UP AND DOWN WALL STREET-BARRON'S

Why the Bull Market May Be Losing Its Mojo

Investors are struggling to determine if the bull is back or whether the stock rebound just reflects another global round of monetary easing.

By
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Are we really headed *back to the future*?

It would appear that Nike (ticker: NIKE) thinks so. The athletic-wear maker last week unveiled a real-life version of a prop from the fantasy flick from three decades ago: self-tying sneakers. With self-driving automobiles on the horizon, why shouldn't sneakers lace themselves up in the 21st century? So what if it takes a feat of engineering to perform a task that can be mastered by 5-year-olds? It's cool.

Technology also is being utilized in rather more productive ways, spurred on by politics. Specifically, the campaign to boost the minimum wage would provide the impetus to put more robots to work—in place of humans.

That's the conclusion of the latest survey of chief financial officers by the Fuqua School of Business at Duke University. Nearly three-quarters of the CFOs polled said they would trim current or future payrolls if the minimum wage were hiked to $15 an hour—the aim of various campaigns. Some 41% said they would lay off current workers, and 66% would slow future hiring. Moreover, 66% of firms said they would also cut employee benefits, and 49% would raise prices with a 15-buck wage floor.

Those impacts wouldn't be immediate, writes Campbell Harvey, the Fuqua professor who is the founder of the survey. Most companies with employees earning less than $10 an hour would gradually invest in labor-saving techniques were the minimum wage to be hiked, he continues. "CFOs are telling policy makers there is a significant unintended consequence: Some jobs will be replaced by robots, and this replacement is permanent."

The fast-food business, a primary target for the $15-an-hour minimum, would probably become a big adopter of automation. At Starbucks (SBUX), there's already a feature for that in its Mobile Order and Pay app for smartphones. Between mandated pay hikes and the ubiquity of iPhones and Android devices, positions for fast-food order takers would most likely dwindle. And anybody who has ever tried to order in a drive-through with one of those unintelligible speakers might welcome the option of a phone app.

Other interesting findings from the Fuqua survey: The CFOs thought there was a 31% chance that the U.S. would be in recession by the end of 2016, nearly double the 16% probability predicted nine months earlier. “Slowing emerging economies and volatile financial markets and commodity prices” were cited, according to Harvey, with the cooling in China mentioned by 59% of the CFOs as the biggest U.S. recession risk. That’s a worry evidently shared by the Federal Reserve (about that more later).

Closely following the global concerns were worries about political turmoil in the U.S., according to the survey, which closed March 4. At least the uncertainty of whom will be heading the presidential tickets has diminished, as challenges to Hillary Clinton for the Democrats and Donald Trump for the Republicans look like exceedingly long shots after last week’s round of primaries.

That still leaves the general election campaign to be fought between two candidates with the highest negative ratings from voters in memory. The prospect of a down-and-dirty fight between Hillary and the Donald is unlikely to boost CFOs’ confidence, already shaky because of the political landscape.

On the positive side, the respondents’ next biggest reasons to fret about a recession—the stock market and the price of oil—have improved decidedly since the survey was completed. For that, they can thank the world’s central bankers.

Most of the central banks around the globe—the majors, such as the European Central Bank, the Bank of Japan, and the People’s Bank of China, plus some smaller ones, most recently Norway’s and New Zealand’s—are in easing mode.

The Bank of England last week held interest rates at historic lows amid the uncertainty of the June 23 referendum on the United Kingdom’s continued membership in the European Union. And, of course, the Federal Open Market Committee also voted last week to stand pat, prominently citing global concerns in lowering expectations for future rate hikes.

With that, the U.S. dollar has eased and commodity prices—most importantly, but not solely, that of oil—have recovered sharply. And with the softening of the greenback, formerly beaten-down commodity-related stocks have rebounded, in the process erasing the 10%-plus correction in the major indexes suffered after the turn of the year. Notable laggards have been the big technology names, top winners when the dollar was in ascent last year.

All of which has set up some unexpected intermarket relationships. The Dow transports have entered “official” bull territory, despite the better-than-50% rebound in U.S. crude prices from their February lows of $26 and change. Higher fuel costs typically are bad for airlines and truckers, but both reacted positively to the reduction in recession risks provided by the central banks.

Bank of America Merrill Lynch strategists' team, led by Michael Hartnett, observes that the recent outperformance of commodity-linked stocks has tracked the strengthening of the Chinese yuan (and concomitantly, the weakening of the greenback). Of course, the assertion of the GOP front-runner is that China is deliberately pushing its currency lower to spur exports unfairly.

In any case, Hartnett's team found that a "pain trade," pairing Facebook (FB) versusPetrobras (PBR), has tracked the yuan's exchange rate (in the offshore market outside China). Last year, as the dollar strengthened and the yuan slid (reflecting deflationary fears from China's slowdown, which spilled into commodities), Facebook trounced the Brazilian oil company's shares. As the yuan has strengthened this year (and the dollar has weakened), the rebound in Petrobras has left the social-media giant in the dust.

The question now is if the commodity-led rebound in risk assets is more than a snap-back reaction. Central banks are either in full-tilt easing mode or, in the case of the Fed and the BOE, holding back on rate hikes. Will that worldwide easing keep the rebound going? The uncertainty could keep investors tied up in knots—without any self-lacing Nikes.

WITH THE MONETARY WINDS AT THEIR BACKS, the major U.S. averages notched their fifth straight winning week and recouped their losses since the Feb. 11 lows. That came despite the shocking plunge in Valeant Pharmaceuticals International (VRX); seeThe Trader Extra for the gory details.

Junk bonds also have been big winners. Junk funds have enjoyed their strongest four-week skein of inflows in four years, as investors try to capture fat returns and risk appears to recede. The price of the popular iShares iBoxx Dollar High Yield Corporate Bondexchange-traded fund (HYG) is up 9.6% since the low close of that date.

Maybe it's just spring fever. The calendar says spring starts this week in the Northern Hemisphere, with the Easter holiday next weekend. But snow is forecast for the Northeast—a shock after the warmest winter in U.S. history. The meteorological readings will affect the economic data, which are supposed to be adjusted for seasons. So observes the ever-perspicacious David Levy, the third-generation head of the family business, the Jerome Levy Forecasting Center.

After the brutally cold and stormy Februaries of 2014 and 2015, the seasonal adjustments that take into account those miserable months make this February's data preternaturally sunny, he explains.

“However, as spring data appear and the warm-winter boost vanishes, the presently elevated data will drop back to trends, which in most cases are not very good trends,” Levy writes to clients.

He thinks the risk markets will have to adjust when the less-massaged March and April numbers are published in six to eight weeks, ending the bear-market rally. At which point, Levy says, the bubble he sees in emerging markets will return to the fore. And that, he adds, is as big or bigger than the late 1990s tech bubble and the 2000s U.S. housing bubble, which were easier to spot.

The emerging market overexpansion is a result of the repeated economic stimulus applied to offset the bursting of the preceding bubbles, Levy argues: “This time, many people see parts of the bubble, but few understand they are all part of the same gigantic, global manifestation of speculative excess.”

Contracting global trade, falling capital- goods orders, the decline in industrial commodity prices, weakness in purchasing managers’ surveys and in executive confidence (such as the CFO survey noted earlier), plus tighter bank lending conditions, all are signs of excess capacity globally, he continues.

Perhaps these are among the global factors to which the FOMC alluded in the statement accompanying its decision last week to hold its interest-rate target steady at 0.25% to 0.5%. Moreover, the panel’s dot-plot graph of year-end rate expectations pointed to two more hikes this year, down from the four forecast in December.

Even that sounds aggressive. The federal-funds futures market thinks only one hike is likely this year, probably not until December. And Bloomberg calculates a 68% probability of an increase—hardly a sure thing.

The futures and Treasury markets have had a better record than the prognosticators. Their reluctance to pencil in multiple rate hikes is consistent with less optimism about a continued bull run.

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