2019 Market Outlook: Start Investing for 2030

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DURING THIS YEAR, our commentary will focus on the "Investing for 2030' theme and speak in greater detail on the specific trends, industries, and companies we believe will best serve the equity investor; our investment advice will mirror this outlook.

THE STREAK IS OVER: -6% FOR EQUITIES IN 2018[1]. Powered by fears of a slowing economy and led by a selloff in high-flying tech names such as Amazon and Netflix, the market tumbled through what was a rather solid earnings season and for the first time since 2011, ended in the red. The few bright spots included the defensive healthcare and utility sectors, up 5% and 4%, respectively[2]. The news was worse overseas: developed foreign markets returned -13%, and emerging markets, -15%.

The bond market, ballast for equity volatility, combatted rising interest rates and ended the year essentially flat: a 0.16% return as measured by the Barclay's US Bond Aggregate Index.

With assets prices falling, interest rates rising, and the daily renewal of fear and angst over, well, nearly everything—where does that leave us? I am of the firm belief that despite the near-term results, we stand at the beginning of a terrific opportunity for investors in the United States, in several industries of the economy, powered by technological innovation and adaptation.

And this recent selloff provides a buying opportunity in high-quality growth companies that provide the foundation for exposure to these growth paradigms, central to our investment guidance over the next few years. These paradigms are:

* Technology as utility. The technology-led growth of US equities is likely to continue: technology and communication services are 1/4th of the entire US equity market[3], and as integral to every industry as running water. Given this technology imperative, capitalizing on *essential technology providers* offers investors excellent opportunity for consistent earnings and share price expansion with possibly lower volatility.

* Technology-forced change. Traditional utilities, such as water and electricity, do not change. Their production, delivery and use are under constant scrutiny for efficiency gains and conservation, but the core product does not change. Not so for technology, where the demand for improvements in speed, complexity, and efficiency requires new semiconductors, hardware, software, and other infrastructure. This forced change means spending, and the beneficiaries of this spending are companies with significant and entrenched competitive advantages (such as Microsoft and Visa) in their respective industries.

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* The continued expansion of health care. The GDP of health care is expected to only increase as our nation ages; healthcare spending is estimated to increase by 5-6% annually to at least 2025 and may then represent 20% of GDP[4].

The dollars involved continue to be re-shuffled and re-allocated (sadly, away from the consumer due to increasing costs) but the health care sector, as a growth opportunity, remains firmly in place.

* The continued efficiency of defensive sectors. The trio of health care, consumer staples, and utilities provide what are known as 'defensive' industries, less sensitive to economic conditions and having little to no change in their cyclicality of demand (save for utilities in times of extreme weather, when heating demands spike). Defensive equities have historically displayed less volatility than the market as a whole: for investors this means ***upside performance can and will often lag the US stock markets for periods of time, but also protect from losses during downturns, leading to more consistent annual returns.*** Many investors reach for these industries only during periods of volatility; my view is to make them a permanent holding in a portfolio, when suitable, often to replace less efficient or speculative high-yield bond exposure.

* Concentrations of quality over diversified speculation. Moving forward, I believe it more critical over the next decade to form concentrated positions in quality companies as the centerpiece of a portfolio strategy, rather than broad market exposure via an index fund. This seems to run counter to the 'diversify' mantra that permeates most concepts of portfolio construction but committing a segment of one's portfolio to best-in-class ideas (and surrounding it with diversified assets) may be more efficient moving forward.

Finally: 'short-termism' is now reaching epidemic levels among financial media. Even Barron's magazine, one of the last bastions of source material for the long-term investor, routinely features stories about 'where to put money NOW' or "what to do this year". Many of their focus articles on individual companies frame the performance argument to the more immediate future as opposed to long-term potential. It will be increasingly difficult for us as adult investors to ignore the constant noise and headline risk that may stir irrational investment decisions.

But I offer this final takeaway: Over the next decade, I strongly believe that the investor with intelligent, concentrated exposure in high-growth segments of technology, communications, healthcare, and defensive sectors stands an excellent chance of performing as consistently and efficiently as any index-based, broad market, diversified stock-and-bond portfolio. It is time to invest accordingly as these substantial opportunities unfold.

1,2. Source: Morningstar, Inc.
3. Source: Russell Investments, January 2019.
4. Centers for Medicare & Medicaid Services, National health expenditure projections, 2014–24.