



Closing Year-End Comments 2019

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A year ago, one of the trusted Economists that we follow, Brian Wesbury at First Trust, projected the S&P 500 would hit 3100 at the end of 2019. In spite of the sharp drop in equities in the fourth quarter of last year, our investment team at Strategy Asset Managers as well as Brian Wesbury, didn't see a recession coming in 2019 and continued to believe the U.S. stock market was a buying opportunity. At mid-year, seeing the economic and trade-policy stars aligning for further growth, and with our model for equities still showing room for gains, Strategy Asset Managers and First Trust lifted both of our year-end S&P 500 outlooks. For 2020, we remain bullish and we also believe we have more room to close higher at year-end. The first consideration we make when forecasting our economic and investment outlook is whether we see a near-term recession. This step is important because even if the stock market is undervalued relative to long-term norms, a recession would almost certainly send equities lower in the short term; stocks would go from undervalued to more undervalued. Needless to say, we don't see a recession anytime soon. The economy is still adapting to lower tax rates and monetary policy remains loose. The Federal Reserve has an accommodative monetary policy, interest rates remain low, consumer confidence remains steady and we are seeing continued innovation and entrepreneurship growing around the U.S. and abroad. In addition, home builders are still generating too few homes given our population growth and scrappage rates, while banks are sitting on ample capital. There are

additional factors that help to shape our economic outlook, but a very important indicator provided by Brian Wesbury's at First Trust is their Capitalized Profits Model. Their model takes the government's measure of profits from the GDP reports, divided by interest rates, to measure fair value for stocks. Our traditional measure, using a current 10-year Treasury yield of 1.85% suggests the S&P 500 is grossly undervalued. However, we think long-term interest rates are headed higher and this change can have a large effect on the model's assessment of fair value. First Trust anticipates that the 10-year Treasury yield will finish the year at 2.5%. Using 2.5% (instead of 1.85% current yield) suggests an S&P fair value of 3775. In other words, we should finish 2020 with more room for the bull market to keep running. In addition, it's important to notice that in recent years operating profits generated by the companies in the S&P 500 have risen much more than the government's measure of corporate profits that we use in our model. In the prior business cycle, the one that ended in the Great Recession, profits peaked in the second quarter of 2007. Since then, S&P operating profits are up 55% while the GDP measure of profits is up only 31%. This divergence suggests using the GDP measure of profits in our models may be underestimating the fair value of equities.

In addition to our positive outlook on the U.S. stock market, we see an opportunity to diversify into European equities. We have been under weight in our foreign stock allocation over the last three years and have been correct to do so as foreign equities have underperformed the U.S. broad market returns. However, after a long period of underperformance, valuations have become relatively favorable and there are signs of a potential upturn in economic activity within Europe. Furthermore, the European Central Bank is injecting billions of Euro's of liquidity into their financial system; this is the third such major liquidity injection and the past two liquidity injections have presaged strong runs in European stocks. Therefore, we have started to increase our European foreign stock equity allocation.

The biggest risk to our optimistic market outlook is that someone on the far left wins the White House in 2020 and the Democrats simultaneously get a majority in the US Senate. We think that's very unlikely. Most likely, the outcome of the election ensures that the tax cuts remain in place without any radical new entitlements or expansions of the entitlements already in place. This will probably be one of the most optimistic forecasts you'll see, if not the most optimistic one of all. But, in the end, we do best by our readers when we tell them exactly what we think is going to happen, without altering our projections so we can run with the safety of the herd. Last year we told investors to hold tight and do nothing because those who stay invested in the year ahead should earn substantial rewards. Our advice remains the same. The bull market is not yet done.

Please welcome a year-end call from me or one of our senior team members: David Chong, Lee Grichuhin, Alan Haft, Brian Kelly, Harold Parker and Greg Wertz, to ensure you have all of our updated contact information and we have current information about your investment and financial well-being. We will continue to strive for outstanding service and thoughtful advice as a steward for your relationship. Thank you for being our client. Happy holidays from all of us at Strategy Asset Managers.

Sincerely,

Tom Hulick, CIMA
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Contributing comments from First Trust Advisors:

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