IM&R Economic and Market Review Q4 2019

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Economic Review

After cutting rates three times this year, Federal Reserve officials voted to hold interest rates constant at the current range of 1.5% to 1.75%, in the central bank's final monetary policy-making meeting of the decade. The Fed stated that the current level of interest rates is appropriate to support sustained expansion of economic activity, strong labor market conditions and inflation near 2%. More importantly, they currently intend to keep rates steady at the current range until at least the end of 2020.

The economy grew at a 2.1% pace in the third quarter according to the latest Bureau of Economic Analysis gross domestic product (GDP) report as consumers continued to spend and wages increased. Economic growth is expected to continue at a similar clip in the fourth quarter with the latest Atlanta Fed GDPNow forecast at 2.3%.

Consumer sentiment, already at a very favorable level, improved again in December according to the University of Michigan Survey of Consumers. Current economic conditions improved among consumers while overall expectations ticked higher. The impeachment hearing had a barely noticeable impact on economic expectations, as it was mentioned by just 2% of all consumers in the survey. Consumer inflation expectations declined to 2.3%.

The jobless rate was little changed in November at 3.5% leaving unemployment at its lowest level in five decades, according to the Bureau of Labor Statistics. The labor force participation rate was also little changed at 63.2%. Average hourly earnings increased by 3.1% over the last 12 months to $23.83.

Business activity growth accelerated to a five-month high in December according to the IHS U.S. Composite PMI. The survey showed the economy continuing to regain growth momentum at the end of 2019, with the outlook also brightening to fuel hopes of a strong start to 2020. December's expansion was led by the services sector, accompanied by another month of steady manufacturing growth.

The Conference Board Leading Economic Index (LEI) was unchanged in November after three consecutive monthly declines. Strength in residential construction, financial markets, and consumers' outlook offset weakness in manufacturing and labor markets according to Conference Director who also stated that the Index suggests that economic growth is likely to stabilize around 2% in 2020.

Financial Markets Review: Domestic Stock Market

U.S. equity markets surged ahead in the fourth quarter to end the best year since 2013, as optimism about a trade accord with China propelled the major averages to record highs before slipping slightly on the final two trading days of the year. For the quarter, the S&P 500 vaulted ahead 8.53%, excluding dividends, to 3,230.78. The Dow Jones Industrial Average finished up 6.02% to 28,538.44 and the technology heavy Nasdaq composite put in a spectacular return of 12.16% to close out the year at 8,972.60.

Ten of the 11 S&P sectors were positive in the fourth quarter with information technology rocketing 14.40%, followed closely by health care soaring 14.37% and financials rounding out the double-digit gainers at 10.47%. The bottom three sectors for the quarter included real estate with a negative return of -0.54%, utilities edging up 0.75% and consumer staples advancing 3.51%.

Growth stocks continued the long dominance over value stocks for the quarter in both the large cap and small cap space as a signs of a style reversal have not materialized. Growth has outperformed value over the past 1, 3, 5 and 10 years.

The strongest holding in the Dow Jones Industrials Average for the fourth quarter was UnitedHealth Group which gained a remarkable 35.77%, followed by Apple with an impressive 31.46% return and JPMorgan Chase adding 19.21%. Boeing fell double digits, shedding -13.84% while McDonald's Corp. and The Travelers Companies dropped -7.28% and -7.34% respectively.

The best performing S&P 500 industries for the quarter were technology hardware storage and peripherals (+29.60%), health care providers & services (+26.57%) and metals & mining (+19.28%). The poorest performing industries included leisure products (-10.40%), communications equipment (-3.00%), and aerospace & defense (-1.75%).

As we begin a new year, the trade truce with China, historically low unemployment and a tight labor force, solid consumer confidence, accommodative central banks, low inflation and a still growing economy all point to continued advances ahead. Potential issues that could put the brakes on the good times, however, include a re-escalation of trade conflicts, policy mistakes by the Fed, geopolitical risks, ongoing dysfunction in Washington, a pickup in interest rates and inflation, growth and earnings disappointments and investor complacency. A broadly diversified, well-constructed and periodically rebalanced investment portfolio remains our suggested approach for the year ahead.

	Total Returns (12/31/19)			Annualized Returns (12/31/19)		
Category/Style	**4th Quarter**	**Year-to-Date**	**One Year**	**Three Years**	**Five Years**	**Ten Years**
S&P 500	9.07	31.49	31.49	15.27	11.70	13.56
S&P Midcap 400	7.06	26.20	26.20	9.26	9.03	12.72
S&P Small Cap 600	8.21	22.78	22.78	8.36	9.56	13.35
Russell 1000 Large Cap Growth	10.62	36.39	36.39	20.49	14.63	15.22
Russell 1000 Large Cap Value	7.41	26.54	26.54	9.68	8.29	11.80
Russell 2000 Small Cap Growth	11.39	28.48	28.48	12.49	9.34	13.01
Russell 2000 Small Cap Value	8.49	22.39	22.39	4.77	6.99	10.56

Source: Standard and Poor's, Frank Russell Company

International Stock Markets

The IMF lowered its outlook for 2019 world growth to 3.0%, its lowest level since 2008-09. Growth, however, is projected to pick up to 3.4% in 2020 reflecting an anticipated improvement in economic performance in a number of emerging markets.

Amid some signs of economic stabilization and an easing of trade frictions, the MSCI EAFE Index of developed markets advanced 8.17% for the fourth quarter. Emerging markets fared better with the MSCI Emerging Markets Index gaining 9.54% and the MSCI Frontier Markets Index up 6.63%.

The result of Boris Johnson's significant victory in the UK elections reduces the danger of a "hard Brexit" and should pave the way for a less contentious separation from the EU. Looking to the Eurozone stock markets, the Euro Stoxx Index was up 5.14% for the quarter to 403.94. Among key Euro members, France's CAC-40 Index returned 5.29% (in local currency) to 5,978.06 and Germany's DAX Index gained 6.60% to 13,249.1, while the UK's London FTSE 100 edged up 1.02% to 7,542.44 as the election brought a little more clarity to the Brexit outcome.

The de-escalation of US-China tensions is welcome news for emerging markets. Asia-Pacific markets moved higher in the fourth quarter. In developed markets, Japan's Nikkei stock index vaulted 8.74% (in local currency) to 23,656.62. The "phase one" trade deal with the US aided the China Shanghai Composite Index's rise to 3,050.12 for a 4.99% gain. The pact is expected to be signed in January. In other emerging markets, India's S&P BSE Sensex Index jumped 6.82% to 41,306.02.

Among the S&P Global Broad market Indexes, top performing countries (in $US) for all of 2019 were Latvia (48.6%), Greece (46.3%) and Russia (41.8%). Laggards included Nigeria (-19.7%), Chile (-18.5%) and Bangladesh (-18.2%).

The dollar fell 2.747% to 89.47 against world currencies in the fourth quarter according to the WSJ Dollar Index. The dollar rose 0.62% against the yen to 108.76 (JPY/USD) and fell 3.24% higher versus the euro at $1.126 (USD/EUR).

World Bond Markets

The yield curve steepened in the fourth quarter with the 10-year/3-month Treasury spread at 0.35%. The U.S. 10-year note yield advanced 0.23% to 1.91% at the end of the quarter and the 3-month yield stood at 1.56%. As a result of the yield gain, bond prices struggled and the Barclays U.S. Aggregate Bond Index rose a mere 0.18% for the quarter. The Barclays Municipal Index added 0.74% and the Barclays U.S. Treasury TIPS Index returned 0.79%. The average money market yield was 1.46% according to the Crane 100 Money Fund Index at year end.

Yields on EU and Japanese bonds remained in negative territory in the fourth quarter but total negative yielding debt retreated from a global peak of $17 trillion in the summer to $11 trillion as the year ended. The 10-year bond yield stood at -0.24% in Germany and -0.2% in Japan. Canada's 10-year bond yield climbed to 1.61% and United Kingdom bonds moved higher to 0.77%.

Commodities

Commodities as a group rose a robust 6.15% in the fourth quarter to 642.31, as measured by the DJ commodity index.

Gold continued to shine, rising 3.67% to $1,519.50. A weaker dollar and global trade frictions propelled the metal to its best year since 2010, gaining 18.87%.

Oil futures rallied in the fourth quarter and the black gold gushed 13.93% or $6.99/barrel to $61.06. The 34.68% return for the year was oil's best since 2016. According to the American Automobile Association (AAA), the national average price of gas slid six cents for the quarter to $2.59. Hawaii, the highest cost state, checked in at $3.66. Missouri was lowest at 2.22%.

Mutual Funds/Exchange-Traded Funds

According to the Investment Company Institute (ICI), exchange-traded funds (ETFs) continued the move above $4 trillion in assets, ending the quarter at $4.25 trillion among 2,085 funds. Mutual fund assets still dwarf the ETF market ending the period at $20.9 trillion represented by 7,954 funds. The number of mutual funds continues to shrink, declining by another 55 in the quarter.

MUTUAL FUNDS OVERVIEW AS OF DECEMBER 31, 2019

	Total Returns		Annualized Returns			
Category	**4th Quarter**	**Year-to-Date**	**One Year**	**Three Years**	**Five Years**	**Ten Years**
Municipal Bond Interim-Term	0.53	6.87	6.87	4.05	2.89	3.70
Short-Term Taxable Bond	0.59	4.70	4.70	2.46	2.00	2.18
Interm.-Term Taxable Bond	0.11	8.04	8.04	3.58	2.71	3.54
Long-Term Taxable Bond	0.18	19.29	19.29	7.87	5.51	7.39
High Yield Bond	2.30	12.61	12.61	5.31	4.87	6.42
World Bond	1.21	6.71	6.71	3.92	1.78	2.21
Small-Cap Blend	7.98	23.75	23.75	6.82	7.10	11.15
Mid-Cap Blend	7.06	26.12	26.12	9.10	7.09	11.03
Large-Cap Blend	8.14	28.83	28.83	13.29	9.80	12.05
World Large Stock	8.06	25.54	25.54	12.02	8.08	8.58
Foreign Large Blend	8.38	21.61	21.61	9.08	5.36	5.14
Natural Resources	8.57	14.85	14.85	2.80	1.38	2.83
Real Estate	0.64	27.27	27.27	8.34	6.79	11.29

Source: Morningstar Category Returns, Morningstar, Inc.

Important Definitions and Disclosures

The opinions and material presented are provided for informational purposes only. No person or system can predict the market. This material includes forward-looking statements that are subject to certain risks and uncertainties. Actual results, performance or achievements may differ materially from those expressed or implied. No predictions or forecasts can be guaranteed. Companies mentioned are for informational purposes only. It should not be considered a solicitation for the purchase or sale of the securities. Any investment should be consistent with your objectives, time frame and risk tolerance. Neither asset allocation nor diversification guarantee a profit or protect against a loss. All investments are subject to risk, including the risk of principal loss. There is no assurance that the investment goals and process described herein will consistently lead to successful investing. The investment return and principal value of an investment will fluctuate, and an investor's shares, when redeemed, may be worth more or less than their original cost. Funds that invest in stocks of small-cap or mid-cap companies involve additional risks. The securities of these companies may be more volatile and less liquid than the securities of larger companies. Funds that invest in international securities involve special additional risks. These risks include, but are not limited to, currency risk, political risk, and risk associated with varying accounting standards. Investment in emerging markets may accentuate these risks. Alternative strategies, including those used in mutual funds, have risks that may substantially increase the potential for loss. Bonds are subject to interest rate risk. Bonds have interest rate risk and credit risk. As interest rates rise, existing bond prices fall and can cause the value of an investment to decline. Changes in interest rates generally have a greater effect on bonds with longer maturities than on those with shorter maturities. Funds that hold bonds are subject to declines and increases in value due to general changes in interest rates. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and/or interest payments.

The information shown does not constitute investment advice and does not consider the investment objectives, risk tolerance or financial circumstances of any specific investor. The information provided is not intended to be a complete analysis of every material fact with respect to any portfolio, security, or strategy and has been presented for educational purposes only. Data obtained from the sources cited is believed to be reliable and accurate at the time of compilation. Nothing contained herein should be construed as a recommendation to buy or sell any individual securities. It should not be assumed that an investment in any of the securities identified was or will be profitable.

The Bureau of Economic Analysis (BEA) of the United States Department of Commerce is a U.S. government agency that provides official macroeconomic and industry statistics, most notably reports about the gross domestic product (GDP) of the United States and its various units such as states, cities, towns, townships, and villages. **Gross Domestic Product** (GDP) is a measure of output from U.S factories and related consumption in the United States. It does not include products made by U.S. companies in foreign markets. **Real Gross Domestic Product** (real GDP) is a macroeconomic measure of the value of economic output adjusted for price changes (i.e., inflation or deflation). The **Atlanta Fed GDPNow** estimate is a model-based projection not subject to judgmental adjustments. It is not an official forecast of the Atlanta Fed, its president, the Federal Reserve System, or the Federal Open Market Committee. **The Conference Board Leading Economic Index® (LEI)** for the U.S. are the key elements in an analytic system designed to signal peaks and troughs in the business cycle. The leading, coincident, and lagging economic indexes are essentially composite averages of several individual leading, coincident, or lagging indicators. They are constructed to summarize and reveal common turning point patterns in economic data in a clearer and more convincing manner than any individual component – primarily because they smooth out some of the volatility of individual components. **Personal Consumption Expenditures** (PCE) is a measure of price changes in consumer goods and services and consist of the actual and imputed expenditures of households; the measure includes data pertaining to durables, non-durables and services. The **ISM Manufacturing Index** is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management (ISM). The ISM Manufacturing Index monitors employment, production, inventories, new orders and supplier deliveries. A composite diffusion index monitors conditions in national manufacturing and is based on the data from these surveys. The **Federal Reserve System** (also known as the Federal Reserve, and informally as the Fed) is the central banking system of the United States. The Federal Reserve System is composed of 12 regional Reserve banks which supervise state member banks. The Federal Reserve System controls the Federal Funds Rate (aka Fed Rate), an important benchmark in financial markets used to influence the supply of money in the U.S. economy. The **Federal Open Market Committee** (FOMC), a committee within the Federal Reserve System is charged under United States law with overseeing the nation's open market operations (i.e., the Fed's buying and selling of United States Treasury securities). The **S&P/Case-Shiller Home Price Indices** are the leading measures of U.S. residential real estate prices, tracking changes in the value of residential real estate both nationally as well as in 20 metropolitan regions. The **unemployment rate** percentage of total workforce who are unemployed and are looking for a paid job. Unemployment rate is one of the most closely watched statistics because a rising rate is seen as a sign of weakening economy that may call for cut in interest rate. A falling rate, similarly, indicates a growing economy which is usually accompanied by higher inflation rate and may call for increase in interest rates. Labor force participation rate is the percentage of working age population that is part of the labor force. It is a measure of what proportion of a country's population is employed or actively looking for employment. The index of leading economic indicators is intended to predict future economic activity. Typically, three consecutive monthly LEI changes in the same direction suggest a turning point in the economy. **Inflation** is the rise in the prices of goods and services, as happens when spending increases relative to the supply of goods on the market. Moderate inflation is a common result of economic growth. Hyperinflation, with prices rising at 100% a year or more, causes people to lose confidence in the currency and put their assets in hard assets like real estate or gold, which usually retain their value in inflationary times. **Treasury Yield Curve** is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. **The Michigan Consumer Sentiment Index** was created in the 1940s is conducted by the Survey Research Center and consists of at least 500 telephone interviews posed to a different cross-section of consumers in the continental U.S. each month. The survey questions consumers on their views of their own personal finances, as well as the short-term and long-term state of the U.S. economy. The **International Monetary Fund (IMF)** is an international organization that was initiated in 1944 at the Bretton Woods Conference and formally created in 1945 by 29 member countries. Each survey contains approximately 50 core questions, and each respondent is contacted again for another survey six months after completing the first one. The answers to these questions form the basis of the index. An **exchange-traded fund (ETF)** is a security that tracks an index, a commodity or a basket of assets like an index fund, but trades like a stock on an exchange. Indexes are unmanaged and investors cannot invest directly in an index.

Morningstar Category Returns are composed of the average return for the funds in each Morningstar category over the indicated time period. Categories are defined by Morningstar based on holdings statistics. The category returns are adjusted for survivorship bias, meaning they include all investments even if liquidated, merged or otherwise now obsolete. The returns also include funds that were in a given Morningstar category, but have since changed to another category.

<u>Benchmark Definitions</u>

The **S&P 500 Index** is an index of 500 of the largest exchange-traded stocks in the U.S. from a broad range of industries whose collective performance mirrors the overall stock market. The **Dow Jones Industrial Average** is a widely watched index of 30 American stocks thought to represent the pulse of the American economy and markets. The **NASDAQ** is an index that tracks the cumulative results on a market capitalization basis of all stocks trading in the NASDAQ system. An investment concentrated in sectors and industries may involve greater risk and volatility than a more diversified investment. The **S&P Small Cap 600 Index**

(S&P600) covers roughly the small-cap range of U.S. stocks, using a capitalization-weighted index. The index covers roughly three percent of the total U.S. Stock market. The **S&P Midcap 400 Index** (S&P400) is a stock market index from S&P Dow Jones Indices. The index serves as a barometer for the U.S. mid-cap equities sector and is the most widely followed mid-cap index in existence. To be included in the index, a stock must have a total market capitalization that ranges from roughly $750 million to $3.3 billion. The **Russell 1000 Index** is a capitalization-weighted price-only index, which is comprised of 1000 of the largest capitalized U.S.-domiciled companies whose common stock trade in the United States on the New York Stock Exchange, American Stock Exchange and NASDAQ which are included in the Russell 3000 Index. This large cap market-oriented Index is highly correlated with the S&P 500 Index. **Russell 2000 Index** is a market-value-weighted index representing the 2,000 smallest companies in the Russell 3000 index, representative of the U.S. small capitalization securities market. **NAREIT Equity Index** is comprised of real estate investment trusts which own or have an equity interest in rental real estate (rather than making loans secured by real estate collateral). REITs involve risk, including the loss of principal and the possible lack of liquidity. **Morgan Stanley Capital International** (MSCI) All Country World Index (ACWI) is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. **MSCI EAFE Index** is a market capitalization-weighted index of the leading stocks in Europe, Australasia and Far East. Membership of the index is selected by MSCI and designed for leading stocks roughly to match market sector weights. The **MSCI Emerging Markets Index** is an index created by Morgan Stanley Capital International (MSCI) that is designed to measure equity market performance in global emerging markets. It is a float-adjusted market capitalization index that consists of indices in 21 emerging economies: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey. The **MSCI Frontier Markets Index** provides broad representation of the equity opportunity set while taking investability requirements into consideration within each market. MSCI classifies 34 countries as Frontier Markets, 26 of which are included in the MSCI Frontier Markets Index. The **STOXX Europe 600 Index** is derived from the STOXX Europe Total Market Index (TMI) and is a subset of the STOXX Global 1800 Index. The **CAC 40 Index** is a benchmark French stock market index. The index represents a capitalization-weighted measure of the 40 most significant values among the 100 highest market caps on the Paris Bourse (now Euronext Paris). The **DAX Index** is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The **FTSE 100** is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. The **DJ Asia-Pacific Index** represents the leading stocks by dividend yield traded in the Asia/Pacific region. The **Nikkei Index** is a stock market index for the Tokyo Stock Exchange (TSE). The **Shanghai Composite Index** is a stock market index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. **S&P BSE Sensex index**, is the benchmark index of the Bombay Stock Exchange (BSE). It is composed of 30 of the largest and most actively-traded stocks on the BSE, providing an accurate gauge of India's economy. The **BM&F Bovespa**, also known as the Sao Paul Stock Exchange, is Brazil's stock exchange. It is the third largest stock exchange in the world by market value with over 500 companies traded on the exchange. The IBOVESPA is an index of about 50 stocks and is the main indicator of the Brazilian stock market's average performance. **S&P/TSX 60 Index** is a stock market index of 60 large companies listed on the Toronto Stock Exchange. Maintained by the Canadian S&P Index Committee, a unit of Standard & Poor's, it exposes the investor to ten industry sectors. **S&P/BMV IPC Index** seeks to measure the performance of the largest and most liquid stocks listed on the Bolsa Mexicana de Valores. The index is designed to provide a broad, representative, yet easily replicable index covering the Mexican equities market. The constituents are weighted by modified market cap subject to diversification requirements. In exchange for greater growth potential, investments in foreign securities can have added risks. These include changes in currency rates, economic and monetary policy, differences in auditing standards and risks related to political and economic developments. The **S&P Global BMI (Broad Market Index)** comprises the S&P Developed BMI and S&P Emerging BMI, is a comprehensive, rules-based index measuring global stock market performance. **Barclays Aggregate Bond Index** is made up of the Lehman Brothers Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Based Securities Index, including securities that are of investment grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $100 million. The **Barclays Municipal Bond Index** is a market value weighted index of investment grade municipal bonds with maturities of one year or more. The **Barclays Capital U.S. Government Inflation-Linked Bond Index** (U.S. TIPS) measures the performance of the TIPS market. TIPS form the largest component of the Barclays Capital Global Inflation-Linked Bond Index. Inflation-linked indices include only capital indexed bonds with a remaining maturity of one year or more. Treasury notes (T-notes) are intermediate securities with maturities of 1 to 10 years. Denominations range from $1000 to $1 million or more. The notes are sold by cash subscriptions, in exchange for outstanding or maturing government issues, or at auction. The **Crane 100 Money Fund Index** measures the average yield of the 100 largest taxable money market funds. **Barclays Capital Global Aggregate ex-U.S. Index** measures the performance of the global bond market, excluding U.S. securities. **The Dow Jones Commodity Index**SM is a broadly diversified index that allows investors to track commodity futures through a single, simple measure. The index is designed to minimize concentration in any one commodity or sector. Due to market fluctuation, the commodities represented by this index may experience loss of invested principal and are subject to investment risk.