What Top Advisors See On The Horizon For Markets In 2020

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KEY POINTS

- Despite potential volatility on the horizon, advisors expect 2020 could be another good year for both the economy and the stock market.
- Topping most advisors' list of risks is the trade war between the U.S. and China.
- Softer than expected corporate earnings or the election of Sen. Elizabeth Warren or Sen. Bernie Sanders to the U.S. presidency could affect stocks, advisors cautioned.

The bull market in U.S. stocks rolls on.

From the trade war between the U.S. and China and the slowdown in global economic growth, to Britain's messy exit from the European Union and the potential impeachment of President Trump, nothing has dampened the enthusiasm for stocks.

The American economy remains in the midst of the longest economic expansion on record and the longest — if not strongest — bull market in stocks. Despite some concerns about higher volatility from a range of potential factors, registered investment advisors expect 2020 could be another good year for both the economy and the stock market.

"The cycle has been long but the economy has also been slower than in past cycles and without the big imbalances we've seen previously," said Alan Cohn, president of Sage Financial, ranked No. 50 on the CNBC FA 100 list of top investment advisors for 2019. "With interest rates low and the U.S. economy good, we think there's still room to run."

"We're clearly extended in the cycle but that doesn't mean that it can't continue," added Jason Graybill, co-director of fixed income at Carret Asset Management and a member of the firm's investment committee. Carret is ranked No. 14 on the FA 100 list. "There are global risks out there but we think there's a high probability that 2020 could be another good year."

Topping most advisors' list of risks is the trade war between the U.S. and China — the world's two biggest economies. Since the battle erupted last year, when President Trump began levying tariffs on Chinese-made products, business confidence and capital expenditures have slipped, contributing to the recent tapering of global economic growth.

Graybill thinks the slowdown now presents an opportunity for at least partial resolution of the dispute.

"All eyes are fixated on trade," he said. "We've seen slower growth in the last two or three quarters due to the uncertainty and that creates the opportunity to resolve some of the tariff issues."

A so-called Phase 1 trade deal would see the U.S. postpone new tariffs set to take effect this month and begin rolling back previously levied tariffs as China agrees to resume more purchases of U.S. agricultural products. "It's our view that President Trump and the administration don't want to have tariffs in the election headlines next year," said Graybill. With growth also slowing significantly in China, it, too, has a strong incentive to strike a deal.

While the U.S.-China dispute still has business leaders nervous about investing new capital, trade is not the only factor affecting the economic outlook. With the U.S. currently at record low unemployment and consumer spending still solid, the economy continues to grow, albeit at a slower pace.

"It's important not to focus solely on one issue like trade," Cohn said. "We're seeing better corporate earnings than expected and lower interest rates are driving the [stock] market higher."

Federal Reserve Chairman Jay Powell and, as President Trump has called them, the "boneheads" at the Fed deserve a good deal of the credit, despite frequent withering criticism from the commander in chief. Earlier interest rate hikes followed by a "mid-cycle adjustment" of three rate cuts has restored market confidence that the Fed will respond to signs of further economic weakness.

"If the economy softens and people have less ability to service debt, the Fed will lower rates further," said Graybill, whose firm invests three quarters of its $2.9 billion in assets under management in fixed income. The current Fed Funds rate is 1.5% to 1.75%.

Graybill focuses solely on the U.S. fixed income market. "we stick to what we're good at," he said.

However, he believes the flexibility that the Fed still has relative to other developed markets in Europe and Japan that currently have negative interest rates provides more potential support for domestic bond prices.

"There has been so much central bank intervention globally," he said. "If they back off now, interest rates could rise rapidly," he said.

Nevertheless, Graybill is underweight U.S. Treasury bonds. "We think U.S. Treasurys are one of the more over-valued areas of the fixed income landscape," Graybill said.

After bottoming below 1.5% in early September, the yield on the 10-year Treasury bond has risen to 1.76%.

"It's not enough compensation for the duration risk," he said.

Instead he favors corporate credit risk on the short-end of the market again because of the duration risk of holdings bonds in such a low-rate environment.

Cohn’s firm is also overweight U.S. bonds versus other developed markets, though it maintains an allocation to higher-yielding emerging market bonds. Sage brought down exposure to emerging market stocks and bonds in July when it became clear the U.S.-China trade war could be protracted but still believes in emerging markets “in a structured way.”

“The economies are growing faster, the demographics are favorable and the valuations are good,” Cohn said. “We expect to see stronger returns there.”

He also favors so-called unconstrained bond funds that can invest anywhere and change strategies quickly based on changing circumstances. “We like them heading into an election year,” said Cohn. “We think volatility could pick up with comments from a candidate like Elizabeth Warren or Bernie Sanders.”

Michael Morrill, a portfolio manager and chief operating officer at D.F. Dent and Company, No. 20 on the FA 100 list, doesn’t spend much time thinking about the economic outlook. “We’re bottom-up stock-pickers and less interested in the short-term outlook,” he said. “We keep an eye on the macroeconomic picture but we don’t obsess over it.”

Morrill said his firm looks to own stocks of “good companies with great management teams” for a five- to seven-year period based on fundamentals and valuation. He sticks to U.S. stocks and, as a growth manager, his largest sector weightings are currently technology, business services and health care. He is avoiding utilities, consumer staples and energy companies.

Morrill does have some concerns about corporate earnings in the coming year, given the highly valued market. “It’s tougher to find new ideas,” he said. “We expect more volatility in the stock market if companies miss expectations, but that will give us opportunities to add names to our portfolio.”

If enough of the smart money sees volatility as opportunity, the bull market could roll on in 2020.