THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – NOVEMBER

U.S. Markets and Economy

November brought another month of all-time records for U.S. stocks, with the Dow Jones breaching 28,000, the S&P 500 reaching 3,150, and the NASDAQ touching 8,700. The broad-based S&P 500 is now up an astounding 25% for the year. Although the 2009–2019 bull market is already the longest in U.S. history, it is moving closer to the strongest in U.S. history. The 1990s bull market witnessed a rise in the S&P 500 of 417%, with the current bull market in all-time second place with a total gain of 366%. A further rise to 3,500 on the S&P 500 (about 10% above the current level) would make this the longest and strongest bull market in U.S. history!

One of the key drivers of this bull run has been the longest economic expansion in U.S. history, which is now more than 10 years old with no sign of recession looming. Although real growth in the third quarter of 2019 is now estimated at 2.1%, this rate is close to what most economists think is the "speed limit" for U.S. growth, with the labor force growing by 0.9% per year and the productivity of the average worker increasing by 1.1% per year.

Although the labor force can grow faster if more nonworkers are lured back into the labor force, economists estimate that labor force participation rates of prime age workers are now back to the levels last seen before the Great Recession. Unemployment rates have also fallen to the lowest levels in more than 50 years, with the November unemployment rate falling to 3.5%—within a few ticks of the lowest unemployment rate ever recorded in peacetime. At the same time, employment growth in November was a robust 266,000, a sharp recovery from the previous two months (this data was reported in early December). And rank-and-file workers have seen their wages rise about 3% in the past year, showing that this rising economic tide is lifting many boats.

The Federal Reserve certainly deserves a lot of credit for this outstanding economic performance. The FOMC kept short-term interest rates at zero for many years into the recovery, and only gradually raised them as the U.S. moved closer to "full" employment. Three interest rate cuts this year have brought short rates back down to 1.5%, a bit below the current inflation rate of 2%, which happens to be the Fed's target for inflation. The Fed's fine-tuning of interest rates this year is designed to keep the economy humming next year, as monetary policy only acts on the real economy with substantial lags of as much as 12 months.

The Fed wants to head off any future weakness tied to an escalation of trade wars (which almost all economists argue make the U.S. and the whole world worse off) and a continued slowing of world economic growth rates, especially in Europe, Japan, and even China. The Fed is also trying to avoid changing interest rates during an election year, which could make it appear that the apolitical and independent Fed is trying to influence the election. In addition, the level of policy uncertainty will rise in 2020, with impeachment on the horizon and the outcome of the 2020 election, based on early polls, extremely close. This environment could mean that business investment, which has already been relatively weak, will remain weak until policy uncertainty is resolved.

World Markets and Economy

The British are now within days of an election that may lead to Brexit, the departure of Great Britain from the European Union. The election, however, may not settle the matter at all, and no one can tell when, if, or how Brexit will be achieved. Although the FTSE Index managed a small gain for the month of November, that gain was wiped out at the beginning of December when it appeared that the world's trade wars might intensify. European stocks did manage a gain for November, led by Germany and France, even though the German economy is barely growing, and the French are once again convulsed by labor unrest. For the year to date, however, both French and German stocks are up almost 25%, which is a useful reminder that the short-term link between economic growth and the stock market can be relatively weak. The long-run link is stronger: over the last two years, the British FTSE is down more than 5%, while German stocks are essentially unchanged.

Japanese stocks added small gains in November to their large gain in October. The economy seems to have survived an increase in the consumption tax to 10%, and the Japanese government is gearing up for the 2020 Olympics with a burst of new spending that should help drive economic activity forward. Monetary policy is still very accommodative and should provide further support for Japanese stock prices. Chinese stocks, as measured by the Shenzhen 300 Index, took a small loss in November. China's economy continues to grow, albeit at a slower pace, while trade uncertainty rises and falls as the prospects for some kind of trade deal with the U.S. improve or deteriorate from day to day. Chinese monetary authorities have been easing policy recently to offset any ill effects of the trade battle with the U.S.

Outlook

The economic outlook is still constructive after almost eleven years of economic growth, and monetary policy is still accommodative. The bull market has also been driven by rising corporate profits, although 2019 will not show much growth after a strong 2018, which was bolstered by the effects of corporate tax cuts. Currently, Wall Street estimates that profits for the S&P 500 will rise 8% in 2020, which will support further increases in stock prices. Even though economic growth in Europe and Japan is still very slow, their markets also have room to rise after strong increases in 2019. The path of least resistance is still upward for world equities.

In summary, U.S. stocks have already had a record-breaking year, with the S&P 500 up 25% and other indexes also setting all-time records. With monetary policy still relatively easy and corporate profits set to rise next year, the bull market still has room to run. The rise will not be smooth, and sharp corrections of 5–10% can appear at any time, but long-horizon investors will look past this short-term volatility to reap the rewarding long-horizon returns that equities provide.