EQUITY

# US Market Volatility and Sleepless Summertime Nights

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The summer of 2019 has given equity investors a lot of things to worry about. Yet, Franklin Equity Group's Grant Bowers says the health of the US equity bull market shouldn't be one of them—at least not now. He discusses the biggest growth driver for both the US and global economy and explains why he likes the long-term prospects for select companies in the health care and technology sectors.

This summer, investors have grappled with a series of market-moving headlines on a slew of topics, from politics to global trade to interest rates. More recently, the US Treasury yield curve inverted, leading some market commentators to suggest a US recession or market downturn is on the horizon.

In our view, this debate about where we are in the economic cycle and when we will see the next downturn or recession will affect US equities for the remainder of 2019. There has already been a lot of talk around the duration of this bull market.

## The Ageing US Equity Bull Market

While we don't expect markets to climb forever, history has shown us that bull markets don't die of old age alone. These are the types of issues that have brought the end to bull markets in the past:

- rapidly rising inflation or interest rates,
- the buildup of speculative excesses or bubbles, or
- a geopolitical shock that impacts demand.

The current US equity bull market has been running for more than a decade, which is long by historical standards. However, it has also been very shallow and slow compared to past periods of economic expansion. This slower rate of growth is a result of the severity of the global financial crisis a decade ago, and the low-inflation, low-interest-rate environment that followed.

Given the modest rate of growth this recovery has seen over the last 10 years, it is not surprising the market's run has lasted longer than many expected. Nor is it surprising to us it has not generated the levels of excess that typically begin to show this late in the cycle.

## Digital Transformation

In our view, the biggest growth driver for both the US and global economy is the broad digital transformation that is taking place at all levels—individual, enterprise and government. Companies that embrace the new digital landscape to improve operations, lower costs or connect with their customers will remain competitive in the global marketplace. We believe this theme will continue to be an area for investment this year and beyond, even as the economic cycle ages.

What originated in the technology sector is moving beyond tech and into the broader markets. More companies are starting to realise they must move quickly to embrace the data-centric digital world, or face disruption.

In recent years, this digital transformation theme has played out in the retail and media sectors. Now, we are starting to see this happen in the transportation, education, health care and financial services sectors.

For this reason, we are focused on disruptive areas of technology such as software and services, the internet and semiconductors. Companies in these sectors are often the building blocks that enable digital transformation across all sectors or industries.

## Health Care

We also continue to look favourably on the long-term outlook for the health care sector. In our view, an ageing global population, as well as a rising emerging-market middle class, will drive increased consumption of health care services and demand for improved treatments and cures.

We believe this demographic tailwind, combined with innovation in drug development and medical technology, will create numerous potential investment opportunities. There's a growing middle class around the globe that is increasingly demanding better treatments and outcomes in the health care realm. We think medical device makers and medical technology companies, as well as many pharmaceutical and biotech companies, will step up to meet that need.

## Potential Risks to Our Outlook

Admittedly, both the information technology (IT) and health care sectors have traditionally experienced bouts of short-term volatility. IT, in particular, may be buffeted by intensified or protracted US-China trade tensions.

US-China trade is a complex topic that can have significant implications on global trade and economic growth. We are watching the negotiations cautiously to understand our potential exposure.

Despite the rhetoric, we still believe that the process is more of a trade negotiation than a trade war. As a result, we see periods of market volatility as an opportunity to increase ownership of target companies at more attractive prices.

We also see the risk of rising US inflation. US employment has been strong, and wages are picking up and prices are rising modestly.

As long-term investors, we believe that rigorous fundamental research on individual companies will add value to our portfolios over time. Therefore, we prefer to stay focused on stock picking versus making macro predictions. Even with that confidence, we do find ourselves lying awake at night thinking about how all the chess pieces will move around the global economy.



## What Are the Risks?

**All investments involve risks, including possible loss of principal. The value of investments can go down as well as up, and investors may not get back the full amount invested.** Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. Investing in fast-growing industries, including the technology sector (which has historically been volatile) could result in increased price fluctuation, especially over the short term, due to the rapid pace of product change and development and changes in government regulation of companies emphasizing scientific or technological advancement. Value securities may not increase in price as anticipated or may decline further in value. Growth stock prices reflect projections of future earnings or revenues, and can, therefore, fall dramatically if the company fails to meet those projections.