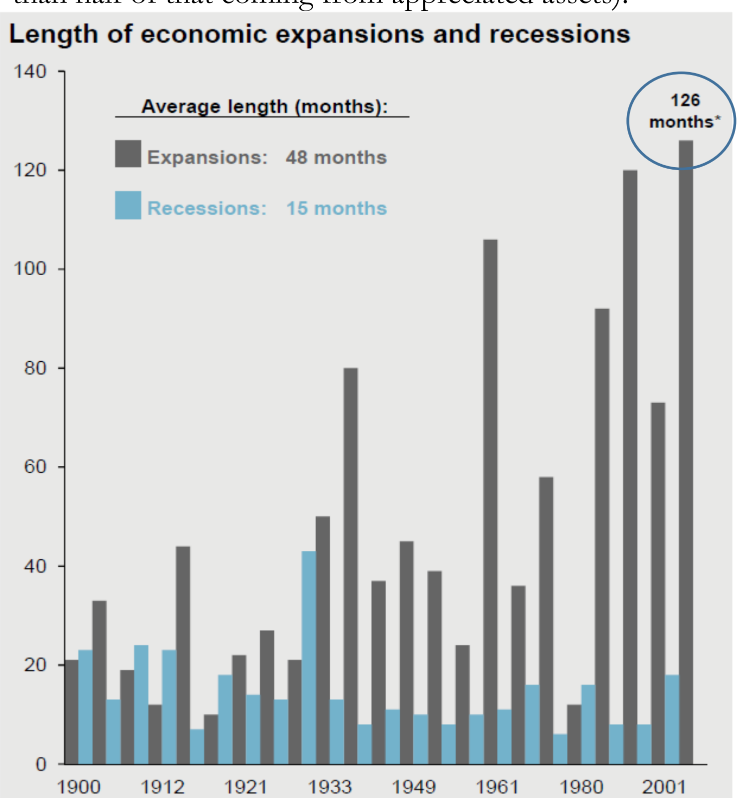
2019 Year-end Summary
Encore, Anyone?

What a Year! The economy is now in its 126th month of expansion, the unemployment rate is at its lowest since 1969 at 3.6% (minority unemployment lowest ever), the U.S. Standard and Poor's 500 added the best return in 13 years at more than 30%, while the MSCI All Cap World - ex US index - added 22%. According to the Wilshire Associates' estimates, U.S. equities increased in cumulative value by $7.5 Trillion. Federal tax receipts are projected to be up in 2020 (deficits down) as a result of capital gains and a higher number of people on the payrolls (employed). Philanthropy is up 20%, according to Vanguard Charitable fund (more than half of that coming from appreciated assets).

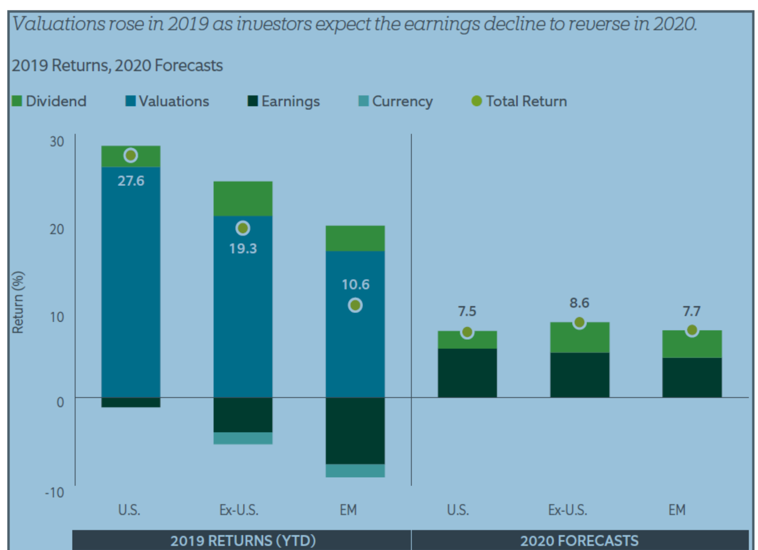


Source: BEA, NBER, J.P. Morgan Asset Management. *Chart assumes current expansion started in July 2009 and continued through December 2019, lasting 126 months so far. Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research (NBER). These data can be found at www.nber.org/cycles/ and reflect information through December 2019. Past performance is not a reliable indicator of current and future results.
Guide to the Markets – U.S. Data are as of December 31, 2019.

Investors are euphoric about the amazing year and ready for an encore.

But what goes up must come down…right? Or at least stop going up? Just a few short months ago that was the consensus, and we even mentioned it in the second quarter 2019 commentary (*Long in the Tooth or Room to Grow?*)

However, the rumor of the death of economic growth may be greatly exaggerated! As the calendar is set to a new year, do we have a new Roaring 20s? We don't believe that the domestic economic picture will be roaring, but the likelihood of continued modest economic expansion into 2020 is great. The U.S. equity market returns in 2019 were primarily propelled by expansion of the multiple of stock prices x earnings (P/E ratio) and liquidity from easy Federal Reserve Policy. The chart below breaks down the components of 2019 equity returns.



Source: Northern Trust Asset Management, Bloomberg. 2019 returns through November 30, 2019. Proxies: U.S. - S&P 500; Ex-U.S. (Developed ex-U.S.) - MSCI World ex-U.S.; EM (Emerging Markets) - MSCI Emerging Markets. Index performance returns do not reflect any management fees, transaction costs or expenses. It is not possible to invest directly in any index. **Past performance is no guarantee of future results.**

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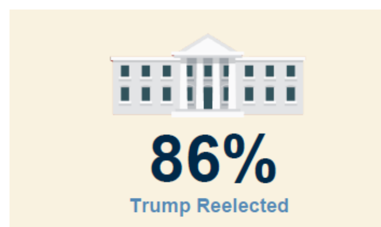
As the right-hand portion of the chart illustrates, most economists believe that the pause in positive earnings growth that occurred in the second half of last year will reverse in 2020.

Unfortunately, with the Price to Earnings at elevated levels as we enter the new year, the historic return projections are typically more muted than what investors were rewarded with last year. The Goldman Sachs analysis below illustrates various valuation metrics and their corresponding equity rate of return forecast for domestic equities between 2.1-7.5%.

Chart Source: Goldman Sachs Global Investment Research, Bloomberg, Robert Shiller, and GSAM as of November 30, 2019. Percentile levels for the cyclically-adjusted price-to-earnings (C ratio are calculated from December 30, 1927, the inception of the S&P 500 Price Index. Subsequent returns analysis is from January 30, 1928 on a price return basis. **Past performance doe guarantee future results, which may vary.**

We would be remiss if we didn't at least broach the landmine of politics. Being an election year, this is probably one of the most frequently asked questions in our reviews. To avoid the awkwardness of your family Thanksgiving political discussions, I will try to cover the facts and attempt to avoid personal opinion. Markets hate uncertainty. Regardless of investors' opinions of President Trump, they know from the past three years that he is a pro-growth, anti-regulation, low-tax advocate. All of these things are good for the stock market. From a historical standpoint, the economic environment six months prior to the election is the strongest determinant and indicator of re-election of an incumbent. As the economy goes, so goes the presidency. George H. Bush was a victim of a recession in 1991-92 that lingered into his re-election year. His early popularity waned, and he did not win a second term.

In a survey of 784 institutional investors, 86% believe that due to the strength of the economy, President Trump will be re-elected.



Again, if you're not a fan, don't shoot the messenger, but that is the historical reality during an economic expansionary election year. Given this likelihood, this known outcome would be a positive for equity markets. Combined with a resurgence in corporate earnings discussed earlier, and continued easy monetary policy by the Federal Reserve, these all provide tailwinds for domestic equities.

Another important macro theme for 2020 is that international markets have lagged domestic equity markets since the Great Recession of 2008 (50% longer than normal). The global landscape is beginning to favor international equities with higher earnings growth rates, higher dividends, and lower valuations.

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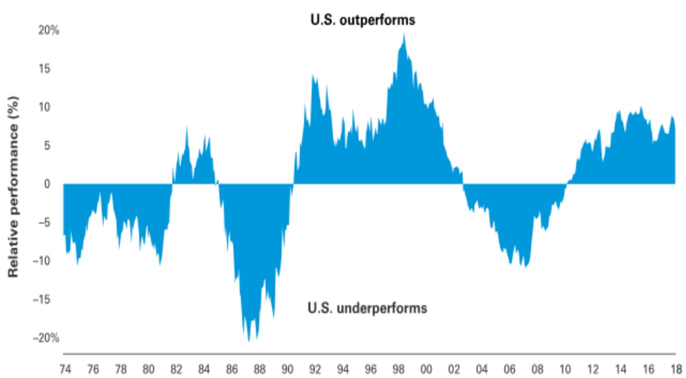
Performance leadership between U.S. and international equities has been mixed

(U.S. equity vs. international equity rolling five-year returns: January 1970–December 2018)



Source: Morningstar Direct, Vanguard analysis.

Data as of 12/31/2018. International equity returns as measured by MSCI World ex US Index; U.S. equity returns as measured by MSCI USA Index.

Emerging markets in particular look poised to rebound, compared to the developed economies with earnings growth. The projection for the average Emerging Market country is 4.25-5.25% economic GDP growth, with outliers like India with high estimates over 6.5%!

Real GDP Growth YoY

	2018	2019 estimate	2020 forecast
DM[1]	2.2	1.7	1.00-1.50
U.S.	2.9	2.3	1.50-2.00
Euro area	1.9	1.2	0.75-1.25
U.K.	1.4	1.3	0.75-1.25
Japan	0.8	0.9	0.25-0.75
EM[2]	5.6	4.8	4.25-5.25
China	6.6	6.1	5.00-6.00
Brazil	1.1	0.9	1.00-2.00
Russia	2.3	1.2	1.50-2.50
India	7.4	5.2	5.50-6.50
Mexico	2.0	0.5	0.50-1.50
World[3]	3.3	2.7	2.25-2.75

Note: All data for real GDP and headline inflation are year-over-year (YOY) percentage changes. 2018 is actual data, 2019 is our estimate, and 2020 is our forecast.
1 DM is the GDP-weighted average of U.S., euro area, U.K., and Japan.
2 EM is the GDP-weighted average of China, Brazil, Russia, India, and Mexico.
3 World is the GDP-weighted average of all countries listed in table above.
Source: Bloomberg, PIMCO calculations

The demographic growth of a younger middle-class population that is an active consumer in the emerging market regions is exciting. Technology has provided a multitude of opportunities, from online merchandising and entertainment to manufacturing and financial services. The world has become very small, with the exponential connectivity of virtually every hamlet and village.

The pace of disruptive technology is another theme that our team is striving to stay abreast of globally. We currently have more disruptive innovations than at any time in history. A disruptive innovation is something that changes the very way that we live, in such a way that the old paradigm is obsolete. An example in our history is pony express, to trains, to telegraph, to telephone, to wireless telephone. Each disruption made its predecessor obsolete. The current development in biotechnology, autonomous vehicles, robotics, 3D printing, and crypto-currency will change the landscape of how we live in the future.

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In summary, here are the Macro themes for 2020:

1. The U.S. economy will extend its expansionary record into 2020, with no recession in the next calendar year.

2. The Federal Reserve will continue to provide accommodative monetary policy aiding growth.

3. President Trump will be re-elected, providing a level of market comfort with known policy agenda.

4. Domestic equities will continue its bullish run, but they are fully valued, which will create a more muted return environment.

5. International markets will outperform domestic markets, with Emerging market equity and debt being a top performer.

6. Disruptive technology will continue to be major investment themes in 2020 and beyond.

We appreciate your continued confidence and trust!

The Brechnitz Group

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