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FOURTH QUARTER 2019 MARKET RECAP

The US-China Phase 1 Trade Deal is no Joke! Or is it?? We Need to See it to Believe it.

2019 Market Returns Leave Investors Laughing With Joy

A global rally during the fourth quarter capped off a very strong year of returns for stocks. Much of this 4Q rally was due to progress towards a US-China phase 1 trade deal and evidence that the global manufacturing slump may have ended. Meanwhile, bonds continued to benefit from global monetary easing, including three rate cuts by the US Federal Reserve ("Fed") since the end of July.

We anticipate that future stock results will be heavily influenced by trade relations between the US and its global partners. Bond results will be buoyed by expectations for a continued low interest rate environment. The Fed's "reveal" of a new monetary policy framework during the middle of 2020 will also further bolster the market's "lower for longer" view on interest rates. We continue to maintain a tactical emphasis on bonds relative to stocks given valuations here in the US, however, we will consider shifting our preference to stocks should we see concrete evidence of a stabilization in global trade relations and/or a persistent recovery in global manufacturing trends.

US Stock Market Recap

The Standard & Poor's 500 Index ("S&P 500"), which measures the performance of the 500 largest publicly traded companies in the US, rose 9.1% during fourth quarter 2019. Continued monetary policy loosening by the US Federal Reserve ("Fed") and the announcement of a (pending) phase 1 US-China trade deal drove US stock prices higher during the quarter. For full year 2019, the S&P 500 Index experienced the second largest gain since 2010, rising 31.5%. Expectations for a much more accommodative Fed and optimism over a US-China trade deal fueled sharp gains throughout the course of the year.

Within the S&P 500, technology (+14.4%), healthcare (+14.4%), and financials (+10.5%) led all sectors over the fourth quarter while real estate (-0.5%), utilities (-0.8%), and consumer staples (3.5%) were the sectors with the poorest results over this timeframe.

For 2019, technology (+50.3%), communication services (+32.7%), and financials (+32.1%) led all sectors while energy (+11.8%), healthcare (+20.8%), and materials (+24.6%) were the laggards. During 4Q 2019, value stocks, or shares of defensively oriented S&P 500 companies that generally have slower growth and higher dividend payouts, rose 9.9% while growth stocks, or shares of S&P 500 companies growing sales and profits faster than the broader market, increased 8.3%. For the year, value stocks nominally outperformed growth stocks, rising 31.9% versus +31.1%. The Russell 2500 Index, a measure of domestic small and mid-cap stocks (US companies with a market capitalization lower than $10 billion) rose 2.1% in 4Q 2019 and increased 27.8% during 2019.

International Stocks Recap

Foreign stocks, both international developed markets and emerging markets, lagged US stocks during 4Q 2019 and over full year 2019. The MSCI EAFE Index (“Europe, Australia-Asia, and Far East”), which measures the US dollar-denominated return of medium-to-large capitalization stocks in developed markets outside of the US and Canada, increased 8.2% during the fourth quarter while rising 22.0% in 2019. Developed markets economic growth is heavily reliant upon exports of manufactured goods, which were impacted by the cyclical slowdown in global manufacturing and the decline in global trade as a result of increased tariff activity between the US and its trading partners (particularly China). This in turn moderated investor enthusiasm towards developed markets stocks relative to US stocks throughout 2019. Uncertainty over the United Kingdom’s (“UK’s”) inability to ratify a withdrawal plan ahead of its exit out of the European Union (“EU”), otherwise known as Brexit, further served as a headwind to developed market stocks relative to US stocks for most of 2019.

Developed international small-to-mid (“smid”) cap stock returns once again outperformed their larger cap peers during the quarter. The MSCI EAFE SMID Cap (US dollar) Index increased 10.5% in 4Q 2019, bringing the full year return for this index to +24.4%. Smid cap, developed international stocks did better than their larger cap peers throughout 2019 given their lower exposure to global trade and disproportionate benefit from central bank policy easing (or the perception that domestic financial conditions will loosen).

Emerging markets stocks (countries with less than a $25,000 per capita income), as measured by the MSCI Emerging Markets USD Index, rose 11.8% (on a US dollar-denominated basis) in 4Q 2019 and were up 18.4% in 2019. China, which accounts for 34% of the value of the MSCI Emerging Markets USD Index, drove emerging market stock returns both in the fourth quarter (+14.7%) and full year 2019 (+23.5%). China stock returns were influenced by US-China trade developments and the expectation for increased monetary and fiscal stimulus support throughout 2019.

Real Assets and Alternatives Recap

The S&P Real Asset Index, which measures the results of physical assets including those that can produce relatively stable income streams, such as real estate and infrastructure assets, rose 3.1% during 4Q 2019 and was up 17.2% for the year. Inflation-sensitive real asset prices, namely commodities and natural resources, benefited from the sharp rise in crude oil prices in 4Q 2019 (+8.6%) and throughout 2019 (+22.7%). The extension of OPEC production cuts and geopolitical tensions in the Middle East fueled (no pun intended) the appreciation in oil prices during the year.

Tangible, income-generating assets continued their steady rise throughout the course of 2019. The Dow Jones Global World Real Estate Index and the MSCI World Core Infrastructure Index rose 3.7% and 3.6%, respectively, during the fourth quarter due to continued demand for comparatively safe, income-generating assets that can be owned in place of lower yielding bonds. For the year, the Dow Jones Global World Real Estate Index and the MSCI World Core Infrastructure Index increased 25.3% and 26.6%, respectively.

After rising 20.9% over the first six months of 2019, the Alerian US Midstream Energy Index, which measures the results of US companies that gather, process, transport, and store oil and gas, declined 8.9% during 2H 2019, which reduced the full year return to +15.6%. The weakness in the US midstream energy sector started in response to a general lack of visibility provided by company management teams regarding future capital allocation plans during their third quarter financial results conference calls. Given the slowdown in drilling activity (pulling oil/natural gas out of the ground) within the exploration and production sector ("E&P"), some investors were betting on increased shareholder capital distributions out of US midstream energy companies. The (mis)perception was that lower drilling activity should translate into lower capital expenditures to buildout the necessary infrastructure needed to transport oil/gas thus higher capital deployment to investors in the form of higher dividends and share repurchases. This sector was then hit by an E&P company's disclosure that it may not be able to continue as a going concern given persistently low energy prices (namely natural gas prices). This increased fears that other weaker E&P natural gas players may be forced to restructure their pipeline/storage contracts to remain solvent.

The losses incurred on US midstream energy investments in 2H 2019 triggered temporary liquidations of midstream stocks during December by investors wanting to realize losses that can be used to offset realized gains during 2019. These "tax loss harvesting" transactions helped push sector returns down 4.1% during the fourth quarter. Given the positive portfolio returns realized in 2019, we took advantage of this opportunity to reduce clients' 2019 tax burdens by harvesting losses where appropriate. In certain cases, we purchased an exchanged traded fund ("ETF") to maintain exposure to the sector. Generally, the ETF we used is administered by the same mutual fund management team we recommend to gain exposure to the US midstream energy sector.

The Credit Suisse Liquid Alternatives Index, which measures the returns of investment assets/strategies that have very low correlation (i.e. relationship) to traditional stocks and bonds (i.e. "alternatives"), increased 2.1% in 4Q 2019 and finished 2019 up 8.1%. Alternative assets continue provide an effective means by which to diversify risk, especially during periods of financial market turbulence. During 2019, the US stock market experienced three drawdowns or periods of peak-to-trough price declines averaging -4.6%. The alternative funds we recommended owning experienced much lower volatility relative to the S&P 500 during these periods.

US Fixed Income (Bond Market) Recap

The Bloomberg Barclays US Aggregate Bond Index (“Barclays Agg”), a measure of high-quality US bonds of all types (i.e. “core bonds”), rose 0.2% in 4Q 2019. During the fourth quarter, credit-sensitive US investment grade bonds benefited from the broader financial market shift to a “higher risk tolerant” mentality, which compressed the spread between the yields on credit sensitive bonds and US Treasury bonds. (Tighter credit spreads denote higher demand for credit sensitive bonds given their lower yield premium, or spread, over US Treasury bond yields of the same maturity). Even though the Fed lowered its target for overnight borrowing rates (i.e. the federal funds rate) by 25 basis points for the third time since the end of July, US Treasuries still underperformed the broader universe of core bonds in 4Q 2019 due to the market’s preference for bonds with higher perceived (credit) risk. During the quarter, the Bloomberg Barclays Aggregate Treasury Index declined 0.8% while credit sensitive core bond sectors, as measured by the Bank of America Merrill Lynch US Corporate Bond Index and the Bank of America Merrill Lynch US MBS (mortgage-backed security) Index rose 1.2% and 0.7% respectively.

The Barclays Agg experienced its highest annual return since 2008, rising 8.7% in 2019. During 2019, the yield on the 10-year Treasury note declined 74 basis points from 2.66% on 01/01/18 to 1.92% on 12/31/19. Core bonds benefited from the Fed’s shift to a more accommodative monetary policy stance in response to slowing trends in manufacturing activity and corporate capital investment. After declining 2.3% in 2018, investment grade corporate bonds experienced their strongest annual return in a decade, rising 14.2% in 2019, while Treasury bonds and MBS rose 6.9% and 6.5% respectively for the year. Longer maturity investment grade bonds (i.e. bonds that mature after five or more years) outperformed shorter maturity investment grade bonds due to their higher sensitivity to interest rate movements. Longer-dated bonds also benefited from the shift in demand for longer-dated bonds due to the perception that the Fed will unlikely adjust its target for the federal funds rate ahead of the presidential elections in November 2020.

The S&P National Municipal Bond Index rose 0.6% in the 4Q 2019 and was up 7.4% for 2019. Municipal bond valuations were boosted by higher demand for credit sensitive bonds in the fourth quarter while favorable supply and demand dynamics provided a tailwind to bond prices throughout 2019. Specifically, municipal bond demand remained high among investors impacted by the $10,000 state and local tax (SALT) deduction cap and foreign investors seeking higher yields. Tax-exempt municipal bond prices have also been bolstered by a relative benign new issuance activity during 2019 due to a lower capacity (or need) for municipalities to assume more debt.

International Fixed Income (Bond) Recap

Outside of the US, the Bloomberg Barclays International Aggregate Bond USD Index, a measure of international developed markets investment grade bonds of all types, rose (in US dollar terms) 0.7% in 4Q 2019 and was up 5.1% for 2019. Developed markets corporate bonds, as measured by the S&P International Corporate Bond Index, were the key driver of returns for international developed market bonds in the fourth quarter (+3.8) and for the year (+9.9%). Throughout 2019, international corporate bond prices benefited from 40 international central banks easing monetary policy conditions and generally stable currency trends relative to the US dollar (source: Goldman Sachs). Fourth quarter returns were especially strong given a tightening of credit spreads post the announcements of a Brexit agreement between UK Prime Minister Boris Johnson and the European Union and a US-China phase 1 trade deal.

The Bloomberg Barclays Emerging Markets Aggregate Bond Index, which measures the results of USD-denominated debt of emerging markets government and corporate issuers, increased 2.1% in 4Q 2019 and finished 2019 up 13.1% for the year. Improving investor sentiment in response to easing of monetary policy conditions and stabilizing economic growth trends, especially in China, helped propel emerging markets bond prices higher throughout the course of 2019. With the value of negative yielding debt reaching a peak of $17 trillion or roughly 30% of total outstanding bonds within the Bloomberg Barclays Global Aggregate Bond Index in July (source: J.P. Morgan), higher-quality emerging markets bonds were especially desirable to “search for yield” investors given their attractive return profile. (Investors who purchase bonds with a negative yield and hold them until maturity end up losing money on their investment.)

US-China Phase 1 Trade Deal…A Source of Risk?

We were not surprised by the sharp rise in global equity valuations last quarter in response to the announcement that the US and China plan to sign a phase 1 trade deal in January 2020. The ongoing US-China trade dispute had triggered a meaningful slowdown in capital investment as corporations, both in the US and abroad, either delayed or reduced their spending plans given the uncertainty over future tariff activity. The slowdown in capital investments added fuel to a contraction in global manufacturing activity, which threatened to further reduce global economic growth if the trade war continued to escalate. There was also concern that new US tariffs set to occur on December 15th would have directly impacted US consumers since the tariffs would have increased prices on imported toys and electronic products from China. To date, the US consumer has been relatively immune to the escalation in the US-China trade war since most tariffs target the corporate sector. Considering consumer spending on goods and services accounts for 68% of US gross domestic product (“GDP”) (source: Federal Reserve Bank of St. Louis), the next round of tariffs had the potential to negatively affect consumer confidence and ultimately the health of the US economy. (GDP represents the value of all goods produced and services rendered within the borders of a country or geographic region. Growth in GDP is the most common indicator used to track the health of an economy.)

The US-China phase 1 trade deal, if consummated, will stop the imposition of new tariffs by both countries. It will also ease some existing tariffs and increase purchases of US agriculture, manufacturing, and energy products/services by China. The deal includes commitments by China to curb forced technology transfers from US companies to Chinese companies and to ease market entry of US companies into the Chinese financial sector. It is worth noting that China has pledged to address these issues for years without much progress. The phase 1 agreement also does not structurally change the primary causes of the trade war, namely China's unfair trading policies and lack of intellectual property protections. These issues are supposed to be addressed in the next phase of trade negotiations, and both countries need to adhere to the terms laid out in the phase 1 agreement to even advance to a phase 2 agreement.

We are dubious China can adhere to the purchase targets outlined in the agreement since they require the country to more than double the value of American products/services purchased prior to the trade war. We are also skeptical that China will make meaningful progress towards curtailing forced technology transfers or truly ease market barriers for the expansion of US financial companies into China. The strategists we consult with think China wants to "wait out" the US until after the presidential elections in November so that they know who they will be negotiating with over the next four years. As such, we are concerned the past will come back to haunt the markets given China's modus operandi towards executing on its promises and an impatient US President whose erratic behavior may increase under the pressure of impeachment.

The Fed's New Way of Looking at Things

During the middle of 2020, the Fed will officially disclose a new framework for how it will administer monetary policy. The new framework is intended to give the Fed more flexibility to manage inflation, which remains stubbornly below the Fed's 2.0% target. As part of this new framework, the Fed is expected to officially confirm its use of a "symmetric" inflation target. Symmetric inflation targeting simply replaces a hard 2.0% inflation target with a moving average inflation target of 2.0%. Since the latest reading for the Fed's preferred inflation gauge, core personal consumption expenditures price index ("core PCE") is 1.6% and the 12-month moving average for core PCE is 1.8%, the Fed will need to maintain accommodative monetary policy to let economic growth heat up enough for core PCE to rise. The economists we confer with expect GDP growth and inflation for 2020 to be relatively the same as 2019, which means the Fed will be inclined to keep interest rates low and stable for at least the next 12 months since the symmetric inflation target will unlikely be met. The fact that 2020 is an election year provides even more impetus for the Fed to maintain rates at their current low levels since it wants to appear apolitical ahead of the November elections.

Outlook for US Stocks

US stocks should benefit from a positive economic backdrop and loose monetary policy conditions over the course of 2020. US stocks also have the positive tailwind of 2020 being an election year. Since 1928, there have been 23 election years, and the S&P 500 had a positive return during 83% of these years with an average return of 17% (source: Dimensional Fund Advisors). Our enthusiasm for US stocks, however, remains tempered considering valuations remain high relative historical levels. In other words, the market is already pricing in much of the positive outlook with little-to-no discount associated with a worsening in the US-China trade war or overly loose monetary policy leading to an unanticipated rise in inflation expectations. We think it is plausible US stock prices have the potential to grow in line with earnings expectations for the S&P 500 for 2020 of +9.5% (source: Goldman Sachs) or to deliver a total return of 11.5% for the year (+9.5% earnings growth plus a current dividend yield of 1.9%). This expectation assumes, the US-China trade truce persists, progressive democrats do not take control of congress and the presidency, and the US does not fall into a recession over the next 12-18 months. Regarding the later point, while the US is firmly set in the late phase of its business cycle and the risks of a potential recession have risen (from very low levels), the strategists we speak with believe there is still a lower than average probability of the US falling into a recession for at least the next 12 months.

We are generally maintaining current exposures to US stocks but will be shifting the mix of exposure towards value-oriented stocks where appropriate. Value stocks tend to reduce portfolio risk by lowering overall sensitivity to domestic stock market fluctuations due to their relatively lower valuations and high dividend payouts. We acknowledge that all value stocks are not created equal. The managers we utilize to invest in these securities focus on owning companies with competitive market positions, healthy financials, and durable cash flows. These types of companies tend to further reduce volatility by having a greater ability to generate stable-to-growing dividend payment streams over time.

Outlook for Foreign Stocks

We continue to emphasize foreign stocks over US stocks primarily due to their lower valuations. The forward price-to-earnings ratio (i.e. “P/E” or current stock price divided by estimated earnings per share over the next 12 months) for the MSCI All Country World (ACWI) ex-US Index, which measures the performance of international developed markets and emerging markets stocks, of 14.2x is currently 22% lower than the forward P/E ratio for the S&P 500 of 18.2x (source: FactSet). Historically (over the past 20 years), the forward P/E multiple for foreign stocks is 12% lower than the forward P/E multiple for US stocks. A reversion to this historical discount means foreign stock prices would rise by 13% from current levels. The potential price appreciation for foreign stocks is even higher when comparing the current dividend yield for the MSCI ACWI ex-US Index of 3.3% to the current dividend yield of 1.9% for the S&P 500. The prevailing yield premium for foreign stocks relative to US stocks is 168% when historically this premium is 151% (source: FactSet). Foreign stocks would rise 14% if the market started to apply this historical value to current foreign stock prices.

What catalysts could trigger a reversion towards historical relative valuations for international developed markets stocks and emerging markets stocks? The key catalyst for international developed markets will be concrete evidence of a recovery in global manufacturing given their dependence on industrial product exports. The average share of exports as a percentage of GDP for Japan, UK, Euro Area, and Canada is more than 2.4x that of the US (20% versus 8%) (source: J.P. Morgan). Since reaching a peak in 4Q 2017, global manufacturing growth has been in a cyclical downturn as excessively high inventory levels have led to a contraction in new product orders (i.e. producers have decreased new product manufacturing activity to work down high inventory levels). The beginning of the US-China trade war in 1Q 2018 and China's crackdown on non-regulated shadow banking consumer loans (think lower demand for automobiles) further exacerbated this downturn leading to a contraction in manufacturing activity, GDP growth, and corporate earnings in the Euro Area and Japan over the course of 2019.

There are concrete signs, however, that the global inventory overhang is abating and manufacturing activity will begin to rebound in earnest. Global monetary policy easing, which historically precedes a resurgence in manufacturing activity by 7-9 months, picked up steam during 1H 2019. There has also been an upturn in global new orders, which tends to be a strong indicator for declining inventory drawdowns. Lastly, a potential US-China trade deal, greater confidence in an orderly Brexit, and the prospect of increased infrastructure spending in the European Union will help to reinvigorate business confidence and capital spending, which ultimately will translate into higher global manufacturing activity over the next 12 months.

For emerging markets, the key catalyst will be increased investor confidence that the recent upward inflection in corporate earnings will be sustained. Stabilization in Chinese economic growth will be the primary driver of sustained earnings momentum. Chinese authorities have pursued a number of targeted stimulus measures over the past two years to address decelerating economic growth trends. As with most stimulus measures, there tends to be a delay between the launch of a measure and its impact on an economy. China's previous stimulus efforts are just starting to kick-in and the government plans to modestly boost fiscal spending in 2020. China's central bank, the People's Bank of China ("PBoC"), also plans to become more accommodative through modest cuts to short-term borrowing rates and by allowing a modest level of credit expansion during 2020. All of these efforts should further stabilize economic growth thus not serve as a headwind to broader emerging markets earnings growth. Outside of China, we expect the recovery in global manufacturing activity and, to a lesser extent, a US-China trade truce to reinvigorate emerging markets commodity exports to developed markets.

It is important to note that China's economic "growth recession" was largely self-inflicted due to the central government's efforts to reduce financial system risks within its economy, namely excessive lending and high real estate prices. The timing of China's de-risking efforts coincided with the start of the US-China trade war and the decline in global manufacturing activity. This has led some market participants to assume the slowdown in Chinese economic growth was due entirely to the US-China trade war and the contraction in global manufacturing. Considering net exports (the value of a country's exports minus its imports) are projected to account for ~1% of China's GDP in 2019 (source: Matthews Asia), the US-China trade war simply exacerbated the slowdown in economic growth. Like the US, China is now predominately a consumer-based economy, with consumer spending projected to account for ~62% of 2019 GDP (source: J.P. Morgan). Also like the US, Chinese economic growth can withstand downdrafts in manufacturing activity so long as the domestic consumer remains healthy, which continues to be the case for China. We continue to advocate a tactical emphasis on Asian-Pacific emerging markets stocks due to their exposure to the Chinese consumer.

Outlook for Real Assets, Tactical Opportunities, and Alternative Investments

The outlook for real assets is favorable. The Fed is unlikely raise interest rates in 2020, and global monetary policy is expected to stay highly accommodative. This means global bond yields will remain low and demand for relatively safe, high income generating (non-bond) assets will remain high. The unique attributes of real assets also make them ideal investments to own given where the US is in its business cycle (late phase of its current long economic expansion). Real assets offer a hedge against rising inflation, which tends to occur near the end of an expansion cycle, while their relatively stable income streams offer stability to returns during the early stages of a recession.

Midstream energy infrastructure assets offer an especially attractive opportunity over the next 12 months. Tax loss selling at the end of 2019 and fears associated with natural gas E&P counterparty risk have artificially lowered valuations. The median US midstream energy company is currently trading at an EV/EBITDA (enterprise value to earnings-before-interest-taxes-depreciation & amortization) multiple, a key valuation metric in the industry, that is far lower than historical levels. Specialists we speak with view this valuation discount as "significantly overblown" since the midstream contract renegotiations that have occurred have been net present value neutral (i.e. the reduction to contract fees are offset by longer contract term commitments, higher volume guarantees, and increased acreage dedications). Counterparty restructuring with natural gas E&P companies is also not a systemic risk since it pertains to a subset of highly leveraged E&P companies with excessive concentration in a few high cost natural gas acreages.

We maintain our favorable outlook for US midstream energy companies. The average US midstream energy company is expected to yield 7-10% in 2020 (source: Tortoise) while growing cash flow per share by 4-6%. The need for additional energy infrastructure (thus cash flow growth opportunities) remains strong, and the downdraft in natural gas prices is a temporary issue. The global replacement shift from dirtier coal-fired power generation to cleaner natural gas, especially within China, will provide strong support to natural gas prices over the mid-to-long term.

We continue emphasize consumer staples, healthcare, and technology/communication services sector stocks within client portfolios where appropriate. Holding consumer staples stocks in client portfolios helps to stabilize stock returns due to the inherent nature of their underlying products (essential goods), their stable cash flows, and their relatively high dividend yields. We are encouraged by the sharp rebound in healthcare sector stock valuations in 4Q 2019 after underperforming the broader financial markets during the first nine months of the year. Fears associated with "Medicare for All" and pervasive drug price controls may be overblown, and we expect the valuation gap between healthcare stocks and the broader equity market to narrow as we progress through 2020. Generally, we maintain an emphasis on the technology/communication services sector but at half the weight we currently advocate for consumer staples and healthcare. The half weighting to these stock sectors balances our cautious view on valuations with the potential for continued excess returns driven by constant innovation and robust secular growth tailwinds.

Alternative investments serve as an important portfolio "diversifier" considering US stock valuations are near one standard deviation above historical levels and investment grade bond yields are near all-time lows. We continue to evaluate our clients' alternative holdings to help ensure these investments mitigate portfolio risk (via differentiated return streams and risk profiles). Alternatives enhance portfolio outcomes over time (by delivering higher returns than what can be attained with investment grade fixed income). To this end, we are replacing one of our existing alternative fund managers focused on fundamental-based, global macro, long-short investments with a new alternative investment fund. The new alternative manager combines a quantitative-based, systematic managed futures (i.e. "trend following") strategy with a passively managed, globally diversified, equity portfolio. This approach has enabled the manager to generate excess returns over investment grade fixed income (bonds) by exploiting "trend" opportunities in over 125 markets while also scaling exposure to a globally diversified equity portfolio to benefit from broad-based equity market rallies. The manager also has a proven ability to deliver positive returns during equity market downturns. We intend to add this fund to client portfolios where appropriate.

Outlook for Fixed Income (Bonds)

In 4Q 2019, we took advantage of the global rally in stocks to tactically reduce risk in client portfolios by trimming equity positions and increasing weightings to core bonds where appropriate. We are encouraged by signs that the cyclical slowdown in global manufacturing is coming to an end, but we are cognizant there is a strong precedence for likely further escalation in the US-China trade war. Such an escalation could extend the swoon in global economic activity and potentially trigger tariffs on key consumer products into the US. This would negatively impact the US consumer and ultimately US GDP growth. There is also risk the Trump administration may still impose penalties on $110 billion of US auto/auto part imports from Europe and Japan and the US "Section 301" investigation against France's digital tax may be extended to Italy, Turkey, and Austria.

Intensification of either situation could lead to retaliatory tariffs, which will further impact US and global economic growth.

We remain comfortable with tactically emphasizing more core bond exposure in client portfolios given our view on interest rates during 2020. Core bonds have also shown a neutral to negative correlation (i.e. relationship) to falling stock prices, which provides a hedge to adverse stock market movements caused by a negative trade-related event or further softening in global trade and manufacturing dynamics. We will consider reducing our tactical emphasis on core bonds (in favor of owning more stocks) if we receive more concrete signs that the truce in the US-China trade war will persist and/or if the recovery in global manufacturing trends accelerate.

Municipal bond prices remain supported by the continued contraction in the par amount of bonds outstanding. Foreign demand for taxable municipal bonds also remains strong, especially with expectations that US dollar trends will remain relatively stable versus major global currencies over the next 12 months. We continue to advocate holding a portion of core bond exposure in investment grade national municipal bonds for clients in high tax brackets. The share of investment grade municipal bonds as percentage of core bonds has been tempered, however, by the relatively tight spread between municipal bonds and US Treasuries.

We continue to recommend complementing clients' core bond holdings with US dollar-hedged, international developed markets, investment grade bonds. The addition of these bonds lowers risk by diversifying US duration (interest rate) and credit risks among multiple global markets. We maintain our positive outlook for emerging markets bonds. This asset class remains one of the few areas within fixed income to offer attractive long-term, risk-adjusted, return opportunities supported by robust secular tailwinds.

The US-China Trade War is no Laughing Matter

We remain skeptical that the US-China trade truce will hold. Until we receive concrete evidence that both sides will adhere to the terms of the phase 1 deal, assuming terms are even agreed upon during China's visit to Washington June 13-17, we maintain our "see it to believe it" approach to adjusting our clients' weightings to stocks and bonds. Meanwhile, the Trump impeachment proceedings, heightened tensions in the Middle East, potential for more trade-related tensions, and a late US economic cycle further keeps us cautious on stocks for the time being.

We Want to Help You Attain Your Financial and Personal Goals!

The general information in this report is not intended to reflect our specific recommendations for any client portfolio. Please contact us with any questions to discuss your personal goals and your investment portfolio.

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We welcome the opportunity to discuss your goals and the most appropriate strategy to attain them. We are also honored to speak to any of your friends, associates, or relatives should they have an interest in our financial planning or investment management services.

This information is compiled by Ginsburg Financial Advisors.

Unless otherwise noted, financial data are as of December 31, 2019

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Additional risks are associated with international investing, such as currency fluctuations, political and economic instability, and differences in accounting standards.

Index descriptions:
-The MSCI EAFE SMID Cap Index captures mid and small cap representation across Developed Markets countries around the world, excluding the US and Canada. With 2,865 constituents, the index covers approximately 28% of the free float-adjusted market capitalization in each country*

-The Dow Jones Global World Real Estate Index is designed to measure the performance of publicly traded real estate securities, including globally traded real estate investment trusts (REITs) and real estate operating companies (REOCs).

-The MSCI World Core Infrastructure Index captures large and mid-cap securities across the 23 Developed Markets (DM) countries. The Index is designed to represent the performance of listed companies within the developed markets that are engaged in core industrial infrastructure activities.

-The Russell 2500 Index is a broad index, featuring 2,500 stocks that cover the small- and mid-cap market capitalizations.

-The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets outside of the U.S. & Canada.

-The MSCI Emerging Markets Index stands for Morgan Stanley Capital International (MSCI), and is an index used to measure equity market performance in global emerging markets.

-MSCI ALL CHINA INDEX (USD) MSCI ALL CHINA INDEX. The MSCI All China Index captures large and mid cap representation across all China securities listed in China and Hong Kong as well as in the US and Singapore.

-The S&P Real Assets Index is the first index of its kind designed to measure global property, infrastructure, commodities, and inflation-linked bonds using liquid and investable component indices that track public equities, fixed income, and futures.

-Alerian Midstream Energy Index. The capped, float-adjusted, capitalization-weighted index, whose constituents earn the majority of their cash flow from midstream activities involving energy commodities, is disseminated real-time on a price-return basis (AMNA) and on a total-return basis (AMNAX).

-The Wilshire Focused Liquid Alternative IndexSM measures the performance of a focused basket of mutual funds that provides risk adjusted exposure to equity hedge, global macro, relative value, and event driven alternative investment strategies.

-BofA Merrill Lynch US Corporate Index: Tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the US domestic market.

-BofA Merrill Lynch Constrained Duration US Mortgage Backed Securities Index - ETF Tracker. The index tracks the performance of US dollar denominated 30-year, 20-year and 15-year fixed rate residential mortgage pass-through securities publicly issued by US agencies in the US domestic market.

-The S&P National AMT-Free Municipal Bond Index is a broad, comprehensive, market value-weighted index designed to measure the performance of the investment-grade tax-exempt U.S. municipal bond market. Bonds issued by U.S. territories, including Puerto Rico, are excluded from this index.

-The Bloomberg Barclays US Aggregate Bond Index, or the Agg, is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States.

-JPMorgan EMBI Global Diversified Index - ETF Tracker. The index is an unmanaged, market-capitalization weighted, total-return index tracking the traded market for U.S.-dollar-denominated Brady bonds, Eurobonds, traded loans, and local market debt instruments issued by sovereign and quasi-sovereign entities.

-The Bloomberg Barclays Global Aggregate Bond Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

-The MSCI ACWI is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI is maintained by Morgan Stanley Capital International (MSCI) and is comprised of stocks from 23 developed countries and 24 emerging markets