JJ BURNS



**“What the people need is a way to make them smile / It ain't so hard to do if you know how”** **The Doobie Brothers,** ***“Listen to the Music”***

Many years ago, the Wall Street Journal ran its ‘Dartboard Contest.’ The idea was that staffers randomly throwing darts at stocks could pick better-performing stocks than professionals. Results were mixed and not firmly conclusive, but last’s year’s market results made the ‘dartboard portfolio’ seem like a great idea. Of the 17 indexes listed below, 11 did better than the very long-term return for U.S. stocks (about 10%). U.S. and international stocks shrugged off Q4-18’s bear market and a lot of policy uncertainty to rally for well-above-average returns. Equity and bond markets rallied on the Fed’s decisions to first pause—and then reverse—its rate-hike regime, despite civil unrest around the world and other policy uncertainties, particularly with global trade. With a nod to 2020 Rock and Roll Hall of Fame inductees The Doobie Brothers, here are the results:

## Index Returns
**as of 12/31/2019**

| Index | Q4 2019 | YEAR 2019 | YEAR 2018 | Two Years 2018 - 19 (Annualized) |
|---|---|---|---|---|
| **FIXED INCOME** | | | | |
| BbgBarclays US HY 2% Issuer Cap | 2.61% | 14.32% | <2.08%> | 5.80% |
| BbgBarclays Municipal | 0.74% | 7.54% | 1.28% | 4.36% |
| BbgBarclays Global Aggregate | <0.49%> | 8.22% | 1.76% | 4.94% |
| BbgBarclays US Agg Bond | 0.18% | 8.72% | 0.01% | 4.27% |
| **U.S. STOCKS** | | | | |
| Russell 1000 [Large-cap Stocks] | 9.04% | 31.43% | <4.78%> | 11.87% |
| Russell 2000 [Small-cap Stocks] | 9.94% | 25.52% | <11.01%> | 5.69% |
| S&P 500 | 9.07% | 31.49% | <4.38%> | 12.13% |
| **INTERNATIONAL STOCKS** | | | | |
| MSCI ACWI Ex USA NR [All Stocks] | 8.92% | 21.51% | <14.20%> | 2.11% |
| MSCI EAFE NR [Developed Markets] | 8.17% | 22.01% | <13.79%> | 2.56% |
| MSCI EM NR [Emerging Markets] | 11.84% | 18.42% | <14.57%> | 0.58% |
| **REAL ASSETS** | | | | |
| U.S. Dollar | <3.01%> | 0.22% | 4.40% | 2.29% |
| Morningstar US Real Asset Index | 1.36% | 9.87% | <3.17%> | 3.14% |
| Bloomberg Commodity | 4.42% | 7.69% | <11.25%> | <2.23%> |
| S&P GSCI Crude Oil Spot | 12.93% | 34.46% | <24.84%> | 0.53% |
| S&P GSCI Gold Spot | 3.41% | 18.87% | <2.14%> | 7.86% |
| S&P United States REIT | <0.80%> | 24.45% | <3.79%> | 9.42% |
| S&P Global Ex US REIT | 4.66% | 24.75% | <6.52%> | 7.99% |

*Source: Morningstar, Inc. USD data with dividends and interest*
*Two Years 2018 - 19 data are ANNUALIZED returns.*

### “It's better to burn out / Than to fade away / My my, hey hey” Neil Young, solo inductee 1995, *“My My, Hey Hey (Out of the Blue)”*

We expected slower economic growth and positive, but muted, equity and bond returns in 2019. We were directionally right but underestimated the strength of market rebounds after the Q4-18 ‘flash bear.’ We continue to be happily surprised by the markets’ willingness to shrug off policy missteps that have no seemingly rational resolutions, but that amplifies our sense of *cautious* optimism. As we look at what might be ahead, let’s look first at the elephant in the room: a possible U.S. recession. This table reflects some key economic indicators and where are we with respect to past recessions:

**U.S. Recession Risk Indicators**

- 12 variables have historically foreshadowed a looming recession

| | | Fourth Quarter 2019 | Third Quarter 2019 | Second Quarter 2019 |
|---|---|---|---|---|
| Financial | Yield Curve | ✕ | ✕ | ✕ |
| | Credit Spreads | ⬆ | ⬆ | ⬆ |
| | Money Supply | ● | ● | ● |
| Inflation | Wage Growth | ✕ | ● | ● |
| | Commodities | ● | ✕ | ✕ |
| Consumer | Housing Permits | ⬆ | ⬆ | ⬆ |
| | Jobless Claims | ⬆ | ⬆ | ⬆ |
| | Retail Sales | ⬆ | ⬆ | ⬆ |
| | Job Sentiment | ⬆ | ⬆ | ● |
| Business Activity | ISM New Orders | ✕ | ✕ | ● |
| | Profit Margins | ● | ● | ⬆ |
| | Truck Shipments | ⬆ | ⬆ | ⬆ |
| | **Overall Signal** | ● | ● | ● |

⬆ Expansion ● Caution ✕ Recession

Data as of December 31, 2019.

Sources: ClearBridge Investments, BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, and Bloomberg. The ClearBridge Recession Risk Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time.

We can see that six of the twelve indicators here are still positive, and only three are negative. We might argue that the yield curve indicator has become positively sloped again (i.e. long-term yields are greater than short-term yields), and the inversion has a limited (i.e. few observations) history of predictability. Consumer measures remain positive, and measures of consumer sentiment are high.

We would also note that there was slowing in wage growth and ISM New Orders, and a declining trend in margins, which may influence stock earnings going forward. The new orders trend may be a byproduct of the global trade war. Phase 2 of the U.S. / China trade agreement, Brexit issues and implementation of the USMCA trade deal (the NAFTA replacement) may be having some effects on corporate planning and production.

The following table takes these same indicators and illustrates their levels through the past seven recessions. The current year-end readings are on the far left for comparison:

## U.S. Recession Risk Indicators

- 12 variables have historically foreshadowed a looming recession

| | | Current | 2007-2009 | 2001 | 1990-1991 | 1981-1982 | 1980 | 1973-1975 | 1969-1970 |
|---|---|---|---|---|---|---|---|---|---|
| | | | Recession | | | | | | |
| Financial | Yield Curve | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ |
| | Credit Spreads | ⬆ | ✕ | ✕ | ✕ | ✕ | ✕ | ⬆ | ● |
| | Money Supply | ● | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ |
| Inflation | Wage Growth | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ |
| | Commodities | ● | ✕ | ✕ | ✕ | ✕ | ● | ● | ● |
| Consumer | Housing Permits | ⬆ | ✕ | ● | ✕ | ✕ | ✕ | ✕ | ✕ |
| | Jobless Claims | ⬆ | ● | ✕ | ✕ | ✕ | ✕ | ⬆ | ✕ |
| | Retail Sales | ⬆ | ✕ | ✕ | ✕ | ✕ | ✕ | ● | ✕ |
| | Job Sentiment | ⬆ | ✕ | ✕ | ✕ | ✕ | ● | ● | ● |
| Business Activity | ISM New Orders | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ | ✕ |
| | Profit Margins | ● | ✕ | ✕ | ✕ | ✕ | ✕ | ● | ✕ |
| | Truck Shipments | ⬆ | ● | ✕ | ✕ | ✕ | ✕ | n/a | n/a |
| | **Overall** | ● | ✕ | ✕ | ✕ | ✕ | ✕ | ● | ✕ |

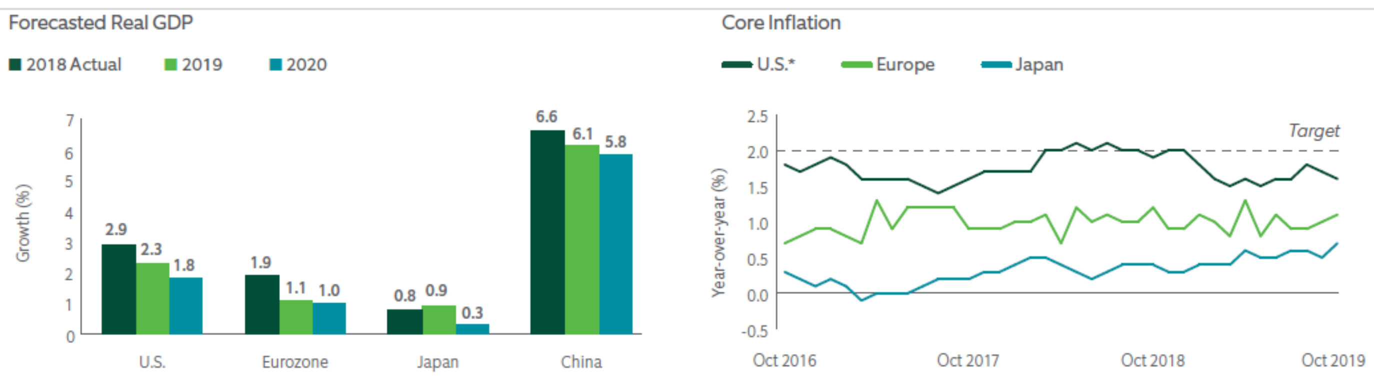
⬆ Expansion ● Caution ✕ Recession

Data as of December 31, 2019.

Sources: ClearBridge Investments, BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, and Bloomberg. The ClearBridge Recession Risk Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time.

### “Live right each day and smile on your way / And it don't cost very much” Mahalia Jackson, inducted 1997, *“It Don’t Cost Very Much”*

This U.S. data, particularly the consumer readings, has promoted faith in a continuing economic expansion, but at lower rates than from just two years ago. These muted U.S. expectations have rolled globally as well, as this snapshot of regional growth and core inflation demonstrates:




Source: Northern Trust Asset Management, Blue Chip Economic Indicators November edition.
* U.S. uses core PCE while Europe and Japan use core CPI. Data from October 31, 2016 to October 31, 2019.

Each of these regions is *expected* to have positive but low growth below the levels of 2018. That may not sound like the best news, but there are few signs of—or expectations for—recessions. A key contributor to this slower growth is demonstrated in the right-hand graph: persistently low inflation.

As we’ve previously discussed, some inflation is desirable for several reasons, including pricing power, wage growth and higher interest rates (which are important for pensions and savers). Of course, persistently high inflation is destabilizing, but we can also see that these range-bound numbers have resisted the massive post-Financial Crisis monetary stimulus from global central banks.

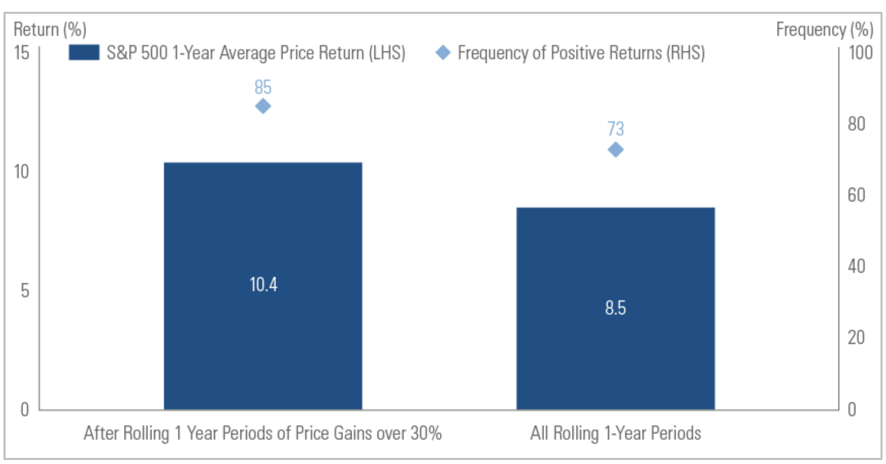
If we translate lower inflation expectations to still-accommodative monetary policy and continued growth, we also expect more tailwinds for access to capital markets. A key question that follows at this point in the cycle is, what are the markets pricing in, and what might cause bouts of heightened volatility? We would classify general sentiment as 'cautiously optimistic,' but believe that global trade uncertainty and fear of policy missteps will be potentially the biggest deterrents to markets this coming year. Here's a summary of key expectations that are 'priced in' to markets:

| WHAT'S PRICED IN | WHAT'S *NOT* PRICED IN |
|---|---|
| A total of 25 bps cut in 2020 | A Fed pause |
| Restarting quantitative easing (QE) in Europe including purchase of equities | A more circumspect ECB |
| A phase 1 trade deal with roll-back of the September 1 tariffs | No rollback of tariffs |
| 8% earnings growth in 2020 for the S&P 500 | Earnings deterioration in 2020 |
| GDP of approximately 2+% as the consumer and service sector remain strong | US GDP less than 2% |
| Inflation remaining tame | An inflation spike |
| Absorbable impact from the tariffs as the December 15 'consumer tariffs' get delayed | A resumption of the global fundamental slow down |
| No European auto tariffs | European auto tariffs |
| A negotiated Brexit | Hard Brexit or a second Brexit referendum |
| More China stimulus and a soft landing | Ineffective China stimulus and a hard landing |

*SOURCE: BNY Mellon*

**"So tell me now and I won't ask again / Will you still love me tomorrow" The Shirelles, inducted 1996, *"Will You Love Me Tomorrow"***

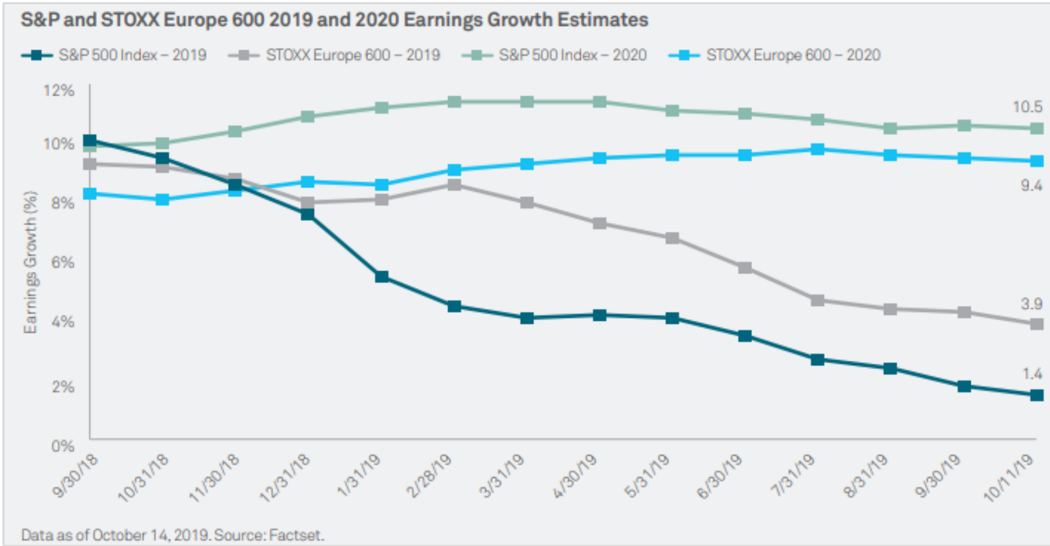
Investors are naturally concerned about stock returns this year, due to recessions worries and the blowout year they experienced in 2019. The good news is that, historically, the S&P 500 has often followed good years (30% or greater rolling 1-year returns) with…another good year:



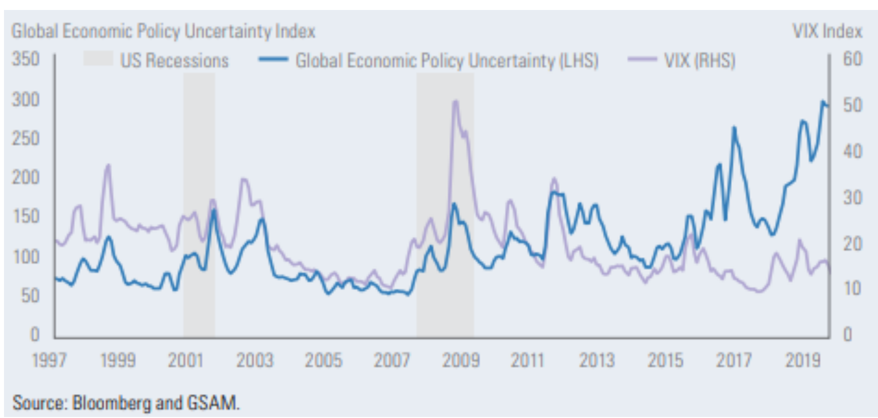

*SOURCE: Goldman Sachs*

This data indicates that positive returns occurred in 85% of the post-30% return years, and returns were about 2% higher than all the rolling 1-year periods in the data.

We also frequently comment on the fact, and fervently believe, that earnings drive stock prices. While we share other observers' concerns over higher valuations, margin pressure and trade-related growth issues, we see some robust earnings-growth estimates for the U.S. and Europe:



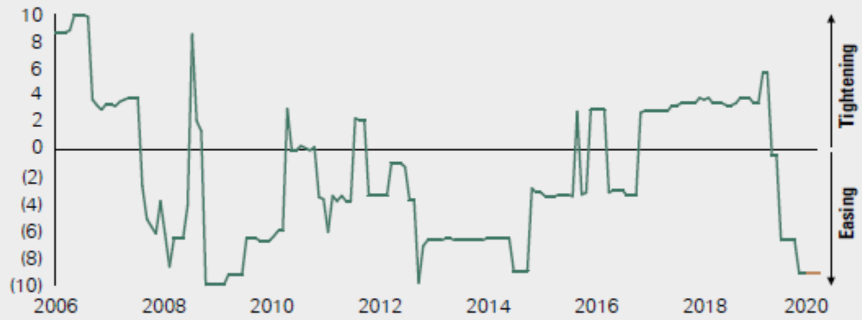

This data should be considered with the caveat that many of the risks to these estimates are to the downside, including the previously noted trade and other policy issues and an unforeseen shock, such as an inflation spike or a broader regional conflict involving the U.S. military. We should note that volatility fears (as measured by the VIX) appear to be currently contained, despite a rise in policy uncertainty. The authors of this graph accurately describe it as "few signals, plenty of noise":




### "And you may ask yourself, well / How did I get here?" Talking Heads, inducted 2002, *"Once in a Lifetime"*

One important backstop to the many estimations of growth and market returns is the (again) 'easy money' polices of central banks. Initial tightening regimes (i.e. higher rates and/or reduced asset purchases) were the order of the day until the 'flash bear.' Rather than ride into mini-recessions, many central bankers (CBs)—including the Fed—erred on the side of caution and either lowered policy rates, bought bonds or did both. The Fed has recently been providing liquidity to the overnight repo markets as an additional support strategy to its rate cuts last year. Some estimates indicate that global monetary policy is at its most 'accommodative' levels since the Global Financial Crisis (GFC):

**Key Takeaway:** Global monetary policy is near the most accommodative levels since the global financial crisis of 2008–2009.



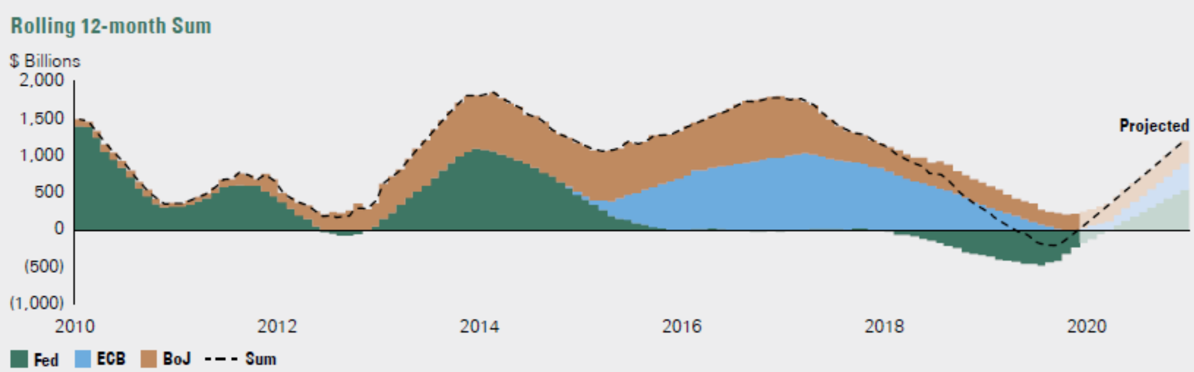

As of November 2019. Negative values indicate monetary policy easing, while positive values indicate tightening. Includes monetary policies of the U.S., Europe, Japan, U.K., China, Australia, and Canada. Weighted by share of global foreign exchange reserves. Projected values in gold.

Source: Council on Foreign Relations

*SOURCE: Bessemer Trust*

This re-emergence of looser central bank activity gives us some hesitation in our positive market reviews. Almost all the post-GFC stimulus has been monetary in nature; central bank balance sheets have mushroomed, and the continued efficacy of Central Bank actions and easy money is earning increasingly skeptical reviews. Fiscal policy—expenditures such as the proposed national infrastructure rebuild in the U.S.—have been scarce. Under the current administration, we have seen deficits soar without a corresponding 'hard money' spend. The increased Central Bank activity has also helped promote a growing global debt load (private and public), negative rates internationally, and the lack of 'true' pricing in capital markets:

**Key Takeaway:** Central bank balance sheets are set to expand further.




As of November 30, 2019. Projections are dashed and are based on current trends.

Source: Bank of Japan, Bloomberg, European Central Bank, Federal Reserve

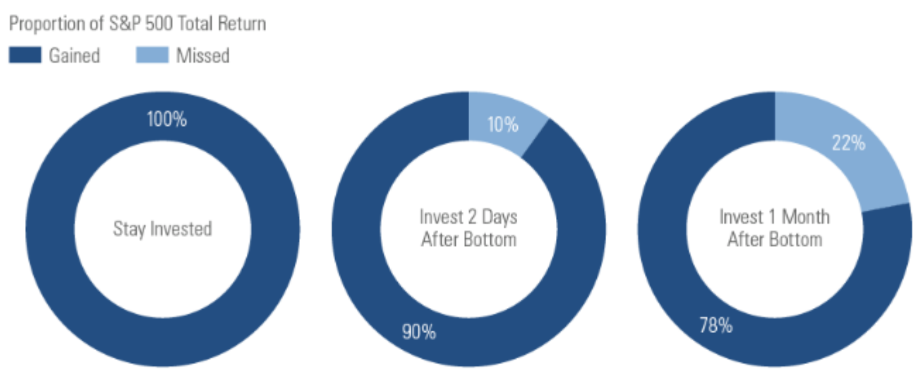
*SOURCE: Bessemer Trust*

### "They'll stone ya when you're tryin' to make a buck / They'll stone ya and then they'll say, "good luck" / Tell ya what, I would not feel so all alone / Everybody must get stoned" Bob Dylan, inducted 1988, "*Rainy Day Women #12 and 35*"

This annual review is an opportune time to review our prior-year expectations. We thought stocks and bonds would rebound into positive territory from the 2018 'flash bear,' the global economy would exhibit slow growth, and policy uncertainty would remain a key driver of markets and growth expectations. We don't see much difference in this year's review and current data to cause us to radically alter those expectations for 2020. We expect positive returns for most asset classes, but at lesser levels than 2019 and harder earned (i.e. more volatile). We also attribute much of the growth in portfolios in 2019 due to allocation positioning: broad exposure to global equities (across market cap and style), longer duration (interest-rate exposure), and a good blend of risk assets in equities and fixed income. Our expectations for 2020 results can be summarized as follows:

- Global growth by region will be positive but lower than recent trend.
- Equities will post solid but unspectacular returns; ex-U.S. stocks have favorable currency and valuation tailwinds.
- Bonds, barring a crisis, will trade in a range that approximates current yields.
- Global policy uncertainty will remain, with many regional flashpoints; more heated rhetoric and volatility should be expected as the U.S. fall elections near.

A key 2019 tailwind for investors was a strategic approach to asset allocation; put simply, it's the ability to resist trying to time the market. Investors who stayed invested during the Q4-18 bear were well rewarded last year. We've found that holding to the discipline of setting appropriate asset allocations and periodic portfolio rebalancing as markets correct keeps our clients on track with their long-term goals. This important behavioral control is frequently measured and written about, but a new review of the near-impossible task of successful market-timing is shown below:




*SOURCE: Goldman Sachs*

Briefly, this data demonstrates cumulative returns earned five years after market troughs in October 1990, October 2002 and March 2009. The average five-year cumulative return was 147%; clearly, missing two days or one month of rebound returns can be costly. Note that these returns are based on market bottoms, when investor sentiment is at its most negative. Clearly a strategic approach that avoids tactical timing proves more advantageous for the majority of equity investors.

Our job is to ensure that our clients meet their long-term goals. We know that these may periodically change, so please be sure to contact us to discuss your plan and portfolio(s) so we can keep you on track.

As always, we welcome your comments, questions and feedback. We wish you and your families a healthy, happy and prosperous new year.

-Your Wealth Management Team at JJ Burns & Company

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Unless otherwise stated performance numbers refer to indexes, which cannot be invested in directly and have no fees or trading expenses associated with them. All index data provided by Morningstar, Inc.

 Indices are not available for direct investment; their performance does not reflect the expenses associated with the management of an actual portfolio.

Past performance is no guarantee of future results. This information is provided for educational purposes only and should not be considered investment advice or a solicitation to buy or sell securities.

Investing risks include loss of principal and fluctuating value. Small cap securities are subject to greater volatility than those in other asset categories. International investing involves special risks such as currency fluctuation and political instability. Investing in emerging markets may accentuate these risks. Sector-specific investments can also increase these risks.

Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed-income investments are subject to various other risks, including changes in credit quality, liquidity, prepayments, and other factors. REIT risks include changes in real estate values and property taxes, interest rates, cash flow of underlying real estate assets, supply and demand, and the management skill and creditworthiness of the issuer.

The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership. The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The Barclays U.S. Corporate High-Yield Index covers the USD-denominated, non-investment grade, fixed-rate, taxable corporate bond market. The Barclays U.S. Aggregate Index covers the USD-denominated, investment-grade, fixed-rate, taxable bond market of SEC-registered securities.

The Citi World Government Bond Index (WGBI) provides a broad benchmark for the global sovereign fixed income market. It measures the performance of fixed-rate, local currency, investment grade sovereign bonds, currently includes sovereign debt from over 20 countries denominated in a variety of currencies.

The Morningstar® US Real Asset Index is a diversified portfolio of four different asset classes that have historically displayed high sensitivity to inflation. Real assets are defined as TIPS, commodity futures-based strategies, real estate investment trusts, and inflation-sensitive equities such as upstream commodity stocks and master limited partnerships

The S&P U.S. REIT Index defines and measures the investable universe of publicly traded real estate investment trusts domiciled in the United States. The S&P Global REITis a comprehensive benchmark of publicly traded equity REITs listed in both developed and emerging markets. The S&P 500® index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

The MSCI ACWI index captures large and mid-cap representation across 23 Developed Markets (DM) and 23 Emerging Markets (EM) countries. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada. The MSCI Emerging Markets Index captures large and mid-cap representation across 23 Emerging Markets (EM) countries.

The Bloomberg Commodity Total Return index is composed of futures contracts and reflects the returns on a fully collateralized investment in the BCOM. The index currently represents 20 commodities, which are weighted to account for economic significance and market liquidity.