Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

Portfolio Manager Investing Insights

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The Diminishing Power of Negative Stories

In 2015, weak growth numbers in China were worrying investors. There was also China's decision to devalue their currency, which sent equity markets into a brief tailspin. China was posting weaker-than-expected manufacturing and export figures, and the currency devaluation felt like a desperation move to revive growth.[1]

In 2016, investor fear shifted to the second coming of a credit crisis, as banks were starting to write-off non-performing energy loans that went bust after the steep drop in crude oil prices in 2014. Germany's biggest bank, Deutsche Bank, saw the cost to insure its debt soar by over 180% in just a three-month period, and Credit Suisse and other major European banks were reporting similar squeezes. Many prognosticators, at the time, were warning of a crisis in banking.[2]

Go back to 2011 (which it's worth mentioning was still part of the current bull market), and all talk was centered around the 'European Debt Crisis,' with worries of Europe's impending collapse. In 2013 and 2014, the news spent months covering the fiscal cliff and the repercussions it could have on the economy.

In all of these cases, the stock market endured volatility along the way, sometimes with sharp, steep, and scary declines. But I believe the crucial understanding you should draw from this walk down memory lane is: *did this volatility ever last long enough to hurt long-term returns?*

Throughout these years, I spent quite a bit of time (and several pages) hashing and re-hashing all of the above-listed fears and all the others of the time. China slowing, the energy recession, stock market volatility – these were all stories that were sparking concern that the economic expansion was nearing an end, and that the next bear market was upon us. It still hasn't come.

The equity bull market is still going strong as we enter 2020, posting what appears to be one of the better performance years on record. ***The takeaway: over time, recycled, negative stories – like the ones I've detailed above – tend to have diminishing pricing power, in my view.***

That's why heading into 2020, I think this bull market has more room to run. Lately, a majority of economic stories seem to only focus on a handful of narratives: China (trade), slowing global growth, manufacturing recession, weak earnings, impeachment, and Brexit. In other words, *absolutely nothing new that we don't already know.*

So, around the carousel we go, hashing and rehashing the same stories and worries about the U.S. and global economic future. If, in the new year, you notice that these stories continue to dominate headlines – which I believe they probably will – then I think it makes sense to use this as a cue that there's more bull market left to go. If news headlines move away from these worrying factors and talk shifts to "goldilocks" growth and an unstoppable stock market, then I'd say it's time to start worrying. But we're not there yet.

Bottom Line for Investors

The more effective you are at drowning-out negative, recycled headlines, the more success you will have over time as an equity investor, in my opinion. Above, I made a case for being bullish heading into 2020, without even mentioning anything about positive economic fundamentals as drivers of upside! These positive fundamentals exist, of course. But the point is that you can often parse a great deal of useful information about the stock market simply by identifying the elements of the "wall of worry" and asking yourself: have I seen this already? If you have, the economy and stock market are probably in better shape than many think.

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] https://www.zacksim.com/big-market-downturn-trouble-brewing/?div=mitch-on-the-markets

[2] https://www.zacksim.com/2008-financial-crisis-redux/?div=mitch-on-the-markets

IN FOCUS THIS WEEK

- Is the U.S. and China trade agreement realistic?
- The Brexit is official. Could this lead to a recession for the UK next year?
- The global economy finishes the year on firm footing
- What implications could come from Boeing's halting production of the 737 MAX?

Are Terms of the U.S. – China Trade Agreement Realistic?

The U.S. and China have agreed in principle to terms of a trade agreement, but part of the agreement appears – on the surface – to be wildly farfetched. According to U.S. negotiators, China has committed to agricultural purchases to the tune of at least $40 billion for the next two years, an exorbitant amount by historical standards. Indeed, $40-$50 billion seems far too high relative to China's agricultural needs and previous years' purchases. In fact, $40 billion of agricultural purchases would amount to almost double the record for what China has purchased from American farmers in previous years. China has growing demand for soybeans and pork, but the question is whether they will actually meet targets, or if this is yet another case of over-promising and under-delivering.[1]

Brexit Becomes Official

The U.K. election was nothing short of historic, with the Conservatives (Tories) winning a remarkable 80-seat majority. This victory for the Tories all but solidifies the Brexit mandate, with Britain nearly certain to leave the European Union on January 31. Perhaps the biggest benefit to this vote is not the political outcome, but rather the removal of uncertainty about the fate of Brexit. A second benefit is that there seem to be widespread predictions that the U.K. economy is due to suffer badly as a result of this breakup, with some forecasting recession in the coming year. In our view, this narrative actually works in the equity market's favor, as baseline assumptions of worst-case scenarios often leave wide open the possibility of a positive surprise. If the economic outcome is anything better than recession (even no growth), it could result in a positive response for the markets. On the negative side, British Prime Minister Boris Johnson signaled he would not extend the Brexit transition any further past the end of 2020, which increases the risk that Britain could end up formally leaving the customs union and free trade bloc with no deal in place with the EU.[2]

Global Economy Finishing the Year on Firm Footing

A handful of positive economic data hit the tape this week, and most all signs point to solid footing for the U.S. and global economy. U.S. business activity rose to a five-month high in December, U.S. purchasing managers struck a positive note about economic activity entering the new year, and consumer spending picked up in November. China also reassured markets this week with industrial output and retail sales figures that showed a pickup in growth, not to mention the limited trade deal that appears to be in the works between it and the U.S. Global growth, on balance, is expected to notch a 3% rate in 2020 – slowing but still nicely positive.[3]

The Outsized, Little-Known Impact of Boeing's Problems

Most readers are likely familiar with Boeing's recent woes as they relate to the 737 MAX plane. Two crashes last year led to a grounding of the planes, which led to ongoing investigations, which have now led the company to temporarily halt production of the plane. Typically, we do not write about individual companies or stocks in this column, as we would rather focus on the macroeconomic news that shapes the economic outlook and global markets. But that's just the thing – Boeing's halting production of the 737 MAX could have real implications to U.S. and global GDP. Aircraft production and aerospace is an important part of the U.S. economy, and halting production could lead to job cuts, furloughs, and a hit to the U.S.'s trade deficit if enough planes aren't delivered. By some estimates, Boeing's actions could cut 0.5% from U.S. GDP in Q1 2020.[4]

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[1] The Wall Street Journal, December 18, 2019. https://www.wsj.com/articles/chinas-farm-purchase-targets-under-trade-deal-face-skeptics-11576665004

[2] The Wall Street Journal, December 17, 2019. https://www.wsj.com/articles/johnson-says-u-k-will-cut-eu-ties-by-end-of-2020-11576592223?mod=hp_lead_pos7

[3] The Wall Street Journal, December 16, 2019. https://www.wsj.com/articles/global-economy-steadies-but-europe-remains-a-weak-spot-11576499964

[4] The Wall Street Journal, December 15, 2019. https://www.wsj.com/articles/boeing-weighs-cutting-or-halting-737-max-production-11576448990

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