HIGHTOWER
WESTCHESTER

# MARKET COMMENTARY Q4 2019

After a disappointing 2018, global risk assets had a strong 2019, albeit with an elevated level of volatility. Thanks in part to a somewhat surprising turn in Federal Reserve ("Fed") policy, U.S. stocks returned more than 30% for 2019 (as measured by the S&P 500 Index) and global stock stocks weren't far behind.1 In most (but not all) respects, things played out according to the cautiously optimistic scenario we anticipated coming into the year. As the U.S. economy rolled along, U.S. equities posted big gains; but contrary to many expert's opinions, U.S. long bonds also rallied because the Fed eased more aggressively than anticipated. In our view, the year's most noteworthy developments were that the Fed reversed course from tightening into year-end 2018, to actually cutting rates three times in 2019 and the roller coaster ride we experienced with the U.S./China trade dispute. As the new year begins, it is safe to say the broad macro backdrop looks in many ways better than it did a year ago. The global economy appears to be on more solid footing, thanks largely to an impressively strong U.S. consumer sector and labor market. Yet, there's obviously a concentrated number of stocks driving market performance, much like we have seen in recent years, something we must consider when building out portfolios. The other worries revolved around relatively weak global manufacturing and trade and the tendency of the yield curve to invert.

The economy continues to expand at a 2.0% rate with inflation remaining low. The fully employed consumer is confident, buying homes and spending freely. The consumer represents two-thirds of our economy, so a strong consumer is vital for future growth. With unemployment running at approximately 3.5% and wages rising, the consumer is in great shape.[1] The manufacturing sector has been a drag on economic growth this year, but its decline is showing signs of bottoming. The service sector remains strong.

On the policy front, the Fed and trade disputes have been the leading stories. The Fed had their hand in supporting the markets with a fourth quarter 0.25% rate cut. We expect the Fed to spend 2020 on the sidelines, much like they have stated. After their December meeting, Fed chair Jerome Powell announced, "As long as incoming information about the economy remains broadly consistent with our outlook, the current stance of monetary policy will likely remain appropriate." Stated another way it could read: it's an election year, we like where we are and will stay out of the way.

Speaking of the election year ahead, you will hear many pundits over the next few months claim they know the direction of the market based on certain candidates' chances of victory. This may be true for certain sectors or companies in the short run, but over the long-term, it is almost impossible to determine the true direction of the markets based on one party or candidate getting elected. While we are aware of the risks that are present on the geopolitical landscape, we try our best to filter out the noise and focus on the true fundamentals present in the marketplace.

Trade policy has been a hot topic all year and the fourth quarter finally brought some clarity. The USMCA trade agreement (new NAFTA) made its way through the U.S. House of Representatives and soon should be a done deal. U.S. and China verbally agreed on an initial step toward a broader trade deal with phase one slated to be signed on January 15th. As a result of this phase one deal, new U.S. tariffs that were slated to go into effect on December 15th were canceled. The 15% tariffs imposed on $110 billion of Chinese goods back in September now fall to 7.5%. In return, China commits to buying greater quantities of American crops, factory goods, and energy products. This phase one trade deal should mark the end of the trade war escalation and put the economy on sturdier footing in 2020. However, there is always the possibility for trade wars to continue in other parts of the world such as the rumblings around French wine right now. Yet, with the Fed on the sidelines and trade less of an uncertainty, expect 2020 economic growth to remain steady.

Stock market analysts were pessimistic about corporate earnings as we entered 2019 and the end result supported this view as earnings were basically flat for the year. Earnings growth for 2020 is projected to grow at single digits, as margins may come under some pressure from rising wages and other higher costs. As always, earnings will be an important component to the stock performance in 2020. A potential turnaround in worldwide economic growth and resolution on trade uncertainties may prove to be positive catalysts for the start of the new decade.

International stocks posted double-digit gains for 2019 as well. This may be attributed to central bankers' actions, but trade deals and fiscal policies may be the real heroes in 2020. As central banks shifted to interest rate cuts in 2019, investors drove up valuations for international stocks, believing that these "guardians of the economy" could defeat any threat to global growth. International stock valuations are below long-term averages, reflecting 2019's lackluster global growth and fears of potential weakness ahead. As international stocks tend to be more economically sensitive than U.S. stocks, they may offer more upside potential should growth reaccelerate. Compared to the past 20 years, global stock markets are now less synchronized with each other, suggesting a globally diversified portfolio may provide effective management of market volatility. Looking ahead, recession in some countries is possible, as headwinds from the trade-led slump in output and investment are having unequal impacts around the world. A broad global recession could occur if the manufacturing slowdown spreads to jobs and consumers. An end to the U.S.-China trade war would help, potentially reversing business uncertainty and unleashing investment. Manufacturing-focused economies, like Germany, are at the leading edge of the slowdown. This may lead to fiscal stimulus, with an increasing number of leaders already announcing new tax cuts and spending initiatives in their 2020 budgets.

2019 was a mixed year for emerging market investors, with countries such as Brazil and Russia posting outsized returns while India and others underperformed. A strong U.S. dollar and trade worries, and China's wilting growth had a ripple effect across the developing world. And political and currency crises in Chile, Argentina and Turkey have damaged some investors sentiment. Chinese policy makers are balancing the short-term requirement for stimulus against the medium-term necessity to reduce leverage in the economy. The net result is that stimulus will likely be modest, or enough to stabilize or provide a small boost to the Chinese economy, but smaller than the previous stimulus episodes in 2016 and 2012. Credit growth is unlikely to accelerate sharply, but the authorities have already reduced bank reserve requirements and cut policy rates. They are also likely to increase local government bond issuance to boost infrastructure spending. Gross domestic product (GDP) growth, however, is unlikely to rebound and should remain near 6%. We like the value offered by emerging markets equities. Their central banks outside of China are likely to stay on their easing paths, supporting growth and equity market.

Last year will go down as one of the best years for fixed-income investors in recent memory. Long-duration government bonds, investment-grade corporate bonds, and municipal bonds all outperformed. For fixed-income investors, the past 12 months have delivered outsized returns, as demand for safe-haven assets continued to surge. The U.S. corporate debt market has continued its strong rally of December into the new year, in a reflection of geopolitical tensions and expectations that the Fed will not be raising interest rates any time soon. The yield in high-yield bond land hit its lowest level in more than five years.[1] While higher-quality, investment-grade bonds have also seen their yields tumble, as prices climb. Pressure on Treasury yields have come from expectations of an accommodative central bank, intent on maintaining the current economic expansion. The economy is humming along, defaults are expected to stay low and as a result yields are low. Still, there are signs that corporate-bond investors are still attuned to risk. The incremental yield above U.S. government bonds has risen since its low in December. The investment-grade corporate bond market in the U.S. returned 14.2% last year, the best performance since the aftermath of the financial crisis in 2009.[1] High-yield bonds notched returns of 14.4%, the highest since 2016's rebound from turmoil in the energy sector.[1]

Keeping up this kind of performance could be difficult after a phenomenal 2019. It remains important to have an active and diversified fixed income allocation heading into 2020.

The municipal bond market is coming off a strong year thanks to a combination of tax reform, rising state revenues, declining default rates and improving credit quality. The S&P Municipal Bond Index saw a year-to-date gain of 7.3% in 2019.[1] Supply was equally robust with over a 50% year-over-year increase in issuance.[1] With that said, the municipal bond market is not without its challenges, but with interest rates anchored near record levels, the environment should be favorable for issuers.

| Index | 4th Quarter 2019 | Year to Date 2019 |
|---|---|---|
| **S&P 500** | 9.07% | 31.49% |
| **Dow Jones Industrial Average** | 6.48% | 24.43% |
| **NASDAQ Composite** | 12.47% | 36.69% |
| **MSCI EAFE** | 8.17% | 22.01% |
| **MSCI Emerging Markets** | 11.84% | 18.42% |
| **Barclays U.S. Aggregate Bond** | 0.18% | 8.72% |
| **Barclays U.S. Corporate High Yield** | 2.61% | 14.32% |
| **Barclays Municipal** | 0.74% | 7.54% |
| **Bloomberg Commodity** | 4.42% | 7.69% |

Source: Morningstar[2]

Looking ahead to 2020, the two main questions are whether the broad rally in risk assets can continue, and whether the outperformance of U.S. assets versus the rest of the world will persist. In our year-ending investment committee meetings, we argue that the broad rally can go on, because for the first time in over a decade all the world's major economic blocs are easing monetary policy, and fiscal policy settings are neutral to positive across the board. Moreover, two key sectors that have dragged down industrial production, electronics and automotive, have bottomed out, and manufacturing activity is picking up. As for the dollar, on balance, we see more downside than upside in 2020. This could benefit international and emerging market assets. Despite the positives listed above, we are aware of the risks that remain around geopolitics, the election and the trade disputes. That is why we maintain the diversified active approach you have become accustomed to.

After big years in the markets like last year or the 2008 market meltdown, investors are often faced with the question, "what should I do now?" Let's tackle that question with some prudent things that we do here at Hightower Westchester:

- Revisit and reassess your risk tolerance and current financial situation
- Rebalance your portfolio back to your targeted asset allocation mix
- Consider your investment time horizon and act accordingly
- If your time horizon is over five years, think and invest for the long-term, not the next trading day
- Stay invested and be true to your plan, as "going to cash" is usually a fool's game

At the end of the day, a lot of what we've just talked about, including the election cycle, tariffs and trade battles in the headlines, are somewhat irrelevant from our perspective as long-term investors. What is relevant is investing with a disciplined approach and your time horizon in mind. History shows that such an approach makes other factors in investing largely momentary.

**To discuss this commentary further, please contact us at 914-825-8630.**
**hightowerwestchester.com**

[1] *FactSet financial data and analytics. www.factset.com*

[2] *Morningstar*

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