

Fourth Quarter 2019 Market Commentary

January 3, 2020

Key Takeaways:

- Global growth should remain strong enough to calm any recession fears in 2020.
- The Fed is likely to keep rates steady this year, given the lack of inflationary pressures.
- Earnings growth may be the primary driver of equity markets in the coming months.

While the U.S. - China trade war dominated the headlines, global monetary ease and continued GDP growth were arguably the more important market drivers during the fourth quarter.

Trade Talks Ebb and Flow

It came down to the wire, but the U.S. and China signed the phase one trade agreement. Had a deal not been reached, the U.S. was poised to impose a new 25% tariff on \$250 billion of Chinese imports. The news didn't generate much reaction since the markets had anticipated a successful conclusion to the negotiations. It now appears the trade conflict has entered a state of "détente," meaning the best we can hope for at this time is no further escalation of tariffs. Easing tensions may allow China's expansive fiscal and monetary initiatives to more fully take effect, which would help the government manage the country's economic slowdown.

Outside of China, the U.S. also signed a trade agreement with Japan, and it appears the U.S. may soon execute the USMCA treaty with Mexico and Canada. The likelihood of a trade agreement between the U.S. and U.K. means the most uncertain trade risk has shifted to continental Europe. The U.S. has threatened retaliatory tariffs on France for the imposition of a digital tax on U.S. technology companies. Another risk heading into the first quarter is potential tariffs on German auto imports.

U.S. Economy Chugs Along

The U.S. economy likely grew 2.0% in the fourth quarter. Continued and surprisingly strong job and wage growth generally muted any slowdown in consumer spending. New and existing home sales also appear to be breaking out of the long-term doldrums. Lower mortgage rates and more supply at lower price points are stoking demand among millennials. Business spending on manufactured products remains the one blemish preventing the economy from growing at its full potential, although expenditures for services remain strong.

Developed Economies Show Signs of Life

The best that can be said about the European economy at this point is that it has begun to bottom and did not get worse over the second half of 2019. However, it appears this bottom may extend into the new year as monetary policy has lost its effectiveness. There seems to be little stomach in Germany for fiscal expansion and deficit spending. Japanese economic growth was adversely impacted by the October value-added tax (VAT) increase. That said, the country should avoid a recession as Japan's export sector should benefit from the global de-escalation of trade tensions with the U.S.

The Fed Eases One More Time

The Federal Reserve reduced rates by 0.25% (25 basis points) in October and 0.75% (75 basis points) in total for 2019. Despite pressure from the Administration, the easing program is likely over, given the current strength of the economy. With core inflation still well below the 2.0% target and no signs of burgeoning price pressures, we do not expect any rate increases in 2020. The Fed's pivot to monetary easing and the generally low interest rate environment have been important catalysts to the equity market advance. The impact on global economic growth is more questionable, especially as other countries have entered, and remain mired, in the negative rate zone.

Index Performance Data								
	4Q 2019	YTD	3-Year Annualized		4Q 2019	YTD	3-Year Annualized	
Equity Index Returns				Fixed Income Returns				
Dow Jones	6.67%	25.34%	15.73%	Barclays Aggregate Bond Index	0.18%	8.72%	4.03%	
S&P 500	9.07%	31.49%	15.27%	Barclays 1-10 Year Municipal Bond	0.86%	5.63%	3.57%	
Russell 2500	8.54%	27.77%	10.33%	Merrill Lynch High Yield Master II	2.61%	14.41%	6.32%	
MSCI ACWI	8.95%	26.60%	12.44%	Citi World Government Bond Index	-1.40%	7.64%	4.10%	
MSCI EAFE	8.17%	22.01%	9.56%	JPM Emerging Markets Bond Index Global	2.09%	14.42%	6.06%	
MSCI Emerging Markets	11.84%	18.42%	11.57%	Barclays TIPS	0.79%	8.43%	3.32%	
				Citi U.S. 3-Month T-Bill	0.46%	2.25%	1.65%	
Other Index Returns								
MSCI U.S. REIT	-0.78%	25.84%	8.06%					
Bloomberg Commodity Index	4.42%	7.69%	-0.94%					
HFRI FoF Index	1.03%	6.22%	3.49%					

Source: FactSet
 *HFRI FoF Index Performance as of 11/30/2019
 **Returns are total returns except for the Dow Jones & MSCI U.S. REIT (price returns).
 ***Citi World Government Bond Index is the hedged index.

Global Equity Markets Advance

Global equity markets generally rose through most of the fourth quarter due primarily to the monetary easing and economic growth described above. The willingness to pay more for a dollar's worth of earnings, otherwise known as multiple expansion, drove global equity prices sharply higher as year-over-year earnings in markets such as the U.S. were basically flat to slightly down. Notable during the quarter was the narrowing of the performance gap between the value and growth investing styles. In the U.S., value outperformed growth by roughly 2.5% (250 basis points), essentially closing the gap for 2019. Supportive central bank policy probably benefits both styles equally, but the relative outperformance of value may be a harbinger of a cyclical advance in the economy.

While Brexit and the impeachment garnered significant attention during the quarter, these events seemed to have little effect on the equity markets. U.S. election politics may have more of an impact when primary season begins in February.

Yield Curve "Normalizes"

The resolution of the yield curve inversion dilemma was arguably the most significant development in the fixed-income markets this past quarter. The interest-rate spread between the ten- and two-year U.S. Treasury notes turned negative for a short period in August and began the quarter basically flat. The subsequent steepening in this spread reflects Fed ease and the strength of the U.S. economy. By quarter-end, the range between the ten- and two-year notes had risen to 0.30% (30 basis points). Another sign of an expanding U.S. economy is the continued spread contraction and strong performance of the high-yield and emerging market debt asset classes. Pending default rates remain under control, especially outside the energy sector.

Commodities Feel the Impact

Speaking of energy, OPEC and Russia held an important meeting during the quarter, where the group demonstrated a surprising resolve to maintain production cuts to prevent oil prices from falling further. Thawing trade tensions and the positive impact this is likely to have on global demand helped push oil prices above the high end of the \$50 to \$60 trading range by quarter-end. Industrial metals, primarily reflected in the price of copper, also rose, providing further evidence the U.S. economy isn't at any imminent risk of recession.

Looking Ahead

As we enter the next decade and 2020 specifically, there isn't a significant risk of global recession, given the U.S. and China expected growth rates of 2% and 5.5%, respectively. Central banks will likely maintain their accommodative stances across the globe with minimal tightening. While the yield curves are likely to steepen a bit, we don't expect any sharp upward spike in rates in this stubbornly low inflation environment. The equity markets may get some multiple expansion but will have to rely on earnings growth to achieve the bulk of their returns. Fortunately, we believe earnings growth will again turn comfortably positive in a continued environment of global economic expansion.

For more insights, contact a Cerity Partners advisor or visit ceritypartners.com.

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Fourth Quarter Market Summary

		1Q19	2Q19	3Q19	4Q19	YTD	1-Year	Annualized		
	Price							3-Year	5-Year	10-Year
U.S. Equity Benchmarks										
Dow Jones Industrial	28,538	11.81	3.21	1.83	6.67	25.34	25.34	15.73	12.59	13.40
NASDAQ Index Composite	8,973	16.81	3.87	0.18	12.47	36.69	36.69	19.86	14.93	16.05
S&P 500	3,231	13.65	4.30	1.70	9.07	31.49	31.49	15.27	11.70	13.56
Russell 1000 (Large Cap)	1,784	14.00	4.25	1.42	9.04	31.43	31.43	15.05	11.48	13.54
Russell 1000 Growth	1,771	16.10	4.64	1.49	10.62	36.39	36.39	20.49	14.63	15.22
Russell 1000 Value	1,348	11.93	3.84	1.36	7.41	26.54	26.54	9.68	8.29	11.80
Russell Mid Cap	2,382	16.54	4.13	0.48	7.06	30.54	30.54	12.06	9.33	13.19
Russell Mid Cap Growth	1,229	19.62	5.40	(0.67)	8.17	35.47	35.47	17.36	11.60	14.24
Russell Mid Cap Value	2,184	14.37	3.19	1.22	6.36	27.06	27.06	8.10	7.62	12.41
Russell 2000 (Small Cap)	1,668	14.58	2.10	(2.40)	9.94	25.52	25.52	8.59	8.23	11.83
Russell 2000 Growth	1,087	17.14	2.75	(4.17)	11.39	28.48	28.48	12.49	9.34	13.01
Russell 2000 Value	1,926	11.93	1.38	(0.57)	8.49	22.39	22.39	4.77	6.99	10.56
S&P GICS Sectors		Weight								
Consumer Discretionary	9.8%	15.73	5.28	0.51	4.47	27.94	27.94	16.63	13.12	17.18
Consumer Staples	7.2%	12.01	3.72	6.11	3.51	27.61	27.61	9.89	8.31	12.13
Energy Sector	4.3%	16.43	(2.83)	(6.30)	5.49	11.81	11.81	(3.22)	(1.85)	3.32
Financials	12.9%	8.56	8.00	2.01	10.47	32.13	32.13	11.98	11.17	12.26
Health Care	14.2%	6.59	1.38	(2.25)	14.37	20.82	20.82	16.23	10.31	14.76
Industrials	9.0%	17.20	3.57	0.99	5.53	29.37	29.37	10.73	9.48	13.45
Information Technology	23.2%	19.86	6.06	3.34	14.40	50.29	50.29	27.66	20.20	17.50
Materials	2.7%	10.30	6.31	(0.12)	6.38	24.58	24.58	9.59	7.07	9.13
Communication Services	10.4%	13.98	4.49	2.22	9.00	32.69	32.69	4.65	7.91	9.65
Utilities	3.3%	10.84	3.48	9.33	0.75	26.35	26.35	13.82	10.29	11.80
Real Estate	2.9%	17.53	2.46	7.71	(0.54)	29.01	29.01	11.82	8.64	13.45
Global Equity Benchmarks		Price								
MSCI ACWI	2,358	12.18	3.61	(0.03)	8.95	26.60	26.60	12.44	8.41	8.79
MSCI AC World x-USA	302	10.31	2.98	(1.80)	8.92	21.51	21.51	9.87	5.51	4.97
MSCI EAFE	2,037	9.98	3.68	(1.07)	8.17	22.01	22.01	9.56	5.67	5.50
MSCI EAFE Growth	1,793	12.04	5.73	(0.45)	8.45	27.90	27.90	12.84	7.71	6.95
MSCI EAFE Value	2,810	7.92	1.54	(1.74)	7.82	16.09	16.09	6.31	3.54	3.98
MSCI Emerging Markets	1,115	9.92	0.61	(4.25)	11.84	18.42	18.42	11.57	5.61	3.68
MSCI BRIC	340	13.99	(0.22)	(4.56)	13.13	22.80	22.80	14.66	7.90	2.87
MSCI Japan	3,437	6.66	1.02	3.13	7.64	19.61	19.61	8.92	7.70	6.59

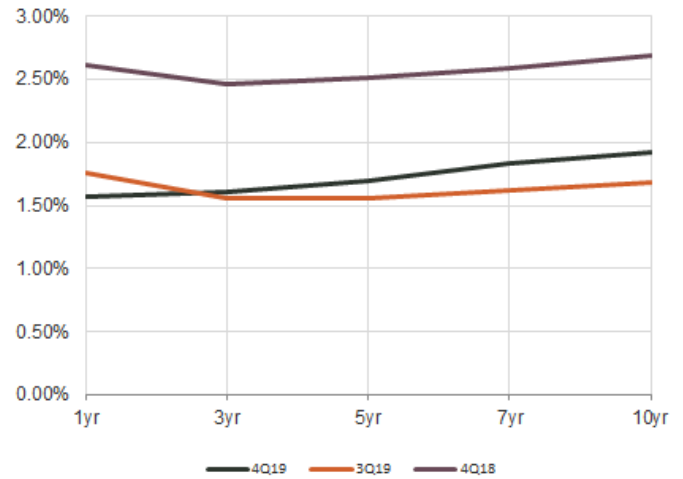
		1Q19	2Q19	3Q19	4Q19	YTD	1-Year	Annualized		
								3-Year	5-Year	10-Year
Interest Rates	Yield									
3m Treasury Bill	1.55	0.58	0.58	0.50	0.40	2.09	2.09	1.66	1.07	0.57
U.S. LIBOR 3m	1.91	0.66	0.62	0.55	0.48	2.33	2.33	1.97	1.39	0.85
U.S. Treasury 3m	1.60	0.60	0.52	0.41	0.40	1.94	1.94	2.04	1.63	1.18
U.S. Treasury 10yr	1.92	0.65	0.58	0.45	0.45	2.14	2.14	2.46	2.27	2.40
U.S. Treasury 30yr	2.39	0.73	0.69	0.57	0.56	2.58	2.58	2.86	2.81	3.19
Fixed Income	Price									
Citi 3-month T-bill	656	0.60	0.61	0.56	0.46	2.25	2.25	1.65	1.05	0.56
BC U.S. Gov't & Related 5-7	105	3.37	3.19	2.15	0.17	9.14	9.14	4.80	3.47	4.23
BC Municipal Bond 1-10 Year	112	2.21	1.64	0.81	0.86	5.63	5.63	3.57	2.60	3.15
BC TIPS	105	3.19	2.86	1.35	0.79	8.43	8.43	3.32	2.62	3.36
BC Aggregate	106	2.94	3.08	2.27	0.18	8.72	8.72	4.03	3.05	3.75
ML High Yield Master II	101	7.40	2.57	1.22	2.61	14.41	14.41	6.32	6.13	7.50
Citi World Gov't Bond Index	923	2.73	3.09	3.08	(1.40)	7.64	7.64	4.10	3.46	3.91
JPMorgan EMBI Global	882	6.59	3.76	1.34	2.09	14.42	14.42	6.06	5.88	6.57
Real Estate	Price									
MSCI U.S. REIT	1,279	16.27	1.29	7.69	(0.78)	25.84	25.84	8.06	7.03	11.93
FTSE EPRA/NAREIT Europe	2,050	11.73	(2.50)	4.16	12.22	27.33	27.33	12.82	7.16	8.18
Commodities										
Bloomberg Commodity Index	81	6.32	(1.19)	(1.84)	4.42	7.69	7.69	(0.94)	(3.92)	(4.73)
Energy	36	15.93	(4.56)	(4.53)	5.82	11.78	11.78	(2.26)	(7.87)	(11.69)
Agriculturals	41	(3.18)	4.50	(6.15)	7.11	1.72	1.72	(6.89)	(7.00)	(3.96)
Livestock	27	4.69	(11.01)	0.77	0.15	(5.99)	(5.99)	(0.57)	(5.52)	(1.80)
Softs	33	0.42	(0.29)	(8.61)	13.94	4.26	4.26	(11.61)	(6.77)	(5.60)
Industrial Metals	115	12.85	(7.23)	2.44	(0.25)	6.98	6.98	3.67	(0.46)	(3.55)
Precious Metals	187	0.02	7.15	5.28	3.72	17.02	17.02	7.40	3.74	2.09
Private Equity / Hedge Funds	Price									
Red Rocks Global Listed PE Index	13	14.17	5.62	0.71	10.96	34.75	34.75	12.43	9.68	10.38
HFRI FOF Index	6,220	4.60	1.49	(0.96)	1.03	6.22	4.47	3.49	2.03	2.70
Currencies	Price									
ICE Dollar Index	96	1.16	(1.19)	3.38	(3.01)	0.22	0.22	(1.94)	1.32	2.16
Euro / U.S. Dollar	1	(1.78)	1.42	(4.27)	2.96	(1.81)	(1.81)	2.10	(1.49)	(2.42)
Pound / U.S. Dollar	1	2.31	(2.33)	(3.17)	7.50	4.02	4.02	2.35	(3.21)	(1.96)
U.S. Dollar / Yen	109	0.88	(2.66)	0.31	0.56	(0.95)	(0.95)	(2.33)	(1.95)	1.56

Source: Factset, Morningstar Direct, iShares website

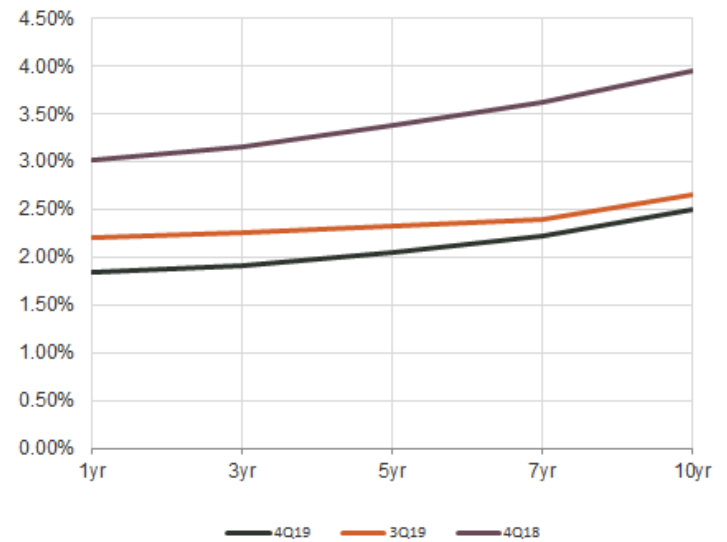
Note: HFRI FOF Index returns as of 11/30/2019

Global Equity Valuation Summary	3Q19	4Q19	QoQ
S&P 500			
Price	2,976.74	3,230.78	254.04
Trailing P/E	19.24	21.17	1.93
Est P/E	16.97	18.21	1.24
Trailing 12m Earnings	151.45	149.55	(1.90)
Est Forward 12m Earnings	175.79	177.42	1.63
Implied 1yr Earnings Growth	16.08%	18.64%	2.6%
Russell Mid Cap			
Price	55.95	59.62	3.67
Trailing P/E	19.16	20.59	1.43
Est P/E	16.99	18.10	1.11
Trailing 12m Earnings	2.51	2.40	(0.11)
Est Forward 12m Earnings	3.30	3.28	(0.02)
Implied 1yr Earnings Growth	31.43%	36.80%	5.4%
Russell 2000			
Price	151.34	165.67	14.33
Trailing P/E	16.63	18.56	1.92
Est P/E	21.73	23.37	1.64
Trailing 12m Earnings	3.57	3.19	(0.38)
Est Forward 12m Earnings	7.08	7.08	(0.00)
Implied 1yr Earnings Growth	98.12%	121.77%	23.7%
MSCI EAFE			
Price	65.21	69.44	4.23
Trailing P/E	14.48	15.79	1.30
Est P/E	13.81	14.81	1.00
Trailing 12m Earnings	4.34	4.21	(0.13)
Est Forward 12m Earnings	4.73	4.67	(0.06)
Implied 1yr Earnings Growth	8.93%	10.87%	1.90%
MSCI EM			
Price	40.87	44.87	4.00
Trailing P/E	12.66	14.66	2.00
Est P/E	11.98	12.92	0.94
Trailing 12m Earnings	3.07	2.88	(0.19)
Est Forward 12m Earnings	3.42	3.46	0.04
Implied 1yr Earnings Growth	11.47%	20.43%	9.00%

U.S. Treasuries



Municipal Bonds



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