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INVESTMENT MANAGEMENT

Mitch on the Markets

Portfolio Manager Investing Insights

WEEKLY CLIENT COMMENTARY November 26, 2019

Reacting to “Doom and Gloom” Stock Forecasts May Cost You

Investing in the equity markets means confronting a constant barrage of economic, political, and financial information – with most of it tilting to the negative. Then there are times when prominent commentators ratchet-up the rhetoric with “Armageddon” scenarios, forecasting economic ruin and using phrases like “the death of equities.” Many investors, understandably, get shaken up by such predictions, and in extreme cases might make a sudden decision to switch from stocks to bonds or cash.

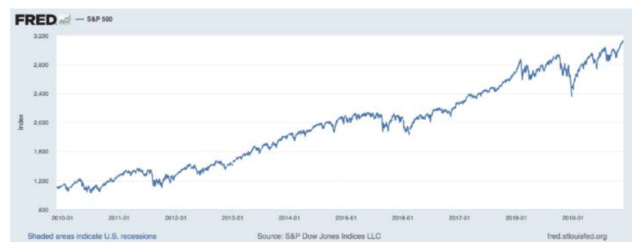
But these sudden decisions to ‘run for the exits’ at the first mention of Armageddon are almost always wrong. This has consistently been my opinion on the matter, but now there is actually research showing that heeding Armageddon predictions can lead to poor, negative performance.

A recent study looked at Armageddon predictions made by over 15 prominent financial thought leaders – from asset managers, to journalists, to the heads of major banks and hedge funds. These prognosticators and managers made Armageddon predictions at various times over the last 10 years.

Given that we know the stock market is near all-time highs, it’s evident each prediction was wrong. But the study takes matters a step further, and examines the actual financial impact of moving $1 from the S&P 500 to the Barclay’s Aggregate Bond Index at the time of doomsday prediction.

Heeding the doomsday predictions resulted in returns ranging from -25% to -60%.[1] The fact of the matter: at any point in the last 10 years, taking a call for Armageddon seriously would have proven costly, in my opinion.

The S&P 500’s Performance Reflects the Opposite of Economic Collapse



Source: Federal Reserve of St. Louis[2]

This study of Armageddon predictions over the last 10 years just reinforces what I’ve been observing throughout my entire career and what I know from deep stock market research.

When Russia tested an atomic bomb with an explosion in 1949, and the Korean War started a year later, it surely felt like Armageddon was approaching – particularly with World War II just a few years before. But the S&P was up +18.30% in 1949 and +30.81% in 1950. Kennedy was tragically assassinated in 1963, but the S&P 500 rose +22.61% that year. "Black Monday" in 1987 led to a precipitous -22.6% decline for the Dow, but *the market still finished positive that year.*

Fast forward to our current decade, and the 2008 global financial crisis has given way to the longest economic expansion in history, with the S&P 500 near all-time highs. Long-term, it has not paid to think in doom-and-gloom terms.

Since 1950, the S&P 500 has been in the throes of a correction (-10% decline or more) for 7,135 days. That probably seems like a lot. But when you consider that there has been a total of 25,535 days (through November 30) since 1950, it becomes evident that the S&P 500 has spent a great majority of the time trending higher. Looked at another way:

• 7,135 days in correction mode
• 18,400 days in rally mode
• **Equals the S&P 500 in rally mode 72% of the time.**[3]

You don't have to be a mathematician to see that forecasting Armageddon at any point throughout history has most likely meant being wrong about it. The market rises far more often than it falls.

Bottom Line for Investors

The history of the U.S. equity market is a history that favors long-term optimists. It is not to say that we should blindly trust the stock market will always go up, and that as a result it is not worth trying to identify trends and weaknesses across sectors, industries, and individual companies. That's what we do every day.

But it is to say that heeding Armageddon predictions is very risky, and, as shown above, has a low probability of success. The next time you encounter a doom-and-gloom forecast, remember these lessons from history.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior 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] The Wall Street Journal, November 13, 2019. https://blogs.wsj.com/dailyshot/2019/11/13/the-daily-shot-heeding-financial-armageddon-predictions-can-be-costly/

[2] S&P Dow Jones Indices LLC, S&P 500 [SP500], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/SP500, November 21, 2019.

[3] The Motley Fool, May 14, 2019. https://www.fool.com/investing/2019/05/14/6-stock-market-plunge-statistics-you-need-to-know.aspx

IN FOCUS THIS WEEK

- What is next for the trade deal?
- Upcoming British elections
- How will Holiday sales play into Consumer spending?
- Will Leading Economic Indicators continue turning over?

With the end of the year fast approaching, many investors may be wondering what factors could affect the market before year-end and what can they expect in 2020. In this week's market update, we look at four factors we believe you should keep an eye on before year-end, such as:

Factor #1: A Positive or Negative Surprise on Trade

A few weeks ago, markets cheered the announcement of a potential "Phase 1" of a trade deal between the U.S. and China. It appeared as though China was going to agree to new commitments on intellectual-property protections, issues related to technology transfer, further liberalization of its markets, and a substantial increase in agricultural purchases. Fast forward to today, and most of that optimism has faded.

The false-positive and topsy-turvy nature of these trade negotiations should surprise no one at this point, and markets do not seem pressured by recent reports that the talks are fizzling. China has invited American trade negotiators back to Beijing for another round of face-to-face talks, but top American officials are reluctant to make the trip without firm commitments that China will follow through on Phase 1 terms. Meanwhile, President Trump has threatened to raise tariffs even further if China fails to meet U.S. demands.[1]

In short, the trade deal is set up now in such a way that, in our view, the market has priced-in gridlock. If the back-and-forth continues with no deal, we do not think the market will be overly affected. But the factor to watch between now and the end of the year is whether we'll be delivered a huge breakthrough with an inked deal (positive surprise) or a total collapse of the talks where the two sides enter 'cold war' mode (negative surprise). In either outcome, the market could respond accordingly.

Factor #2: British Elections

Mark your calendar for Thursday, December 12. That's when 46 million voters in the United Kingdom will have the option of heading to the polls to vote for their areas' member of Parliament (MP), which could ultimately determine what party will gain power and form a government. The Conservative party, currently led by Prime Minister Boris Johnson, is hoping they can increase the number of MPs to pass laws more easily. They currently hold 298 seats, and need 326 total to have a majority.[2]

This vote is crucial because it could very well seal Brexit's fate. If Conservatives gain a majority in the House of Commons and form a government on their own, the likelihood of a "hard Brexit" increases significantly. Leaving the European Union without a deal in place become a distinct possibility. On the other hand, if the Labour party picks up more seats it may serve as indication that the electorate has concerns about Brexit, which would give way to "soft Brexit" – or the insistence on leaving the EU with a deal and roadmap in place.

Factor #3: Holiday Retail Sales Activity

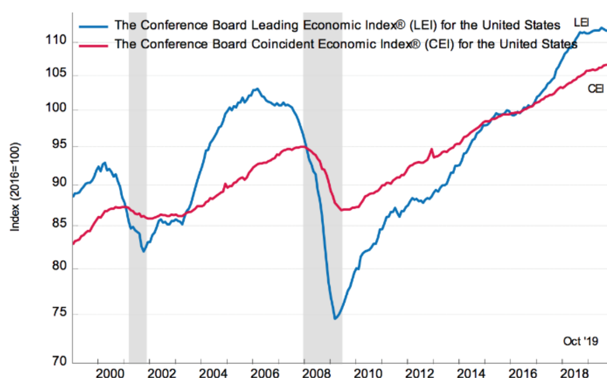
Consumer spending is a key driver of growth in the US economy. It follows that 2019 is shaping up to be the most critical holiday shopping season of this 10+ year economic expansion. Will the U.S. consumer continue spending at a healthy clip, or will we see a front-and-center indication that the consumer is running out of steam? The numbers in December will matter.

Early indications of consumer health are positive. Consumer confidence is rebounding ahead of holiday shopping season, and retail sales are coming off a +0.3% month-over-month uptick. Data also indicates that shoppers are expected to increase spending by 5% over last year's figures, with over 50% of all holiday shopping expected to take place online.[3] The job market is a key driver of consumer spending, and continues to hold its own with steady job growth. Companies of all sizes, however, are starting to reveal concern over lack of qualified workers.

Factor #4: Will Leading Economic Indicators Continue Turning Over?

The Conference Board's Leading Economic Indicator Index (LEI) has been a reliable predictor of recessions over the last few decades, as you can see from the image below. Historically, as the LEI (blue line on chart) peaks and starts to turn over, a recession has followed shortly thereafter:

The LEI Index has Turned Over Before Each of the Previous Two Recessions



Source: Conference Board LEI[4]

The Conference Board's LEI for the United States declined for a third consecutive month in November, with its six-month growth rate turning negative for the first time in over three years. According to the Conference Board, weakness was driven by weak new orders in manufacturing, falling average weekly hours for workers, and rising unemployment insurance claims. In short, a softening in the labor market that may be tied to the lack of qualified workers detailed in Factor #3. In all, the LEI suggests the U.S. economy may end on a weak note, making it a key factor to look for in December, in our view.

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[1] The Wall Street Journal, November 21, 2019. https://www.wsj.com/articles/china-invites-u-s-trade-negotiators-for-more-talks-11574330869?mod=djem10point

[2] BBC News, November 1, 2019. https://www.bbc.com/news/uk-politics-49826655

[3] CNBC, September 23, 2019. https://www.cnbc.com/2019/09/23/holiday-spending-expected-to-rise-5percent-this-year-driven-by-online-sales.html

[4] The Conference Board, November 21, 2019. https://www.conference-board.org/pdf_free/press/US%20LEI%20PRESS%20RELEASE%20-%20NOVEMBER%202019.pdf

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