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MARKETS

Stocks Are Back Near Records, but Memories of 2018 Leave Investors Uneasy

The S&P 500 last year peaked in late September, only to tumble almost 20% over the following three months

By Akane Otani

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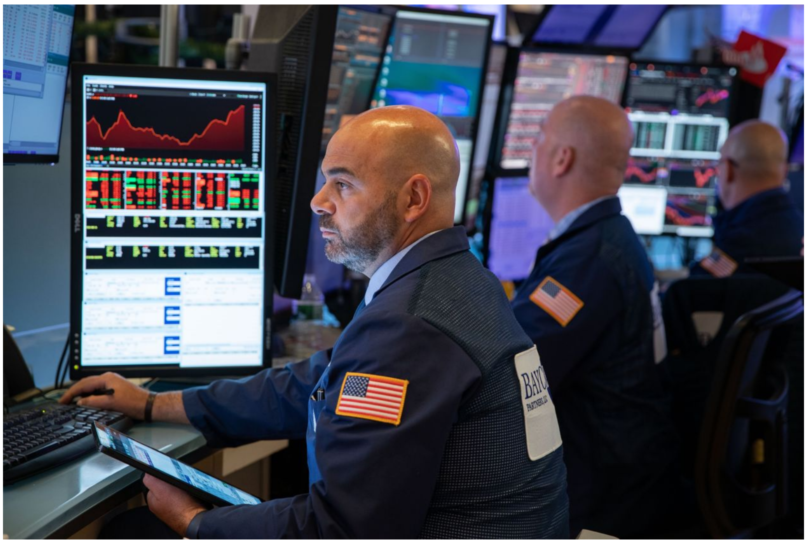
Stocks have raced higher to start September, but signs of faltering growth are keeping investors on edge as they navigate what historically has been a turbulent period for markets.

Going back to 1928, the S&P 500 has on average fallen only in three months—with September proving to be the index's worst month of the year, according to Dow Jones Market Data. The parallels between market and economic conditions today and last fall are heightening the anxiety of many money managers.

The S&P 500 is within 2% of July's all-time high and is holding on to a 19% gain for the year, outperforming the Stoxx Europe 600, Japan's Nikkei Stock Average, MSCI Emerging Markets Index and Germany's DAX. Yet many money managers are questioning whether the index can maintain its gains the rest of the year, citing memories of 2018, when the S&P 500 peaked in late September, only to tumble almost 20% over the following three months.

Like this time last year, the U.S. and China remain mired in a trade war that few are confident will end soon. Making matters worse, the manufacturing malaise that showed signs of spreading in Europe and Asia in late 2018 has started to materialize in the U.S., with Institute



Money managers are veering away from companies vulnerable to escalation in the U.S.-China trade war. New York Stock Exchange traders last week. **PHOTO:** GUO PEIRAN/XINHUA/ZUMA PRESS

for Supply Management data on Tuesday showing the manufacturing sector shrank in August for the first time in three years.

Estimates for corporate profits, which took a sharp hit last fall, are declining by the week: FactSet figures suggest earnings of S&P 500 companies are in the midst of their longest streak of contraction since 2016.

Signs of strength among consumers and in the services sector have helped investors brush off talk of an imminent recession for now. Labor Department data Friday showed the U.S. extended the streak of job creation to a record 107 months, while a report Thursday showed the service sector grew for the 115th consecutive month.

But even those who believe the decadelong bull market still has legs say their optimism has faded materially since the start of the year.

“I’ve been extremely bullish the last six years, and this is the most cautious I’ve been in quite a long time,” said Jonathan Golub, chief U.S. equity strategist at Credit Suisse.

“[It’s] not that I’m calling for the market to correct in a major way, and not that I’m calling for a recession, but I do see a deceleration in the underlying data that I think is an impediment to the market going forward,” he said.

Stocks had rallied earlier in the year as investors bet on central banks loosening monetary policy. But markets appear to have gotten less of a boost from central banks lately as investors have worried about the economic outlook darkening despite policy makers’ moves. The European Central Bank is expected to unveil a package of stimulus measures at its policy meeting this week, while the Federal Reserve is expected to lower interest rates at the conclusion of its meeting the week after.

Money managers are veering away from shares of companies that look vulnerable to further escalation in the U.S.-China trade war.

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Rebecca Felton, senior portfolio manager and chief risk officer at RiverFront Investment Group, says her firm has shied away from semiconductor stocks even as it has purchased shares of other types of technology companies.

"The trade overhang is such a big factor," Ms. Felton said. She added that with major stock indexes already up double-digit percentages in 2019 and markets headed for a "seasonally tricky" period, it wouldn't be surprising if investors were generally reluctant to add to their holdings of risky assets in the final months of the year.

Some believe the market is ripe for an even sharper pullback in the coming months. Oliver Jones, senior markets economist at Capital Economics, believes the S&P 500 will have a "sizable fall" before the end of the year.

"You don't have to believe a recession is on the corner to believe earnings estimates have to come down quite a bit more," Mr. Jones said, adding that assumptions that earnings growth will rebound in 2020 look overly optimistic.

Currently, analysts are projecting S&P 500 earnings in 2020 will rise 8.1% in the first quarter and 9.2% in the second quarter—a jump from the pace of projected growth throughout 2019.

Part of the reason some investors are having difficulty accepting rosy 2020 estimates is that bond yields have continued their 2019 slump, behaving in ways that have historically signaled a recession is coming. The three-month Treasury yield, for instance, has exceeded the 10-year Treasury yield for much of the past couple of months.

But not all investors see the drop in bond yields as a reason to sour on stocks.

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Are you making any changes to your portfolio in expectation of a market downturn? Why or why not? Join the conversation below.

“The lower interest rates are, the more exciting it becomes to own equities in the long term,” said Dev Kantesaria, a portfolio manager and founder of equity hedge fund Valley Forge Capital. He said he believes investors’ search for yield will help keep U.S. stock prices higher.

Like Ms. Felton, Mr. Kantesaria has tried to steer money away from industries that rely heavily on manufacturing or trade in Asia, instead investing in shares of companies involved in software, payment processing and information technology.

“The trade turmoil continues, but the average S&P 500 company is very attractive at these valuations,” he said.

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