A Look Back at the Markets in January and Ahead to February 2019

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After a terrible fourth quarter in the financial markets, we had a sizable bounce in January. Markets were up significantly, both here in the U.S. and around the world, and sentiment seemed to change markedly from pessimism to a new optimism. The question going forward is whether things have really changed that much.

A look back

A slow start. January started with the government shutdown, trade talks in limbo, and markets down worldwide. Growth slowed in China, and Brexit (with the failure of the British government to deal with it) dominated the European headlines. This political dysfunction, combined with slowing growth, had taken markets and sentiment down significantly over the past quarter.

Market perception turns. But then something funny happened. Job growth came in much stronger than expected. Consumer confidence, although down, held at healthy levels. Companies reported earnings that were better than expected, showing that they could still make money despite all the worries. Markets started to turn as the economic news didn't follow sentiment.

Risks subside. And then more good things happened. The government reopened, taking a wide set of risks off the table (at least for the moment). Both China and the U.S. reported progress in the trade talks. The Brits still don't have their act together, but at least they are starting to deal with the problems. And, perhaps most important, the Fed delayed raising rates and signaled that it would support the financial markets after all.

Now, none of this solved the outstanding problems. But the fact that things had stopped getting worse—and had a real prospect of getting better—turned market perception around. And, as became clear, it was perception that had driven the decline.

So, what does this changing perception mean for February and the rest of the year?

A look ahead

The risks remain. First, let's be clear that significant risks remain. We have a potentially bigger government showdown on the horizon over the debt ceiling, we do not have a trade deal yet, and growth is still slowing both here and in China. We are not out of the woods, and markets could easily take fright again.

Supportive fundamentals. Even if they do, though, the economic fundamentals are likely to continue to be supportive. Job growth remains very strong. And with the end of the shutdown, consumer confidence may well move back up even higher. China has started a stimulus package, which should help its growth, and the Democrats and Republicans have significant incentives to cut a deal rather than shut the government down again. So, although risks remain, they look less significant and less damaging than they did last month. From an economic standpoint, things are certainly not quite as strong as they were last year at this time. But they are significantly better than what investors were thinking last month.

Markets moving up. You can see that improvement in the markets as well. With the significant gains in January, most stock markets have moved back above significant trend line support and are closing in on bull market levels. Although they are not quite back in rally mode, they seem to be getting there.

Chances are that this trend will continue. Corporate earnings are coming in above expectations, and the combined effects of improving confidence, steady fundamentals, and positive earnings surprises may well keep markets rising through February, despite the risks.

As goes January . . .

It is even possible the gains could extend through the rest of the year. A traditional stock market maxim is that "as goes January, so goes the rest of the year." If so, this year could end up being much stronger than previously thought.

All in all, we start February in a much better place than we would have imagined a month ago. We certainly need to keep an eye on the risks. But for the moment, the trend is up.

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