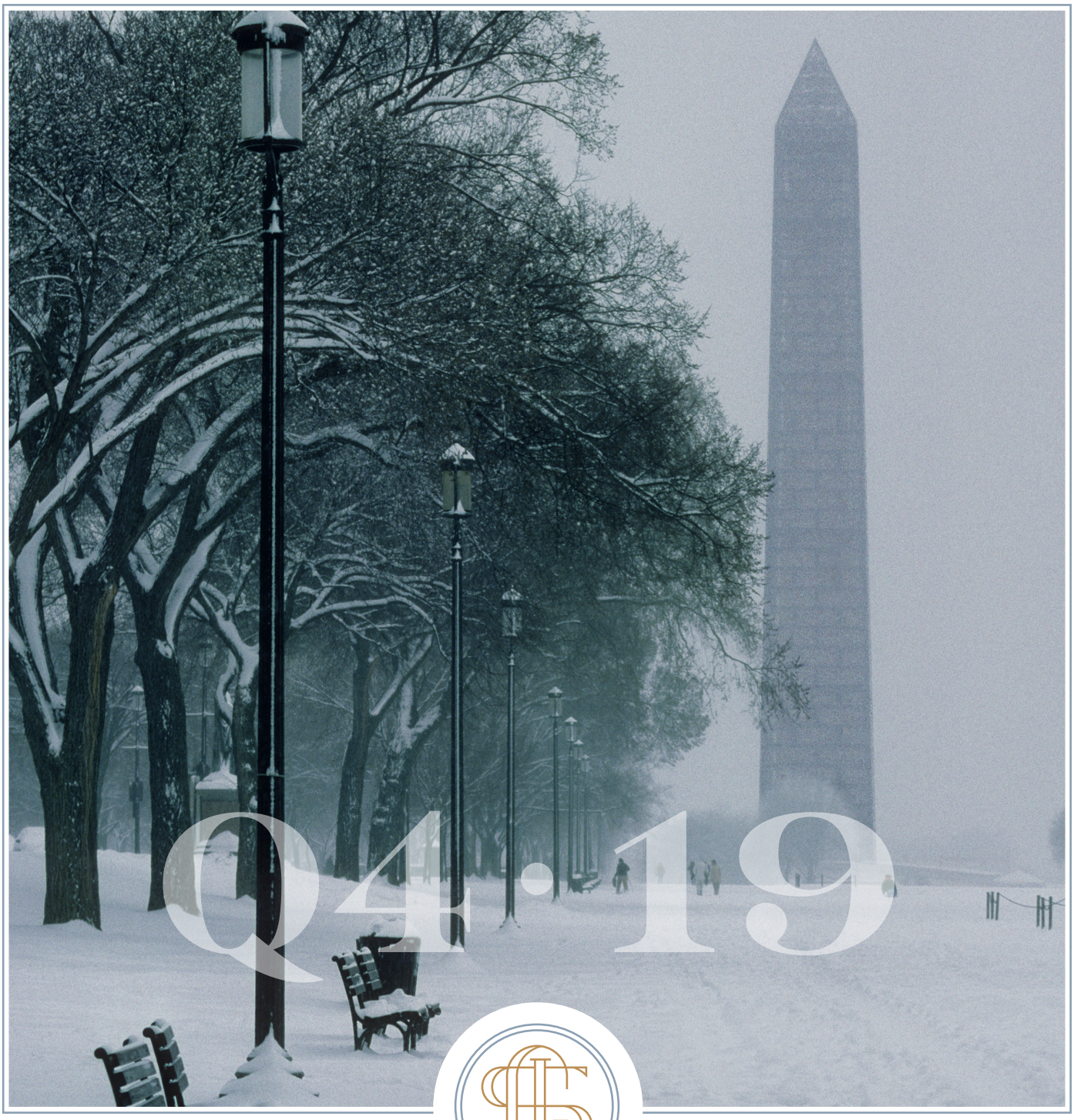
# QUARTERLY MARKET REVIEW

## FOURTH QUARTER 2019

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JANUARY 22, 2020

Dear Investors,

We are pleased 2019 was a year for the record books, completing the tenth year of the current bull market while posting the strongest calendar year equity returns since 2013. Following a lackluster third quarter, which left market participants concerned, the S&P 500 posted a 9.07% total return (including dividends) during the fourth quarter of 2019. Overall the S&P 500 was up 31.49% for the year, while a 60/40 (S&P 500/Barclays U.S. Aggregate Bond Index) portfolio was up 22.16%. This remarkable performance followed predictions for a recession as the S&P 500 declined 13.52% during the fourth quarter of 2018, which led to a negative 4.38% return for full year 2018. These numbers remind us to put 2019's performance in perspective: including the noise created by the volatility of the fourth quarter of 2018, the S&P 500 appreciated only 13.71% from October 2018 through year-end 2019. Although a 13.71% return over a fifteen-month period is no doubt terrific, it certainly feels very different than a 31.49% return in one year, especially as we all ask ourselves the critical question of "how long can this continue?"

In an attempt to answer that question, we must first try to understand what led to last year's strong performance before we can try to put it into the context of longer-term trends. Despite all the reasons to have been nervous about the markets heading into 2019, we now know the correct course of action was to maintain one's investment plan. The Federal Reserve continued to be accommodative, which along with subdued inflation, provided a positive environment for the bond market. Economic growth continued at a moderate pace stimulated by strong consumer spending. Moreover, U.S. household debt relative to disposable personal income remains at all-time lows, which suggests that the consumer can continue to spend. Valuations in the equity markets also improved as trade tensions with China moderated and concerns about an unfavorable Brexit outcome lessened.[1]

This last point is one to drill down on as it was a significant component of last year's performance. Whereas the S&P 500 has traded at an average 16.26x earnings over the last 25 years, paradoxically, the market traded at approximately 14x earnings by the end of 2018, a year during which earnings rose sharply.[2] The earnings growth that led to this below average multiple was stimulated by the corporate tax cut passed in December 2017. Equities then rebounded and traded above their 25-year average valuation in 2019 while earnings were basically flat. With that recent increase in valuation closer to elevated levels, we believe the market in 2020 will need to see earnings growth in order to produce a positive return, as opposed to relying on continued multiple expansion.

Not only did we wrap up another year of performance, we closed out another decade. Comparing last year's performance to the longer term averages of the last two decades highlights just how remarkable of a year 2019 was, especially considering the almost unanimous concerns of market participants. Thanks to the bear markets of 2000 and 2008, the average annualized return of the S&P 500 from January 1, 2000 to December 31, 2009 was exactly -0.95%, including dividends. As noted above, last December closed the tenth year of the current bull market during which

[1] *Goldman Sachs Asset Management, Market Monitor; January 17, 2020; p. 1*
[2] *JP Morgan Asset Management, Guide to the Markets; U.S. 1Q 2020; p. 5*

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the S&P 500 returned an average annualized total return of 13.56% from January 1, 2010 to December 31, 2019. The combination of these periods gives us a 20 year long-term annual average return of the S&P 500 of 6.06%. What is also notable is that a 60/40 (S&P 500/Barclays U.S. Aggregate Bond Index) portfolio over the same 20 year period produced an average annualized return of 6.16%, while assuming far less risk. This emphasizes the importance and power of capital preservation during periods of decline and can be a good reminder particularly after a very strong year.

Now the critical question we are all asking: how long can this continue? As we have learned in past years, trying to predict market movements is a very difficult, if not an impossible task. Therefore, we must remain focused on the fundamentals of our investments and maintain appropriate risk levels in our portfolios. As the markets continue to produce the unexpected, it is our job to remain diligent, flexible, and unemotional in order to keep our portfolios aligned with their objectives. Heading into 2020 we would expect to see volatility as we navigate the impeachment process, enter a more decisive stage in our Presidential Election, watch Brexit negotiations unfold, and monitor trade relations with China. This volatility should be moderated by an expectation that the Federal Reserve will remain accommodative in its monetary policy, thereby continuing to provide a backdrop of lower interest rates. The combination of these uncertainties with the current positive fundamental underpinnings of the economy lead us to believe there is no reason why this bull market can't continue for at least another year. That said, it would likely not be without volatility.

We would like to thank you for your trust and confidence, and we look forward to the continued opportunity to serve you as we begin this next decade!

Warm regards,

Chris

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