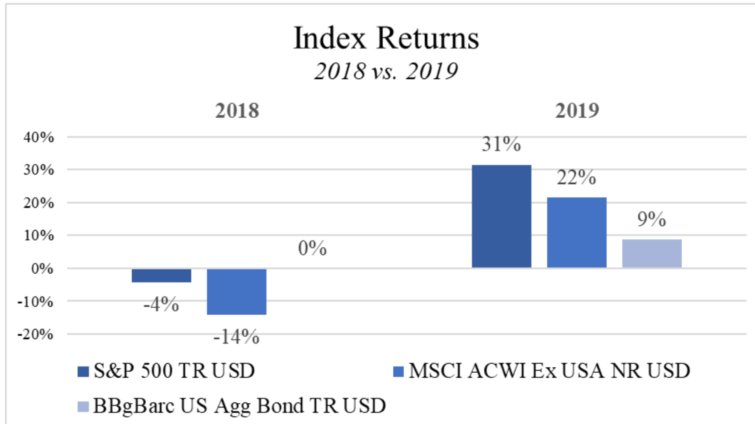
Freedom Capital Management Strategies®

Quarterly Market Review & Outlook

January 2020

2019 REVIEW: A Year to Remember Follows a Year to Forget

2019 was a strong year for both stock and bond markets, a 180-degree change from 2018, when asset prices were down nearly across the board. Indeed, investors entered 2019 with low expectations: global manufacturing data was in decline, leading economic indicators were falling, and markets were worried about an incipient recession. Yet, ultimately, equity markets were able to overcome these fears to post excellent returns. Interestingly, bonds, which often struggle during a stock market rally, also performed well over the course of the year. Let's explore the major market catalysts of 2019 in greater detail to see what drove this performance:



Source: Morningstar Direct

Economic data held steady

As mentioned above, investors were discouraged entering the year. However, because expectations were so low, it didn't take much to hearten equity investors: when early-year economic data stabilized, it was enough to abate recession fears, and stock markets rebounded. Data was mixed as the year continued, which led to volatility in stock prices in the middle of the year. Global manufacturing numbers continued to show weakness, and the U.S. Treasury yield curve inverted over the summer, a traditional leading indicator for recession. However, these concerns were offset by strong consumer sentiment and a resilient service sector, which helped encourage investors and boost equity markets through year end.

The Fed changed direction

Another major catalyst for markets this year was a change in tone from the Federal Reserve Bank (Fed). After raising interest rates throughout 2018, the Fed began 2019 by introducing more dovish language, indicating that they would be willing to cut interest rates if data remained weak. Central bank easing can promote economic growth, and so this rhetoric helped support the first quarter rally in equities. Likewise, bond investors, anticipating interest rate cuts, flocked to U.S. Treasury bonds over the summer, which drove much of the year's fixed income return (interest rates and bond prices are inversely related). As the year progressed and manufacturing data remained weak, dovish Fed words transitioned into action: the Fed cut interest rates in three consecutive months (August, September, and October). Other global central banks followed suit, and equity markets responded with a further rally.

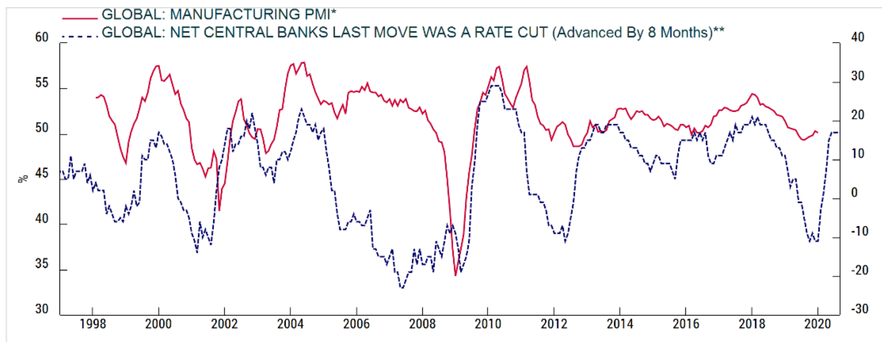
Geopolitical tensions eased

Markets have been particularly sensitive to geopolitical pressures in recent years, and 2019 was no different. Trade tensions between the U.S. and China and a delayed resolution to Brexit impacted markets throughout the year. However, in the fourth quarter, the promise of a Phase One trade deal between the U.S. and China and a clearer path to Brexit due to a decisive Tory victory in the U.K. eased pressures and helped feed the rally in equity markets..

Authored by the Freedom Capital Management Strategies® Investment Team | January 2020

2020 OUTLOOK: Will Global Growth Rebound?

Net Central Bank Easing and Global Manufacturing



Source: BCA

As we begin 2020, investor sentiment is elevated, as expectations of a long-awaited upturn in global economic growth were catalyzed by recent central bank easing. We feel the most critical factor for markets in the new year will be whether this anticipated turnaround in economic growth comes to fruition.

As shown in the accompanying chart, central bank easing frequently leads to a rebound in global manufacturing activity, but with a lag, so it is likely any positive economic growth effects from recent central bank activity will manifest in 2020. In particular, China, which helps drive the global manufacturing cycle, undertook meaningful monetary and fiscal easing in 2019; this, combined with recent optimism about trade, may help improve not only China's but also Europe's economic prospects (Europe is a major exporter to China). If we do see this turnaround, it would provide further support to stock markets.

However, when investor expectations are high, it is important to be vigilant. While the optimistic scenario is that global economic activity will accelerate in 2020, this has not yet shown up in the data. We must continue, then, to watch and wait and to also consider potential risks to this optimistic outlook:

Geopolitical Risk

While the progress toward a Phase One U.S.-China trade deal and a likely resolution to Brexit are potential "pluses" for markets this year, geopolitical tensions may arise from other quarters. Investors will be keeping an eye on the upcoming U.S. presidential election, especially regarding potential changes to trade policy, regulation, and corporate taxes. Further, a recent flare-up in tensions in the Middle East could also have an effect on markets as the year continues.

Liquidity Risk

Recent hiccups in the market for overnight repurchase agreements (repos) highlighted potential issues around liquidity. Liquidity in these markets is essential for the banking system to function properly. While Fed action has seemingly contained these issues, it will be important to monitor this market, as it can be a bellwether for the health of the financial system.

Inflation Risk

As discussed above, global central banks eased monetary conditions in the back half of 2019. Loose monetary policy can drive inflation, though this effect has largely been absent from developed economies since the global financial crisis. However, recent rounds of easing in the U.S. have come on the back of burgeoning wage pressure and a tight labor market, a scenario that may be more conducive to inflationary pressures. While unlikely in the near term, if inflation were to unexpectedly rise, it could result in upward pressure on interest rates, which would likely lead to volatility across stock and bond markets.

In summary, although investors are entering 2020 with an optimistic tone, it will be important to monitor whether the anticipated recovery in global growth materializes. Further, when expectations are elevated, it is also important to remain vigilant about potential risk factors that could prove particularly disruptive in a seemingly benign environment.

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