Virtus Vital Signs, March 2016
Market Insights from Joe Terranova, Chief Market Strategist
Interview conducted on March 2, 2016
Transcript edited for clarity

Brian Portnoy: *Hi, welcome to Virtus Vital Signs for the month of March 2016. I am Brian Portnoy, director of investment education at Virtus, and as always, I have my friend and colleague, Joe Terranova, with me. Joe is senior managing director and chief marketing strategist for Virtus. Hi, Joe.*

Joe Terranova: Good morning, Brian.

Brian Portnoy: *So it has already been a busy year in terms of market activity, market volatility. We just wrapped up, or are in the middle of wrapping up, earning season. Can you give us some perspective on where we have come so far this year?*

Joe Terranova: Brian, the year so far is as expected, following the script. January weakness lended itself to February stability on the back of buybacks, and the removal of some of the recession concerns that we had. Earnings were as expected, lousy for a second consecutive quarter. For S&P 500® companies, on the top-line we saw a contraction of 4%. On the bottom line we saw a contraction of 8% -- in particular energy, materials were double-digits deep in the red. Surprisingly, technology had EPS contraction of 3% and revenue contraction of 5%, so that was a little bit disappointing.

On the plus side, the evidence still is there that the consumer is strong. You had consumer discretionary EPS growth of 9%, 4% in terms of sales growth, but overall earnings were as expected. I think the upcoming quarter we will have the ability to begin to comp our way out of this mild earnings recession. There is a willingness, thankfully, despite the FOMC giving a token 25 basis point hike. Keep in mind, 10-year Treasury yields fell, so you have a lot of corporate debt activity that is allowing S&P 500 companies to focus on continued capital allocation strategies that are favorable for investors and that has stabilized the market in February.

Brian Portnoy: *Okay, and given your comment about earnings generally being aligned with expectations and given what you just said, any sectors you have a particular eye on in the months to come?*

Joe Terranova: Well, I think there are two themes for the market right now, number one value is favored over growth right now. Certainly the defensive strategy seems to be the one that the market in February and January aligned themselves toward. Consumer durables, global durables are working. Domestic cyclicals right now are the weak link in the global story. Global cyclicals are actually outperforming, so there still is a little bit of a defensive mindset and I think that is warranted. I have not moved away from my expectation that 'flat is the new up,' and that all assets must be treated 'as guilty until proven innocent,' but we do, Brian, have stability in the marketplace in February, which you and I talked about last month. The world has been reminded about the risk to reward about going short oil in the mid-20's level – 25, 26, 27. [That] does not mean oil is going to spike significantly, but we are seeing stability there. Stability is the new buzzword for the market. We [witnessed] it in February.

Currencies were even seeing [stability] in the last couple of weeks. Very underneath the radar, the [People's Bank of China] is marking its currency flat to relatively stronger against the U.S. dollar. Keep in mind, an important theme for you and I [in previous discussions] – slowing the rate of appreciation for the U.S. dollar – we have done that in the last sixty days. The high for the U.S. dollar [was] actually back in December, so that is a good thing, and lends itself to stability.

Brian Portnoy: *Joe, you were very explicit in your comments on the dollar, so quite prescient. Let us move to one of the big topics of the day, which is negative interest rates, an area where history does not play the best guide because it is so unique. Make some sense of negative interest rates for our listeners and give us a sense of what it means for the markets going forward.*

Joe Terranova: Make some sense of zero interest rates….That is a very difficult thing to do. I mean [former Federal Reserve Chairman] Alan Greenspan accurately highlighted that number one, [negative interest rates] disrupts investment behavior. It puts investment behavior in the wrong light. Secondarily, I think you and I have talked in the past about this game of [countries] exporting deflation, exporting excess savings, exporting their weak domestic demand elsewhere. It really is ultimately a game of hot potato. We have talked about that. It is a zero sum game, Brian, and the question now becomes does [negative interest rates] come to the U.S.? I do not think the answer to that is yes. I do not believe it does.

Let us talk about global central banks because they are important. On March 16, the Federal Reserve will have a press conference. I think, as we have discussed, they need to hold serve given the volatility in global financial markets and given the fears as it relates to a recession. I do see a lot of the economic data and I will point to yesterday's ISM manufacturing [report]. New orders were strong, so a little bit better than expected, so I think we are removing ourselves from that recession concern. I think the Fed holds [rates] on pause, but you have other central banks, the Bank of Japan, using negative interest rates.

On March 10, you have an incredibly important [European Central Bank (ECB)] meeting at which, Brian, investors should expect the deposit rate to go even more negative, another 10 basis points from 30 basis points to 40 basis points. I expect additionally with this, [the ECB's] monthly bond buying purchases to actually increase by at least 10 billion euros, which would take them up to 70 billion, and let us extend that program all the way out so we have 18 months in full vision. So, you are going to get easy monetary policy from the ECB on March 10.

Lastly, let's talk about the National People's Congress in China. [Its annual session] is this weekend. Last weekend at the G20 meeting in Shanghai, policymakers from China clearly marked what their intentions are, 6.5% real GDP. The signs are there, Brian, that they are moving away from focusing on the dramatic reforms and focusing more on stabilizing the rate of decline in terms of domestic growth.

So, collectively, what does it all mean? I do not believe in negative interest rates, I do not think it works. The U.S. holds serve and we are almost back to a Goldilocks environment. Does that mean you treat risk assets now as all innocent on a reflation story? No, you do not. Flat is still new up [for equity markets.] [Assets are] guilty until proven innocent. But global central banks operating in a [such a manner] where Goldilocks is back provides stability for risk assets, which is important.

Brian Portnoy: *All right, we will pick this up a month from now. As always, we appreciate your comments, Joe, thank you so much.*

Joe Terranova: Okay Brian, hopefully by then we will have a clearer understanding of the political landscape, who the Democratic nominee will be (it looks to be Hillary), and who the Republican nominee looks to be – but clearly right now, none of the above is the leading candidate and that is what the American electorate is telling all of us is the problem right now for the market. It is impacting the market. So, hopefully when [we have our next] conversation in April, we have a bit more political clarity because the markets need that as well. Thanks for the time today, Brian.

Brian Portnoy: *Okay, take care, Joe.*