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Q4 2019 MARKET RECAP

JAN 9, 2019

THE YEAR IN REVIEW

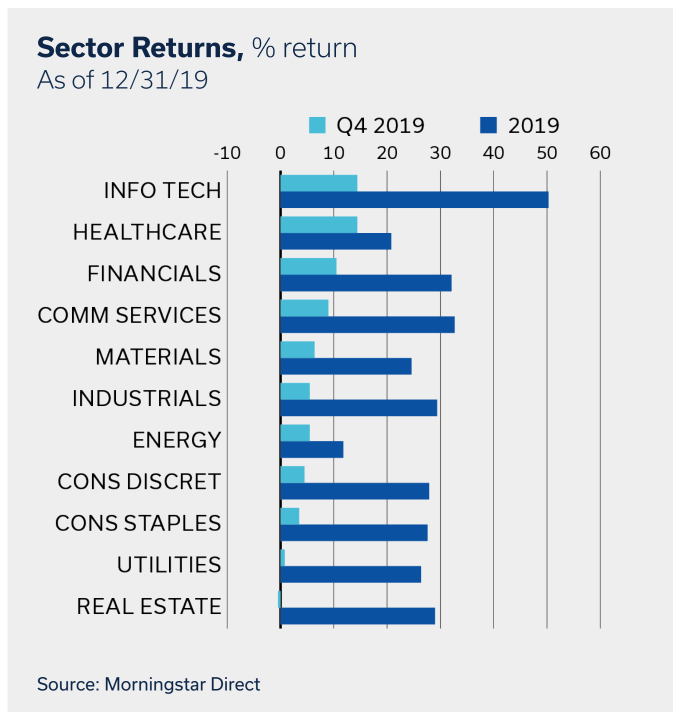
Entering 2019, few predicted the year we just had. We thought that it might be a mulligan, or do-over, following the difficulties that abounded in the fourth quarter of 2018, but our expectations were largely exceeded. While there was consistent uncertainty in the global macroeconomic environment, markets digested it with relative ease and moved steadily higher throughout the year. There were a couple of drawdowns, but markets recovered quickly and nothing compared to what we saw in Q4 2018. Unlike 2018 when all major asset classes except cash posted losses, all major asset classes had positive returns in 2019. Despite this, sentiment during the year seemed more fearful than the strong market performance would have indicated. US equities were up over 30% but flows went into fixed income and the bond market essentially priced in a recession with yields moving from just below 3% to under 2%. It certainly seems as though 2020 is starting out with more optimism, which may need to be tempered as we move further into the economic cycle.

There were a couple of headlines that persisted throughout the year, of which the ongoing trade war with China was likely the biggest. Central bank policy was another ongoing consideration. Most notable, the US Federal Reserve pivoted from forecasting 2 rate hikes during 2019 to cutting rates 3 times in response to weakening economic data. It's worth noting that the Fed hiked rates 4 times in 2018 and the S&P 500 returned roughly -4.5% (total return) while earnings per share were the best in 8 years. 2019 stood in stark contrast with the Fed cutting rates 3 times, the S&P rising over 30%, yet earnings per share had the worst return since 2015-2016. The ECB and other central banks arguably took things a step further in 2019 and we saw negative interest rates in various markets for the first time in years. All told, central banks around the world cut rates a remarkable 51 times in 2019. How that situation unwinds remains to be seen, but it could prove to be tricky.

U.S. HOLDS ONTO ITS RECOVERY – FOR NOW

Domestically, the economy continues to stretch the recovery out longer than many ever imagined. US GDP growth has slowed from the strong numbers we saw in 2018, but it continues to hover around 2%, following a mid-year soft patch which prompted the Fed cuts, and some forecasts are even calling for an acceleration from here. The labor market continues to be tight, with the unemployment rate hitting multi-decade lows and wage growth posting steady gains above 3%. Inflation has remained stubbornly below expectations and has come into focus both in the US and around the world, with central banks trying to figure out how to boost it a bit. Typically, at the end of an economic cycle, headline inflation rises by an average of 2.4%. However, it currently remains below 2%. Nonetheless, the consumer is enjoying the increased buying power and is driving the economy through solid retail spending, especially in the e-commerce sector.

In the markets, the S&P 500, NASDAQ, and Dow Jones Industrial Average have all posted new record highs. Valuations have increased as a result, but remain roughly in line with historical levels, despite what some may believe about the markets being very expensive. A year ago, the trailing P/E on the S&P 500 was 15.5x (source: FactSet) and now it is nearly 20x. That's a roughly 28% expansion over the past year, but only 10%+ above the 25-year average of 18x. Earnings estimates for 2020 are for mid-to-high single digits, and if history is any indicator, returns in the next year are more likely to be positive than negative.



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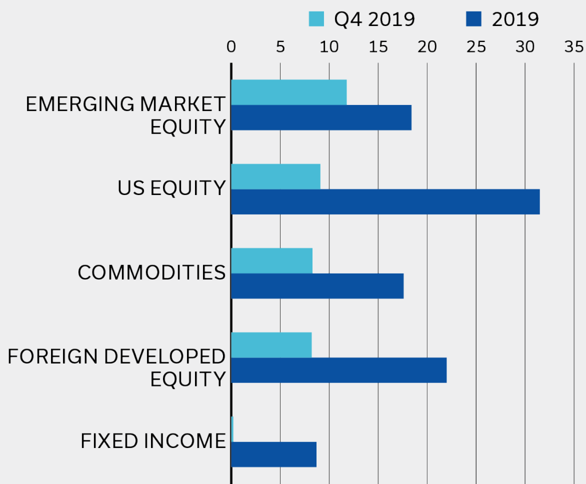

STIMULUS, MANUFACTURING AND BREXIT

Outside of the US, China remains in the driver's seat. GDP growth is slowing but should be around 6%, coupled with subdued inflation. Their stimulus measures are benefitting its economy, stabilizing the GDP deceleration and manufacturing PMI numbers, and allowing the SSE Composite to post a 20% gain in 2019. Other Asian countries and Europe are sensitive to China through trade and if China continues to improve, it may bode well for much of the globe. When manufacturing PMI numbers are moving from contraction into expansion, as they are now, Value, Small Cap, and International Markets have performed the best in the past. This strength could be boosted by a softening US Dollar, or at least one who's strength is decelerating, and would favor Energy after a decade of underperformance in the face of a strong US Dollar. Brexit continues to move forward and with each new development, more and more of the surrounding uncertainty is removed and markets are able to better price in the results. The ECB is continuing its loose policy in an effort to spur growth in Europe, and other central banks, like the Bank of Japan, are enacting similar policies. Even with the strong equity returns in 2019, Europe is only trading in-line with its valuations over the past 25 years.

WHAT AWAITS US IN 2020?

Moving into 2020, the market environment appears decidedly less uncertain than it was a year ago. The trade war continues to be at the forefront of investors' minds, and as we move later into the year, the presidential election will no doubt take center stage. But those events should be handled in stride by the markets, barring any unforeseen complications. The typical 4-year election cycle is strongest in the third year (which we just exited) with the fourth year the second strongest. Remember that 2017 was up over 20%, so while it might be hard for 2020 to beat that and actually be the second strongest year of the cycle, history indicates that 2020 is more likely to be positive than negative. We ran our own analysis on election years which were preceded by a year of returns above 25% and found that since 1928, this has happened 6 times and all those years were positive, with an average return of roughly 14%. As the election process plays out, the US economy should continue its low and slow growth and the rest of the world will likely hinge on China, which seems to be stabilizing and perhaps even consolidating for an acceleration. Our recession dashboard is more neutral/positive than in recent months and we remain constructive heading into 2020.

We are going on our 18th year in business and our story continues to resonate. If you are considering investing additional funds let us take a look at your current asset allocation – we have some interesting ideas in the new year.

Sincerely,

Kim David Arthur
CEO and Portfolio Manager

Performance Data from the following indices: Commodities – S&P GSCI TR USD, US Equity – S&P 500 TR USD, Fixed Income – BBgBarc US Agg Bond TR USD, Foreign Developed Equity – MSCI EAFE NR USD, Emerging Market Equity – MSCI EM NR USD, Communication Services – S&P 500 Sec/Commun Services TR USD, Cons Discret – S&P 500 Sec/Cons Disc TR USD, Cons Staples – S&P 500 Sec/Cons Staples TR USD, Energy – S&P 500 Sec/Energy TR USD, Financials – S&P 500 Sec/Financials TR USD, Healthcare – S&P 500 Sec/Healthcare TR USD, Industrials – S&P 500 Sec/Industrials TR USD, Info Tech – S&P 500 Sec/Information Technology TR USD, Materials – S&P 500 Sec/Materials TR USD, Real Estate – S&P 500 Sec/Real Estate TR USD, Utilities – S&P 500 Sec/Utilities TR USD. Main Management, LLC ("Main Management", or the "firm") is an investment adviser registered under the Investment Advisers Act of 1940. The firm was founded in 2002 and provides investment management services primarily to high net worth, family groups, foundations/endowments, and serves as a sub-advisor to third-party investment advisors & broker-dealers. The information contained herein was prepared using sources that the firm believes are reliable, but the firm does not guarantee its accuracy. The information reflects subjective judgments, assumptions and the firm's opinion on the date made and may change without notice. The firm is not obligated to update this information. Nothing herein should be construed as investment advice or a recommendation to purchase or sell securities. The information is not intended as an offer to provide advisory services in any state or jurisdiction where such offer would not be permitted under applicable registration requirements. All equity investing entails risk of loss. The firm cannot assure any potential client that it will achieve the investment objectives discussed in these materials. In addition, potential clients should not assume that their returns, if any, will be comparable to returns that the firm earned in the past. The firm and its clients, affiliates and employees may, from time to time, have long or short positions in, and buy or sell, the securities or derivatives (including options) thereof, of the ETFs mentioned in these materials and may increase or decrease their positions. Upon request, Main Management will furnish additional information regarding the firm's policies for calculating and reporting returns. Past performance does not guarantee future results. Indices are unmanaged and do not take transaction costs or fees into consideration. It is not possible to invest directly in an Index. Performance figures assume reinvestment of dividends and capital gains.

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