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Investment Institute

Weekly perspective on current market sentiment February 12, 2020

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Last Week's S&P 500 Index: +3.2%

Packing Light

Key takeaways

- Traders are hesitant to carry much of an unhedged equity position into the weekend as negative coronavirus headlines could surface.
- Easing trade tensions, accommodative central banks, and a search for more dependable places to put money have helped U.S. equities.

With the S&P 500 and the other major domestic indices at or near all-time record highs, it would seem investors don't have a care in the world. The CBOE Volatility Index (VIX), a market gauge of underlying stock market volatility, is near 15, which is virtually in line with the five-year average according to Bloomberg. Yet, we believe many investors perceive the volatility of the stock market to be anything but average over the last 6-12 months. Trade tensions, questionable global growth, and more recently, the coronavirus have resulted in uncertainty from time to time and increased volatility. Yet, despite these issues, the equity market has continued to march higher with few meaningful setbacks.

The midpoint of our year-end 2020 target range is 3430, less than 3% above current levels as of midday Monday. At that target midpoint level, based on our $175 earnings estimate for the S&P 500 Index, the price-to-earnings (P/E) ratio would reflect a valuation of 19.6x. This is above the 12-month trailing 20-year average of 17.7x. Realize that in a low-interest-rate environment with sentiment on the rise and many underinvested at this stage of the cycle, we would expect the market valuation on this large-capitalization domestic stock index to be above the longer-term average. Since early October the market has benefitted from easing trade tensions, continued global central bank monetary policy support, and better-than-expected global economic data. In addition, the coronavirus appears to have pushed some global investors toward the perceived dependability of U.S. stocks and bonds.

Recent economic data in the U.S. has come in better than expected and continue to support our favorable rating on the Consumer Discretionary sector. The S&P 500 Consumer Discretionary Index that tracks this sector's performance has also traded to an all-time record high this week. It's hard to bet against the consumer in a strong labor environment. We rate the Information Technology sector as most favorable. The Tech sector, particularly the more consumer-oriented segments, appears to still have promising underlying fundamentals that suggest we should stick with this recommendation.

However, investors should not forget that risks do exist. The ultimate impact of the coronavirus on global growth is uncertain as is the timeframe for when the spread of the virus will peak. The market seems to be pricing in a virus that will be at least somewhat contained in the nearer term. But it is no surprise that the accuracy of Chinese data related to the spread and death toll of the coronavirus has been in question since the outbreak was first reported.

That is one reason why stocks have been down the last couple of Fridays and why that trend could potentially continue in the near term. Quite simply, traders want to "pack lightly" for the weekend and go home without large speculative positions that could be negatively affected by coronavirus headlines that come out over the weekend while trading markets are closed.

Risk Considerations

Forecasts and targets are based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve.

Stock markets, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors.

Risks associated with the Consumer Discretionary sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players; reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment.

Risks associated with the Technology sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market.

Definitions

CBOE Volatility Index (VIX) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the U.S. stock market.

S&P 500 Consumer Discretionary Index comprises those companies included in the S&P 500 that are classified as members of the GICS® consumer discretionary sector.

An index is unmanaged and not available for direct investment.

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