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Steadyhand

Four reasons to be upbeat about markets you won't find in the headlines

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By Tom Bradley

What's with the stock market? It's on wheels this year even though the world's a mess. The U.S. & China trade file has become ever more dysfunctional, Brexit is never-ending and interest rates are telling us the economy is fragile.

There are a few possible explanations for this disconnect. First, we must always remember that Mr. Market isn't reading the current news. He only cares about what's happening 12-18 months from now.

Second, a portion of this year's return is a recovery from last year's weak fourth quarter. It's now clear that the pullback went too far.

And finally, there's the forgotten positives. Factors that are hidden in the shadows while gloom and controversy hog the spotlight. Bad news gets the most attention, even if it's not most important.

As we look forward, here are four positive factors that aren't dominating the headlines.

Growth in the distance

Many investors are concerned that the current economic slowdown will spiral into recession and devastate corporate profits. To weigh this risk, it's useful to look at some numbers. The most recent forecast from Capital Economics pegs Global GDP growth at 2.7 per cent for 2020, down from 2.9 per cent this year and 3.6 per cent in 2018. These numbers tell us that while western countries scratch and claw for growth, the rest of the world is on a faster trajectory.

In support of these estimates, the Brookings Institution projects that the world's middle class will grow by 150-170 million people per year between now and 2030. It may not be middle class as we define it, but this trend will translate into increased purchases of goods (appliances and TV's) and services (transportation, entertainment and vacations).

Investors with a good set of binoculars are still finding growth and the potential that goes with it.

Turbulence leads to change

Tariff wars are causing disruption, but world trade may exit this period of uncertainty on a much stronger foundation. I say that because companies are being forced to be less U.S. and China-centric. New relationships are developing as the dominant powers show themselves to be unreliable partners.

Contributing to this new balance is a more realistic assessment of the risks that go along with dealing with China. The risk premium has been reset as it gets more difficult to ignore the giant's lack of respect for foreign capital, intellectual property and human rights.

In Canada, we're feeling the effects of this reset. Some exporters are being negatively affected (hopefully temporarily), but other industries are benefiting. For instance, we're creating a record number of technology jobs as global companies expand here and an eco-system develops for home-grown start-ups.

The uncertainty around trade may prove to be worse than the worst outcome.

Reasonable valuations

Price-to-earnings multiples (P/Es) are in the middle of their historical range at the moment, despite the market's impressive run. This is because P/Es started the year at a low level and the 'E' (earnings) continues to grow.

Drilling deeper, the market multiple understates just how reasonable some valuations are. There's been a bifurcation in the market whereby companies with above-average growth are trading at historically high valuations and the rest are priced quite reasonably. Indeed, the P/E gap between growth and value has only

been this wide once before, which was during the tech boom in the late 1990s.

Investor mood

The most common questions we get these days are about the next recession. Is it near? How bad will it be? What impact will it have on portfolios? What this tells us is, that despite rising stock prices, investors are wary of what's ahead and are not overly bullish.

Investor sentiment is a contrarian indicator — too bullish is bad for stocks; too bearish is good. At extremes, it provides a much-needed gut check. Today's readings, however, are unremarkable. The mood of investors is neither greedy nor fearful.

What will drive the market in 2020 is anyone's guess, but it's less likely to be the hot button issues we read about every day. They're already baked into the cake. It's more likely to be the things that are not yet appreciated. After all, Mr. Market is good at nosing around in the shadows.

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