'Weather hug' reprised

The Fed adds to reasons to believe in this rally, making inevitable pullbacks potential buying opportunities.

Published 02-01-2019

Linda Duessel, CFA, CPA, CFP
Senior Vice President
Senior Equity Strategist

About five years ago, I made my annual trip to Southwest Florida, escaping a polar vortex back home. My local colleague, with a most unique and infectious laugh, remembers that I got off the plane that week to warm sunshine and gave him a big hug, which he called a "weather hug." What fun we had this week visiting advisors, one of whom remarked in response to my confessing a lack of technological prowess, "I'm just as dumb as you." Serious concerns also were discussed. A lady advisor wondered how, 25 years from now, our globe can sustain the way we live today amid continuing population growth, pollution and use of limited resources. This sort of remark kept coming up in other meetings as investors increasingly consider ESG investing—short for environmental, social and governance. Nearer-term, increases in the magnitude and speed of the 15% run-up off the Christmas Eve low are extremely rare, and technicians say investors should expect a retest. But since 1950, returns three, six and 12 months after similar spikes have been significantly above-average, suggesting any downdraft may represent a buying opportunity. While earnings-to-date have disappointed, with underlying

earnings-per-share (EPS) growth down sharply to 3.4% from a relatively steady 11% earlier, it appears this was priced into the market. Contrarian indicators are favorable. AAII bearish sentiment—the number of Bears less Bulls—has only been more severe 13% of the time since 1990. And mutual and exchange-traded fund (EFT) flows remain weak; a basket of cyclical ETFs are experiencing their worst flows this side of the financial crisis despite outperforming year-to-date.

At a lunch in Fort Myers, a boomer dad shared concerns for his millennial son, who, in discussing the boy's future plans said, "I don't want to work like you. I want to be outside and doing things." "So do I!" replied the incredulous dad. At a client dinner in Bonita Springs, this topic came up again. "Raise your kids right and you won't have to raise your grandkids," said one gentleman. This was the first of five client events during my visit, and it quickly turned into a rowdy political debate between guests, which I believe is a taste of what's to come in the months heading into our next presidential election. As I attempted to diplomatically tiptoe back to my seat at the table, our charming, immigrant host reminded the group how lucky we are to live in a country where we can debate freely. Amen. The balance of my week was speaking at client events in Naples to snowbirds from Chicago, along with my good friend and colleague from the area. We were all proud of ourselves for steering clear of the record cold temperatures up North—shout-out to my beloved daughter Anne who wasn't so lucky and worked from home this week! At lunch a gentleman asked if I thought that the volatile stock market was in any way related to the course our country's politics is taking. Interesting question, as the recent turn of events is being partly blamed for the *near-record* difference between consumers' sentiments of their current condition vs. expectations for the future (*more below*). At dinner, a more pointed question, "If a socialist wins the election, along with a Democratic Congress, how will the economy and the market react?" Indeed, this question arose in every client event this week.

Unlike last year, nobody debated an inflation worry with me. Forward inflation expectations remain below the Fed's 2% target, with the risk to the downside as global growth slows. Wage growth in the U.S. remains modest—up 2.7% in the latest quarter and 2.9% year-over-year (y/y). And core PCE has turned over and has been above 2% *only 5% of the time* over the past decade. All of this implies lower volatility and higher equity market P/E multiples, particularly given the Fed's doubled-barreled dovish blast this week, replacing "some further gradual increases" with "patient" in the policy language and taking balance-sheet reduction off autopilot. The addition of "sustaining the expansion" to its objectives provided a highly accommodative twist. Since 1984, there have been six S&P 500 corrections during expansions. All ended after supportive central bank moves, followed by significant rebounds, +25% on average. Still, while the recent improvement among 50-day moving averages is consistent with more optimistic sentiment, 200-day averages continue to reflect a bear market, with only 15 out of 47 MSCI All Country World Index markets rising to that level. Asian markets, many of which are nearing 200-day resistance for the first time in six months, bear watching. A breakthrough there could send a bullish global macro message. Meanwhile, I've been thinking, the older I get, the colder I get. But my snowbird conversations with the Mister are always squashed by his season tickets to the Steelers and Pens. Perhaps I can interest him in the Pirates spring training games here in Florida. Do you think he'd make that trade?

POSITIVES

- **Job growth strong** January's 304K jump in nonfarm jobs almost doubled consensus, reflecting a job market that's going strong even after a significant downward revision to December's outsized gain. ADP's separate measure of private payrolls also came in well above forecasts, led by the biggest increase in manufacturing jobs since 2012.

- **Soft landing watch** ISM and Markit manufacturing gauges both surprised in January, coming in above consensus on notable strength in domestic orders. Regional Chicago and Dallas gauges were mixed but supportive of manufacturing expansion.
- **A positive housing surprise** Perhaps this month's upturn in builder sentiment reflected November's jump in new home sales, which soared 17%, the most in since January 1992, to an 8-month high as price increases eased and mortgage rates turned lower.

NEGATIVES

- **Soft landing watch** Conference Board consumer confidence fell a third straight month in January to an 18-month low, with all of the drop-off in the expectations component, which plunged to its lowest reading since October 2016. This morning's final read on University of Michigan consumer sentiment came in slightly above expectations, but held near its lowest level since President Trump was elected, again on a souring outlook.
- **A negative housing surprise** Pending home sales fell in December for the fifth time in the past six months, dragging the y/y decline down to 9.8%, the most since April 2011. The National Association of Realtors said it expects sales to start picking up, aided by improving affordability as prices moderate and mortgage rates decline.
- **I don't think this is priced into the market** Recent weakness in PMIs and earnings revisions, which lead EPS growth by six months, suggest that earnings expectations could decline to zero sometime this summer. If PMIs continue falling, an earnings recession—if not an economic one—is increasingly likely.

WHAT ELSE

The other CBO report While the media homed in on the Congressional Budget Office's estimate that the government shutdown caused a $3 billion unrecoverable cost to the economy, it largely overlooked the CBO's annual budget and economic outlook. That report raised April 2018's nominal GDP forecast by $750 billion over the next 10 years, and has upgraded nominal GDP by $7 trillion since tax reform became law. These higher levels of projected growth should reduce the deficit as a percentage of GDP and lower our debt-to-GDP ratio.

The numbers don't lie Despite all the concerns around global growth slowdown, Credit Suisse reports that corporations with higher overseas sales are delivering stronger revenue and EPS growth this earnings season—200 and 290 basis points, respectively—than companies with a greater domestic footprint.

I hope the Mister sees this Although the number of U.S. consumers planning to celebrate Valentine's Day continues to decline, spending is expected to reach record levels this year, with those taking part in the holiday planning to spend more than ever, according to a National Retail Federation survey. Jewelry is expected to account for the biggest outlays.

Connect with Linda on LinkedIn

TAGS

EQUITY LIQUIDITY

DISCLOSURES

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector.

Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

Personal Consumption Expenditure (PCE) Index: A measure of inflation at the consumer level.

Price-earnings multiples (P/E) reflect the ratio of stock prices to per-share common earnings. The lower the number, the lower the price of stocks relative to earnings.

S&P 500 Index: An unmanaged capitalization-weighted index of 500 stocks designated to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indexes are unmanaged and investments cannot be made in an index.

The American Association of Individual Investors (AAII) Bulls Minus Bears Index is a measure of market sentiment derived from a survey asking individual investors to rank themselves as bullish or bearish.

The Conference Board's Consumer Confidence Index measures how optimistic or pessimistic consumers are about the economy.

The Institute of Supply Management (ISM) manufacturing index is a composite, forward-looking derived from a monthly survey of U.S. businesses.

The Markit PMI is a gauge of manufacturing activity in a country.

The University of Michigan Consumer Sentiment Index is a measure of consumer confidence based on a monthly telephone survey by the University of Michigan that gathers information on consumer expectations regarding the overall economy.

Federated Equity Management Company of Pennsylvania

263008416

Federated®

Copyright © 2019 Federated Investors, Inc.