Bell Bank
Wealth Management

EQUITY & FIXED INCOME OUTLOOK FEBRUARY 2020

A month ago, pundits were finalizing their 2020 forecasts for the overall economy, stock market and bond market. We read many of them as they became available. Two unexpected developments in January – the scuffle surrounding Iran and General Soleimani and the start of the coronavirus scare – reflect the uncertainty of forecasting. None of the outlooks we read made mention of the prospect for either event. They are some of the many random events that fall outside of the purview of forecasts, yet distinctly impact the economy and the markets.

Many readers probably remember the SARS virus, Ebola outbreak and bird flu – not to mention the Asian currency crisis, or the Long Term Capital Management (LTCM) debacle which created a financial panic. LTCM's principal shareholders in this firm were Nobel Prize-winning economists Myron Scholes and Robert Merton. Then came the tech stock bubble, the 2008 financial crisis, and the Fed tightening that drove the stock market toward a 20% sell-off as recently as late 2018.

My point is, these things happen all the time, and they tend to fall outside any forecasting scope – which is why we beat the drum of staying humble and, most important, properly diversified. There is a trick to being an accurate forecaster. Here's the secret: If you give a number, don't give a date. If you give a date, don't give a number. If you get it right, don't look surprised.

Extended impact from the coronavirus could spill over to impact economic growth. Starbucks and Apple are already closing their shops in China to help prevent the virus from spreading. Airline travel, along with sales of jet fuel, are already curtailed. Pharmaceutical companies are rushing for a solution. (The pharma stock sector has been under political pressure to lower drug costs, but now that sector is rising as its research labs rush to develop a vaccine or find a cure.) The Federal Reserve initially indicated its activities may be on hold all year – but now, there is talk of a 25- to 50-basis-point cut to help address the prospect of economic slowing. Side note, the SARS scare lasted about six months back in 2003. The bird flu epidemic took place over 18 months from the first half of 2009 to the last half of 2010. Ebola was a concern for about three years between 2013 and 2016.

Did you notice it? Brexit officially occurred on January 31. During an 11-month transition period, the United Kingdom now will negotiate its future relationship with the European Union (apparently the last three and a half years was not enough time). We don't see a reason for much change on the horizon.

We often hear questions about how elections will affect the markets. Using the 2016 presidential election as an example, the answer is "different from what anyone expects." Regardless of who is elected, people's lives go on. Besides, Congress seems to spend all its time bickering back and forth as though there is some sort of political Super Bowl title to win. When could they possibly find the time, or the composure, to talk with someone outside their own party boundaries and search for compromises aimed at solving today's challenges?

Stock market earning reports for the fourth quarter are about half complete. So far, combined earnings are down about 0.3% compared to this time last year. If the remaining announcements occur as anticipated, the increase will be about 1%. These are not the kind of numbers that support rallies in the stock market. The stock market is considered a forward looking indicator, and these levels suggest future earnings are expected to be stronger. If they are not, there could be some downward market pressure at some point.

Bonds with negative yields around the globe hit a peak $17 trillion at the end of August last year. (This means investors are guaranteed a loss if the bonds are held to maturity – what a deal!) Since that time, the level steadily declined, reaching $11 trillion around the middle of January. The discovery of the new coronavirus changed all that. Bonds with negative yield now stand at $13.9 trillion as investors seek the relative safety of bonds, even if they do lose money along the way. Fortunately, this investment "wisdom" has not made it to the United States. Mind you, interest rates here have declined, with the 10-year U.S. Treasury bond yield dropping from 1.92% at the end of the year to 1.52% today. However, bond returns year-to-date have handily beaten stock returns so far.

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