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# 2019 Fourth Quarter Commentary

This year-end marks the conclusion of the second decade of this century, and it seems like just yesterday the markets were worried about Y2K. Now is a great time to reflect on the developments of this century so far, and how they set the stage for the future. It is our opinion that we are in the midst of a technological revolution that is changing the structure and model of economic growth, similar to the industrial revolution which occurred around the turn of the twentieth century. During the industrial revolution, productivity was increased through the use of industrial engines to replace manpower and the production line to increase output.

In the twenty-first century we are employing technology and robotics to achieve similar results. We continue to expect productivity gains through continued technological developments in robotics, artificial intelligence, machine learning, internet of things, SaaS, consumer internet, autonomous vehicles and the like. Technology development is expected to continue to expand globally, as will commerce. This suggests that growth capital will continue to invest in sectors and companies that can be disruptive to older systems. I remind you that it was in January of 2007 that Apple unveiled the I-phone, yet in the past 13 years, the smart phone has revolutionized the method of social interaction, communication and access to information. We should all continue to expect more of the same in future years.

Given this backdrop, we will review not only calendar year 2019, but also look at US stock market returns over the past two and ten year periods for perspective purposes. The stock market, as defined as the S&P 500 index, closed 2019 with a flourish and provided an annual return of 28.78% to investors. This return followed the dismal year of 2018 where the index was down 6.59%, and over the resultant 2 year period, the index returned 20.61% or approximately 10.3% per year. During the past ten years, market returns have averaged well over the historical 10% expected return, but it is important to recall that this period began after the fiscal crisis and market collapse which ended in 2009. It shouldn’t surprise you that the market in the past ten year period returned 188.81% or approximately 18.8% per year.

As we look forward, we are reminded of what one of our mentors always said; “the stock market is a gauge of fear and greed loosely connected to economic activity.” What he meant was that the stock market will be driven in the short term by emotion, news and noise, but over time, corporate earnings will drive the valuations on individual companies and their stocks.

Clearly, calendar year 2019 was a time to be greedy, but as we consider 2020, we need to reflect on what's ahead that will likely drive shorter term market movement.

However, there are plenty of areas of concern that investors must consider. The three most likely to create volatility will be US politics, international trade, and foreign policy. These may be countered by the current economic conditions, probable trade resolution and a market friendly Federal Reserve. So once again, we should anticipate volatility in the stock markets.

This year will be dominated in large part by politics and the Presidential election. Of course, first the President will need to resolve the pending impeachment process, but the market's reaction to date suggests that this is not seen as a high hurdle, given the Senate's Republican bias. Furthermore, the continued upward trend of the market suggest that many believe President Trump will be re-elected.

Over the next several months we will observe the process for designating a Democratic contender for the White House. It's our expectation the Democratic race for a Presidential candidate will not create much market turmoil unless we see a contested convention in which a surprise candidate wins. Current polls suggest Elizabeth Warren as front-runner and several analysts suggest that this could create a severe negative impact to the market, as many of the policies espoused by her would increase regulatory costs and potential taxes, which could negatively impact corporate earnings and resultant stock prices.

This view is countered by many political analysts who indicate that, as long as we have a divided Congress, the impact of a Democratic win for President will be muted. Accordingly, there will be much focus on both House and Senate races.

Other risks that investors must consider involve foreign trade and policy. While it appears that the phase one deal with China will be signed shortly, any disruption in that process would likely send the market lower. On the other hand, a completed deal will help improve the outlook for many multi-national corporations who have provided mixed forward looking statements with earnings announcements, as uncertainty over tariff costs and trade restrictions have been difficult to factor.

With the passage of the USMCA deal and the signing of the China trade deal, we should anticipate that President Trump will turn his attention to the EU and begin negotiating a new trade agreement. Should this process become adversarial, we will see a repeat of uncertainty in earnings reports of those companies that rely strongly on trade from Europe. The EU will also be dealing with Brexit, so we anticipate some market volatility from the uncertainty around Brexit and trade.

These concerns are countered by conditions in the US. Domestically, the US is benefitting from a strong consumer as unemployment remains at record lows. Corporate balance sheets continue to benefit from low interest rates, low taxes, share repurchases, and low GDP growth. GDP growth in the US is estimated to be slightly above 2% for calendar year 2019. There are expectations for increased GDP in 2020 based on increased purchasing from China, continued strength from the US consumer, and a continued accommodative policy from the Federal Reserve Board which is likely to keep interest rates low.

Current low interest rates along with current low inflation gauges are two of the factors which support current market valuations. Some analysts argue that the market has gone too far and valuations are stretched. Others suggest that expected GDP growth will help support 2020 earnings projections and that current valuations are further supported by low interest rates and the comparative rates of US Treasuries versus corporate dividends.

Our outlook for 2020, is that we will likely see continued upward movement in stocks, although also a likely reversion towards historical averages, along with increased volatility during the election periods. We remain cautiously optimistic for stocks, and barring any significant surprise from exogenous events, we would expect another good year for equity investors.

Now that equity values are at new highs, it is important to review your overall asset allocation and targets. It is also a good time to discuss your risk management strategy should the unexpected happen. We cannot control the market, only try and anticipate its behavior, but we can control how we react.

Here are some questions to consider and discuss. Has your equity portfolio outpaced your fixed income portfolio in terms of relative value, and is your target for asset allocation in need of rebalancing? Do you have more risk in your portfolio than is desirable? Are you on track to reach your personal goals? Now is a good time to make decisions about adjustments and rebalancing that may be needed to realign your portfolio.

Sincerely,

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