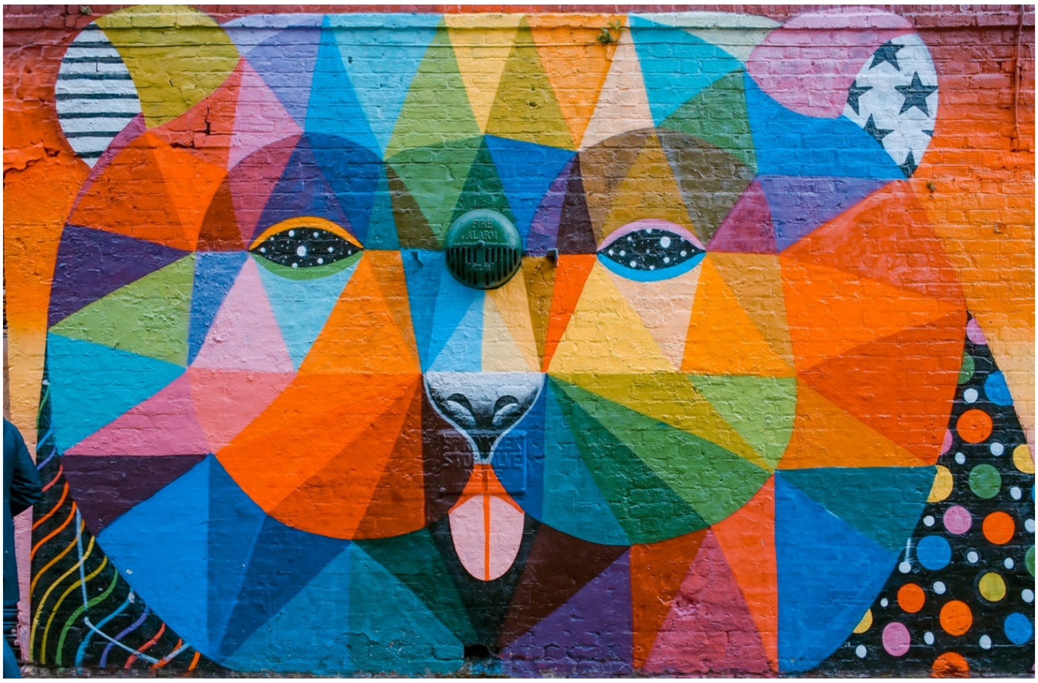
June 4, 2018

The bear market that wasn’t



The bear market that wasn’t

History hardly ever repeats itself, but it tends to rhyme and the current range trading environment is similar to that of 2015. What is different now and what can we learn from the past?

Roughly 3 years ago the US stock market hit a peak. Over the following 9 months, investors increasingly found themselves standing on the brink of a bear market as stocks struggled and repeatedly failed to move to new highs. August as well as September 2015 saw two significant sell-offs only to be followed by three more rally attempts, all of which failed.

By early 2016, corporate earnings that had been forecasted to grow by more than 20% heading into 2015 were falling by as much as 15%. Real GDP growth was slowing and all signs pointed to further weakening. The S&P 500 had entered a rare technical set up in the form of a so-called “death cross” where the 200-day moving average had fallen below the 400-day moving average. This had only taken place 6 times in market history - in 1929, 1937, 1940, 1973, 2000, and 2008 – and in each case preceded a major sell-off.

And yet, despite all these ominous signs the bear market that many feared did not materialize and 2017 was one of the strongest years of the bull market that started back in 2009.

How did the US equity market survive its close encounter with the bear?

The major global central bank collective - the Fed, the ECB, the BoJ, and the PBoC – rushed to "save" the day and increased their combined balance sheets by 40% from $15tn to $21tn. Simultaneously, the Fed cut its 4 intended rate hikes to just 1 at the end of the year. This provided the rocket fuel that carried equity and other asset prices to new historic highs.

But the key difference between then and now has to do with "monetary morphine". Back in 2015, central banks were eager to bend over backward and do whatever necessary to keep asset prices afloat. Today, the Fed is shrinking its balance sheet and didn't pay much notice when a hurricane blew through the stock market in February. The ECB has pretty much already purchased every asset in sight, the BOJ is showing signs of exhaustion with asset purchases, and the PBoC's balance sheet started shrinking amid the ongoing crackdown on its shadow banking system.

However, there are still reasons to believe the bull market can continue. The outlook for corporate earnings is far more promising today thanks to the tailwind of the major corporate tax cut. A large portion of the cash garnered from cuts is being ploughed into share buybacks. The record volumes should cushion whatever blows the market absorbs this year allowing equities to remain in a trading range, for now.

The extended consolidation phase in 2015-16, demonstrated that quality stocks with a degree of predictability count when times get tough. Defensive sectors also delivered. While both consumer staples and utilities were slow getting started, they continued to steadily rise while the rest of the stock market declined. This is not uncommon behavior for these types of stocks in and around market peaks, as concerns about inflation and/or higher interest rates overwhelm the defensive appeal of these stocks for a time before the forces of downside risk protection and sector rotation finally kick in.

While central banks may not come to the rescue this time around, the positive effects of the tax cut and projected record share buybacks in 2018 establish a floor for equity prices for the next few months. In this increasingly challenging environment sector selection will be key to outperformance.

Disclaimer

All financial data and/or economic information released by this Publication (the "Publication"); (the "Data" or the "Financial data and/or economic information"), are provided for information purposes only, without warranty of any kind, including without limitation the warranties of merchantability, fitness for a particular purpose or warranties and non-infringement of any patent, intellectual property or proprietary rights of any party, and are not intended for trading purposes. Banque Internationale à Luxembourg SA (the "Bank") does not guarantee expressly or impliedly, the sequence, accuracy, adequacy, legality, completeness, reliability, usefulness or timeless of any Data. All Financial data and/or economic information provided may be delayed or may contain errors or be incomplete. This disclaimer applies to both isolated and aggregate uses of the Data. All Data is provided on an "as is" basis. None of the Financial data and/or economic information contained on this Publication constitutes a solicitation, offer, opinion, or recommendation, a guarantee of results, nor a solicitation by the Bank of an offer to buy or sell any security, products and services mentioned into it or to make investments. Moreover, none of the Financial data and/or economic information contained on this Publication provides legal, tax accounting, financial or investment advice or services regarding the profitability or suitability of any security or investment. This Publication has not been prepared with the aim to take an investor's particular investment objectives, financial position or needs into account. It is up to the investor himself to consider whether the Data contained herein this Publication is appropriate to his needs, financial position and objectives or to seek professional independent advice before making an investment decision based upon the Data. No investment decision whatsoever may result from solely reading this document. In order to read and understand the Financial data and/or economic information included in this document, you will need to have knowledge and experience of financial markets. If this is not the case, please contact your relationship manager. This Publication is prepared by the Bank and is based on data available to the public and upon information from sources believed to be reliable and accurate, taken from stock exchanges and third parties. The Bank, including its parent,- subsidiary or affiliate entities, agents, directors, officers, employees, representatives or suppliers, shall not, directly or indirectly, be liable, in any way, for any: inaccuracies or errors in or omissions from the Financial data and/or economic information, including but not limited to financial data regardless of the cause of such or for any investment decision made, action taken, or action not taken of whatever nature in reliance upon any Data provided herein, nor for any loss or damage, direct or indirect, special or consequential, arising from any use of this Publication or of its content. This Publication is only valid at the moment of its editing, unless otherwise specified. All Financial data and/or economic information contained herein can also quickly become out-of- date. All Data is subject to change without notice and may not be incorporated in any new version of this Publication. The Bank has no obligation to update this Publication upon the availability of new data, the occurrence of new events and/or other evolutions. Before making an investment decision, the investor must read carefully the terms and conditions of the documentation relating to the specific products or services. Past performance is no guarantee of future performance. Products or services described in this Publication may not be available in all countries and may be subject to restrictions in some persons or in some countries. No part of this Publication may be reproduced, distributed, modified, linked to or used for any public or commercial purpose without the prior written consent of the Bank. In any case, all Financial data and/or economic information provided on this Publication are not intended for use by, or distribution to, any person or entity in any jurisdiction or country where such use or distribution would be contrary to law and/or regulation. If you have obtained this Publication from a source other than the Bank website, be aware that electronic documentation can be altered subsequent to original distribution.

As economic conditions are subject to change, the information and opinions presented in this outlook are current only as of the date indicated in the matrix or the publication date. This publication is based on data available to the public and upon information that is considered as reliable. Even if particular attention has been paid to its content, no guarantee, warranty or representation is given to the accuracy or completeness thereof. Banque Internationale à Luxembourg cannot be held liable or responsible with respect to the information expressed herein. This document has been prepared only for information purposes and does not constitute an offer or invitation to make investments. It is up to investors themselves to consider whether the information contained herein is appropriate to their needs and objectives or to seek advice before making an investment decision based upon this information. Banque Internationale à Luxembourg accepts no liability whatsoever for any investment decisions of whatever nature by the user of this publication, which are in any way based on this publication, nor for any loss or damage arising from any use of this publication or its content. This publication, prepared by Banque Internationale à Luxembourg (BIL), may not be copied or duplicated in any form whatsoever or redistributed without the prior written consent of BIL 69, route d'Esch ı L-2953 Luxembourg ı RCS Luxembourg B-6307 ı Tel. +352 4590 6699 ı www.bil.com.