Six Reasons to be Structurally Bullish of Stock Markets

I am structurally positive toward stock markets. At a macro level the largest corporations are extremely powerful and have the capacity to shape the direction of public policy in their interest on a global scale. There are differences between economies and the trends are stronger and weaker in different parts of the world but the following forces are powerful supports for stock prices in my opinion.

Labour costs

Labour is typically the largest cost in a business and in this area the landscape has shifted dramatically in the favour of corporations in the last twenty years. As a result of globalisation the supply of labour available to multinationals has increased by hundreds of millions with the integration of China, India, Indonesia, Eastern Europe, Brazil, Mexico etc. into the global economy in a way they weren't before. Advances in information technology make is as efficient to operate in Bangalore as Boston, while the labour cost savings are enormous.

Influence on Public Policy

At the same time, because of the jobs they can provide and their mobility multinationals are in a position to bully national governments to design policy in their interest. Policy around taxation, employment law and grants for example. National governments have to compete to make themselves attractive. Firms can credibly threaten "give us what we want or we'll bring the 2000 jobs to country x, y or z because they will".

Taxation of Profits

Labour is plentiful and cheap and profits are often barely taxed. At the same time, the capacity to generate sales has expanded as new markets with huge populations and potential have opened up in the last decade. Corporate profits are at record highs. This is often used as a bearish argument for stock markets, in that profits historically mean revert. I don't think historical mean reversion is very relevant because the landscape has changed so dramatically in the last 10-15 years.

Share buybacks and dividends

Multinationals are awash with cash. It is estimated US corporations have more than $2 trillion in cash holdings. It has been pointed out that the main reason this hasn't been invested in a significant way since the financial crisis is that many of the firms with the largest cash piles, technology firms, aren't capital intensive. They don't require large factories to operate. Where they do they outsource the activity.

Activist shareholders are increasingly pressing for this cash to be given back to shareholders through dividend payments and share buybacks. In addition, management are generally incentivised in the direction of share buybacks to achieve a higher EPS and share price. This will be an on-going source of support for stocks.

The Great Rotation

The idea that institutional investors, pension funds etc. are historically underweight stocks and overweight bonds. This trend has been reinforced by a 30 year bull market in bonds and two stock market crashes since 2000. The earnings yield on the S&P 500 is currently 5.6% versus a 2 year US government bond yield of 0.43%. At these yield levels the potential capital gains in bond markets are limited versus the period from 1982. Capital gains (and yield) are to be found in the stock market.

Low Inflation and Monetary Policy

There are differences between economies but globally the trend has been toward low, subdued CPI inflation. Wage inflation is non-existent and is likely to stay that way. Globalisation has broken labour's bargaining power and there is no sign of that trend turning around in a meaningful way. In fact it is spreading, most notably in the Eurozone as the post WW2 social contract is broken down through austere fiscal policies. This is very significant given the size of the Eurozone economy, and is a structural long term positive for European stocks markets.

While inflation remains subdued there is no pressure on central banks to be anything other than very supportive of stock markets.

There is concern about low inflation leading to deflation. Historically, if pricing power was lost, labour costs were sticky so margins narrowed. Today, labour costs are not so sticky so margins can be maintained or even expanded in times of reduced pricing power as has been the case post the financial crisis.

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