GBA Financial

Newsletter
January 2020

The Story of the Baby Bear (market)

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S&P 500 Index Long-Term Chart

If you've heard this once, you've probably heard it one hundred times – we believe the equity markets are in a long-term secular bull market. The previous two (highlighted in green) lasted roughly 17 years after breaking out from a secular bear market (transiting from red to green on the chart). This current secular bull market started in 2013 and if it plays out similarly to the previous two, we are still less than halfway through. Last year, we titled the 2019 outlook – "The Bull Market is over, what's next?". Evidently, the media does math a little differently than we do. Long story short, from the intraday high of 2940.98 on September 21, 2018 to the intraday low of 2346.58 on December 26, 2018, the S&P 500 dropped over 20%. But, from closing price-to-closing price, the drop was just above the standard bear market reading, down 20%. Does it really matter if we "only" dropped 19.78% on a close-to-close? Does the 0.22% that kept us out of a traditional bear market really make sense? To us, it does not. But, instead of fighting the media we will just call this a "baby bear market," keep it to ourselves, and let everyone else worry about the "longest bull market in history".

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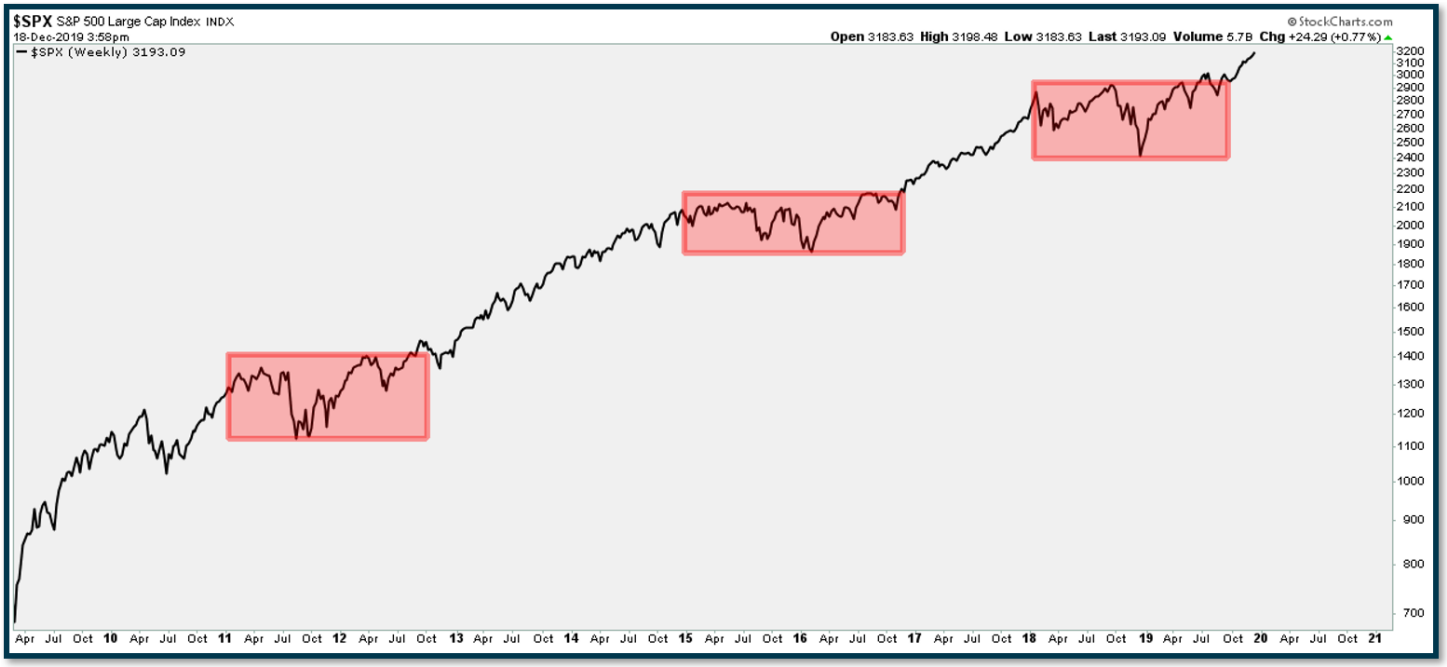
S&P 500 Price Target: 3900



Towards the end of 2019, the market made a push and looks to have broken out of the 20+ months of sideways movement. This sideways trading is similar to the previous two sideways trading periods (red rectangles on the chart). We see similarities to those timeframes and because of this, we are setting our 2020-year end price target to 3900. As a reminder, last year we set our price target at 2800 (which was bold in the face of the December selloff) and revised it to 3200 mid-way through the year. If you think 3900 is a big call, we'd agree, but we're not being bold for the sake of being bold. Maybe we don't hit 3900 in 2020, but the data indicates that is where the equity markets are heading. We are not held to our 3900-price target and if data dictates a change is necessary, we will reevaluate.

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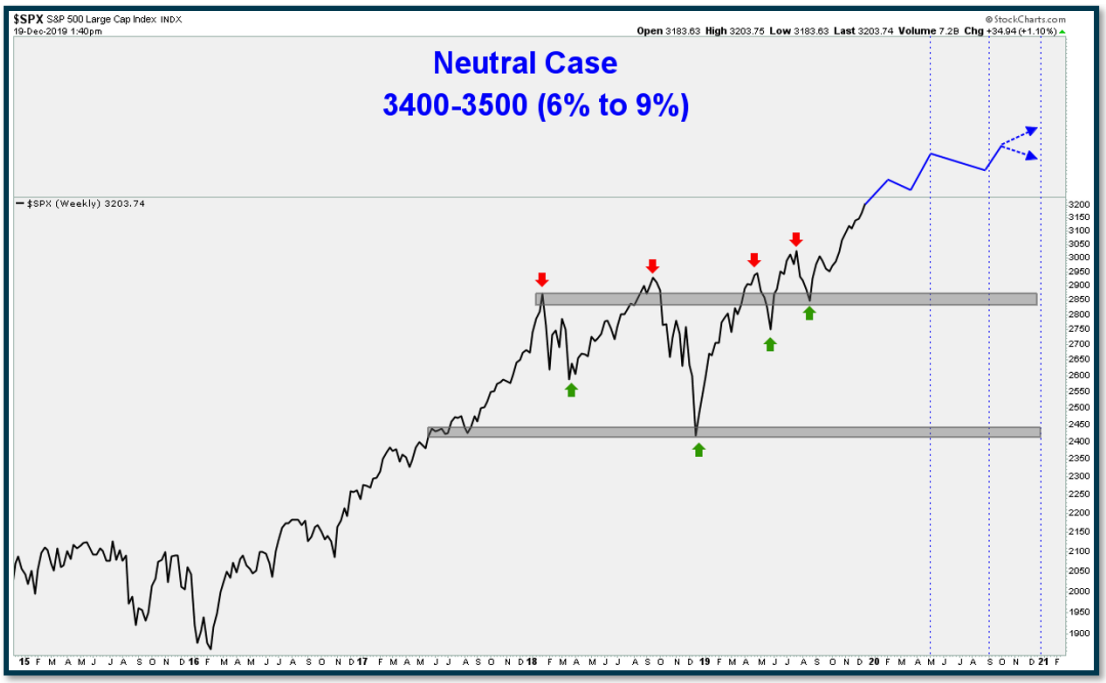
Neutral Case



The Neutral case is a path we could see playing out if our bullish case (next slide) runs into some hiccups along the way. We think the first half of 2020 is setting up nicely for the bulls, but the market could get tired and need a pause over the summer months. After which we will be looking directly at the U.S. Presidential Election which could keep investors on the sideline until afterwards. If corporate stock buybacks start to taper off, we could see a case for single digit returns in 2020. This projection seems to be the consensus range in a lot of forecasts on Wall Street.

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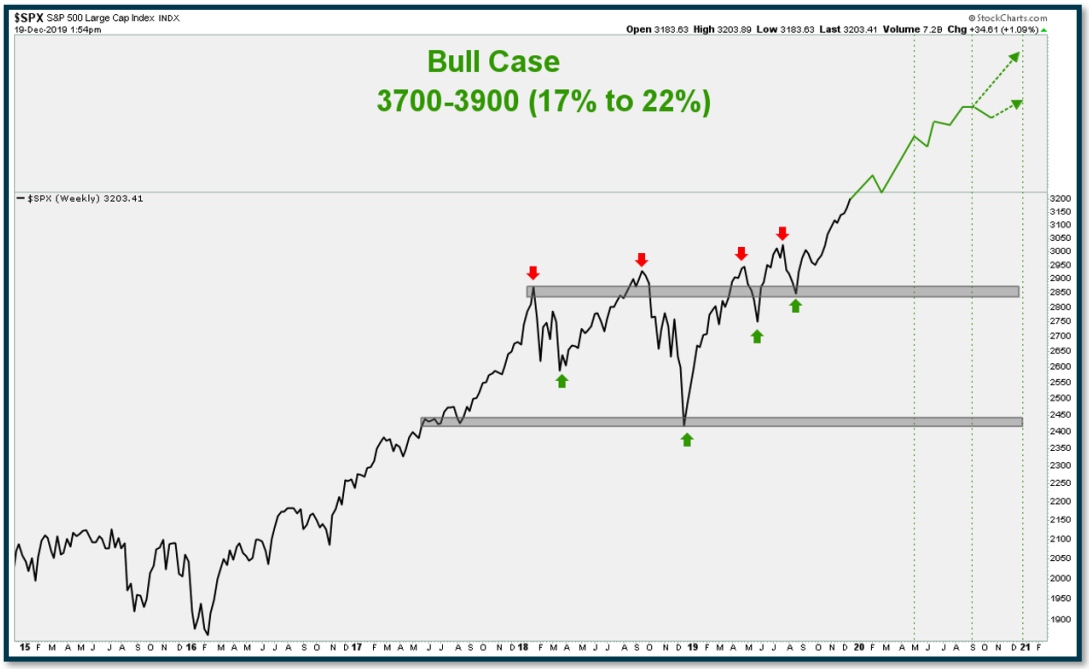
Bull Case



Since the breakout from the previous consolidation range has confirmed, there is a lot going for equities. Sentiment is not all in favor of the bulls right now, which is positive for future money to come in and purchase equities. Markets saw a lot of money rotate into fixed income in 2019, if it unwinds and flows back into equities that could put upward pressure on equity prices. Further trade deals with China, more clarity with Brexit, continued share buybacks, and an overall accommodating Fed could have us looking at a global equity market rally.

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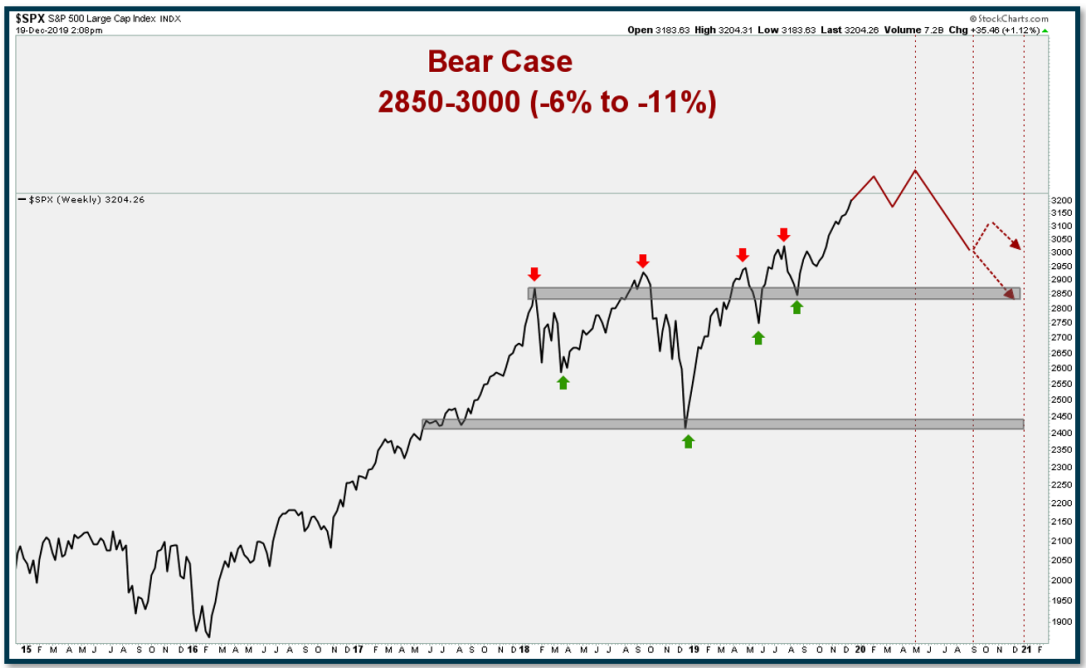
Bear Case



With every bull case there needs to be a bear case. The bears will probably need multiple things to happen for this to play out, however, we are watching for a few things such as, slowdowns in corporate buybacks, if China's trade deal talks fall apart and the trade war is back on, inflation unexpectedly increases quickly forcing the Fed to raise rates, and/or investor sentiment becomes too bullish too fast.

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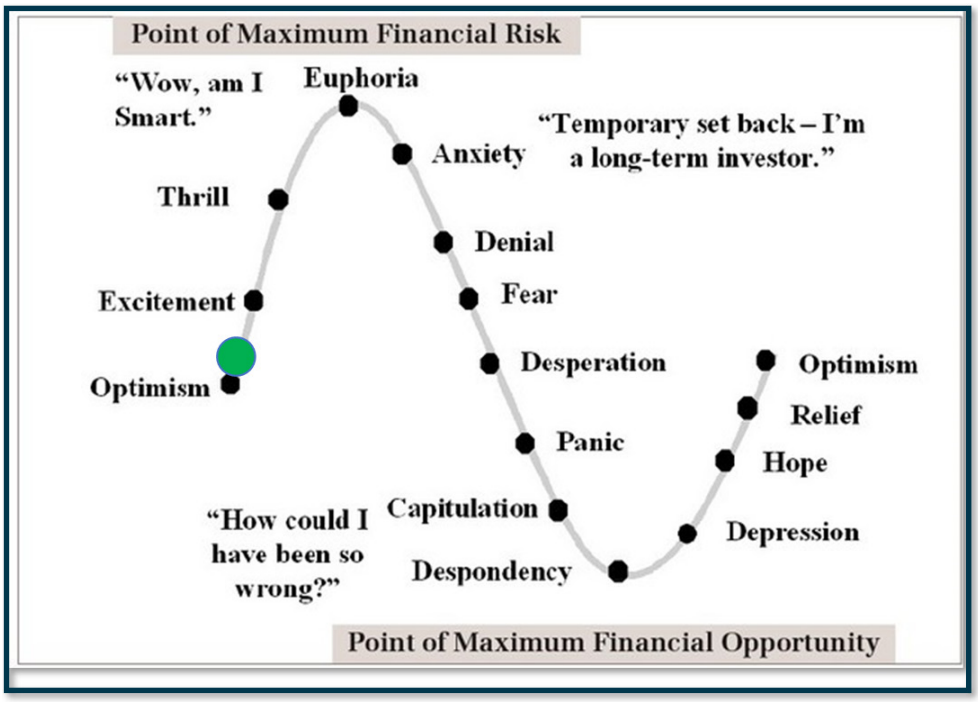
Market Sentiment with Green Dot



Last December felt some panic selling and although it was a quick recovery, we are likely somewhere around the optimism part of the cycle. There are still a lot of cautious investors out there but if the market continues to make new all-time highs, the excitement will start to grow and grow.

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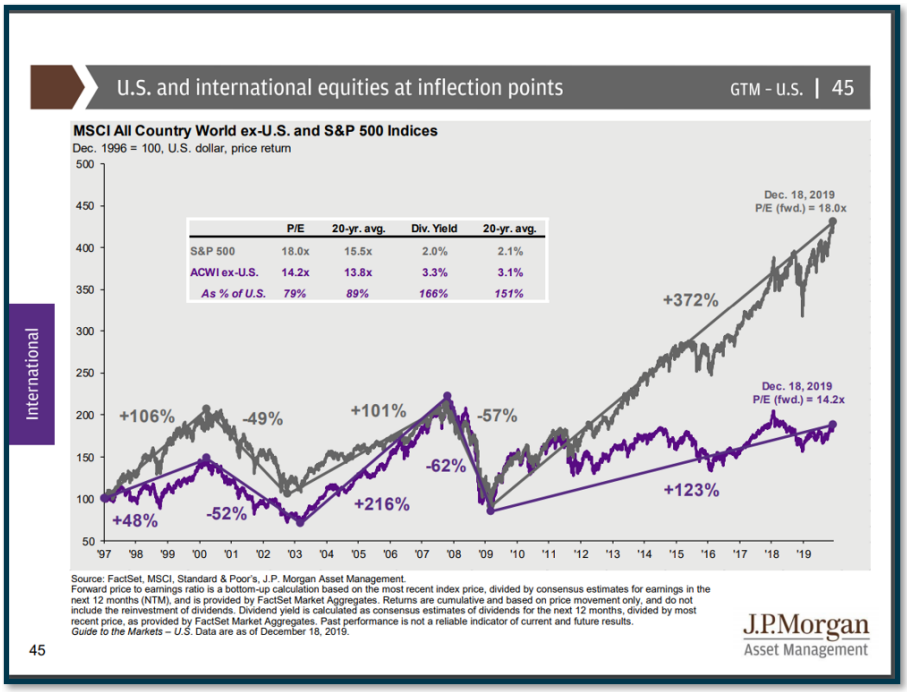
International Equites



International Equities have lagged U.S. Equities in returns since the lows of 2008. There are good companies overseas and investing in them adds to our diversified portfolio. International Equities will lead again, at some point. We want to be positioned for it when that happens. Just look at the total returns from 2003 to 2008 – International had a +216% return vs. 101% return for the US.

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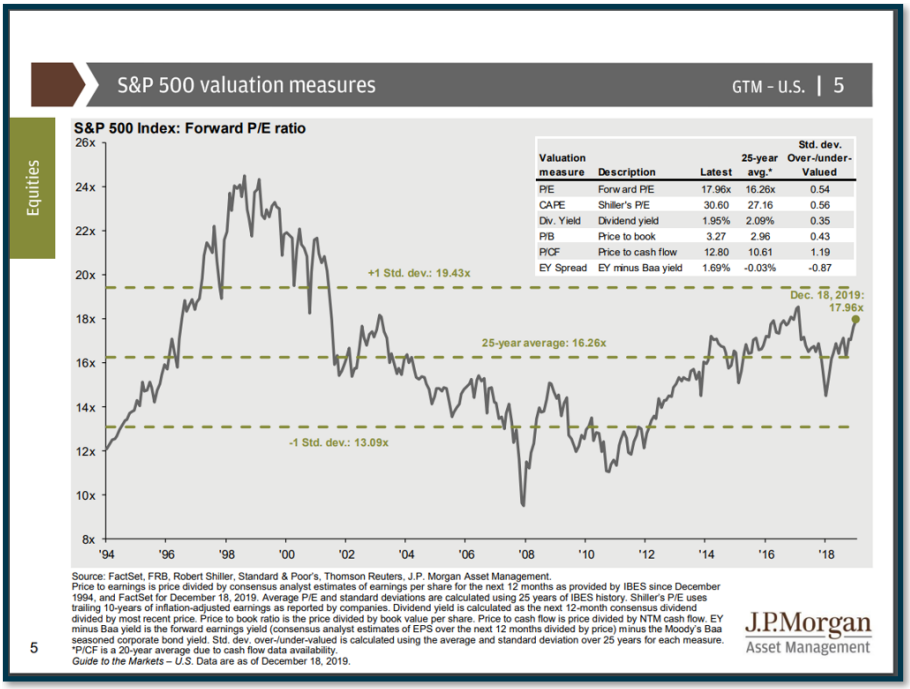
S&P 500 Valuation Measures



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	17.96x	16.26x	0.54
CAPE	Shiller's P/E	30.60	27.16	0.56
Div. Yield	Dividend yield	1.95%	2.09%	0.35
P/B	Price to book	3.27	2.96	0.43
P/CF	Price to cash flow	12.80	10.61	1.19
EY Spread	EY minus Baa yield	1.69%	-0.03%	-0.87

The S&P 500 Forward Price-to-Earnings (P/E) ratio is a little above its 25-year average but doesn't seem too stretched. If a trade deal with China gets worked out, that could provide some future help to companies that operate worldwide.

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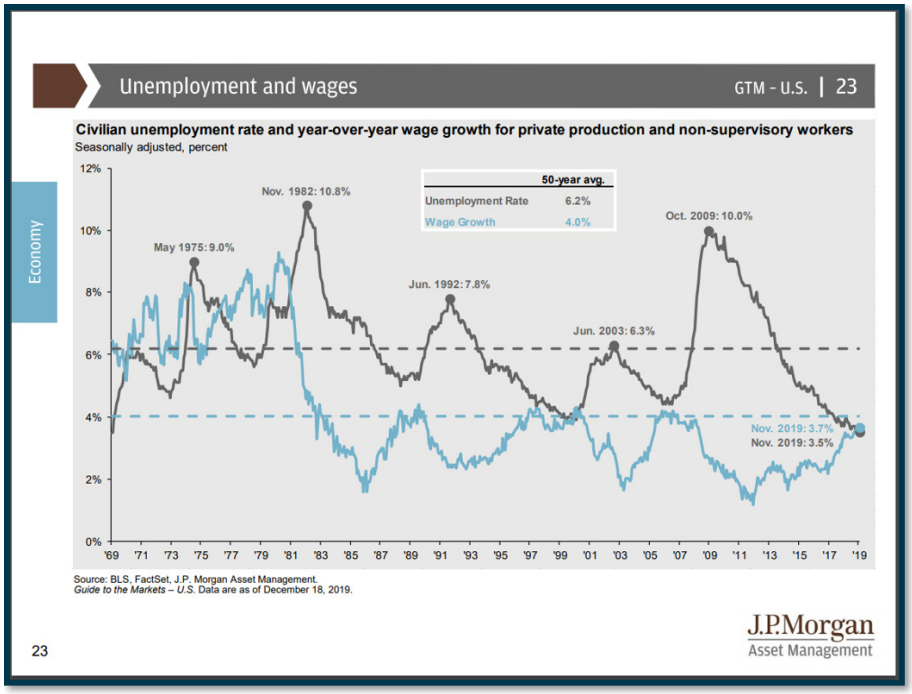
Unemployment Rate and Wage Growth



This is one chart we are watching very closely. Historically, when unemployment gets too low and forces companies to compete with other companies for employees, it has driven up wages which feeds into inflation. When inflation starts to get too high, the Fed steps in to tighten the economy and a recession usually follows. We're not there yet, but we're watching.

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10-Year US Treasury Yield

Since 1980, the U.S. treasury yield has been moving lower and as a reminder, as yields fall, bond prices move higher. We think the bond bull market is over and that we are in more difficult position to get returns from bonds. This doesn't mean avoid them OR take excess risk with your bond portfolio. It's about understanding what you get from your bonds – low correlation to equities, protection in an equity market crash, and stable income.

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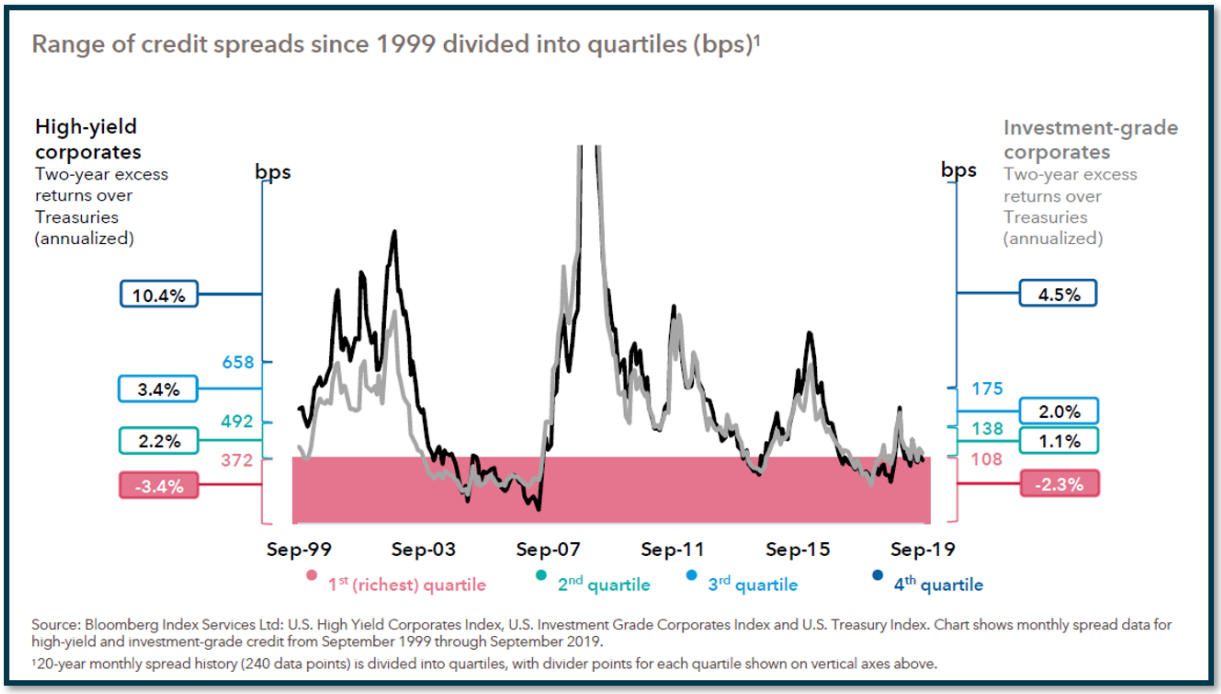
High Yield Spreads



Following up the previous bullet point regarding taking excess risk in the bond market, the current spread between high yield corporate debt and U.S. treasuries is NOT offering a good risk/return profile. With more and more investors searching for income and yield from fixed income, we are seeing more money flowing into riskier bonds. We are not following the crowd on this and would rather take risk in equities that can offer superior returns to that of a bond.

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