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# Five issues for investors to watch in January

## Weekly Market Compass: The conflict in the Middle East could pressure business sentiment

**Jan 6, 2019 | Kristina Hooper, Chief Global Market Strategist**

2019 was a great year for markets, and equities delivered strong returns for the year. US stocks led the way at 29.07%, Chinese stocks returned 20.94%, European stocks returned 20.03%, and emerging markets delivered 15.42%.[1] But the ride wasn't always smooth, with ongoing geopolitical sagas (like Brexit) and short-term market events (like the inverted yield curve) rattling markets – and investors' resolve – along the way.

As 2020 begins, some of the issues we're watching remain the same, and others are just beginning to take shape. Below are five issues that we are monitoring closely in January.

### Issues to watch in January

**1. Middle East conflict.** After the US killing of a senior Iranian official in Iraq last week, Iran promised that there would be harsh retaliation. On Friday, Jan. 3, markets had a fairly modest reaction to what could be a significant escalation in Middle East tensions. This made sense, given that it was too soon to know what the consequences would be, and there seemed a good likelihood that, similar to the Iranian drone strikes on Saudi oilfields in September, this would not result in any significant increase in conflict. US President Donald Trump attempted to de-escalate the situation over the weekend by saying the US was not seeking regime change in Iran and was not trying to start a war. However, the market might have a more marked reaction in the coming days given that, over the weekend, Iran announced its withdrawal from the nuclear weapons accord, which suggests it may move forward with the creation of a nuclear weapon, and Iraq voted to expel the US from the country. Some experts suggest that Iranian retaliation could come in the form of a cyberattack that could be crippling for US businesses. I suspect that the Fed will continue to be the dominant factor for markets, which should provide support for stocks despite concerns about Iran-related turmoil. We will want to follow the situation closely, paying particular attention to business sentiment for any signs of deterioration.

**2. Trade.** Trump announced plans to sign the Phase 1 US-China trade deal in Washington, DC, on Jan. 15. It seems clear that the deal will be signed, although it is still unclear whether China will commit to actual purchase levels of US goods. But what is positive for China could be negative for the European Union if the US decides to turn its attention to the EU and begin a trade war with it. We will want to closely follow the rhetoric from Trump and members of the administration who are responsible for trade policy. A trade war with the EU could have a negative impact on the already weak eurozone economy – the most recent economic data remains largely disappointing – and spillover effects on business sentiment and economic growth globally.

**3. Brexit.** With the holidays over, UK Prime Minister Boris Johnson and Parliament will get to work on final legislation that will allow Britain to formally leave the EU on Jan. 31. However, the problem remains the very tight deadline he has set for arriving at a comprehensive trade deal with the EU by the end of 2020. Johnson has resisted asking the EU for an extension and, in my view, this is unnecessarily increasing economic policy uncertainty, even raising the possibility of a "crash out" from the EU. We will want to follow the negotiations closely in the hopes that a deal can be reached quickly – although I would not hold my breath on this.

**4. The Federal Reserve.** The Federal Open Market Committee (FOMC) recently released the minutes from its December meeting, and they show that the Fed is comfortable with its current monetary policy stance. The new "dot plot" indicates that the Fed's current policy prescription is no rate cuts in 2020 – although I believe it is more important to focus on the reality that the bar remains high for any rate hike. The Fed remains worried about inflation being too low. and it will be important to see if the central bank continues to indicate a willingness to overshoot its inflation target. We will want to follow the Fed closely for any signs that it may change its stance, although that seems unlikely for 2020 as the Fed appears comfortable with hitting the "pause" button on rate moves for an extended period of time. The caveat is that if the Fed were to somehow become even slightly more hawkish, that could be problematic for US stocks.  We will get our first opportunity to hear from the Fed this week when NY Fed President John Williams speaks in London at a panel on the future of inflation targeting.

**5. Emerging market stocks.** While US stocks were the standout performer for calendar year 2019, emerging market stocks outperformed the US in the fourth quarter (11.36% versus 8.60%).1 One important catalyst for that performance was the end of balance sheet normalization, which occurred in September. In particular, China had a strong fourth quarter, with Chinese stocks returning 14.64% for the last three months of the year.1 We will be watching to see if this trend continues, especially given the continued stimulus in China. For example, just last week the People's Bank of China cut the reserve ratio requirement. I, for one, am excited about emerging markets equities, especially Chinese equities, and will be following them closely.

**Source**

[1]Source: Bloomberg, L.P. as of Jan. 6, 2020. US stocks represented by the MSCI USA Index, European stocks by the MSCI Europe Index, Chinese stocks by the MSCI China Index and emerging market stocks by the MSCI Emerging Markets Index.

**Important information**

The yield curve plots interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates. In a normal yield curve, longer-term bonds have a higher yield. An inverted yield curve is one in which shorter-term bonds have a higher yield than longer-term bonds of the same credit quality.

Brexit refers to the scheduled exit of the UK from the European Union.

The Federal Reserve's "dot plot" is a chart that the central bank uses to illustrate its outlook for the path of interest rates.

The reserve ratio is the portion of reservable liabilities that commercial banks must hold, rather than lend or invest. This requirement is determined by each country's central bank.

The MSCI USA Index measures the performance of the large- and mid-cap segments of the US market.

The MSCI Europe Index is an unmanaged index considered representative of European stocks.

The MSCI China Index captures large- and mid-cap representation across China H shares, B shares, Red chips, P chips and foreign listings (e.g., ADRs).

The MSCI Emerging Markets Index captures large- and mid-cap representation across 26 emerging markets countries.

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