



Asset Strategy Consultants

# MARKET ENVIRONMENT

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Fourth Quarter 2019

# Market Environment: Global Economy

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*The U.S. economic picture remained largely unchanged. Unemployment lingered at historically low levels, GDP growth hovered around 2%, inflation remained benign and manufacturing sector continued to be one of very few points of weakness. Meanwhile, there was an uptick in optimism overseas regarding the economic outlook. The perceived progress in U.S./China trade negotiations and some degree of closure around Brexit overshadowed various areas of concerns including unrest in Hong Kong and tensions in the Middle East and North Korea.*

## U.S.

- Third quarter GDP grew at 2.1% (annualized), driven by consumer spending
  - Personal consumption expenditures up 3.1%
  - Business investment dropped at a 2.3% rate in Q3
  - Government spending growth was raised to a 1.7% rate
  - Trade deficit widened; sliced off 1.9 percentage points from GDP growth
  - Boeing's temporary cessation of 737 Max production could trim 0.5% off first quarter GDP growth
- Unemployment rate at a 50-year low of 3.5%
- Housing starts were up 13.6% (y/y) in November
  - Building permits increased 1.4%, the highest level since May 2007
- Inflation remained benign at 2% in October
  - November's headline CPI print was 2.1% (y/y); Core CPI was 2.3% (y/y)
  - Core PCE Deflator rose 1.7% over the trailing year
- Manufacturing remains weak
  - The December Manufacturing ISM was 47.2, below 50 for the fifth consecutive month. Readings below 50 signals contraction.
- Fed once again cut Fed Funds target rate to 1.50%-1.75%
  - Third cut in 2019
  - Year-end fed funds futures prices indicated a less than 50% probability of any Fed action in 2020

## Overseas

- Euro zone
  - Third quarter GDP expanded 1.1% (annualized)
  - Inflation rate was 1.0% (y/y) in November, up from 0.7% in October but well below the ECB's target of 2.0%
  - Euro zone manufacturing PMI remained weak at 46.9
  - Unemployment rate fell to 7.5% in October; wage growth remained positive at 2.1%
  - ECB urged governments to boost public investment in order to increase domestic demand in Europe
- U.K. economy avoided entering a technical recession in Q3 after contracting in the previous quarter
  - Third quarter GDP growth was 0.4% (q/q) vs. -0.2% in Q2
  - Near-term political picture was improved following a general election victory and some degree of closure around Brexit
  - Manufacturing remained weak with UK PMI at 47.4 in December
- Japan's Q3 GDP growth was 1.7% (y/y)
  - Significant divergence between the strength in service sectors and the weakness in manufacturing
- China's GDP growth slows to 6% in Q3
  - The U.S. and China reached a phase one trade agreement, to be signed on January 15, 2020
  - Manufacturing showed signs of modest expansion with PMI at 51.8 in November



# Market Environment: Fixed Income

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*Fixed income markets posted strong returns in 2019 fueled both by falling interest rates and strong investor demand, especially for higher-yielding sectors. Overseas, rates followed a similar path with most higher in the fourth quarter but lower for the year. The amount of negatively yielding debt declined and the U.S. dollar gave up some gains in the fourth quarter. Emerging market debt posted strong returns, benefitting from both rate cuts and a risk-on environment.*

## U.S. Fixed Income

- The improving economic and inflation picture lifted rates and steepened the U.S. Treasury curve
  - 2-year U.S. Treasury Note declined 5 bps to close at 1.58%
  - Demand for U.S. Treasuries waned during the quarter, pushing the 10-year Treasury to 1.92% at the close of the year
  - Worries over an inverted yield curve continued to fade; the spread between the 2-year and 10-year Treasury was at 34 bps at year-end (whereas it was close to 0 at the start of the fourth quarter)
  - 30-year Treasury yield increased 27 bps and closed at 2.39%
- Bloomberg Barclays Aggregate rose: +0.2%; +8.7%
  - Bloomberg Barclays Corporate: +1.2%; +14.5%
  - Bloomberg Barclays US Treasury: -0.8%; +6.9%
- TIPS outperformed Treasury as inflation expectations rose
  - 10-year breakeven spread ended the year at 1.77%, up from 1.53% (09/2019) and 1.71% (12/2018)
  - Bloomberg Barclays TIPS Index: +0.8%; +8.4%
- High Yield posted sharp gains:
  - Bloomberg Barclays High Yield Corp +2.6%; +14.3%
- Municipals outperformed U.S. Treasuries in Q4 as the sector attracted record inflows
  - Bloomberg Barclays Municipal Bond Index: +0.7%; +7.5%

## Non-U.S. Fixed Income

- Rate cuts were prevalent across developed markets and the U.S. dollar weakened versus most currencies in Q4
  - Bloomberg Barclays Global Agg ex-U.S. (unhedged): +0.7%; +5.1%
  - Bloomberg Barclays Global Agg ex-U.S. (hedged): -1.1%; +7.6%
  - The German 10-year yield increased from -0.57% to -0.19% while France's rose from -0.27% to 0.12%
  - The Italian 10-year yield rose from 0.82% to 1.41%, as political risk resurfaced
  - The UK 10-year yield rose from 0.49% to 0.82% amid a decisive election victory for the incumbent Conservative party and optimism around Brexit.
- Negative yielding debt declined from a high of \$17 trillion in August to less than \$12 trillion as of year-end
- Emerging market debt benefited from both rate cuts and a risk-on environment in Q4
  - The U.S. dollar-denominated JPM EMBI Global Diversified Index gained: +1.8%; +15.0%
  - Local currency emerging market debt, as measured by the JPM GBI-EM Global Diversified also posted positive results: +5.2%; +13.5%
    - Turkey: +2.5%; +20.7%
    - Brazil: +5.7%; +10.6%
    - Mexico: +6.7%; +23.9%
    - Russia: +10.0%; 34.1%



# Market Environment: Global Equity

U.S. Equity markets were propelled to record highs. The S&P 500 gained 9.1% in the fourth quarter, bringing its year-to-date result to a whopping 31.5%. Non-U.S. developed markets equities were also up sharply, benefitting from the improved global economic data and a weakening of the dollar. Emerging markets ended higher thanks to the advancement in trade negotiations and a pick-up in crude oil prices.

## U.S. Equity

- S&P 500 Index returned +9.1% in Q4; +31.5% y-t-d
  - All sectors were positive in Q4 except for Real Estate (-0.5%)
  - Top sector performers were IT (+14.4%), Health Care (+14.4%) and Financials (+10.5%) for the quarter
  - Quality factors (Operating Margin, ROE) were negative while Beta and Volatility factors were positive for the quarter
- Growth dominated Value, leading in 2019
  - R1000 Growth: +10.6%; +36.4%
  - R1000 Value: +7.4%; +26.5%
- Large caps trailed small caps, but outperformed in 2019
  - R1000: +9.0%; +31.4%
  - R2000: +9.9%; +25.5%
- High-flying growth stocks “FAAMG” plus Netflix
  - Contribution to return in 2019: +25% (S&P 500); +40% (R1000 Growth)

	4Q19	2019
Facebook	+15.3	+56.6
Apple	+31.5	+89.0
Amazon	+6.5	+23.0
Microsoft	+13.8	+57.6
Google (Alphabet Class C)	+9.7	+29.1
Netflix	+20.9	+20.9

## Non-U.S. Equity

- Non-U.S. developed markets also up sharply for the quarter and the year, with virtually all countries/sectors posting gains
  - EAFE: +8.2%; +22.0%
  - ACWI ex-U.S.: +8.9%; +21.5%
  - Top sector performers included IT, Health Care and Discretionary for both the quarter and the year
  - Value trailed Growth for both the quarter (by 1.4%) and the year (by over 10%)
  - U.K. (+10.0%; +21.1%) rallied on more certainty surrounding Brexit
  - Japan (+7.6%; +19.6%) rose in each month of Q3 but trailed the broad developed markets
- U.S. Dollar gave up some gains in Q4
  - USD underperformed against the euro (-3.0%; +1.8%), the Australian dollar (-4.2%; +0.2%) and the British pound (-7.5%; -4.0%)
  - USD posted a modest gain versus the Japanese yen (+0.6%; -1.0%)
- Emerging markets benefited from easing geopolitical concerns
  - MSCI EM: +11.8%; +18.4%
  - China (+14.7%; +23.5%) posted strong gains, as did tech-heavy Taiwan (+17.9%; +36.4%)
  - Russia (+16.8%; +50.9%) and Colombia (+14.4%; +30.8%) generated strong returns, supported by crude oil price strength
  - Chile (-8.8%; -16.9%) was negative as mass protests erupted amid wider concerns over inequality



# Market Environment: Liquid Real Assets

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*Real asset returns were mostly strong in the fourth quarter. Commodities posted solid gains, led by energy, which was helped by the rally in crude oil prices. MLPs, however, declined in Q4. TIPS outperformed U.S. Treasuries as inflation expectations rose. For the full year, returns across all of the aforementioned real asset categories were positive, with Infrastructure and REITs leading the pack.*

- Brent crude oil prices slid from \$58.47/barrel to \$54.07/barrel
- Brent crude oil prices rallied from \$54.07/barrel to \$61.06/barrel as OPEC+ announced further production cuts to ease oversupply concerns
  - S&P 1200 Energy: +5.6%; +12.7%
  - Alerian MLP Index: -4.1%; +6.6%
- Commodities gained
  - Bloomberg Commodity TR Index: +4.4%; +7.7%
  - S&P GSCI Commodity Index (+8.3%; +17.6%) delivered a strong return in Q4, led by energy
  - S&P Gold Spot Price Index: +3.4%; +18.9%
- Listed Infrastructure rose while REITs posted a modest loss
  - DJ-Brookfield Global Infrastructure Index: +4.0%; +28.7%
  - FTSE NAREIT: -0.8%; +26.0%
  - FTSE EPRA/NAREIT Global: +3.3%; +22.5%
- TIPS fared well as real rates fell
  - Blmbg Barclays TIPS Index: +0.8%; +8.4%
  - 10-year breakeven spread ended the year at 1.77%, up from 1.53% (09/2019) and 1.71% (12/2018)



# Returns for Various Periods

		October	November	December	Last Quarter	Year to Date	Last Year	Last 3 Years	Last 5 Years	Last 10 Years	Last 15 Years
EQUITY	1 Russell:3000 Index	2.15	3.80	2.89	9.10	31.02	31.02	14.57	11.24	13.42	9.03
	2 Russell:1000 Index	2.12	3.78	2.89	9.04	31.43	31.43	15.05	11.48	13.54	9.12
	3 Russell:1000 Growth	2.82	4.44	3.02	10.62	36.39	36.39	20.49	14.63	15.22	10.50
	4 Russell:1000 Value	1.40	3.09	2.75	7.41	26.54	26.54	9.68	8.29	11.80	7.63
	5 Russell:Midcap Index	1.05	3.57	2.29	7.06	30.54	30.54	12.06	9.33	13.19	9.49
	6 Russell:Midcap Growth	1.85	4.98	1.17	8.17	35.47	35.47	17.36	11.60	14.24	10.15
	7 Russell:Midcap Value	0.54	2.67	3.04	6.36	27.06	27.06	8.10	7.62	12.41	8.82
	8 Russell:2500 Index	1.91	4.29	2.11	8.54	27.77	27.77	10.33	8.93	12.58	8.79
	9 Russell:2500 Growth	2.57	6.81	0.93	10.57	32.65	32.65	15.17	10.84	14.01	9.86
	10 Russell:2500 Value	1.44	2.45	3.02	7.07	23.56	23.56	6.12	7.18	11.25	7.67
	11 Russell:2000 Index	2.63	4.12	2.88	9.94	25.52	25.52	8.59	8.23	11.83	7.92
	12 Russell:2000 Growth	2.85	5.89	2.29	11.39	28.48	28.48	12.49	9.34	13.01	8.81
	13 Russell:2000 Value	2.42	2.34	3.50	8.49	22.39	22.39	4.77	6.99	10.56	6.92
	14 S&P:500	2.17	3.63	3.02	9.07	31.49	31.49	15.27	11.70	13.56	9.00
	15 S&P:400 Mid Cap	1.13	2.97	2.81	7.06	26.20	26.20	9.26	9.03	12.72	9.48
	16 S&P:600 Small Cap	1.95	3.06	2.99	8.21	22.78	22.78	8.36	9.56	13.35	9.20
	17 MSCI:ACWI ex US	3.49	0.88	4.33	8.92	21.51	21.51	9.87	5.51	4.97	5.25
	18 MSCI:EAFE	3.59	1.13	3.25	8.17	22.01	22.01	9.56	5.67	5.50	4.84
	19 MSCI:EM	4.22	(0.14)	7.46	11.84	18.44	18.44	11.58	5.61	3.68	7.48
	20 MSCI:ACWI	2.74	2.44	3.52	8.95	26.60	26.60	12.44	8.41	8.79	6.86
FIXED INCOME	21 Blmbg:Aggregate	0.30	(0.05)	(0.07)	0.18	8.72	8.72	4.03	3.05	3.75	4.15
	22 Blmbg:Gov/Credit	0.28	(0.09)	(0.20)	(0.01)	9.71	9.71	4.35	3.23	3.96	4.21
	23 Blmbg:Credit	0.57	0.19	0.29	1.05	13.80	13.80	5.75	4.39	5.32	5.10
	24 Blmbg:Corporate High Yld	0.28	0.33	2.00	2.61	14.32	14.32	6.37	6.13	7.57	7.20
	25 Blmbg:Municipal Bond	0.18	0.25	0.31	0.74	7.54	7.54	4.72	3.53	4.34	4.33
	26 Blmbg:US TIPS	0.26	0.15	0.38	0.79	8.43	8.43	3.32	2.62	3.36	3.78
	27 Blmbg:Glob Agg ex USD	0.96	(1.36)	1.09	0.67	5.09	5.09	4.36	1.62	1.50	2.41
	28 S&P:LSTA Levlg Loan	(0.45)	0.59	1.60	1.73	8.64	8.64	4.35	4.45	5.00	4.74
	29 ML:US Treasuries 1-3 Yrs	0.33	(0.03)	0.21	0.51	3.55	3.55	1.84	1.39	1.22	2.15
	30 LIBOR - 3 Month	0.16	0.16	0.16	0.49	2.35	2.35	1.99	1.40	0.87	1.79
	31 3 Month T-Bill	0.19	0.12	0.14	0.46	2.28	2.28	1.67	1.07	0.58	1.39
REAL ASSETS	32 Blmbg:Commodity TR Idx	2.02	(2.56)	5.04	4.42	7.69	7.69	(0.94)	(3.92)	(4.73)	(2.55)
	33 GS Commodity Index	1.24	(0.01)	6.99	8.31	17.63	17.63	2.35	(4.32)	(5.44)	(4.63)
	34 MSCI:US REIT Index	1.42	(1.53)	(0.65)	(0.78)	25.84	25.84	8.06	7.03	11.93	7.88
	35 Alerian:MLP Index	(6.22)	(5.75)	8.53	(4.08)	6.56	6.56	(4.45)	(7.00)	4.19	6.40
	36 DJB:Gibl Infrastructure	0.24	(1.53)	5.33	3.97	28.69	28.69	11.15	5.75	10.22	9.66
	37 US DOL:CPI All Urban Cons	0.23	(0.05)	--	--	--	--	--	--	--	--

