We think stocks will climb a rockier road ahead, as the U.S. economy and earnings grow more slowly in 2019 and volatility remains high. But a return to slower growth rates can lengthen this long economic cycle, and global prospects could improve. Realistic expectations and a few adjustments can help keep you sure-footed in the year ahead.

Solid fundamentals support the aging bull market
U.S. economic growth accelerated in 2018 due to the tax cuts and higher government spending. As those effects fade in 2019, we expect growth to decelerate from near 3% to about 2.5%, a pace that's faster than average in this long-running expansion. Expansions don’t die of old age, and we don’t see signs of a recession ahead.

Earnings of S&P 500 companies rose more than 20% in 2018 according to FactSet, improving their valuations. We expect earnings to decelerate to 7%-8% in 2019 as costs rise, and stocks could rise in line with earnings as they have in the past.

Interest rates edge higher
We expect the Federal Reserve to continue slowly raising short-term interest rates as long as inflation remains near 2% and economic growth stays solid. Longer-term rates are also likely to increase due to a growing economy, expectations for higher short-term rates, wage increases and the effects of tariffs on import prices. Short- and intermediate-term bonds and cash can help reduce portfolio volatility and limit the impact of rising interest rates.

International prospects could improve
Slower global growth and a strong dollar have weighed on international stocks, which lagged U.S. stocks in 2018. Foreign rates remain low and monetary policies are designed to boost economic growth in Europe and Japan. We think international stocks reflect a pessimistic outlook, which could improve if global economic growth accelerates, the dollar falls, trade tensions with China ease or some of Europe’s political uncertainties are resolved. We recommend adding broad-based developed-market and emerging-market equity investments if appropriate.

A rockier road ahead
Stocks became more volatile in 2018 as investors reacted to greater uncertainty about the outlook and worried about prospects for higher interest rates, slower earnings growth and rising international tensions, including higher tariffs. We don’t think these concerns will vanish in 2019, which is why we expect normal volatility to continue. Pullbacks can be opportunities to add quality investments at lower prices. To help address higher market volatility, we recommend reviewing your portfolio and adding the following if appropriate:

- Short- and intermediate-term investment-grade fixed-income investments to rebalance to the appropriate mix of stocks and bonds based on your comfort with risk and long-term goals.
- Small- and mid-cap U.S. stocks as well as large-cap stocks—the 2018 pullback lowered valuations, and stocks could benefit from solid earnings in 2019.
- International equity investments in developed and emerging markets, where prospects could improve.

This cycle has been lengthy, and in our view slower growth rates could help the later stages last longer than many expect. Don’t let a rockier road darken your outlook.

Kate Warne, Ph.D., CFA, is Principal, Investment Strategist at Edward Jones.

Past performance does not guarantee future results. Investors should understand the risks involved in owning investments, including interest rate risk, credit risk and market risk. The value of investments fluctuates, and investors can lose some or all of their principal.

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