Real News, Fake News.... Both Need Warning Labels

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While the country worries about fake news, I worry about all news... fake and real. In my unscientific study based on roughly 25 years of investment experience, I have concluded that very few things appearing in the newspaper, television or internet have investment implications. I am not suggesting that the news is not important or interesting; instead I believe investors should be more discriminating in their news consumption for three reasons:

1. News with clear investment implications like quarterly earnings calls or new product announcements tends to be discounted in the market immediately. In other words, by the time the average investor is made aware of it, it is **too late** to do anything about it.

2. Many news stories making headlines such as political scandals or organized public demonstrations have **little or no direct investment implications**.

3. Often the 'hottest news', like trade talks or budget negotiations, are **too incomplete, too inconclusive or subject to too many other variables** to allow an investor to make an informed investment decision.

For this reason, I propose that newspapers, radios, televisions and internet-connected devices all come with warnings, like those seen on other dangerous products.

'Warning! Utilization of this information can cause elevated heart rate, anxiety and impair investment judgement. Users should not make investment decisions immediately after use. Research has shown that 'short-termism' and investment decisions inconsistent with long-term financial plans have been observed after use.'

That being said, not all news is noise. So, what is not noise? The short answer is that it depends. The markets can be fickle regarding what it pays attention to and its tastes vary with the business cycle. We believe that the best investment decisions are made when investors can tune-out the noise and focus on the news that is most likely to have investment implications. Below is the news that we think currently matters and is worth paying attention vs. the 'noise' broken down by U.S., Developed International and Emerging Markets.

U.S.: Given that the U.S. market is the most mature, investors are most sensitive to the early warning indicators that have historically preceded a bear market.

- **News that Matters:**
  - **Inflation Concerns:** Indications of rising inflation could cause the Fed to hit the brakes on economic growth by rapidly increasing interest rates. Currently, inflation data has been benign, in our view, as can be seen in the recent Producer and Consumer Price indexes (PPI & CPI).
  - **Earnings:** A second likely cause of a bear market is a recession; therefore, investors pay close attention to corporate earnings and any signal that they may have reached their peak. Today, S&P 500 earnings growth in the second quarter is expected to be a robust 19% according to Factset, which puts it on track to be the second highest earnings growth quarter since Q1 2011.
- **Noise:** In our view, U.S. investors no longer care about data pertaining to the employment rate, auto sales or housing starts because they are expected to be strong and weak readings that can generally be traced to supply/capacity constraints.

DEVELOPED INTERNATIONAL: Given that these economies are just getting off the ground, investors are most sensitive to 'early cycle indicators' that provide confidence that their recoveries are on-track.

- **News that Matters:**
    - **Evidence of Inflation:** Inflation is akin to the 'smoke' one wants to see when starting a fire. It signals that demand for products and services is accelerating. Most recently, inflation has started to return in the developed markets. It will be important to see inflation stabilizing around 2%.
    - **Accommodative Central Bank stance:** In their early stages, economic recoveries are the most vulnerable. Therefore, investors want to be reassured that these fragile economies will be supported by Central Bank behavior. For this reason, the market will be focused on Central Bank press conferences, speeches and meeting minutes for assurances that monetary policy will remain accommodative. As recently as a few weeks ago, both the Bank of Japan (BOJ) and the European Central Bank (ECB) have confirmed that monetary policy will remain loose. On June 12th, for example, the ECB noted that they would not consider raising rates until the summer of 2019, at the earliest.
- **Noise:** Backward-looking data on the economy, such as GDP, is not currently in the focus of Developed International investors. These measures can signal false positives and false negatives owing to the typical erratic behavior of an economy in the early stages of recovery, in our view.

EMERGING MARKETS: Emerging market economies are less synchronized and are in different stages of the business cycles. For this reason, there are few single data points that universally effect all markets, with two major exceptions:

- **News that Matters:**
    - **Directives from the People's Bank of China (PBC):** There is truth to the saying: 'As goes China, so goes the emerging markets.' The PBC controls the bridle on the Chinese economy and has proven effective in either letting it run or reining it in. An unbridled Chinese economy leads to growing demand for agriculture and energy products like semiconductors and base metals, which are important exports for many emerging market countries. In May, governor Yi Gang pledged to continue the PBC's 'prudent and neutral' policy stance.
    - **Dollar Direction:** The U.S. dollar is the major funding source for many emerging market countries, particularly in Latin America. Therefore, the direction of the dollar can have a significant impact on the financial well-being of emerging market companies and economies. When the dollar strengthens, funding costs escalate, and emerging markets can be expected to underperform. Recently, the USD has strengthened, and emerging market equities have lagged.
- **Noise:** Investors have historically viewed economic data from China with a grain of salt because of its inconsistency and tendency to be manipulated. Additionally, investors tend to pay less attention to geopolitical concerns in peripheral countries, like those in the Middle East, Africa or Latin America, because of its regularity and those countries small representations in the index.

Bottom Line: The final arbiter of news, in our opinion, is the market. Everyday millions of individuals determine what news is important and what is not through the buying and selling of stocks and bonds. James Surowiecki's seminal book *The Wisdom of Crowds* (2004) concluded that the collective insights of the many are superior to those of the few. Therefore, while we have theories about what news matters and how it should be interpreted, we must always recognize the market's message, especially when it conflicts with our own. The market's latest missive suggests to us that it is likely to stay in a confined trading range between 2550 and 2800 (S&P 500) and excessive risk taking should be discouraged.

Foreign investments, especially investments in emerging markets, can be riskier and more volatile than investments in the U.S. and are considered speculative and subject to heightened risks in addition to the general risks of investing in non-U.S. securities. Also, inflation and rapid fluctuations in inflation rates have had, and may continue to have, negative effects on the economies and securities markets of certain emerging market countries.

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