JPM – *Equities September* – Transcript – TIME: 5:24

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Mr. **Manoukian**: Welcome to the September edition of Markets Monthly. My name is Jake Manoukian. I'm an investment strategist at J.P.Morgan Private Bank. I'm lucky enough to be joined by Stephen Parker, a global equity portfolio manager at the Private Bank. One thing that I've noticed about this year is that it's been pretty good for equity markets. The S&P 500 is up 8%. The MSCI World is up 4. But it doesn't really feel that way. There's a lot of anxiety that investors are feeling. The first one that we all have to grapple with is the length of the cycle. It's no secret that we're getting a little long in the tooth. So how are you thinking about investing in equities at this stage in the cycle?

Mr. **Parker**: Look, cycles don't end because of old age, they end because imbalances build up over time and eventually are unsustainable which is why it's not just the length of the cycle but also the pace that's important and this has been a very slow paced recovery. If you think about the economy kind of like a treadmill you can stay on a treadmill at a very low

speed for a long time. It's not until you ramp up the speed when you start to get tired and eventually stumble. That's why I think this slow paced but long lived recovery still has legs to it.

Mr. **Manoukian**: How do you think about that yield curve in terms of your framework?

Mr. **Parker**: The yield curve has been a very good indicator of recession but I think context is important. If you go back to the 1960s, the yield curve traditionally inverts about a year before equity markets peak and almost a year and a half before a recession starts. And as an equity investor you tend to see really strong results this time in the cycle. On average we've seen about a 13% return in equity markets in the year leading up to an inversion and another 20% on top of that until the market peaks. So while we should be watching that as an indicator, it's not a time to be selling equities or getting too worried about the economy right now.

Mr. **Manoukian**: Another thing that some investors have pointed out is that there's been 20% year-on-year earnings growth every quarter so far this year but the market's only up, as I said, mid-single digits. Why hasn't the

market been able to keep up with the earnings growth?

Mr. **Parker**: Look, I think this is a healthy normalization. Last year, investor enthusiasm around tax reform, deregulation, synchronized global growth meant that an 11% earnings growth year for the S&P translated into a 20%-plus return year for the S&P. That multiple expansion brought us into this year with valuations on stocks at the high end of the historical range. The fact that earnings are outpacing the market this year is just bringing us back to a more normal level of valuations. And interestingly, if you look at last year plus this year combined, the strong equity market returns that we've seen have been very much consistent with the earnings growth, which is exactly what you would expect at this point in the cycle.

Mr. **Manoukian**: So the market's really keeping up with earnings, you just have to expand your timeframe.

Mr. **Parker**: Right.

Mr. **Manoukian**: I guess the final risk that I wanted to bring up is this risk of a trade war.

Mr. **Parker**: I think it's clear that an escalated trade war would be bad for the market and bad for the economy but investors are starting to price that in. Since late January through the end of June as trade rhetoric escalated, emerging market equities were down nearly 20% while U.S. small cap stocks which investors view as more insulated are actually up. And a recent survey by fund managers show that over 60% of them identified a trade was as the number one risk for markets. We're actually looking at this as a potential opportunity, looking for parts of the market where the fundamentals are still strong but that have underperformed like EM as a buying opportunity.

Mr. **Manoukian**: What is priced in at this point and where are you seeing opportunity?

Mr. **Parker**: You know the good news as an investor, all of this investor anxiety that we're seeing as a result of all of the things we've talked about has taken us from that place where valuations at the start of the year were a headwind. Now in not just the U.S. but globally we've seen multiples come down dramatically. And I think in a world where earnings growth is

strong, that puts us in a much better position. We're also seeing greater dispersion between the winners and the losers. Sectors like technology, healthcare, consumer discretionary are outperforming meaningfully because they're driving the earnings growth. Defensive sectors like utilities and staples have lagged because they don't have that earnings power. At this point in the cycle we think a more focused approach to investing creates opportunities for active managers and that's why we're being more selective in where we're taking opportunities.

Mr. **Manoukian**: So it seems like the later part of the cycle is a great time to be tactical and a great time to take really meaningful exposures in your portfolios. Well Steve, thank you so much for spending the time. Thank you all for watching. We really appreciated it and we'll see you next month.

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