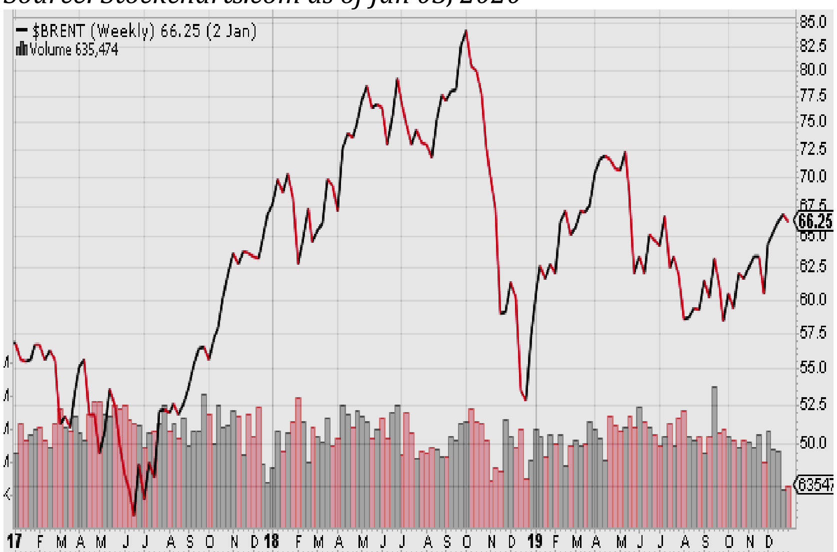
Portfolio Management
Monthly update

December 2019

2020 Markets to follow earnings growth unlike 2018 & 2019

Brent Crude Oil
Source: Stockcharts.com as of Jan 03, 2020



Highlights

- JP Morgan expects Markets to follow earnings growth, up 8-9% unlike 2018-19
- Synchronized but muted Global Economic recovery, cyclicals & value to improve
- Too early to position for recession, watch copper, gold, global bond yields & Asian currencies
- U.S. election years help markets, but expect volatility on policy uncertainty
- Business spending to continue to be weak, Consumers strong

2019 posted a strong recovery, after the rough end to 2018. Markets climbed a wall of worry over a number of issues, the main one being the U.S. trade war which slowed global economies & corporate earnings growth. Global monetary easing & trade war de-escalation allowed markets to rise. The S&P 500 started the year at a 14.2x earnings multiple & ended at a 18.4x multiple. (Cornerstone Macro Jan 2, 2020).

As we highlighted in our November report, we expect better earnings growth in 2020. JPMorgan expects the market to move more in line with earnings in 2020 –up 8-9%, as opposed to the last 2 years when earnings did little to predict market direction. In 2018 S&P 500 earnings rise 18% and the market fall 6%, while 2019 saw 1% earnings growth and a 28% rise. (JPM 2020 Strategy Jan 2, 2020).

In line with our chief strategist Brian Belski, JPM thinks earnings bottomed in Q3. They estimate 2% growth in Q4, followed by 6% growth in the first ½ of 2020. JPM expects a synchronized global recovery, largely due to lower trade tensions and the easing measures of 16 central banks in the last 8 months.

JPM looks for a gentle rise in inflation to 2% and a steepening of the yield curve, with 10 year U.S. treasury rates getting to 2.05% in Q4. They see one more .25% Fed rate cut in Q2, which should help cyclical stocks in the first ½ of the year.

They don't see a dramatic rise in commodities however, due to only 6% growth in China & only 1.5% expected U.S. GDP growth. The main cause of mediocre growth is slow business spending. Businesses have been suffering from falling margins due to wage pressures and an inability to pass on cost increases. Trade & tariff uncertainty has also been a major holdback. Upcoming U.S. elections highlighting huge differences in policies between parties will further delay business spending. Conversely consumer spending is very strong, up 4.6% in Q2 & 2.9% in Q3. Consumer savings were 8.1% of income in Q3 vs the 7.4% average in the last 5 years. Bank lending is still tight, up only 2.7% in 2019, limiting how much the consumer can push GDP growth.

JPMorgan's Stock Market & Sector View
After an inverted yield curve which we saw in mid-2019 the market usually peaks about 2 years later. This is often due to insurance Fed rate cuts, which we got recently.

It is too early to position for a recession, and cyclicals should do better, especially since they have been avoided until recently. The cyclical improvement will likely be more muted than usual given lingering trade tensions and weak business spending. Leading indicators for the cyclicals are copper & gold prices, global bond yields and Asian currencies. If these are rising or stable the cyclicals should be okay. If the global economy & cyclicals do well, worries will start to surface about rising rates, which will limit the recovery, especially since everyone expects the Fed to be on hold. This is not a concern for a number of months yet.

Housing looks better with the drop in rates. Mortgage rates are down 1.4% from the November 2018 peak. There is a lag effect and residential housing investment rose 5.1% in Q3. It has likely slowed since, but still strong. Household (family) formation has increased, which is supportive of housing demand. We continue to like Home Depot & recently added West Fraser Timber for more aggressive accounts.

They have a modestly positive view on banks and interestingly think they will get a big positive rerating once we get through the next recession and investors realize that the banks have been very conservative. JP Morgan favours quality cyclicals and value stocks. They don't see a junk rally due to the more subdued and shorter life of the expected global upturn. They like agricultural commodities best and see a limited improvement in energy. We like energy in Canada better than the U.S. since they have been in a bear market longer and the better companies have dramatically cut costs. U.S. shale production growth should be limited due to their constrained access to capital after a number of years of subpar returns. JP Morgan likes the outlook for advertising spending in an election year. They like Disney, Comcast & Facebook.

Regards,

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