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Clear Direction in a Complex World

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Quarterly Insights – January 2020

Happy New Year! Last year proved to be a great year for the US Stock Markets. The solid gains during the fourth quarter of 2019 helped the S&P 500 index achieve its best annual return since 2013.

At the start of the fourth quarter, markets were facing four significant macroeconomic uncertainties: Could the U.S. and China strike a trade deal? Would the Fed cut interest rates for a third time in 2019? Could U.S. and global economies stabilize? Would Brexit get passed? Each of these unknowns, which had weighed on markets earlier in 2019, saw positive progress throughout the final three months of the year.

By far, the most important event for markets during the fourth quarter was the agreement to a "phase one" trade deal by the U.S. and China. Since early 2018, the U.S.-China trade war, and the tariffs that came with it, pressured the global economy and weighed heavily on investor sentiment. Twice in 2019, first in May and again in August, tariff increases caused a significant spike in market volatility.

But in mid-October, after intensive negotiations, both the U.S. and China agreed, in principle, to a phase one trade deal that would result in the reduction of some existing tariffs, the promise of no additional tariffs, and increased imports of American goods by China. Anticipation of this "in principle" deal being formally agreed to powered stocks higher from mid-October through mid-December. And then on December 13th, more specific details of the phase one deal were announced, and that clarity helped stocks extend the 2019 rally into year-end.

Improvement in U.S.-China trade relations wasn't the only positive event in the fourth quarter though. The Federal Reserve met market expectations by cutting its benchmark interest rate by another 25 basis points at the meeting on October 30th. That cut brought the total reduction in interest rates in 2019 to 75 basis points, the largest annual reduction in over a decade. Additionally, at the December policy meeting the members of the Federal Open Market Committee showed they do not expect to raise interest rates in 2020. That added clarity for Fed policy expectations, specifically that the market can expect rates to stay low for the foreseeable future, also helped power stocks higher in the fourth quarter.

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The global and U.S. economies also showed signs of stabilization in the fourth quarter after losing positive momentum for much of 2019. First, in the United States, concerns were growing that sluggish business spending and investment would potentially cause a broader economic slowdown. But the market's preferred measure of business spending and investment, the monthly Durable Goods report, rebounded in the fourth quarter, easing some of those growth concerns. Internationally, measures of Chinese manufacturing activity, which had shown the industry was in contraction for the past several months, turned positive again in December, and that implied activity was stabilizing. So, while concerns remain about the next direction of the global economy, these signs of progress in the fourth quarter helped stocks rally.

Finally, after three-and-a-half years of Brexit uncertainty, investors can finally expect some progress as the mid-December elections in the United Kingdom resulted in a strong conservative (or Tory) party majority. As a result, the Brexit agreement with the EU is expected to pass Parliament in early 2020.

In sum, the fourth quarter of 2019 was a reminder that macroeconomic fundamentals matter. Good Corporate earnings, historic Low unemployment in the United States, and the positive news on four key macroeconomic fronts fueled a broad rally in the stock market and makes it more likely, but not certain, that we will see improved global economic growth and better earnings in 2020.

4th-Quarter and Full-Year 2019 Performance Review

The major U.S. stock indices were all solidly higher in the fourth quarter led by the tech-heavy NASDAQ which handily outperformed thanks to rising optimism on U.S.-China trade and expectations for a rebound in economic growth. The S&P 500, Dow Jones Industrial Average and Russell 2000 (the small-cap index) all had smaller, yet positive, quarterly returns. The performance of the major indices in the fourth quarter mirrored the full-year performance, as the NASDAQ easily outperformed the other three indices in 2019 as investors sought the secular growth potential of the tech sector amidst macroeconomic uncertainty.

By market capitalization, large caps outperformed small caps for the full year. That reflected investor concerns about a potentially slowing global economy, as large caps are historically less sensitive to slowing growth than small cap stocks. Notably, however, small caps did narrow the performance gap in the fourth quarter, which implied rising optimism towards the global economy in 2020, following the announcement of the U.S.-China trade deal. From an investment style standpoint, growth outperformed value again in the fourth quarter due to strength in large-cap tech. That widened the performance gap for the full year 2019, as growth considerably outperformed value, again thanks mostly to strength in the tech sector.

On a sector level, 10 of the 11 S&P 500 sectors finished the fourth quarter with positive returns. Technology, financials and healthcare stocks led markets higher in the fourth quarter, which is a reversal from the defensive sector outperformance we witnessed in the third quarter of 2019. Expectations that the U.S.-China trade deal would lead to better economic growth combined with higher bond yields helped power the rally in tech and financials, while healthcare gained on a reduction in political headwinds as candidates who favor expansion of the government healthcare programs, dubbed "Medicare for all," dropped in the polls. For 2019, the big fourth-quarter rallies by tech and financials helped those two sectors outperform on a full-year basis.

Sector laggards in the fourth quarter were the traditionally defensive market sectors. Real Estate was the only S&P 500 sector to finish negative in the fourth quarter, while utilities and consumer staples underperformed the S&P 500 as the U.S.-China trade deal caused investors to rotate into sectors that are more sensitive to a potential upswing in global growth. On a full-year basis, energy was the relative sector laggard as market worries about a slowing global economy combined with the potential oversupply of oil weighed on energy shares, although the energy sector still finished 2019 with a respectable annual gain.

S&P 500 Total Returns by Month in 2019											
Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
7.78%	2.97%	1.79%	3.93%	-6.58%	6.89%	1.31%	-1.81%	1.72%	2.04%	3.40%	2.86%

Source: Morningstar

Looking internationally, foreign markets saw positive returns in the fourth quarter thanks mostly to the U.S.-China trade deal, although most foreign markets still underperformed U.S. markets. Foreign developed markets posted solid gains in the fourth quarter but lagged emerging market returns. Emerging markets outperformed both foreign developed markets and the S&P 500 in the fourth quarter thanks to rising expectations for a global economic rebound, combined with some declines in the U.S. dollar. For the full year 2019, foreign markets registered solidly positive returns, with foreign developed markets modestly outperforming emerging markets. However, both underperformed the S&P 500 in 2019.

Switching to fixed income markets, the total return for most bond classes were positive in the fourth quarter, although longer-dated Treasuries saw mild declines, which is not surprising given rising expectations for a rebound in global growth. The leading benchmark for bonds (Bloomberg Barclays US Aggregate Bond Index) experienced slightly positive returns for the fifth straight quarter.

1st Quarter and 2020 Market Outlook

The markets' performance in 2019 was a good reminder of the difference a year can make. In January 2019, the S&P 500 was coming out of its first negative year in a decade; we had a 20% correction in the S&P 500; worries about the global economy were surging due to the U.S.-China trade war and the Federal Reserve had just hiked interest rates the previous month.

Now, we begin 2020 on the opposite end of the spectrum.

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The S&P 500 just registered its best annual return since 2013, worries about the global economy are receding thanks to the U.S.-China trade deal and the Fed cut interest rates three times in 2019.

For us, the takeaway from this is clear: What happened in the markets last year doesn't mean much for what could happen in the markets this year.

Put in more familiar phrasing: Past performance is not indicative of future results.

So, while the macroeconomic environment is favorable as we begin 2020, a new year always brings new challenges and uncertainties, especially when it's an election year.

More specifically, as we begin 2020, we are monitoring several unknowns that, with the market at historically high valuation levels, could cause volatility in 2020.

Regarding U.S.-China trade, markets are now wondering what's in the phase one trade deal. The text of the agreement should be released in early-January, and while sentiment towards the deal is clearly positive, specific details remain very light. At some point, the market will demand that the details of the trade deal meet now-elevated expectations.

Turning to the economy, markets are expecting a rebound in global economic growth. So, the upcoming economic data needs to continue to show signs of stabilization and, ultimately, a re-acceleration of economic growth not just in the United States, but globally.

Looking at domestic politics, markets have ignored the impeachment of President Trump and that's not likely to change as the odds he is removed from office by the Republican-controlled Senate are very low. But there is an election coming in November, and while many analysts don't expect it to begin to influence the markets until later this summer, we could know who the Democratic nominee is by the end of March. Depending on who that person is, it could cause unexpected volatility.

Meanwhile on the geopolitical front we have rising tensions with Iran and North Korea. It is anybody's guess that will happen in the Middle East. The United States is now energy independent. China gets most of its imported oil from the Middle East.

Bottom line, the fundamental outlook for the economy and asset markets has improved since the depths of the 2018 correction, and stocks have responded accordingly. But it's very important to realize that, despite the strong performance in 2019, markets still face significant uncertainties, and we are committed to monitoring these situations and their impact on the markets and your portfolio.

At Zick Whitted Taub Investment Strategies, we've been through both good and bad markets, and those experiences ensure that we guard against complacency following a year of strong annual returns. We remain committed to helping you navigate this ever-changing market environment, with a focused eye on ensuring we continue to make progress on achieving your long-term investment goals.

Our years of experience in all types of markets (both positive and negative) have taught us that successful investing remains a marathon, not a sprint.

Therefore, it remains critical to stay invested, remain patient, and stick to a plan. That’s why we’ve worked diligently with you to establish a personal allocation target based on your financial position, risk tolerance, and investment time horizon.

The strong market performance of 2019 notwithstanding, we remain vigilant towards risks to portfolios and the economy, and we thank you for your ongoing confidence and trust. Rest assured that our entire team will remain dedicated to helping you successfully navigate this market environment.

Please do not hesitate to contact us with any questions, comments, or to schedule a portfolio review.

Sincerely,

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Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transitions costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Commodities' investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuation even during periods when prices overall are rising. There is an inverse relationship between interest rate movements and bond prices. Generally, when interest rates rise, bond prices fall and when interest rates fall, bond prices generally rise.

Barclays Aggregate Index is comprised of the Government/Corporate, the Mortgage-Backed Securities and the Asset-Backed Securities indices.

The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ

The NASDAQ Composite is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market.

The Russell 2000 Index is a small-cap stock market index of the bottom 2,000 stocks in the Russell 3000 Index. The Russell 2000 index is an unmanaged index of small cap securities which generally involve greater risks.

MSCI EAFE (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 21 developed nations.

MSCI Emerging Markets Index is designed to measure equity market performance in 23 emerging market countries. The index's three largest industries are materials, energy, and banks.

The MSCI ACWI (All Country World Index) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. As of June 2007 the MSCI ACWI consisted of 48 country indices comprising 23 developed and 25 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. The emerging market country indices included are: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey.

S&P GSCI Crude Oil is an index tracking changes in the spot price for crude oil.

The S&P MidCap 400® provides investors with a benchmark for mid-sized companies.

LBMA Gold Price refers to the London Bullion Market Association (LBMA) Gold Price.

S&P GSCI (Broad- Based Commodities) is a leading measure of general price movements and inflation in the world economy.

Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market.
The Barclays Capital Municipal Bond is an unmanaged index of all investment grade municipal securities with at least 1 year to maturity.
The Bloomberg Barclays U.S. Corporate High Yield Bond Index is composed of fixed-rate, publicly issued, non-investment grade debt, is unmanaged, with dividends reinvested, and is not available for purchase.
The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility and Finance, which include both U.S. and non-U.S. corporations.
The Barclays Capital US Aggregate Index is an unmanaged market value weighted performance Benchmark for investment-grade fixed rate debt issues, including government, corporate, asset backed, and mortgage backed securities with a maturity of at least 1 year.
The **Bloomberg Barclays US Mortgage Backed Securities (MBS) Index** tracks agency mortgage backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon and vintage.
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