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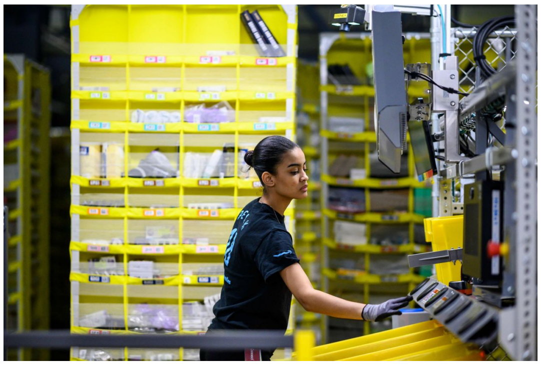
MARKETS

History Shows Rebound May Have More Legs as Dow Extends Rally

There are multiple factors driving this year's stock performance following the fourth quarter's bruising selloff



The popular FAANG stocks, which include Amazon, are rising again. PHOTO: JOHANNES EISELE/AGENCE FRANCE-PRESSE/GETTY IMAGES

By Jessica Menton

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U.S. stocks extended their winning streak to nine consecutive weeks and are on track for their biggest early-year advance in three decades, a dramatic turnaround that has given investors renewed faith in the nearly 10-year bull market.

A more flexible approach to monetary policy from the Federal Reserve, easing U.S.-China trade tensions and a better-than-feared corporate earnings season have encouraged investors to ease back into the stock market, following the fourth quarter's bruising selloff.

The Dow Jones Industrial Average and technology-heavy Nasdaq Composite, along with the small-cap Russell 2000, notched their ninth straight weekly gain, while the S&P 500 rose for the fourth consecutive week.

All four indexes rose more than 0.6% Friday amid continuing hopes for a trade deal between the U.S. and China ahead of a March 1 deadline when tariffs on some Chinese imports are set to rise. President Trump has signaled some potential for greater White House flexibility on the matter this week, sparking modest stock-market gains.

"This year's gains are consistent with investors being confident that nothing scary is on the horizon," said Charles Lemonides, portfolio manager of ValueWorks LLC. "We're in a 'goldilocks' place where the economy isn't running too hot, so therefore the Fed likely won't tighten policy further, and it's not running too cool because we still have a strong labor market. And when it comes to trade, any news is good news."

Both the Dow and S&P have surged more than 11% to start 2019, on pace for their biggest two-month surge since 1987 and 1991. The indexes are sitting at 3% and 4.7%, respectively, below last year's all-time highs. Volatility has also eased this year: The Cboe Volatility Index, or VIX—also known on Wall

Street as the “fear gauge”—has fallen for nine consecutive weeks, its longest-ever losing streak.

Those trends could bode well for the rest of the year: The Dow and S&P move in the same direction in the first two months and remainder of the year more than 60% of the time, according to Dow Jones Market Data.

In 1991, the last time the S&P 500 climbed more than 10% in January and February, it rose an additional 14% over the following 10 months, according to DJMD. And in the other five years when the index added at least 10% to start the year, it rose more than 6% from March through December three times.

The two cautionary tales: 1931, in the midst of the Great Depression, and 1987, the year known for Black Monday. In both cases, the S&P 500 rallied at the beginning of the year before suffering a major crash.

Among the risks that have given some investors pause this year are the looming deadline for a trade agreement, a projected slump in corporate earnings and slowing economic activity in China and Europe.

“Sure, the Fed and trade are giving investors some confidence that all is well, but I’m still not confident,” said Ken Moraif, senior adviser at Money Matters, a Dallas-based wealth management and investment firm, who said he advised clients to sell equities in the fourth quarter. “Are we unhappy that we missed this rally? Of course, but we don’t see much that has changed since the December swoon.”

Traders are looking for more insight into the Federal Reserve’s interest-rate path when chief Jerome Powell delivers his two-day semiannual monetary-policy report on Capitol Hill on Tuesday and Wednesday. The Fed signaled in January that it plans to hold off on further rate increases as officials monitor mixed inflation data and concerns on slowing global growth.

Investors will get their next snapshot on the health of the economy Thursday when the Commerce Department releases its initial reading on fourth-quarter gross domestic product.

They keep a close eye on those figures because robust business activity typically translates to higher corporate profits. Many investors had worried that the tariff battle between the U.S. and China, along with higher borrowing costs, would threaten to put a dent in corporate profits. However, with results in from about 90% of the companies in the S&P 500, fourth-quarter earnings are up 13% from a year earlier, according to FactSet. Estimates, though, suggest that momentum will stall this year, partly because of fading windfalls from the tax overhaul.

Some investors point to signs of breadth in the recent rally as an encouraging sign. The S&P 500’s industrials sector has led the way in 2019 with an 18% gain, followed by the energy and technology groups, which both have risen 14%..

“The character of who’s leading a rally really matters,” said Willie Delwiche, an investment strategist at R.W. Baird. “You want to see cyclically sensitive areas like industrials and consumer discretionary do well as evidence that the economy is on firmer footing than people might have otherwise thought.”

Another bullish sign for stocks: The NYSE advance-decline line, a popular indicator of market breadth that tracks the number of stocks rising minus the number falling each day, has hit new highs. Meanwhile, 91% of S&P 500 stocks on Friday were trading above their 50-day moving average.

The popular FAANG stocks— Facebook Inc., Amazon.com Inc., Apple Inc., Netflix Inc. and Google parent Alphabet Inc. —are rising again after last year’s tumble, but only two, Netflix and Facebook, are outperforming the S&P 500. That may not be a bad thing: Some analysts are encouraged to see broader participation in the market rebound across other sectors.

“In order for a rally to really take shape and be long term, you have to have market breadth,” said Nick Giacoumakis, president and founder of New England Investment and Retirement Group. “By having a much broader advance-decline line, that signals this is a rally that potentially has more legs.”

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