MARKET

Insights

January 2020

2020 Vision: A Forward Look

EXECUTIVE SUMMARY

2019 Review

2019 Themes proved mostly accurate, with four consecutive quarters of negative S&P 500 earnings growth, and an accommodative Fed. Volatility on the whole was more subdued than we expected, but did come in pockets throughout the year (most notably May & August).

2020 Outlook

Our 2020 expectations are for more subdued returns relative to 2019, increased market volatility brought on by geo political issues and the upcoming 2020 US presidential election, and for interest rates to stay lower for longer as central banks learn from the Fed's missteps in late 2018.

Portfolio Positioning

Portfolio positioning: Remain overweight in US equities versus International Developed and Emerging Markets, add duration to bond holdings as interest rates creep higher, continue to use liquid alternatives as balanced-portfolio complements, given their ability to enhance portfolio diversification.

2018 – 19: The Past Is Prologue

As of December 31, 2018 the US stock market (S&P 500) had fallen **13.5%** in Q4-18 and ended 2018 with a loss of **-4.4%**. Thankfully, 2019 saw the US market (S&P 500) come back strongly from a challenged 2018, with the S&P 500 delivering positive returns in 10 out of 12 months and generating a total return of **31.5%**. International markets generated positive returns as well, with developed foreign markets (MSCI EAFE) appreciating **22.0%** and emerging markets (MSCI EM) appreciating **18.4%**. Surprising many market participants were the impressive returns seen from bonds as interest rates moved downward instead of upward as many had anticipated at the start of the year. Investment-grade bonds ended the year with a return of **8.7%**, while high-yield bonds notched double digit returns of **14.3%**.

Asset Class	Category	Index	4 Qtr 2019	YTD 2019
Equity	US Large Cap	S&P 500	9.07%	31.49%
	US Small Cap	Russell 2000	9.94%	25.52%
	International Developed	MSCI EAFE	8.17%	22.01%
	Emerging Markets	MSCI EM	11.84%	18.42%
Fixed Income	US Investment Grade Bonds	BBgBarc US Agg	0.18%	8.72%
	US Inflation-Indexed	BBgBarc US Treasury US TIPS	0.79%	8.43%
	US High Yield	BBgBarc US Corporate High Yield	2.61%	14.32%
	EM US$ Debt	JPM EMBI Global	1.81%	15.04%
Alternatives	Absolute Return	Credit Suisse Equity Market Neutral	-1.51%	0.06%
Cash	US T-Bill 90 Day	US T-Bill 90 Day	0.39%	2.06%

Source: FactSet Indexes, total returns in USD as of December 31, 2019. US Large Cap is S&P 500 index, US Small Cap is Russell 200 index, Intl Developed is MSCI EAFE index, Emerging Markets is MSCI EM index, Investment Grade is Barclays US Aggregate index, High Yield is Barclays, Market Neutral is Credit Suisse Equity Mkt Neutral index, REIT is MSCI US REIT Diversified.

As we sat down to review 2019, we took a look back at the Market Insights newsletter we published in January 2108. As mentioned above, the S&P 500 had a rough end to 2018, declining -15.4% from September 20th to where it bottomed on December 24th. In the conclusion of our newsletter, we shared a chart that showed stock market corrections of -10% to -20% since 1950. The chart showed that on average the subsequent 12 month returns were positive by an average 30%+. Based on this historical data and the economic indicators not flashing red, we encouraged investors to stay invested. As we turn the page from 2019 to 2020, we can now look back and see our view was correct. Following that painful -15.4% decline, the stock market (S&P 500) has returned a cumulative +40.25% from 12/24/2018 to 12/31/2019.

Stock Market Corrections of -10% to -20% Since 1950

S&P 500 Index Monthly Total Returns

Start	End	Duration In Months	Total Decline (with dividends)	Next 12 Month Total Return	State of Economy
May 2011	Sep 2011	5	-17.0%	+27.3%	Expansion
Jul 1998	Aug 1998	2	-15.6%	+37.9%	Expansion
Jun 1990	Oct 1990	5	-15.8%	+29.1%	Recession
Jul 1983	May 1984	11	-10.4%	+25.9%	Expansion
Feb 1966	Sep 1966	8	-17.6%	+26.3%	Expansion
Aug 1959	Oct 1960	15	-11.8%	+28.5%	Recession
Aug 1956	Dec 1957	17	-19.0%	+38.1%	Expansion
Jan 1953	Aug 1953	8	-12.2%	+27.9%	Recession
Average		*9*	*-14.9%*	*+30.1%*	
Current Market Correction…					
Sep 2018	Dec 2018	4	-15.4%	+40.25%	Expansion

Source: Morningstar database, monthly total returns.

Themes for 2019: The Report Card

In the January 2019 Market Insights, we identified three themes that would dominate market behavior for the year. Here is a review of those themes and what actually happened over the year:

2019 THEME 1: *The Path Of Interest Rates Is Changing*

We noted it was highly unlikely the Fed would continue to raise short term interest rates in 2019, after hiking in Q4 2018. The Fed proved us correct by performing an about-face, and ended up cutting the overnight Fed Funds rate three times in 2019. Our bias toward shorter-dated bonds versus longer-dated bonds resulted in positive absolute returns for the year. These returns lagged versus the Barclays aggregate bond index due to its exposure to longer dated bonds that many fearful investors flocked to throughout 2019.

2019 THEME 2: *Volatility Is Here To Stay*

Of our three themes of 2019, this was the least accurate. With that said, while overall equity market volatility was subdued in 2019, there were certainly periods of turbulence (mostly related to macro factors such as the trade dispute with China). The largest intra-year decline in 2019 occurred in May, with the S&P 500 falling -5.9% between May 1 and June 3. (Source: FactSet). Going into 2020 we expect volatility to be more elevated (see our 2020 themes later in this piece).

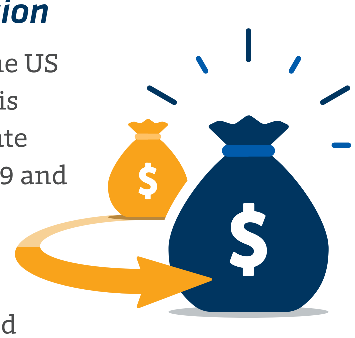
2019 THEME 3: *Earnings Growth Becomes More Difficult*

Earnings growth certainly was more difficult to come by in 2019, with the first three quarters of the year seeing year-over-year earnings declines. Expectations are for more of the same in the fourth quarter with final results to be reported in late January. If this comes to pass, it would mark the first time since Q3-2015 thru Q2-2016 that we have had four straight quarters of year-over-year S&P earnings declines (Source: FactSet Earnings Insight, 12/20/19).

So, where do we go from here? The Wall of Worry we wrote about at mid-year was more of a Stairway to Heaven in the second half of 2019. Can that continue? Below we lay out the themes that will heavily influence market behavior in 2020.

Themes for 2020: The Road Ahead

2020 THEME 1: *Recovery Not Recession*



A proactive Fed helped the US economy maintain what is likely to be an approximate **2.0%** growth rate in 2019 and helped stocks generate outstanding returns. Inflation remained low while unemployment held below **4%**. While 2019 corporate earnings declined for four straight quarters, the market soared **31.5%**. Forward P/E multiples for the S&P 500 are now at **18.2x** well above the 20 year average of 15.5x.

With the Fed now on hold, market returns will depend primarily on a re-acceleration of earnings growth rather than multiple expansion. S&P 500 earnings growth (year-over-year) for calendar year 2020 is estimated to be **9.6%** (Source: Factset). Whether or not this type of earnings growth comes to fruition could make or break the US equity markets. One thing is for sure– companies that miss earnings estimates will get punished, given the "perfection pricing" that currently exists across the S&P 500. We believe a slow and steady economy will allow the earnings recovery to take place, but will result in more muted returns for stocks.

2020 THEME 2:
Geopolitical risks make for volatile markets

While overall volatility was relatively low in 2019, the ongoing US/China trade war has been the cause of turbulent daily fluctuations throughout the year. When trade talks have broken down, the market has fallen. When trade talks have begun again, the markets have risen. Phase one of the US / China trade deal was signed on January 15th. Subsequent phases are likely to be increasingly difficult. With the election looming, President Trump is unlikely to risk undermining the progress already made, and China arguably knows that. Get ready for unlimited "headline volatility", whether it be from the latest Middle East situation, ongoing trade negotiations, or election handicapping and the perceived impact on several economic sectors to various candidates' polling strength (e.g. healthcare sector).

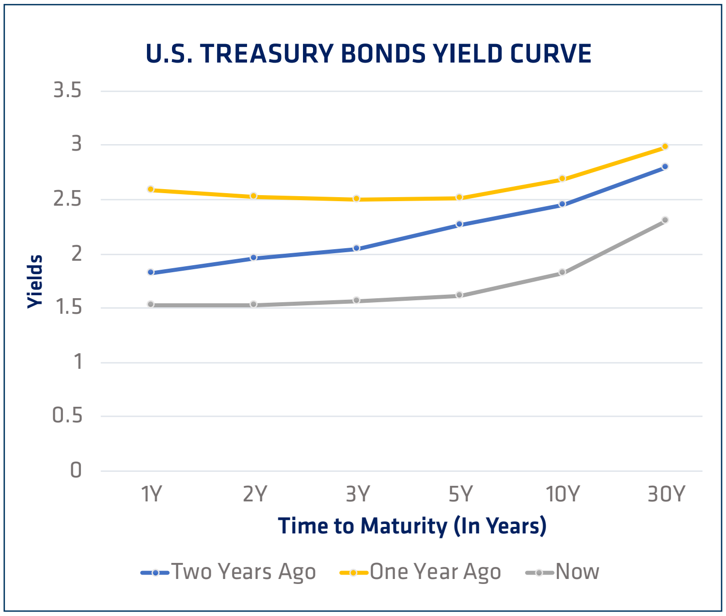
Our view is that, while the 2020 Presidential Election is arguably the most divisive in at least the 21st century, economic fundamentals ultimately drive market returns higher, while politics create volatility. It's important to note the market can still have positive years during a contentious election: Since 1952, the Dow has climbed an average of **10.1%** during election years in which an incumbent is running for re-election.

2020 THEME 3:
Range-Bound Rates

After three rate cuts in 2019, Federal Reserve Chairman Jerome Powell has indicated that the Fed will pause at **1.75%**, unless the data & outlook change materially. As a result, investors cannot count on continued cuts from the Fed to juice stock returns.

We expect the yield curve to continue to modestly steepen over the balance of 2020 and likely stay lower for longer. In a recent Barron's magazine survey, the 10-year Treasury yield was forecast to remain at or below **2.20%** for the year. An environment where investors no longer fear a quick jump in bond yields is one where they can begin utilizing bonds as they have historically: a means of downside protection to hedge against equity volatility.

We plan to use the gradual rise in interest rates to slowly add back exposure to longer dated bonds. We believe that by doing this client portfolios will be better equipped to weather the more significant bouts of volatility equity markets might encounter in 2020.



Positioning Your Portfolio For The New Year

We remain modestly bullish on equities for clients with longer time horizons. With volatility expected to increase, clients in need of liquidity in the near-term should reduce equity exposure now. We favor US equities over both International Developed and Emerging Markets, given the lack of a growth catalyst in Europe, and slowing GDP growth in China.

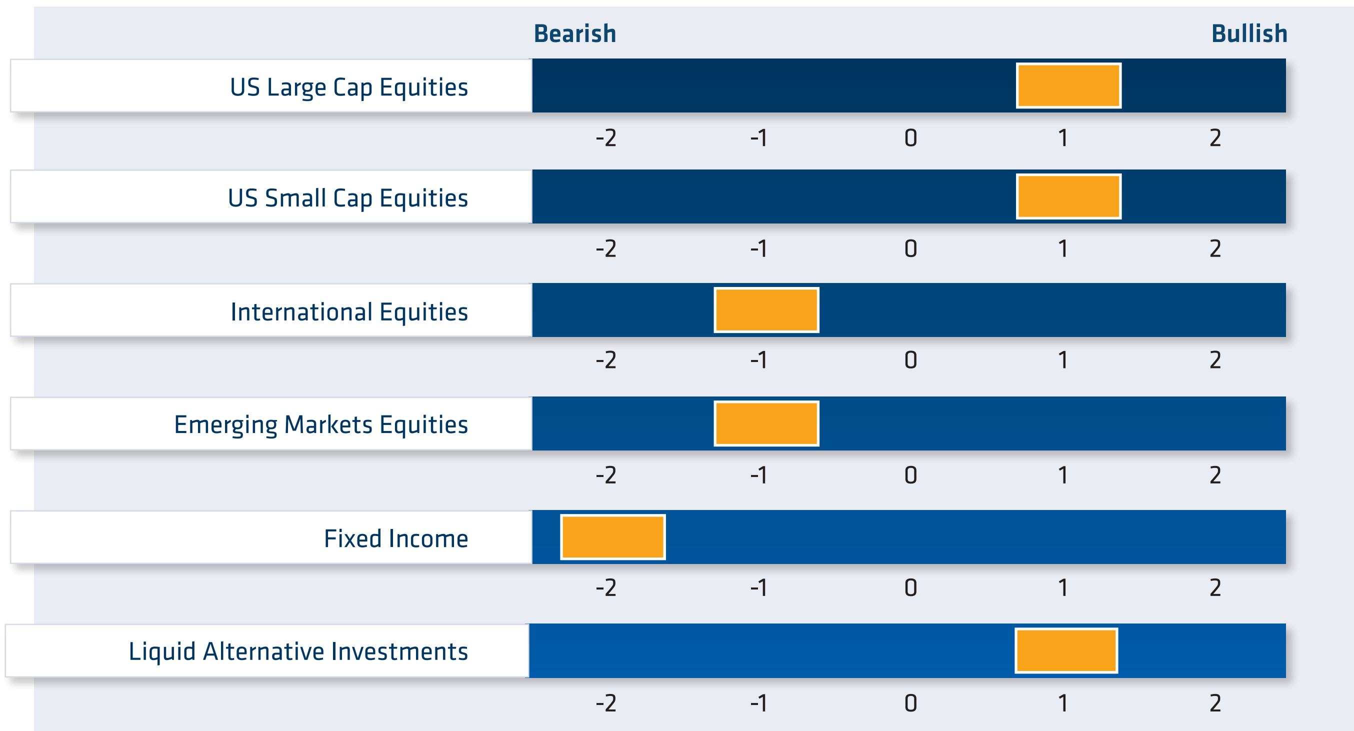
We have recently added to actively managed intermediate-term bond funds that are well-equipped to tactically manage a wider range of bond sectors. As rates continue to trend higher, we anticipate adding additional duration.

Lastly, we continue to diversify portfolios with a combination of liquid alternative funds that have low correlation to traditional stock and bond markets and complement each other in changing market conditions.

As always, we value the trust you have placed with us, and welcome your comments, insights and concerns. Please contact your Webster Private Bank Portfolio Manager at any time for a discussion about your personal investment portfolio.

Happy New Year!

BEARISH VS. BULLISH



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