CURBED ENTHUSIASM

As a new decade got underway last month, price trends in global capital markets mostly continued their recent trends through mid-January. Global equities (+2.5%) advanced strongly, with large cap US growth stocks (+4.9%) leading the way. But macro-level global events thereafter – principally, growing concerns about the *coronavirus* in China and its potential negative impact on rates of global economic growth – resulted in a pullback of risk asset prices and strong gains in low risk (e.g., US Treasury bonds) assets across the last half of January. As a result, equity prices finished January with their first monthly decline (-1.1%, MSCI ACWI Index) since August 2019. Rallying bond prices pushed returns on fixed income investments (+1.9%, Bloomberg Barclays Aggregate Index) higher. Developments and investment market outcomes of note included:

- **Coronavirus and contagion:** Responses by China and by governments worldwide to curb the virus's potential spread have created rising uncertainties about the pace of global economic growth in 2020. China's economy – the world's 2nd largest and its largest exporter – is now projected to slow in comparison to earlier forecasts, though it is far too soon to accurately quantify the adverse GDP impact of domestic and international travel restrictions and temporary business closures.

- The **US economy**, consistent with consensus estimates, grew at a +2.1% annualized rate in the fourth quarter of 2019; for the full year it expanded +2.3%. **Consumer spending** slowed somewhat during the year's final quarter, and business investments (in equipment; in structures) were slower across the year's second half in the face of trade uncertainties. **Growth estimates** for the current quarter and for all of 2020 (+1.6% and +1.8%, respectively) suggest a slowing domestic economy but not an end to the expansion that began in mid-2009.

- **BREXIT:** The UK's long-anticipated exit from the European Union became effective as of January 31, 2020. Uncertainty remains, however, as to the exit's near-term and longer-term economic impact; final terms of its trade policies with Continental Europe, and new trade policies with the US and other world economies, remain to be negotiated.

- **US Politics:** The US Senate largely finished its hearings into the impeachment of Donald Trump in January, and the 2020 Presidential Election season kicked into a higher gear as February began. The primaries and the general election alike are anticipated to generate both rising vitriol and record-high spending on political advertising; predictions as to which Presidential candidate's policies will be better/worse for the economy and for capital markets will likewise proliferate in the months immediately ahead, potentially creating greater market volatility.

- **Corporate Profits and Earnings:** The Fourth Quarter 2019 earnings season is well underway, with nearly half of companies in the benchmark S&P 500 Index now having reported quarterly results. Strong gains within the Communication Services and Information Technology sectors lifted prices of those companies that topped expectations; earnings weakness and falling commodity prices (e.g., crude oil, which fell nearly -15% to $52/barrel in January amid concerns about slowing global growth) led to poor outcomes in and projections for the Energy sector. Inclusive of estimates for the balance of companies' quarterly earnings reports, overall earnings for calendar year 2019 are currently projected to be unchanged from those produced in all of 2018 at about $150/share. Net of the market's late January sell-off, US stocks currently sell at a premium valuation (Price/Trailing Earnings) of 21.4x.

- In late January, the **US Federal Reserve** confirmed its target interest rate policy (i.e., a Fed Funds target of 1.75%). This left short-term bond market yields little changed in January. A flight-to-quality rally in bond prices across the second half of January, however, pushed yields lower on long-term bonds. The 10-year Treasury yield, for example, declined 30 basis points (0.30%) to 1.51% on January 31, its lowest level since August 2019.

Barely one month ago (in *A Positive Spin by Rota Fortunae,* our annual review of capital markets*)* we cautioned that the new decade would likely produce its share of *unknown unknowns* that could cause short-term market outcomes to vary from expectations. We did not know then that it would be worries about the coronavirus – and not pre-existing concerns about BREXIT or US politics – that would come to dominate geopolitical and capital market outcomes so early in 2020. At this juncture, much remains unknown about the virus – the pace and the breadth with which it might spread, its mortality rate – and the economic impact of related business and border closures and curtailed consumer spending. We will continue to monitor how virus-related developments are affecting capital markets, and evaluate what, if any, changes should be made to investor portfolios.

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