STRAIGHT TALK

4th Quarter 2019

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Market Returns

Domestic Large
S&P 500
31.49%

Domestic Small
Russell 2000
25.52%

Intl Developed
MSCI EAFE
22.01%

Emerging Markets
MSCI EM
18.42%

Fixed Income
BBgBarc US Aggregate Bond
8.72%

**Returns are from Morningstar, with dividends reinvested, and are through 12/31/19*

It's amazing how much can change in a relatively short period of time. When contrasting the last two years, we have opposites in terms of market performance and investor sentiment. Much of the last two years has been dominated by trade issues, principally involving the US and China. It has been the near singular issue that has driven market returns. It started in 2018 with tariffs and harsh rhetoric on both sides. This caused the global slowdown in industrial activity and as a result, sent stocks to lower valuations. Market moves last year were largely dictated by the ebb and flow of trade talks. The slowdown led to central bank easing and lower bond yields globally. Finally, on optimism and the eventual news of a "Phase One" trade deal, stocks bounced to higher levels and valuations to end 2019. It's been an interesting ride and, fortunately for investors, last year was a year where just about anything and everything worked. The question now is, where do we go from here?

We have a trade truce, for now, and with it recession fears for this year have greatly dissipated. Stocks are once again trading at high valuations relative to their history, but they look cheap relative to the most common alternatives (bonds and cash). Bond yields, however, are closer to their historic lows than to cycle highs. We believe that stocks can have a good year, but it will hinge on seeing strength in global manufacturing. We will continue to keep an eye on central banks in this process to act as a predictor of strength. Nearly all major global central banks have been easing policy, and while many are now on hold, the impact of lower rates and higher liquidity will filter through in the coming months and should help boost economic activity. At the same time perhaps businesses will be ratcheting up capital expenditures on the hopes that there are no more disruptions caused by trade issues.

It's safe to say that our outlook for stocks in 2020 is cautiously optimistic. Of course, as money managers we are almost always cautiously optimistic. At this stage, however, we'd say that there is a little bit more emphasis on the caution part of our view. We are in the midst of an historic economic and market cycle, and while it may well continue beyond this year, we've seen volatility and the frequency and magnitude of selloffs pickup in the most recent years. In the short-term markets may, at some point, be subject to a small pullback, after strong returns in the last few months.

Meanwhile, the outlook for bonds is much more muted this year. Few if any are expecting bond yields to decline the way they did last year. In our view, the bar for further rate cuts by the Fed is fairly high and the bar for rate hikes is even higher. It wouldn't be surprising to see the Fed stay on hold for much of this year. There is a chance that if economic data picks up enough we'll see bond yields move higher, but it's too early to make that call. We could be looking at a year where prices don't move much and returns are mostly comprised by the interest paid on bonds, which, for the mostly commonly followed US Aggregate Bond Index, is a little over 2%.

Now is a good time to review portfolios and rebalance accounts to reduce the positions that have, in our view, exceeded our expectations. While the general consensus calls for a good year with more modest returns, there are still questions as to how it will play out. As the year progresses we will adjust allocations to reflect the outlook for the economy and markets. Please contact us with any questions or concerns.

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