

Besides the Fed, What on Earth Could Move the Market Higher Now?

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Investors have done well in most asset classes in 2019, raising the question: Is everything priced in? If not, what would allow the equity markets to move higher besides more rate cuts?

As investors look back at returns year-to-date for both stocks and bonds, there is plenty to celebrate. Despite a small hiccup in May, the equity market continues to march forward, making new highs on a regular basis, and bonds have rallied as well. In fact, according to UBS, the

performance for a classic 60/40 (stocks/bonds) portfolio over the last six months is the best we have seen in over 10 years.

While a catalyst for further upside is unclear (Will earnings growth continue to provide a boost? Or is it already baked in and growth is slowing or even contracting?), there are several macro risks that threaten to derail this “double bull market.” Worries about a global trade war, largely due to U.S. tariffs, tensions in the Middle East, rising global populism, as well as the never-ending Brexit saga, remain, but the market has so far climbed this “wall of worry” with relative ease. The only factor that seems to really matter to the U.S. markets is whether or not the Fed will lower interest rates and by how much. Indeed, the markets are so focused on the Fed, that should it disappoint by only targeting modest rate cuts, there is a heightened risk that this could crater the market.

Given current valuations and the global risks that appear present, maintaining a risk aware approach with one’s equity allocation seems prudent. At Westwood, we have taken some of our equity allocation off the table within our Multi-Asset portfolios and are looking to redeploy opportunistically at more attractive valuations. Presently, our equity exposure is predominantly in high-quality stocks with somewhat lower market beta. We are focused on companies that are enjoying secular tailwinds, like Honeywell International, or where we see a valuation discount as with AT&T. On the fixed income side, we added some longer duration, high-quality bonds earlier in the year, which have benefited as rates and spreads have declined.

As we look toward the future, one thing seems clear, volatility is cheap. Historically, the flattening and ultimate inversion of the 2- and 10- Year Treasury Yield curve has preceded higher levels of volatility by anywhere from 18 to 36 months. This gives us confidence that volatility is here to stay and is in the midst of a secular shift higher. We think it will remain at levels above that of 2016-2017 for several years, which should create opportunity for disciplined active managers. Active managers who can tactically position across multiple asset classes should be best positioned in this environment. Moving between equities, credit, government bonds as well as specialty assets such as preferred stocks, convertible bonds and MLPs, allows us to utilize the tools needed to navigate this uncertain environment.



David Clott, CFA

Senior Co-Portfolio Manager of Westwood Income Opportunity Fund

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