U.S. Stocks Rose Last Week After Refocusing on Fundamentals

The risk aversion that prevailed in the wake of the U.S. drone strike in Iraq dissipated quickly last week, replaced by a focus on fundamentals that resulted in stocks resuming their ascent. The S&P 500® Index added 0.9 percent last week, more than reversing its 0.2 percent loss from the prior week. Brent crude oil retreated as well, falling $3.62 to $64.98 a barrel, where it was last in mid-December. The VIX index fell, while gold came off its high, but still managed a small gain for the week, as did the ten-year note yield. It closed the week at 1.82 percent, up from 1.79 the prior week, but down from its Wednesday high of 1.87.

Whether we have seen the last of the U.S.-Iran confrontation for now remains to be seen.

U.S. Data is Soft, Yet Indicates Continued Strength for the Consumer, Manufacturing

Last week's economic calendar was headlined by the December jobs report, which came in slightly softer than expected, but was nevertheless strong enough to suggest the labor market remains healthy. The economy created 145,000 new non-farm jobs. That was below the 160,000 consensus, and the prior two-month total was revised lower by 14,000 as well. In addition, the pace of hourly wage growth moderated to 2.9 percent year-over-year, down from 3.1 percent in November. The length of the average work week in November was revised lower by 0.1 hour and remained there in December. Taken together, these data points suggest some moderation in worker income growth. The report was strong enough, however, to maintain the unemployment rate at 3.5 percent, and reduce the underemployment rate to 6.7 percent.

There were several other encouraging economic reports last week. Both the flash and ISM non-manufacturing reports rose during the month, as did factory orders-ex-transportation in November. And the Bloomberg Consumer Comfort Index rose to its highest level since September 2000 (although from there it took a precipitous plunge as the dotcom bubble popped). The calendar in the week ahead is loaded with reports on prices, housing, and retail sales, but the focus will be on earnings.

Next, All Eyes Turn to Fourth Quarter Earnings

According to FactSet, fourth quarter earnings are now expected to decline by 2 percent. With the typical aggregate result exceeding expectations, the implication is for the quarter to produce a small gain. Revenues are expected to grow by 2.6 percent.1 With earnings growth sluggish throughout 2019, the 28 percent gain in the S&P 500 index last year has pushed the trailing P/E to 21.8X and the forward

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P/E to 18.7X according to Bloomberg data. Both are well above their historical averages. Analysts expect earnings growth in 2020 to be approximately 9 percent, but that could prove optimistic. But even if that level of growth materializes, will it be enough to push stock prices higher, or simply allow them to grow into their already inflated valuations? A lot will depend on whether the global economy improves throughout the year, and whether the manufacturing sector can return to relative stability. The Fed appears to be on hold indefinitely, and that will provide an important support for stocks. But earnings matter and will need to start growing again at some point if stocks are to push higher in the new year.

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1S&P 500 Earnings Season Preview: January 10,2020, FactSet Insight.

The Standard & Poor's 500 Index (S&P 500® Index), an unmanaged index of common stocks, is frequently used as a general measure of market performance. The index reflects reinvestment of all distributions and changes in market prices but excludes brokerage commissions or other fees.

The Chicago Board Options Exchange (CBOE) Volatility Index (VIX) is a widely used measure of market risk. It shows the market's expectation of 30-day volatility. The VIX is constructed using the implied volatilities of a wide range of S&P 500 index options.

It is not possible to invest directly in an index.

Brent Crude is a major trading classification of sweet light crude oil that serves as one of the two main benchmark prices for purchases of oil worldwide.

The Institute for Supply Management (ISM) manufacturing index is a national manufacturing index based on a survey of purchasing executives at roughly 300 industrial companies.

The Bloomberg Consumer Comfort Index measures Americans' views on the U.S. economy, personal finances and the buying environment. 150 consumers are surveyed weekly; the index tracks a moving average of 1,000 responses.

Past performance is not a guarantee of future results.

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