Market Commentary: What Headlines Will Next Year Bring?

November 2019

One of the main headlines in the November 22, 2019, issue of The Wall Street Journal (WSJ) declared: “Bridgewater Makes $1.5 Billion Options Bet on Falling Market” (link). On the surface, a billion-dollar bet by one of the most successful hedge funds around seems scary. However, once one digs deeper into the story, and given a basic understanding of how equity options work, it becomes obvious that the positioning of Bridgewater is either a hedge or at most a small bet. There is a good chance the position was placed to hedge an exceedingly bullish bet by the firm.

This past week (Thanksgiving weekend) the WSJ tackled the typical holiday season article about strategist forecasts of what the market will bring us in the following year. It was titled “Stocks Projected To Slow” (WSJ Exchange section - November 30, page 1 - Link unavailable). Given the banner year we’re currently having, (S&P 500 ~ +25% YTD), it would be pretty exciting if stocks didn’t slow. The article then provides a probable range of -20% to +10% for 2020. It all sounds reasonable. (Note: We are not picking on the WSJ - it is a great newspaper and that is why we read it.)

The point is we are inundated by news headlines playing on our base fear and greed emotions. No one would read either article if the main point of both were distilled in the headlines. For article one: “Bridgewater makes a large, though directionally unclear bet,” and for article two: “No one knows where markets will go in 2020, but it is highly unlikely we will match this year’s performance.”

Headlines move markets.

This month we continued our recent upward trajectory as the risks that kept us in a sideways pattern for upwards of a half-year seemed on the precipice of dissipating. There is hope of some sort of China deal (seemingly any deal will make market participants happy). Earnings continue to come in better than the low expectations originally set. Economic numbers remain fine despite fears of a slowdown. The yield curve has normalized somewhat from earlier in the year.

What headlines will next year bring?

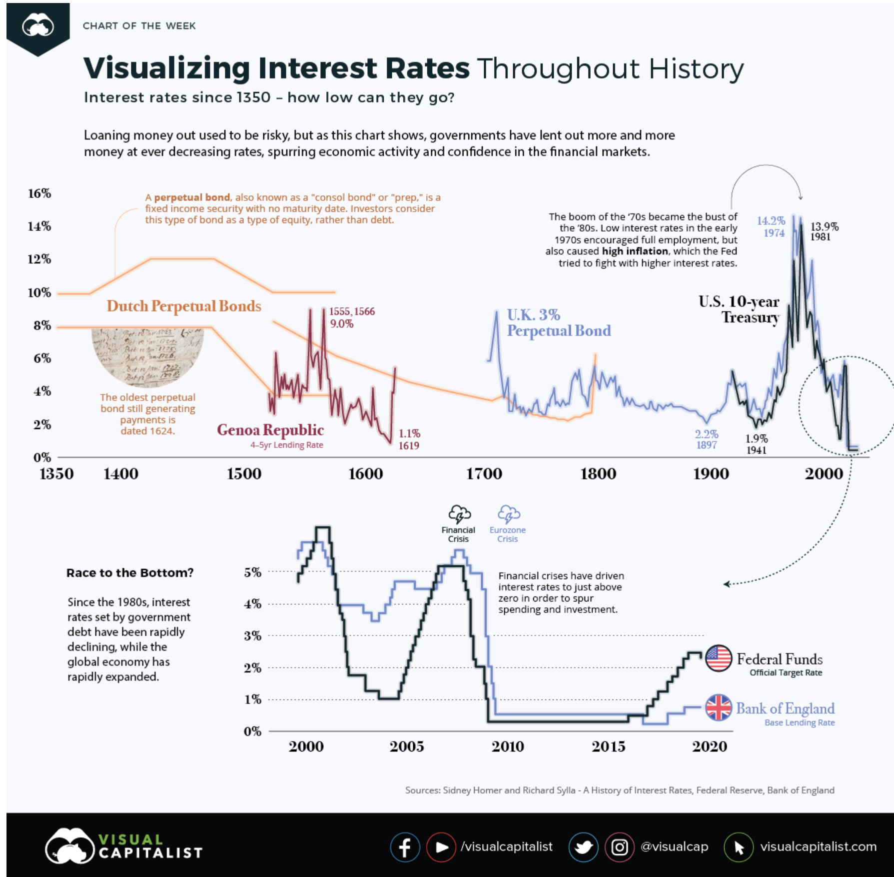
One definite topic will be China. They are slowly taking over the role of lead adversary to the US from Russia (perhaps sped up by the current administration, but likely to occur in any case). They are our economic competitor and very quickly becoming the primary challenger with respect to political influence. We will most likely see more negative China headlines on topics ranging from Hong Kong influence to exerting too many controls over their citizens, especially those of Muslim faith. Any breaks in trade discussions will naturally be blamed on them as well.

There is still uncertainty about capital spending as the world shifts to a potential new reality of restructured trade agreements. This may begin showing further in company earnings, as it has in some of the more transparent firms, notably Cisco.

The biggest headlines for 2020 will most likely surround the coming elections. The last election made it clear that there are many dissatisfied citizens in this country, and seems to have resulted in flight from the political center to that of the extreme left and right. How will it play out in our elections and in the country in general? And how will those actions be fanned by the headlines of our news media, further manipulated by social media? It's hard to believe this won't add volatility to the market environment.

Interest Rates From a Historical Context

In last month's market commentary (FAM - 2019 October Market Commentary), as we observed 10-year treasuries touch 1.5% annual yield, we asked the question, how low interest rates can go?. 10-year treasuries have since popped back up to a frothy 1.8%+ yield. Most investors understand that we have been in a multi-decade fixed income bull market starting in the '70s when interest rates were in the double digits. But how about prior to that?



Evidently, the kind folks at Visual Capitalist had the same thought and produced the above chart a couple of weeks back. One of the primary reasons we have been attempting to scope out how low yields can possibly go is simply to understand our risk / reward of holding longer-term bonds. Conceptually, the lower bound used to be 0% (now we all understand that negative rates are indeed possible) and the upper bound is high single digits, however unlikely that now seems. As the world continues to add debt to the books it seems logical for the powers that be to have an increasing interest in keeping those yields low in order to maintain a reasonable interest coverage level - this is scarily circular.

IMPORTANT DISCLOSURE

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