute is resolved by then, which I think it will be).

Bottom Line for Investors

Remember, the stock market has thrived historically even in challenging moments. Over time, there are events and obstacles that seem insurmountable, and sometimes these events result in mass casualties or the destruction of numerous businesses, banks, or even industries. Yet stocks have managed to battle through the adversity and have continued throughout history to trend higher, reaching new highs in every cycle.

In some cases, the gains seem to defy logic, but at the end of the day it's just the course that history has carved (and will continue to carve, in my opinion). Stocks love to climb a wall of worry, and *stocks have shown over time that solid long-term returns have come to those who wait.* Waiting requires patience and an ever-constructive attitude about human potential and the potential for relentless growth in the global economy. My constructive outlook today keeps me bullish until proven otherwise.

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] Forbes, May 14, 2019. https://www.forbes.com/sites/michaelcannivet/2019/05/14/simplifying-the-trade-war-risk/#163405ed1c01

[2] The Wall Street Journal, Mary 20, 2019. https://www.wsj.com/articles/iran-says-it-is-poised-to-exceed-limits-on-nuclear-stockpile-11558383576?mod=hp_lista_pos1

[3] Zacks Investment Research, May 13, 2019. https://www.zacks.com/commentary/413542/making-sense-of-the-earnings-picture.

DISCLOSURE

Past performance is no guarantee of future results. Inherent in any investment is the potential for loss.

Zacks Investment Management, Inc. is a wholly-owned subsidiary of Zacks Investment Research. Zacks Investment Management is an independent Registered Investment Advisory firm and acts as an investment manager for individuals and institutions. Zacks Investment Research is a provider of earnings data and other financial data to institutions and to individuals.

This material is being provided for informational purposes only and nothing herein constitutes investment, legal, accounting or tax advice, or a recommendation to buy, sell or hold a security. Do not act or rely upon the information and advice given in this publication without seeking the services of competent and professional legal, tax, or accounting counsel. Publication and distribution of this article is not intended to create, and the information contained herein does not constitute, an attorney-client relationship. No recommendation or advice is being given as to whether any investment or strategy is suitable for a particular investor. It should not be assumed that any investments in securities, companies, sectors or markets identified and described were or will be profitable. All information is current as of the date of herein and is subject to change without notice. Any views or opinions expressed may not reflect those of the firm as a whole.

Any projections, targets, or estimates in this report are forward looking statements and are based on the firm's research, analysis, and assumptions. Due to rapidly changing market conditions and the complexity of investment decisions, supplemental information and other sources may be required to make informed investment decisions based on your individual investment objectives and suitability specifications. All expressions of opinions are subject to change without notice. Clients should seek financial advice regarding the appropriateness of investing in any security or investment strategy discussed in this presentation.

Certain economic and market information contained herein has been obtained from published sources prepared by other parties. Zacks Investment Management does not assume any responsibility for the accuracy or completeness of such information. Further, no third party has assumed responsibility for independently verifying the information contained herein and accordingly no such persons make any representations with respect to the accuracy, completeness or reasonableness of the information provided herein. Unless otherwise indicated, market analysis and conclusions are based upon opinions or assumptions that Zacks Investment Management considers to be reasonable. Any investment inherently involves a high degree of risk, beyond any specific risks discussed herein.

It is not possible to invest directly in an index. Investors pursuing a strategy similar to an index may experience higher or lower returns, which will be reduced by fees and expenses.

The S&P 500 Index is a well-known, unmanaged index of the prices of 500 large-company common stocks, mainly blue-chip stocks, selected by Standard & Poor's. The S&P 500 Index assumes reinvestment of dividends but does not reflect advisory fees. The volatility of the benchmark may be materially different from the individual performance obtained by a specific investor. An investor cannot invest directly in an index.