PAPAMARKOU WELLNER
ASSET MANAGEMENT, INC.

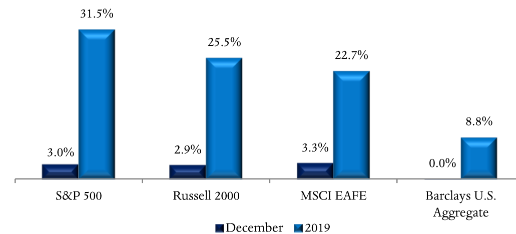
December 2019 / January 2020 Issue # 200

2019 Year In Review

Equity markets delivered stellar returns in 2019, in stark contrast to the malaise of the prior year, catalyzed by monetary policy support from global central banks, in an effort to keep the economic expansion intact. In their best showing since 2013, US stocks led the way higher, with the S&P 500 index rising +31.5%, boosted by its technology components (which rose +41.3%). The smaller capitalization Russell 2000 benchmark advanced +25.5%. Looking below the surface, the growth investment style once again outperformed value by a staggering 14%, extending a multi-year trend. Global stocks also fared well with the Stoxx Europe 600 index posting a +27.8% return. In Asia, Shanghai equities rose +24.9%, while in Japan the Nikkei 225 index added +20.7%. Emerging market stocks trailed but still advanced +18.6%.

It wasn't rosy all year long. From April through September, equities traded sideways with some volatility, as investors digested the ebbs and flows in the trade negotiations between the US and China, as well as the continued deterioration in macroeconomic indicators. Thereafter, a pick up in service sector data (and to a lesser extent manufacturing), coupled with the resilience of overall employment, helped restore market confidence that a recession was not imminent. From a fundamental perspective, earnings growth significantly trailed stock price appreciation, leading to an expansion in valuations.

Global bond markets also rallied, on the back of decelerating economic data and easy monetary policy. In the US Treasury market, the 2-year note gained +0.9%, the 10-year rose +5.7%, and the 20yr+ bond leaped +13.0% as the Federal Reserve (Fed) pivoted, reducing interest rates three times during the year, which led to a brief inversion of the yield curve. With regard to credit, the



investment grade Bloomberg Barclays US Aggregate index rose +8.8%, while high yielding bonds jumped +14.4%. Overseas, the ECB resumed asset purchases, leading German Bund yields to decline from +25bps to -75bps, culminating in a peak of $17 trillion worth of bonds trading with negative yields.

In commodity markets, gold had its best year since 2010, rising +18% to $1,517/oz. Crude also rallied +35%, with the WTI benchmark reaching $61 per barrel, towards the upper end of its five-year trading range, and double the early-2016 lows.

Geopolitics

US-China trade relations deteriorated throughout the year with tariffs enacted by both sides. Spurred by the December 15 planned escalation of US levies on Chinese goods, a last minute "phase one" trade deal was agreed upon, leading to somewhat improved relations.

In the UK, the March 31 Brexit deadline was extended. Subsequent failed negotiations led to national elections in which Boris Johnson's Conservative Party achieved a resounding victory. This outcome should now allow the Parliament to pass a European Union withdrawal bill, activating a transition period until December 31, during which the UK's trading relationship with the EU will be negotiated. Paradoxically, the pound sterling was the world's best performing developed market currency in 2019.

The past quarter was notable for leadership changes at

key central banks. Christine Lagarde, formerly the Chair and Managing Director of the International Monetary Fund, was appointed to take over from Mario Draghi as President of the European Central Bank (ECB). Interestingly, at her first press conference she promptly proclaimed herself a "wise owl" as opposed to a hawk, seeking tighter monetary policy, or a dove, favoring greater stimulus. Andrew Bailey was also announced as Mark Carney's successor at the Bank of England. Mr. Bailey is chief executive of the Financial Conduct Authority, the finance industry watchdog, and has amassed 30 years of experience at the British central bank. He is seen as a "safe pair of hands" who should be able to guide the UK economy through the Brexit transition and beyond. With regard to policy action, both the Federal Reserve and the ECB increased monetary support of the financial system, once again, via both interest rate cuts and asset purchases.

United States

The past year featured ongoing but slowing gains in US employment, proving that the American labor market has not run out of breath. In 2019, the economy added 2.1 million jobs, fewer than the 2.7 million created in 2018 and the smallest increase since 2011, but more than enough to handily outpace population growth. Sluggish economic growth and trade related uncertainty, combined with a maturing labor market, contributed to slimmer payroll gains of 2.9% (down from 3.3% a year ago).

There are signs the US economy maintained a moderate pace of expansion as the year ended, supported by a strong labor market. Recent data suggests that full year 2019 GDP growth will approximate 2.2%, a deceleration from the first half's growth rate of 2.6%. The apparent soft economic landing, indicated by forecasts for 2.0% economic growth in 2020, should empower policymakers at the Fed to stick to their wait-and-see approach on further changes to the central bank's benchmark interest rate.

However, since September, the Federal reserve has

December 2019 Economic Statistics

	Dec-19	Dec-18	Dec-17
Federal Funds Target Rate	*1.50-1.75%*	2.25-2.50%	1.25-1.50%
Consumer Confidence Index	*126.5*	128.1	122.1
Manufacturing PMI Index	*47.2%*	*54.1%*	59.7%
Unemployment Rate	*3.5%*	*3.9%*	4.1%
JPY/USD	*108.61*	*109.56*	112.67
USD/EUR	*1.1210*	*1.1469*	1.1996
Gold/oz.	*$1,517.01*	*$1,282.73*	$1,302.45
Oil (WTI)/bbl	*$61.06*	*$45.41*	$60.42

injected $400 billion into the overnight repurchase "repo" agreement market, in response to dislocations caused by a combination of too few reserves and too much collateral (a result of significant federal government deficit spending and the T-bill issuances needed to fund it). The Fed was reportedly caught off guard when overnight funding rates in the "repo" market spiked to nearly 10% from 2%, forcing the central bank to start offering daily cash facilities to keep short-term rates low. Subsequently, the Fed commenced buying Treasury bills, at a $60 billion monthly rate, to boost bank cash reserves, with a plan to extend these purchases through at least the second quarter of 2020.

Europe

Concerns about Brexit, a global economic slowdown, and tense trade talks with the US, led to an eventful year for European financial markets. Germany's economy stagnated, and its manufacturing sector entered recession, leading to contagion throughout the eurozone, partially offset by a growing services sector. For 2020, forecasts call for manufacturing to bottom and rebound slightly, while the services and the labor markets slow further.

Eurozone GDP is estimated to have grown 1.2% in 2019, a continuing deceleration from 1.8% in 2018 and 2.4% in 2017. Consensus forecasts call for economic growth to dip below 1% (within a range of zero to 1.5%) in 2020, the eurozone's slowest rate of growth in seven years. The continuation of tepid economic growth is likely to prompt louder calls for governments with stronger financial positions, such as Germany and the Netherlands, to legislate fiscal stimulus.

The European Central Bank reacted to the anemic economic data by cutting interest rates further into negative territory and restarting its bond buying program (€20bn per month), further hinting that conditions will remain accommodative. However, with the recent changing of the guard at the ECB, the central bank seems to have stepped away from the mantra of negative rates policy, and is now engaged in a policy review, which will require the better part of 2020 to produce.

Asia

The second year of the US-China trade dispute transitioned from a short-term conflict with the potential for a quick remedy into an entrenched standoff with associated tariffs. Despite the unpredictable environment, China's economic performance in 2019 was surprisingly stable, producing another year of gradual economic deceleration, with GDP expected to have grown a notch above 6%, thanks to modest reforms and ample government support of the economy (establishment of free trade zones, reduction in VAT rates, and easing of bank liquidity requirements). Though, China is also in the midst of a manufacturing recession. At the start of 2020, a new Foreign Investment Law went into effect, aimed at further opening Chinese markets to the world and strengthening intellectual property (IP) protections (also addressed in an updated Trademark Law).

Outlook

Following a year during which weak trade and investment dragged the world economy to its slowest performance since the global financial crisis, global economic growth is poised to rebound to 2.5% in 2020, as per the World Bank. Importantly, economic growth is expected to continue edging higher over the forecast horizon, albeit dependent on global trade and central bank monetary policies remaining even-keeled. Further challenges include high debt levels and subdued productivity growth (reflecting weakness in investment and moderating efficiency gains). US-China trade talks seem to be moving in the right direction, with the hope of a 50% reduction in September tariffs, 30 days post signing of the phase one agreement, but further negotiations will ensue. There is also the US election, and its repercussions, for investors to contend with.

For equity markets, rewards are unlikely to stem from the same sources as 2019, given that price to earnings multiple expansion accounted for nearly all of last year's total return in the S&P 500 index. Similar divergences occurred from 1997 to 2000 and 2006 to 2008. Of note is the recent stark shift in factor performance, whereby the massive outperformance in Momentum, producing a +28.0% return through the end of August, was reversed to close out the year up only +1.8%. Of further interest was the resurgence of Cyclical stocks, exceeding Defensives by 12.0% over the past four months. Value oriented equities, globally, and overseas stocks have both experienced multi-year lagging returns. In both cases, relative valuations are compelling, creating opportunity for patient investors. With regard to our favored large capitalization US equities, while not the same bargain as last year, it is not unreasonable to expect them to grow in line with profits, with total returns aided by dividends and stock buybacks.

The global economy has experienced four waves of debt accumulation over the past fifty years. The first three ended with financial crises, which spread globally. During the current wave, which started in 2010, the increase in global debt has been larger, faster, and more broad-based than in any of the previous three episodes. Global debt to GDP is at an all-time high of 322% (363% in the US, down from a peak of 417% reached in 2009, but up from 287% two decades ago), as per the latest data. Current low interest rates, which markets expect to be sustained into the medium term, appear to mitigate some of the associated risks of high and rising indebtedness. However, if the global economy reaccelerates, government bond yields may move higher. As such we maintain a cautious stance with regard to fixed income investments, favoring short duration and floating rate securities.

In light of the aforementioned uncertainty of financial market prospects, and imbalances, we recommend allocation to select alternative investments to aid in diversification as well as to dampen the effects of volatility.

Wishing you a happy, healthy and prosperous 2020!

Important Disclosure and Terms of Use: Property of Papamarkou Wellner Asset Management, Inc. For targeted distribution only and not a solicitation. This report may not be displayed, reproduced, distributed, transmitted, or used to create derivative works in any form, in whole or portion, by any means without express written consent by Papamarkou Wellner Asset Management, Inc. or its operating subsidiary, Papamarkou Wellner & Co., Inc. MEMBER: FINRA/SIPC. All opinions expressed within unless otherwise stated are those of Papamarkou Wellner Asset Management, Inc. based on the most recent market, security, and economic data available.

Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal

430 Park Avenue · 17th Floor · New York, NY 10022 Tell (212) 223-2020 · Fax (212) 758-9804 · www.papamarkou.com