Lock In a Good Year?

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Last Week's S&P 500 Index: +0.2%

Key takeaways

» *Many in the financial media are asking whether or not investors should lock in profits given the big rally in the stock market this year.*

» *Given our forward macro outlook and current valuations, we believe investors should stay in the market and look for modest returns in 2020.*

If you have tuned in to the financial media of late, you know one of the topics being bandied about is whether or not professional money managers are going to take profits and recognize their gains as we move toward the last couple of weeks of the year. It is true that traders often back away from taking aggressive new positions during November and December if they are happy with their calendar-year profits up to that point.

But most investors are in the stock market for the longer term, not the next three or six months. That is the strategy we continue to promote. Trying to be all in or all out of the market at any given time can present meaningful timing problems. The longer-term historical bias in the stock market has been up. Consider all the turmoil and volatility in equites over the last 20 years (or the last 90 years), including the bursting of the tech bubble and a major financial crisis, and here we sit very near the all-time record high in the major domestic indices. As the global economy has grown, companies have participated. The stock market has reflected this participation. We do not expect that trend to fade in the coming decades. That is why we continue to believe that one of the best ways to potentially build and grow wealth over time is through the ownership of equities.

While some investors may be focused on the shorter term, we believe the rest of us should be trying to look ahead and figure out what the macroeconomic environment is going to look like in 2020 before doing anything drastic with our equity exposure. We think the likely environment ahead features modest growth with only modest inflation and a Federal Reserve that does not make a monetary policy mistake. One also may want to take into account overall equity valuations that are, in our opinion, fair based on the level of interest rates and the growth outlook. Given that forward outlook, our take is the S&P 500 Index has the potential to register a mid-single digit price return between now and the end of next year. Tack on a couple more percent for dividends, and our total return expectation looks to largely be in line with or just slightly below the longer-term average.

How does the stock market get from here to there? We still think the cyclical playbook is the one to follow. In other words, we think sectors like Technology, Consumer Discretionary, and Financials that can benefit from a continuation of the expansion will outperform in the quarters ahead. We believe consumer-oriented segments of the economy should continue to benefit from a robust labor market where the unemployment rate is at a 50-year low and wages are growing north of 3%. We do not want to count out the American consumer. If trade tensions ease a bit from here, companies may also choose to boost capital spending, which could further add to economic growth.

So from our perspective, individual investors should stay the course and expect modest returns in 2020.

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