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Sheaff Brock Investment Advisors, LLC

Easing Fears And Reducing Risk With Value Stocks

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Abundant data suggest that a recession isn't right around the corner and the bull market still has legs, but expectations of near-term economic and market doom have many individual investors fearful for the fate of their portfolios.

Managing such clients is among the most difficult advisory challenges: It's extremely difficult to walk the line between capitulating to client pressure to make infeasible revisions to portfolios and leaving clients feeling dismissed if you don't take action.

Making this balancing act particularly precarious in recent months has been market noise from an antiphonal chorus of talking heads repeating superficial conclusions that the economy is about to tank and take the stock market with it. The driving rhythm for this din is the assumption that, because the bull has been running for a decade, it will die soon from old age, rather than any particular reason.

Feeding these fears are formulaic, dated interpretations of yield curves and somewhat valid yet by no means portentous indicators of slowing economic growth. Further, to skim the headlines, you'd think that the trade war had slowed trade to a trickle, yet total global trade is actually up.

Ironically, significant Fed data don't indicate near-term recession. Employment is high and consumer confidence is still quite strong. And various indicators don't suggest that we're at a market top.

Despite this, fears abound. Money is flowing out of stocks and into bonds for paltry yields. The AAII Investor Sentiment Survey for the week ending Oct. 23 registered 36.5% bullish. Though this was just a bit under the historical average of 38%, it was two points up from the previous week, which capped several weeks of low bullishness. This could be viewed as a contrarian indicator because these low bullish periods have historically often been followed by high average forward 12-month returns for the S&P 500.

So current fears could be viewed as affecting the market in ways that provide opportunity for those who want to stay invested. After all, they must be in it to win it. Of course, for highly skittish clients, staying invested these days might mean an over-concentration of bonds or even going to cash.

But what if you could adjust client portfolios in a way that would both assuage their fears and provide some protection from portfolio losses in the event of a slowing or bear market—while also positioning them for potential gains if the bull continues?

An attractive version of such a staying-in-it-to-win-it strategy potentially lies in value stocks—a category that has taken a drubbing throughout this bull market but has been peeking it's head up lately. According to Morningstar, over the past one month and three months ended October 23, 2019, the SPDR S&P 500 Value ETF outperformed both the S&P 500 index and the SPDR S&P 500 Growth ETF. And the Value ETF has just crept ahead year-to-date.

As value tends to fare better than growth in down markets, depending on an individual client's portfolio makeup, introducing or increasing value stock allocations can be a way of taking action in response to client concerns.

Here are some points to use in client meetings when suggesting the appropriate addition of value stocks or allocation increases, if warranted:

- Many value stocks have a history of paying healthy dividends, meaning superior dividend yields.

- Along with the downside protections of buying value stocks cheap—they currently have the widest relative performance spread against growth in several years—the category may now be positioned to help portfolios offensively as well.

- As of August, relative S&P 500 sector weightings for value against growth were bullish indeed, with consumer staples, financials, energy and utilities. In September, the category continued to improve, with some mid-cap value ETFs benefitting from double-digit increases by month's end.

- To the extent that a client—and his or her advisor—is optimistic about the near-term prospect of a deal to end the trade war with China, owning more value and less growth could be viewed as positioning nicely for this event (as could favoring small cap over large and international over domestic). The mere fact of a deal, or its perceived imminence, might be more impactful than the actual terms, as this would tamp down headlines that tend to suppress the market. And the disappearance or mere diminution of such news coverage would benefit value more than growth, relatively.

- Along with a move to value would come a coincident opportunity to acquire some big names that are hanging out—for now, at least—in the valueish section of the style box. Recently, some tech companies—including Google, Amazon and Facebook—had acquired value characteristics. The likely reasons for this new—and temporary—style box status are exogenous factors affecting market perception, including the trade war and fear of regulation. These factors have pushed prices down while surface revenues and earnings have continued to grow.

As of October 23rd, Facebook shares were trading about 15% off its high, hit in mid-summer 2018, and Amazon shares were 13% off their September 2018 high. Albeit back near previous highs, Google (Alphabet) shares have been treading water since the summer of 2018. These values should be viewed in the context of all three companies' history of halting upward climbs—substantial spurts interrupted occasionally by stalls, albeit with occasional short-term fluctuation. For now, at least, these values suggest an opportunity for tech BARP (behemoths at a reasonable price).

These points may hit home with clients who want to prepare for the possibility of a near-term bear in a practical way while still positioning for portfolio growth—if they can be persuaded to turn a deaf ear to negative market noise.

Dave Sheaff Gilreath is a founding principal of Sheaff Brock Investment Advisors LLC, an equities management firm in Indianapolis. The firm started in 2001 with $60 million in assets. Today, Sheaff Brock and its affiliates have AUM of more than $1 billion.
