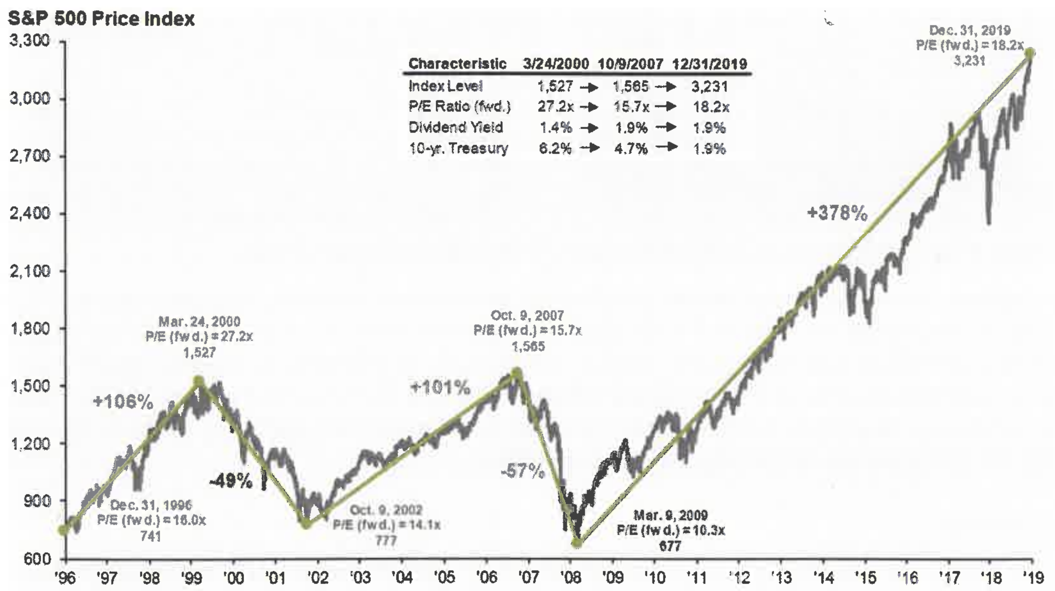
The Longer View

Comments & Outlooks from Longer Financial

January 3, 2020

Stocks Reach New Highs to Close out 2019

Markets experienced a broad rally in the fourth quarter, propelling many of the major indices to their best annual performances since 2013. The Dow Jones Industrial Average and the S&P 500 finished the year with returns of 25.34% and 31.49%, respectively, and the CRSP Large Cap Value Index gained 22.25%. After a volatile year in 2018, and recessionary fears clouding the landscape for much of 2019, the breakout to new highs (illustrated in the chart below) was a welcome relief.



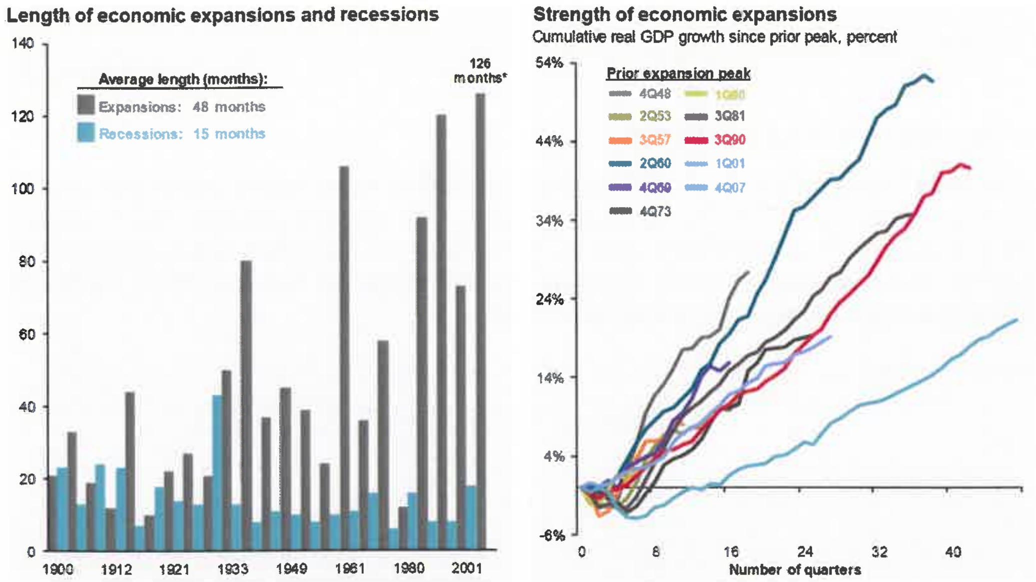
Source: Compustat, FactSet, Federal Reserve, Standard & Poor's, J.P. Morgan Asset Management.

Interest rates ticked up slightly in the fourth quarter, with the 10-year Treasury yield landing at 1.92%. However, on a full-year basis, rates finished dramatically lower than where they started the year, which gave the Bloomberg Barclay's U.S. Aggregate Bond Index an impressive 8.72% total return for 2019 (including both price appreciation and income received). As we mentioned in our newsletter last quarter, this rare combination of stocks and bonds both rapidly appreciating simultaneously has provided excellent portfolio returns for conservative and aggressive investors alike.

Recessionary Fears Fade, but Risk of Volatility Remains

The greatest driver of stock returns in the fourth quarter came from progress on trade, as "phase one" of an agreement between the U.S. and China provided hopes that, at a minimum, further escalation can be avoided in the spat between the world's two largest economic powers. Although we would classify this as more of a "cease fire" rather than a sweeping deal, it did alleviate one of the major fears that was weighing on the global economy. The outlook has also been bolstered by dovish Federal Reserve actions, as Chair Powell seems committed to low rates for the foreseeable future with inflation still largely perceived to be dormant. Finally, a combination of historically low unemployment and steady wage growth has kept the U.S. consumer running at full speed, offsetting clear weakness in the manufacturing sector.

As seen in the chart on the following page, we are now officially in the longest period of economic expansion in U.S. history, with many economists forecasting another year of modest growth in 2020.



Source: BEA, NBER, J.P. Morgan Asset Management. *Chart assumes current expansion started in July 2009 and continued through December 2019, lasting 126 months so far. Data for length of economic expansions and recessions obtained from the National Bureau of Economic Research

We have been pleased to see all the positive developments in recent months, but we also bear in mind that several risks remain in play as we start the new year. As we have very recently seen, further violence in the Middle East could soon reach a tipping point, adding uncertainty to markets, and particularly to oil prices. We are also in an election year here in the United States, and stocks in sectors that could be impacted by sweeping policy changes may face more violent movements as markets attempt to price in the potential outcome of both the presidential and congressional elections.

Portfolio Implications

After an excellent 2019, we are taking a guarded approach to start the new year. We recently harvested gains in some of our appreciated stock positions, and have ample cash available to take advantage of any potential sell-off. We will continue to maintain a rigorous stock selection process and use protective stops as appropriate to limit our downside risk where possible. Given the current level of interest rates, we have also limited our duration exposure by using shorter-maturities in our fixed-income portfolios, to mitigate potential price declines due to any move upward in rates. We want to participate in the upside, should markets keep marching forward, but will do so with caution as we work to protect our clients' portfolios.

We hope that you enjoyed a wonderful holiday season, and wish you a prosperous new year. Thank you for continued trust and partnership!

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