John Dessauer Investments, Inc.

John Dessauer's market review and update as of Wednesday December 18, 2019

It is that time of year again, when I provide my outlook for the coming year for the economy and financial markets. To prepare, I read a wide range of other opinions, from firms including Morgan Stanley, BNY Mellon, Argus Research, Zacks Investment Management and others. As you probably know, there is a wide difference of opinion among the broader crowd of market pundits. There are the usual pessimists, trying to convince us to sell stocks because the economy is heading for recession and stocks are going into a significant decline. The group of millionaires surveyed by UBS has largely bought the pessimists' siren song. Louis Navellier, a seasoned pro, with an excellent record is far more optimistic. However, most opinions fall somewhere in the middle, mildly optimistic.

The U.S. economy is still growing, but at a slower pace. The drawn-out trade negotiations have taken a toll on the economy, business investment and manufacturing in particular. The good news on trade is that the House of Representatives finally will vote on the new deal with Mexico and Canada. It will easily pass in the House with strong bipartisan support and sail through the Senate to become fully approved by all three branches of government. It is arguably more important than the deal with China. Canada and Mexico are our two biggest trading partners. The U.S. exports five times as much to Mexico and Canada than to China. Experts say the new USMCA deal will create hundreds of thousands of new jobs, and usher in a wave of new prosperity for the U.S., Mexico and Canada. This trade deal will give the U.S. economy a boost and diminish concerns about a recession any time soon.

Otherwise the strong labor market with rising wages is fueling growth in consumer confidence and spending. Combine that with the USMCA deal and in my view, there will not be a U.S. recession in 2020. Quite the opposite, once USMCA is fully approved and in effect I expect the rate of U.S. economic growth to rise above a 2% annual rate. In addition, President Trump has made major progress, forging a phase one deal with China and will not impose the additional 15% tariffs on $160 billion of Chinese goods. This is more good news for the U.S. and China. The now historic U.S. expansion will continue for at least one more year.

The investment team at BNY Mellon describes the current situation as “Equity friendly.” We have low inflation, low interest rates and an accommodative Federal Reserve. It doesn’t get much better than this. Plus, liquidity in U.S. financial markets is improving and even with very low interest rates the U.S. bond market is attractive to foreign investors because they face negative interest rates in several major bond markets. A 2% yield is far more attractive than a minus 1% rate. U.S. interest rates will not go up until global interest rates go up.

BNY Mellon says they see signs that global manufacturing is bottoming out. If so then the next recession may be much further away.

The Standard and Poor’s 500 stock index has had a very good year, up 27.35% so far. The ten-year average for the S&P 500 is plus 13.2%. That makes this year look really good until you take into account the 14% decline in the final quarter of 2018. Adjusting for that decline makes this year look far more average. The obvious question is what can we expect for the S&P 500 in 2020. One part of the answer is that stocks look fully valued. We are not likely to see an expansion in valuation in 2020. Some argue that stocks are overvalued. That might be true if interest rates and inflation were much higher. But both are low and the investment team at BNY Mellon calculates that in this low inflation-interest rate environment stocks are simply fully valued. We are not in a euphoria or overvalued situation, and don't want to be.

For stocks to keep climbing they must be supported by fundamentals, especially sales and earnings.

Earnings growth has slowed. NIPA corporate profits, a very broad measure of U.S. corporate profits was flat through the third quarter. CEOs and CFOs have been very cautious during third quarter earnings conference calls. Clearly U.S. businesses are facing real challenges from the trade war with China, other tariffs and stiff competition at home and from foreign competitors.

We don't know yet what the full impact of the deals with China and USMCA will be for the U.S. economy. But it clearly is very good news and a solid indicator that a full-blown trade deal can be reached with China. Analysts and market pundits will wait for actual results from China phase one and USMCA before revising earnings estimates and market outlooks. But now there is a possibility that business conditions will improve next year.

BNY Mellon thinks the S&P 500 stock index will rise in single digits next year. I agree. But a 5%-8% return on stocks will still be far better than cash or bonds. And there is a possibility that business investment will increase, providing the fundamentals needed to drive stocks up at a double-digit rate.

Both Christmas and New Year fall on a Wednesday. Therefore, my next market review and update will be three weeks from today on Wednesday January 8, 2020. Happy Holidays, Merry Christmas and Happy New Year.

All the best,

John Dessauer