Bad Weather Ahead? 2014 Equity Market Outlook

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Key Takeaways

One of Wall Street's most influential market strategists, the founder of Strategas Research Partners offers prescient insights as a regular guest host on CNBC's Squawk Box and Bloomberg Surveillance with Tom Keene. His 2014 investment strategy outlook and the implications for IROs:

Everything is better, but nobody's happy
The stock market reached record highs in 2013, with the S&P 500® posting 30% gains, but no one was dancing in the streets on December 31. In 2013, the underlying economy was completely disconnected from the roaring bull market, and many investors believe the U.S. Federal Reserve's stimulus program artificially propped up markets. Everyone is worried about what will happen when the Fed slows down its asset-purchase program. Trennert said tapering is not tightening – and that the Fed will continue to be accommodative with monetary policy, as it may tolerate a bit of inflation if it's tied to job growth. IROs take note: P/E ratios are inversely correlated with low inflation, so this is a good time to issue equity. Inflation of between 2% and 4% is the sweet spot for P/E ratios.

He's bullish on equity markets because T.I.N.A.
Trennert is particularly bullish about equities, because "there is no alternative"(T.I.N.A.) to the stock market as long as the central banks control interest rates. Corporations are sitting on hoards of cash and are under pressure to use it. IROs take note: Because dividends play a big part in the total return of stocks and in the search for yield, investors will be looking for cash-rich companies with the potential to increase their payout ratios.

The U.S. also must grow through capital spending and exports to make up for the declines in consumer spending. Pent-up demand for capital spending could realistically fuel a 3% to 3.5% gain in GDP this year. The current administration is now much more amenable to exploiting our natural gas resources, which hold the potential for real GDP growth.

Inflation could be the catalyst for an asset class rotation because T.I.N.A.
Disillusioned after two significant market downturns in a decade, fiduciary and endowment investors are underweighted in equities in favor of alternative investment classes, particularly private equities. However, private equity returns have disappointed investors. If inflation gets high enough, stocks will become a more attractive asset class. The wild card in the stock market is the retail investor, who largely sat on the sidelines in 2013. It may take "meaningful inflation" before individual investors return to the equity markets.

The perfect storm for shareholder activism and M&A
What a difference a few decades make. In the search for returns, the amount of investor money allocated to hedge funds has increased dramatically, creating a new activist shareholder base. *Time Magazine* cover boy Carl Icahn has been recast from ruthless corporate raider to caped crusader. With profits under pressure and significant cash on the balance sheet, companies will need to use that cash to produce profit improvements through investments in real growth strategies – either voluntarily or through pressure from outside investors. Unlike the 1980s, boards today are much more likely to work with dissidents than enter into a proxy battle.

– By Bess Gallanis, January 2014