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Market Commentary

Winter 2020

Despite my annual effort to "de-clutter" my home at the end of each year, I find it amusing on how little I am willing to part with things. I'm not sure why I still need my deceased mother's tax records from a decade ago, but I guess some things are just hard to let go. After a failed attempt to clean up the house, I tried again, but this time at the office. It is amazing what you can see in your office all year long and not move once throughout the year. Last week, my eye caught a glimpse of some discolored, aging Wall Street Journals which have never been opened. When I unfolded them, the September 15th and 16th of 2008 editions and the October 11-12, 2008 weekend edition were revealed. Now you know why they were never opened. The weekend edition's headline was "Wild Day Caps Worst Week Ever for Stocks." Wachovia Bank's stock was down 17% for the week, despite a 43% rise on Friday!

The markets of today are much different, of course. While we do not believe we are at the other extreme of the markets during the financial crisis, we do recognize a lot has gone right during the past year. First and foremost was the recovery of the markets from a precipitous decline in the fourth quarter of 2018 when the Dow Jones and the S&P 500 declined 12% and 14%, respectively, driven by the Fed's determination to raise rates at that time. The reversal in this stance caused the market to bottom in December and shoot higher throughout 2019. One could argue almost half of the return in 2019 was "getting back" what the market lost at the end of 2018. The other half was driven, in our opinion, by a well-functioning economy and lower interest rates. The US economy chugged along in 2019, although at a slower rate than 2018, causing, in part, a decline in interest rates. The 10-year US Treasury yield fell 29% from 2.71% to 1.92% by years end. In the long run, the price of a stock should track the intrinsic value of a company. In the short run, however, it is more driven by supply and demand. When rates fall, other sectors of the investment world, such as bonds, become less attractive, resulting in money flowing into the stock market, driving up prices. Additionally, from a fundamental perspective, the intrinsic value of an asset such as a stock or a home is inversely correlated with interest rates. (The intrinsic value of a company is its future cash flows and future cash flows increase in value as rates come down.)

Despite a growing (but slowing) economy and lower interest rates, the market's rise in 2019, or at least the extent of it, was a bit of a surprise given what happened to earnings expectations throughout the year. Earnings estimates for 2019 took a different route that than of the market, but a familiar route, declining throughout much of the year. Wall Street has a bad habit of being overly optimistic in January.

Typically, earnings growth is a big component in the degree of the market move in a given year. During the

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financial crisis, earnings estimates fell 34% and the market declined 39%. In the decade 2000-2010, the annual price return of the S&P 500 was 11.2% compared to the earnings growth rate of 10.2% according to Credit Suisse. However, in 2019, the market was up 31.5% despite earnings increasing just 1.4%. Some of this can be explained by the recovery of the fourth quarter in 2018 as previously discussed and by the expectation that materialized in the fourth quarter of 2019 that the economy would start to re-accelerate in 2020. This is a what the recent move of the market is predicated on, in our opinion, and failure to realize the 9.6% expectation for EPS growth in 2020 could put a damper on the markets given an above average price-to-earnings multiple. Other risks we see in the market are trade war developments with China, geopolitical risks with Iran and North Korea and any type of surprise in the November elections. For those reasons, we believe the market returns in 2020 may be somewhat front-end loaded. We remain in the bullish camp for 2020 but realize returns will not be as easy to come by as they were in 2019.

Of course, our expectations come with the caveat that predicting the next 12 months of the market is at best, an educated guess. We didn't predict the disastrous markets of 2008-2009 and we didn't think we would see the increases of last year. Quite frankly, predicting markets from one year to the next is not the primary purpose of what we do. Building portfolios to help others achieve financial success is what we do. We are responsible for the prudent management of your portfolio. And like 2008 where rebalancing of portfolios should have taken place (increase equity), a rebalance of portfolios should be reviewed now after a strong year like 2019. We realize that there is no expiration date on a bull market, but taking some profits after the longest bull market ever and the best calendar year returns since 2013 makes sense in our opinion.

Finally, there is also no expiration on our good wishes to you and your family for a happy, healthy, and prosperous 2020!