Ballentine Partners

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Is the Gloom About to Lift?

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One of the familiar adages to describe the price action in the stock market is "it takes the stairs up and the elevator down." The dramatic decline in stock prices since mid-September certainly fits this pattern. Since September 20, the S&P 500 has fallen 13.1% (as of December 17) and wiped out all of its 2018 gains. Investors have voted with their feet by withdrawing $46 billion from U.S. equity funds and $13.4 billion from bond funds in the week ending December 12. Sentiment has turned decidedly negative: the American Association of Individual Investors' latest reading showing bullish sentiment at just 20.9%, a 17-percentage point drop since the last reading. Is this a typical market "correction" or the start of something much more serious?

We believe the recent volatility has been driven by three critical factors: (1) the Federal Reserve's raising short-term interest rates in an attempt to keep future inflation in check, (2) the ongoing trade disputes and the threat of further escalation, particularly between the US and China, and (3) tangible evidence of an economic slowdown in both the Eurozone and China, and its impact on the rest of the world. How serious are these threats to asset prices?

We believe the odds are good that items 1 and 2 are moving toward a more favorable outcome, at least relative to current expectations. Fed Chairman Powell has recently signaled a softer tone in his policy pronouncements. A growing chorus of economists (and the President himself) are warning the Fed to slow down or stop the pace of interest rate increases to avoid plunging the US economy into recession. Consensus expectations for three rate hikes in 2019 (plus one more this year) have shrunk to two, with some forecasters expecting even fewer. Although the tone of US economic data remains strong, overseas weakness and the recent market volatility may be nudging the Fed to a more accommodative stance.

China's economic growth has noticeably slipped in the last few months. After sustaining years of 10%-plus increases in year-over-year retail sales, growth slipped to 8.1% in November. Export orders are slipping and manufacturing has slowed. While this deceleration may be unrelated to the trade dispute with the US, it is certainly ramping up pressure on the Chinese authorities to negotiate. And US companies, generally unhappy with the Trump administration's trade policy, are becoming increasingly concerned about the macroeconomic outlook for 2019, causing them to pull back on capital expenditures. In short, pressure is increasing in both sides to reach a deal. A de-escalation in the trade dispute is likely to lead to a strong relief rally.

Overseas growth remains an area of concern. As a result, we expect conditions to remain difficult for equity investors until these issues are resolved. In the meantime, US economic growth remains solid, interest rates are low, and valuations are attractive. Furthermore, 2019 represents the third year of the presidential cycle. The last time the Dow Jones Industrial Average declined during the third year of a presidential election cycle was 1939, nearly 80 years ago. While attempting to forecast the market's bottom is a fool's errand, we expect a meaningful rebound in equity prices in 2019.

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Bruce is a Partner and Director of Research at the firm. Bruce rejoined Ballentine Partners in June 2016 after more than 5 years as Chief Investment Officer of City National Rochdale, LLC, in Los Angeles. City National Rochdale, a wholly owned subsidiary of City National Bank, serves family clients across the United States with a staff of nearly 100 investment professionals. Before moving to Los Angeles, Bruce served as Chief Investment Officer of Ballentine in our Waltham office for three years. Prior to that, Bruce spent four years with Morgan Stanley Private Wealth Management in New York and eight years with Glenmede in Philadelphia as Chief Investment Officer and Portfolio Manager. In addition to working directly with a number of family clients, Bruce serves on Ballentine's Investment Management Committee, which is responsible for the oversight of all of the investment activities for the firm. Bruce received an MBA with a concentration in Applied Economics from George Washington University and a BS degree in Business Administration from Penn State University. Bruce holds the Chartered Financial Analyst (CFA) and the Certified Private Wealth Advisor (CPWA®) designations. He lives with his wife in Palm Beach Gardens, Florida.