2019 Stock Market Outlook: 'A Tale Of Two Cities'

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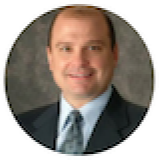

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I help people on their path to Financial Freedom. FULL BIO
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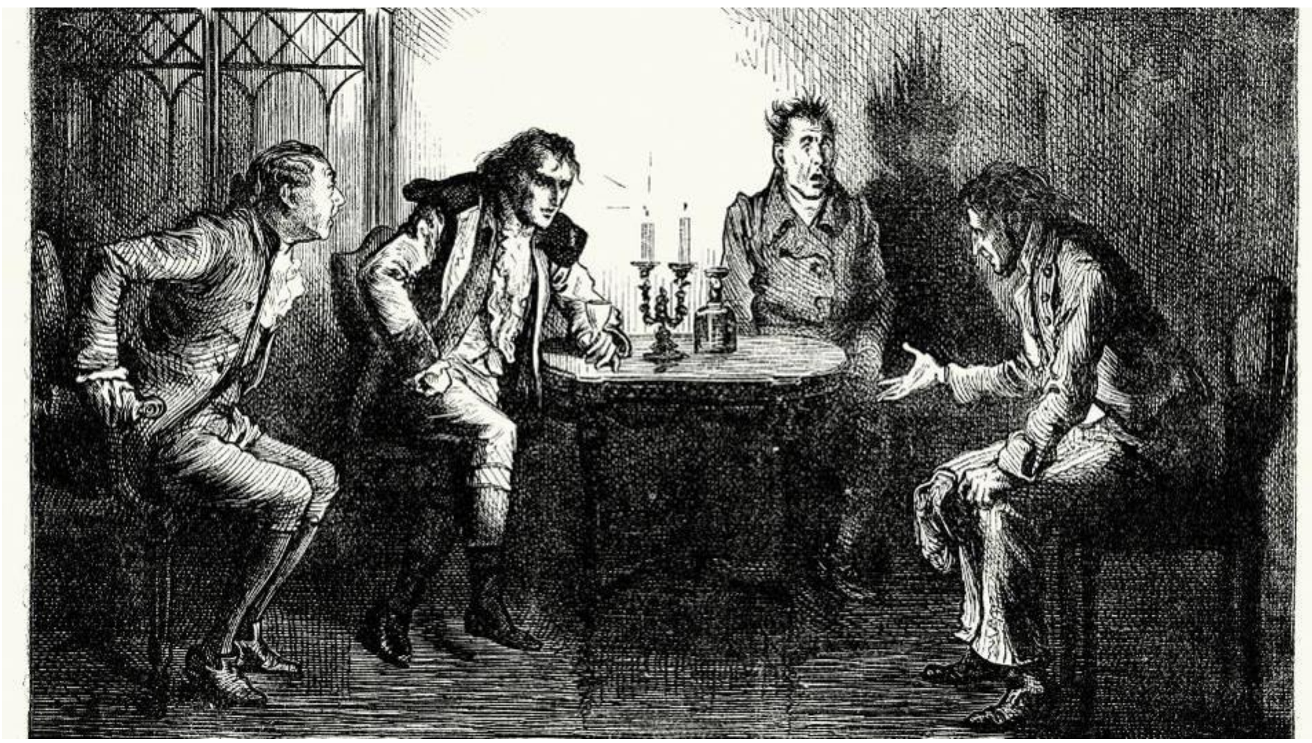
The year-end Holiday Season often recalls Charles Dickens' character Ebenezer Scrooge. However, with the divergence between the strong U.S. economy and most of the rest of the world, I find myself thinking more about his classic novel *A Tale Of Two Cities*. In 2019, investors will face a stark, contrasting choice when making investment decisions.



On the one hand, an optimistic investor can focus on the strong U.S. economic data and our healthy economic fundamentals. While the 2018 daily headlines often rang a tale about chaos and discord in Washington, the economy solidly chugged forward. This year saw U.S. GDP jump above the 3% range, with strength in manufacturing, service industries, and transportation all boosting corporate profits. We also saw a strong U.S. consumer spending at record levels, fueled by a jump in year-over-year wage growth (to over 3%) and unemployment near generational lows of 3.7%. Despite our strong economic growth, we continue to have modest inflation, thanks in part to declining prices of oil. All of these indicators point to a strong economy and are usually considered positives for the stock market.

Alternatively, the pessimistic investor can legitimately worry about global geopolitical and economic uncertainties coming out of Europe, trade tensions with China, slowing global economic growth, and a hawkish Federal Reserve Bank (The Fed) raising interest rates.

European troubles include the uncertainty surrounding the British exit from the European Union, riots in the streets of Paris that go far deeper than just a tax on gasoline, an Italian government in a budget battle with the EU, and Europe's largest bank, Deutsche Bank, in financial difficulty (joining many of Italy's biggest banks). Europe has structural unemployment, a large migrant and youth population that is economically disenfranchised, and ballooning budget deficits.

Another factor further weakening overseas economies has been the trade dispute that the U.S. is having with our European and Chinese trading partners. These trade actions, while legitimately trying to correct some inequities, have been pursued in a highly charged, public manner, which may reduce the probability of a smooth resolution. The net result could be higher costs to consumers and market uncertainty—which is rarely positive for stocks.

On top of these two dramatically different perspectives, we have the wild card of a Federal Reserve Bank that is concerned about the rapid growth of the U.S. economy causing inflation. Because no one can know how the Fed will approach monetary policy (and perhaps he Fed itself is grappling with the best path forward), uncertainty permeates our economic environment.

So the 2019 market outlook is fuzzy but with reasons to be optimistic. Valuations have improved significantly since January, when the forward S&P 'price-to-earnings multiple' (a measure of how stocks are valued) was elevated at over 18. Now that number is 15x forward earnings, which is close to the historical average. So while there are global issues (noted above), we've built a margin of safety with improved stock valuations. The Fed, despite some recent increases to interest rates, is still neutral (Fed Funds rate is about 2.50%, which is near current economic growth and inflation rates). And with slow overseas economies and the decline in oil prices, inflation expectations have diminished, which may allow the Fed to slow down or stop future interest-rate hikes. Another positive is that divided government and gridlock have been historically good for stocks. Anecdotally, each year following the past 14 mid-term elections has been positive for U.S. stocks!

While investors have reasons to remain cautiously positive, if you are concerned about the value of your portfolio in the short run, are retiring soon, or are having trouble sleeping at night, you can consider lowering your stock allocation and reducing risk. Otherwise, barring an unforeseen 'Black Swan' or catastrophic event, it appears the U.S. economy will remain healthy, earnings should rise again (albeit at a much slower rate), and the consumer should continue to be strong. Furthermore, the benefit of the tax cuts, while waning, will still be felt throughout the economy. If the Fed doesn't act too aggressively, stocks could perform well. It's also important to remember that, in the long run, stocks typically outperform cash. As we all know, investing is rarely is a smooth ride, and we expect continued volatility in 2019. So while it may feel good to have cash on the sidelines, it may be prudent to remember that volatility is the price you pay to be invested in stocks.

Contributor's Bio

Mark Avallone is the author of Countdown To Financial Freedom, and founder and President of Potomac Wealth Advisors, LLC a financial advisory firm serving clients through holistic financial planning and wealth management. Avallone writes on a variety of financial topics, and his contributions have appeared in the Wall Street Journal as well as in Forbes where he is a regular contributor. He has appeared on CNBC and has been a repeat guest on the Fox Business Network. His insights have also appeared in USA Today, U.S. News & World Report, The Washington Post, and other leading publications.

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