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COOKSONPEIRCE

TAKING STOCK

THE DECADE IN REVIEW

As we bring to close the second decade of the twenty-first century, it is interesting to contrast the economic results of the past ten years against those of the previous ten. While the current decade began with the impacts of the Great Recession fresh in everyone's mind, the 2010s were the first calendar decade without a recession in American history and the first since at least the 1920's that didn't feature an equity index drop of at least 20% (though the results of late last year were just a rounding error away). Despite a decade of abundant successes, many investors remain skittish about the economy as the current advance has been pronounced in length, but not amplitude. Despite lasting a record 123 months, cumulative real GDP growth since the peak of the previous cycle in 2007 is just 21%. This lackluster gain trails seven of the previous ten recoveries. However, this extended economic recovery has been fruitful for domestic equity investors. Over the course of the past ten years, the S&P 500 has produced a total return of more than 250%. This contrasts sharply with the first decade of the new millennium which featured two recessions, two bear markets and a stock market which dropped by 10%.

BENCHMARK RETURNS

INDEX	RETURNS				
	OCT	NOV'	DEC	4th QTR	YTD
S&P 500 (Equity)	2.17%	3.63%	3.02%	9.07%	31.50%
Russell 3000 (Equity)	2.15%	3.80%	2.89%	9.10%	31.02%
MSCI World (Equity)	2.54%	2.79%	3.00%	8.56%	27.68%
Lehman Intermediate Bond	0.40%	-0.15%	0.13%	0.37%	6.80%
Lehman Municipal Bond	0.18%	0.25%	0.31%	0.74%	7.54%

2019 RECAP

After succumbing to tightening monetary pressures in late 2018, stocks quickly changed to a bullish course with the onset of 2019. This change in trajectory can be directly tied to the Federal Reserve's pivot towards accommodative policy. With Fed policy becoming a tailwind, the US economy continued to expand, though at a slower rate than the most recent past. While recessionary concerns remain, odds of an outright domestic slowdown have slowly diminished to the extent that the Federal Reserve appears unlikely to adjust rates in the foreseeable future. The yield on the 10-year Treasury Note dropped from over 3% at the tail end of 2018 to under 1.5% by early September 2019. The more than 30% rally in the S&P 500 was driven in its entirety by an expansion of the valuation multiple, as earnings were essentially unchanged on the year. The price to trailing earnings multiple of the S&P 500 rose from less than 17 in early January to over 22 by year end in concert with an increasingly benign interest rate environment.

While domestic equity gains were appreciable, leadership was surprisingly concentrated. Gains by the largest capitalization firms far outpaced those of smaller firms, an interesting, if not odd, occurrence in such a sharply appreciating environment. Even within the S&P 500, the advance of the largest constituents accounted for an outsized contribution. This trend has persisted for each of the past three years, with the skew between the very largest firms and their smaller peers now as broad as any point in the past 20 years. The phenomenon can be illustrated by the recent results of the index's trillion-dollar constituents, Apple and Microsoft. These two companies accounted for 15% of the S&P 500 30% advance and more than half of the gain within the Technology sector. Further illustrating the dominance of mega-cap Tech stocks, in the past three years the S&P 500 has risen by more than 50% with the performance of just four companies (Apple, Microsoft, Amazon and Google) accounting for about a quarter of that total gain.

Technology soared in 2019, but many of the industrial aspects of the economy suffered under slower conditions brought on by tariff uncertainty. Domestic manufacturing trends fell to a stall while global manufacturing slipped into a recession. Tariff effects in both the Eurozone and Japan were appreciable as the economies of each are export-focused. The US was able to weather the impacts rather efficiently given the domestic consumer orientation of the economy, but clarity on the trade front is necessary to further propagate the current long-running advance. It appears that an initial, Phase One, compromise between the US and China is likely, but a comprehensive, enforceable longer-term pact may remain elusive in the foreseeable future.

OUTLOOK

Buoyed by falling rates and a normalizing yield curve, stocks rose sharply in 2019 in anticipation of stronger earnings momentum in the coming year. Corporations will now have to deliver upon these expectations or equities could see investor demand quickly dissipate. The current outlook for 2020 earnings shows expected corporate profitability growth near 10% and revenue expansion above 5%. Energy, Industrial and Materials firms struggled in 2019 as their prospects were negatively impacted by a global manufacturing slowdown, at least partially attributable to trade and tariff uncertainty. With prospective clarity emerging on trade rules, global manufacturing momentum appears to be building and, consequently, these three cyclical sectors are expected to lead earnings growth in the coming year.

In the year ahead, interest rates are unlikely to play the supportive role they have over the past twelve months. However, with the Federal Reserve on pause, rates are likely to remain benign. Investors may continue to thirst for yield in this low-rate environment. This could allow dividend paying stocks to continue their run of recent success despite elevated valuations. Also, after an extended period of underperformance, international equities trade at a substantial discount to their domestic peers. Another discrepancy which may unwind in the year ahead is the persistent growth versus value skew. Growth-oriented firms have firmly outgained value-styled firms in recent years, though this trend showed signs of abating in late 2019. With the valuation gap between these two classes of equities broader than at its previous peak in the late 1990s, investors should be mindful of a possible reversal.

While opportunities are prevalent, risks to any forecast can manifest. In the coming year investors may see concerns arise over the Presidential election and the propagation of trade disputes. The market may be pressured by the policy rhetoric emanating from the campaign trail, particularly from those campaigns voicing support for programs outside the traditional mainstream. But note, in 2016 a Trump presidency was forecast to have a swiftly detrimental effect on the stock market due to his unpredictability. Yet, this outcome failed to materialize with the market rallying slightly in response to the final vote tally. New and escalating trade disputes are possible risks in 2020. Until corporations are confident that the rules of economic engagement are firmly set, business investment is likely to remain suboptimal.