Q-4 2019 In Review

January, 2020

Market Review

Twenty nineteen was a most interesting year. Investors who sold positions in the very volatile and negative financial markets of the fourth quarter of 2018 and remained on the sidelines throughout 2019 are regretting their timidity in the face of investment returns obtained in both the debt and US Treasury markets.

Equity investors entered 2019 with the Standard and Poor's Index down 4.4% over the twelve-month period. In the fourth quarter of 2018, the S&P had dropped 13.97% and the Nasdaq 17.5% as reported by CBNBC on December 31, 2018.

Three successive Federal Reserve Bank 0.25% rate increases, a series of punitive tariffs imposed on China by the Trump Administration and the threat of tariffs on other trading partners had destabilized global and domestic markets for much of the year but especially during the fourth quarter. Europe struggled to maintain positive economic growth and the almost ten-year business expansion in the US appeared to be fast maturing with ominous signs of an impending recession in in 2020.

Despite all these bad omens, however, some investors saw opportunity in 2019. Because of the significant sell-off in December 2018 some believed there was upside potential for equity markets in 2019. Those who acted on that sentiment realized significant rewards.

At Seslia, we stayed the course with our client investments. This resulted in most clients enjoying positive investment returns during 2019.

Twenty-nineteen began with admissions from the Fed that short term rate and liquidity tightening needed revisiting. Interest rate decisions in 2019 would, therefore, be more data driven. Additional rate increases and run off of the Fed balance sheet would slow. This more market conciliatory stance tampered the volatility of Q-4 and was positive news for Fed watchers and investors.

By the midpoint of the year, the discernable slowing of the global and European economies prompted the Federal Reserve to be further proactive. Short term interest rates were cut twice, by an aggregate of 0.50%. This evidenced the Feds determination to get in front of what seemed a possible contagion effect from an off-shore economic slowdown.

Market watchers initially questioned the efficacy of this action. Rates were already low and there was skepticism the Fed could offset a slow-down that appeared imminent. In addition, the Administration's penchant to impose sanctions against its enemies (Iran) and tariffs against its allies (Canada, Mexico, Europe, South Korea) in an effort to change political, trade or immigration practices, further destabilized global and U.S. economic growth.

By summer's end, however, the Fed's actions along with improving global economic performance, staved off what seemed a looming domestic recession.

Noteworthy is that throughout the year, the US Consumer remained a bulwark of the economy providing stability to retail and housing sales, albeit the latter in individual geographic markets.

Unlike non-US economies, domestic consumer spending accounts for in excess of 70% of economic activity. It renders this economy less dependent on export sales and it provides a robust market for domestic manufacturing and services.

Employment data and unemployment rates evidenced that domestic manufacturing and the service sector generated new employment opportunity throughout the year. Wage growth in 2019 will likely exceed a 3% gain last achieved in 2016.

Job gains appeared wide spread across sectors with health leisure and hospitality and professional and business services being particularly noteworthy.

In November, non-farm payrolls surged 266,000 and unemployment fell to 3.5%. Through November, the labor force increased on average 180,000 monthly. This was less than the 223,000 average in 2018, but we are later in the economic growth cycle. The US economy must create 107,000 jobs monthly to keep the unemployment rate steady, according to calculations from the Atlanta Federal Reserve.

This workforce growth performance is particularly noteworthy in the face of a 40-day worker strike at General Motors in September and October. That labor action was the longest auto worker strike in 50-years and directly impacted employment for 48,000 workers.

By November and December, more conciliatory comments from the White House on tariff and trade relations with China encouraged the upward climb of the equity markets. In typical Trumpian communication style, the markets learned of an expected Phase 1 trade deal with China that would increase farm product sales and possibly eliminate the need for further tariff increases on Chinese consumer manufactured products in December 2019.

All conspired for an end-of year close to the Standard and Poor's index, up 31.5%.

US Treasuries returned 6.9% to investors over the same twelve-month time period, though the fourth quarter returns were negative 0.8%.

The Bloomberg Barclays US Aggregate Index return for 2019 was negative 0.1%.

Internationally, in London, the December election of Boris Johnson brought a welcome end to the saga of whether Britain would or would not leave the European Union. With majority control of the House of Commons, Mr. Johnson can now move forward with leaving the EU. and pursue a trade deal with the Union in the coming twelve-months and the United States thereafter. Neither successes are assured either in terms of scope or timing.

The Chinese economy continues to slow. The Phase 1 trade deal with the United States will allow China to focus on issues more within its government's control. Hong Kong continues to be a thorn not easily exorcised. Its importance as a gateway to the world should not be underestimated. Street demonstrations extending over many months as well as the stunning victory for pro-democracy parties in the November local elections sent a clear message to the Government of The People's Republic of China that further diminution of democratic rule in the special administrative region would come at a pricey cost to the Chinese economy. In 2020, we will undoubtedly get clarity as to how China's central government decides to deal with this challenge.

Market Indicators

Indices performance

Equities:

Annual JP Morgan12/31/2019)*
Standard & Poor's' 500 Index-- +31%

Q-4 JP Morgan12/31/2019)*
Standard & Poor's 500 Index-- +9.1%

Fixed Income:

Annual JP Morgan12/31/2019)*
Bloomberg Barclays US Aggregate Bond Index*-- (0.1%)

Q-4—Putnam Investments Q-4 2019 Fixed Income Outlook
Bloomberg Barclays US Aggregate Bond Index Q-4 2.27%

*The above market data is provided for illustration purposes only and has limited applicability to investment portfolios differently constructed. The indices described serve as an indication of overall market performance for both US domestic and fixed income instruments.