It's Time to Focus on the Facts

I am writing today's market commentary from Dallas. Tomorrow morning, I have been asked to be a panelist at the Texas RIA Summit. One of the main topics for discussion is how to manage portfolios given the risks anticipated in 2020. I thought I would incorporate my presentation tomorrow with our weekly discussion.

The past few months have seen a real slowdown in growth prospects domestically and around the world. Interest rates have plunged to near record lows. The United States is one of very few countries to pay a positive return for investment in their bonds. As such, we have seen a flight to our treasuries across all parts of the yield curve. Longer term treasuries have seen the most inflows. This has led the yield on longer-duration bonds (like the 10 year) to be pushed below short-term bonds (like the 2 year). I have mentioned many times that this is a generally unhealthy economic condition and is consistent with a recession on the horizon. It also makes it very difficult for banks to make money on their loans. This results in restriction of monetary supply at the very worst time. Of course, much of this negativity is due to trade tariffs, which act as a tax on the supply chain. This negatively impacts both ends. China as an exporter is hurt because goods produced there are suddenly more expensive. The U.S. as a net importer is hurt because those increased costs must be borne by the company here purchasing the goods or passed on to the consumer. Any way you look at it, tariffs hurt earnings. This situation has been at the forefront of investors minds and is very much tied to the hopes that our Federal Reserve lowers rates this month to boost liquidity (money supply) in the U.S. economy. As a result, the market is being driven by the latest news out of our White House. Investors are trying to decipher if a trade resolution is in the cards and if so, how that will impact a rapidly slowing economy. It is hard enough to evaluate the relative attractiveness of various assets when things are presented in an orderly and predictable fashion. It is nearly impossible when it is presented via random tweets. This new reality of how fundamental and important economic information is conveyed has been a major factor in the stock market's volatility.

So, what do we do as investors in the face of the weekly risk on/risk off swings? Well, I think we focus on the facts. Earnings growth is waning here in the U.S. and is negative in many other parts of the world. Commodities of all types are in bear markets. Inflation is negligible as a result, and higher interest rates are not supported by demand side growth. Bonds have had a huge run up, even after selling off this week. With record low rates and no inflation, dividend payers and real estate looks attractive. Blue chip staples and utility stocks look awfully good considering they yield 2 or 3X what bonds yield. After all, people continue to buy diapers, shampoo, and Coca Cola, even in the worst of times. As long as unemployment remains at record lows, people will continue to pay their mortgages and business owners will keep paying rent. REITs (real estate) pay dividends and should benefit. Corporate grade and junk bonds are worthy of a look as well. Bonds of all types are down the risk spectrum and pay a good deal more than their treasury counterparts. I also like preferred stocks. Like corporate grade bonds, they pose less risk than their equity counterparts and the dividend is appealing.

All of this is subject to the next tweet, and anything can change on a moment's notice.

Last week's market commentary can be found here.

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