The Hefter Report – January 2020

Hostilities with Iran appear to have deescalated for now, the phase one trade deal with China is anticipated to be signed on January 15th, and the moderate candidates are currently leading the polls in the Democratic presidential primary race. As it stands, I don't know what to worry about. And that worries me.

This long term bull market has persistently climbed a wall of worry for over 10 years and now most fears, other than fear itself, have largely been mitigated. Of course, people are still nervous primarily due to the length and breadth of the rally. However as we've been saying, interest rates, unemployment and inflation remain low while the Fed remains on hold – providing sufficient support for the relatively high current P/E ratio of 20. So, what happens next?

The key to market direction in our opinion will be corporate earnings. We believe expectations are low and that 2020 S&P 500 earnings will be better than expected at about $175 per share. If we are correct about earnings and the multiple remains at 20, the S&P 500 should reach 3500, which is about a 7% return from current levels. With the US 10 year bond currently yielding less than 2%, I don't feel there are many decent alternatives to stocks.

So why am I worried that there appears to be no worries? With retail investors beginning to show net inflows to stocks and investor sentiment becoming more positive, I'm less comfortable than in 2019 when the headlines were more negative and worrisome. As we've said for the past 12 months, our belief is that this bull won't end until investors become euphoric and there's a capitulation to the upside. Although we're not there yet, we do believe we have entered into the initial stages of that predicament.

This does not mean we are negative or prone to immediate selling. With M2 money supply rising to 7.4% from 3.3% a year ago, we see plenty of liquidity and do not expect a recession through 2020. Central banks across the globe remain accommodative and we are beginning to see the effects of that as global GDP has begun to improve. We believe this pickup in growth will lead to slightly higher inflation and higher interest rates as the year progresses.

We anticipate a decent although volatile year for stocks in 2020. We believe performance for small cap, mid cap, and international stocks will begin to catch up with large cap US equities. Our favorite sectors are Industrials, Technology and Communications. If we see bullish sentiment reaching historically high levels, we will reduce equity exposure. But we do not expect that to occur until earnings are better than expected, GDP growth exceeds 2.5%, and inflation rises above 2%.

In our opinion, 2020 will not be a good year for fixed income. We prefer floating rate bonds and adjustable rate preferred stocks.

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