

Quarterly Market Commentary

Perspective on the economy and trends in the marketplace.

It was a banner year in 2019 for most asset classes rebounding from a volatile fourth quarter of 2018, which was one of the worst quarters for stocks since 2009. Headwinds at the start of the year such as slowing global growth, looming trade negotiations, and a largely expected hawkish Federal Reserve did not derail investor confidence. Economic momentum decelerated over the course of the year but remained positive with GDP growth up 2.1% year-over-year as of the end of the third quarter. This growth was largely due to a healthy consumer who was supported by a robust labor market as proven by the unemployment rate being as low as 3.5% as of November. Low consumer prices also gave the consumer more purchasing power with the Consumer Price index (CPI) up only 2.1% year-over-year as of November. Despite businesses being hurt by the ongoing trade battle between the U.S. and major trading partners, tensions eased as mutual agreements were eventually reached by year-end. With sluggish growth and subdued inflation in 2019, the Federal Reserve made a dramatic policy shift and cut rates three times to stimulate the economy. These rate cuts pushed asset prices higher and helped steepen the yield-curve which had inverted in August. While most asset classes ended higher in 2019 and more recent data has been encouraging, there are uncertainties which lie ahead in 2020 such as the potential for ongoing trade tension and a presidential election cycle on the horizon.

■ U.S. Equities

U.S. stocks surged in 2019 with the S&P 500 up 31.49% for the year and up 9.07% in the fourth quarter alone. Although investors enjoyed this stellar performance, not everything was rosy throughout the year. Stocks climbed higher while global growth slowed, U.S.-China trade flare-ups postponed business spending and earnings growth of companies within the S&P 500 moderated from their exceptional levels in 2018. Earnings growth for companies in the S&P 500 were down -1.02% however sales growth remained positive, up 3.52% as of the third quarter of 2019. While there was some conflicting economic data, the rally in stocks was broad-based, with midcap and small cap stocks up 30.54% and 25.52% respectively. Aside from simply recapturing the losses investors incurred in 2018, stock prices were boosted by a more accommodative Federal Reserve, as rates were cut 3 times throughout the course of the year, resulting in lower borrowing costs for companies in the U.S. So, while U.S. stocks exhibited strong performance in 2019, we ask ourselves at what cost were these returns achieved and what lies ahead in 2020? We are expecting a slow grind higher in economic data, supported by the consumer, which should result in mild equity market returns, barring no exogenous events derailing the markets.



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■ International Equities

The global economic expansion continued to slow as the year unfolded and the effects of global trade uncertainty began to materialize in economic data. Among advanced economies, growth disappointed in the euro area and the United Kingdom, as the slowdown in trade hurt Germany's export dependent manufacturing economy, and ongoing Brexit negotiations continued to weigh on businesses in the U.K. Within emerging markets, China's high debt levels, high borrowing costs, aging demographics, and heavy U.S. tariffs all dragged on exports. Despite this, foreign stocks were able to rally, posting double-digit returns in 2019, with international developed equities and emerging market equities up 22.01% and 18.42%, respectively.

Phase one of a trade deal between the U.S. and China is nearly complete, which is helping to lift China's outlook in the short-term, but it does not remove the headwinds facing its economy moving forward. Still, we are optimistic that global economic growth will remain positive in 2020, as many of 2019's headwinds look less significant this year: The Federal Reserve appears to be on pause, which indicates the U.S. dollar may stabilize or soften, the leaders from the two largest economies appear to have made progress on trade deals, and the U.K. may see improved growth once the uncertainty surrounding Brexit dissipates. As a result, we believe foreign equities remain undervalued and may present buying opportunities.

■ Fixed Income

After a difficult 2018, fixed income was supported by a dovish Federal Reserve and economic uncertainty in 2019, with the Bloomberg Barclays Aggregate Bond Index finishing the year up 8.72%. Following three Fed rate cuts, short-term rates decreased from 2.49% to 1.57% while the 10-year U.S. Treasury yield ended the year at 1.92%, well below where it started the year, after reaching a low of 1.45% in September. As long-term rates fell during the year, the difference between long and short-term rates briefly went negative. When the two-year yield surpasses the 10-year yield, it has historically been a leading indicator of a recession in the next 12 months, but we do not expect this to happen in the near term. The decrease in interest rates was an effect of multiple tailwinds in 2019, including easing monetary policy, demand for yield from both retirees and foreign investors from lower yielding countries, as well as a broad-based flight to quality from risk assets during a volatile year. Lower credit quality bonds outperformed higher credit quality bonds, as investors sought yield amidst a risk-on environment.

Over the next year, we project the path for interest rates to remain neutral, but we anticipate fewer rate moves in 2020, as economic data does not appear to warrant further easing or tightening. Thus, we believe fixed income securities will continue to benefit portfolios from a diversification perspective but may offer low returns moving forward.



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■ Alternatives

Alternative asset classes moved higher throughout 2019 as U.S. equities led the way. Oil prices rebounded from the selloff in Q4 of last year, with WTI crude ending 2019 at \$61.06 per barrel, rising from \$45.41 per barrel at the end of the 2018. Liquid alternatives provided some cushion from the bouts of volatility markets experienced over the year, with the Morningstar Diversified Alternative index having a standard deviation of 3.82% in 2019 versus the S&P 500 having a standard deviation of 15.01%. Hedge fund-like alternatives will continue to play a key role in downside protection and reducing volatility within a portfolio by maintaining low correlation to equity and fixed income markets as the economy potentially slows.

■ Real Estate

Real estate rebounded in 2019 as higher housing demand and lower financing costs supported the sector. Increased housing affordability was mainly due to lower mortgage rates that bottomed out at 3.82% in September. Recent data has been positive with housing starts and building permits both remaining near cycle highs and new and pending home sales both posting positive gains for the month of November. The NAHB index, an index that tracks homebuilder optimism and a leading indicator for the housing market, rose to 76 from 71 in November, the highest level since 1999. The housing sector is poised to slowdown in 2020 as financing costs are expected to creep higher, however, with a tight labor market, solid income growth, and already low financing costs, the housing market could be resilient heading into the new year.

■ Conclusion

Stocks and bonds had a fantastic year in 2019 as U.S. stocks posted their best annual return in six years and fixed income securities had one of the strongest years of the current expansion. This boded well for multi-asset class portfolios, as diversification helped to drive returns. Although investors experienced standout performance, the economic backdrop looked less rosy, with modest growth in the U.S. that continued to slow over the course of the year. As we look to 2020, we are hopeful the consumer remains resilient and earnings growth will rebound, but acknowledge that uncertainties still loom, due to the upcoming election cycle and further trade negotiations. While we wouldn't be surprised if we experienced a pickup in volatility, we expect modest growth to continue, resulting in a mild grind higher for equity markets and a favorable environment for diversified multi-asset portfolios. 

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