Macro Summary

National:

- The Federal Reserve continued its bias to an accommodative policy and signaled it will pause to confirm if these easing steps are enough to sustain the economic expansion.
- Congress approved $1.4 trillion in spending packages to avoid a government shutdown. The spending increases both the military & domestic programs and eliminates key taxes to fund the Affordable Care act.
- In addition to the $1.4 trillion in aforementioned spending, Nancy Pelosi, the Speaker of the Democratic-controlled House of Representatives, said she is willing to work with the Republican party and President Trump on a stimulative infrastructure bill.
- Inflationary pressures are muted and serve as the rationale for increased stimulus. The Federal Open Market Committee (FOMC) projects inflation of 1.9 percent for 2020 and 2.0 percent for 2021.
- The final third quarter Gross Domestic Product (GDP) report of 2.1 percent exceeded expectations. Consumer and government spending drove it while business investment remains soft.
- A Wall Street Journal economic survey revealed an average probability of 25.9 percent for a recession in 2020; just over one-third of economists surveyed believe a recession is likely in 2020.
- The unemployment rate hovered near 50-year lows with healthy job creation, near-record job openings, and muted layoff activity. Many states will implement higher minimum wages this coming year.
- Consumer wealth continues to grow from income gains and asset appreciation, but the growth remains disproportionate and favors middle-to-upper income households.
- Despite near-record levels of policy uncertainty, the Standard & Poor 500 Index (S&P 500) experienced twenty-six new record highs in 2019, and only seven price moves greater than two percent. The financial markets successfully ignored headline noise.

International:

- Washington and Beijing reached a Phase I trade agreement that will reduce tariffs and force China to purchase larger volumes of US farm products.
- The October 31, 2019 Brexit date was delayed and now the United Kingdom is scheduled to leave the European Union (EU) on January 31, 2020. EU officials are signaling more time may be necessary to prevent a hard Brexit.
- Global central banks reduced interest rates 56 times in the third quarter 2019 versus 27 interest rate increases in the third quarter 2018.
- A $7 trillion Wall Street powerhouse is finally matching its climate-change rhetoric with action. BlackRock chairman and CEO Larry Fink recently signed two letters that could change the face of Wall Street as we know it. The firm is in the process of removing, from its actively managed portfolios, stocks, and bonds of companies that get more than 25% of their revenue from thermal coal production.

A Look Back at 2019…What A Difference A Year Makes!

2019 came in like a lion and went out like a lamb. This time last January, investors were worrying about a significant market swoon driven by fears of higher interest rates, the impact of quantitative tightening as the Federal Reserve began unwinding its balance sheet, and a trade war with China. The Fear & Greed Index, a quantitative measure of investor emotion, was pointing to extreme fear. Twelve months later, Chairman Powell has lowered interest rates three times and seems poised to hold rates steady for the foreseeable future. President Trump signed an initial trade agreement with China. Meanwhile, the yield curve, which inverted mid-year, has since returned to normal. The Fear & Greed Index is now pointing towards max greed. These factors, along with a continued healthy job market, led to a strong recovery in the global financial markets after nearly two years of treading water.

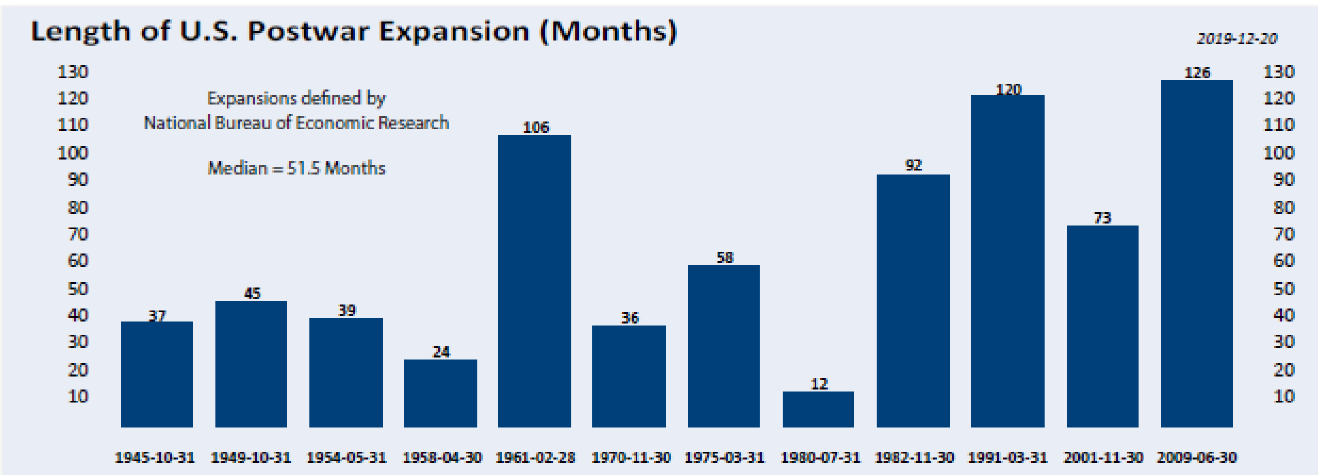
The 2019 Headlines In Review

Date	Headline
January	Chairman Powell Suggests Interest Rates Will Be On Hold
February	Corporate Earnings Reveal China's Economic Slowdown
March	Boeing Jet Draws Criminal Probe
April	U.S. Sees Trade Deal With China In Weeks
May	U.S. Slaps Higher Tariffs On China
June	Federal Reserve Puts Interest Rate Cuts In Play
July	Jobs Report Allays Fears of Slowdown
August	Trump Plans New Tariffs On China
September	Federal Reserve To Trim Interest Rates By A Quarter Point
October	Impeachment Inquiry Of President Trump Begins
November	Powell Cuts Interest Rates Again, Signals A Pause
December	Online Shopping Sets Strong Pace As Holiday Season Begins

The Economy

> *"None of the post-war expansions died of old age. They were all murdered by the Fed."*
> –Rudi Dornbusch, Economist & MIT Professor

We agree with Professor Dornbusch. The median economic expansion dating back into 1945 has lasted 51.5 months. As shown in the chart below, at 126 months, this current expansion is the longest on record and is almost 2.5x the average length of past expansions. Some reasons the current expansion has been remarkably resilient is due to few periods of overinvestment and a record amount of monetary stimulus.



The fading growth drag from the trade war and the increasingly positive growth from easier financial conditions should keep the US economy on sturdy footing in 2020. We also expect business investment - one of the weak spots of the United States economy last year - to recover as companies respond to strong demand growth in an environment of diminished recession fears.

While any significant progress on a Phase Two trade deal is unlikely given fundamentally unreconcilable differences, increased tariffs should not be a headwind ahead of the 2020 election. President Trump has every incentive to keep China relations strong until he retains the oval office. With the absence of new fiscal stimulus and fading benefits from the tax overhaul, we believe the domestic economy will grow at a 2.25 percent pace in 2020, with potentially more upside potential from the easy monetary conditions.

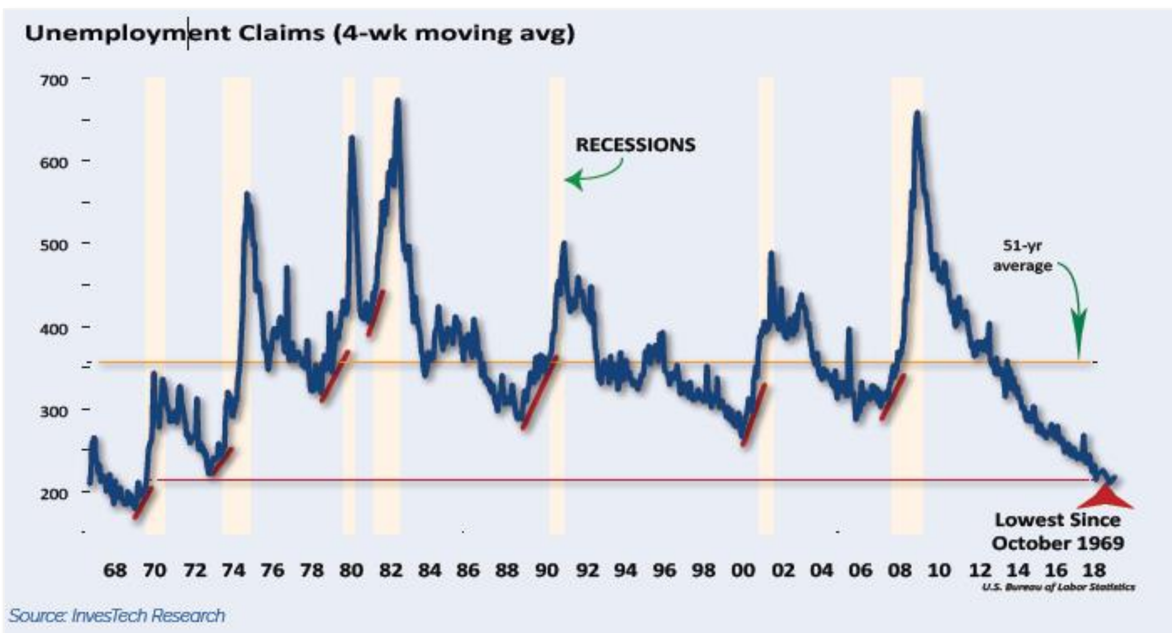
There are a lot of indicators to gauge the health of the economy; however, there are several that our investment team favors when assessing the intermediate-term outlook. Those are the Conference Board's Index of Leading Economic Indicators, first time unemployment claims, and the health of the housing market.

Although we are later in this economic expansion, the indicators still suggest continued economic expansion. Let's review each one.

The Conference Board's Index of Leading Economic Indicators (LEI) has hit new high after new high since rebounding from the 2008-2009 crisis. While Leading Indicators have recently declined, they are still elevated and are not showing the weakness that normally precedes economic recessions.

We place a lot of emphasis on leading indicators because, over the past 60 years, early weakness in the Leading Indicators Index has preceded every recession in the United States. The typical lead time between the peak in LEI and the start of recessions has ranged between four and twenty-one months. Since 1960, the average lead time has exceeded 11 months.

Another indicator that is signaling continued expansion is the number of new claims for unemployment benefits. Typically, unemployment claims start rising about six to twelve months prior to the start of a recession (red lines on graph). As shown below, the four-week moving average of jobless claims recently hit its lowest level since October 1969, a 50-year low, which is consistent with continued growth in the economy.



Almost 70 percent of our economy is driven by consumer spending; therefore, an employed and financially healthy consumer is a key driver of economic growth. The unemployment rate and jobless claims are hovering near 50-year lows and we continue to believe the job market is strong as we move into the new year.

Mortgage rates have declined by approximately 100 basis points and history tells us that declines in mortgage rates lead an acceleration in GDP by about twelve months. Furthermore, housing starts and the business cycle are closely linked. A housing start is a metric that shows the number of new residential construction projects began in a month.

As indicated in the following chart, housing starts peak roughly two years before recessions. Given the fact that housing starts just hit a new cycle high, it suggests that the economy has a good bit of runway to keep expanding.

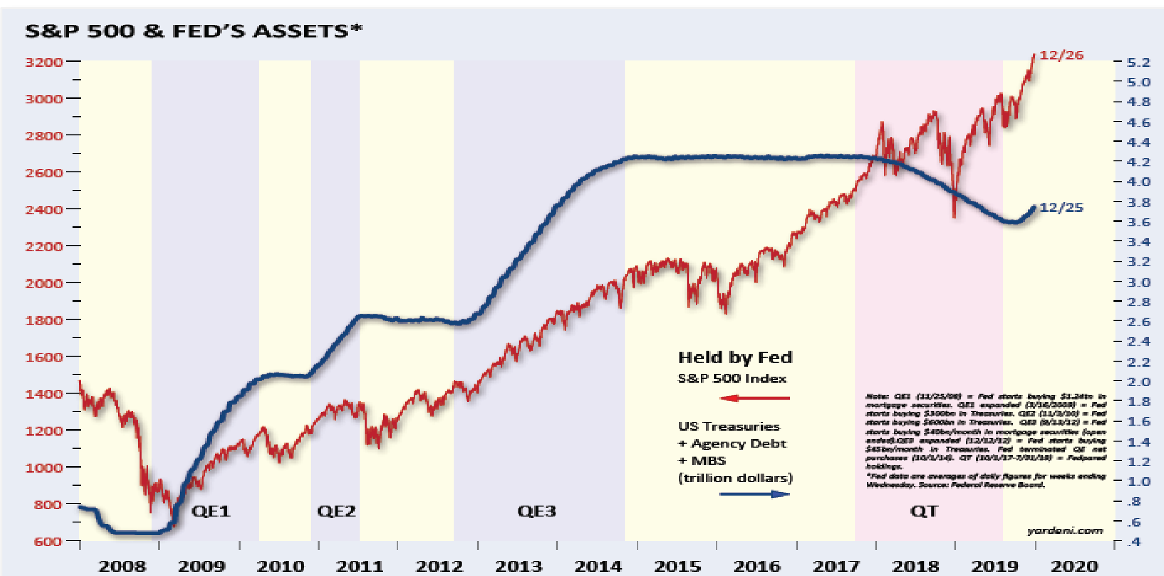
Figure 3. | Housing Starts as a Long Leading Indicator

Peak	Trough	Recession	Peak to Recession
Mar-99	Dec-00	1-Mar	24
May-86	May-91	Jul-90	50
Aug-78	Jul-80	Jan-80	17
Jan-73	Apr-75	Nov-73	10
Jan-69	Jan-70	Dec-69	11
		Average	**22**

Source: Renaissance Macro Research

The Federal Reserve

The Fed's accommodative monetary policy can be seen by the growth of its balance sheet since Quantitative Easing 1 was launched amid the 2008 Financial Crisis. As you can see from the chart, virtually all gains in the financial markets since 2008 occurred when the Federal Reserve has been expanding its balance sheet. Volatility in 2018 and subsequent equity market losses both occurred after Chairman Powell had already begun shrinking the balance sheet and, in fact, only accelerated when he discussed additional interest rate increases.



Source: Yardeni Research

An important question we ponder as we move into 2020 is whether the Federal Reserve's quick and rather dramatic reversal of policy was enough to curtail the potential damage done by higher short-term interest rates. Were the three rate reductions in 2019 enough to rekindle growth and avert a near-term recession? Yes, we believe so.

The Financial Markets

> *"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in the corrections themselves."*
>
> –Peter Lynch, American Investor, Mutual Fund Manager & Philanthropist

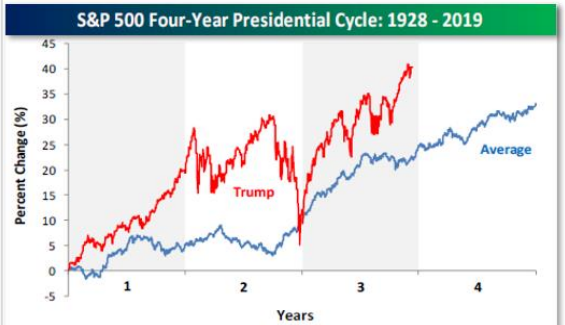
We do our best to avoid making predictions. Rather our investment committee prefers to focus our attention on several directional views on where the financial markets will trend over the coming year. We expect 2020 will start slow from an economic standpoint due to an earlier Chinese New Year, and remaining uncertainty about the go-forward rules around the recently-signed trade agreement. Another short-term headwind is the uncertainty around Boeing and their production issues related to the ongoing 737-Max jet saga. While it is just a single company, Boeing's issues have a disproportionate impact on certain economic statistics and resonate through its huge supply chain. Based on the latest forecasts, Boeing should be back up and producing at more normalized rates late in the first or early second quarter of 2020.

Shifting to tailwinds, the GM strike, which was a headwind to the economy late in 2019, should turn into a tailwind in 2020 as production resumes. Additionally, earnings comparisons are easy in the first half of this year in many industries due to the excessively wet weather that much of the country experienced in the first half of 2019. It's hard to imagine that the weather impact could be much worse in 2020 but it, as always, is a wild card.

S&P 500 Average Presidential Cycle Returns: 1928 - 2019

Year	Median S&P 500 Change (%)	Percent of Time Up (%)
1	7.06	56.5
2	1.06	56.5
3	17.27	81.8
4	9.26	72.7
All Years	10.46	67.0

S&P 500 Four-Year Presidential Cycle: 1928 - 2019

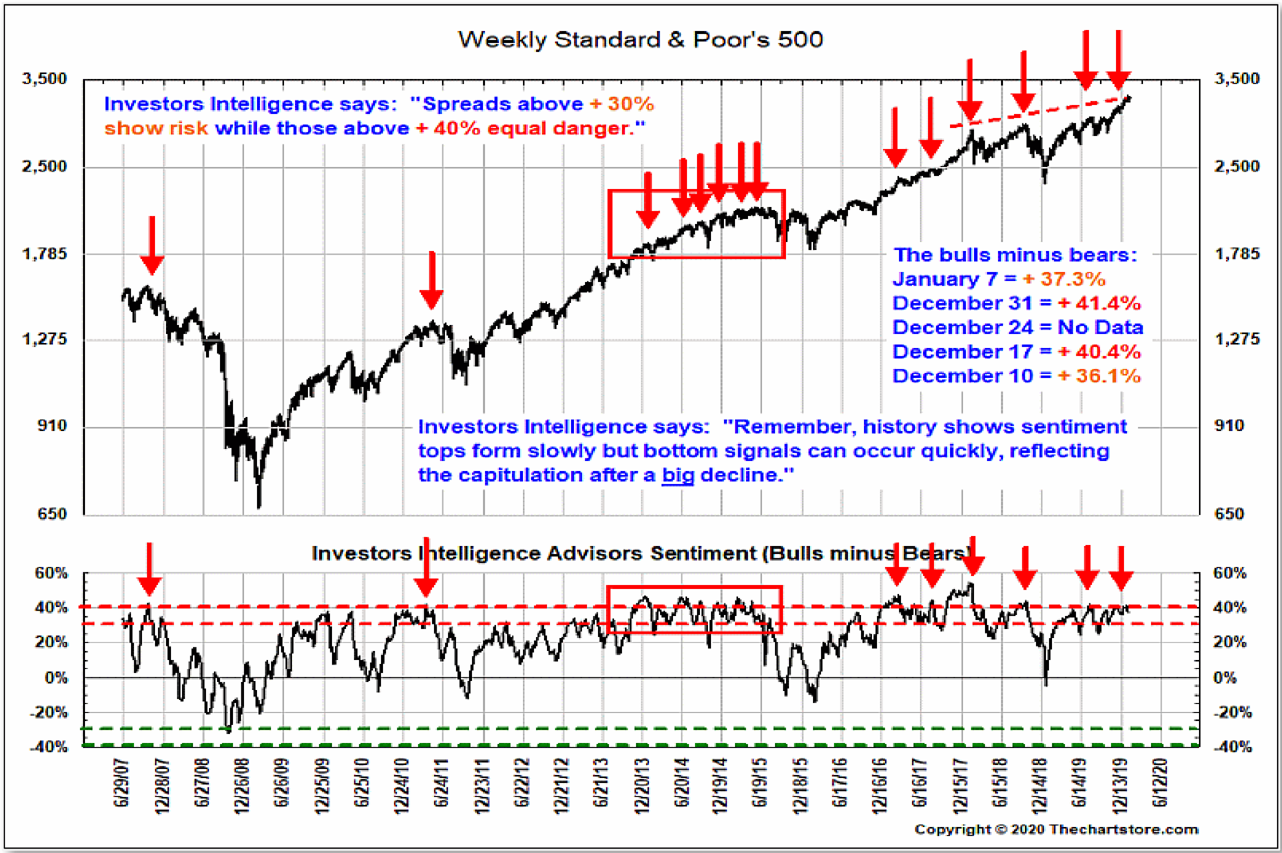


President	Year	Change (%)
Hoover	1932	-14.8
FDR	1936	27.9
FDR	1940	-15.1
FDR	1944	13.8
Truman	1948	-0.7
Truman	1952	11.8
Eisenhower	1956	2.6
Eisenhower	1960	-3.0
JFK/LBJ	1964	13.0
Johnson	1968	7.7
Nixon	1972	15.6
Nixon/Ford	1976	19.1
Carter	1980	25.8
Reagan	1984	1.4
Reagan	1988	12.4
Bush I	1992	4.5
Clinton	1996	20.3
Clinton	2000	-10.1
Bush II	2004	9.0
Bush II	2008	-38.5
Obama	2012	13.4
Obama	2015	9.5
Median (All Year 4s)		9.3
Republicans		3.5
Democrats		12.4

Source: The Bespoke Report 2020

Many of the characteristics that have been supportive to the US economy will remain in place: historically low interest rates, low unemployment, and accelerating wages with subpar inflation. This environment should also be supportive of merger & acquisition activity. The other wild cards remain President Trump, the November election, and China.

With the 2020 election less than 11 months away, politics will be a mainstay in the headlines this year, and polling data trends will impact short-term market returns. Capitalism has become the enemy among a few candidates and, depending on how their poll numbers move, the global financial markets will move in the opposite direction. Regarding the four-year election cycle, we're just ending what has historically been the best year (year three), but year four ranks as number two. As the stock market has continued to hit record highs, investor sentiment has risen to an optimistic extreme. As shown in the chart below, extremes in the Investor Intelligence data are normally contrarian indicators, with optimistic sentiment leading to corrections or pullbacks, and pessimistic extremes leading to rebounds.



While the global financial markets recovered meaningfully in 2019, our investment committee has identified five areas of concern where the risk of an unpleasant surprise or deterioration in the macro environment shouldn't be ignored.

1- Valuation risk. For us a critical question is always, 'What's in the price?' In other words, what economic assumptions and expectations are already embedded in current asset prices and valuations? With valuations above average historical levels, the financial markets may be vulnerable to disappointment or a negative surprise.

2- The ongoing United States & China trade war. Despite the recent positive developments, the trade war could reignite (we've seen this story before), or a different area of geo-economic conflict between the two countries could escalate. This would hurt a still soft manufacturing sector, capital spending, and business confidence. In turn, this could lead to layoffs triggering negative sentiment and risk aversion, which feeds on itself in a self-reinforcing cycle.

3- The US election uncertainty. Given the polarizing differences between the Republican and Democratic presidential candidates and their policy proposals, financial markets will likely see increased short-term volatility depending on whether the incumbent Republican President Donald Trump, a moderate Democrat, or a further-left Democrat appears most likely to be elected. Control of the Senate is an additional wildcard. It's still way too early to say how the election will play out; however, investors will discount each new political development in real-time right up to the election.

4- **Inflation surprises.** If inflation surprises to the upside (e.g., due to accelerating wage growth), the central banks may be forced to tighten policy. This would be a negative surprise for both bonds and stocks. On the other hand, if inflation surprises to the downside, this may rekindle fears the economy is sliding into a recession – also negative for stocks, but good for bonds.

5- **Unexpected geopolitical risk.** There is always risk of an unexpected shock in the geopolitical realm (e.g., the Middle East, North Korea, China-Hong Kong, or some other area off most investors' radars).

In conclusion, any reasonable correction we could see given optimistic sentiment polls, expensive valuation, geopolitical risks, etc., should be short-term and replant seeds of fear for the market to again 'climb the wall of worry.'

Advancing ESG (Environmental, Social and Governance) Initiatives

As mentioned in the Summary on page one, it should be brought to your attention that BlackRock, which holds $6.28 trillion in assets under management, is in the process of exiting investments in thermal coal producers. Specifically, it's phasing out from its actively managed portfolios, stocks, and bonds of companies that get more than 25% of their revenue from thermal coal production, which promises to be a game changer.

"With the acceleration of the global energy transition, we do not believe that the long-term economic or investment rationale justifies continued investment in this sector," BlackRock's executive committee said.

The firm expects to divest these holdings fully by mid-2020 and will be scouring its portfolios for other exposure to "heightened ESG risk." The firm is creating ESG versions of its most popular models for portfolio allocations, based on index exposures optimized for sustainability factors instead of traditional market-cap weightings. BlackRock is also making sustainable versions of its iShares exchange-traded funds, coming later this year, and working on a sustainable version of its LifePath target-date strategy for retirement funds.

** ESG refers to the three central factors (environmental, social, and governance) in measuring the sustainability and societal impact of an investment in a company or business.*

International Markets

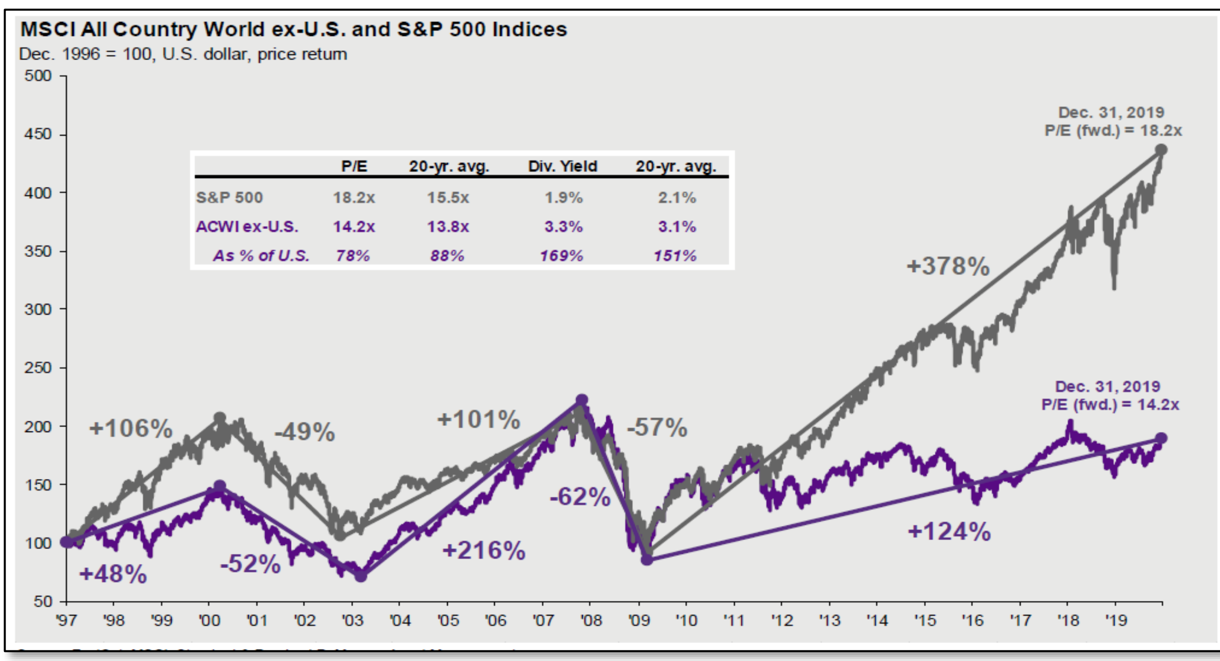
Could 2020 be the year where international stocks begin to outperform? We believe it's long overdue as US stocks have outperformed in eight out of the past ten years. It's early, but that trend may be shifting as evidenced by the international markets keeping pace with domestic gains since mid-August, and emerging markets have outperformed.

In fact, at the same time ten years ago (November 2009), the top three performing broad asset classes were alternative investments, emerging markets, and fixed income. Domestic equities were down on an annualized basis just over one percent over that prior decade.

	10K invested in '00 and held to 11/19	'00-'09 Return	10K invested in '09 and held to 11/19	'10-'19 Return	10K invested in '20 grows to
S&P 500 Index	$8,917.97	(1.15%)	$34,620	13.34%	?
MSCI EAFE Index	$11,074	1.03%	$16,547	5.21%	?
MSCI Emerging Market Index	$24,336.34	9.38%	$13,354	2.96%	?
Barclay's US Aggregate Bond Index	$18,768	6.55%	$14,454	3.79%	?
HFRI Macro Index	$21,153.38	7.85%	$11,242	1.19%	?

Source: Bloomberg

Looking ahead to the 2020s, we think it's highly unlikely that domestic stocks will be able to deliver similar returns as it has versus the rest of the world for the next decade. We like to buy low and sell high, and you're certainly buying low now if you're gaining exposure to international equities relative to the United States. For example, the price-to-earnings (PE) ratio for the Standard & Poor 500 Index is above its historical average of sixteen. International markets are much cheaper, with the MSCI All Country World ex-United States trading at a price-to-earnings ratio of sixteen and the MSCI Emerging Markets trading at a price-to-earnings ratio of fifteen. Valuations are not the only factor that matters, though. Monetary policy operates with a lag, and currently eighty-two percent of global central banks are in easing mode.



Concluding Thoughts

As investors have experienced over the past fifteen months, the pendulum continues to swing—at times moving what fundamentals justify in both directions. As many of you know, our team encourages investors to look past shorter-term market movements and focus on their long-term goals. Those who stick with their strategies during periods of both calm and turbulence realize greater long-term wealth than those who may make changes based on the short "mood" of the market.

A lot is going on in the world today, but we come to the office every day with a disciplined process, an experienced & talented team, and a long-term perspective to help clients prepare for the future.

On behalf of the Next Generation Wealth Management team, we are grateful and privileged to help you grow your family's wealth. Thank you for giving us this opportunity.

Here's to a happy New Year and a prosperous new decade!

David

David A. Massart
President & Founding Partner

To learn more about Next Generation Wealth Management, please visit us at www.ngwealth.com.

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