JANUARY 2020 REVIEW

The bullish sentiment and price action from 2019 carried over into the first two weeks of 2020, but then quickly grinded to a halt over growing concerns of the Wuhan coronavirus. A considerable part of the world's second largest economy has been shut down.. Entire cities in China have been quarantined, travel restrictions have been enacted including major U.S. airlines suspending flights to and from China, and more cases are being diagnosed around the world. The U.S. may be less reliant than others on China's supply chains, however in 2019 it imported more than $400B in goods through November. It may be too early to accurately quantify the economic impact to China and the globe, however some projections have China's 2020 GDP falling to 5.5% from 6.1% in 2019. China's PBOC responded by using repurchase agreements to supply 150 billion yuan (net basis) of liquidity ($21.7B) which has helped stem declines in the broader markets so far in February. The S&P 500 was down 1% for the month, the DJIA was down 2%, but the NASDAQ bucked the negative trend and was up 2% for the month.

Flows rotated into traditional safe haven treasuries and the 10YR UST yield registered its 3rd biggest monthly decline (-41bps) since the summer of 2011. According to the CME, futures are currently pricing in an 82% probability for one 25bps rate cut by the end of 2020 versus 66% at the start of the year. In the final days of January the 10YR – 3Month Treasury spread inverted for the first time since early/mid-October. Personally I think that the Fed would prefer to do nothing with rates with year, in order to stay out of the Presidential debate this summer and fall.

At roughly the midpoint of Q4 earnings season and results are playing out as expected with large bank earnings helping sentiment. As of Friday January 27th about 45% of S&P 500 companies reported results, according to FactSet data. The blended earnings growth rate of -0.3% is an improvement over the expected decline of 1.6% at the beginning of the quarter, though companies generally beat estimates. The percentage of companies beating estimates, 69%, is currently below the 1-year (74%) and 5-year (72%) average. The current trajectory implies flat earnings growth for Q4 compared to the approximate 2% declines initially expected by analysts.

LOOKING FORWARD

Equity investors are being patient after flat 2019 results but expectations of sharply improving results in the second half of this year will need to play out to justify current near-record valuations.

Expectations for S&P 500 earnings growth for 2020 are in the 9-10% range. The S&P 500 is rich with a forward PE of about 19, a sharp increase over the 15 handle in place just one year ago and the 10-year average of 16. This is due to stocks hitting record highs despite a lack of earnings growth, helped by a now-dovish Fed. As we look forward, there seems to be hope that the contra virus (and related economic and earnings impacts) can be contained, that the Fed and global central banks will maintain ongoing stimulus measures, and that global growth will pick up later this year. Stocks seem "priced for perfection" with the S&P 500 approaching valuations that have led to two corrections just since 2016.