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Best January performance in 30 years

The US equity market measured by the S&P 500 index registered its best January performance in 30 years. It climbed by 7.9% marking the most positive start to the year since 1987 when it had rallied by 13.2%. Moreover, it is worth noting that the January 2019 performance marked the strongest monthly gain since October 2015.

Statistical studies conducted in the US suggest that stock market returns in January are a good precursor of returns over the next 11 months. This is known as the 'January barometer'. Since 1950, the measure of January's performance to predict the trend for the rest of the year has worked 87% of the time.

Following the best January in three decades, should 2019 be a good year for equity markets?

The performance of the past month must be viewed in the context of the significant decline during the previous three months especially in December 2018 when international equity markets crashed and the S&P 500 shed 9.2% after partially rebounding during the last few days of the year from a decline of 15% until the third week of December. Such a negative performance for December was also an outlier since it was the biggest loss for the final month of the year since 1931. Despite the sharp upturn during January 2019, the S&P 500 index is still below its level at the end of November 2018 and moreover the current reading of 2,706.53 points is 8% below the all-time high of 2,940.91 points recorded on 21 September 2018.

Many investors may be surprised at the extent of the volatility and the reasons for such wild swings from one month to the next.

The sharp sell-off in December was mainly due to concerns that the Federal Reserve had not yet reached a "neutral" interest rate indicating that it would need to continue to increase interest rates. The prospect of higher rates weighed particularly heavily on growth stocks such as the largest technology-related companies. The share prices of many of these companies all suffered losses in December namely Alphabet (-5.8%), Amazon (-11.1%), Apple (-11.7%), Facebook (-6.8%) and Microsoft (-8.4%). These equities had accounted for a sizeable part of the significant rally in equity markets in previous months and years. Moreover, the negative performance of these equities during the last few weeks of 2018 was also due to the warnings issued by Apple and Amazon that their crucial holiday season may not be as positive as many analysts had been predicting.

On the other hand, at the start of the year, the Federal Reserve Chairman Jerome Powell had some soothing comments when he stated that given the muted inflation readings, the central bank would need to act patiently to see how the economy evolves before proceeding with further interest rate hikes. This was confirmed at the recent Federal Reserve meeting last week when it was announced that the central bank would be "patient" in increasing interest rates further.

The dovish outlook from the Federal Reserve due to an expected economic slowdown and optimism over US-China trade talks lifted investor sentiment and also led to a weaker US Dollar which is positive news for the share prices of the major US multinationals. President Donald Trump told reporters last week that he hoped to strike a deal with China before the deadline of 2 March. Failure to reach such a deal would result in a significant hike in tariffs on Chinese goods.

Apart from the soothing comments by the Federal Reserve as well as optimism over US-China trade talks, the start of the reporting season produced some reassuring performances from a number of the large companies across the US and Europe. Share prices of several of the largest capitalised companies in the US registered remarkable gains after their results announcement. For example, the share price of Boeing jumped by more than 6% after the company announced that its Q4 financial performance was better than expected and projected another year of strong profitability growth in 2019. Also, the share price of General Electric initially jumped by 18% after it announced that revenues in the fourth quarter of 2018 were better than forecasts.

Share prices of some of the large technology-related companies also rallied as a result of previous muted expectations following warnings in late 2018. Apple’s share price climbed 6.8% after slightly beating quarterly earnings forecasts and reporting a record earnings per share, while Facebook initially gained 13% after its quarterly results topped analysts’ estimates.

It is worth noting that despite the rally in January 2019, several financial experts on Wall Street have a median target of 2,950 points for the S&P 500 for the end of 2019, representing a potential gain of 9% from the current reading of 2,706.53 points.

With respect to the Maltese equity market, the MSE Equity Price Index lost 1.8% as only five share prices posted gains during the first month of the year. The strong performances by Malta International Airport plc (+8.6%) and GO plc (+7.1%) were not sufficient to offset the declines suffered by 15 equities. The main contributors to the overall decline in the equity benchmark were Bank of Valletta plc (-4.5% to its lowest level since October 2009), HSBC Bank Malta plc (-5.5%) and Simonds Farsons Cisk plc with a drop of 8.6% as the equity failed to rally back to the €8.75 level following the one-day decline on 16 January.

Although the ‘January barometer’ provides interesting statistics of the performance across US equity markets since the 1950’s, the overall direction of equity markets during the course of 2019 will be largely shaped by the notable upcoming economic and political developments such as the US-China trade negotiations and the unpredictable outcome of the Brexit impasse.

Meanwhile, the overall performance of the Maltese equity market is largely dependent on company specific developments. The upcoming annual reporting season starting on 19 February when HSBC Bank Malta plc publishes its 2018 financial statements will shed important light on the health of the companies listed on the Regulated Main Market of the Malta Stock Exchange. Another important imminent event is the commencement of trading in the shares of BMIT Technologies plc which is due on 18 February and the announcement expected a few days earlier on the extent of the over-subscription of this sizeable equity offering. A successful debut on the secondary market as we had experienced when PG plc was admitted to trading in the first half of 2017 could help overall investor sentiment towards the local equity market.