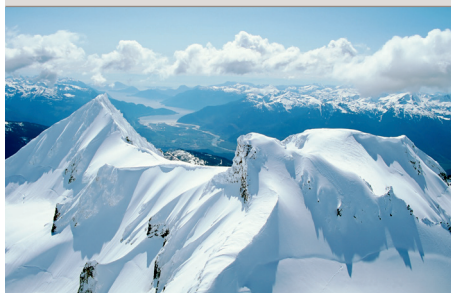


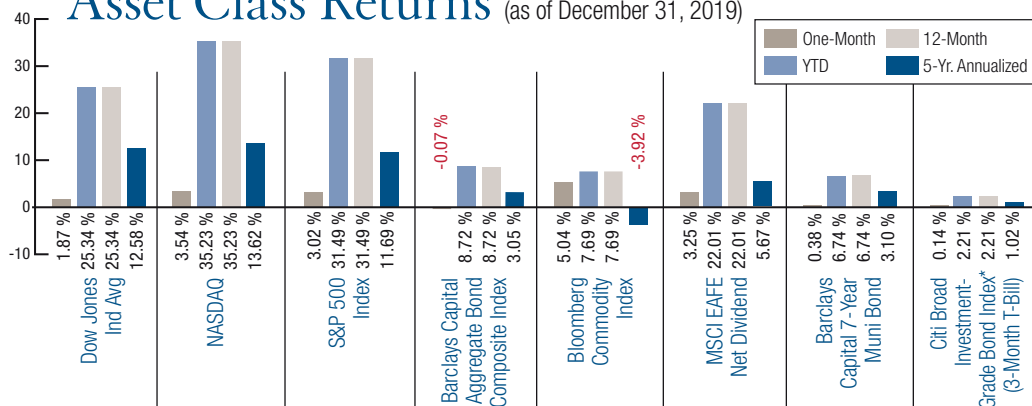
From the Office of Jeff Sgroi, CFP®



"Wealth is not his that has it,
but his that enjoys it."

— Benjamin Franklin

Asset Class Returns (as of December 31, 2019)



Market & Economic Synopsis

- Multiple expansion elevates S&P 500 to all-time highs at year end in 2019.
- Iranian attack of American embassy in Iraq, followed by U.S. drone strike killing top Iranian general, renews military activity in Middle East.
- Strong market performance in most global asset classes in 2019 more than offsets 2018 losses.

- U.S. GDP continues slow, albeit steady and positive, with growth at 2%.
- Unemployment rate remains at multi-decade lows of 3.5%.
- Wildfires ripping through Australia show little sign of letting up.
- Investors rush into safe-haven assets gold and oil as concern of Middle East oil disruption escalates.
- Bernie Sanders' campaign picks up steam; enjoys frontrunner status in Iowa in some polls.

2020 Market Outlook

2019 was a phenomenal year for the financial markets by all measures. As we flipped the calendar into 2020, and I reflected upon the previous year, I appreciated what a reversal we had in the markets over the previous twelve months. Specifically, I recalled walking out of the office on Christmas Eve 2018, on the heels of a 20% drop of the S&P 500, somehow not feeling a great sense of concern going into the final week of the year. As it turned out, fortunes reversed in 2019. We expect the strong finish in 2019 to continue through the new year, as has been the case through the first couple of weeks in January.

Raymond James' Chief Investment Officer, Larry Adam, recently published *Ten Themes for 2020* that he (and I) expect to play a critical role this year.

#1: Keeping a Close Eye on the Economy

The state of the economy is of the utmost importance when evaluating the return potential of the major asset classes. We forecast that U.S. GDP growth will be moderate at 1.7%, but that the current record-setting economic expansion will continue unabated at least through the presidential election. A resilient labor market, robust consumer spending, and a rebound in global growth should be supportive. Although it is rare for recessions to begin in an election year, multiple dynamics will cause us to sharpen our pencils when assessing the economy post-election. Our real-time economic indicators suggest a small probability of a recession over the next twelve months, so keeping a close eye on them will be crucial should the economy meaningfully weaken.

#2: The Fed's Corrective Surgery

When the U.S. economic outlook was clouded by trade tensions and slowing global growth, the Federal Reserve (Fed) performed corrective surgery in the form of three 'insurance' rate cuts. Those

actions recalibrated Fed policy and have extended the duration of the expansion thus far. Knowing that the impact of monetary policy lags, and given that the Fed has limited ammunition with the fed funds target rate at 1.50 – 1.75%, we do not anticipate interest rates will be altered in 2020. The ongoing expansion of the Fed balance sheet will provide stealth easing as it provides further liquidity.

#3: Tunnel Vision on the U.S. Presidential Election

Until November 3, investors will have tunnel vision when it comes to U.S. politics. While Congressional gridlock (Republican Senate, Democratic House) continues to be the likely outcome, uncertainty remains at the top of the ticket. The determination of the Democratic candidate may last well into the summer with an increasing probability of a 'brokered convention' – the first for the Democratic Party since 1952 – the longer the process lasts. If history serves as a precedent, positive economic data leads to a favorable outcome for the incumbent. But given the level of division across the country, the election may be determined by two key swing states: Pennsylvania and Wisconsin.

#4: A Magnified Look at the Bond Market

Investors searching for yield may need to look through the magnifying glass, as global yields and spreads remain near record lows and continue to reduce the upside return for the bond market overall. Due to more moderate U.S. growth, muted inflation, international demand, and favorable demographics, we do not expect the 10-year Treasury yield to move significantly over the next twelve months (year-end target: 1.75%). While credit market spreads will widen slightly, we do not think this will negate the positive performance of our favored sectors—investment grade and emerging market bonds.

#5: See the Bigger Picture for U.S. Equities

Following the best year for U.S. equities since 2013, investors need to see the bigger picture. The macroeconomic backdrop remains supportive with muted risk of a recession, easing financial conditions, and lower interest rates. 2019 performance was largely driven by P/E expansion, but 2020 should renew the emphasis on earnings growth, which we forecast at 5% – 6%. History will play a role too, as election years have been historically positive for the equity market. Since 1936, in presidential election years, the S&P 500 has rallied 9% on average and was positive 86% of the time. In the case of no recession (our forecast), the trend is more impressive with an average return of 10.7% and positive 94% of the time. Our base case is that the S&P 500 will notch new highs and rally to ~3,350 by year end.

#6: Double Vision of Favorite Sectors

We still favor cyclical over defensives, with four of our five favorite sectors being Information Technology, Communication Services, Financials, and Industrials. Our lone defensive choice is Health Care, which lagged the broader market in 2019 due to political risk. This sector selection has us seeing double, as a bias towards these sectors is inherently beneficial to small-cap stocks. From both a market capitalization and revenue perspective, small cap carries its highest exposures and weightings towards these same sectors.

#7: Near & Far Sights for Technology Sector

We envision the technology sector being a stand out again this year. Our near sights are focused on earnings visibility, which remains strong with the anticipated rollout of 5G. The transition from 4G to 5G is the largest enhancement in wireless technology in a decade, so our far sights believe this will be a multi-year catalyst for everything from semiconductors to phone carriers. The benefits should permeate across other industries, keeping demand for new technologies, applications, services, and software resilient.

#8: Blurred Vision for International Equities

Our preference for U.S. equities over international equities was a relatively easy choice over the past several years. However this year, the line between the two is beginning to blur. A possible bottoming in Europe's economic data, attractive valuations on a relative basis, an acceleration in earnings growth, and the possibility of substantial fiscal stimulus packages (especially in Germany) have the potential to propel international equities moving forward. We maintain our view on emerging markets as an appealing allocation for long-term investors.

#9: A Panoramic View of the Dollar and Oil

After rallying six times in the last seven years, a further broad based rally in the U.S. dollar is unlikely. A Fed on hold,

decelerating U.S. economic growth and burgeoning twin deficits will likely keep a stronger dollar out of view. A stable, slightly weaker dollar is a positive for commodities. Specifically, we believe that oil prices will recover to six-year highs by the end of 2020 and rally to \$65/barrel. Our expectation that global oil demand will grow slightly faster in 2020 than 2019 (and mark 11 consecutive years of growth) is supportive of this view. Furthermore, the slow upward movement in oil prices has exerted pressure on the capital budgets of U.S. oil and gas companies which should translate into a sharp slowdown in U.S. oil production.

#10: Volatility is Hiding in Plain Sight

With 2019 being the best year for U.S. equities since 2013 and aggregate bonds since 2002, investor complacency and elevated expectations are evident. However, with relatively more expensive markets versus last year, volatility is hiding in plain sight. From trade wars to impeachment, and from growth concerns to geopolitical tensions, there is no shortage of headline risk for 2020. The burden remains on us to decipher if, and when, any of these headlines alter our economic or asset class views in a demonstrable fashion. Increased volatility and the aging bull market make selectivity at the regional, sector, and individual stock level even more important.

To his credit, Larry Adam did a recap of his *Ten Themes for 2019*, scoring a 90% for accuracy. If his predictions for 2020 prove to be as precise as last year, and we have follow-through momentum from December, we expect another strong twelve months. *All expressions of opinion reflect the judgment of Raymond James & Associates, Inc., and are subject to change.*

From the Homefront

Below is a picture of Stella (9) and Hannah (6) at the top of Buttermilk ski area, ready to offload the Summit Express chairlift. As the name implies, this chair whisks skiers from the base, up 2,000 vertical feet, to the top of the mountain. The 10 minutes I



spent waiting for them at the top were 10 of the more frightful moments of my existence as a parent. This was their first chairlift ride unaccompanied by an adult (which was in large part, my fault, since we were separated on the previous run).

It is difficult to decipher from the picture, but both girls were all smiles at the top. It's one of my favorite all-time photos of them. Wishing you a safe and happy ski season!

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The DJIA index covers 30 major NYSE industrial companies. The NASDAQ represents 4500 stocks traded over the counter. The S&P 500 is a broad based measurement of performance of 500 widely held common stocks. The Barclays Aggregate Bond Index is a diversified index measuring approximately 6,000 investment grade, fixed-rate taxable securities. The Bloomberg Commodity Index is a diversified benchmark for the commodity futures market. The MSCI EAFE index is designed to measure the equity market performance of developed markets excluding the U.S. & Canada. The Barclays Municipal Bond Index is a measure of the long-term tax-exempt bond market with securities of investment grade. The Citigroup Broad Investment Grade Bond Index is market capitalization weighted and designed to track the performance of U.S. dollar-denominated bonds issued in the U.S. investment-grade bond market.

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