"Logical, Patient, And Decisive"

Market Commentary – November 2019

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The advance estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 1.9% in the third quarter of 2019. This is slightly lower than the 2.0% reading in 2019 Q2. The components of the 2019 Q3 GDP number are: consumer spending +1.93 percentage points, investment -0.27 percentage point, net exports -0.08 percentage point, and government spending +0.35 percentage point. The sum of these numbers equals 1.93%. Consumer spending, which historically makes up about 70% of GDP, was robust once again. Business investment was soft, however, with non-residential fixed investment weighing on GDP by -0.40 percentage point. On a favorable note, residential fixed investment boosted GDP by +0.18 percentage point, its first positive contribution to GDP since 2017 Q4. The economy continues to do well in its 11th year of expansion, despite a backdrop of cautious business spending.

As expected, the Federal Open Market Committee (FOMC) lowered its benchmark federal funds rate another 0.25% on October 30 to a range of 1.50% to 1.75%. This is the third 0.25% rate cut during 2019. Fed Chair Jerome Powell said in a press conference yesterday about lowering interest rates, "We took this step to help keep the U.S. economy strong in the face of global developments and to provide some insurance against ongoing risks." Unemployment stood at only 3.5% in September, the lowest since December 1969, and inflation is running below the Fed's target of 2%. Futures markets see one additional 0.25% rate cut by May 2020. The next FOMC decision on monetary policy is scheduled for December 11.

Technical factors of the market are bullish (more demand than supply), while fundamentals are attractively priced – therefore, we are bullish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) over the next 12 months is $172.18, which implies a price-to-earnings (P/E) ratio of 17.6 with the S&P 500 at 3,037. The earnings yield (E/P) of 5.67% represents attractive value relative to the 10-year U.S. Treasury note yield of 1.69%. There are even cheaper, high quality stocks available right now. Overall, the Banyan Asset Management portfolio has a dollar-weighted average P/E of 12.5, beta of 0.81, and dividend yield of 4.2%.

The S&P 500 broke above its all-time high of 3,026 to form a new all-time high of 3,046 in October. Interestingly, the breakout was not very powerful, and stocks have pulled back slightly since then. Our hypothesis remains that stocks will hit new all-time highs in the coming months. Support should exist around 3,026 (July 2019 high), 2,968 (50-day moving average), and 2,886 (200-day moving average).

On October 25, 2019 at the American Association of Individual Investors 2019 Investor Conference in Orlando, Florida, Jim Paulsen (Chief Investment Strategist for The Leuthold Group) gave a bullish assessment for the U.S. stock market. Two major things to be bullish about, he said, include fear (the national discussion of recession is "off the charts") and massive monetary/fiscal stimulus. The recent global slowdown is a lagged effect of tightening interest rates, which is being corrected with a global policy response of lower rates, synchronized between the Fed and central banks of China, Japan, and the Eurozone. Still, earnings will need to drive the stock market higher from here, which he believes will happen. His biggest worry is observing that this has been a "weird" economic recovery since 2009; will it have a weird ending? By this, he means the economy crashes for reasons we do not currently understand because we have never been through it. He thinks that the 10-year Treasury note will eventually jump up to around 4%, which would be a huge negative for stocks. He did not opine on what might trigger that, however.

According to Sam Stovall, Chief Investment Strategist at CFRA Research, investors are plagued by emotion, impatience, and indecision. Emotion is magnified by social media. Impatience is linked to the instant gratification we expect in this world. Indecision results from analysis paralysis; there is too much information available. Astute investors seek competitive advantage by being logical, patient, and decisive.