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INVESTMENT MANAGEMENT, LLC

2019 Year End Letter

A Great Year to End a Great Decade

On the heels of the 'lost decade' (the worst decade in the history of the stock market, '00 – '09) we posed the question in our 2010 year-end client letter if that year was "The Start of Great Decade?". While the decade wasn't immune to periods of extreme market volatility, including some years with negative returns, this past decade certainly ended up being a great one for the markets and our clients.

We took a similar stance in last year's client letter, writing that "We Approach 2019 With Optimism". Fortunately for our clients, we took advantage of the volatility of the 4th quarter of 2018 and entered 2019 with a convicted stance in our clients' portfolios. We made the case that the market was over-reacting to the rhetoric surrounding Fed policy and the lack of progress with China on a trade deal. Much of the year-end 2018 selloff was driven by technical factors and nervous retail investors.

With the backdrop of moderate inflation and slow economic growth, the Fed was able to reverse course on its late 2018 tightening cycle and lower benchmark interest rates three times during 2019. The Fed joins other global central banks in taking an accommodative stance on interest rates. Lower interest rates are a positive for consumers, businesses, and the equity market. The Fed is most likely on hold with interest rates for the foreseeable future, especially given the fact that we are in an election year and the Fed doesn't want to appear politically motivated. The clarity provided by the Fed on their interest rate path moving forward has removed some of the uncertainty in the market that we saw this time last year.

China: Phase One Trade Deal a Positive Sign

While volatility remained relatively subdued during most of 2019, the spikes in volatility that we did see in May and August were driven primarily by concerns over the progress of the trade negotiations between the U.S. and China. This demonstrates the ongoing importance of this issue to the overall tone of the market. We view the recent de-escalation of the trade war in the form of a phase one deal as a significant step in the right direction. There will likely be many more phases to be negotiated in the coming years as we establish a new trading relationship with China. This could continue to be a source of market volatility but should ultimately dramatically improve our increasingly important trading relationship with China.

The Consumer Saves the Day

While the slowdown in manufacturing, partly driven by trade uncertainty, brought talks of a possible recession in 2019, the consumer (70% of the US economy) has remained resilient due to the strong labor and housing markets:

- Unemployment at 3.5% (50-Year Low)
- Wage Growth at 3.7% (10-Year High)
- Consumer Confidence / Retail Sales Remain High
- Low Interest Rates Supporting Housing Market

As we look forward to 2020 and a new decade, we are optimistic that the strong consumer will continue to provide a solid economic foundation even if the recovery in manufacturing takes longer than expected.

Election Year: A Cause for Potential Volatility

As with any election year, we would expect negative political rhetoric to intensify as we get closer to the elections in November. Historically, this has been a source of short-term volatility in the markets. Volatility caused by politics tends to be short lived and the market returns to trading on fundamentals once the volatility subsides. In prior election cycles, we have been able to take advantage of opportunities that this volatility has presented to us. The market tends to favor divided governments (at least one out of three of the President, Senate, and House are in the hands of one party, while the other two are in the hands of the other). At this time, that outcome seems likely, but we will continue to monitor the positions of the candidates and the polling and make any adjustments to the portfolios we deem prudent as we get closer to the November elections.

Global Demographic Phenomenon – The Emerging Global Middle Class

One of the key secular themes we have been following for some time now and are focused on in this new decade is the significance of the emerging global middle class. According to the Brookings Institution, about half of global demand comes from private household consumption – two thirds of that demand coming from the middle class. They are projecting that by the end of this new decade, there will be 5.3 billion people in the global middle class, an increase of 1.5 billion or 40% from current levels. Not surprisingly, 1.1 billion of these new members of the global middle class will be coming from China and India. The projected spending growth rate of the emerging middle class is actually higher than the projected growth rate of the population itself.

This global demographic phenomenon will continue to provide enormous economic support for corporations based directly in these emerging markets but also to corporations based in developed economies such as the US that are selling into the emerging markets. We have maintained a significant allocation in our clients' portfolios to both.

In Conclusion

While there will inevitably be periods of political and market volatility in the coming decade, we certainly enter the decade on a positive note. Central banks around the world are in an accommodative stance and the trade deals that have either been completed (USMCA) or are in the process of being negotiated (China) will put us in a stronger economic position long term. In the UK, the growing optimism surrounding BREXIT has given the market confidence.

The advancements made in technology and medical science over the last decade have truly been remarkable and it will be most interesting to see what this new decade will bring. As a human race, we are living longer, healthier, and more financially secure lives than at any other point in time.

We would like to express our sincere gratitude to our clients for entrusting us with their irreplaceable wealth. We wish you and your family peace and happiness in this new decade.

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