Gries Financial Partners

GFP*Outlook & Strategy*

Fourth Quarter 2019 Commentary

A strong fourth quarter and year leads to more tempered expectations for 2020*.*

The fourth quarter of 2019 will be remembered as one of reduced economic and market uncertainty both at home and abroad. The U.S. market's reaction to the impeachment of President Trump in the House of Representatives was, overall, insignificant, given the likely acquittal in the Senate. Having reached a temporary truce in the trade war with China, global economic growth should begin to stabilize and improve. In the Eurozone, progress on Brexit negotiations is having a positive effect on sentiment and growth. Given these factors, the market staged a material rally in the fourth quarter. The 10-year U.S. Treasury yield is now at 1.9% (up 40 basis points, or 0.40%, from recent lows) as the domestic economic growth outlook improved.

On the other hand, we realize that global uncertainty can rear its head at any point, as evidenced by the early January U.S. drone strike that killed Iranian military leader Qasem Soleimani and Iran's subsequent response. We remain keenly aware of economic and market risk factors and continue to closely monitor both.

Our current perspective is that global growth will continue to be relatively slow but may accelerate slightly moving into 2020. Valuations are higher than normal, putting a lid on future market gains. However, with interest rates still low and growth improving, we view another multiple point of expansion as possible (in other words, moving price/earnings ratios and similar valuation metrics slightly higher). On the whole, we remain comfortable with our current positioning as further explained below.

Equity Outlook

We anticipate continued upward momentum in the equity markets, albeit tempered significantly from 2019. Corporate earnings reports will most likely bring a relatively uneventful first quarter for 2020. When the election cycle hits in earnest during the second quarter, we will follow the polls closely and its potential impact on stocks. Any proposal from a leading candidate to raise corporate taxes and/or other actions perceived as unfriendly to corporate earnings would present market risk.

In addition, stock valuations are currently already above long-term averages and any significant equity market gain from here would require higher corporate earnings to materialize. Also, a rise in inflation expectations would be problematic for equities (although currently inflation is not an issue). As of now, we expect positive mid-to-high single-digit returns in 2020 within our overall equity allocations, which are well diversified geographically as well as from an investment strategy perspective. However, we remain ever diligent from a positioning perspective, in anticipation of any risk factors that may negatively impact the market.

Fixed Income Outlook

As mentioned above, the 10-year U.S. Treasury yield rose 40 basis points (0.40%) but still remains relatively low versus historical levels. With U.S. Treasury rates much higher than rates in Europe, and the U.S. still seen as a 'safe haven' globally, demand for domestic bonds remains significant. As a result, interest rate increases (moving inversely to price) will probably remain muted unless inflation becomes a substantial threat.

We strategically employ income and global allocation strategies to enhance our portfolio construction, allowing us to dynamically manage bond duration (more duration equals greater interest rate risk) and credit risk. This is a necessity in the present environment. Yields are still too low to allocate substantially to U.S. treasuries or other more traditional fixed income strategies. Generating attractive risk-return is difficult in core fixed income at present and we have continued to identify idiosyncratic risk-return opportunities to benefit clients in this space.

Alternatives

We are currently sourcing and conducting due diligence on several alternative investment opportunities that have low to zero correlation to the rest of our portfolio positions, providing an effective means of increasing return potential while mitigating market risk. Examples include: Event-driven, middle market debt, renewable power, socially responsible and infrastructure investment strategies. In 2020, we anticipate taking advantage of several opportunities with a high current income and relatively low sensitivity to the economy and markets.

Conclusion

The outlook for 2020 has improved since last quarter with the diminishment of some global uncertainty. Once we approach the second half of 2020 however, the future is likely to become less clear. For now, given the macro and market backdrop, we anticipate modest market gains during the year. Continued healthy corporate earnings and geopolitical stability will be vital to future positive sentiment and growth as we are late in the economic cycle.

A note on our opinions and sources

Your team at Gries Financial forms its opinions through deep internal and external research and a strong network of subject matter experts. Our goal with this quarterly newsletter is to provide thoughts on the market that are concise, clear, and interesting. If you would like more information on any topic we've covered here, or if you have questions or feedback, please don't hesitate to contact us.

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