Reilly Financial Advisors

THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – DECEMBER

U.S. Markets and Economy

December was a strong month for U.S. stocks, which made 2019 one of the best years ever on Wall Street. Stocks, as measured by the broad-based S&P 500, rose almost 3% in December alone (and almost 30% for the year). The NASDAQ and the Dow also rose sharply, and all three indexes set all-time records in the month. The current bull market only needs to rise about 7%, to 3,500 on the S&P 500, to break the record for the largest gain in a bull market ever!

One of the key drivers of this bull run has been the longest economic expansion in U.S. history, which is almost 11 years old with no sign of recession looming. Real economic growth in the fourth quarter of 2019 will not be announced until the end of January, but the latest estimate from the Atlanta Fed is for 2.3% growth, which is a strong number for an economy already operating at "full employment." Job growth is still strong, and unemployment is at a 50-year low of 3.5%. Even better, inflation remains very low at 1.5%–2.0%, which means that the Fed does not need to raise short-term interest rates to head off rising inflation. In fact, the Fed's three rate cuts in 2019 helped give stocks a boost all the way through December. The FOMC will probably stand pat on rates in 2020, which means monetary policy will remain accommodative, providing support for stocks in the new year.

The Fed cut rates in 2019 as a precaution against weakening U.S. growth in 2020, which could be caused by a continuation of trade wars, especially the battle between the U.S. and China. Although in December the stock market celebrated the announcement of a "Phase 1" deal between the U.S. and China, the two parties are still far apart on many core issues that have led to the current levels of tariffs and rounds of retaliation by each side. Almost all economists agree that these trade battles hurt all countries, but a truce could lead to a more comprehensive agreement in 2020. Such an agreement would be a major positive for stocks in the yew year.

In December, stocks also shrugged off the impeachment of the President. Most analysts point to the near certainty that the majority Republicans in the Senate will vote to acquit. Of more concern is the looming 2020 election, which looks to be very close. Although anticipation of a Republican loss would likely mean fewer business-friendly policies, historically, the stock market has done as well (or better) under Democratic presidents.

The long bull market has also been driven by rising corporate profits, although profit growth paused in 2019. Growth should pick up again in 2020, as the economy will almost certainly avoid a recession. Current estimates are for profit growth of as much as 10%, a further support for stocks.

In summary, U.S. stocks had a near-record year, capped by a strong December. Historically, January is also one of the strongest months of the year. With monetary policy still relatively easy, and corporate profits set to rise next year, the bull market should continue.

World Markets and Economy

British stocks rallied strongly in December, as an early Brexit moved closer to certainty. The details must still be worked out, and British stocks will probably remain volatile right up to, and even after, an actual Brexit. The rally in Britain helped pull up all European stocks for the month, although the gain for the Euro STOXX 50 blue-chip index trailed the U.S. by a significant margin. The star of the month and year was certainly Greece, which has made significant progress since the dark days of default and potential “Grexit.” Greek stocks gained enough in December to reach a five-year high, up 50% for 2019! The new center-right leader has boosted business confidence, and the Greek economy is now growing again. The most recent data shows faster economic growth in Greece than in Germany, which is still flirting with recession. Even more amazing is that Greek government 10-year debt has a lower yield than U.S. 10-year debt!

Japanese stocks added more gains in December to finish the year ahead about 20%. The 2020 Olympics should provide a temporary boost to the economy, and monetary policy will remain stimulative. The government has also announced new spending plans that will drive the economy forward. A reduction in trade tensions between the U.S. and China should also help the Japanese. Chinese stocks, as measured by the Shenzhen 300 index, soared in December as news hit of a “Phase 1” agreement with the U.S., plus a new burst of stimulative monetary policy (a reduction in banks’ required reserves) pushed stocks up more than 5% for the month and 35% for the year. Nonetheless, Chinese stocks still remain well below their “bubble” high set in 2015.

Outlook

U.S. stocks remain in one of the greatest bull markets in history. The economic outlook is still constructive after almost eleven years of economic growth, and monetary policy is still accommodative. 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.