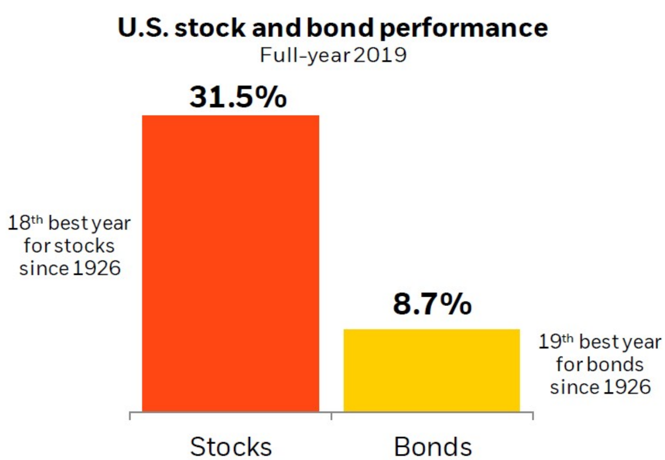
Quarterly Update – December 2019

The 4th quarter of 2019 was very strong from a returns perspective. The S&P500 set new all time record highs, rising 9.07% and finishing the year up 31.49%. New all time highs were also made by other US equity indices, including the Dow Jones Industrial Average, the NASDAQ, and the Russell 2000 (US small cap) index as they increased 6.67%, 12.17%, and 9.94% respectively during the quarter. The annual performance for these indices were exceptional as well. The Dow was up 25.34%, the NASDAQ rose 35.23%, and the small caps gained 25.52% for the year. The international markets were positive, but underperformed the US market. The international index (MSCI EAFE) was up 22.01% while the emerging markets (MSCI EM) gained 18.42%. According to T. Rowe Price, there were 90 rate cuts from central banks across the globe.[1] These rate cuts helped the global bond market perform very well. The Barclay's Aggregate Bond Index was relatively flat in the 4th quarter but ended with a fantastic year up 8.72%. [2]

Since 1926, this was the 18th best year for stocks and the 19th best year for bonds. Only 4 other years (1985, 1989, 1995, and 1997) have been better for the combination of stocks and bonds. According to the chart below, if history is any guide, we can expect a positive year from both stocks and bonds again in 2020. In the previous four occurrences, the average return the following year for stocks was 16.72% and bonds returned 9.15%. We don't anticipate that type of return will occur for bonds in 2020, but we are optimistic about the outlook for stocks.



Only 4 years have been better than 2019 for both
Out of 94 years since 1926, full-year performance

			Following year	
	Stocks	Bonds	Stocks	Bonds
1985	31.7	22.1	18.7	15.3
1989	31.7	14.5	-3.1	9.0
1995	37.6	18.5	22.7	3.6
1997	33.4	9.7	28.6	8.7
2019	31.0	8.7	?	?

[3]

As we have discussed in earlier commentaries, much of the annual return in 2019 was the market recovery following the very sharp decline in the 4th quarter of 2018. As the year progressed, the markets were bolstered by improving investor sentiment. Sentiment continued to rise as trade negotiations between the US and China progressed, the US employment picture stayed strong, and the Federal Reserve cut interest rates. In addition, as these issues were being sorted out, the US consumer continued to spend and support the economy.

[1] Source: T. RowePrice, "2019 Year in Review"
[2] Source: Morningstar Advisor
[3] Source: Blackrock, "Student of the Market" p.3

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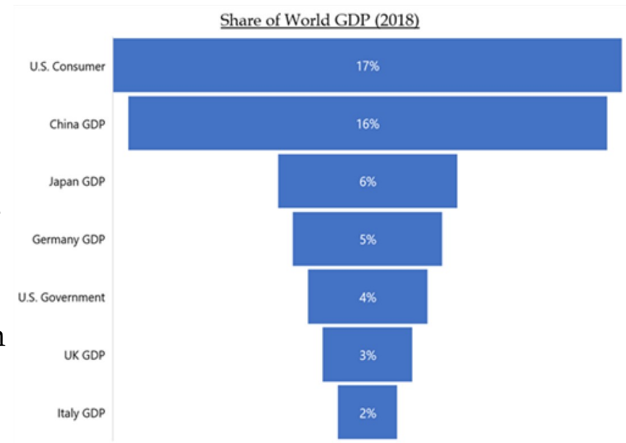
Looking back, 2019 was a great year. That's in the past and now we must move our attention to the issues and opportunities ahead in 2020. There are always a list of issues to worry about. The issues that we believe may have the most impact on investors this year are: trade negotiations with China, political uncertainty around the impeachment of President Trump and the upcoming election.

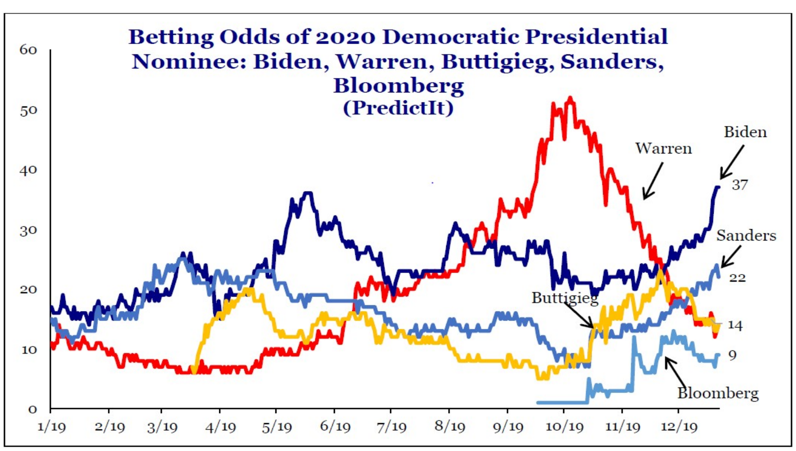


[4]

With the US and China coming to an agreement on "Round 1" issues, we have seen this problem move to the back burner for a while. If China does something to back away from the terms of the deal, you may see a significant negative reaction from the market. But for now, the short term truce is good for both countries. In addition, it is also good for global growth considering these are the two largest economies in the world.

We expect the political uncertainty in the US may be a "thorn in the side" of investors in 2020. Not only do we have to handicap the probable results from the recent impeachment, but we also have to evaluate the possible market reactions to the election results in November. We expect there will be a resolution to the impeachment sometime soon. It appears the US Senate is already leaning towards acquittal of President Trump. We believe this result is already factored in to the market so the impact of impeachment will be negligible.

The election, however, may have a meaningful affect on the market. Typically, in a Presidential election, the market simply waits out the uncertainty of the outcome which leads to short term volatility. Then investors make portfolio adjustments based on the results. However, the 2020 election may bring more volatility than normal. Obviously it will take months to determine the Democratic nominee, but we expect the market will have very different reactions to the nomination of some of the current frontrunners. Warren and Sanders both have signaled an inclination to raise taxes (or create new taxes such as a wealth tax) to pay for new federal programs. Regardless of the political view of these programs, we would not expect the market to react positively to either candidate becoming the Democratic nominee. We think the market reaction to Biden or Bloomberg as the nominee should be relatively neutral.



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[4] Source: Strategas, "2019 Year in Review" p.9
[5] Source: Strategas, "2019 Year in Review" p.64

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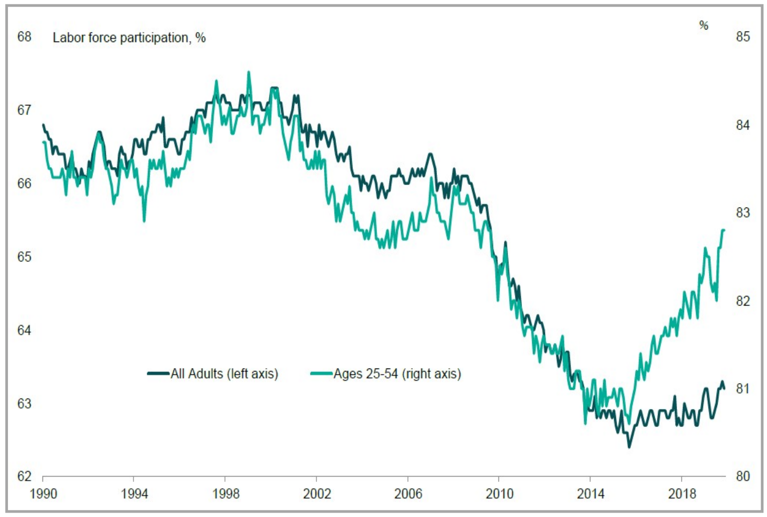
Regardless of the economic and political issues facing the US in 2020, we firmly believe there is no recession on the near term horizon and risk assets like stocks may continue to perform. The US employment picture has been great in 2019 and we expect that to continue in 2020. As employment improves, there are more consumers with money to spend. Typically the younger portion of the population spends a higher percentage of their income than those that are older. The chart to the right shows the labor participation rate in the US vs the labor participation rate for middle age adults. The labor participation rate is the percentage of people working relative to the number of people looking for work. You can see from the light green line, the dramatic improvement in employment for those age 25-54.



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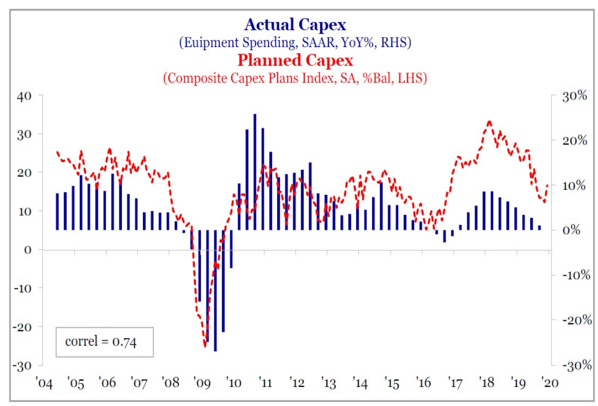
In addition to a strong consumer, we believe that an improvement in capital spending may contribute to this ongoing economic expansion. Given the changes in monetary policy combined with political and trade uncertainty, corporate capital spending has been significantly lower than anticipated. In the chart to the right, the red line plots the expected capital spending and the blue bars show the actual amount. Clearly a meaningful gap for the last few years. If this trend reverses as the trade situation improves, it will be a very good sign for future growth.



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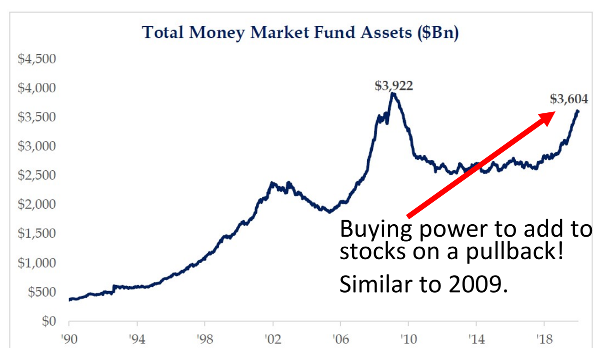
We believe the best investment opportunities in 2020 will be companies benefiting from long term secular growth. Because the market has performed so well over the last few years, most of these companies are trading at (or near) fair value. We believe many of these companies still have upside considering they are growing both revenues and earnings at a higher rate than the market. We believe companies in the technology, health care, and consumer sectors will benefit from current growth trends. Since there is almost as much cash on the sidelines as there was at the end of the last recession in 2009, we expect investors may add to these growth companies during market pullbacks.



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[6] Source: Nuveen, "2020 Global Lookout" p.10
[7] Source: Strategas, "2019 Year in Review" p.16
[8] Source: Strategas, "2019 Year in Review" p.22

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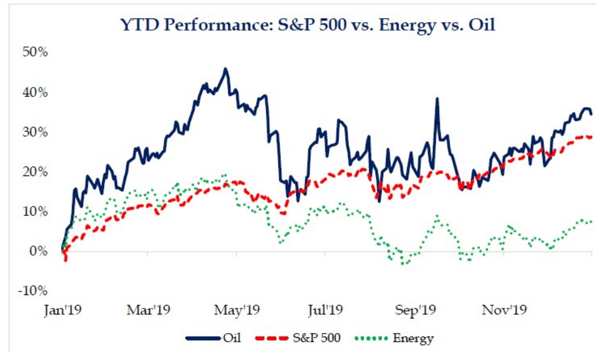
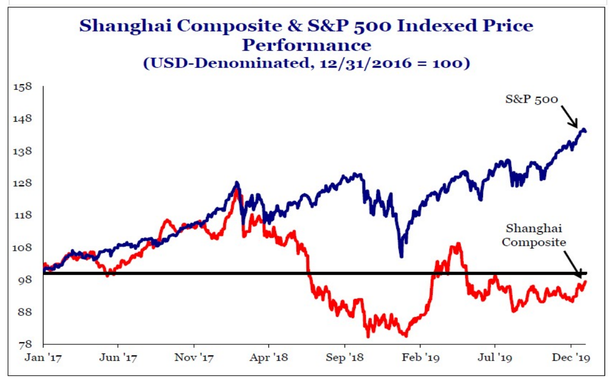
We also think there are a few undervalued investment opportunities to evaluate. Two that we are currently following are US energy and international stocks. Us energy stocks have dramatically underperformed both the price of oil and other US stocks over the last year. We believe the stocks may potentially perform well as energy companies increase production, reduce debt, and improve operating margins. In fact, Strategas Research estimates the energy sector will grow earnings over 20% in 2020. A meaningful improvement over 2019.



[9]

We also believe that Emerging Markets stocks are undervalued relative to their long term growth potential and positive demographics. Primarily because of trade/tariff issues, China stocks have underperformed meaningfully over the last year (see chart to the right). We think emerging markets stocks may benefit from a rebound in China as they have implemented new stimulus measures and are expected to sign "Round 1" of the new trade deal with the US on January 15th.



[10]

While we concede there are headwinds for the market to overcome, but we expect stocks to perform well in 2020. Given the political landscape, we fully expect more volatility this year than last, but we don't expect an economic recession. Our eyes are wide open to the potential pitfalls in the market, but we maintain our optimism for 2020.

Lynn Shaw	Lynn Shaw II	Kevin Dallas
Managing Director	1st Vice President	Sr. Investment Portfolio Analyst

[9] Source: Strategas, "2019 Year in Review" p.45
[10] Source: Strategas, "2019 Year in Review" p.48