New Highs for Stocks

John Burke, MS, CFP® | October 2019

On October 28th, the S&P 500 hit a new all-time high for the first time in three months. John made an appearance on Fox Business that day. Click on the hyperlink below to watch.

The appearance, which is just over two minutes long, is preceded by a brief commercial. We must make a correction to a mistake that Fox Business made in the graphics. The four stocks mentioned were listed as examples of international stocks – we are NOT necessarily recommending the stocks, and especially not Toyota as we have never recommended auto stocks because in our view they are too cyclical.

John Burke - Fox Business 10.28.19

These are the prior comments John sent to the producer:

The trade war eases, stocks move up. Trade tensions increase, stocks move down. Repeat, repeat, repeat. In the last 12 months, the S&P 500 is up about 10%, 12% with dividends, despite this nauseating cycle. The trade tensions have hurt global trade with manufacturing statistics showing a clear downtrend. Durable Goods orders fell 1.1% this week. Why is the market up?

Many have mentioned that there is no alternative, meaning that with rates so low, where else can you earn money. We think that is part of the reason, but we also want to point out that the fourth year in the election cycle, which is next year, has historically been the best for markets. That may once again hold true next year because President Trump can boost the economy simply by easing up on the trade war. You would think that he will do that; he seems to like being President.

The trade war, and the market reaction to it, have been well covered. We'd like to point out something that has not. International stocks have started to outperform U.S. stock over the last three weeks. It is early to call that a trend, especially because U.S. stock have outperformed international stocks by 9% per year over the past 10 years. But that outperformance may be the cause of the rally in international stocks, because it makes U.S. stocks expensive relative to international stocks. Further, despite the reluctance that many have in predicting economic outperformance in Europe and Japan, which represent the largest portion of what we call international stocks, we don't necessarily need those countries to have strong economic growth for a recovery in their stocks.

Let us explain. Consider the top four stocks in the most oft quoted international index, MSCI EAFE: Royal Dutch Shell, Roche, Novartis and Toyota. These are considered blue chip stocks by most, and they are certainly big companies with market caps all over $200 billion. These companies do as much business here in the U.S. as competitors Chevron, Merck, Pfizer and General Motors. Yet, like the EAFE index, they have underperformed their American peers for many years, perhaps making them seemingly undervalued. We know that the stocks in the EAFE index have higher yields. These companies' earnings are not tied to Britain, Switzerland and Japan, their home countries, because their sales span the world, much like the U.S. companies.

Most investors are underweight international stocks. Most investors are seeking alternatives to low yielding bonds. We think investors should consider combining these ideas, especially because the international stocks tend to pay higher dividends. The four stocks listed above have an average yield of over 3%. Government bonds in Europe and Japan have very low or negative yields. We believe the recent three-week rally in international stocks should pick up, and the yield comparison will be a big factor.

If trade tensions ease, we will be looking to see if manufacturing activity will start to pick up, and with it, a profit recovery in 2020. High yielding international stocks may be a good way to play that recovery.

Some of you have asked us if we should sell, now that stocks have hit another all-time high. Generally, but not always, we do not encourage trying to time the market, which is what investors would be doing by selling now. We like to stay invested unless we feel an extreme conviction to decrease portfolio risk. We remain cautious about the market because earnings, not to mention economic results, have been lackluster. On the other hand, stock have tended to do well in the November to January time frame, and in the last year of the four-year election cycle. Sitting Presidents tend to do what they can to propel the economy, hoping for reelection. Also, Bespoke, one of our research firms, reports that when the market has been flat for several months (as it has), and then hits a new high, the market tends to make further new highs in the coming months. Finally, stocks are moderately priced, and not highly priced by historical standards, and consumer debt levels are not elevated. High prices were the cause of the 2001 – 2002 bear market, and high consumer debt was the cause of the 2008 bear market.

As always, if you would like to discuss the risks in your own portfolio, please call.

Note: As a practice, we are neither endorsing the views of President Donald Trump nor criticizing his views, and the same holds true for Fox Business News. John has also been a frequent contributor to CNBC Closing Bell.