MID-CONTINENT CAPITAL

CONSILIUM*

Volume 41 ~ January 2020

*advice; judgment; resolution; wisdom

US Stocks Surge Back Toward Bubble Territory – *Business Insider, 1/11/10*
After Facebook, More Fear of Stock Market – *New York Times, 5/28/12*
Time to Worry About Stock Market Bubbles – *New York Times, 5/6/14*
Economists: A Trump Win Would Tank the Markets – *Politico, 10/21/16*
Is Stock Market in a Bubble? – *USA Today, 8/9/17*
Turbulent Stock Market Is Flashing a Warning About the Economy – *New York Times, 11/20/18*

Predictions of imminent doom – merely because US equities have risen in price, apparently – have been a staple of media coverage of the markets and the economy for the last decade. We have seen such forecasts many times, and at much lower prices.

Concerns about elevated market levels seem especially widespread after a stellar 2019, which saw the S&P 500 index generate a 31.5% total return – its best performance since 2013, and one of the two best years of the last 20. But starting points do matter, and this year's rise began after a weak 2018. Are we experiencing a climactic burst of buying after a long period of gains? Or has the market merely resumed its advance?

Skepticism about the longevity of the economic and market cycle extends beyond just the news headlines. In the year ending 11/30/19, investors in mutual funds and ETFs withdrew $67 billion from domestic equity funds, while plowing a whopping $415 billion into bond funds offering low-single-digit yields. In the last four years, while the S&P 500 was rising by over 60%, cumulative flows into domestic equity funds were approximately zero. A popular refrain is that stocks have been in "the most hated bull market ever", and investor action appears to support this view.

This is an important time to reaffirm that nothing is foreordained in investing. Past events can alert us to *possible* future outcomes. But stock prices are not subject to physical laws, and being up significantly in 2019 should not bias investors against a potentially good 2020. Since 1950 the S&P 500 has generated annual gains in excess of 20% on 18 occasions, and the market was higher the following year 15 times (with only one occurrence outside of a recession). Strong markets are almost never immediately followed by weak markets – generally, there is a period of waning momentum, stretched out over many months, before prices turn decisively lower. We see absolutely no signs of this occurring; in fact, reliable measures of long-term momentum have just recently given bullish signals, not bearish ones, for the first time in nearly three years.

Similarly, there is no rule that the economy must grind to a halt merely because it has been expanding for a decade. Economists have been declaring that we had reached "full employment" for at least half that time and now struggle to explain why their pessimism has not been borne out. We continue to believe that investors are best served in this setting of unprecedented wealth and economic well-being by giving stocks the benefit of the doubt and waiting for evidence of a turn in the economy, rather than anticipating a shift which may still be some time in the future – and thereby sacrificing meaningful opportunities.

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Investor attention naturally is turning to the upcoming presidential election and its potential impacts. We love a bold prediction as much as anyone, but it is far too early to speculate about the outcome, let alone act, not even knowing who the Democratic Party nominee will be. However, we can state the following confidently:

- After being the center of market attention for at least a year – first by raising short-term rates, then cutting them – the Federal Reserve will fade into the background as a market-moving factor. There is almost no chance that rate hikes are coming in 2020, and it is likely that recent rate cuts will be enough to keep the economy moving forward without additional stimulus. Nevertheless, President Trump will keep up his Twitter campaign against the Fed, calling for lower rates regardless of the circumstances.

- As to the election, not only are events unpredictable, so is the market's response to events. Much will depend on how the market and the economy are behaving in the months immediately prior to the election. For example, many leading market pundits are on record predicting a market calamity if Sen. Elizabeth Warren were to be elected. If this became a consensus view, and the market were to weaken ahead of election day, a Warren victory could be met with a surprise rally. Stranger things have indeed happened.

- On average, the fourth year of a presidency is strong for stock markets (only the third year, which just ended, is historically better).

- Incumbents usually win unless the economy is in, or was recently in, a recession. More specifically: Trump is only the seventh president (and just the second Republican since Rutherford B. Hayes) in the last 170 years to run for reelection not having had the economy fall into recession during his first term. In none of the prior cases did the incumbent lose a reelection bid.

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On behalf of everyone at Mid-Continent Capital, we would like to thank our clients and readers of *Consilium* for their interest and support, and we offer our best wishes to all for a healthy and prosperous 2020.

Sources: Morningstar, Bloomberg, NBER, Investment Company Institute

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