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Buoyantly optimistic markets got off to a running start this year but were soon checked by growing concerns over a highly disruptive viral epidemic in China. Efforts to contain the outbreak are likely to put a temporary—but not lasting—dent in global economic growth, which has been trying to turn the corner out of a slow patch. Despite these headwinds, solid consumer confidence continues to drive positive U.S. economic momentum.

Annual U.S. GDP growth for 2019 came in at +2.3%, a perceptible slowdown from +2.9% in 2018. Growth in the final quarter beat much lower expectations at +2.1%, unchanged from Q3. Most of that—a full point and a half bump—came from a narrower U.S. trade deficit, but that was mainly due to a sharp −8.7% drop in imports—not necessarily a good sign, given that consumption growth slowed and business investment declined for a third straight quarter. Though the U.S. trade deficit shrank slightly in 2019 after widening the prior two years, in real terms, the year saw no growth in U.S. exports, reflecting a slowing global economy as well as ongoing tensions over trade.

Consumption growth slowed from +3.2% in Q3 to +1.8% in Q4. U.S. consumer confidence, however, remains strikingly strong, supported by steady jobs and income growth. The U.S. economy added +225,000 jobs in January, far surpassing expectations, and initial jobless claims remain near 50-year lows. Personal income in December was up a solid +3.9% from a year ago, while consumer spending was up +5.0%. Retail sales were up +5.8%, compared to a weak December last year. While auto sales remain tepid at 16.9 million vehicles in 2019, down from 17.2 million in 2018, the housing market has seen an impressive rebound. Residential investment grew +5.8% in Q4, its second straight quarter of solid growth after a year and a half long downturn. New home sales in December were up +23.0% from a year ago; new housing starts were up +40.8%. The ISM Non-Manufacturing Index, which rose +0.6 points in January to 55.5, continues to show most of the U.S. economy in expansion mode.

The ISM Manufacturing Index, which has been in contraction for five months, showed a new glimmer of hope in January, jumping +3.1 points back to (modest) expansion territory at 50.9. New orders, including new export orders, also flipped into positive territory—an encouraging sign for the struggling manufacturing sector. Still, its recovery has some ways to go to reach solid ground. Industrial production slipped −0.3% in December, down −1.0% from a year ago. Though orders for durable goods surged a welcome +2.4% in the year's final month, they were still down −3.6% compared to last December. Business investment fell −1.5% in Q4, its third straight quarter in decline. Businesses also pared back their inventories as the year came to a close, shaving more than a full point off GDP.

Manufacturing's nascent rebound may face a setback from China's coronavirus outbreak, which has placed sizeable chunks of global supply chains on lockdown. While the latest official numbers, showing a slowdown in the daily rise in confirmed cases, suggest that the country's drastic control measures may be having some success, they come at a cost. Many millions of workers remain displaced following the Chinese New Year holiday, business and tourist travel has been halted, and stores and factories across China are shut down. The key question is how long this unprecedented quarantine will go on. A few weeks will do little lasting harm as companies around the world draw down their China-sourced inventories and restock once the interruption has passed. A few months could put a more noticeable dent in global growth and corporate earnings, beyond China.

Reports that China's oil demand plunged −20% in January has sent oil prices tumbling to their lowest levels in over a year. That is likely to weaken inflation, which had been edging upwards on rising oil prices, giving the Fed room to move to soften a shock from China, if necessary. U.S. Treasuries have rallied, once again partially inverting the yield curve, signaling both renewed concern over global growth and calculations that the Fed could resume cutting rates, if growth begins to stutter.

The S&P 500 Index ended January down −0.2%, following a vigorous three-month rally, which has pushed the end-of-quarter 12-month trailing P/E ratio above 20.5x for the first time in two years. With 61% of companies reporting, last quarter's operating earnings per share (EPS) for the S&P 500 is expected to be up +11.8% from a very dismal Q4 a year ago. That is largely due to the financial sector, however; six out of eleven sectors are expected to see quarterly earnings down year-on-year. Compared to Q3, earnings for Q4 are expected to have slipped −1.6%, while annual EPS growth for 2019 is estimated at a more modest +3.6%, bolstered by record share buybacks at the start of the year. The road for corporate earnings is expected to remain challenging, at least through the first quarter.

The cash flow premium to investors in U.S. equities, as opposed to low-yielding safe harbors, remains historically elevated at 5.2%. The virus outbreak in China is a reminder that surprises can seemingly come out of nowhere. It is fear of those surprises, which the long-term investor can usually ride out, that is keeping interest rates and inflation low, an environment that—despite its short-term hazards—favors investors willing and able to accept equity risk.

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