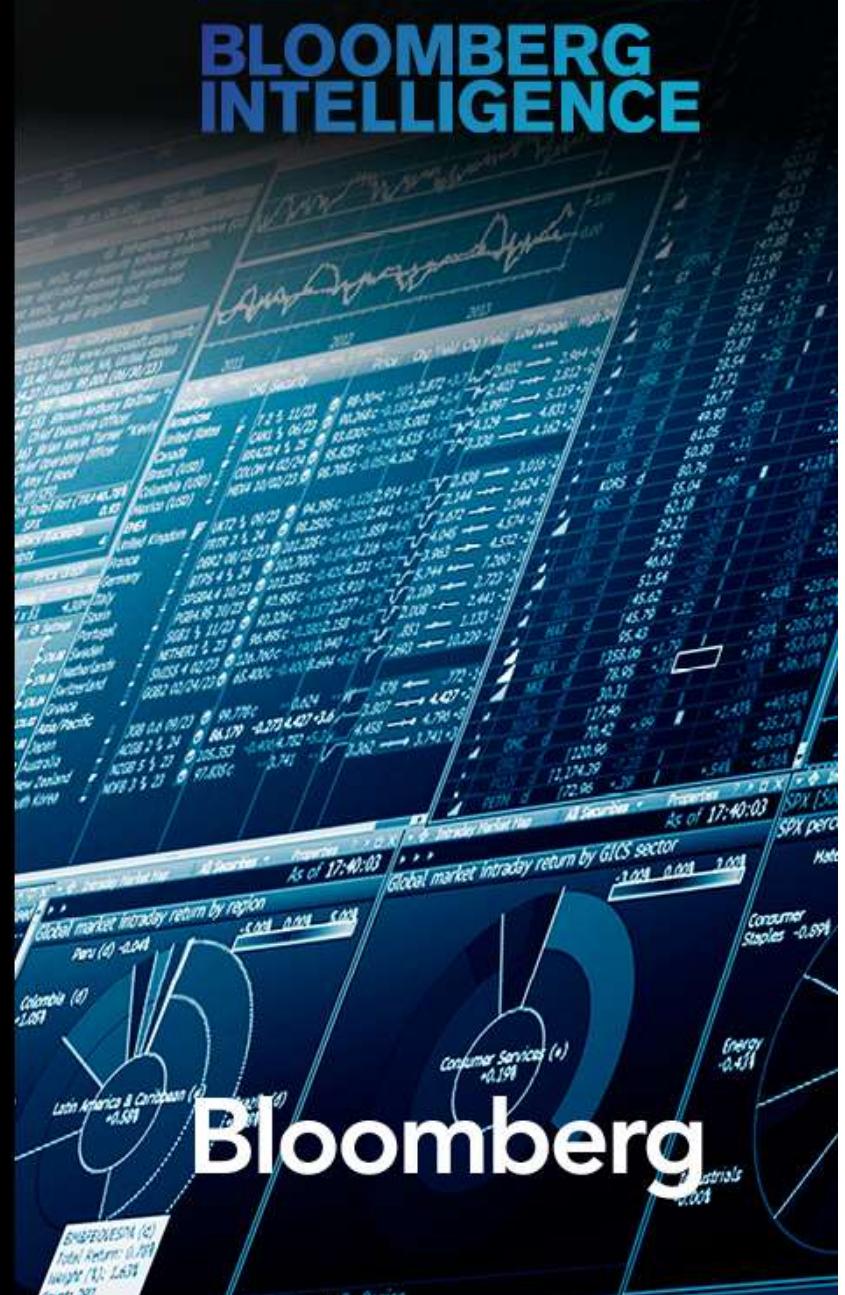


Equity Market Outlook

Equity Market Bull
Should Plod Through the
Swamp in 2020

Gina Martin Adams, CFA, CMT
Chief Equity Strategist
gmartinadam1@bloomberg.net
212-617-6192





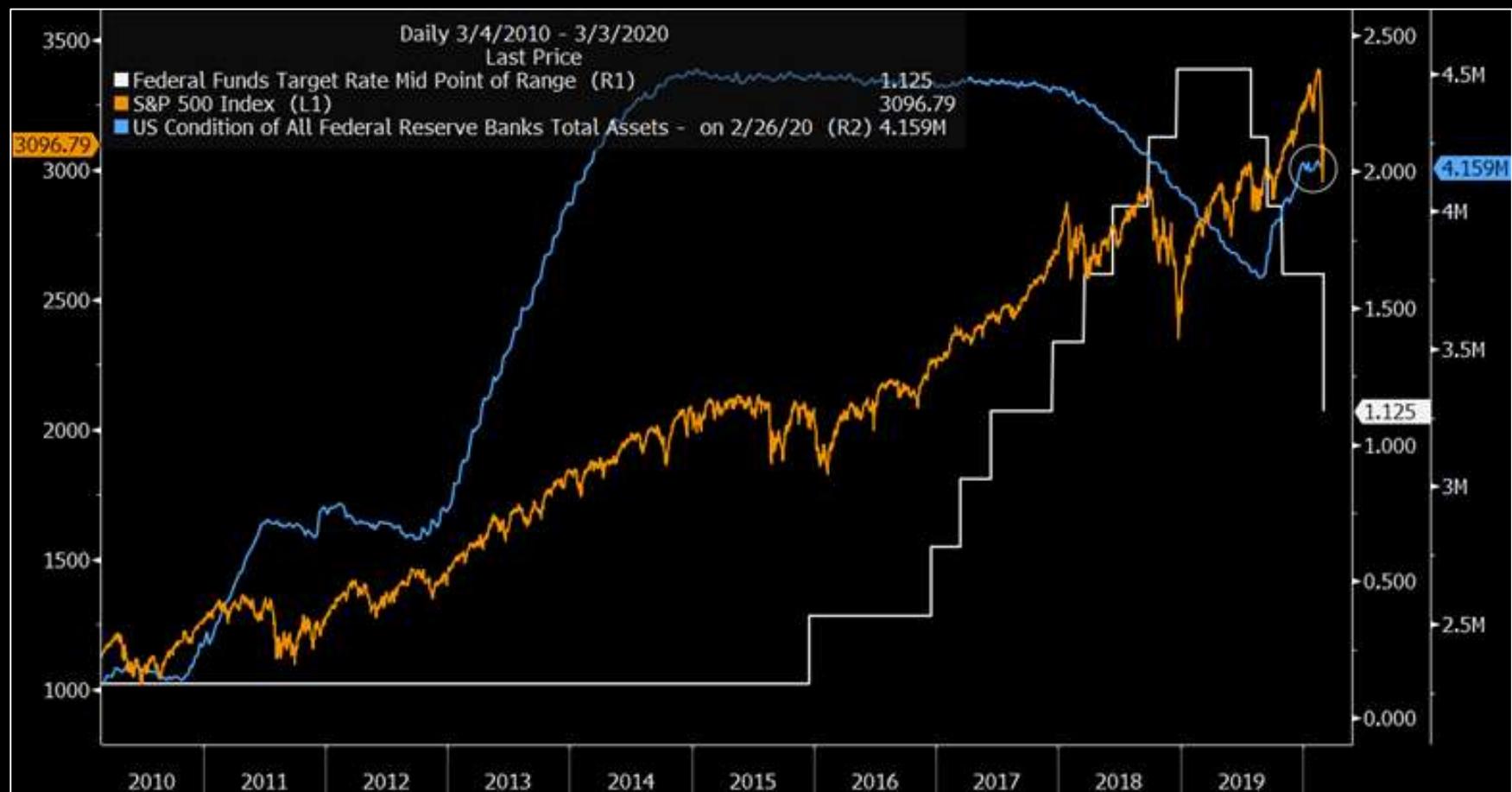
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- Extraordinarily interventionist monetary policymaking has created a global equity market with very high sensitivity to **interest rates**.
- Growth concerns continue to plague investors as Fed policy moves incrementally less dovish. As a result, performance is hugging secular themes of **momentum, growth and size**.
- **Earnings sentiment** is proving a powerful driver of returns as company guidance continues to shrink. Investor concerns are wide-ranging, from the top to bottom line.
- Not all uses of cash are treated equally. Amid economic cycle nervousness, **dividend increases and investment** are powerful signals of strength.



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FED STILL DRIVING STOCKS BUS





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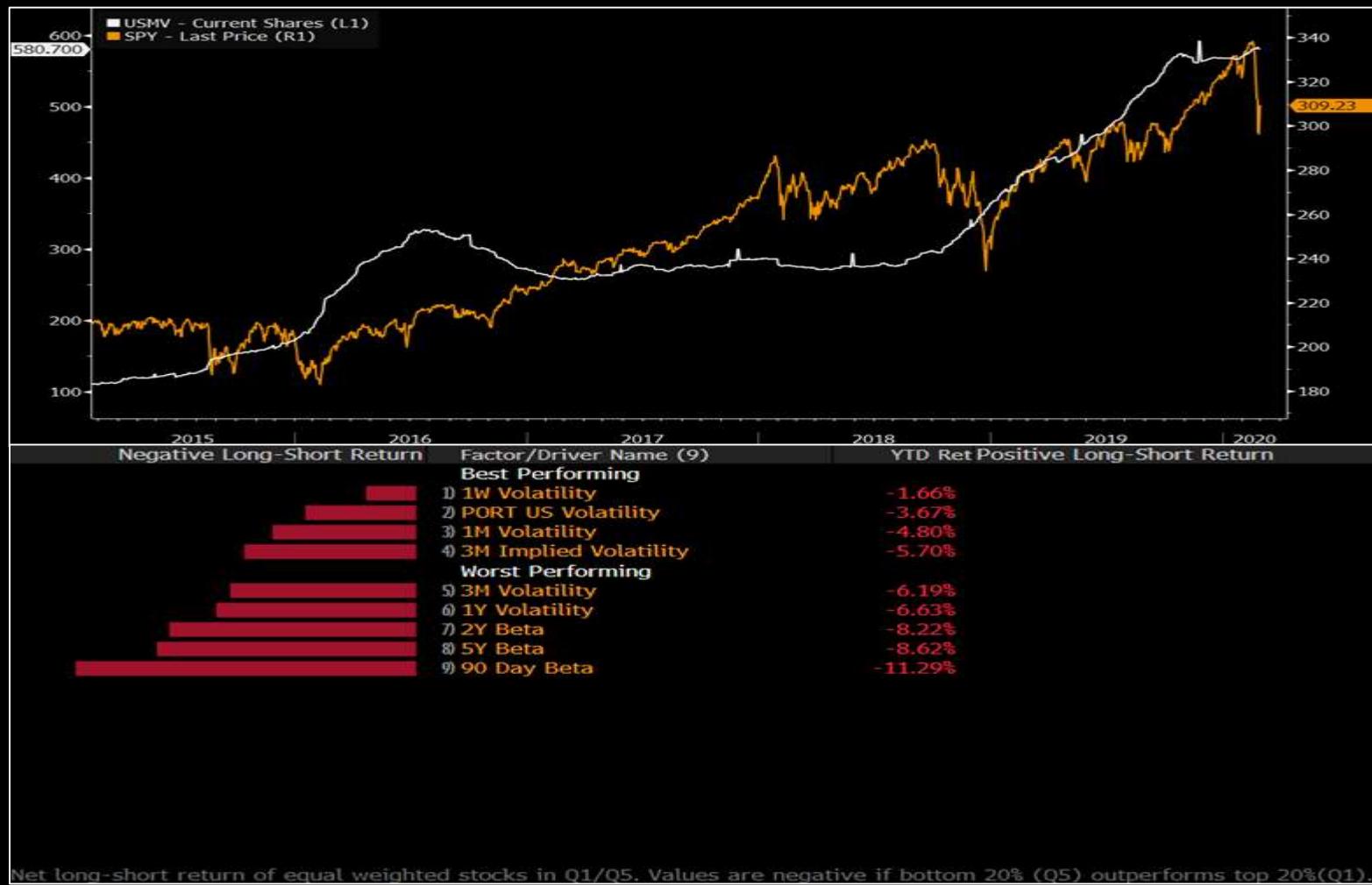
VALUE REVERSED PRE-CORONA





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LOW VOLATILITY IN DEMAND





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UTILITIES SURGE STARTED EARLY





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REAL RATES DRIVE MULTIPLES





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PE SCENARIOS: AIDED BY RATES

Macro Model	Scenario Analysis		
	Base	Bull EPS	Recession
2Y Yield	1.60	2.20	0.50
10s2s	0.25	0.60	0.80
BAA Spread	3.00	2.00	3.50
NTM EPS Growth*	4.0	12.35	4.00
Estimated ERP	3.47	2.43	4.77
Estimated PE	19.7x	21.6x	19.0x

* Estimated 12M growth 12M Forward



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EARNINGS STILL IMPORTANT





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...ESPECIALLY FOR SELECTION





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TECH RELATIVE EARNINGS





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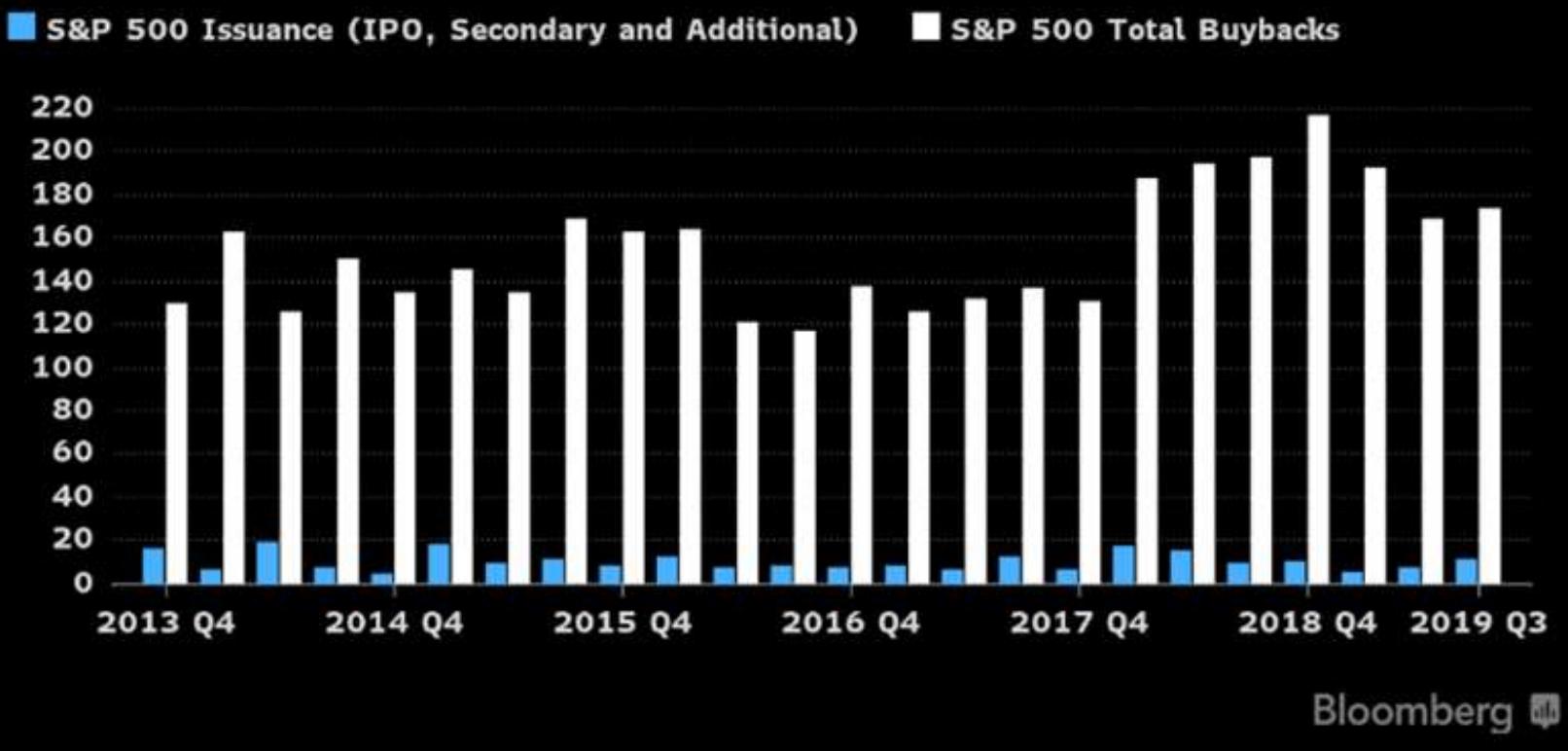
BUYBACKS HAVE HELPED TOO





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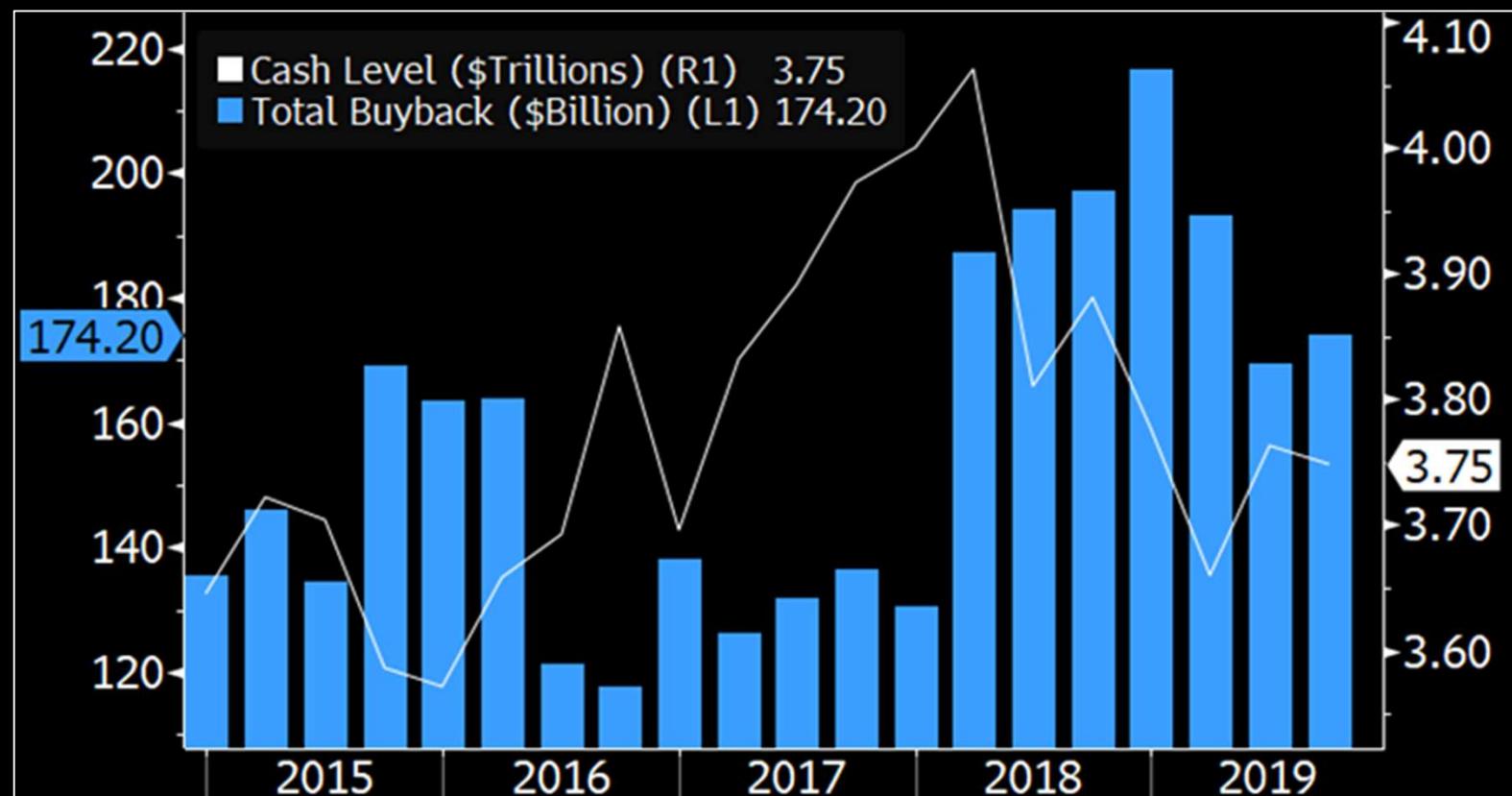
EQUITY SUPPLY IS SHRINKING





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CASH DOES NOT DRIVE BUYBACK





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WHERE TO FROM HERE?

- Market Health Mixed – Suggests Rocky Outlook in Short Run
- Secular Themes Win, Unless Balance Sheet Shift is In Play
- Margins are Key to Turn in Earnings Outlook
- Don't Count on a Bailout from Buybacks



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MARKET HEALTH CHECKLIST

Indicator	Signal	Commentary
Relative EPS Growth	Yellow	Cyclical sector EPS growth has reliably fallen short of defensive sector EPS growth in advance of the last three earnings recessions.
EPS Cycle	Green	The average return for years where S&P 500 earnings troughs is 11.4% vs. a 4.6% gain in years where earnings peak.
Earnings Breadth	Yellow	The percent of S&P 500 companies with EPS growth reaches peaks prior to market peaks and confirms bottoms.
Margin Forecast	Yellow	Operating margin forecasts have peaked in advance of each major correction since 2009.
Sentiment	Green	Flows into equity markets should be strong at major peaks, as evidence of optimistic sentiment.
Price Trend	Yellow	Stock prices rise and hold above key moving averages in uptrends. Moving averages themselves trend up and the 50-day moving average holds above the 200-day moving average.
Breadth & Momentum	Yellow	More than 50% of stocks trade above 200-day moving average and 14-day RSI trends between 50-70 in uptrends.
Sector & Industry Signals	Yellow	The ratio of technology to utilities stocks tends to turn higher with the S&P 500. Semiconductors, transportation stocks and homebuilders are consistently strong leaders of overall market trends.
Financial Conditions ex-Equity	Red	The Financial Conditions ex-Equity Index peaked on average 38 days before market highs post-crisis.
ISM Manufacturing Index	Yellow	The ISM Manufacturing Index peaked prior to major market moves in 1998, 2000, 2007, 2011 and 2015 with an average lead time of 13.4 months (6.5 excluding long lead time prior to 2007 peak).
Unemployment Rate	Yellow	The unemployment rate on average starts to rise 3 months before recession-related peaks in the equity market.
High Yield Spreads	Red	On average, high yield spreads widen 125 basis points 6 months in advance of major equity market peaks.
Stocks/Bonds Correlation	Green	Stock prices and bond yields have been positively correlated since 2000, and correlation breakdowns offered an average 17-month lead to equity market peaks in the time since.
Yield Curve	Yellow	The yield curve spread between 10Y and 2Y Treasuries inverts on average 13 months before recession-related peaks in the equity market.
Short Term Funding Spreads	Red	Short term credit spreads were effective leading indicators of distress last cycle with spikes starting in mid-2007.

Legend: Favorable Neutral Unfavorable

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S&P FINDING ITS SUPPORT





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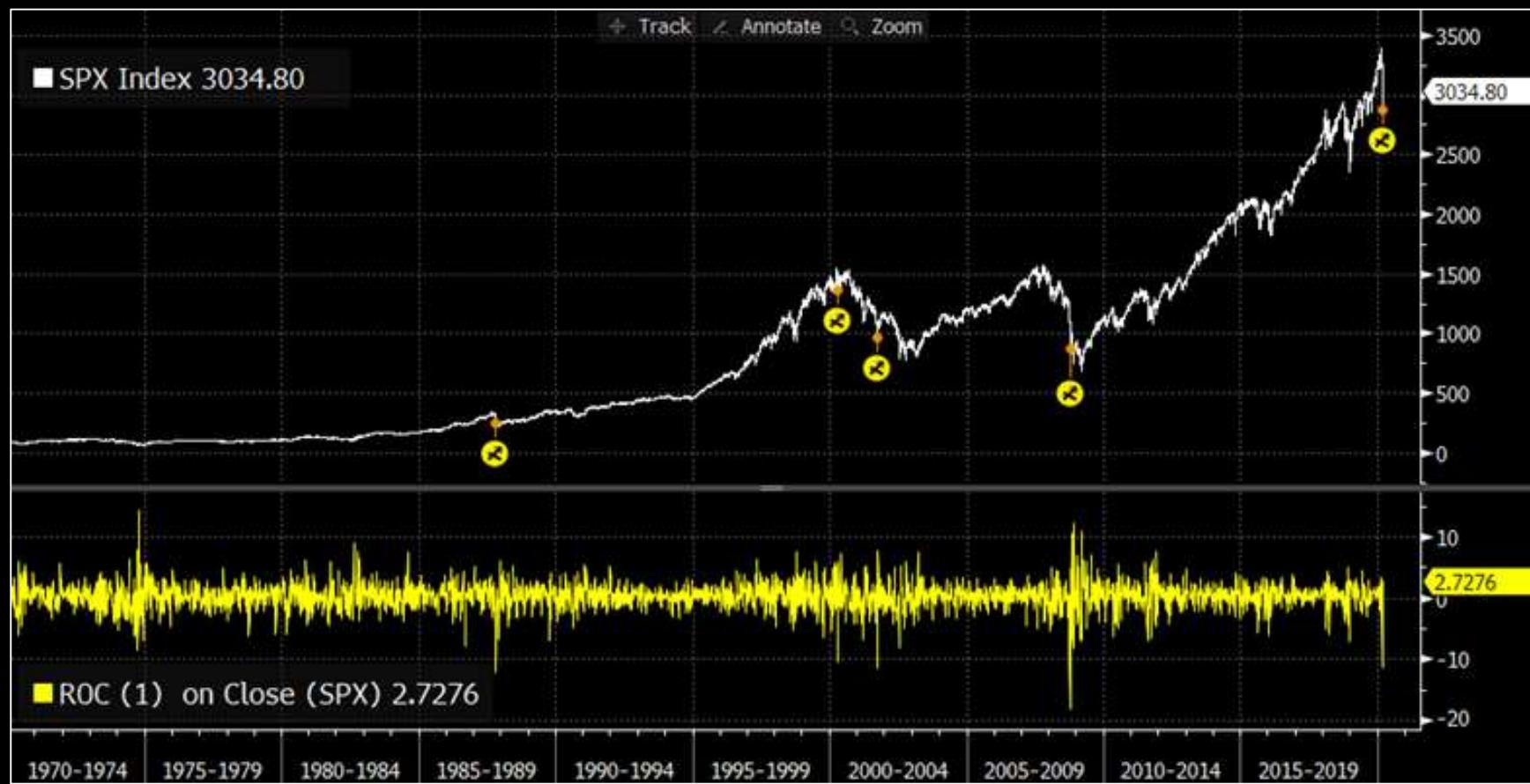
U.S. CAUGHT UP TO ROW





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10% CORRECTIONS RARE





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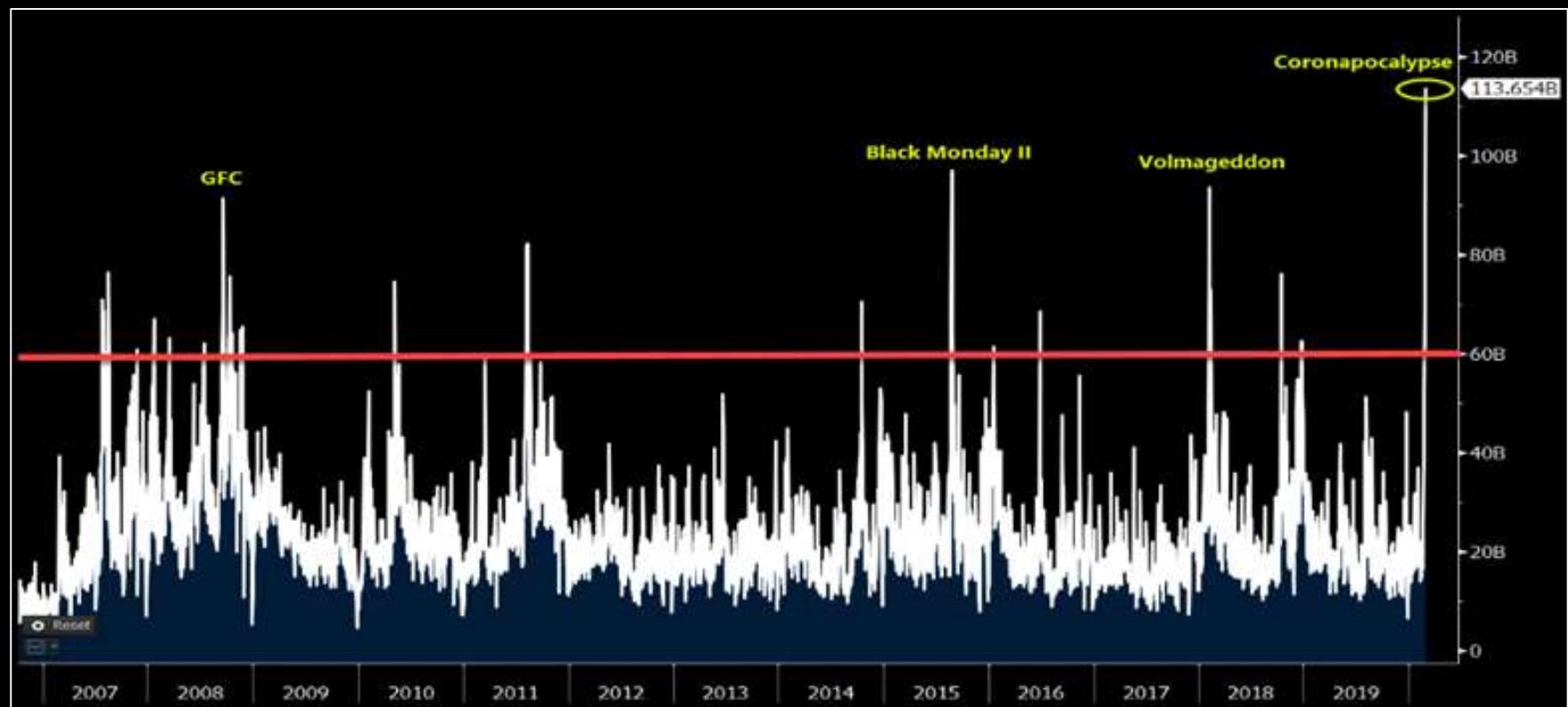
VOLATILITY SIGNAL EXTREME





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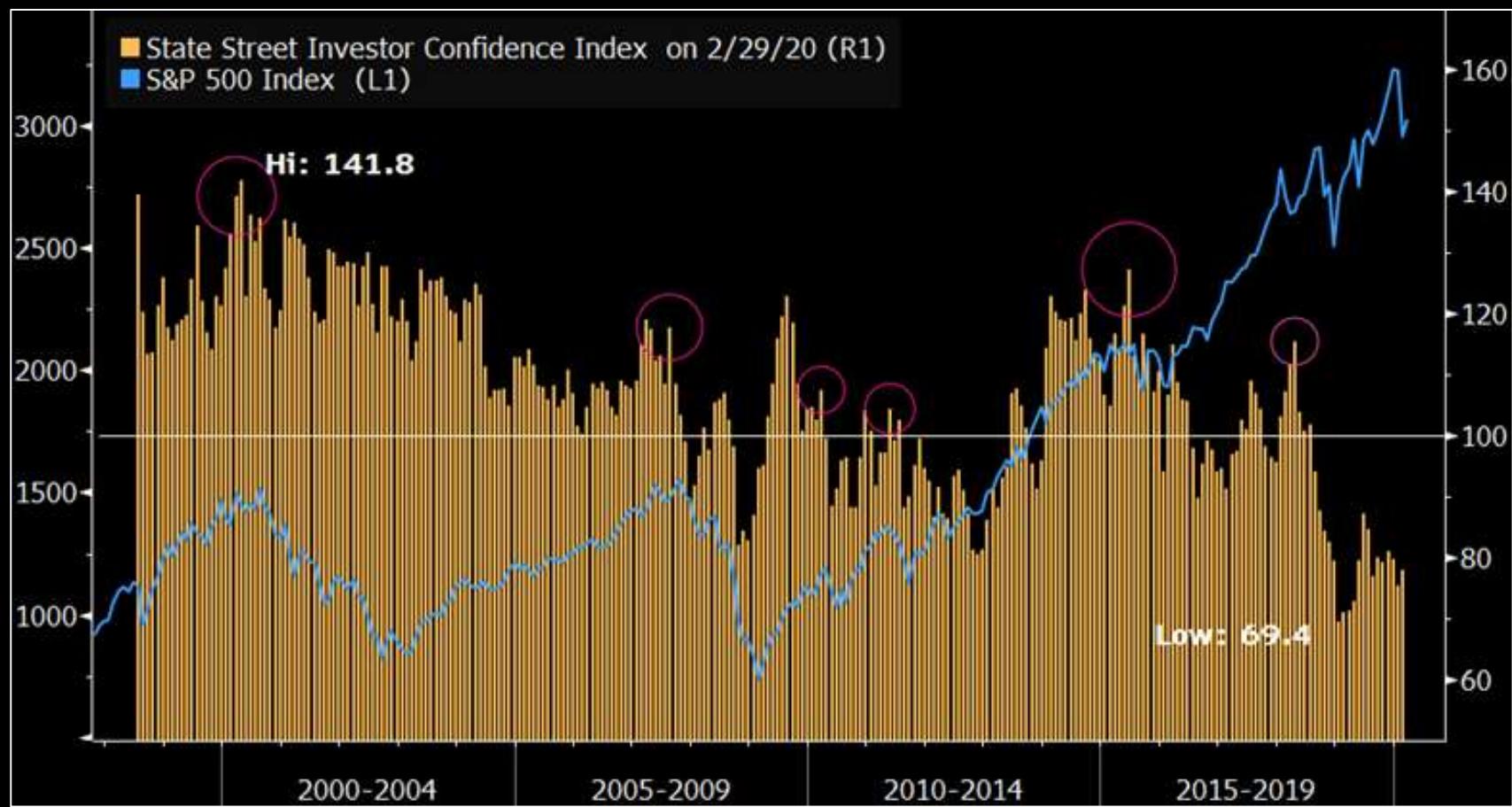
ETF FLOWS: (SPY) FEAR





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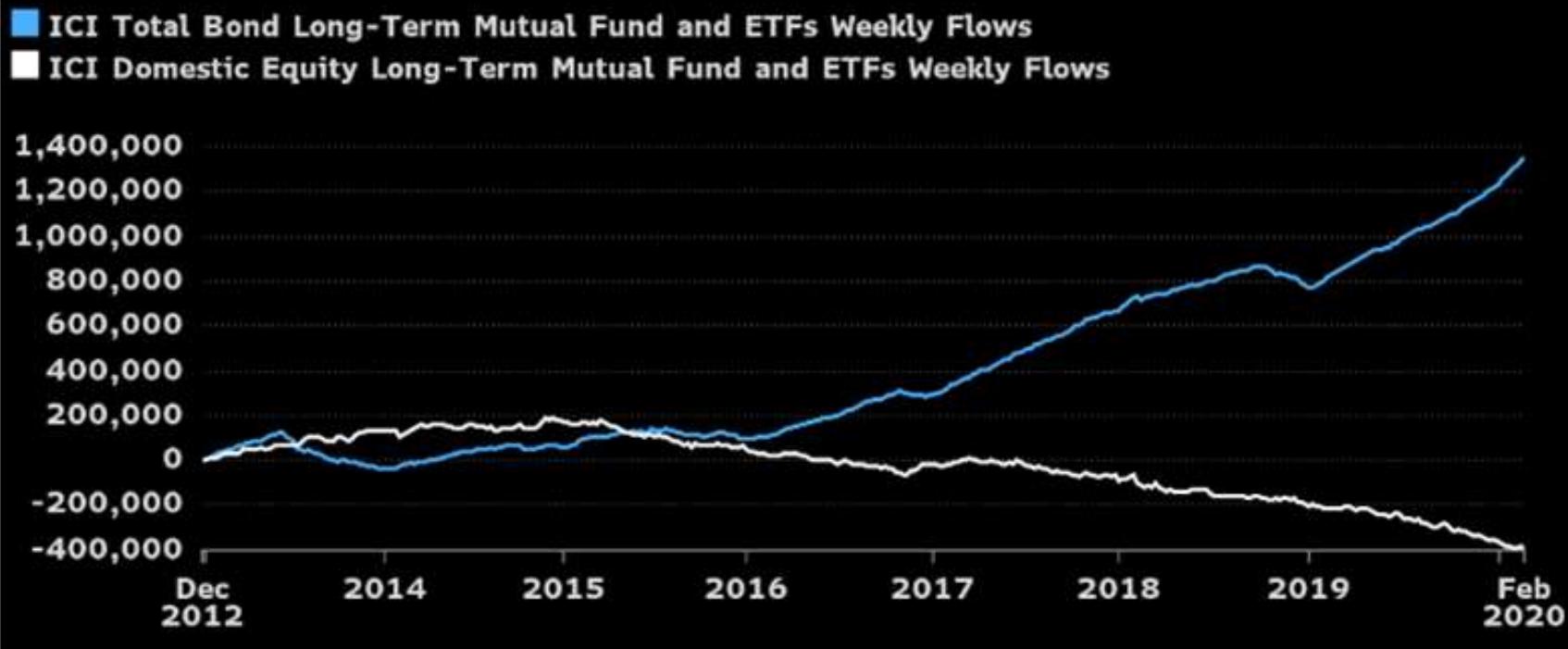
INVESTOR SENTIMENT IS AWFUL





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U.S. FLOWS STILL NEGATIVE



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FAAMG FLYING TOO CLOSE TO THE SUN?





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CORRELATION INTACT





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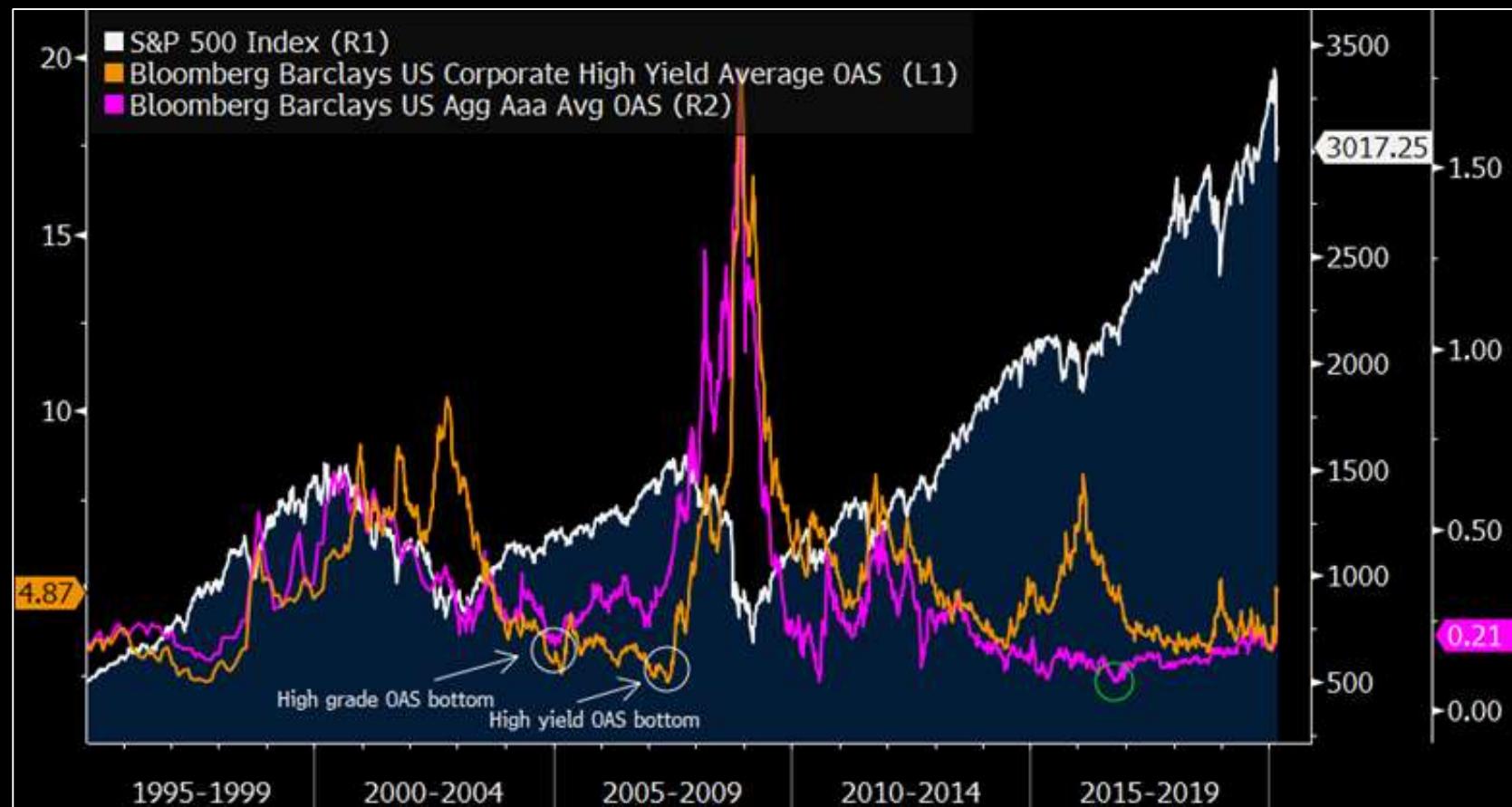
YIELD CURVE CONCERNING





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SPREADS WIDENING





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SHORT TERM DISTRESS EVIDENT





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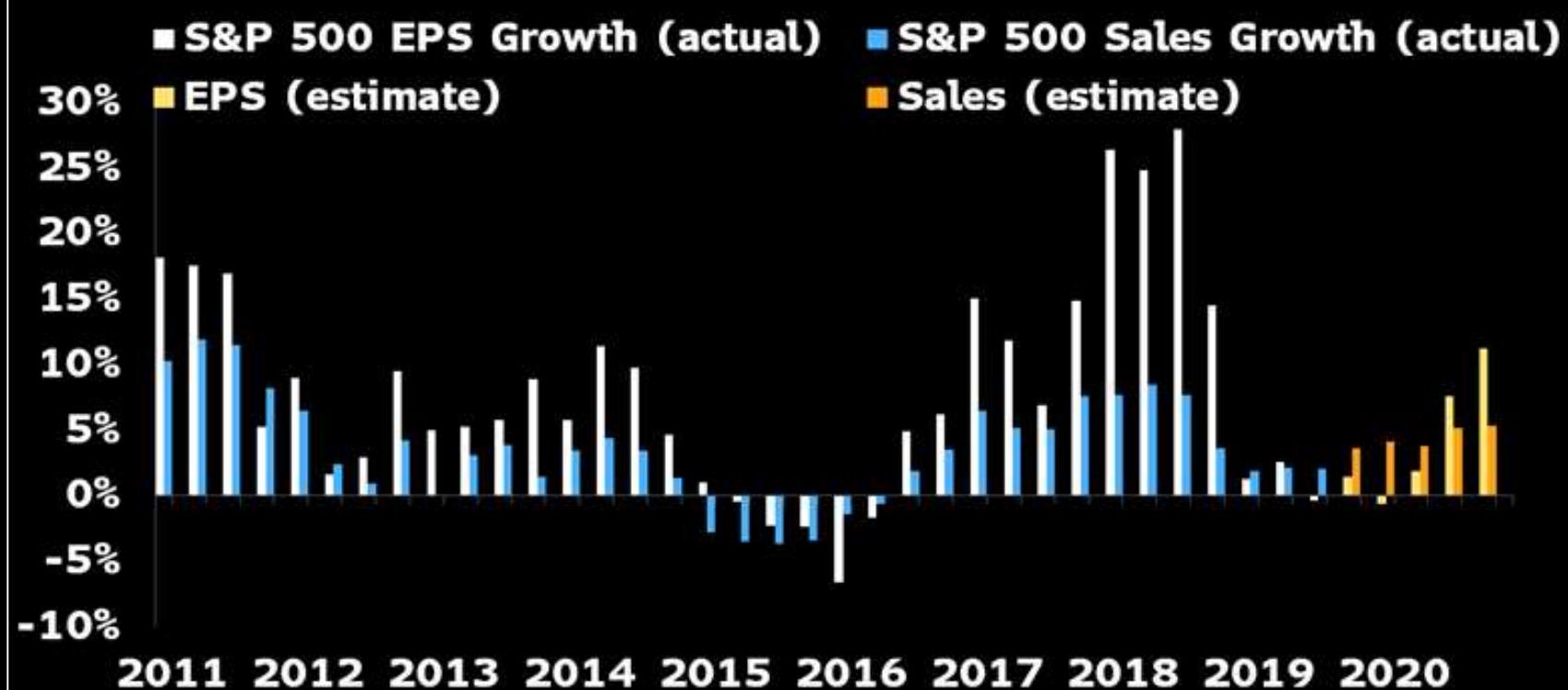
FINANCIAL CONDITIONS TIGHT





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EARNINGS SLUMP CONTINUES



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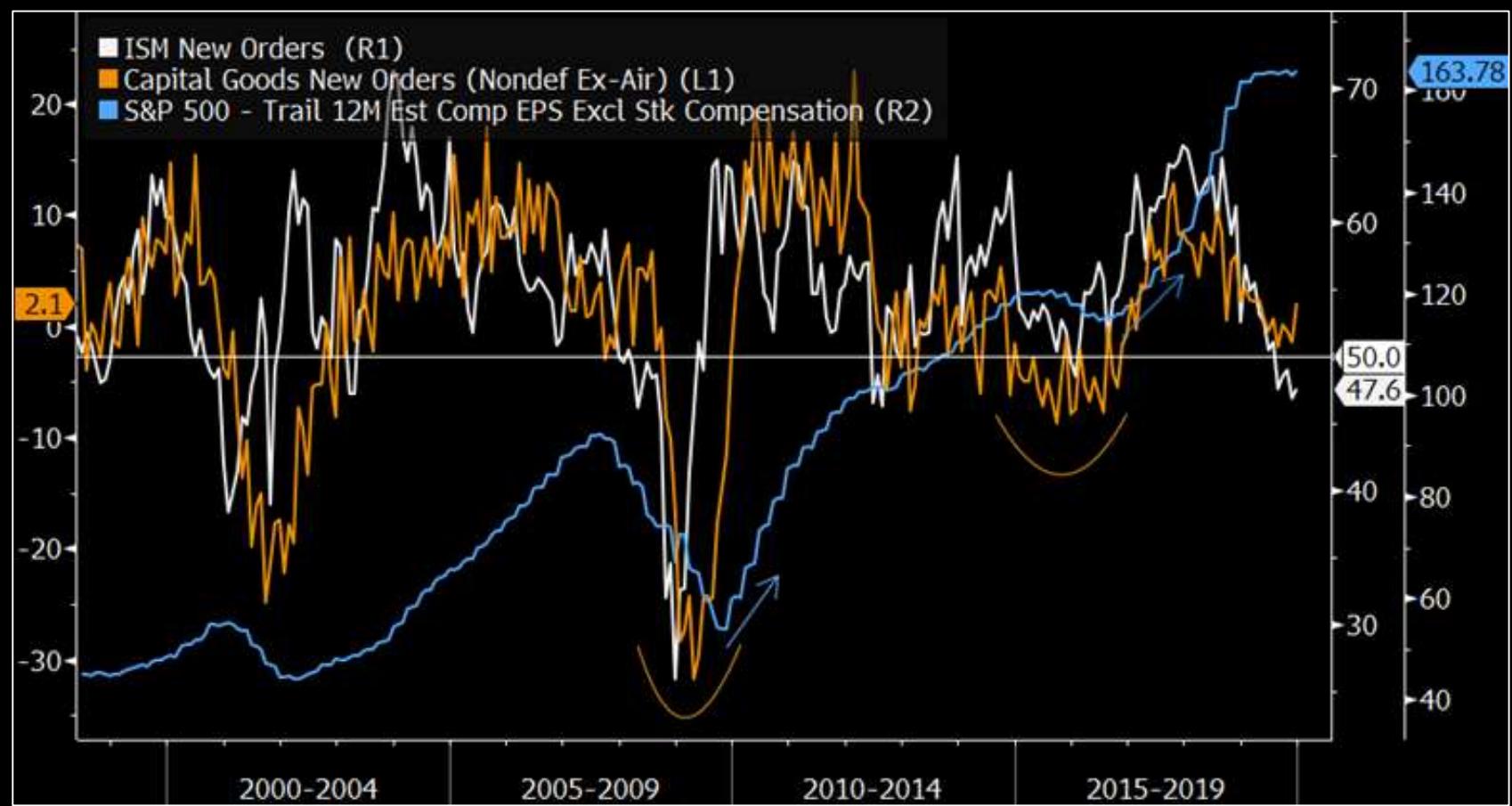
EPS SCENARIOS

Macro Model	<u>Scenario Analysis</u>		
	Base	Bull	Bear
TTM EPS	163.86	163.86	163.86
New Orders % Chg	(2.00)	6.00	(11.30)
Bps Chg in 2Y	0.40	0.24	0.21
Bps Chg in UR	0.10	(0.20)	1.30
CRB Commodity % Chg	(9.00)	5.00	(28.80)
NTM % Growth	2.16	12.35	-14.45
NTM EPS	\$167.39	\$184.09	\$140.18



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EPS HINGES ON INVESTMENT





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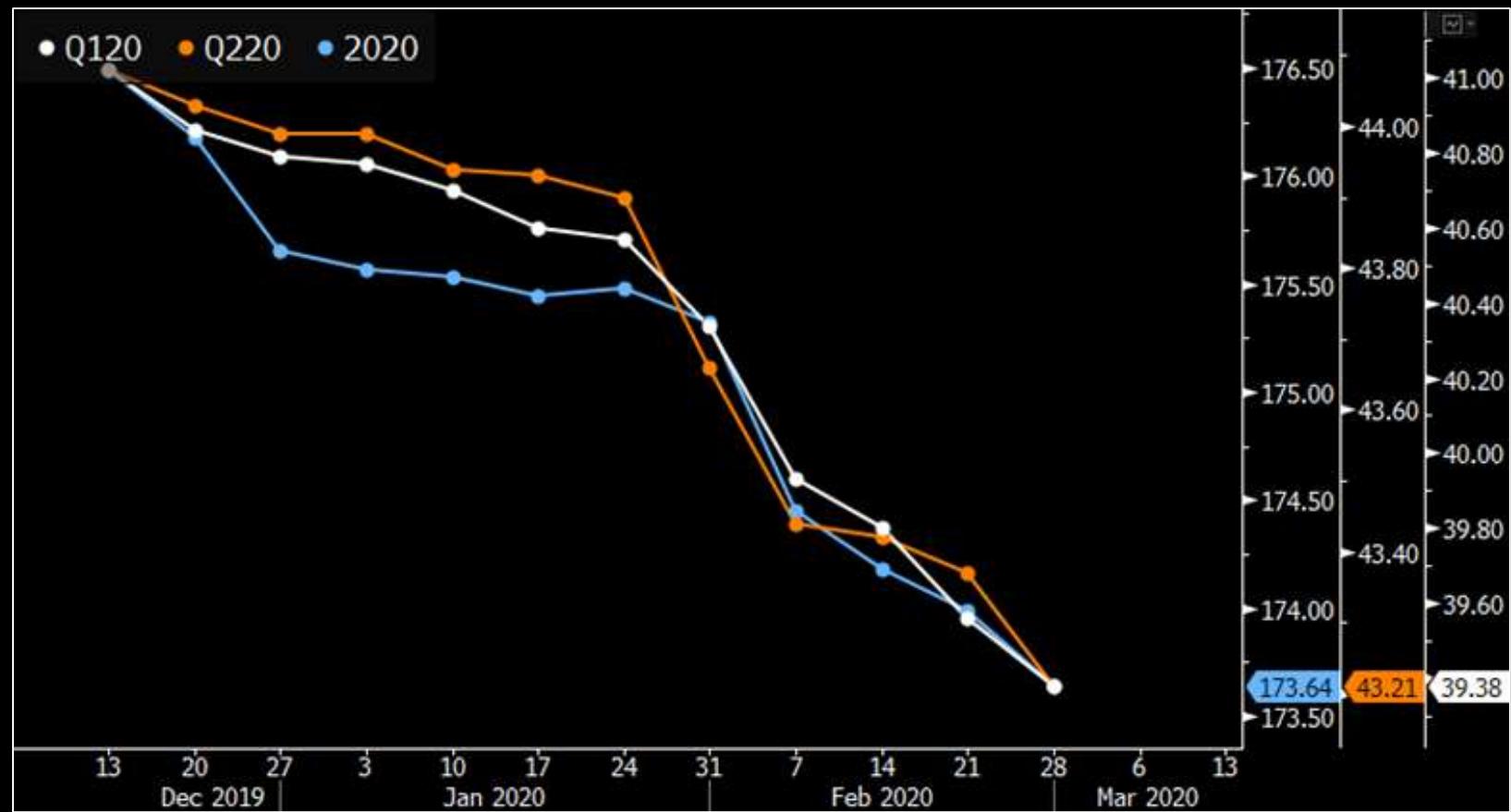
MARGINS TROUBLING





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REVISIONS ARE PROBLEMATIC



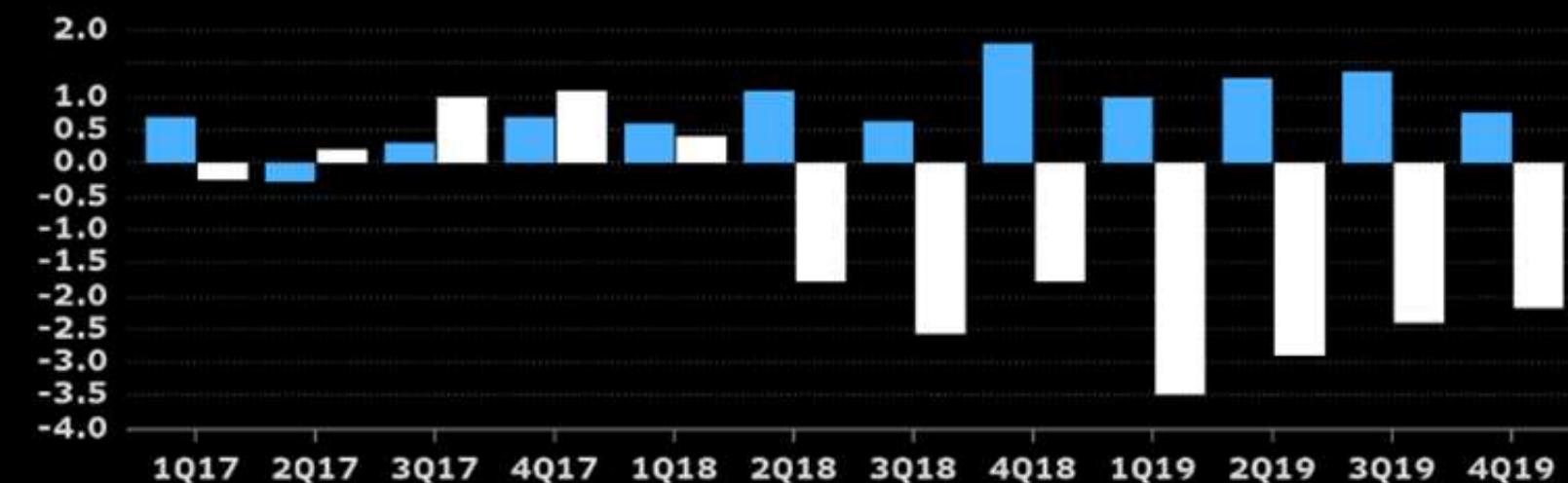


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MARKET NO LONGER FORGIVES EPS MISSES

EPS Reactions

- Average "Beat" 1-Day Return in excess of S&P 500
- Average "Miss" 1-Day Return in excess of S&P 500



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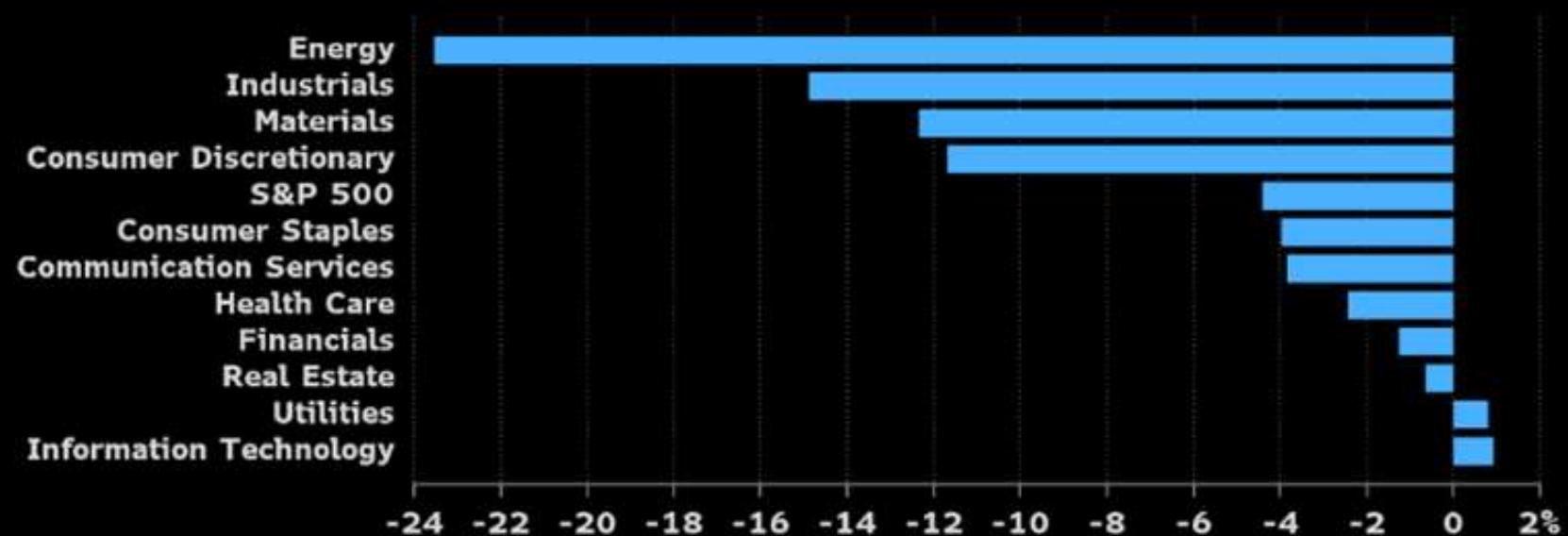
Source: Bloomberg Intelligence Equity Strategy



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FEW POSITIVES IN REVISIONS

Change in EPS Growth Estimate - Last Three Months (Percentage Points)



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GUIDANCE IS INCREASINGLY SCARCE

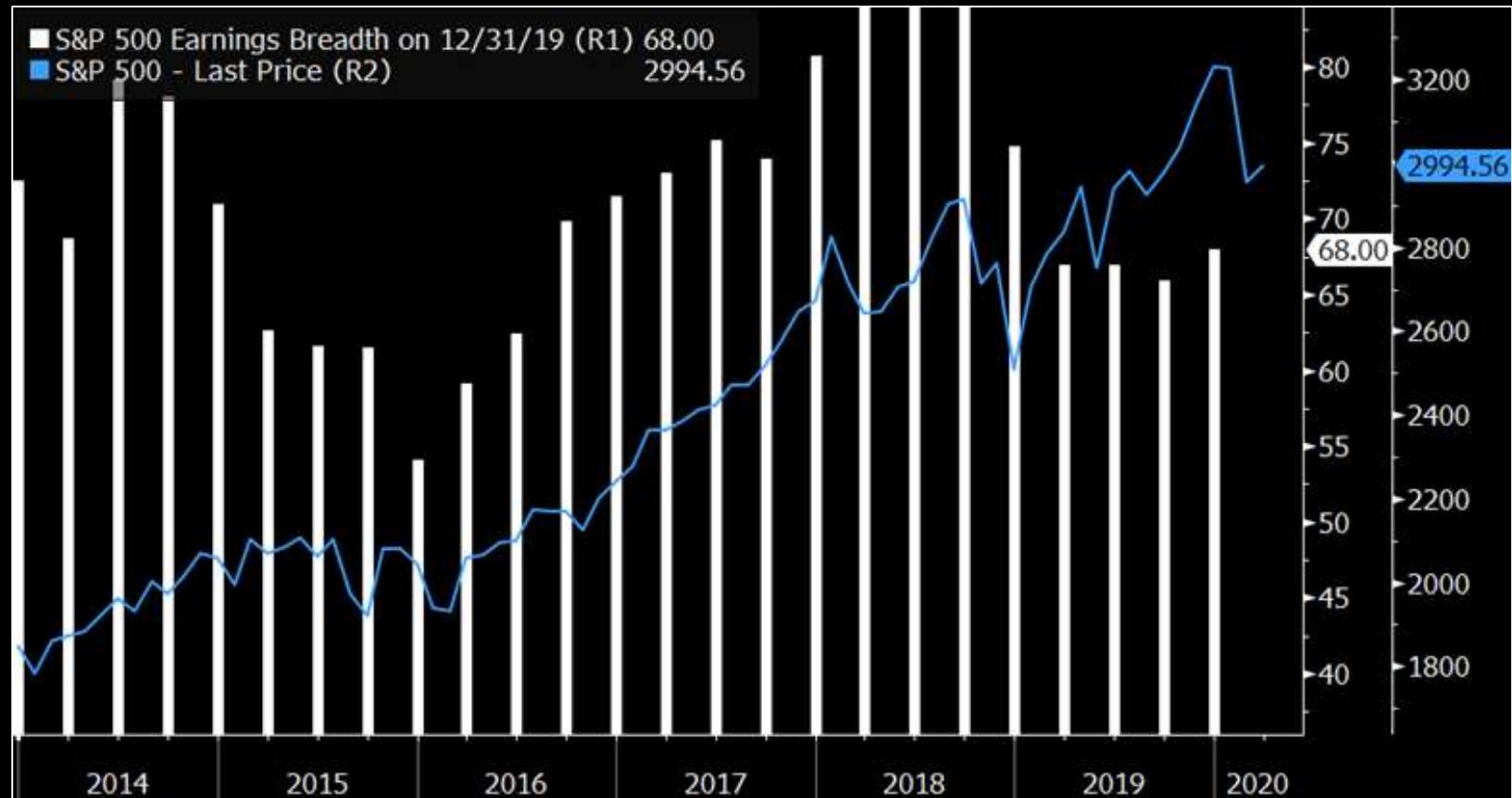


Source: Bloomberg Intelligence Equity Strategy



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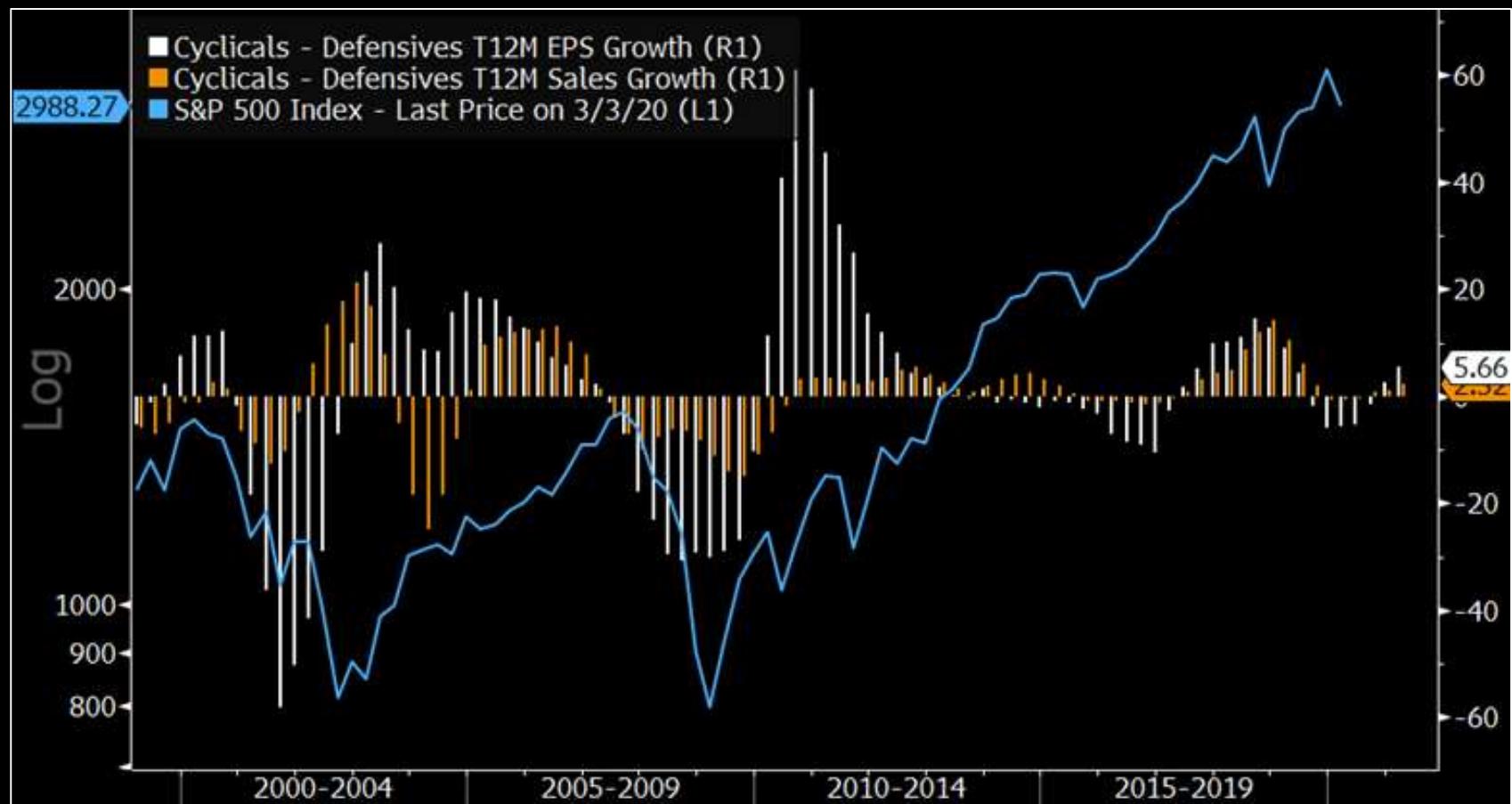
GREEN SHOOTS IN EPS?





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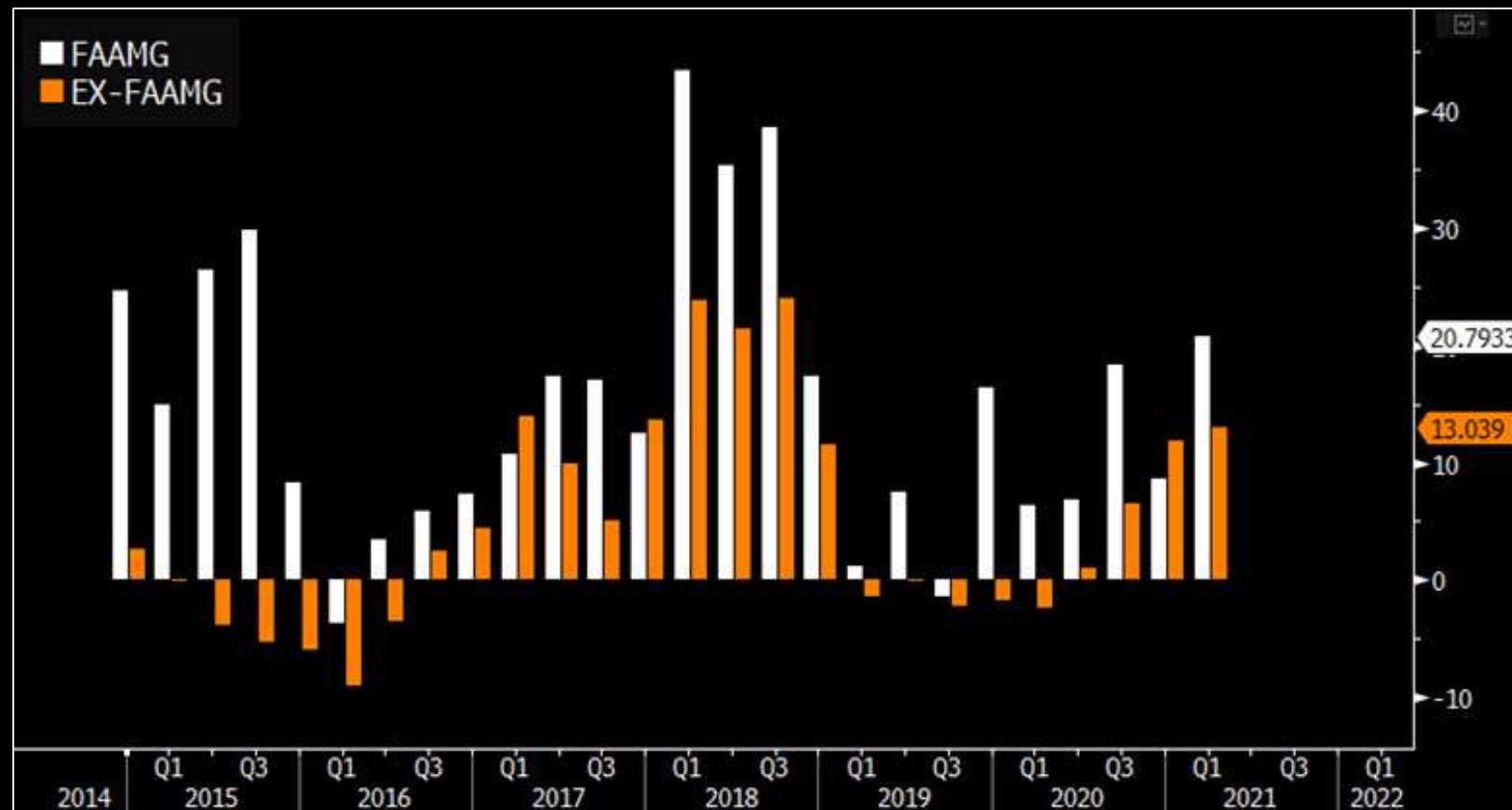
OUTLOOK FAVORS CYCLICALS





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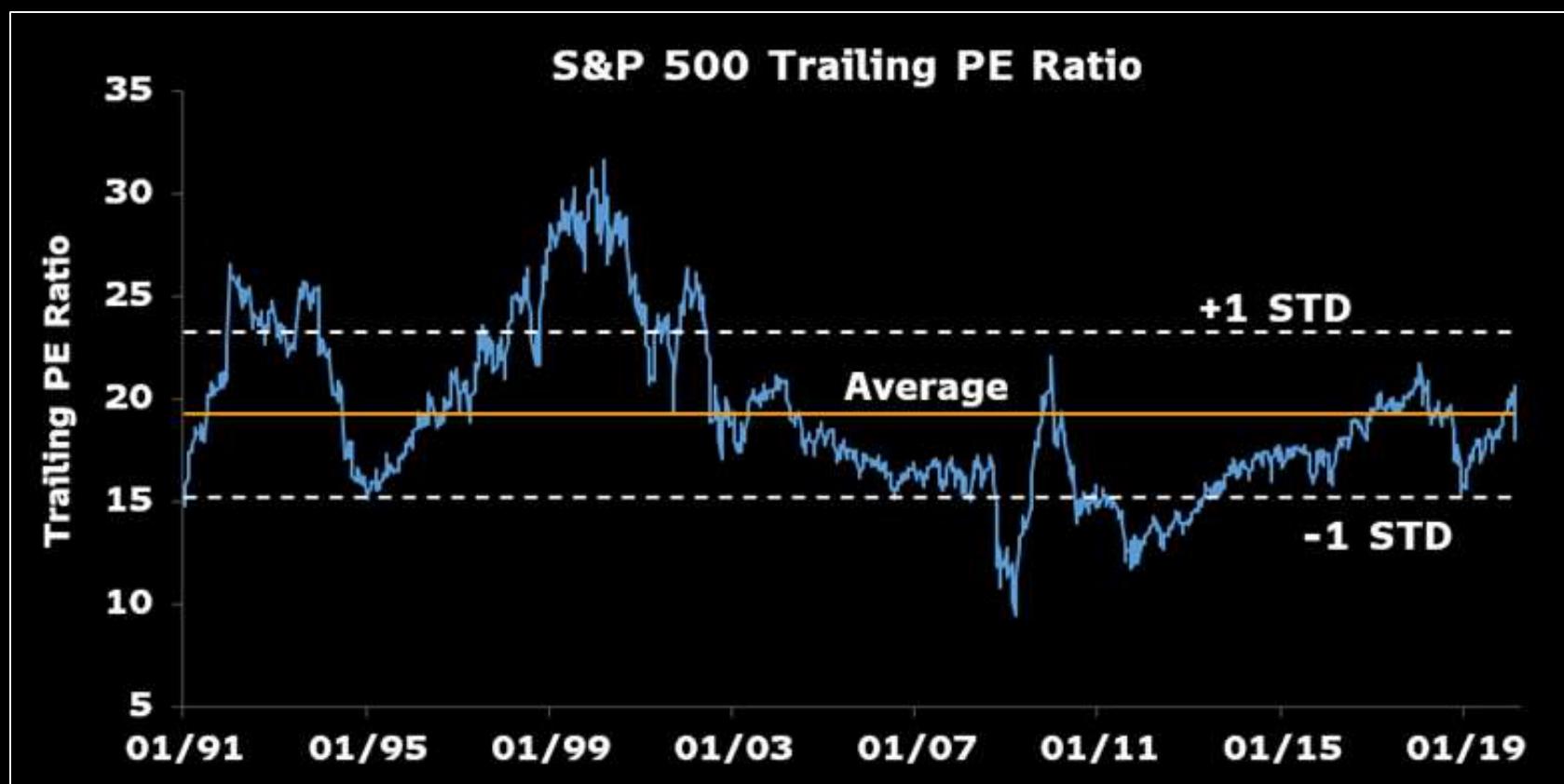
FAAMG CARRYING INDEX





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P/E: TOO EXPENSIVE?





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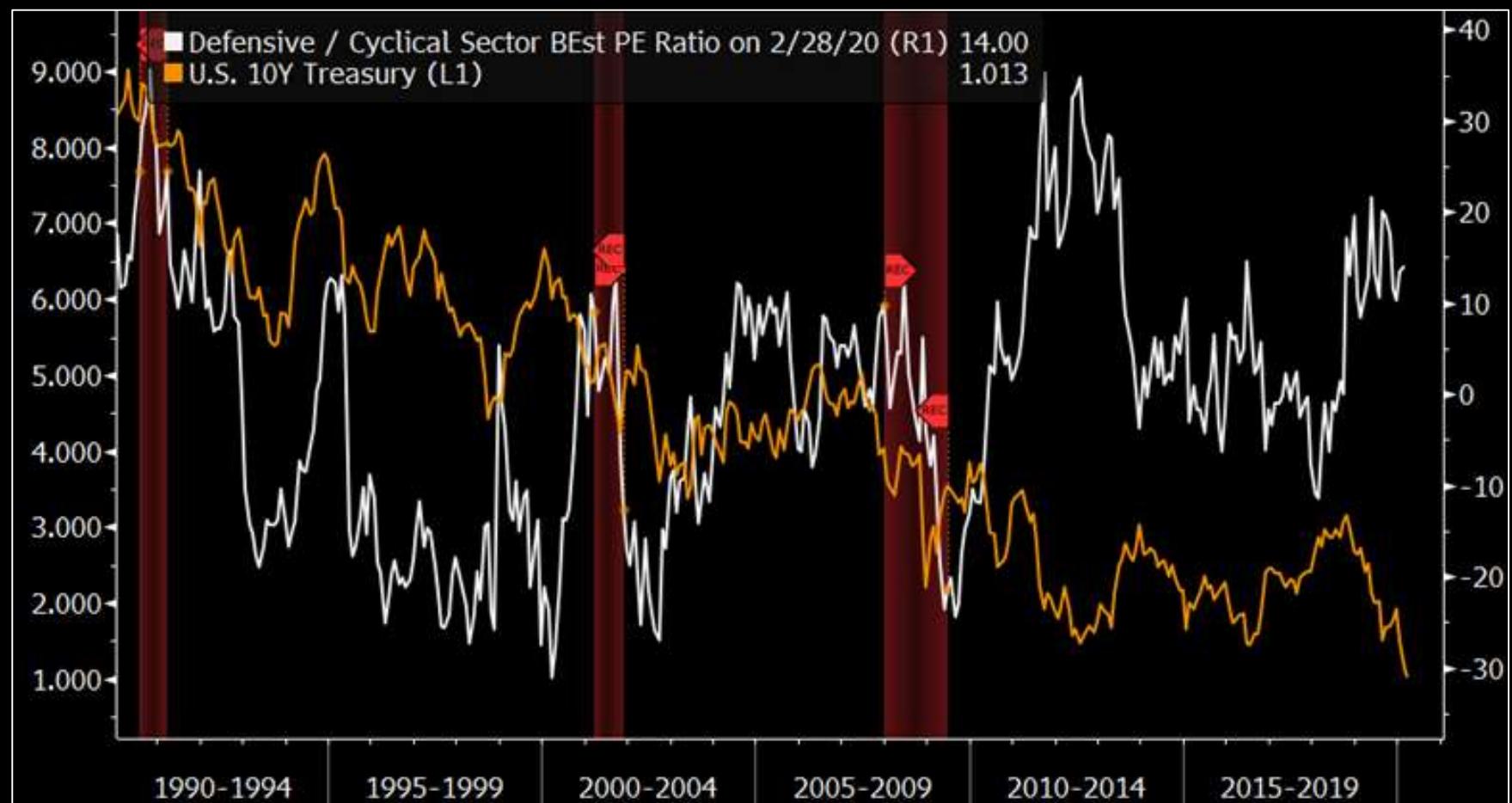
RISK PREMIUM STILL VERY HIGH





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DEFENSIVE PREMIUM REMAINS





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EX-FAAMG VALUE IS THERE



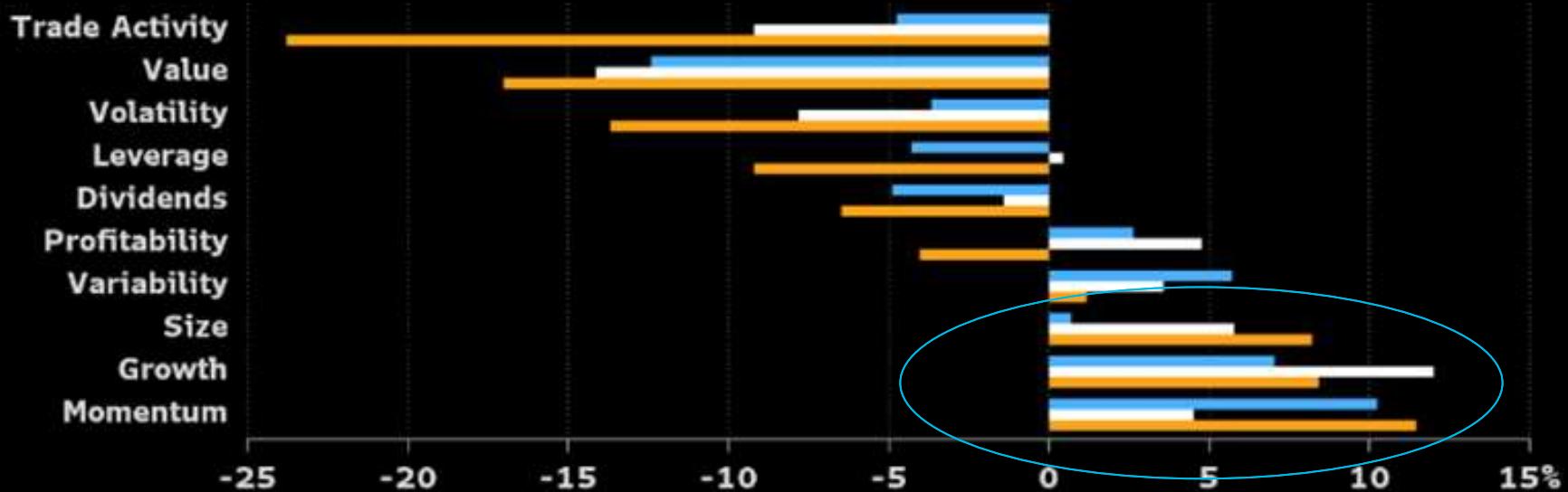


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PURE FACTOR RETURNS

FTW Pure Factor Returns - Russell 1000

■ YTD ■ 1Y ■ 7Y



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SECTOR SCORECARD



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GROWTH DOMINANCE





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VALUE NEEDS YIELD CURVE SAVE





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RETURNS FOR USE OF CASH

S&P 500 Sector Neutralized Average Monthly Return Q-Spreads

■ 1 YR ■ 7 YR



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Source: FTW – Factors to Watch



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DIVIDEND YIELD IS NOT WORKING

Negative Long-Short Return	Factor/Driver Name (6)	YTD Ret Positive Long-Short Return
	Best Performing	
	1) 3Y Avg Dividend Payout	-0.64%
	2) Dividend Payout %	-2.99%
	3) 5Y Z-Score Dividend Yield	-4.40%
	Worst Performing	
	4) Dividend Yield (Indicated)	-5.04%
	5) PORT US Dividend Yield	-5.05%
	6) 10Y Z-Score Dividend Yield	-10.65%

Net long-short return of equal weighted stocks in Q1/Q5. Values are negative if bottom 20% (Q5) outperforms top 20%(Q1).

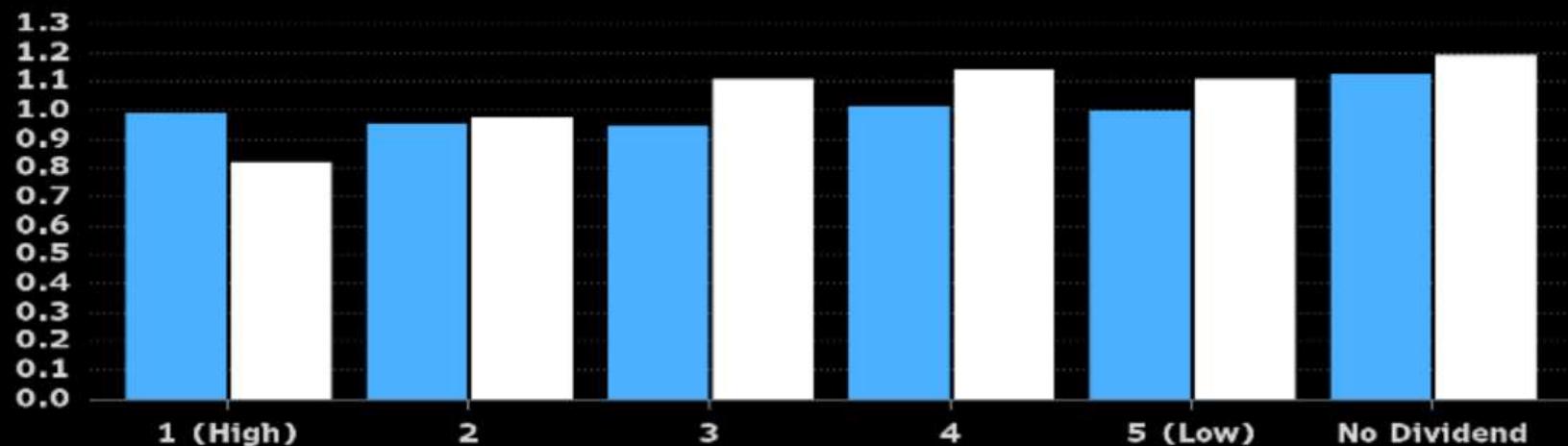


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YIELD IS GETTING RISKIER

Median Beta of S&P 500 Dividend Yield Quintiles - Today vs. 5Y Ago

■ Beta Today ■ Beta 5Y Ago



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SUMMING IT UP

- Short Term Pain likely followed by Longer Term Gain
- Interest rates at low levels ultimately support share prices, but falling yields should be heeded.
- Unless Fed eases policy, earnings should drive stock prices. Lack of visibility elevates stocks with strong short term earnings trends rather than big recovery prospects.
- Momentum, low volatility, growth and size likely continue to lead while value, dividend yield, high volatility could remain laggards.
- Dividend increases and investment are powerful signals of strength.



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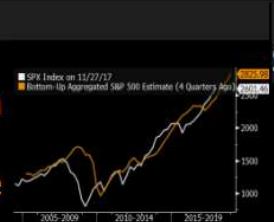
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U.S. Equity Bull to Plod Through the Swamp: 2020

THESSIS: A modest gain for U.S. large-cap stocks in 2020 is implied in our fair value model as most likely, unless a policy shock manages to swing the economic pendulum away from slow growth. The



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Featured Research

- 1) [Three Ts Drive Stocks Earnings Outlook](#)
- 2) [Global Equity Outlook \(MXWD Index\): January 2020](#)
- 3) [BI Equity Strategy: The Week in Charts, Jan. 9](#)
- 4) [Weekly Equity Market Minute: Jan. 8](#)

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