

# 2019 Equity Outlook

## Back from the Future — 12 Newspaper Headlines from 2019



**Edward J. Perkin, CFA**  
Chief Equity Investment Officer  
Eaton Vance Management

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- At EVM Equity, we regularly ask our portfolio managers and analysts to imagine they are financial journalists with access to a time machine. The idea is to take ourselves out of the noise of the current moment, which usually involves overemphasizing a current market theme or risk.
- As always, the catalysts that have the biggest impact on markets are those that come as a surprise. By thinking like a time-travelling reporter, investors can expand the range of potential outcomes they consider when making important decisions.



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At EVM Equity, we regularly ask our portfolio managers and analysts to imagine they are financial journalists with access to a time machine. They are instructed to write the headline of *The Wall Street Journal* or *The Financial Times* at some point in the future, usually one year hence. The idea is to take ourselves out of the noise of the current moment, which usually involves overemphasizing a current market theme or risk. Instead, let's ask ourselves what the market might be focused on in 12 months. This is a subtle, but important, distinction from a "forecast" which projects the future forward from the standpoint of today. We were partially inspired by Chuck Klosterman's fascinating book, *But What If We're Wrong: Thinking About the Present As If It Were the Past*.

If we had a time machine and could travel back and forth between now and various dates in 2019, we think the newspaper headlines could potentially look like the list below. The intention of this list is not precision as to date or content, but to be provocative around the range of outcomes that the future may hold.

### January – "U.S. Companies Report Record Year of Profits for 2018"

As companies report fourth-quarter earnings results early in the new year, earnings per share (EPS) for the S&P 500 are likely to have risen more than 20% for 2018, marking an all-time record for profits. Earnings in 2018 will have benefited both directly and indirectly from the corporate tax cut. With uncertainty around trade, interest rates and geopolitics, corporate management teams are likely to be conservative as they give guidance for 2019 earnings, but single-digit earnings per share growth should still be an achievable outcome.

### February – "Bloomberg Announces Candidacy for Democratic Nomination"

Michael Bloomberg has toyed with the idea of running for president multiple times in the past, so it is easy to dismiss the possibility of him joining the race. Our contacts in Washington estimate a 70% probability that he enters the race early in the new year. With his estimated net worth of \$45 billion and strong name

recognition, he would be a formidable candidate. His strategy would be to let other candidates fight each other while he occupies a more centrist lane.

### March – "Brexit Deadline Extended"

March 29, 2019 is the deadline for the United Kingdom to negotiate its exit from the European Union under Article 50 of the Treaty of Lisbon, or face a so-called "Hard Brexit," whereby access to the European market is severed and a hard border goes up between the Republic of Ireland and Northern Ireland. Negotiations seem likely to continue to the 11th hour when each side will force the other to stare into the uncertainty of the abyss in hopes of coming to an agreement. Alternative headlines in the same vein would be: "New General Election Called," or "U.K. Voters to Consider a Second Brexit Referendum."

### April – "Peace Treaty Signed in Trade War"

The stock market spent much of the second half of 2018 worried about tariffs and trade, particularly with respect to China. It is likely that these worries will subside during the first few months of 2019. Both countries, and their leaders, have a shared incentive to find common ground. China has already been lowering tariffs that it places on goods imported from countries other than the U.S. Additionally, there may be some relaxation of the requirement on foreign firms to enter China through joint ventures, the mechanism by which intellectual property is transferred to Chinese companies. However, China is unlikely to give up on its "China 2025" policy that aims to domestically source 70% of the content of its materials by 2025.

### May – "Democratic Field Grows to Two Dozen"

The size of the 2020 presidential field for the Democrats is likely to surpass that of the Republicans during the 2016 primary season. The reasons for this are several fold: (1) President Donald Trump is viewed as beatable, (2) There is no obvious heir apparent for the Democrats, (3) Wealthy businesspeople and celebrities believe the mold is now broken for non-politicians to win, and (4) There is very little downside to running as losing can still lead to higher name recognition, and other opportunities in government or media. The impact on the markets will be a function of who the front runners are and their proposals around regulation, taxes and other fiscal matters.



### June – “Fed Pause Continues”

On June 19, 2019, the Federal Open Market Committee (FOMC) of the Federal Reserve holds its fourth meeting of the year. In the absence of tangible signs of inflation, accelerating GDP growth or exuberant markets, it is likely the Fed will stay on hold through mid-year.

### July – “U.S. Women Beat England on Penalties to Win World Cup”

The FIFA Women’s World Cup final will be held on July 7, 2019 in Lyon, France. The co-favorites are likely to be the defending champions (USA) and the hosts (France). With the England men’s and women’s teams both surprising as semi-finalists in their last respective World Cups, perhaps further progress is possible. After tensions around Brexit in the early part of the year, this would come as welcome relief.

### August – “Trump Tweets: ‘Government is Shut Down ‘til Chuck & Nancy Build the Wall’”

This headline could come earlier than August as there are multiple budget windows where a government shutdown is possible. Assuming President Trump intends to run for reelection, he will likely feel the need to show progress on his signature campaign promise from 2016. With a Democratic House of Representatives and a slim Republican majority in the Senate, the budgetary process will be his main point of negotiating leverage. Government shutdowns used to move markets but, more recently, complacency has set in. This complacency could be a risk factor for stocks as President Trump’s calculus about taking credit/blame for the shutdown may be unique.

### September – “U.S. Economy Still Showing No Sign of Recession”

At the end of 2018, “Where are we in the cycle?” was everyone’s favorite question. If U.S. GDP growth is still coming in at more than 2% in September, pessimistic economists will begin to push their forecasts out to 2021 or beyond.

### October – “Bipartisan Fiscal Package Passes”

Fears of a fiscal cliff are likely to abate as Congressional Republicans come together to pass a budget with increases to both defense and non-defense spending. Increases in infrastructure spending are also likely, though well short of the \$1 trillion figure that has been floated.

### November – “Treasury Secretary Mnuchin Implements Inflation Indexing of Capital Gains”

Having to pay capital gains taxes on gains that are the result of inflation has been a sore point for supply siders for many years. There is a school of thought within the Trump administration that the Treasury Department has the authority to index capital gains for inflation without an act of Congress. This would be an aggressive move, and would likely draw lawsuits from Democrats in Congress, but once the 2020 elections are on the 12-month horizon, expect to hear more about this idea.

### December – “Stocks Prove Doubters Wrong by Beating Bonds in 2019”

Stock prices badly lagged growth in earnings throughout 2018. This had the effect of meaningfully lowering price-to-earnings ratios. Assuming earnings levels are sustainable, valuations at the start of 2019 look reasonable. Warren Buffett has said investors should, “be fearful when others are greedy, and greedy when others are fearful.” The wise investor who followed this advice would have been cautious in January 2018 when others could see no risks, and would be more aggressive at the start of 2019 as volatility and fear run high.

### Conclusion

The potential catalysts mentioned above do not comprise an exhaustive list. Other events to monitor will include: actions from foreign central banks, foreign exchange rate moves and geopolitical developments. As always, the catalysts that have the biggest impact on markets are those that come as a surprise. By thinking like a time-travelling reporter, investors can expand the range of potential outcomes they consider when making important decisions.



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