MARKET COMMENTARY: FOURTH QUARTER 2019

EXECUTIVE SUMMARY

Low rates continue to be a boon for both equity and fixed income markets. The Fed lowered rates for the 3rd time in 2019 and adopted a more accommodative monetary policy than previously held. Going forward, the Fed is signaling a wait-and-see approach to additional rate changes, leading many to believe that rates will remain unchanged throughout 2020.

In addition to low rates, the easing of hostilities in the US/China trade war also helped to bolster investor confidence and rally the markets. With the phase one trade deal expected to be signed in Q1 2020, investors remain optimistic that continued progress will help drive positive market performance. International equities have continued to underperform relative to their US counterparts. However, when looking at valuation metrics, international equities are looking increasingly attractive to investors.

MARKET SPOTLIGHT: GLOBAL DIVERSIFICATION & 2019 REVIEW[1]

According to research by BlackRock in their *Student of the Market* report, 2019 was one of the best years for both U.S. stocks and bonds going back to 1926. Only 1985, 1989, 1995, and 1997 realized better returns for both U.S. stocks and bonds. Looking back over the entire decade, the 2010's were strong for both stocks and bonds. Going back to 1930, this was the 4th best decade for stocks (out of 9 decades) and the 5th best for bonds.

While returns have been better than historical averages for the U.S. over the past decade, international stocks measured by the Morgan Stanley Capital International Europe, Australasia, and Far East Index (MSCI EAFE) have lagged. In fact, MSCI EAFE had its 2nd worst decade (of 9) since 1930. This underperformance of MSCI EAFE, and other international stocks relative to the U.S. has led to questions from investors regarding the benefit of global diversification.

KEY TAKEAWAYS FOR INVESTORS

- 2019 was one of the best years for both U.S. stocks and bonds since 1926
- The 2010's saw historically strong returns for the U.S., but was less kind to international stocks
- Global diversification still rewards long-term investors

Unfortunately, global diversification can be uncomfortable, as any asset class can underperform another at any given point in time. It is important to remember the benefits of diversification as the next decade will almost certainly look different from the one that is now ending.

DOMESTIC EQUITY MARKET

The U.S. stock market had a strong end to the year, finishing up 9.07 percent for the 4th quarter and 31.49 percent for 2019 as measured by the S&P 500.

Strong stock market performance was supported by an economy that continued to expand in the 4th quarter. While the trade war was somewhat subdued to

DOMESTIC MARKET RETURNS		
Equity Index	4Q 2019 Return %	2019 YTD %
S&P 500	9.07%	31.49%
Dow Jones Industrial	8.96%	31.15%
NASDAQ	12.90%	38.99%
Russell 2000	9.94%	25.52%
Source: BlackRock Benchmark Returns Comparison as of December 31, 2019		

DOMESTIC EQUITY KEY TAKEAWAYS

- 4th Quarter performance led to a strong end of 2019
- A seemingly tight labor market has yet to translate to substantial wage gains
- The FOMC maintains the status quo as the remains on solid ground

end the year with the announcement of a "Phase One" trade deal, manufacturing readings [2, 3] diverged as the Purchasing Manager's Index report remained in contraction. Contraction in the ISM report started in August and shows potential for continued weakness to start the year based on weak product demand and hiring. Service sector readings in December were some of the year's best, but weak demand indicates potential for slowing[4,5]. The labor market is still on solid footing with low jobless claims[6], and a historically low unemployment rate of 3.5%,[7] which is consistent with strong labor growth. Despite apparent strength, wage growth has been elusive and soft at 2.9% year over year in December.

While the economy remains steady, the Federal Open Market Committee minutes indicate the Federal Reserve will maintain the status quo with monetary policy for the time being.[8] The committee is looking for signs of deterioration or strength in the economy before recommending additional interest rate moves, though they have expressed some concern around persistent low inflation and it limiting their options from a policy perspective.

Consumer sentiment remains optimistic [9, 10] but confidence is less rosy. Continued consumer spending will remain important and could help continue the economic expansion.

INTERNATIONAL EQUITY MARKET

Despite strong performance, foreign markets lagged the U.S. per the World ex-USA index but ended up 22.49 percent for 2019. Developed markets were weaker than emerging markets in the 4th quarter, but outperformed for the year with Europe, Australasia, & the Far East at 22.44 percent compared to the Emerging Market Index which rose 17.64 percent.

Global manufacturing readings recovered and are back in expansionary territory at 50.1 in December according to the Purchasing Managers Index[11]. The service sector provided a ballast to foreign economies just like in the U.S. Weakness in manufacturing continues to be found in more developed economies like Germany, while emerging economies had higher rates of growth.

INTERNATIONAL EQUITY KEY TAKEAWAYS

- Germany narrowly avoided a recession, but global manufacturing remains subdued
- Christine Lagarde took over as President of the ECB and is hoping to boost public investment
- Global returns were strong despite lagging the U.S.

With a cooling in the trade war, Germany narrowly avoided a recession for the time being and the United Kingdom performed relatively well as the situation around Brexit is now a little more certain. With the Conservative Party winning the election they are set to leave the Eurozone by January 31, 2020.

In November, Christine Lagarde took over as President of the European Central Bank. One of her first orders of business was to ask European governments to boost public investment and stimulate their collective economies.

Q4 INTERNATIONAL MARKET RETURNS

Index	4Q2019 Return %	2019 YTD Return %
World, ex-USA	7.86%	22.49%
Europe, Australasia and Far East (EAFE)	8.64%	22.44%
Europe	8.84%	23.77%
Japan	7.67%	20.07%
Emerging Markets	11.59%	17.64%
China	14.72%	23.66%

Source: BlackRock Benchmark Returns Comparison as of December 31, 2019

As China and the U.S. announced a "Phase One" trade deal China and other emerging market economies were relieved as tariffs were suspended on $160 billion of Chinese imports. Oil exporting countries like Columbia and Russia also benefited from an increase in crude oil prices.

As a year-end valuation update, according to JP Morgan, international markets remain in line with their 25-year averages from a forward Price to Equity standpoint, though they are less expensive than the U.S. Japan especially stands out at a low P/E of 14.4 compared to an average of 21.7[12].

Despite lagging the U.S. in 2019, international markets display attractive valuation and long-term opportunities. The 2010's returned strong positive U.S. stock returns while returns for international stocks were modest according to data from BlackRock. Though difficult, we believe it remains important to stay globally diversified since markets tend to trade leadership over time.

FIXED INCOME

While 2018 was a flat year for fixed income, 2019 was a boon for bonds. Bonds rallied in 2019, with all segments well into positive territory, posting strong returns across the board ranging from 3.53 to 23.20 percent. According to the Bloomberg Barclays U.S. Aggregate Bond Index (AGG), an index used to track the U.S. bond market, bonds were up 8.72 percent in 2019, marking the best year for bonds since 2002, where the AGG returned 10.26 percent. To put this in perspective, over the past 10 years the AGG averaged a 3.80 percent annual return. [13] This years' solid bond performance can be attributed, in part, to modest inflation, falling yields, and increased demand.

Personal Consumption Expenditures (PCE), the Fed's preferred inflation measure, has been well below its 2 percent target, recording 1.5 percent as of November 2019. [14] Helping fuel the bond rally was the pickup in demand. Bonds experienced large steady inflows throughout 2019, with taxable bonds bringing in a net $518 billion and municipal bond funds gaining $65 billion in net inflows.[15]

FIXED INCOME KEY TAKEAWAYS

- Highest bond returns since 2002
- Fed cut rates three times, stating willingness for additional actions to continue the economic expansion
- Bond yields fell by approximately 1 percent across categories and maturities
- Negative sovereign bond yields persist in Germany and Japan

2019 marked a reversal in U.S. central bank action. The Fed cut rates three times in 2019, reversing nearly all four rate hikes in 2018. The federal funds rate now stands at 1.50 -1.75 percent. Fed Chairman, Jerome Powell, stated the rate cuts were intended to "provide some insurance against ongoing risks." These rate cuts were also described as a mid-cycle adjustment, potentially in response to the Fed raising rates too quickly in 2018. The last time the Fed cut rates was back in 2008. While the Fed's dot plot chart doesn't bake in rate cuts in 2020, the Fed stated it will respond accordingly to economic data and geopolitical risks. Additionally, the Fed is no longer shrinking its balance sheet and is now engaged in balance sheet expansion, once again. Rate cuts along with balance sheet expansion indicate the Fed is moving away from a restrictive monetary policy and towards a more accommodative policy. [16] Given the inverse relationship between a bond's price and yield, bonds have continued to rally as yields continue to fall across the board. Yields fell by approximately 1 percent in 2019. [17] Bonds with higher durations have benefited the most. Long-term bonds, which have higher durations, outperformed short-term bonds across all categories. Corporate bonds led the way, with Corporate Long posting a strong 23.20 percent return for the year. The worst performing bond class was Muni National Short, which still posted an impressive 3.53 percent return.

Fixed Income Performance	4Q19	2019	2018	2017	2016
Broad Market Index					
Bloomberg Barclays US Aggregate Bond	0.18%	8.72%	-0.01%	3.54%	2.65%
US Corporate Index					
Corporate Short	0.85%	6.85%	0.91%	2.45%	2.63%
Corporate Intermediate	1.06%	14.46%	-2.71%	6.38%	6.16%
Corporate Long	1.04%	23.20%	-6.91%	12.40%	10.59%
Corporate High Yield	2.68%	14.97%	-3.18%	6.48%	14.75%
US Government Index					
Treasury Short	-0.15%	5.78%	1.36%	1.19%	1.22%
Treasury Intermediate	-1.25%	8.38%	0.82%	2.47%	1.00%
Treasury Long	-4.25%	14.93%	-2.07%	8.92%	1.36%
Mortgage-Backed Securities	0.71%	6.17%	0.87%	2.37%	1.43%
Inflation-Protected Securities	0.73%	8.28%	-1.43%	2.92%	4.56%
US Municipal Index					
Muni National Short	0.71%	3.53%	1.39%	1.26%	-0.44%
Muni National Intermediate	0.62%	7.50%	0.94%	4.96%	0.31%
Muni National Long	0.50%	7.53%	0.43%	5.59%	-0.18%
Muni High Yield	0.48%	8.73%	2.14%	10.50%	0.40%
Non-US Index					
Emerging Markets Bond	2.00%	15.57%	-5.67%	9.98%	9.41%
International Bond	-1.27%	7.88%	2.94%	2.40%	4.67%

Source: Morningstar, Inc. Data as of 12/31/2019

Fourth quarter bond performance was muted due to risk-on investor sentiment. Two exceptions to this were Emerging Markets and Corporate High Yield. These bond classes performed well, since they behave more like equities and benefit from investors seeking riskier investments. Treasury Long performed the worst in Q4, since its viewed as the quintessential "safe haven" asset class, posting a -4.25% percent loss for the quarter. However, overall, Treasury Long had an impressive year posting a 14.93 percent return.

Yield curve inversion between the 3-month T-bill and the 10-year treasury bond reversed, alleviating recession fears, as this inversion has been a leading indicator for past recessions. The Mather Group's investment committee will continue to monitor economic and geopolitical risks, deploying sophisticated rebalancing technology to maintain proper portfolio exposures. It's important to stay focused on your goals and stick with your long-term financial plan. As always, please doesn't hesitate to contact us with any questions or concerns you may have.

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SOURCES

1. BlackRock Student of the Market January 2020
https://www.blackrock.com/us/financial-professionals/literature/investor-education/student-of-the-market.pdf
2. Purchasing Managers' Index (PMI) Manufacturing expanded in December to 52.4, with some improvement seen in exports and hiring.
http://fidelity.econoday.com/byshoweventfull.asp?fid=510033&cust=fidelity&year=2020&lid=0&prev=/byweek.asp#top
3. Institute for Supply Management Index (ISM) Manufacturing contracted to 47.2. Employment fell 1.5 points to a deep sub-50 low of 45.1 that indicates ISM's sample, for a fifth month in a row, was cutting their staffs. Contraction in production, down nearly 6 points to 43.2 and another deep low, underscores the lack of urgency for new hiring.
http://fidelity.econoday.com/byshoweventfull.asp?fid=509769&cust=fidelity&year=2020&lid=0&prev=/byweek.asp#top
4. Purchasing Managers' Index (PMI) Services continued to expand in December at an improved 52.7 driven by moderate new order and hiring readings.
http://fidelity.econoday.com/byshoweventfull.asp?fid=510045&cust=fidelity&year=2020&lid=0&prev=/byweek.asp#top
5. Institute for Supply Management Index (ISM) Non-Manufacturing grew in December to a 55.0 reading. Business activity rose and employment was solid, but slowing new order indicate weak future demand.
http://fidelity.econoday.com/byshoweventfull.asp?fid=509781&cust=fidelity&year=2020&lid=0&prev=/byweek.asp#top
6. Jobless claims remain at low levels consistent with strong labor market growth.
http://fidelity.econoday.com/byshoweventfull.asp?fid=509794&cust=fidelity&year=2020&lid=0&prev=/byweek.asp#top
7. Employment Situation – Unemployment remained at 3.5% with the participation rate steady at 63.2%. Wage growth stayed at 2.9% year over year.
https://us.econoday.com/byshoweventfull.asp?fid=509579&cust=us&year=2020&lid=0&prev=/byweek.asp#top
8. Following the December FOMC meeting it seems that monetary policy will remain as is until the economy displays deterioration or strength. There is also continued concern among committee members around low inflation which may limit policy options.
http://fidelity.econoday.com/byshoweventfull.asp?fid=497096&cust=fidelity&year=2020&lid=0&prev=/byweek.asp#top
9. Consumer Sentiment improved to 99.2 in December (from 96.8) with improvement to current and expected economic conditions.
https://www.marketwatch.com/story/consumer-sentiment-improves-markedly-in-december-2019-12-06
10. Consumer Confidence was mostly flat in December at 126.5 which does not point to increase consumer enthusiasm. The outlook for employment seems slightly weaker, and the rich are less optimistic about the stock market.
http://fidelity.econoday.com/byshoweventfull.asp?fid=499066&cust=fidelity&year=2020&lid=0&prev=/byweek.asp#top
11. https://www.yardeni.com/pub/ecoindglpmi.pdf
12. JP Morgan 4Q Guide to the Markets:
https://am.jpmorgan.com/us/en/asset-management/gim/adv/insights/guide-to-the-markets/viewer
13. https://www.thebalance.com/stocks-and-bonds-calendar-year-performance-1980-2013-417028

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15. https://www.barrons.com/articles/bond-funds-had-a-strong-2019-next-years-performance-depends-on-this-one-factor-51577806268 & www.refinitiv.com/

16. https://www.federalreserve.gov/monetarypolicy/fomccalendars.htm

17. https://fixedincome.fidelity.com/ftgw/fi/FILanding