

ECONOMIC & MARKET REVIEW

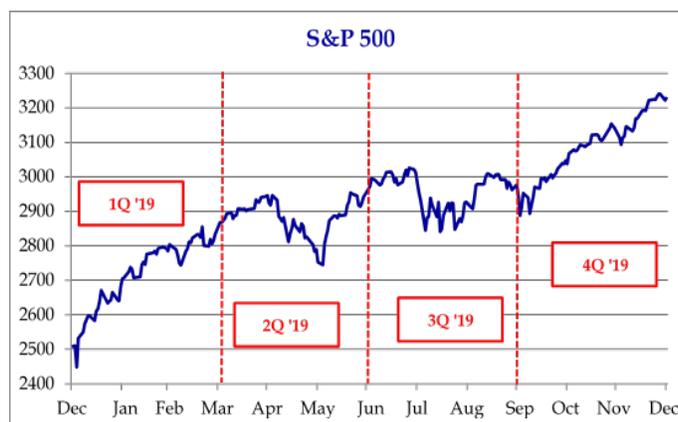
Fourth Quarter 2019

2019 ends on a high note

For multi-asset class portfolios, everything worked in 2019. The longest bull market in stocks continued its run as 2019 finished with a flourish. As you can see from the returns listed above, everything performed well. The equity market had the wind at its back as returns bounced, after taking it on the chin hard in the last quarter of 2018 with a -13.5% slump. 2019 got off to a fast start and kept going, finishing the year with a 31.5% return. The S&P 500 set 35 new all-time highs and is up 498% since its low point in March 2009.

Q4 and Year to Date Investment Performance

	Q4	YTD
S&P 500	9.07%	31.49%
Russell 2000	9.94%	25.52%
Barclays Aggregate	0.18%	8.72%
MSCI EAFE	8.21%	22.66%
MSCI EM	11.93%	18.88%



Source: Factset Research. As of 12/31/2019

2020 interest rate outlook: "Steady as she goes"

Beginning in December 2015, the Federal Reserve

raised rates nine times over the course of three years. The collective impact of those hikes coupled with trade issues raised concerns that the U.S. economy was poised to slow in 2019. Recognizing the slowdown potential and an inflation rate that was below target, the Fed lowered rates three times in the second half of the year. While these cuts prompted an immediate positive psychological influence on market participants, rate movement from central banks generally takes at least a year to affect the broader economy. This means we can expect to see the impact of the 2019 rate cuts by the summer of 2020. The Fed has said they will allow inflation to exceed their target, as inflation has been below their goal for a decade; for 2020, we should expect little in the way of Federal Reserve rate moves.

Trade issues still loom despite the Phase 1 deal with China

Trade was high on the list of concerns in 2019. The Phase 1 trade deal, announced in December, really did not amount to much: The U.S. reduced some tariffs and the Chinese agreed to buy additional farm products. The most important Chinese-related issues for the U.S. are the theft and forced transfer of intellectual property and allowing more U.S. companies to compete in the Chinese marketplace. Those issues remain unresolved. However, what the agreement did accomplish was removal of the risk that trade related issues were going to get worse, maybe much worse.

Consumers have plenty of reasons to be confident

The U.S. consumer continues to be a positive for the economy as confidence is high for a

number of reasons. Unemployment claims are at a 50-year low, with the unemployment rate at only 3.5%. Wage hikes, stable to higher home prices and all-time highs in the equity markets have led to strong consumer confidence. Consider that rank and file employees are seeing wage growth twice that of their managers, and there are 7 million unfilled jobs in the U.S. We start 2020 with 70% of the economy — consumers — in good shape.

Manufacturing remains slow due to trade issues, but may be ready to tick upward

The manufacturing portion of the U.S. economy remains slow. Trade issues have clearly impacted manufacturing, both in the U.S. and around the world. However, trends in the closing months of 2019 indicate that global manufacturing may be nearing the bottom. It would clearly be a positive for world economic growth not to have the drag from manufacturing.

What could possibly go wrong?

It is not a short list. At the top is the potential for inflation to be hotter than expected. We have had a long downward slide in inflation for 50 years. Now there is an entire generation of investors who have never seen an inflationary environment. Over the last decade, fixed income funds, ETFs and individual bonds have attracted massive inflows. Bond investors have scrambled to chase increasingly lower yields. Also related to the bond market is a concern about yield spreads, which are at historic lows. More than 50% of investment grade bonds are BBB rated, the lowest rung of investment grade ratings. Even more concerning are high yield bonds, whose spreads are also at all-time lows. High yield bonds are often being issued with few, if any, covenants. Covenants are used to protect lenders (bond buyers) in the event the company's financial condition begins to deteriorate.

Low interest rates could fuel inflation

In a world of very low interest rates, it is the retired individual investor who has been hit the hardest.

My concern is that the potential exists for inflation to return later in the year. Central banks have created the kindling for inflation by keeping short term rates near zero and plying the economy with rounds of quantitative easing. Until now, there has been no match to light the inflationary fire. I wonder if a notable jump in money supply, increasing wages resulting from a tight labor market coupled with a significant number of states raising minimum wages, will lead to inflation. I think this possibility is not currently on the radar of many investors.

2020 outlook – positive, but not a rocket ship

I expect a positive, single-digit return for stocks in 2020, coupled with slightly higher interest rates. 2020 will not be an elevator ride higher for equity prices. While GDP growth will probably be weaker in the first quarter, related to the production cuts announced by Boeing, 2020 growth should average 2% or more. We close 2019 on a bit of a roll, as both economic news and overall market performance has been strong. Not surprisingly, the impeachment drama, continued trade issues and the coming election will combine to inject more volatility into the market. In our favor, we have the lagged impact of monetary policy, a substantial improvement in consumer net worth, and significant decreases in mortgage rates to look forward to this year, all of which will help the U.S. economy in 2020.

Here's to a great 2020!



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December 31, 2019

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