MARKET AND ECONOMIC REVIEW & OUTLOOK

AN UPDATE FROM THE ADVISORS AT GASKIN ASSET MANAGEMENT *CHARLOTTE, NORTH CAROLINA*

What a year! What a decade!! Back in the dark days of the Great Recession, a common theme among the market "experts" was a warning to us all – we should prepare for single-digit returns from our stock market investments for the foreseeable future. Many of the newspaper headlines pointed to a financial future that was likely to not be as bright as previous decades. We were cautioned to adjust our financial plans to reflect much lower expected returns. Our best days would only be visible in the rearview mirror as we moved into the 2010s. We cannot entirely blame the market experts. After all, with the clarity of hindsight, we now know that the last decade was the first decade since the Civil War that the U.S. economy did not experience a recession according to *Barron's* Lisa Beilfuss.[i]

It is also entirely possible that the experts did not fully appreciate the lengths to which the Federal Reserve (Fed) would go to stimulate the economy. Chairman Bernanke, a student of the Great Depression, was keenly aware of the role that the Fed could play in shortening the recession, so he led a series of historic Fed-funded cash infusions and rate cuts that likely prevented another protracted economic malaise as experienced in the 1930s. The economy stabilized and the markets rebounded much more quickly than following the Great Depression. According to Randall Forsyth of *Barron's*, "the Dow Jones Industrial Average did not return to its 1929 peak for nearly an entire generation, until 1954".[ii] By contrast, following the Great Recession, the market returned to the level of its 2007 peak by mid-2013. The Fed continued its loose monetary policy through the first half of this last decade with only slight tightening in the second half. Following the slowdown in late 2018, the Fed loosened monetary policy again which helped fuel the economy through the second half of last year.

Much has been written about the causes for the last recession and the timing of the next one. If the past is any indication of what the future holds, it would seem inevitable that the U.S. economy will experience another recession within the next few years. We do not yet see significant indicators of a slowdown at this point. Some argue that the reason we have not yet experienced another recession is due to the modest rate of the economic expansion following the Great Recession. Stated another way, the trough we fell into was so deep and the recovery so slow, we still have more room and time for the expansion to continue. David Kelly, chief global strategist at JP Morgan Funds puts it simply when he states, "This economy all the way through has been a tortoise rather than a hare … it's been a very slow expansion and constant underachievement."[iii] As noted above, fear of a slowdown in mid-2019 prompted the Fed to lower rates in July and two additional times before year end. Randall Forsyth believes the Fed will remain accommodative throughout 2020 with the Fed Funds Rate likely to remain steady until after the November elections with only 50% odds of a change by December.[iv]

According to Brian Wesbury of First Trust Advisors, the U.S. economy remains in the longest economic recovery in history with this January being the 128th consecutive month of growth[v]. During the first seven years, the U.S. saw average GDP growth of 2.2% while the average annual growth rate has increased to 2.6% since the beginning of 2017. The unemployment rate remains at the lowest level in 50 years and could be headed lower. While many attribute our economic recovery to the actions of the Fed, Wesbury believes stronger growth in the second half of the recovery is due to better regulatory policy and lower tax rates. He believes these factors should continue to help fuel growth but will be challenged by continued government spending. Wesbury backs up his concern of government largess with the following data: Federal spending (excluding national defense and net interest)

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averaged 13.3% of GDP in the 1980's and '90's. By the 2000s, it had increased to an average of 14.2% of GDP and then grew further to 16.2% of GDP by the 2010s. The increased government spending and the taxes necessary to accommodate such spending reallocates private funds to the public sector thus limiting corporate growth. This growth in government is another reason for the slower expansion following the Great Recession.

2019 Review

A December rally in the equity markets punctuated an already strong year – quite a reversal from a year ago. In 2018, the worst December in history pulled annual returns for most major asset classes into negative territory. In 2019, domestic and international markets responded positively to December news of an agreement in the U.S.-China trade dispute and the avoidance of a no-deal Brexit, while largely brushing off the impeachment of President Donald Trump. Overall, investors regained their appetite for risk in 2019, pushing major U.S. stock indices to multiple new highs.

The S&P 500 gained 2.86% in December and 28.88% for the year, representing the strongest year since 2013 for the broad U.S.-market index. The Dow Jones Industrial Average (1.74%), NASDAQ (3.54%) and Russell 2000 (2.71%) also made positive strides during December. Solid fundamentals, accommodative central bank policy – 65% of central banks eased policy in 2019, including the U.S. Federal Reserve, compared to just 5% in 2018 – and strong holiday shopping sales also contributed to the rally, according to Chief Investment Officer Larry Adam. In Washington, D.C., agreements on trade and a bipartisan government funding package also removed lingering uncertainties, according to Washington Policy Analyst Ed Mills. Despite declining bond prices in December, core fixed income had its strongest year since 2002, with the Bloomberg Barclays U.S. Aggregate Bond TR index returning 8.72% for the year.

	12/31/18 Close	12/31/19 Close	Annual Change	Annual % Gain/Loss
DJIA	23,327.46	28,538.44	5,210.98	22.34%
NASDAQ	6,635.28	8,972.61	2,337.33	35.23%
S&P 500	2,506.85	3,230.78	723.93	28.88%
MSCI EAFE	1,719.94	2,036.96	317.02	18.43%
Russell 2000	1,348.56	1,668.47	319.91	23.72%
Bloomberg Barclays US Aggregate Bond Index	2,046.60	2,225.00	178.4	8.72%

Performance reflects price returns as of market close on December 31, 2019.

Here is a look at some key factors we are watching, both here and abroad:

Economy

- The U.S. economy was mixed in 2019, and is expected to remain mixed into the first half of 2020, Chief Economist Scott Brown notes.
- Consumer spending growth should continue to be supported by job gains and wage growth. There will be some distortions from temporary hiring for the census, but slower population growth should dampen the underlying trend in job growth.
- Business fixed investment has been weak, reflecting slower growth and trade policy uncertainty. The Phase One trade agreement between the United States and China will help, Brown said, but does not eliminate uncertainty.

- Recession fears have decreased, but not gone away. The economy will be sensitive to any shocks that may occur – "and we can be certain there will be some surprises in 2020," Brown said.

Equities

- Equity market momentum remains strong, according to Joey Madere, senior portfolio strategist, Equity Portfolio & Technical Strategy.
- Technical indicators monitored by Madere and his team signal the broad-market index has been "overbought." Valuation levels suggest a normal consolidation would be healthy for the index to digest its strong gains before climbing higher, Madere said. Pullbacks are expected to be light and can be viewed as buying opportunities, particularly for favored sectors such as Information Technology, Healthcare, Communication Services, Financials and Industrials.
- On the energy front, progress on U.S.-China trade and Brexit – the United Kingdom's withdrawal from the European Union – contributed to oil prices approaching 52-week highs in December, said Pavel Molchanov, equity research analyst. While demand-related concerns remain, he considers the supply side of the oil equation remains bullish.

Fixed income

- Short term interest rates fell in December, with one-month and one-year Treasuries down nine basis points, according to Doug Drabik, managing director for fixed income research.
- Contrarily, Drabik said rates for Treasuries three years and out were higher for the month, with 10-year and 30-year rates climbing 15 and 17 basis points, respectively. The spread between two-year and 10-year Treasuries was its largest of the year at 33 basis points.
- The short end of the yield curve (one year and under) ended the year 80 to 110 basis points lower, while the longer end (two years and out) ended 65 to 90 basis points lower, Drabik said.

Bottom line

Coming off a strong year for both equity and bond markets, stock valuations are extended. Low interest rates, however, help support those high prices and low inflation. You may see slight pullbacks in coming months as the market digests its gains – these are considered healthy and represent the opportunity to selectively add to your portfolio.

Dow Jones Relative Risk Indices

	2019		Annual Returns			Annualized		
Index	**4th**	**YTD**	**2018**	**2017**	**2016**	**3 Yr**	**5 Yr**	**10 Yr**
Conservative Portfolio Index	1.47%	8.13%	-0.62%	5.73%	3.01%	4.35%	3.07%	3.97%
Moderately Conservative Portfolio Index	3.62%	14.14%	-3.15%	10.91%	5.65%	7.03%	5.08%	6.05%
Moderate Portfolio Index	5.41%	18.60%	-5.21%	15.15%	7.67%	8.99%	6.61%	7.76%
Moderately Aggressive Portfolio Index	7.10%	22.84%	-7.33%	19.08%	9.31%	10.67%	7.77%	9.17%
Aggressive Portfolio Index	8.79%	27.13%	-9.45%	23.20%	10.98%	12.35%	8.93%	10.64%

Source: S&P Dow Jones Indices as of December 31, 2019

We would like to close this *Market and Economic Review & Outlook* with a reminder of the importance of maintaining a diversified investment portfolio that reflects both your personal comfort with investment risk & volatility, as well as your investment time horizon. These factors are unique for each investor and can even vary within the same household but are of crucial importance for long-term financial success. While there can be no guarantees of success, a primary goal for our team is to help you improve the predictability of your investment performance. As you can see from the Dow Jones Relative Risk indices noted above, the past upside performance of the more aggressive indices has exceeded that of the more conservative ones. However, when contrasting the 2018 performance with those of 2019, we can see that the volatility of returns expands progressively. If you would like to discuss where your portfolio falls relative to the indices noted above or to discuss anything else, please give us a call at your convenience. We wish you a wonderful New Year and look forward to speaking with you!

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[i] Beilfuss, Lisa, "The Economy, 2019: A Microscosm of the Decade", Barron's, December 23, 2019, p. 25
[ii] Forsyth, Randall W., "Merry and Bright", Barron's, December 23, 2019, p.6
[iii] Beilfuss, Lisa, "The Economy, 2019: A Microscosm of the Decade", Barron's, December 23, 2019, p. 25
[iv] Forsyth, Randall W., "2020 With Imperfect Vision", Barron's, December 30, 2019, p. 5
[v] Wesbury, Brian, "Blame the Overweight Jockey", First Trust Monday Morning Outlook, January 6, 2020