Zacks
INVESTMENT
MANAGEMENT

Mitch on the Markets

Portfolio Manager Investing Insights

WEEKLY CLIENT COMMENTARY June 18, 2020

The Only Reason to Change Your Portfolio's Allocation

The stock market's recent moves have a lot of people confused.

On one level, it's easy to understand the -34% plunge from February highs – the stock market was pricing-in the steep, pandemic-driven global economic downturn that engulfed the world during the spring months. But since March 23, which was still early days for the pandemic and economic crisis, stocks abruptly switched into full rally mode. The "v-shaped" bounce caught many investors by surprise, as did the -5.9% wallop to the downside last week. The end result has been a lot of confusion about where this market is actually headed.

This confusion has been playing out in investor sentiment metrics. According to the American Association of Individual Investors survey in May, 53% of respondents cited being bearish for the next six months. Following a few more weeks of sustained rallying, the bearish number dropped to 38% a two weeks ago.[1] But following the steep one-day selloff last week, the number ticked higher again – all underscoring the investor confusion. Fund managers increased their investments in global stocks last month as well, but their overall equity allocations still remain far below long-term averages. No one is quite sure what to make of this market.

These topsy-turvy shifts in investor sentiment bring to light an age-old question that investors consistently grapple with: if today is a big up day for a stock, what does that tell us about tomorrow's performance? Or, if this month/quarter was a strong one for the stock market, what can we assume or forecast about performance in the next month/quarter? Generally speaking, there are three points of view in answering these questions.

The first point of view is held by 'momentum' investors and traders. It says that the move from today or this month will carry into tomorrow or next month, especially if there is a high volume supporting the trend. A second point of view is the belief that market timers are likely to swoop in to buy the dip or sell the rally to take profits, essentially reversing the price direction for the stock from one time period to the next. In this point of view, the strong rally in recent weeks must mean that "what goes up must come down."

The final point of view – which is the camp I'm firmly in – is that stocks are not serially correlated to any meaningful degree. In other words, what happens today, or this month, or this quarter has little-to-no influence or predictive power over what will happen tomorrow, or next month, or next quarter. Market returns are independent over time.

My concern today is that too many investors are basing their outlook for stocks on past performance. In my view, this explains why so many investors are becoming less bearish as the market rallies, and more bearish following steep, one-day declines like we saw last week. It's a signal that investors are using past performance as an indicator for future returns – which I advise against.

Ask yourself this question: has the recent market rally got you wondering if you should take profits off the table now? Or maybe you're thinking that now is a good time to sell-out of stocks, so as to ensure you at least "break even" as this pandemic and crisis continue to unfold? If the answer to either of these questions is yes, then you're using past performance as a predictor of future returns. Again, not advisable.

Bottom Line for Investors

In my view, the worst possible outcome happens when a person changes their asset allocation (usually by reducing their equity allocation) because they think a market rally was too strong, too fast, or unfounded. I see this happening a lot today, but I think it's evidence that investors are basing decisions on technical indicators and past performance versus fundamental drivers.

I strongly believe the only reason to change your portfolio's asset allocation is if your financial situation and/or long-term goals have changed. For many, the pandemic and economic downturn may have triggered personal financial changes that warrant portfolio adjustments. But for most, it probably hasn't, and any portfolio changes happening now could be happening for the wrong reasons.

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, June 14, 2020. https://www.wsj.com/articles/frustrated-stock-market-skeptics-stick-with-cautious-bets-11592127000?mod=djem10point

IN FOCUS THIS WEEK

- Consumer spending is bouncing back
- Powell warns of "long-term risks" to the U.S.
- The Fed takes unprecedented measures

The U.S. Consumer, Back in Action

Consumer spending is the foundation of the U.S. economy, accounting for nearly two-thirds of annual GDP. In March and April, the Covid-19 pandemic was a literal cliff for retail spending – job losses and the inability to leave home led to sharp declines across nearly all categories of spending, except for groceries and essential home goods. May saw the consumer spring back to action, with the Commerce Department reporting a +17.7% increase in retail sales from a month earlier. The push higher was driven by apparel, furniture, home improvement, entertainment, restaurants, and spending on autos (which makes up about 20% of total retail sales). In February, when there were no restrictions in the U.S., retail sales hit $527 billion. In May, retail sales totaled $485 billion – not too far behind pre-pandemic levels. Consumer spending has been boosted by loosening restrictions across all 50 states, as well as government stimulus such as IRS checks and unemployment benefits.[1] Key data will come in July when the extra unemployment benefits are set to end.

Fed Chairman Warns of "Long-Term Risks" to the U.S. Economy

Federal Reserve Chairman Jerome Powell appeared (virtually) before Congress this week, and his message was far from rosy. The Fed Chairman said the U.S. economy could potentially suffer significant long-term damage from sustained high unemployment and small business failures. He added that "until the public is confident that the disease is contained, a full recovery is unlikely." Mr. Powell also urged Congress to consider more spending with regards to helping unemployed workers, supporting fiscal budgets for states and municipalities, and taking steps to boost consumer confidence with health measures like virus testing and contact tracing. Mr. Powell's testimony painted a rather bleak outlook for the U.S. economy, which in our view actually helps stocks in the medium-to-long term. With the bar set fairly low on long-term economic growth, there is a higher possibility of the actual outcome being better than expectations – a positive outcome for equities, in our view. On a similar note, many economists are scrambling to re-state expectations for the "shape" of the economic recovery in the U.S. With strong retail sales in May and economic activity continuing to tick higher in June, the possibility of an "L-shaped" recovery – where economic activity remains depressed at pandemic levels – is pretty much out of play.[2]

The Fed Steps Up Participation in Corporate Bond Markets

The Federal Reserve has taken unprecedented measures to provide liquidity, credit, and confidence in the capital markets since February. In its latest installment of monetary accommodation, the central bank announced this week an additional $250 billion lending program to buy corporate bonds – providing additional stability and liquidity to credit markets. The Fed plans to build a diversified portfolio of corporate bonds, focused only on companies that were investment grade on March 22 and with a duration of no greater than five years. The Fed's role here is essentially as another major institutional player in the corporate bond markets, to keep demand steady and to provide financing to corporations with the potential to earn returns on the back end. The Fed's debt-purchase program is being backed by $25 billion from the U.S. Treasury.[3]

ZACKS INVESTMENT MANAGEMENT, INC.
www.zackspcg.com

[1] 1 The Wall Street Journal, June 16, 2020. https://www.wsj.com/articles/shoppers-returned-in-may-likely-spurring-increased-retail-sales-11592299802

[2] The Wall Street Journal, June 16, 2020. https://www.wsj.com/articles/powell-says-despite-signs-of-stabilization-risks-of-long-term-economic-damage-are-significant-11592316029

[3] The Wall Street Journal, June 15, 2020. https://www.wsj.com/articles/fed-will-amass-corporate-bond-portfolio-using-index-approach-11592246982?mod=djem10point

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.

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.