Consumer Spending and Low Rates Favor Stocks in 2020

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Portfolio Managers Jeremiah Buckley and Marc Pinto believe equity valuations look reasonable heading into 2020, thanks to low interest rates, healthy consumer spending and strong earnings growth, particularly among companies on the right side of technological and economic disruption.

Key Takeaways

- In our opinion, the outlook for equities in 2020 is positive for a number of reasons. For one, we think inflation and interest rates will stay low next year, an environment that tends to be supportive of stocks.
- Second, the U.S. consumer was a bright spot in 2019 and could continue to be so in 2020, so long as trade disputes, the U.S. election and other political events remain manageable.
- Finally, many companies sitting on the right side of technological and economic disruption are delivering strong earnings growth, helping support multiples.

Marc Pinto: I think 2020, we're going to continue to see a lot of the same themes that we saw in 2019, both on the positive and potentially on the negative. I continue to believe that we will see a benign interest rate environment. I mean, inflation really hasn't been a factor. We continue to see very, very benign inflation data, both in the CPI and PPI. So I think bond yields are going to still be below 2% on the 10-year [Treasury]. And then remember, we've got trillions of central bank debt overseas that's trading at negative interest rates, and that's going to keep, I think, a lid on our interest rates.

So a good interest rate environment, I think, bodes well for growth equities. So I like that. On the negative side, or on the area-for-concern side, the two big things that we've been talking about in 2019 – the trade war with China and the upcoming general election in the U.S. – I think are going to continue to weigh on the market. And the market is going to react to positive and negative developments in those two areas. And obviously, we will get an end result in the election in 2020; the trade war, who knows, but I'm optimistic we'll see some progress there.

Jeremiah Buckley: I think one of the areas that really drove economic growth in 2019 was consumer spending, and so I think we need to continue to watch wage growth. We're currently at 2% to 3% [in the U.S.]. Not too high that it's driving inflation; that hopefully will keep rates low. But I think we also need to focus on what happens with the trade war and how that impacts the industrial and manufacturing economy to make sure that those companies don't get into a place where they need to start cutting employment, which could disrupt this strength that we've seen in consumer spending through 2019, that we expect to continue into 2020.

Pinto: Yes, so I think you're right, the consumer will continue to be an important factor. And as you've pointed out in the past, it's not just the U.S. consumer, it's the global consumer.

Buckley: Yeah, and I think one important thing to note is, in 2019, we certainly saw a lot of headlines, a lot of geopolitical risk. But in my 20-plus years following consumer stocks, there's always geopolitical risk, there's always headlines. The consumer endures; there could be short-term blips. But I also think as long as these geopolitical concerns and risks stay at a manageable level, I think the consumer will endure and continue to drive good economic growth.

Pinto: And I would also mention that I think if there's one lesson we learned in the last couple of years, it's the importance of brands and consumer awareness. And when we see disruption in the retail chain, and we see disruption in general, companies with strong brands that have an ability to go direct to the consumer and essentially bypass the retail channel have been the real winners.

I look at valuations today and continue to believe that equity valuations are very reasonable, well within the historical range that we've seen. And those valuations in the context of lower interest rates and still decent earnings growth – maybe it's slowed a little bit, but still decent earnings growth – among U.S. corporates. I think those valuations are very reasonable and defendable. And frankly, I think there's potential for upside.

On the flipside, we look at where Treasury yields are – consistently below 2%, with the ceiling that we've talked about with negative interest rates in other markets – and as we talk to our colleagues in the fixed income side, credit spreads are still very tight, both in investment grade and high yield.

Buckley: Yeah, and I think it's important to think about, as equity markets over the last couple of years have certainly had good performance, a lot of that has been driven by the earnings growth, and the cash flow growth and the dividend growth that we've seen. And so, you haven't seen the S&P 500® [Index] dividend yield compress that much. It's certainly compressed less than what U.S. Treasuries have compressed over the last couple of years. And so, I agree, I think U.S. equities continue to present attractive relative opportunities.

Pinto: It's funny, I get questions, and I know you do, about some that have just shown organic topline growth. And I think people tend to focus on, sort of, the nominal multiple on that company. But when you look at it in the context of the market multiple and you look at the growth relative to the market, those valuations are not crazy. In fact, they are, I think, eminently reasonable.

Buckley: Yeah, and I think you make an important point, in that the differentiation between some of the growers and the non-growers, I think, is much different than we've seen in the 20-plus years that we've been doing this. And so, while valuations on some of those companies are a little bit higher, the excess growth that they're achieving and the outlooks that they have being on the right side of trends continues to be very exciting.

Pinto: And I think, also, when you look at it in the context of, we've talked a lot about disruption, right? And we've talked about, who are the companies doing the disrupting? Who are the companies that are being disrupted? And maybe even more importantly, who are the companies that are benefiting from the disruption? The companies that we're talking about that have the superior earnings and revenue growth are generally the companies that are either disrupting or benefiting from the disruption, and conversely the companies that you mentioned – sort of, the haves and have-nots – the have-nots are the ones that are being disrupted. And valuations can be very reasonable on a nominal basis, but that doesn't mean that those stocks are attractive.

Buckley: Right.

Note:
Credit Spread is the difference in yield between securities with similar maturity but different credit quality.

Dividend Yield is the weighted average dividend yield of the securities in the portfolio (including cash). The number is not intended to demonstrate income earned or distributions made by the portfolio.

10-Year Treasury Yield is the interest rate on U.S. Treasury bonds that will mature 10 years from the date of purchase.

S&P 500® Index reflects U.S. large-cap equity performance and represents broad U.S. equity market performance.

Past performance is not a guide to future performance. The value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested.

The information in this article does not qualify as an investment recommendation.

Important information

Janus Henderson
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