INVESTMENT COMMENTARY
January 2020

Happy New Year. As fireworks lit up the skyline to ring in the New Year, investors were already celebrating 2019 as one of the best years for stock and bond market returns. Coming on the heels of an awful fourth quarter in 2018, expectations for 2019 were rather subdued. Despite concerns of an inverted yield curve, political tensions and a trade war with China, equity markets climbed the "wall of worry", as they often do. Amidst negligible earnings growth and inflated stock valuations, consumers' penchant for spending remained a key driver for both economic growth and the best equity market returns since 2013. Holding true to history, equities once again rose during the third year of a presidential term.

Expanding multiples [rising valuations], were a significant contributor to stock index gains, more so than earnings growth; as all 11 sectors of the S&P 500 notched remarkable gains. Technology led all sectors, posting a gain of 50.3%, while the energy sector was the 'laggard'—up a respectable 11.8%. Strong performance by Apple and Microsoft boosted the technology sector, with the two also accounting for 14.8% of the S&P 500 Index's total return and 8.45% of the total return for the decade. Over the past 10 years, the top 10 stocks contributed 19.6% of the total Index return, but a rather noteworthy 29.5% in 2019. Other top gainers in our portfolio include: Applied Materials (+90%), Qualcomm (+60%), J.P. Morgan (+47%), Raytheon (+46%), Costco (+45%), Mastercard (+59%), Facebook (+57%), Proctor & Gamble (+39%), Walt Disney (+34%) & Blackstone (+96%).

Over the past 10 years, the S&P 500 has surged more than 188%, and the broad index's total return (including dividends) topped 255% making it the best performer of the major global benchmarks. 2020 presents a more sanguine forecast for corporate earnings with current estimates up 6-10%. Economic conditions remain stable with a GDP growth rate in the 2-2.5% range. Full employment, rising wages, benign inflation and strong consumer spending trends are providing the foundation for continued economic growth and stock market appreciation. With interest rates at historic lows, the bond market has more risk exposure than equities and any heating up of the economy could force the Fed to raise rates which would negatively impact bond prices.

We're keeping a watchful eye on the major geopolitical and economic risks facing the markets. With much anticipation, and a sigh of relief, Phase One of the US & China trade deal has just been signed. This agreement is a major development for the long-running negotiations, though issues remain which could impede further agreements and delay the Phase Two signing later this year. The U.S. conflict with Iran appears to be moderating for the time being, though any escalation will likely impact oil & gas stocks and disrupt the energy markets.

Contrary to most economists who were forecasting a recession in 2019, we held a more favorable and optimistic view of the economy. As we kick off 2020, the risks of a slowdown have diminished, and we're more confident in our baseline prediction for a moderate recovery in global growth. The presidential election will no doubt dominate the news throughout the coming year and, to be sure, half of the country isn't going to be happy with the outcome. If there's a silver lining to the coming election, it's that stock markets tend to be reasonably well-behaved (in spite of polarizing politics) in election years, no matter which party prevails. In fact, in the 23 presidential elections held since 1928, in only four of those years was the S&P 500 Index negative.

So, what can we can expect in 2020? Yogi Berra's observation that, "It's tough to make predictions, especially about the future" certainly rings true. We look for moderated corporate earnings growth and higher stock valuations compared to the beginning of 2019, which may produce more subdued performance and less appreciation potential than last year. We mention this within the context of low inflation, historically low interest rates, and record levels of available institutional and retail investor cash on the sidelines. We also expect the housing market to be a meaningful area of strength in the U.S. economy this year. Housing trends remain favorable as the decline in mortgage rates last year brought buy vs. rent and payment affordability ratios back in line, which should continue increasing demand. Rising wages, full employment and population growth positively impact the sector and support a continued thesis of upside potential for equities overall in 2020.

One final thought: our investment strategy, which is focused on blending a portfolio of high-quality stocks and bonds, is built to augment returns while reducing equity risk and is very well positioned for this environment. The large, financially sound companies in your portfolio pay dividends and continue to offer considerable upside. Dividend yields still remain more attractive than bond yields and support the case for capital flows into stocks which helps put a floor under the stock market. The resiliency of consumers and corporate America is consistently underestimated and one reason the stock market outperformed almost all forecasts for 2019. In our view, the current environment can be described as a 'Goldilocks' economy - not too hot and not too cold, and under these conditions both corporate earnings and equity markets can benefit.

Thank you for your continued support. Please call us if you have any questions or issues that you would like to discuss.

Warmest regards,

Scott, John, Dave & Richard