CONWAY • JARVIS LLC
Investment Outlook

Volume 28 Issue 3 September 18, 2018

Will the Economy Drive the Market Even Higher in 2019?

In the first half of 2018, we put a long overdue correction in the rear view mirror. From there, the S&P 500 has built a nice base from which it has advanced to new record highs in the current quarter, claiming ownership of the record for what is arguably the longest bull market in history. In terms of total return, this market still trails the tech-fueled bull run of 1990-2000 by a good margin. While the talking heads constantly debate whether that stock market record will fall, we remain focused on the bigger picture: How much runway does this current economic expansion have ahead? While all arrows point to a continued expansion of the US Economy, there are some challenges here at home and around the Rest of the World ("RoW") that could shorten the market's run for the record in 2019.

An Expanding Economy Bodes Well for the Market

In our most recent issue, we reiterated our belief that the stock market is a reflection of the economy and the events impacting its future. Our expectation for the current expansion of the US Economy to continue through 2018 and into next year is the basis for maintaining our bullish outlook. Corporate Earnings and economic data, as you might expect, have positively impacted stocks prices in the wake of this year's correction. As we near the end of Q3, earnings are on track to post an increase of well over 20% for all of this year with Energy leading the way. As for the outlook through the end of this year and into 2019, revenue expectations remain in the 5%-10% range with CAPEX investment on pace to record a 25-year high. This points to low unemployment, higher wages, and continued earnings growth in the year ahead. That, along with record high consumer confidence and sentiment, makes a strong case for the stock market to extend its bull run. With so much good news abound, we're looking over our shoulder for what could alter such a bullish outlook.

Before we examine some obvious risk factors that could come into play, let's talk about what we *don't* see. First, the euphoria that so often accompanies the end of an expansion. We're encouraged by the underlying strength of the US Economy and its companies in the absence of the feverish optimism that so often spells the end of a bull market. There's been no shortage of negative speculation during the advance of this market, and yet it has become the longest, and most vilified, bull market on record. Also absent are the expanded multiples that usually accompany extended markets. Here we find ourselves, three years after the Energy crash, with record earnings and a market valuation equal to that of 2010. One, by the way, that is dirt-cheap in comparison to the record-holding bull market that ended in 2000. The absence of these factors prompt us to maintain our modestly bullish outlook, despite our attention being focused on the risk factors we discussed in our most recent June issue.

An Update on Risks to Expansion

We'll revisit those risk factors that we believe could negatively impact the economy and its markets: The Fed, the global economy, the threat of a trade war. We'll also add a fourth: the mid-term elections.

The Fed: The Fed has been increasing Quantitative Tightening ("QT") while at the same time remaining on schedule to "normalize" (raise) key interest rates. Each alone has the potential to dampen business activity. Together, they have the potential to increase the rate of change in interest rates beyond what is deemed prudent. The most recent data shows a retreat of CPI and could indicate that the Fed is having success in moderating inflation. Our hope is that the Fed *follows* inflation data rather than over-tighten credit and risk smothering the current expansion. All indications are that they'll raise rates next week and again in December even as the rate of QT increases to its maximum level in October. **If the Fed stays on its current path through year-end, we would raise Minimal/Low Risk to Moderate Risk.**

Trade War: The skirmish continues. As expected, US tariffs have triggered retaliation among our trading partners. NAFTA has been re-crafted with regard to Mexico and we're days away from finding out if Canada will join or remain on the outside looking in. The US and EU have agreed to impose no new tariffs and negotiate zero-tariffs for non-auto industrial goods. In other words, not much has happened there. China remains the primary concern as they show a willingness to stare down the US at the risk of hollowing out their manufacturing base. This is the scorched earth policy we feared they might pursue as the heir apparent to the title of the world's biggest economy. Their stock market and that of the Emerging Markets is pricing in the damage. It's still too early to assess any negative impact to US companies at this stage. While remaining alert to news of any developments from the Twitter sphere, we maintain our **Moderate Risk** level.

Europe and the Global Economy: This year's loss of forward momentum in both Europe and Asia, coupled with a stronger dollar and the ongoing trade skirmish, could negatively impact our export markets and earnings from large-cap US multinationals. Italy, Spain, and Turkey continue to struggle while debt crises have emerged in Venezuela and Argentina. So far, The US markets have shrugged these off as non-events. Of greater importance to us is the potential for a no-deal Brexit to take place. PM May is still at the helm with Brexiteer Boris Johnson angling for the position. All the while, the EU Council continues to posture and assert that Britain needs the EU more so than the opposite. It's feasible that Brexit could trigger other EU members to abandon ship. This could significantly increase the risk to both the Global and US economies. We maintain our level at **Minimal/Low Risk.**

Mid-Term Elections: We thought it prudent to add this to the list considering so much of what's transpired in the economy and markets has been driven by fiscal policy enacted in the past year. Clearly, the emphasis has been placed on stimulating business activity in order to grow our way beyond what had been a long and low-trajectory recovery from the travails of 2008. The stated policy goal is to reduce unemployment, impart upward pressure on wages, and increase tax revenues to begin addressing the deficit. So far, data indicates the first two boxes have been checked and expectations are that the third could be by the end of Q2 2019. It's anticipated that there will be a shift in the balance of power in Congress next year. We can't venture a guess as to what extent. Regardless, we don't anticipate any significant change to fiscal policy through 2019. **Minimal/Low Risk**

In summary, we anticipate record earnings in 2018 along with a decent follow-through into next year. We're focused on the Fed and whether they will remain as advertised: Data Dependent. Unfortunately, they've posted an unenviable record of avoiding recession when tightening and a flattening yield curve is additional cause for concern. As for trade, we expect some traction being lost in negotiations with the mid-terms as a distraction, but look for a resumption of meaningful talks and progress in its aftermath. A lot will be happening in Q4 that will generate significant headlines and investors will be challenged once again to parse the news from the noise. All of it has the potential to move the market in either direction so we expect to see increased volatility. As always, we encourage investors to assess liquidity needs for the next year, check their asset allocations against their risk tolerance levels, and if necessary, adjust accordingly.

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