

A December to remember for the global economy

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December is shaping up to be a momentous month for the global economy and markets. Following are some reasons why:



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The global economy

China's changing COVID policy, central bank meetings and inflation expectations promise to make this a memorable month for the global economy.

Equity markets

For markets, December has historically tended to be a good month for risk assets, inspiring the term "Santa Claus Rally" to describe late December surges.

The Federal Reserve

But this year, markets have largely been driven by the Fed, and earnings warnings could exert downward pressure on stocks.

1. Changes to China's COVID policy.

China is making meaningful and positive alterations to its COVID policies. Last week China announced a new initiative to encourage further vaccinations for the elderly, and it has also recently relaxed its COVID testing requirements in some major cities. This news has been very well received by investors, who have driven up Chinese stocks. And it has been reported that China may announce this week a new, less stringent set of national COVID policies that could be stimulative for the economy, which could provide another strong boost to Chinese stocks.

2. China's growth target.

Senior policymakers in China will meet in mid-December for the Central Economic Work Conference (CEWC) in order to agree upon key economic policies for the coming year. All eyes will be on the growth target set for 2023 – specifically whether the target will be 5% or above. I expect it will be 5% or above, and that there will be supportive fiscal policies to help China reach that target. In addition, the People's Bank of China recently cut its reserve requirement ratio, and I expect its supportive policies to continue. This could set the stage for significantly stronger economic growth in 2023.

3. The Tankan Index.

This index helps us take the temperature of the Japanese manufacturing sector, and it's expected that the upcoming reading on Dec. 14 will show conditions have improved since the previous quarter. However, some recent economic data points from Japan have disappointed, such as retail sales. A disappointing Tankan Index could suggest a less-positive outlook for the Japanese economy and weigh down Japanese stocks in the short term, despite a supportive central bank.

4. US Inflation measures.

I'm especially keeping an eye on the US Consumer Price Index (CPI) and Producer Price Index (PPI), as well as preliminary inflation expectations from the University of Michigan. While I do believe that a 50 basis point rate hike in December is almost a "fait accompli," there is a small chance the Federal Reserve (Fed) could hike 75 basis points instead. I don't believe that the higher wage growth in last week's jobs report would be enough to prompt a higher hike on its own; however, if it is followed up with higher-than-expected inflation or inflation expectations, it could change the Fed's mind. Recall that in June, the Fed had communicated it would only hike rates by 50 basis points. However, just a few days before the rate announcement, both

CPI and Michigan inflation expectations were higher than expected, and the Fed pivoted to a 75 basis point hike. And so these upcoming readings have a small chance of influencing the Fed's decision in December, although most likely they will just contribute to higher volatility.

5. Bank of Canada meeting (BoC).

Canada has been at the vanguard of central banks downsizing rate hikes, so it's good to keep an eye on the BoC. Canada is also facing many of the same challenges as the US economy, with a tight labor market and high wage growth; it also has run the risk of slowing its economy too much because of its "fast and furious" rate hike cycle. Like the US yield curve, the Canadian yield curve has experienced a deep inversion. The Bank of Canada was initially expected to hike rates by 50 basis points at its December meeting, although there is a growing likelihood of a 25 basis point hike. A 25 basis point hike, in my view, is more likely and would ease the pressure on the Canadian economy — as well as lead the way for other central banks to follow in normalizing the size of rate hikes.

6. The Federal Open Market Committee.

FOMC economic projections and the accompanying press conference are scheduled for Dec. 14. At the end of the day, markets aren't focused on December's rate hike — they're focused on what the terminal rate will be and when the Fed will hit the "pause" button, because that will help dictate how the stock market performs and when an economic recovery can unfold. And it is the FOMC press conference as well as the "dot plots" that will give us a far better idea of that.

7. The European Central Bank (ECB).

It looks like inflation may have peaked in the eurozone, increasing the likelihood that the ECB will downshift to a 50 basis point hike at its Dec. 15 meeting. However, at a recent conference, ECB President Christine Lagarde disagreed that inflation had peaked and warned about the danger of letting inflation expectations become unanchored, which suggested she may err on the side of greater hawkishness in reinforcing ECB credibility.

Watching the markets

December has tended to be a good month for risk assets, inspiring the term "Santa Claus Rally" to describe late December surges. It's been the third-best month for both the S&P 500 Index (since 1950) and the NASDAQ Composite (since 1971), and the second-best month for the Russell 2000 Index since 1979.¹ International stocks also have historically participated in Santa Claus Rallies. For example, the FTSE 100 Index's average monthly return for December is 2.55%, the MSCI Emerging Markets Index's average return is 3.18%, the MSCI EAFE's average return is 2.34%, and the Hang Seng's average return is 1.79%.²

But this year, markets have largely been driven by the Fed and other central banks because of their historic monetary policy tightening, and so I expect these central banks will likely continue to have an outsize impact on stocks in December. In addition, lowered earnings

revisions could exert downward pressure on stocks. Therefore, I expect significant volatility for the month, although the bias is likely upward given historical trends. I suspect this will be a December to remember for the global economy – and markets – as we get ready for 2023.

Notes

¹Source: The Stock Trader's Almanac 2023, written by Jeffrey Hirsch and Christopher Mistal

²Source: Bloomberg, L.P., from 1990 through 2021

Important information

Past performance is not a guarantee of future results.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

All investing involves risk, including the risk of loss.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

Investments in companies located or operating in Greater China are subject to the following risks: nationalization, expropriation, or confiscation of property, difficulty in obtaining and/or enforcing judgments, alteration or discontinuation of economic reforms, military conflicts, and China's dependency on the economies of other Asian countries, many of which are developing countries.

The Consumer Price Index (CPI) measures change in consumer prices as determined by the US Bureau of Labor Statistics. Core CPI excludes food and energy prices while headline CPI includes them.

The Producer Price Index is compiled by the US Bureau of Labor Statistics and measures the average change over time in the selling prices received by domestic producers for their output.

The Survey of Consumers is a monthly telephone survey conducted by the University of Michigan that provides indexes of consumer sentiment and inflation expectations.

The Tankan is a quarterly assessment of business conditions in Japan that is issued by the Bank of Japan and used to formulate the nation's monetary policy.

The survey is conducted among Japanese businesses. A reading greater than 0 represents favorable conditions, while a number less than 0 represents unfavorable conditions.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

The NASDAQ Composite Index is the market capitalization-weighted index of approximately 3,000 common equities listed on the Nasdaq stock exchange.

The Russell 2000® Index, a trademark/service mark of the Frank Russell Co.®, is an unmanaged index considered representative of small-cap stocks.

The FTSE 100 Index includes the 100 largest companies in terms of capitalization listed on the London Stock Exchange.

The MSCI Emerging Markets Index captures large- and mid-cap representation across 26 Emerging Markets (EM) countries.

The MSCI EAFE Index is an unmanaged index designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the US and Canada.

The Hang Seng Index is an unmanaged index considered representative of the Hong Kong stock market and includes the largest companies traded on the Hong Kong Exchange.

The reserve requirement ratio is the percentage of depositors' balances banks must have on hand as cash.

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

The Federal Open Market Committee (FOMC) is a 12-member committee of the Federal Reserve Board that meets regularly to set monetary policy, including the interest rates that are charged to banks.

The terminal rate is the anticipated level that the federal funds rate will reach before the Federal Reserve stops its tightening policy. The federal funds rate is the rate at which banks lend balances to each other overnight.

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

A basis point is one hundredth of a percentage point.

Tightening is a monetary policy used by central banks to normalize balance sheets.

The opinions referenced above are those of the author as of Dec. 5, 2022. These comments should not be construed as recommendations, but as an illustration of broader themes. Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions; there can be no assurance that actual results will not differ materially from expectations.