MV CAPITAL MANAGEMENT

Weekly Market Flash

The Year In One Word -- Pivot

December 27, 2019

All things come to an end – good, bad and otherwise. As this will be our last market commentary for 2019 it seems appropriate to think back on the events that gave shape to the year in asset markets. Our word for the year is "pivot," defined as "when a central bank plans to do one thing, then turns around abruptly and does the complete opposite instead." The Fed pivot in January gave shape to what has resulted in the second-best performance for US large cap stocks this decade (with a decent chance of claiming the number-one spot from 2013, depending on how things go over the final two and one-half trading days).

Turn the Beat Around

The S&P 500 performance in 2019 is a bit less stellar in comparison to that banner year of 2013 when you consider where the year started: just days away from a near-bear market reached on December 24, 2018. The market's strong bounce back in January was in part a trough recovery (by comparison, stocks had finished out 2012 with decent gains in the mid-teens before going onto that record-breaking performance in 2013). But it was arguably the magnitude of that December 2018 correction that pushed the Fed to abruptly reverse course in January, call off any future rate hikes and set expectations for a return to monetary easing. The Fed put was back – if in fact it had ever gone away.

From Rarity to Mainstream

The Fed was not alone in its renewed embrace of dovishness. The European Central Bank, worried that low growth in the Eurozone was edging closer and closer to negative growth, returned to its bond-buying ways as well. It gradually dawned on investors that monetary policy tools once seen as unconventional, to be used only in extreme circumstances, were in fact the new normal. A mindset took hold that weak organic growth, low productivity and never-ending cascades of easy money were now a permanent feature of the global economic landscape.

Be Careful What You Wish For

While the Fed's initial reversal was met by investors with the expected exuberance, the good feelings started to run out in late spring with the first of several sizable market reversals. The flip side to "permanent easy money" is "chronic stagnant growth." As spring turned to summer, it seemed at times as if the market was trying to talk itself into recession. Investors headed for the safe, but ultra-expensive terrain of high quality bonds. By midsummer over $17 trillion worth of bonds globally traded with negative yields. Stock markets experienced another mini-correction of around five percent. Market chatter turned to thinking the unthinkable: the idea that monetary policy might not be enough to keep the world afloat.

Risks Known and Unknown

A shaky start to October called to mind the ghouls and goblins of fall 2018, but all that dissipated with yet another apparent cease-fire in the weird soap opera that is the US-China trade war. A vague yet comforting proposal for a "phase one" deal seemed within reach, and that summarily took what the market viewed as the biggest known risk factor off the table, at least for the time being. At the same time, macro data releases almost all pointed to the conclusion that the earlier fears of imminent recession were

truly overblown. Jobs, inflation, real GDP growth and other key metrics kept showing the same thing they have been showing for a long time. Finally, the Q3 earnings season that got under way in October, while not particularly impressive (earnings growth is set to be slightly negative for the full year) seemed to the consensus wisdom to be a bit better than expected.

These three drivers – trade war cease-fire, more or less healthy economy and better than expected earnings – fed into a positive momentum trend that gained strength over the last two months of the year (which we suggested was a likely outcome in a commentary in early November). FOMO – fear of missing out – is particularly viral in the closing weeks of a holiday market rally.

It's easy to be complacent in an environment of steady daily price appreciation and accompanying low levels of volatility. Certainly a welcome change from last year's frenetic December. But when things change, they often change rapidly. Easy money is not a free lunch. We got a taste of that back in September with that hiccup in the overnight repo market. Corporate balance sheets are loaded up with lots and lots of debt raised during this extended period of historically low interest rates. There are plenty of reasons to not be complacent as the old year gives way to the new.

May you and your loved ones have the happiest of holidays and a healthy start to the new year. See you next decade!

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