INSIGHT & PERSPECTIVE

Pointing to New Highs...However...

October 30, 2019

Recent new highs in the S&P 500 Index could potentially lead to a nice mini-rally for stocks.

Looking beyond, however, the U.S. election season is usually a drag on the equity market. And the 2020 election season promises to be more contentious than most.

Technical Breakout May Push Stocks Higher

Federal Reserve interest rate cuts have seemingly eased some concern over a full blown equity stall, and the U.S. and China appear to be haltingly stepping toward some near-term trade accord. Both issues have helped lead to an improvement in investor sentiment and a recovery in stock prices. Notably, U.S. and developed foreign markets have recovered to reach all-time highs. The question is whether they will be able to hold key technical price levels. Meanwhile, emerging market equities are still mired in a relative slump as a downtrend in that market has been forming since April 2019 highs.

Our expectation that economic conditions may improve from recent troughs and that U.S./China trade relations could be more constructive than not leave us to believe that new highs in the S&P 500 Index and the MSCI EAFE Index may indeed be sustained. That is, a breakout of new highs may cause a mini rally for stocks in general. However, any rally, in our view, is unlikely to be long-lasting or dramatic. Obstacles to a long-

Equities may sustain the recent technical breakout and move higher, although gains may not be robust.

Figure 1: S&P 500 Index - Daily Chart

Source: S&P Dow Jones, Bloomberg

standing rally likely include corporate profitability numbers that have been sliding and full equity valuations. Add to this the likely 2020 election season worry and you get a market that may prove to be a little soft as we turn the corner to next year.

Figure 2: MSCI Emerging Markets Index
Source: MSCI, Bloomberg

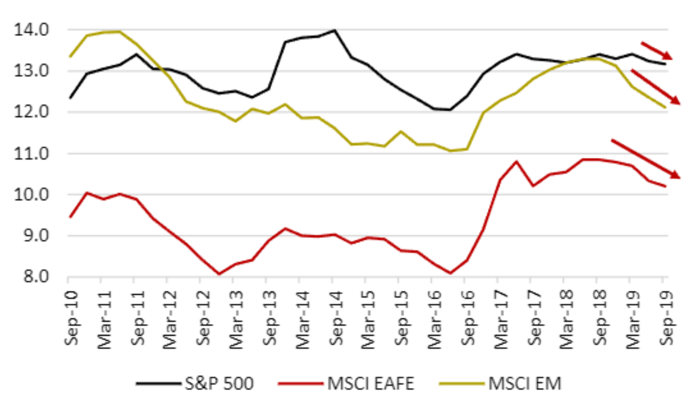
Largely, Emerging Markets have continued to underperform domestic and foreign developed markets since March of 2012.

Watching Profitability Closely

Declining profit margins may mean investors will be less likely to pay premium valuations for equity exposure.

While trade talk and Fed policy have made financial market headlines, a key development for us has been the recent trajectory in corporate profitability. Profit margins across the globe have been under some pressure, particularly in emerging markets. Therefore, investors may be less likely to pay a premium for equity market exposure. This trend is a key reason we may see only a limited rally if we are indeed able to hold the recent new equity highs.

Figure 3: Operating Margin - S&P 500, MSCI EAFE, MSCI Emerging Markets
Source: MSCI, S&P Dow Jones, Bloomberg



Keeping an Eye on the Election Cycle

History has shown that equity returns in an election year, or a fourth year of a U.S. presidency, can be suboptimal as investors become bogged down by the uncertainty of it all. This election cycle is shaping up to be perhaps the most contentious in modern history. Should President Trump overcome the Democrats' impeachment thrust, he likely stands to face a Democrat nominee with diametrically opposing views to his own. The resulting theatre may present some uncertainty for investors, particularly if Trump emerges politically wounded by the impeachment machinations. With this in mind, we believe 2020 may not be a year in which investors feel comfortable taking unchecked risk, especially coming off strong equity performance in this 3rd year of the election cycle.

Our bottom line is that we remain conservative on equity exposure, however, sustainable new highs we may see in the coming weeks/months may not be robust. Equity prices could eventually run headlong into some of the obstacles we mentioned. So we would maintain a slight overweight to equities, but suggest that investors cap their excitement a bit as we ascend to new price levels.

Table 1: S&P 500 Returns Through the U.S. Presidential Election Cycle - Since 1950
Source: S&P Dow Jones, Bloomberg

	Term Year			
				(Election)
	1st Year	2nd Year	3rd Year	4th Year
S&P 500 Index	6.5%	7.0%	16.4%	6.6%

Risks

Investors should be aware of the risks associated with all portfolio strategies, and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, and other geopolitical events can have a substantial effect on portfolio performance, our macroeconomic theories, and the effectiveness of strategic and tactical portfolio approaches.

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