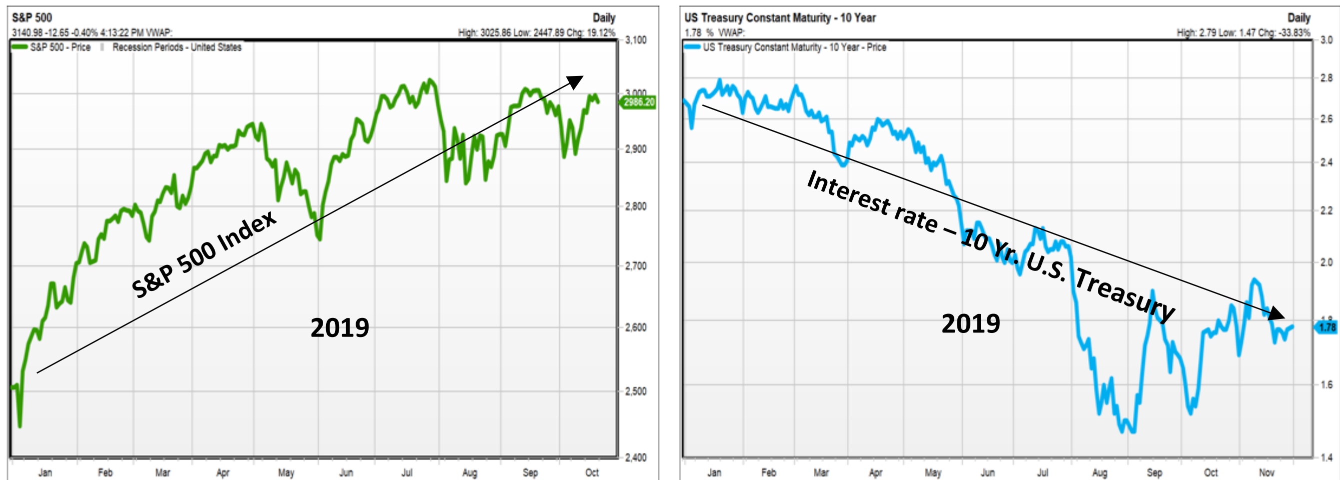
ECONOMIC & FINANCIAL MARKET UPDATE – December 1, 2019
Reflecting On The Past & Looking Ahead

2019

Strong global equity returns and sharply lower interest rates have come together in an uncommon combination to provide both stock and bond investors with strong positive returns in 2019.



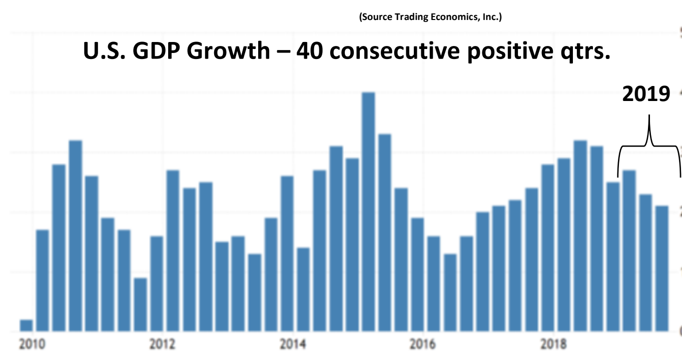
Source: Factset Research Systems, Inc. (both charts)

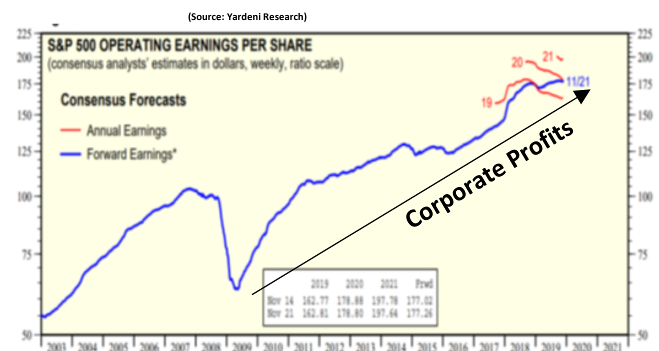
As this year quickly comes to a close, it appears (assuming no meaningful change between now and December 31st) that 2019's S&P 500 returns will be the largest since 2013, with a return near +25.0% (+24.07%, price only, through 11/29/19)[i]. As a result, 2019 will mark the tenth year during the past eleven that S&P 500 returns have been positive[ii]. Quite a record, and very rewarding to investors. The Barclays Aggregate Bond Index, an index of the U.S. investment grade, fixed-rate bond market, including both government and corporate bonds, also provided strong, positive results with a return of +8.79%[iii] through the end of November.

While our initial 2019 outlook for financial market returns was optimistic, even our expectations turned out to be modest compared to what has occurred. There were multiple factors that we viewed at the beginning of the year as having potential positive impacts on the markets and the U.S. economy, but perhaps none as important as the Federal Reserve's policy decisions. As the U.S. and global economies continued to slow, and after the stock market experienced a brief "melt-down" in the fourth quarter of 2018, the Fed began to change its rhetoric from hawkishness (raising rates) to a more dovish tone and eventual action.

Following four rate increases in 2018, the Fed has cut interest rates three times[iv] thus far in 2019 increasing liquidity and lowering the cost of borrowing for corporations and individuals. As a result, expanding a business, financing inventory or purchasing a home or car is more achievable thus increasing the likelihood that those important businesses (employers) will keep production moving and folks employed.

Additional favorable factors that influenced our 2019 outlook as well as our current expectations for 2020, were the combination of a steady decline in domestic unemployment (the lowest in 50 years)[v], rising wages, low inflation, record high Household Net-worth[vi], positive U.S. economic growth (GDP)[vii] and, very importantly, corporate profit growth (see charts on next page).





LOOKING AHEAD – The Economy

The fear of recession remains due to the slowing of the global economy and, particularly, concerns about manufacturing and production. These concerns have been further exacerbated by the continued ***Deal Or No Deal*** "episode" that plays out in the trade negotiations between China and the U.S. and, to a lesser degree, in the UK with Brexit negotiations. To add an additional element of uncertainty, Japan has recently increased its Value Added Tax[viii], making goods more expensive for consumers and possibly further slowing production.

While concerns about recession are legitimate, we ***do not*** anticipate a U.S. or global recession in 2020. We actually see expectations for improvement increasing, particularly in the U.S. Why? Payrolls/employment remain strong; the inverted yield curve (historically a sign of impending recession) has reversed; the improvement in housing has been impressive, and retail sales have recently been improving. The consumer, who is vitally important to the U.S. economy, is on good footing.

A small, but never-the-less positive, pick-up in economic activity in other parts of the globe appears to be occurring as well. This improvement is evidenced by the rise in Consumer Confidence in France, Business Expectations in Germany, Retail Sales Expectations in the UK and both the Manufacturing and Service Purchasing Managers Indexes in China.

Investors view the equity markets as a reflection of the future. If global investors had a high degree of certainty that a recession were probable in the near future, equity markets around the globe would not likely have achieved double digit rates of return in 2019 as many have. We will continue to monitor global economic activity and trade issues carefully.

LOOKING AHEAD – The Financial Markets

Following this year's soaring equity markets, it is not likely we will see a repeat of those returns in 2020. If as we anticipate, corporate profits continue to grow and the clouds of uncertainty surrounding the U.S./China trade spat and the impact of Brexit disappear, the global economy should reaccelerate and U.S. equities will reflect those positive outcomes. We anticipate equity returns will be more along the norms of single digit results.

Historically the stock market has not gotten caught up in the hype surrounding presidential election outcomes until well into the calendar year when the vote actually occurs. However, President Trump has a clear

motivation to avoid a recession before the November 2020 election and thus is likely to increase efforts to de-escalate trade tensions. This ongoing trade "war" may be the most significant risk to our cautiously optimistic outlook, and a resolution makes a great deal of sense for both sides. Investors should be aware that with trade-talk, and election rhetoric likely to intensify, volatility may also increase. Corrections of 5-10% in any given year are normal, healthy and should be expected. 2020 will likely be no different.

The combination of positive economic factors in the U.S., a "trade-war" resolution and the effects of global monetary stimulus e.g., low interest rates, should result in a modest global economic recovery in 2020 and heighten the likelihood that our equity market expectations will be met.

During this past summer and into the fall, as equity markets reached historic highs, we attempted to be as opportunistic as possible, and modestly reduced equity exposure in client portfolios. This action kept portfolio asset allocations (the "split" between stocks, bonds, and "cash") in line with client ***Investment Policy Guidelines***, as well as provided reserves for future purchase opportunities. This action was done without undue tax realization.

CLIENT PORTFOLIO STRATEGY – 2020

As we have described in the past, the key to benefitting from this ten-year plus bull market has been to have had patience, to have maintained a well-diversified stock portfolio, to have remained invested in high quality, financially strong companies and to have stayed focused on economic fundamentals.

That strategy, as well as our focus on the longer-term and attempt to avoid excessive optimism or pessimism related to the economy, will not change. Our focus is always on pursuing client objectives through the management of a well-diversified, balanced portfolio that is consistent with the client's long-term needs for cash flow, desire for growth of capital, possible future liquidity needs and to do so in as tax-efficient manner as possible.

With respect to the current equity portion of client portfolios, we continue to focus on investment in companies that we consider high quality (consistent revenue, earnings and dividend growth), that have only modest debt, a high return on equity and assets and that have strong competitive advantages. Today equity portfolios are heavier weighted in the Technology, Healthcare, Industrial and Consumer Staple sectors than a comparable equity market index.

With respect to fixed-income investments, we continue to recommend focusing on issues of shorter to moderate maturities of high quality. The rationale for this strategy is that interest rates are at historically low levels and the difference in available yields between relatively short maturity bonds and those with longer maturities is quite small.

At the risk of being repetitive, the lists below describe many of the elements that we have described in the above paragraphs and that impact our outlook and actions.

Positives

1. Very strong employment factors.
2. A strong consumer.
3. Fed & global central banks easing.
4. Improving housing market.
5. U.S. corporate earnings growth continues.
6. 4th qtr. seasonal estimates rising (retail).
7. Low inflation.
8. Subdued investor sentiment.
9. Subdued analyst's expectations.
10. Equity valuations (P/E) high but not excessive.
11. Strong market breath.

Negatives

1. Trade uncertainties.
2. Washington turmoil (impeachment, 2020 elections).
3. Weak global manufacturing data.
4. Strong U.S. dollar.
5. IPO market weakening.
6. A multitude of geopolitical issues e.g., Brexit Hong Kong, Syria, China, North Korea, etc.

We appreciate the opportunity to serve you and we value highly our relationship with you. We welcome your question, comments or critique at any time and we look forward to meeting with you in the near future. We wish you and your family a safe, happy and memorable Holiday season.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful. All indices are unmanaged and may not be invested into directly.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.

The prices of small and mid-cap stocks are generally more volatile than large cap stocks.

Stock investing involves risk including loss of principal.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.

Investment advice offered through Stratos Wealth Partners, Ltd., a registered investment advisor.

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[i] BARRON'S, December 2, 2019
[ii] NYU Stern School of Business, Annual Returns of Stocks, T-Bonds & -Bills
[iii] BARRON'S, December 2, 2019
[iv] U.S. Federal Reserve Board, Open Market Actions, November 30, 2019
[v] U.S. Bureau of Labor Statistics, November 30, 2019
[vi] JP Morgan Asset Management, Guide To The Markets, October 31, 2019
[vii] Trading Economics, December 1, 2019
[viii] pwc, Taxsummaries, December 1, 2019