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PEAK CAPITAL MANAGEMENT

Professional Investment Management

BLOG POST

4 Risks for 2020

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As the stock market closes 2019 with a bang, attention turns to the election year of 2020 with investors wondering if the stock market can continue the streak that has made this bull market the longest in history. It is easy to identify the headwinds at the beginning of each year; the difficult part is accurately determining if those headwinds will pose an actual threat to the rising stock market. We kick off 2020 with our risk outlook and conclude with whether the risks will make 2020 the year the bear comes out of hibernation.

RISK #1 – Political Uncertainty

I tend to subscribe to the notion that the crazier things get in Washington, DC, the less they matter. Politicians on both sides of the aisle look less like statespeople and more like B-level actors in a foreign soap opera. The markets have been correct to ignore the circus, also referred to as Congress, and that will probably be the case in 2020. No one expects any surprise in the Senate impeachment trial, assuming the Articles eventually make their way there. The bigger political risk would be if one of the socialist candidates were to make it out of the Democrat primary. Their policies might help address the growing inequality in the U.S., but would not be market friendly. The potential for a technology regulation overreach is real from those on the political left and that could spill over into other segments of the economy. Political risk may be low at this moment but is something to keep an eye on in 2020.

RISK #2 – Trade

Phase 1 of the trade deal between the U.S. and China was celebrated by the markets, and was largely responsible for the markets ending at highs in 2019. The problem is that almost no one on either side can quantify exactly what was agreed to. Halting new tariffs and a small rollback on previously implemented tariffs is certainly a positive, but very few details have emerged that both countries seem to confirm are part of an agreement. Further work needs to be done between the U.S. and China, but even if Phase 1 is simply a temporary "cease fire," the markets will respond positively. I expect sabre rattling between the Trump administration and European leaders, especially now that the UK will leave the EU on January 31. There will be threats and retaliatory threats, but something very close to status quo should prevail in the end.

RISK #3 – U.S. Dollar Appreciation

The risks of the greenback rising to a level that threatens domestic growth is mostly overlooked today, but is the most likely culprit if the economy slumps in 2020. The dollar weakened in the last couple of months of 2019 due to the UK election results and signs that China could be near a bottom in their weak patch. There has been some positive ISM (Institute of Supply Management) readings out of Europe, but I expect growth in that region to be sub-1% in 2020 and yields remaining extremely low or negative. In a yield-starved environment I expect demand for U.S. debt to rise double-digits in 2020, driving the U.S. dollar higher. I am watching the 103 level on the DXY (September 2017 high), and as long as the dollar remains below that level market impact should be negligible.

RISK #4 – Credit Scare

A disruption in the credit markets is the second most significant macro risk to the economy in my view. The spread between credit conditions for BBB and CCC paper have widened, making it difficult for lower-rated issuers. The 4th quarter also saw a deterioration in the interest coverage ratio on non-investment grade bonds. Any concern is premature today, but if the NDR Credit Conditions index, currently at 67, were to drop below 55, it would signal a reason to be concerned about the credit markets.

OUTLOOK 2020

Careful analysis of the risks posed by the above and even those not mentioned: Russia, North Korea, Iran, Repo's, etc. suggests that while these cannot be ignored, they are unlikely to derail the bull market. The most compelling reason why is the global liquidity being provided by Central Banks. We entered 2019 with almost no Central Bank easing and enter 2020 with the most synchronized level of easing since the Great Recession in 2008; higher than the level of easing after the recession of 2000-2002. Liquidity should win this tug-o-war, allowing markets to add to gains in 2020 even if the environment becomes more volatile.