Outlook for Financial Markets

High hopes for holiday cheer

"Millions saw the apple fall,
but Newton was the one who asked why"
- Bernard Baruch

Executive Summary

Our BMO model of holiday retail sales points to growth coming in above consensus

Jockeying among the field of democratic presidential candidates looks set to continue

President Trump's approval ratings are low by historical standards , but whether this will translate into weakening support remains to be seen

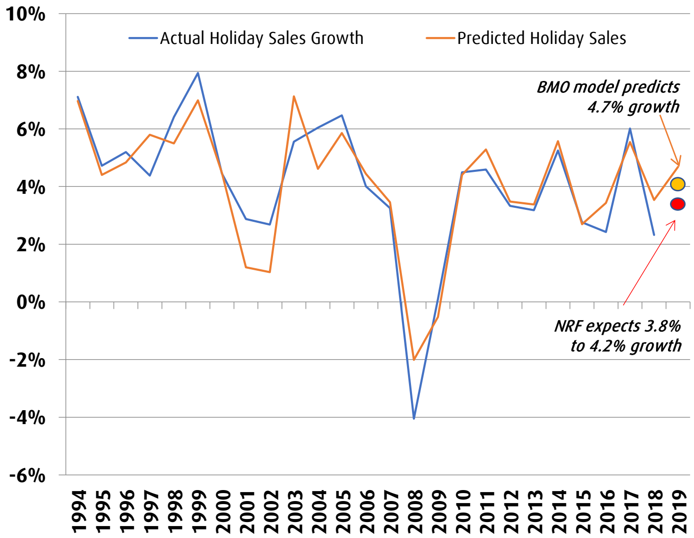
Labor market strength continues

Earnings Expectations and Holiday Spending

As detailed in our recent publication *(Q3 Earnings review: Jumping over the low bar)* the third quarter earnings reports by S&P 500 companies have, in aggregate, shown slightly negative growth. Nonetheless, the equity market took comfort that most companies were able to surpass their forecast levels of earnings, which would have implied an even greater decline. Looking ahead to 2020, equity market progress is likely to hinge on whether earnings growth can re-accelerate rather than being just "less bad." Current analyst estimates for 2020 S&P 500 earnings growth clock in at over 10%. As we move through next year, we can expect a reduction of a few percentage points in this growth estimate, which is typical, and the equity market should be able to take it in stride. Greater deceleration in earnings growth to the low-single digit range would be a headwind to equities should that occur.

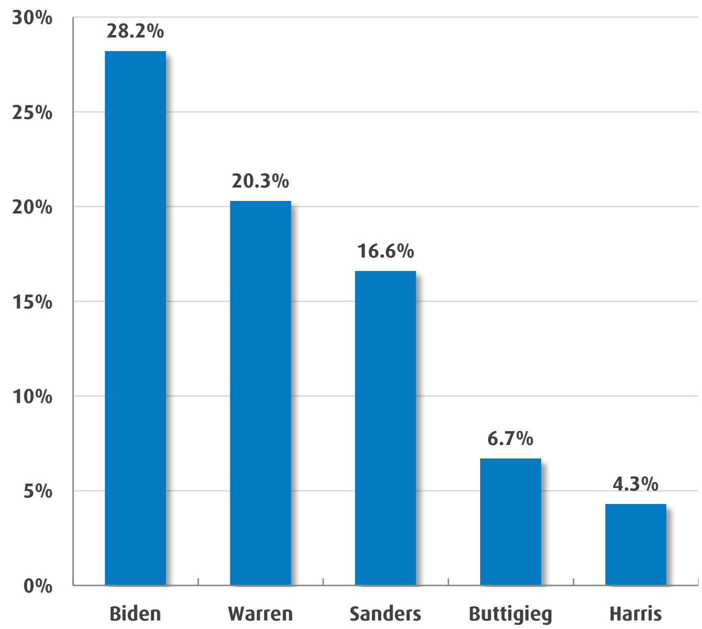
It is possible that upcoming holiday retail sales growth will alleviate slowdown fears and give a boost of confidence to consumers and businesses. The National Retail Federation expects holiday sales to show 3.8% to 4.2% growth compared with last year's holiday season. Our BMO model of holiday sales growth, which accounts for spending trends earlier in the year along with economic and market variables, points to a higher estimate of 4.7% ***(see figure 1)***. This growth estimate would be even higher, but the shortened number of days between Thanksgiving and Christmas this year moderates the expectations. While our base case is for strong holiday sales, the extent to which news flow and concerns surrounding slowing growth, the U.S.-China trade war, campaign narratives, and impeachment hearings will impact holiday spending remains unclear.

Exhibit 1 » BMO Holiday Sales Growth Prediction Model



Source: BMO Wealth Management, National Retail Federation

Exhibit 2 » Democratic Presidential Candidate Polling Averages, Mid-October to Early November



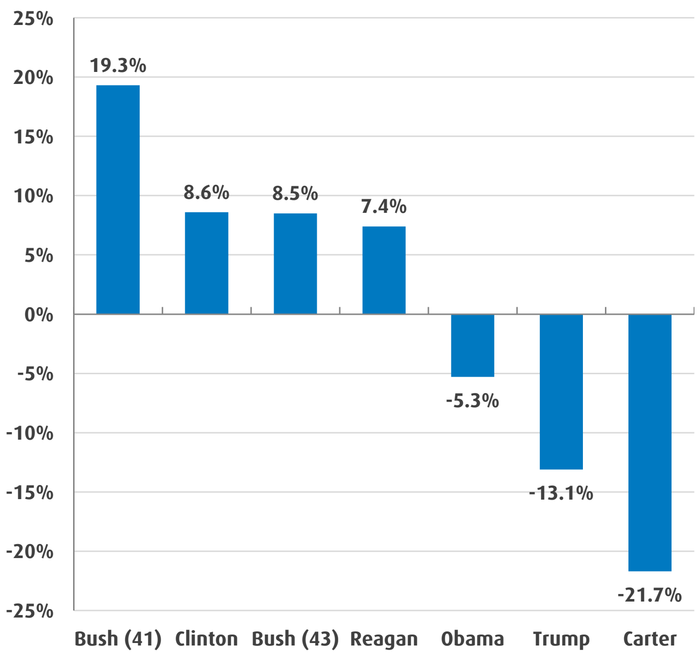
Source: FiveThirtyEight

Democratic Presidential Field and President Trump's Approval Ratings

As of early November, aggregate polling continued to point to Joe Biden leading the field of democratic candidates *(see figure 2)*. In many cases, however, Elizabeth Warren fell within the margin of error for these polls. It also remains to be seen how much the entrance of former New York City mayor, Michael Bloomberg, and former Massachusetts governor, Deval Patrick, will affect the race. Their moderate positioning points toward Biden's support being most at risk. While February of next year will have four democratic primaries and caucuses starting with Iowa, the kaleidoscope of democratic voter preference will come into focus more sharply on Super Tuesday (March 3) when 15 states go to the primary polls.

As for looking ahead to the presidential election in November, there is a lot that can happen between now and then with the economy and politically. At present, suffice it to say that even though President Trump's "net approval ratings" – those who approve minus those who disapprove – are the second lowest of the past seven presidents *(see figure 3)*, it is difficult to draw conclusions from this statistic. For example, at this stage in his presidency, President (George H.W.) Bush (41) had the highest net approval rating among the recent presidents, yet did not win re-election. The phrase, "it's the economy, stupid" remains a lasting soundbite from his re-election bid against President Clinton. In a similar misalignment, President Obama

Exhibit 3 » Net Presidential Approval Ratings at 1,026 Days



Source: FiveThirtyEight

had much lower net approval ratings than President (George W.) Bush (43) at this stage in their presidencies, yet President Obama won the Electoral College re-election much more decisively than did President Bush. Clearly, many variables are in play, including how well candidates match up against one another – particularly in the small number of battleground states. In sum, it's early, but as we move through 2020, election considerations may become increasingly important.

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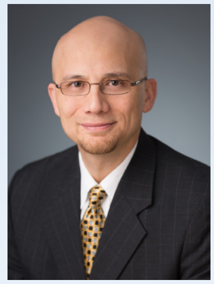
As Chief Investment Officer and National Head of the Investment team, Michael chairs the Personal Asset Management Committee and is responsible for setting investment policy and strategy for our clients throughout the United States. He joined BMO Wealth Management in 2013 as a Managing Director of Investments for our Ultra High Net Worth group, and became National Head of Investments in 2015. In January 2018, Michael took over the role of Chief Investment Officer. With close to two decades of experience in money management, Michael has a deep background in economic analysis, portfolio construction and risk management.

Michael earned a BA in economics from Northwestern University and an MBA with distinction in finance and decision sciences from the J.L. Kellogg Graduate School of Management at Northwestern University in Evanston, Illinois. He is a member of the Beta Gamma Sigma International Honor Society, holds a Chartered Financial Analyst designation, and is a member of the CFA Institute, CFA Society of Chicago, and the Chicago Quantitative Alliance. He is also a graduate of the American Bankers Association – National Trust School.



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As Chief Investment Strategist, Yung-Yu is responsible for performing macroeconomic analysis, valuation modeling and market analysis across asset classes to guide strategic and tactical asset allocations for client portfolios.

Prior to joining BMO Wealth Management, Yung-Yu was a finance professor at Lehigh University, where he taught courses in fixed income, equities and derivatives. His academic studies have been cited in the *Wall Street Journal*, in leading finance journals, top law journals, the *Handbook of High Frequency Trading*, and in *Oxford Handbook of Corporate Governance*. During his tenure at Lehigh, he was awarded the Staub Outstanding Teacher Award, awarded to one faculty member by a vote of faculty and students. Prior to his academic career, Yung-Yu worked for a global consulting firm performing financial and market analysis for global companies with operations in Hong Kong, Taiwan and Mainland China. Later, he oversaw the operations at a Fortune 500 subsidiary in Taipei and Mainland China.

Dr. Ma earned his Ph.D. in Finance at the University of Utah and his B.A. in Economics and Political Science, *magna cum laude*, at Williams College.

Yung-Yu lives in Portland, Oregon with his wife and two children. He is a basketball fan and enjoys cheering on his children's teams.

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