FISHER INVESTMENTS®

Stock Market Outlook

Independent Research & Market Analysis
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2019: Part II

2019 STOCK MARKET OUTLOOK – PART II

Executive Summary

Spring has sprung, and so have global stocks. Up 17.6% since Christmas's low and 12.5% in Q1, global stocks have enjoyed the V-shaped recovery we expected in December.[1] This should be only the beginning of a great year for global markets.

A great 2019 doesn't preclude volatility or another correction (sharp, sentiment-driven drop of roughly -10% to -20%). One is always possible, for any or no reason. Attempting to time such short-term volatility is a folly. Now is the time to consider whether your retirement investments are aligned with your goals, time horizon and comfort level with volatility. Having a solid plan in place and good counsel can help you navigate a correction, if one comes.

That said, we expect stocks to keep climbing in 2019, though the pace likely slows some in the year's second half. The third year of a president's term is far stronger and more consistently positive than years one and two. It is also usually front-end loaded. We think the early boom comes as markets celebrate reduced legislative risk post-midterms. This becomes more widely known later in the year, while political uncertainty starts drifting higher as election year campaigning heats up. Stocks should still do well, but with more swings than in the recent past.

While it is premature to assess 2020 market drivers, election years are usually good for stocks, too. Unlike third years, though, fourth years tend to be back-end loaded. Election uncertainty weighs early. But as primaries thin the herd, conventions pass and nominees square off, stock returns typically improve—cheering falling uncertainty.

Economic fundamentals are far better than appreciated, in our view. Yes, pundits hyped weak manufacturing surveys and the US yield curve's inversion in late March. But rampant fearful headlines over a tiny inversion that reversed a week later seem unwarranted. Even if the inversion had lasted and deepened, our review of history shows it doesn't affect markets or the economy immediately. Hence, we think the hype actually morphs this into a *bullish* factor. Widespread attention saps negative surprise power. Headlines sweated potential inversion months before it occurred. To say it isn't priced in is to argue markets aren't efficient. Hence, the inverted yield curve sets expectations low, extending the wall of worry. The real time to worry about an inverted yield curve is when no one else does, raising the risk of negative surprise.

Then too, we believe what really matters is the global yield curve. Today a big multinational bank can easily borrow for next to nothing in most of Europe and Japan and lend profitably in the US. Globalization and interest rate arbitrage render any one country's yield curve largely meaningless—even a country as big as America. Plus, the difference between a slightly inverted US curve and the preceding months' slightly positive curve is a distinction without meaning. Despite the recently flat curve, US loan growth still rose—interest rate arbitrage in action. Further, as the yield curve's return to positive territory on March 29 shows, shallow inversions can reverse fast.[2]

We think widespread manufacturing gloom is similarly bullish. The chatter centers on surveys called purchasing managers' indexes (PMIs), which loosely measure the percentage of businesses growing in a given country. They showed eurozone manufacturing contraction in March, with Germany especially weak. Yet manufacturing is just 25% of eurozone GDP and 23.1% of German.[3] Services is worlds bigger—73.0% in the eurozone and 68.2% in Germany—and services PMIs are nicely positive.[4] Meanwhile, most evidence suggests manufacturing's woes should soon fade. For one, EU auto emissions rules' impact, which weighed on auto production in recent months, looks to be waning. Additionally, Chinese stimulus taking effect should boost private sector demand for European exports. Other indicators also point positively, including US and eurozone Leading Economic Indexes—high and rising, inconsistent with a looming recession.

This now 10-year-old bull has plenty of fuel, in our view. Bull markets don't die of old age. They die when they finish climbing the wall of worry and euphoric investors ignore weakness—or when some huge unseen wallop knocks trillions off global GDP. Euphoria is absent today. Instead, a surprising amount of skepticism persists despite world stocks being slightly below all-time highs at April's end—December's volatility weighs on sentiment.[5] People overemphasize tiny negatives and ignore good news. They seek wallops in China, Brexit and tariffs, not fathoming that all are too small, misunderstood or unlikely to unfold disastrously. All are widely watched, too, limiting surprise. Rather than looming disasters, we think they represent opportunities—places uncertainty stands to fall. Brexit uncertainty could be over by the time you read this, or it could fall a year or two from now. It is a matter of when, not if.

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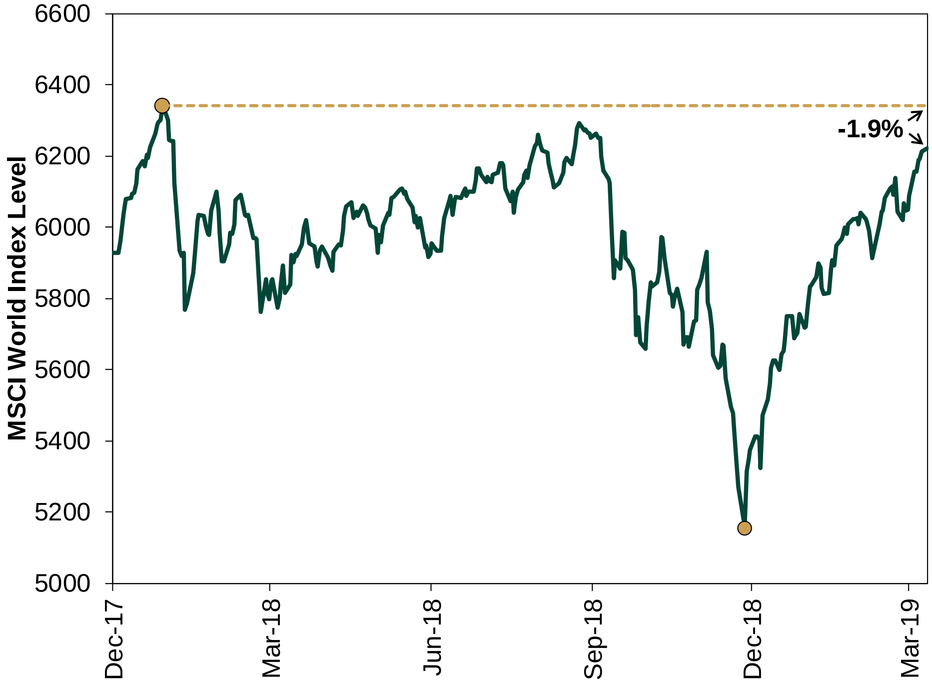
Appendix I: The Vrooming "V"

Stocks flourished in Q1, thanks to the V-shaped rebound we expected following Q4 2018's steep correction. Global stocks jumped 12.5% in Q1, and continued gains in early April put world stocks up 20.7% from their Christmastime low and just -1.9% below all-time highs.[6] Hence, in just over three short months, stocks reversed steep negativity many professionals warned would spiral into a bear market—a quite typical recovery. (Exhibit 1) Following this swift rebound, we expect gains to continue, albeit at a slower pace. Fueling more upside: Q4's decline renewed skepticism. Coupled with brighter-than-appreciated economic fundamentals and bullish political drivers we will discuss in Appendixes II and III, dour sentiment sets up positive surprise.

Exhibit 1: The V-Bounce Retraced Most of Last Year's Decline



Source: FactSet, as of 4/9/2019. MSCI World Index with net dividends, 12/31/2017 – 4/8/2019.

The Nonna Peppa Bull Market

This bull market, now history's longest, turned 10 years old in early March. The economic expansion will similarly hit 10 in June, matching 1991 – 2001 for America's longest. Many therefore wonder if the bull's days are numbered—after all, good times can't last forever. As *New York Times* economics writer Neil Irwin put it in an early April article:

> During the decade I've spent chronicling that growth as an economics writer, a persistent whisper has been: How long can it go? The run has been uneven, underwhelming and repeatedly on the verge of unraveling, including scary moments in 2010, 2015 and this past December. Seemingly every commentator without a good cliché blocker has referred to it as "long in the tooth."[7]

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But bulls don't die of old age. Many die in euphoria atop the wall of worry, when fears vanish and expectations detach from reality. Or a wallop—a negative shock wiping trillions off global GDP—kills the bull before reaching euphoria. Neither is related to time, even for an old bull. Yet observers seem continually surprised the bull market lives on. They approach it almost as they approach Nonna Peppa, Europe's oldest woman, who turned 116 in March—celebrating each birthday sure it is the last.[8] But this bull market has climbed for years since prognosticators first proclaimed its end was nigh. Why shouldn't it keep going?

The Bullish Yield Curve Inversion

In Q1's final week, the inverted US 10-year minus 3-month Treasury yield curve dominated headlines. Based on our forecast for flat to slightly lower long-term interest rates, we anticipated a flattening yield curve—and possible inversion. Yet pundits went bananas, warning nonstop of a flashing danger sign. We think there are big reasons to see it as the opposite: a sign more bull market awaits.

The yield curve displays an issuer's bond interest rates, ranging from short to long-term. Usually, long rates top short—rational, because long-term loans involve more risk. This is a positively sloped yield curve. Economically, it is beneficial as banks borrow short term to fund long-term loans, with the spread their profit.

Inverted yield curves—short rates topping long—may render lending unprofitable. They have historically been fair indicators of troubled credit markets. Inversion preceded each of the last seven US recessions.[9] That said, it isn't a timing tool. Inversion's impact hits the real economy at a lag, as Exhibit 2 shows.

Exhibit 2: Inversion Isn't a Timing Tool

S&P 500 Bear Market		Months Between 10Y-3M Inversion and Start of:	
Start Date	End Date	S&P 500 Bear	US Recession
8/2/1956	10/22/1957	-7	6
12/12/1961	6/26/1962	No Inversion*	No Inversion*
2/9/1966	10/7/1966	1	No Recession
11/29/1968	5/26/1970	-1	13
1/11/1973	10/3/1974	-5	6
11/28/1980	8/12/1982	25	15
8/25/1987	12/4/1987	No Inversion	No Recession
7/16/1990	10/11/1990	16	16
3/24/2000	10/9/2002	19	31
10/9/2007	3/9/2009	21	24
Average		**9**	**16**
Median		**9**	**15**

Source: Global Financial Data, Inc. and FactSet, as of 3/26/2019. *The yield curve nearly inverted on 1/6/1960 (23 months before the bear began), hitting 0.03 percentage point.

But also, March's inversion was a shallow -0.06 percentage point at its deepest.[10] The difference between a slightly positive yield curve and an inversion this tiny is immaterial. Banks base loan pricing on government yields, but they don't match them—they add a premium, which could easily mean positive spreads. We suspect this is why lending rose despite the flat yield curve in

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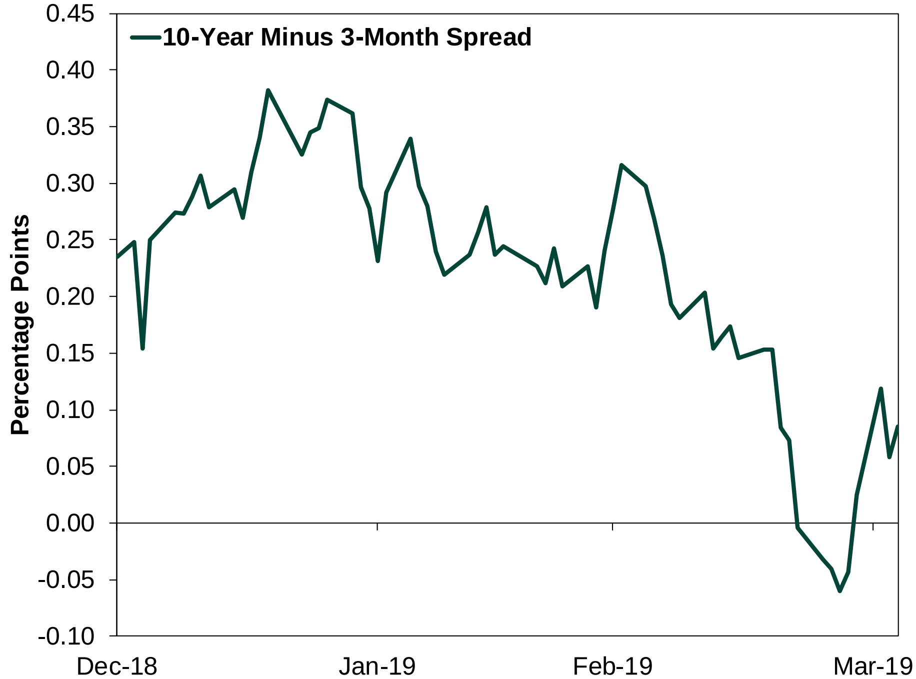
the months before March's inversion. Further, inversion must persist to cause problems. This narrow inversion reverted quickly. (Exhibit 3)

Exhibit 3: The Yield Curve's Shallow Q1 Inversion



Source: FactSet, as of 4/9/2019. US 10-year Treasury yield minus 3-month Treasury yield, 12/31/2018 – 4/3/2019.

But to us, the recent inversion isn't merely "not bearish." Rather, it is *bullish.* Seem perverse? Consider: America's yield curve inversion didn't sneak up on anyone. Pundits fearfully hyped its potential for months. Even a relatively meaningless inversion of the 5-year minus 2-year curve spurred headlines in early December. This scrutiny means stocks likely already dealt with inversion—to argue otherwise is to call markets very inefficient. We think this is unrealistic.

Think Globally to See Why the Inversion Is Bullish

Pundits focusing on America's yield curve miss finance's globalized nature. With the global yield curve still positive, interest rate arbitrage opportunities abound.

Major banks can obtain funding anywhere in the developed world, borrowing at overnight rates abroad and lending to American households and businesses. Presently, America's 3-month yield is the developed world's highest. (Exhibit 4) Rates are *negative* in the eurozone, Sweden, Switzerland and Japan. British short-term yields, while above zero, are far below America's. All are cheap funding sources for US banks.

Once funded, banks can lend in America at our higher longer-term rates. America's 10-year Treasury yield was second only to Italy's at quarter end—and only barely. Banks borrowing cheaply abroad and lending profitably to US borrowers should keep credit flowing here, fueling growth. Pundits generally ignore this—a hugely bullish reality considering the recession fears the inverted yield curve priced in.

Exhibit 4: Cheap Funding Globally Can Fuel Profitable Lending in America

3-Month Government Bond Yields	
Country	Yield
United States	**2.40%**
Singapore	1.87%
New Zealand	1.85%
Australia	1.77%
Canada	1.66%
Hong Kong	1.27%
Norway	1.09%
United Kingdom	0.75%
Israel	0.30%
Japan	-0.18%
Italy	-0.21%
Portugal	-0.36%
Sweden	-0.40%
Spain	-0.49%
France	-0.51%
Germany	-0.53%
Austria	-0.57%
Finland	-0.60%
Ireland	-0.73%
Switzerland	-0.85%
Belgium	-0.85%
Denmark	-0.85%
Netherlands	-0.91%

10-Year Government Bond Yields	
Country	Yield
Italy	2.49%
United States	**2.41%**
Singapore	2.07%
New Zealand	1.81%
Israel	1.80%
Australia	1.77%
Canada	1.65%
Norway	1.61%
Hong Kong	1.41%
Portugal	1.25%
Spain	1.09%
United Kingdom	1.00%
Ireland	0.55%
Belgium	0.42%
France	0.32%
Finland	0.27%
Austria	0.23%
Sweden	0.17%
Netherlands	0.03%
Denmark	-0.01%
Germany	-0.07%
Japan	-0.09%
Switzerland	-0.38%

Source: FactSet, as of 4/18/2019. Respective 3-month and 10-year sovereign yield for all MSCI World constituent nations on 3/29/2019. US yields are constant maturity rates.

Failing to look globally is a common problem, in our view. But money simply doesn't care where it is sourced from. Pretend each state had its own yield curve. If California's and New York's inverted, banks could fund loans to California and New York borrowers from the 48 states with positive curves. Borrowing abroad to fund US loans is no different.

We aren't saying yield curves won't matter in this cycle. We see commentary to this effect occasionally, arguing years of low rates mean inversion isn't concerning. In our view, the reason not to worry is that the vast majority of others are. The time to worry about inversion, in our view, is when it is sustained, global—and widely considered no threat.

Appendix II: Global Gridlock Generates Politics' Sweet Spot

Our commentary is non-partisan by design, and we favor no political party or candidate. We assess politics solely to analyze the potential economic or stock market impact and believe political bias invites investing errors.

With Q2 underway, we are in the presidential cycle's sweet stretch: the first half of President Trump's third year in office. As Exhibit 5 shows, year three is the presidential term's most consistently positive—with the highest average return. It has been negative just twice—the last in 1939, WWII's outbreak in Europe. As Exhibit 6 shows, the average third year is front-end loaded.

Exhibit 5: The Presidential Term Anomaly

S&P 500 Total Returns by Presidential Year, 1925 - 2018								
Winner	Inaugural Year		Second Year		Third Year		Fourth Year	
Coolidge	1925	29.5%	1926	11.1%	1927	37.1%	1928	43.3%
Hoover	1929	-8.9%	1930	-25.3%	1931	-43.9%	1932	-8.9%
FDR -- 1st	1933	52.9%	1934	-2.3%	1935	47.2%	1936	32.8%
FDR -- 2nd	1937	-35.3%	1938	33.2%	1939	-0.9%	1940	-10.1%
FDR -- 3rd	1941	-11.8%	1942	21.1%	1943	25.8%	1944	19.7%
FDR / Truman	1945	36.5%	1946	-8.2%	1947	5.2%	1948	5.1%
Truman	1949	18.1%	1950	30.6%	1951	24.6%	1952	18.5%
Ike -- 1st	1953	-1.1%	1954	52.4%	1955	31.4%	1956	6.6%
Ike -- 2nd	1957	-10.9%	1958	43.3%	1959	11.9%	1960	0.5%
Kennedy / Johnson	1961	26.8%	1962	-8.8%	1963	22.7%	1964	16.4%
Johnson	1965	12.4%	1966	-10.1%	1967	23.9%	1968	11.0%
Nixon	1969	-8.5%	1970	4.0%	1971	14.3%	1972	18.9%
Nixon / Ford	1973	-14.8%	1974	-26.5%	1975	37.3%	1976	23.7%
Carter	1977	-7.4%	1978	6.4%	1979	18.4%	1980	32.3%
Reagan -- 1st	1981	-5.1%	1982	21.5%	1983	22.5%	1984	6.2%
Reagan -- 2nd	1985	31.6%	1986	18.6%	1987	5.2%	1988	16.6%
Bush	1989	31.7%	1990	-3.1%	1991	30.5%	1992	7.6%
Clinton -- 1st	1993	10.1%	1994	1.3%	1995	37.6%	1996	23.0%
Clinton -- 2nd	1997	33.4%	1998	28.6%	1999	21.0%	2000	-9.1%
Bush, G.W. -- 1st	2001	-11.9%	2002	-22.1%	2003	28.7%	2004	10.9%
Bush, G.W. -- 2nd	2005	4.9%	2006	15.8%	2007	5.5%	2008	-37.0%
Obama -- 1st	2009	26.5%	2010	15.1%	2011	2.1%	2012	16.0%
Obama -- 2nd	2013	32.4%	2014	13.7%	2015	1.4%	2016	12.0%
Trump	2017	21.8%	2018	-4.4%	2019		2020	
Percent Positive		58.3%		62.5%		91.3%		82.6%
All (Avg)		10.5%		8.6%		17.8%		11.1%
Positive Years (Avg)		26.3%		21.1%		21.6%		16.9%

Source: Global Financial Data, Inc. and FactSet, as of 1/14/2019. S&P 500 Index annual total returns, 1925 – 2018.

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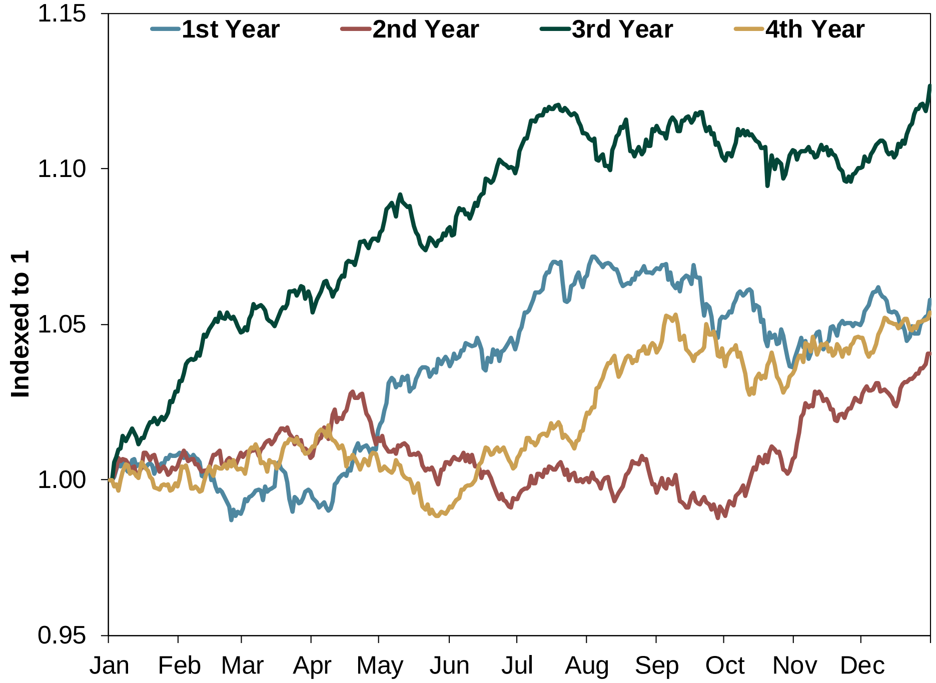
Exhibit 6: Average Returns in the Presidential Cycle

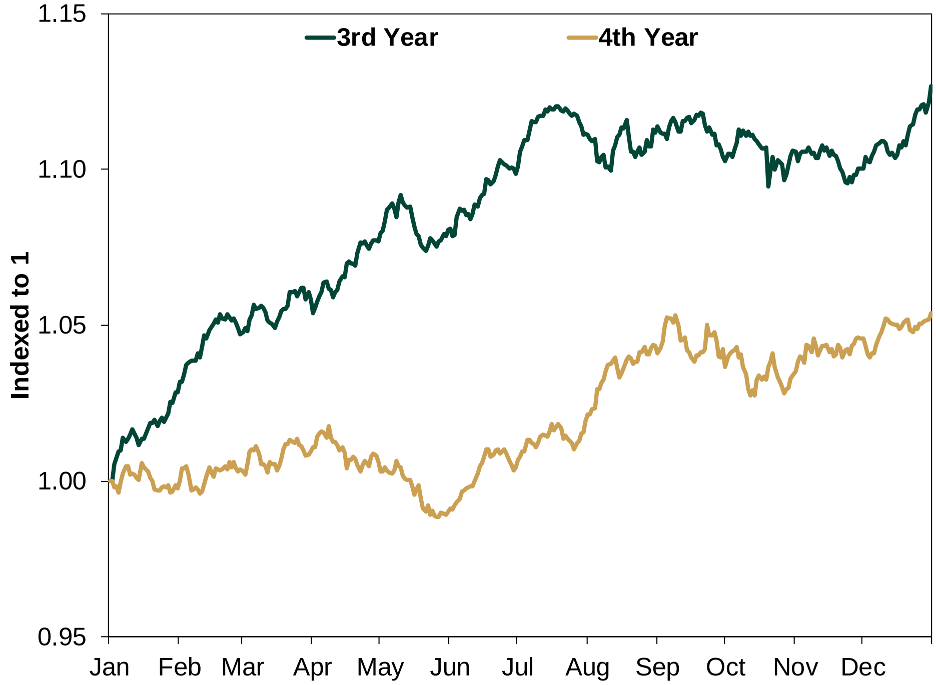


Source: Global Financial Data, Inc., as of 3/12/2019. S&P 500 Index daily price returns, 12/31/1928 – 12/31/2018.

In our view, the driving force behind strong early-year returns is investors gradually appreciating midterm-driven gridlock. Like last November, midterms usually increase gridlock, reducing legislative risk. After a noisy campaign sparks fear, legislative calm is a welcome surprise for stocks. As they gradually fathom this reality in the ensuing months, they typically deliver big returns—as in Q1.

In an average third year, this tailwind wanes in the second half, slowing gains. Averages aren't predictive, of course. They are made up of extremes. But if returns slow, remember: This is typical—nothing to fear. The same holds if a slow patch extends to year four. Election years are also more consistently positive than years one and two, with above-average returns. But they tend to start slowly, as building election noise stokes uncertainty. Returns typically improve late, as a narrowing field gives markets more clarity about the outcome and likely policy direction.

Exhibit 7: Average Returns in Years Three and Four



Source: Global Financial Data, Inc., as of 3/12/2019. S&P 500 Index daily price returns, 12/31/1928 – 12/31/2018.

Too Early to Stew Over 2020

Politics are just one market driver, and we think it is too early to forecast returns in 2020 and beyond. Yet the stage seems set for a typical fourth year. Noise from the crowded field of Democrats is growing. When over a dozen candidates from either party try to outdo each other with extreme campaign pledges, it can create uncertainty for stocks as the primaries approach—a headwind early in the election year. But as primaries begin, the contest narrows. Front-runners emerge, laggards drop out, and markets can start handicapping the field. By mid-summer, we have nominees and a two-person horserace. Uncertainty falls, boosting returns as the year wears on. Of course, negative election years have happened—four times since 1925. Perhaps 2020 proves the fifth, but we don't see drivers for this now.

As a result, we think it is far too early to start fearing (or cheering) the campaign. The market won't get excited about 2020 for a long while. Pundits will chatter endlessly, hyping every poll, debate and town hall. But it is way too soon for the Democratic field to narrow, enabling stocks to start pricing the outcome. If you love political inside baseball, enjoy the show! But for stocks, 2020 is a sideshow for now.

Europe Takes the Stage

The European Parliament, which holds elections in May, has a fixed five-year cycle similar to America's—and a similar trend of boosting stocks as election uncertainty falls. European stock returns typically slow before the election and accelerate afterward. 2014 was the only time stocks were negative in the 6 and 12 months after the contest. (Exhibit 8) We believe the ECB's

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instituting its wrongheaded negative interest rate policy weeks after the election, with quantitative easing following shortly thereafter, explains the outlier.

Exhibit 8: MSCI Europe Ex. UK Returns Pre & Post Election

European Parliament Election Date	Returns Six Months Prior to Vote	Returns Six Months Post-Vote	Returns 12 Months Post Vote
June 10, 1979	-0.9%	5.8%	6.2%
June 14, 1984	-1.4%	-3.8%	20.5%
June 15, 1989	4.2%	24.6%	32.3%
June 9, 1994	-0.1%	3.1%	16.6%
June 13, 1999	-5.2%	22.3%	22.2%
June 13, 2004	1.2%	17.8%	14.3%
June 7, 2009	13.9%	22.1%	-0.6%
May 22, 2014	6.3%	-7.6%	-7.0%
May 27, 2019	?	?	?
AVERAGE	2.3%	10.5%	13.1%
% POSITIVE	50.0%	75.0%	75.0%

Source: FactSet, as of 3/19/2019. MSCI Europe Ex. UK Index return with net dividends. "% positive" is the frequency of positive returns for the periods depicted.

The potential for strong returns and falling uncertainty is hard for many to see. Fear of populist politicians abounds, with many sweating surging populists in the European Parliament. Similar fears surround upcoming elections in Denmark and Spain. What most miss: Populists' rise has bullishly pancaked most of Europe into gridlock.

This is easy to see if you envision the political spectrum as a bell curve. Historically, parliaments in western developed nations were stacked toward the center-left and center-right, with a smattering of tiny fringe parties. Most governments were grand centrist coalitions or big-tent center-left or center-right unions with relative ideological alignment.

Populists' ascent changed this. They carved support away from centrist parties, flattening the bell curve. As the middle shrank, Europe got more fractured coalitions that can't agree on much. Consider Italy. Its "populist" government is a tenuous coalition between the far right and leftists. They agree on little and have accomplished even less, defying fears of instant radical change when they took office last summer. Sweden is another recent example. It went 133 days without a government after last September's election.[11] The stalemate broke only when the center-left prime minister formed a minority coalition with other left-leaning and center-right groups. Even then, they lacked a majority, assuming power only when the former communist party abstained from objecting. Utterly pancaked.

This holds across Europe. Spain voted in April because a minority center-left government couldn't keep Catalan separatists' support. Britain's minority government can't even agree on Brexit, never mind anything else. France? Pancaked by the "Yellow Vests" protests. Germany still has an old-school grand coalition, for now, but populists are gaining ground. Gridlock is powerful and everywhere. While America's two-party system makes this harder to see, the increasing divides within the Republicans (pro-Trump, establishment and conservative) and Democrats (Resistance, Democratic Socialists and establishment) show similar effects.

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People see pancaking as populism shattering their country's politics. They miss its ubiquity in the developed western world. Voters are tired of the establishment. They see it hasn't accomplished anything in decades and want new blood. So they elect populists, who then align with each other or the establishment to govern—coalitions of people who agree on nothing. A tasty pancake for stocks.

Pundits chatter endlessly about this because the establishment is scared. There are new cooks in the kitchen. The old boys' network was comfortable. But it is all fundamentally benign for stocks. To think otherwise is to think the center-left or center-right will do something miraculous to juice the economy or vastly improve society, which neither side has done in over 30 years, in our view. That doesn't mean populists provide real answers or aid, either—rather, they are all politicians. Self-interested first and beholden to the political machine's realities. The swamp is global, and those who try to drain it quite likely get stuck.

Brexit, Briefly

Brexit stole headlines all quarter, with parliamentary votes, negotiations, renegotiations and deadlines coming and going. Yet little changed, aside from the Brexit date (currently unscheduled, but the deadline is Halloween). Still no one knows the endgame, and uncertainty drags on the UK economy.

The situation changes by the day—if not hour—so detailed commentary here would likely be outdated when you read it. Brexit could have a date—or not. There could be an agreement—or not. Theresa May could still be prime minister, or she could have resigned. A snap election could loom, or the Conservative Party could hang on. There is no way to know.

Yet some things hold no matter how the politics shake out. Whatever path Brexit takes, it will end in one of the ways we have discussed before: a "no-deal" Brexit or a "soft" Brexit in name only. Either way, uncertainty falls. If politicians have made radical progress by the time you read this, uncertainty is falling now. If not, that blessed day will come later. It is simply a matter of when, not if—and whenever it happens, it should be a big relief for UK, European and global stocks.

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The UK's Indecisive Brexit Dealmaking

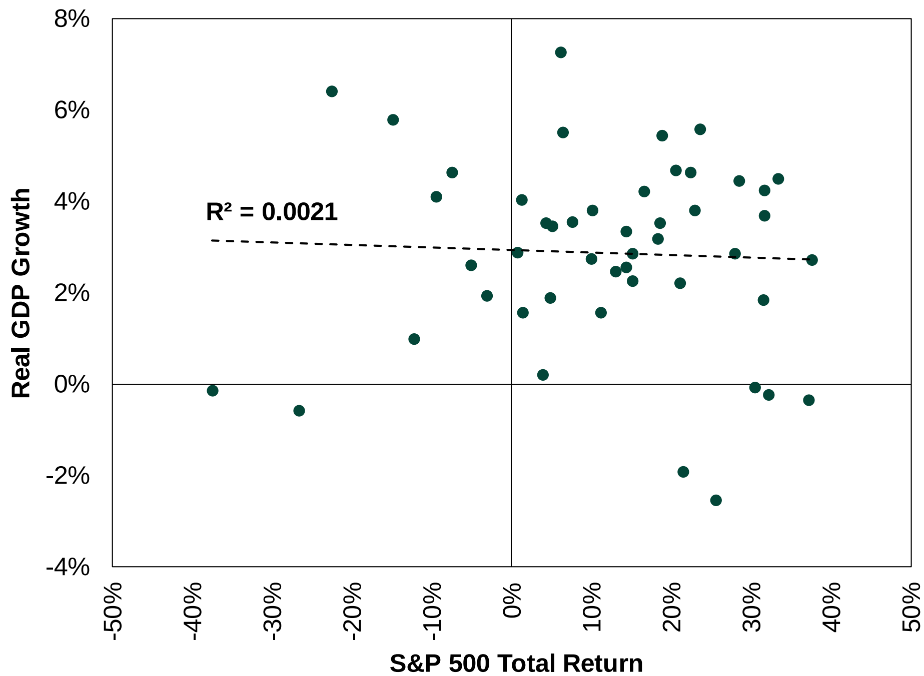
By Mary Wood and Thomas Perez.

Appendix III: The Truth About Slowing Global Growth and Stocks

With manufacturing surveys and other indicators softening, pundits are atwitter about slower growth. The implication? Without faster expansion, stocks will run out of fuel, dooming this bull market. Yet slower growth should be fine for stocks. They have done great without gangbusters growth for most of this bull market. Markets don't move in lockstep with GDP, which isn't an airtight measure of the economy anyway. Stocks focus on one aspect of GDP—the private sector—and how its future profitability squares with expectations. Slow growth dread whacks expectations, raising positive surprise potential. This is bullish.

As Exhibit 9 shows, there is basically no relationship between a given year's GDP growth and stock returns. The scatterplot's R-squared—which measures how much one variable's movement influences another's—rounds to zero. There is a positive relationship between one year's stock returns and *the following year's* GDP growth, as Exhibit 10 shows, but that isn't useful for stock forecasting. Rather, it shows stocks moving ahead of the economy, as we would expect. Hence, they have likely already priced economic slowdown fears.

Exhibit 9: Stocks and GDP Don't Move in Tandem …



Source: Global Financial Data, Inc. and FactSet, as of 3/22/2019. Annual real GDP percentage change and S&P 500 total return, 1970 – 2018. Each dot represents a single year's stock returns and GDP growth.

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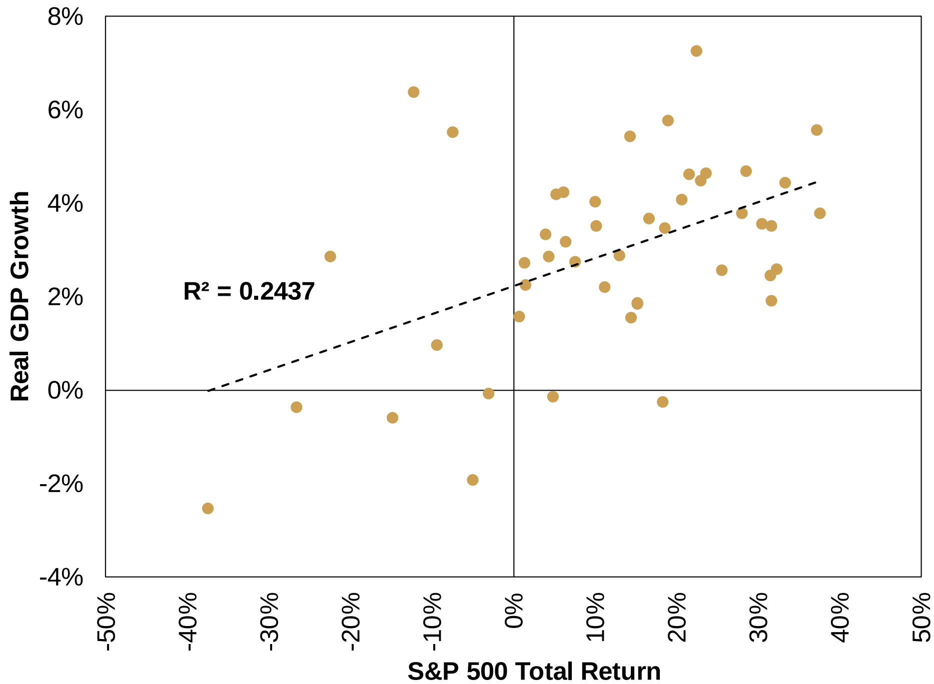
Exhibit 10: … but Stocks *Do* Predict GDP



Source: Global Financial Data, Inc. and FactSet, as of 3/22/2019. Annual real GDP percentage change and S&P 500 total return, 1970 – 2018. Each dot represents one year's stock returns and the following year's GDP growth

About That Supposed Industrial Recession

Global growth fears center on manufacturing—particularly, surveys called purchasing managers' indexes (PMIs). These report the percentage of businesses growing in a given month, with readings over 50 indicating economic expansion. As such, they measure growth's breadth, not its magnitude or rate. PMIs showed manufacturing in Europe and Japan weakening throughout Q1, with several nations contracting. Germany, widely considered Europe's economic and industrial powerhouse, was notably weak. As more data rolled in, falling exports and factory orders seemed to confirm the worst fears.

We won't argue everything is rosy in manufacturing. Throughout Europe and Japan, factories are smarting from weaker private sector demand in China. There are some green shoots, and we expect stronger data as the Chinese stimulus we discussed last quarter takes root. But it will take time to manifest as stronger demand for European and Japanese products. Yet for the global economy—and stocks—tepid manufacturing isn't a huge deal. One, it is widely known—likely priced in. Two, Europe's and Japan's economies are predominantly services-based—as is the US's. Dwelling on manufacturing ignores the vast majority of developed-world output. Even in China, services represents the majority of GDP.

This is good news, because service PMIs are largely doing great. They show solid expansion throughout the US and Europe. China's services PMIs are also much stronger than manufacturing.

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Exhibit 11: Services Dominates the Global Economy—and It Is Growing Fine

	Manufacturing PMI	Services PMI	Manufacturing Share of GDP	Services Share of GDP
Japan	49.2	52	20.7%	69.1%
Eurozone	47.5	53.3	25.3%	73.0%
US	52.4	55.3	11.2%	70.0%
UK	55.1	48.9	10.0%	79.2%
China	50.8	54.4	33.9%	51.6%

Source: FactSet, European Central Bank, US Bureau of Economic Analysis, UK Office for National Statistics, National Bureau of Statistics of China, Economic and Japanese Cabinet Office—Economic and Social Research Institute, as of 4/18/2019. Eurozone manufacturing share of GDP includes construction.

Exhibit 11 isn't a complete look at GDP, as construction and government spending also contribute to output. But these are small components. Services is the lion's share, and its growth overrides manufacturing's soft patch. When the vast majority of your economy is growing at a good clip, you are generally in good shape.

Then too, past data aren't predictive. Extrapolating any one or two months' data forward is always an error. Blips are normal. Monthly datasets are noisy. Moreover, as we examined last quarter, the main culprits for manufacturing weakness appear short-lived. One, the new EU auto emissions tests, already appears to be fading. The other, China's efforts to boost private-sector credit and growth, is slowly taking effect. Already, loan growth accelerated to 13.4% y/y in January, with February matching.[12] Lending jumped again in March, rising 13.7% y/y.[13] Officials also reiterated their commitment to supporting growth last month, suggesting they will keep doing what is necessary to meet their ambitious full-year growth targets. This is welcome news for European, Japanese and American businesses selling into China.

What to Watch Instead of Manufacturing

Other economic indicators point positively—including The Conference Board's Leading Economic Indexes (LEIs) for the US and eurozone. The US LEI has the longest published history, dating to 1959. Since then, no recession began while LEI was in an uptrend. LEI usually falls for several months before recession begins. High and rising LEIs in the US and eurozone suggest recession isn't imminent.

Even LEIs—while very good indicators—underrate services, a common problem in economic data. Stocks, the best leading indicator, also suggest growth will be fine. Efficient markets are aware of weak PMIs, in our view. If Europe were as weak as feared, European stocks should be dramatically trailing US stocks. Yet throughout manufacturing PMIs' weak spell—dating back to last fall—there has been no consistent country leadership. Trust the market—it is seemingly saying Europe's outlook isn't bad.

Same goes for China, whose stock market was lousy last year. This tells us the slowdown everyone fears now is priced. Yet people still have little faith in a turnaround. Most presume stimulus isn't working because they don't see immediate improvement in monthly output data. They forget monetary and fiscal stimulus usually work at a bit of a lag. Chinese stocks haven't

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forgotten this, though—they are rocking! If China's economy were tearing apart, stocks there shouldn't be zooming. Here, too, trust the market.

We hope you've found this information helpful. Please contact Fisher Investments at 800-568-5082 for more information on our outlook and services or to arrange an appointment with one of our representatives for a complimentary review of your portfolio. To follow our ongoing commentary on market and economic events, please visit our *MarketMinder* blog on Fisher Investments' corporate website: https://www.fisherinvestments.com/en-us/marketminder. Alternatively, you can sign up here for MarketMinder's weekly newsletter.

The Investment Policy Committee

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[1] Source: FactSet, as of 4/1/2019. MSCI World Index returns with net dividends, 12/25/2018 – 3/31/2019 and 12/31/2018 – 3/31/2019.
[2] Source: FactSet, as of 4/1/2019. US 10-year Treasury yield minus 3-month Treasury yield on 3/29/2019.
[3] Source: Eurostat and DeStatis, as of 3/26/2019.
[4] Ibid.
[5] Source: FactSet, as of 4/1/2019. MSCI World Index return with net dividends, 1/26/2018 – 3/31/2019.
[6] Ibid. MSCI World Index return with net dividends, 12/31/2018 – 3/31/2019, 12/25/2018 – 4/8/2019 and 1/26/2018 – 4/8/2019.
[7] "What the Rest of the World Can Learn From the Australian Economic Miracle," Neil Irwin, *The New York Times*, April 6, 2019. https://www.nytimes.com/2019/04/06/upshot/australia-lessons-economic-miracle.html
[8] "La Donna Più Anziana Ha 116 Anni: Nonna Peppa la Più Longeva in Europa," Michelangelo Borrillo, *Corriere Della Sera*, March 20, 2019. https://www.corriere.it/cronache/19_marzo_20/donna-piu-anziana-ha-116-anni-nonna-peppa-piu-longeva-europa-e5fd97bc-4b0a-11e9-84f1-6f7b19b096e5.shtml
[9] Source: Global Financial Data and FactSet, as of 4/2/2019.
[10] Source: FactSet, as of 4/9/2019. US 10-year Treasury yield minus US 3-month Treasury yield, 3/22/2019 – 4/8/2019.

[11] "Sweden Forms a Government After 133 Days, but It's a Shaky One," Christina Anderson, *The New York Times*, 1/18/2019. https://www.nytimes.com/2019/01/18/world/europe/sweden-government.html
[12] Source: FactSet, as of 4/1/2019.
[13] Ibid, as of 4/17/2019.

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