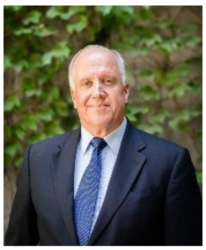
# 2019 – 4th Quarter Review & 2020 Outlook

## Economic and Investment Review

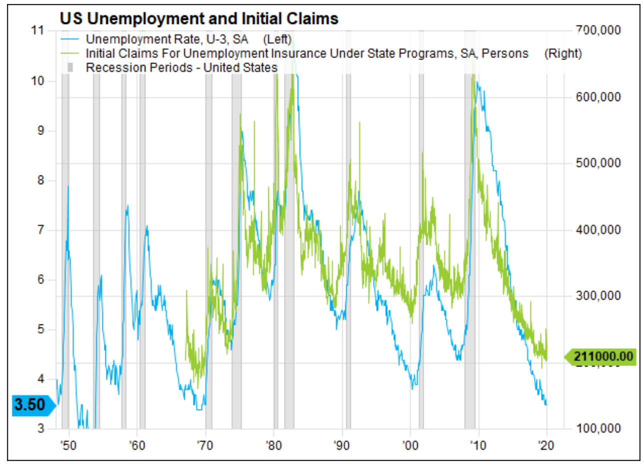


**Mark Anderson**

Chief Investment Officer

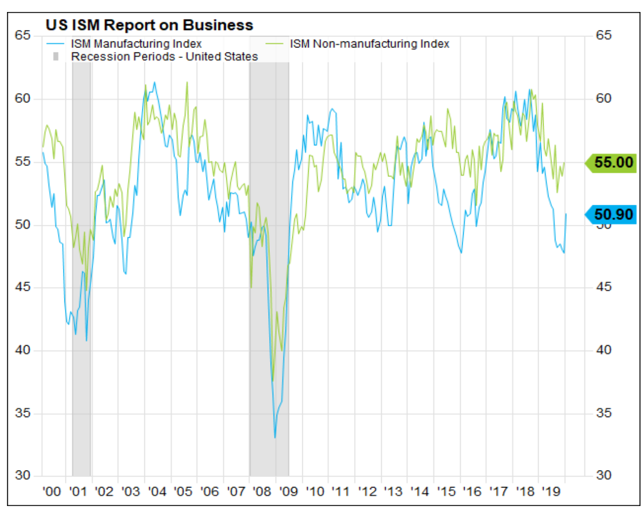
**Economic Growth:** The first preliminary reports for fourth quarter and 2019 GDP showed growth of 2.1% and 2.3% respectively. Fourth quarter GDP was ahead of the consensus estimate of 1.8% and the preliminary number for the full year matched the consensus estimate of 2.3%. This compares with 2.9% for 2018 and 2.4% for 2017. The estimate for 2020 continues to indicate further moderation to 1.8%. Dr. David Kelly, Chief Global Strategist for JPMorgan Asset Management, expects GDP growth to come in a little bit below 2.0% for the year. Conversely, global growth is expected to grow from an estimated 2.9% in 2019 to 3.3% in 2020. The improvement in global growth is based on an expectation that a number of countries that have recently been experiencing slower growth will move closer to historical norms. The case for improving global growth is supported by ongoing monetary stimulus in a number of countries and an improving trade picture. Completion of Phase 1 of the trade deal with the U.S. and China should work to improve stability. The caveat may be the eventual impact of the Wuhan Coronavirus on trade and productivity.

Consumer spending should continue to be the engine for the domestic economy. Consumer confidence remains high due to a very good employment environment and wage growth that exceeds the rate of inflation. The unemployment rate is currently at its lowest level in over fifty years.




Source: FactSet

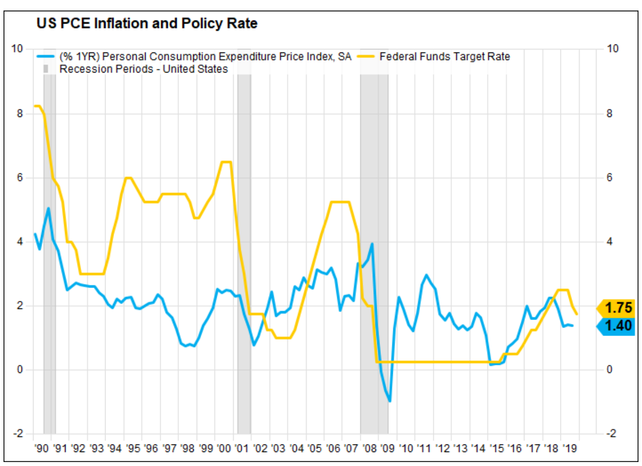
Domestic manufacturing moved from contraction to expansion in January 2020. The Institute for Supply Management (ISM) manufacturing index rose to 50.9 compared with the 48.5 estimate. Domestic manufacturing activity declined during the second half of 2019. Any reading below 50.0 for the index indicates contraction. Contraction of the index is somewhat less concerning than it would have been




Source: FactSet

historically due to the decline in manufacturing as a percent of GDP. Manufacturing only accounts for 11.6% (2018) GDP. However, the index bears watching because every time except once in the last seventy years when the index has dropped below 45 it has been accompanied by a recession. The ISM Non-manufacturing index has also been trending down but remained in expansionary territory at 55.5 in January.

The most recent consumer price index numbers were a bit higher in December at 2.29% for all items and 2.25% for core CPI. However, the outlook for inflation remains moderate. Tariffs, which are reflected indirectly in the inflation data, have added to input costs. The labor force is increasingly tight and costs are rising; however, firms have had mixed success in raising prices of the goods and services that they produce. The Personal Consumption Expenditure Price Index (PCE) is the inflation measure preferred by the Federal Reserve Board (Fed). The PCE number remains below the 2.0% level that the Fed has focused on when making rate decisions. However, the Fed expects inflation to approach 2.0% in the coming months.




Source: FactSet

The lack of inflation allowed the Fed to reduce the Fed Funds target rate by 0.75% in 2019 in an effort to support the economy being hindered by trade and geopolitical issues. Low interest rates will likely continue to encourage investors to tip the scale towards riskier assets in a search for higher income and returns. The European Central Bank and many other central banks also cut interest rates during the year to stimulate growth and to reduce the negative impact of trade wars. Policy rates are not likely to move higher in 2020 which should be a support for economic growth and equity markets.

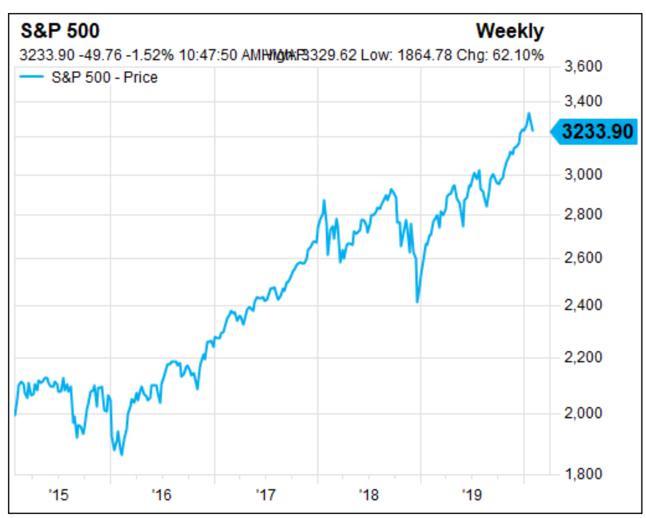
The percentage of economists in the Wall Street Journal Survey forecasting that a recession will start in 2020 has declined significantly from about 35% last fall to about 14% currently.

Business spending was anemic in 2019 but is expected to improve in 2020. Jan Hatzius, Chief Economist for Goldman Sachs, stated that "we expect business investment to recover in 2020 as companies respond to strong demand growth in an environment of diminished recession fear."

GDP for the Eurozone was up only 0.4% (annualized) in the fourth quarter and 1.2% for the year. Both France and Italy saw their economies contract in the quarter. The Wall Street Journal states that "economists don't expect a pickup in economic growth in 2020, although the manufacturing sector is expected to steady as global trade flows level out."

## Equity Markets

Equities returns were exceptional in 2019. Part of the return was in the form of a rebound from the correction in fourth quarter of 2018. Equities performed well despite slower global growth, trade wars, political investigations and impeachment proceedings. Earnings growth was not a driver.




Source: FactSet

Earnings growth expectations for 2019 dropped from near 8.0% at the beginning of the year to only about 1.0% currently. Price/earnings (P/E) multiples rose during the year due to support from low interest rates and relatively good economic numbers.

The S&P 500 was up 9.1% for the quarter and 31.5% for the year.

Mid Cap stocks were up 7.1% for the quarter and 26.2% for the year. Small Cap stocks were up 8.2% in the fourth quarter and up 26.2% for the year.

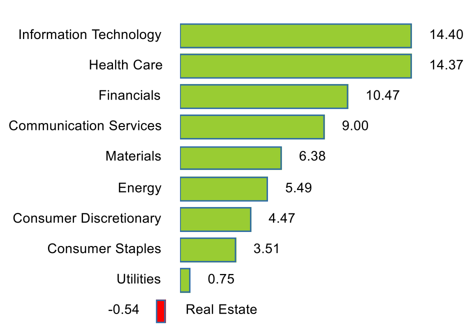
Developed international stocks, as represented by the MSCI EFA index, had their second-best quarter for the year at 8.2% and finished the year at 22.0%. The MSCI Emerging Markets index had its best quarter in 2019 at 11.8% and was up 18.4% for the year. Value stocks slightly outpaced growth stocks for the quarter and year.

| 2019 Q4 Returns | | | | |
|---|---|---|---|---|
| EQUITY | Q4 2019 | YTD 12.31.19 | 1 Year 12.31.19 | 3 Years Annualized |
| S&P 500 | 9.07 | 31.49 | 31.49 | 15.27 |
| S&P 500 Value | 9.93 | 31.93 | 31.93 | 11.49 |
| S&P 500 Growth | 8.32 | 31.13 | 31.13 | 18.66 |
| Dow Jones Ind Avg | 8.96 | 31.15 | 31.15 | 14.83 |
| S&P Mid Cap 400 | 7.06 | 26.20 | 26.20 | 9.26 |
| S&P Small Cap 600 | 8.21 | 22.78 | 22.78 | 8.36 |
| MSCI EAFE | 8.17 | 22.01 | 22.01 | 9.56 |
| MSCI Emerging Mkts | 11.84 | 18.44 | 18.44 | 11.57 |

Source: FactSet

Information Technology continued to post the highest returns for the quarter followed closely by a rebounding Health Care sector. Utilities and Real Estate were the biggest laggards.

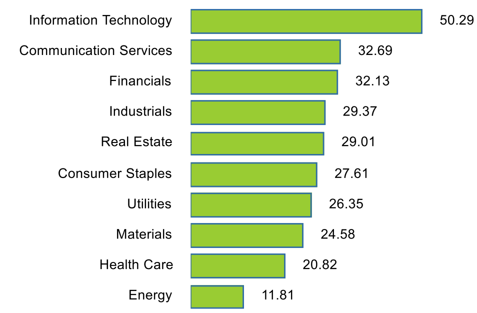
**3 Months Total Return Change - Top/Bottom 5**




Source: FactSet

All sectors were positive for the full year, led by Information Technology. Health Care and Energy were the biggest laggards.

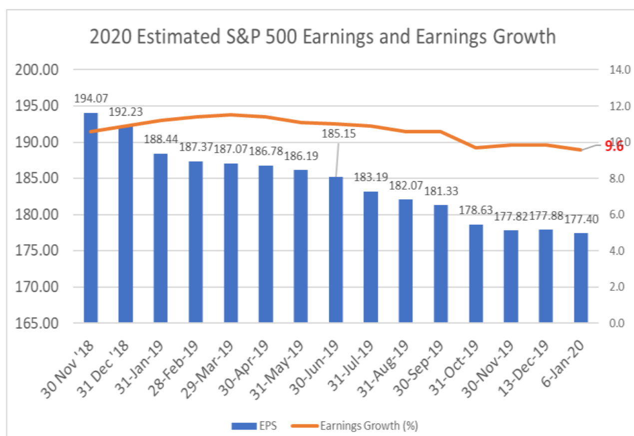
**1 Year Total Return Change - Top/Bottom 5**




Source: FactSet

FactSet reports that for Q4 (with 45% of the companies in the S&P 500 reporting actual results), 69% of the S&P 500 companies have reported a positive EPS surprise (5-year average: 72%) and 65% have reported a positive revenue surprise (5-year average: 59%).

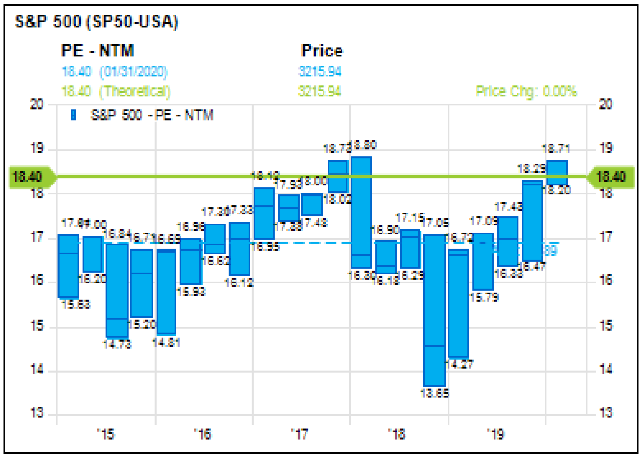
Equity returns for 2020 are not expected to come from price/earnings multiple expansion but rather from earnings growth. Expectations for earnings growth are currently above 9.0% for the year. However, it is fairly normal for earnings expectations to be revised downward as time passes. In order for




Source: FactSet

earnings growth to reach 9.0% margins would have to improve in the face of low unemployment and wage growth.

The S&P 500 is trading at 18.4x P/E for next-twelve-months earnings compared with the 5-year average of 16.9x.




Source: FactSet

Our 12-month forecast for the S&P 500 is 3,335, indicating a low-to-mid single digit return for the year.

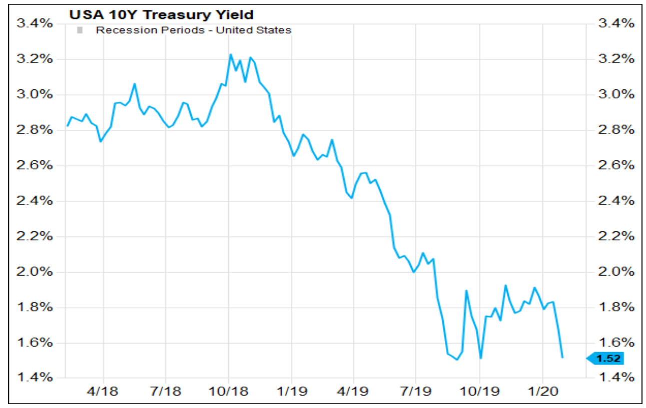
International equities do not appear to be quite as expensive on a relative basis as domestic equities and could benefit from stable global growth, a slower U.S. economy and a declining dollar. However, developed International equity markets suffer by comparison with the U.S. market due to sector weightings. The MSCI EAFE Index (European, Australian and Far East Index) has 22.4% in slower growth Financials compared with 12.5% for the S&P 500 and just 8.2% in higher growth Technology compared with 24.6% for the S&P 500.

Emerging markets should benefit from more stable trade policy between the U.S. and China. However, the Coronavirus will likely disrupt the Chinese economy in the near-term.

## Fixed Income Markets

Return for fixed income investments in 2020 will likely be largely confined to income generated by coupon payments adjusted for premiums or discounts. An allocation to fixed income remains important, not just for income, but also as a tool to manage investment portfolio volatility.

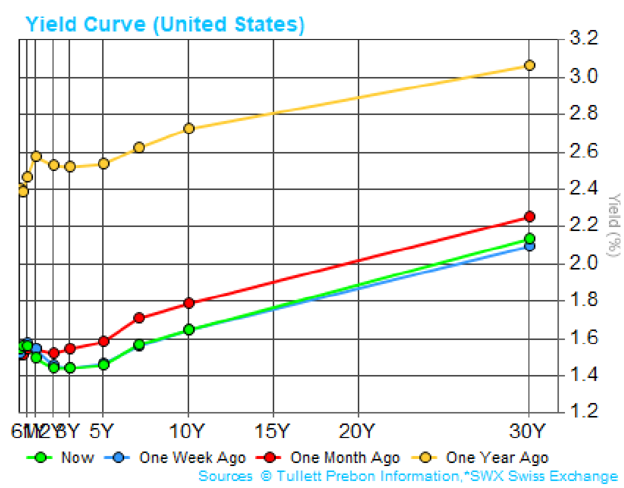
The 10-year U.S. Treasury yield began 2019 at 2.66% and ended at 1.92%. The rate has declined further in early 2020 to 1.64% currently in response to heightened geopolitical tensions, equity valuations and the spread of the Coronavirus.




Source: FactSet

The Fed will likely be on hold through the election in November and will hold tight through a cycle of global central bank easing.

The U.S. Treasury Yield Curve shifted down in relative parallel fashion over the past year. Yields for 1-5-year maturities are below yields for maturities of less than one year due to low inflation, demand from other markets with lower or even negative rates and high levels of liquidity.




Source: FactSet

The Bloomberg Barclays US Aggregate Bond Index was up 0.18% in the fourth quarter and 8.72% in 2019. Municipal bonds, as measured by the S&P National Municipal Bond Index, were up 0.62% for the quarter and 7.42% for the year.

The Markit iBoxx US Dollar High Yield Index was up 2.7% in the fourth quarter and 14.65% for 2019.

## Disclosures

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