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Market Update: December 2019

Stock prices closed out the year with a surge, leaving investors with exceptionally high returns for the calendar year. Global stock indexes advanced over 3% in December and nearly 9% for the quarter … a welcome rebound for investors who suffered through last year's decline. U.S. and international stocks ended the calendar year with returns of 31.01% and 21.51%, respectively.
Declining yields also gave bond investors solid returns during 2019. The 10-year U.S. Treasury currently yields 1.9% … well below the 2.7% yield to begin the year. It's rare to see both risky and safe assets with such strong performance, and the extent of these gains hasn't been seen in over 35 years.

> **I would start 2020 by saying it's unlikely that we'll see another year where everything's positive.**
>
> **Erik Knutzen, Neuberger Berman – WSJ 12/23/19**

Bolstered by easy money policies by the Fed, a strong labor market, and solid consumer spending, the U.S. economy has been extremely resilient. Still, the trade dispute between the U.S. and China could escalate, inflation could heat up, and geopolitical complications can ignite at any time. Everyone is eager to give their market predictions for 2020 and beyond … but most of it is just noise.

> **Part of the problem with making predictions is that we are wired to be reasonable ... The market, though, is rarely reasonable ... Everyone else may be looking at the bright side. We have our doubts.**
>
> **Ben Levisohn - Barron's 12/27/2019**

The Dow Jones Industrial Average has climbed more than 170% over the past 10 years. That ranks as just the fourth-best decade long performance in the past 100 years. Even after such gains, low interest rates and cooling trade tensions could continue to prop up stock prices over the next few years.

> **The headwinds we experienced earlier in 2019 from the trade wars and potential problems with Brexit - those headwinds have diminished sharply. Now that the coast is looking a little bit more clear for the economy, I think it's okay to embrace risk here at this stage.**
>
> **Chris Rupkey, Mitsubishi Financial Group, Inc. - WSJ 1/1/2020**

China is grappling with trade tensions, a slowdown in its domestic economy, a backlash against its treatment of Muslim minorities, and antigovernment protests in Hong Kong. Consumer inflation is rising at its fastest rate in nearly a decade, and economic growth is at its lowest level in three decades. Growth prospects are also constrained by Beijing's concerns over mounting debt levels.

The country's leaders are still aiming for the economy to double over the next decade. Not surprisingly, China started the New Year off by essentially releasing $115 billion of liquidity into the financial system.

> **There are some recent signs of stabilization in the economy, but the slowdown will probably continue. China's central bank is sending a clear message that policy stance won't be tight this year.**
>
> **Liu Xuezhi, Bank of Communications - WSJ 1/1/2020**

China's flagship Shanghai Composite Index is down 6.9% over the past 10 years, one of the rare indexes that finished the 2010s in negative territory. During that same timeframe, the S&P 500 nearly tripled, Europe's Stoxx 600 jumped by 64%, and Japan's Nikkei 225 more than doubled. China's poor stock performance is particularly striking because it comes during a time of strong economic growth.

Lower rates usually bring faster economic growth and inflation. That hasn't been the case with Japan. Fast paced growth of the 1980s lead to asset bubbles in stocks and real estate that were "popped" in the 1990s. Japan's stock market is actually still off nearly 40% from the all-time high reached on 12/29/89. Economic growth has remained muted even with ultra-low government bond yields. All of this has been exacerbated by an aging population.

> **U.S. investors have come to associate Japan's once-mighty economy with slow growth and negative interest rates - a cautionary tale about what happens to investors and markets when developed countries stall.**
>
> **Daniel Kruger - WSJ 12/30/2019**

The after effects of the 2008 financial crisis have elevated concerns that *Japanification* could soon be the destination of other developed economies.

> **And Japan isn't an easily dismissed outlier; it is a free-trading, technologically savvy developed market, in many ways not that dissimilar to the U.S.**
>
> **Akane Otani – WSJ 1/2/2020**

Aging populations are the primary reason the economies of the U.S., Europe, and Japan are experiencing slow growth. While Japan's birthdate is lower and there is less immigration, all three are experiencing a decline in the ratio of workers to retirees … which ultimately leads to reduced consumption and productivity.

> **In terms of interest rates the world has gone toward Japan, but when you look at the underlying structural factors I still think they're very, very different.**
>
> **Marylin Watson, BlackRock - WSJ 12/30/2019**

The Fed certainly doesn't want the U.S. to enter the low-rate, low-inflation, low-growth environment that hampers Europe and Japan. U.S. interest rates are near all-time lows ... but they are still about 2 full percentage points higher than Japan and Germany.

> **It will be almost mechanically impossible to replicate the solid bond returns from 2019 again this year. It's pretty much a guarantee that it will taper off.**
>
> **Guy Stear, Societe Generale - WSJ 1/5/2020**

In 2019, 56 central banks cut rates 129 times, according to data from CBRates, a central-bank tracking service. That compares with 10 central banks that raised rates 20 times. The stock of negative-yielding debt in the world is still more than $10 trillion, although that is down from a high of $17 trillion earlier in the year. Sweden became the first central bank to reverse five years of subzero monetary policy in December, declaring that the policy's problems outweigh the benefits.

> **Heading into the next decade there's going to be a realization that negative policy rates do not work. They hurt pension funds, insurance companies, the banking system, and can stifle needed investment.**
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> **Rick Reider, BlackRock – WSJ 1/2/2020**

If economics were the focus of Dickens' *A Christmas Carol*, the Ghost of Christmas Past would bring us back to the 1970s … a time of weak economic growth and rising unemployment. The Ghost of Christmas Present would display visions of today's thriving markets, the result of years of fiscal and monetary stimulus. The

Ghost of Christmas Future (typically resembling the Grim Reaper) would probably remind us that if something cannot go on forever, it will stop.

> **The U.S. government and the Fed have provided more presents to investors during this long-running bull market run than old Saint Nick himself … Where is all this good holiday cheer flowing? Into financial assets of course … Has feasting on benign inflation, ultra-low interest rates and fiscal policy satisfied our greed? Scrooge eventually succumbed to the Ghost of Christmas Future's warnings – will investors?**
>
> **Michael Arone, SSgA SPDR® – Uncommon Sense 12/2019**

Fiscal and monetary stimulus has given us unemployment levels and interest rates that are at or close to all-time lows. The unintended consequence – deficits have escalated, and we are a world awash in debt. Inflation should be held in check over the near term by the structural headwinds of debt, demographics and technology. But, eventually we will have to come to grips with the fact that growing budget deficits are simply not sustainable.

> **The last decade was about how printing money solves a lot of problems. The next decade will be about the challenges that printing a lot of money can produce.**
>
> **Michael Hasenstab, Franklin Templeton – WSJ 1/2/2020**

This decade has seen tremendous advances, and the next decade should be even better. The trade dispute is really about gaining technological leadership, and as investors we should expect innovations to unfold at an accelerating pace. We find ourselves in a highly-leveraged late cycle economy with elevated stock valuations and low interest rates. Broad diversification will ensure exposure to opportunities and help to reduce the risks inherent in this environment.

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