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INVESTMENT TRENDS, ISSUES, & CHALLENGES FOR THE COMING YEAR

"The Future Ain't What It Used To Be."

"Yogi" Berra, Baseball Player and Philosopher

Lawrence Peter Berra was a gifted New York Yankee baseball player with a knack for uttering 'show-stopping' sayings that were at the same time inane and profound. In our opinion, his quotation above about the future has never been truer.

We are in a new world where "narrative" is the new reality: alternative facts are accepted as truths, and sentiment trumps economic fundamentals. The future is embedded in the present. We are conditioned to believe what's coming up is more of the same, despite the fact that some observations refute the prevailing view.

It is critical that we understand the context of conventional wisdom, and vital that we consider an alternative outcome in order to advise our clients how to invest for potential challenges ahead.

In prior years when we did our annual economic and market forecasts we could assign probabilities to various events and act accordingly.

The process would begin by assembling and collecting lots of data, plotting charts, building a hypothesis, constructing a base case and weighing likely to impact asset prices as we built our asset allocation models. We then constructed portfolios and chose investments. As the year progressed, we would be either more or less confident based on anticipating the market's reactions to events.

In 2020, we begin a new decade with different challenges and uncertainties from the previous one. This time, trying to create forecasts has a different feeling than in prior periods. Not only is this a Presidential-election year, but there are moral and ethical underpinnings that are reaching deep into the American psyche. We are used to dealing with uncertainty even though the picture is often hazy. This year though, has

the potential for surprises and outcomes with pronounced consequences when considering where to invest client assets.

One such related question is whether capitalism will survive in its current form in an era of income and wealth inequality. Another, is the effect of changing geopolitical realignments and relationships militarily, economically and societally.

Finally, there is a question whether nations decide to come together and agree that Climate Change is a real and growing risk, or if the threat is of secondary concern to the need for global economic growth.

The Upcoming Year Outlook

As 2019 comes to a close the stage is set for a tumultuous decade ahead. The past year has seen the US President impeached (by the House of Representatives), disruptive trade wars waged with tariffs enacted, and an (overly?) accommodative Federal Reserve providing continued stimulus and liquidity to a lopsided U.S. economy.

U.S. common stocks have hit all-time highs, unemployment is at historic lows, while U.S. debt and deficits continue to escalate.

Internationally, global economic growth stagnated in both developed and emerging markets – possibly due to the stalemate of trade wars between the U.S. and China.

As we go into 2020 the securities markets expect some trade and tariff relief with China and continued Fed "hands-off" monetary policy. Trillion dollar plus deficits are continually funded by low short-term interest rates in the U.S. while dovish overseas central bankers embrace zero or even negative interest rates. In this "upside-down" world the dollar (on a relative basis) remains strong and U.S. markets appear to be the very best house in a bad neighborhood.

Recently, Bloomberg News has compiled data and condensed thoughts from many of the largest prominent financial institutions about what to expect in 2020. As we try to tie together some loose threads to help us navigate the 2020 investing landscape, there is one thing evident:

There is no consensus.

We have to believe the economic expansion can continue, perhaps at a slower pace, or we must conclude that a reversal and possible recession are approaching by early 2021 (or sooner).

By the end of 2019, the bond and equity markets at home or abroad, while strong, began to show the subtle signs of the exhaustion of the economic business cycle. Surprisingly, though, in the first days of 2020, a feeling of complacency has set in and the markets seem to suggest, so far, that investors can successfully navigate the course.

The Bloomberg survey shows that brokerage houses are by and large wildly bullish. Investment Advisors, on the other hand, are generally waving caution flags and risk mitigating client portfolios to brace for economic and political uncertainty.

It may be too early to say that the general population is fearful, but there does seem to be insecurity brought on by disruptive changes in attitude and mistrust in institutions and the people that manage them – particularly among internet technology companies and social media providers.

Set against the aforementioned backdrop, below are ten 2020 Predictions which we believe are likely to affect assets prices. As in previous years, some of the predictions are of a macro nature and have societal as well as economic and political implications. It is not likely that all of our predictions will occur, but when taken into consideration as a whole, we have only modest expectations for overall returns from financial assets for the full year 2020.

First Forecast:

After a euphoric 2019, where almost all domestic investment markets experienced synchronized, correlated, upwardly biased outsized returns we believe expected returns of at best 6 to 7% from a portfolio of 70% equities and 30% fixed income instruments, as investors navigate a late cycle economy. We believe that the gains of the first six months should, perhaps, be realized by July and investors should take a cautious approach until after the election.

Sluggish nominal growth from trade-related policies enacted in 2019 continue to impact global markets and US GDP in spite of continued relaxed Federal Reserve accommodative interest rate policies throughout all of 2020.

We see the year divided into two different time periods:

The first six months appear to be a continuation of the type of environment that started in mid-September 2019 when the Federal Reserve signaled that it was prepared to pull forward the 2020 returns in advance of the election year cycle. They did something that is the equivalent to quantitative easing as it pumped massive billions into the Repo Market on a weekly basis with no end in sight. They have controlled the narrative to deny that this massive injection in liquidity was needed - ostensibly to address imbalances caused by the calendar. In our opinion, nothing could be further from the truth. The increase in liquidity was meant to make consumers feel the urge to spend in advance of the Holiday season and investors to take on more risk. Asset prices in such an environment can become relatively extended.

Meanwhile, market participants seem to be too complacent to face certain realities. Since everyone appears to be benefitting from the oddity of the markets, there doesn't appear to be much motivation to seek the truth. As a prime example, no one asks how is it that we have one of the largest deficits of over $ 1 trillion when the economy is near full employment and the stock market is at all-time highs. Why are Government receipts so low when we have the stimulus of massive tax cuts that were meant to stimulate the economy?

We believe that the time for answering those questions will develop in the period leading up to the election. The second half of the year promises to be volatile and likely will give back a good portion of gains markets might experience in the first half.

The inattention to the deficit and the lack of inflationary biases will become debate points by the time we reach late October if not sooner.

Second Forecast:

Our Overall Strategy for 2020 is to keep a mindful eye on the two areas the market cares most about: the Fed's focus on controlling the price of money and the real return on invested capital. Said another way, interest rates and growth in GDP require continual vigilance.

As we begin 2020, the accepted meme is that central banks around the world will remain dovish, with yields rising ever so slightly on the back of stronger global

growth. Investors are accepting as given that the ten year US Treasury will be range bound between 1.7% and 2% for the first six months of 2020, inflation will remain low (under 2%) and meaningful trade negotiations will inspire business confidence. Further expectations are that the consumer sustains the economy through the election, the job market remains tight, wage gains are modest, capital remains plentiful, productivity gains are adequate, and liquidity is abundant. The stock market continues its ascent, commodity prices move upward ever so slightly, energy prices remain low and the dollar stays near its peak.

Globally, emerging markets outperform overseas developed markets, China rebounds from its slowdown and there is marginal improvement in the manufacturing sector. The service sector worldwide sees accelerated growth, particularly in the Chinese service sector. So why leave the party when this all feels so good? The answer is, it's typically best to leave before you begin to feel so bad.

Third Forecast:

As in previous years we believe more than ever that Destabilization remains the Norm.

Internationally, the world is a more fractious and dangerous place. The risks of mistakes in foreign policy or missteps in judgment, militarily and financially, are substantial. We believe that there are just too many hotbeds globally for there to not have an incident or two that tests the Administration's resolve. The effect on markets from destabilizing events of high impact is difficult if not impossible to predict.

Having said that, certain economic events are, in and of themselves, destabilizing. For one, restrictive trade and tariff policies have proven to have negative consequences for businesses everywhere. While China - U.S. relations remain front and center, there are numerous alliances affected by bilateral negotiations. During a time where there are signs of a global economic slowdown, countries are forced to choose sides. One thing is for sure - the need to act in their own self-interest will be more noticeable in 2020. **Growth in Protectionism, therefore, remains a central theme.**

As an example, certain "Big Picture" issues cry out for global solutions. One obvious issue is the recognition of the need for enactment of measures that address climate change. Disruptive policies and denial of scientific facts make solutions harder to

attain. There are also issues surrounding immigration policies which must simultaneously address complicated matters of human rights and national security.

These topics have not been resolved.

Without dealing with these types of issues, the feeling that the global economy could enjoy synchronized growth over the long term is somewhat diminished. Europe in particular, is experiencing a slow-down caused by weakened exports in Germany, riots in France, problems in the EU banking and financial systems, tensions in Italy and continued uncertainty over Brexit - just to name a few of the issues. Asia's growth is slowing because of its overall linkage to China. (We highlighted these matters a year ago, and they have not gone away.)

Fourth Forecast:

The US Presidential, Congressional and State and Local Elections in 2020 will have profound importance for the decade ahead. We believe that US politics is the chief source of market-related global political and economic risk over the next 24 months.

We believe that Republican control of the White House and the Senate with Donald Trump remaining President is currently a likely outcome in a hard fought ever so-close election – which may be, once again, settled either in the Electoral College or the Courts.

To us, it seems that this is Donald Trump's election to lose unless the economy and the Stock Market are no longer robust. And, as Trump goes, so does the Republican Party. Even if both houses of congress are controlled by the GOP, a Trump loss could set back the conservative political agenda, except in the Supreme Court, for a long period of time.

A first term President facing an impeachment trial being acquitted in an unfair politically biased Senate, dominated by Republicans, exposes those Senators up for reelection to the possibility that Republican Senate control is lost to a vengeful electorate that failed to remove Trump from office.

If State and local elections swing to progressive Democrats while national politics stay in Republican control as currently expected, the next four years will add to the fractious, divisive bare-knuckle power struggle of the past four years. In our opinion not good for the country, for the citizenry, or, perhaps the common good. From a

market perspective, ironically, political gridlock can sometimes be a favorable environment.

While we do not currently believe that there will be a so-called "Blue Wave" sweeping the presidency and majority control of both houses of Congress, we should touch on that possibility. Such an outcome, if it were to occur, would likely be perceived negatively by the markets as it would likely portend substantial increases in taxation and regulation.

It is impossible to forecast the direct and indirect impact that domestic politics will have at this juncture, but clearly our risk mitigation strategies must take this into account as the year progresses.

Fifth Forecast:

While China remains focused and committed to its strategic goal of technological domination and adoption of its "Made in China 2025" policy, the US needs to determine how to deal with the next phase of Chinese growth.

While China believes that Technology and Innovation are the path to sustainable growth it will only negotiate where today's concessions benefit them in the long-run.

In 2020 we believe that China recognizes that they need to attract foreign capital and provide access to their consumer society. We therefore expect a willingness to consider some minor concessions in return for tariff relief.

China is a controlled economy, a capitalist autocracy not a democracy. Perhaps the central geopolitical question facing the US is whether we are willing to share and in certain instances cede political and economic power in the short run to a nation which curtails individual freedoms in exchange for more normalized order and behavior with greater reliance on international rule of law.

We have always believed that democracies have been the friendliest environment for trade and commerce. It is in our DNA that political freedom aligns with personal economic freedom. Look no further than the success of Hong Kong. Markets with fewer restrictions and intelligently-applied regulations have been quite successful. China does not appear to know how to build an infrastructure to deal with how its citizens would react to the imposition of unexpected taxes and regulations. As China tries to replace its reliance on overseas consumers to fuel and sustain growth with its

own population's consumerism, there appears to be a need to relax some controls over the culture. To fund this transition it has decided until now to financially leverage the economy without encouraging or in most cases permitting foreign access to their capital markets. Now there is a growing realization that a dramatic slow-down in global markets will affect China and impede it from reaching its strategic ambitions in the near-term.

This setback produces a blow to their national pride and is a source that could lead to political uncertainty for their leaders. As important, China is not quite ready militarily, to exert its will, particularly in the South China Sea. So, it will be interesting to watch throughout the year whether trade negotiations result in meaningful concessions and reforms or a continuation of an economic cold war.

Sixth Forecast:

Globalism and the US desire to create a "New World Era" has come to an end. A Globally-integrated world economy was assumed to work in the best interests of all the participants. The focus was on the economic aspects of geopolitics. The theory held that competition could be replaced or supplemented by cooperation. National Security was inseparable from economic security. Each country could prosper as long as the US and other superpowers could focus less on geographic control, maintain détente militarily, and permit and promote trade.

Ian Bremmer of the Eurasia Group has defined globalization as one of the most important features of the post-world-war landscape - people, ideas, goods and capital moving faster across borders around the planet. This acceleration has created extraordinary wealth and opportunity, global equality, reduced poverty, extended lifespans, and supported peace and prosperity.

With the US encouraging a decoupling and withdrawal from the world stage we are now at an inflection point. Military withdrawal from the Mideast, destabilizing Europe by diminished support of NATO, and tearing down institutions is producing a deteriorating environment, creating a vacuum for China and Russia to fill. The result, predictably, is less trade, greater challenges and a likely geopolitical recession. Unilateralism and a feeling that our allies need to figure out how to get along without our support makes the US more vulnerable militarily and economically. The 2020 decade is fraught with geo-political risk.

These risks come at a time when US domestic political risks have never been higher. No matter which party wins in November, 50% of the Country will feel betrayed. We will be in uncharted waters, with a house divided. This occurrence will add to the belief that the US can no longer be relied on and the attitude will be every man for himself.

Seventh Forecast:

There is a consensus view that domestic inflation will remain weak and stable, (sub 2%), for all of 2020 because of downgrades to global GDP growth forecasts and continued low interest rates. We believe that inflation risks are under appreciated. If the economy were to boom there would likely be a rise in inflation expectations, hence we believe that inflation is going to surprise to the upside.

Lesser trade tariffs and restrictions in developed and emerging markets also support higher inflation dynamics abroad.

Our base case assumes that the Federal Reserve would like to pursue a more liberal stance when setting its inflation targets and would be willing to support overshooting its 2% aim particularly if it sees more assistance from Government dedication to creating greater fiscal stimulus. Infrastructure spending, if it were to occur would go a long way toward reliance entirely on monetary help from the Fed. We therefore are suggesting exposure to a global risk-premium through investments in inflation-oriented securities and certain commodities such as gold or silver.

Eighth Forecast:

Cybersecurity threats are likely to impact institutions, individuals, and governments creating the potential for a possible crisis environment in 2020.

With the revelations about Russia's involvement in the 2016 election and the promise of retaliation by Iran for the recent killing of its military leader, there is little doubt that the Government, corporations, financial institutions and individuals are more vulnerable to attack than we were a year ago. Threats to national security from any source will require retaliation. We believe that the world is increasingly at risk of a major cybersecurity disruption, and hence we are repeating our forecast.

Because the digital world has made us more connected and reliant on technology solutions in our every-day lives, the risk of denying access to services we take for granted is amplified by cybercriminal behavior. Breaches in security that safeguard data or identity, even data supplied by government or large institutions, likely will accelerate in 2020.

The likely response will be the creation of new technologies to counteract the potential for future threats, but are they enough? It is one thing for cyber-criminals to be motivated by political, social or economic gain; it is another if their motivation is military in nature. The Mueller probe concluded that there was a degree of complicity that foreign powers have had on elections, the democratic process, and our way of life.

In 2020 we are again likely to find out something we already know. Bad people are capable of bad things.

It is one thing for the battle-lines to be drawn using the strength of the legal system to punish individuals and penalize companies who have been flagrantly causing harm. It is quite another if these attacks are intentionally conceived and carried out by governments. The prospect this time to threats on our national security could lead to war.

The likelihood of some form of geopolitical attack, hitting the US where we are most vulnerable, is real. It falls in the area of unknown unknowns. Whatever economic forecasts we may rely on, in the event of an attack on this country, its internet, or its power grid, these forecasts understandably go out the window.

Ninth Forecast:

Valuations didn't matter much in 2019. They will matter a lot more by year-end 2020

Just as markets often overshoot during periods of complacency, they are apt to underperform during periods of heightened uncertainty. At inflection points, markets tend to accelerate away from their former direction, gathering momentum. Trend followers and momentum theorists tend to exacerbate the trend, taking particular notice of the lack of liquidity in certain markets and sectors. Since mid-September 2019 complacency has once again set in.

One style of investing that has gathered devotees in recent years is determining which *factors* market participants favor at any time.

Initially, *factor* investing was confined to the growth vs. value debate. Now characteristics such as momentum, investor sentiment, and earnings are measured in the same breath. At the heart of the matter is valuation; what one should pay for taking risk. For over seventy-five years security analysis has focused on the price to earnings multiple as a substantial measure of confidence. Higher multiples are associated with a belief that, all things considered, future performance will be better than the past. So, in times of lowered expectations, earnings-based valuations suffer.

For value investors, lowered expectations and lower stock prices can be viewed as opportunities. For that reason, we believe the start of 2020 offers some valuations in certain corners of the market that may be attractive on both an absolute and relative basis. For growth minded investors, looking for attractive entry points on a relative basis, 2020 may also prove rewarding as long as the measure for assuming risk is believing that increased revenues can be sustained in the current economic environment.

Tenth Forecast:

Investor behavior will be greatly influenced by headline risk, often created for political purposes. The use of analytical techniques, data trends and algorithms to predict human responses to fast moving events will become necessary tools for investors and traders to gain a competitive advantage.

In 2020 active managers with an "edge" will gain more prominence in the active-passive debate. Those not equipped with intellectual curiosity, disciplined processes, analytical tools, and conviction will underperform. Human interpretation of the data will be a challenge, but can prove rewarding to those that become contrarian by taking the longer view.

One thing is near certain in 2020, how financial services are delivered to clients is changing rapidly.

In order to meet client expectations investment managers are going to need to understand and build client relationships based on competence but more importantly on developing partnerships based on trust as well as delivering results. Beyond asset

management, thought, clients increasingly expect advisors to understand their needs for advice on things most important to them personally:

health care issues

financial viability of social safety nets

education and how to fund it

lifestyle choices, particularly in retirement

management of disruptions from health reversals, employment issues, failed relationships and tragedies

Every life, it would appear is confronted, at times, with events of an unpredictable nature that create risks and opportunities. No one can predict what will happen with accuracy but is important to emphasize preparedness as part of the way we advise and manage client affairs in the exercise of our fiduciary responsibility.

CONCLUSION

All of the above highlights the particular importance of true diversification to create an investment portfolio whose goals include at least some elements of capital maintenance and preservation as well as risk mitigation. We expect to manage most portfolios by owning a blend of fixed-income securities, equities (many with income components) with potential for growth in principal, actively-managed mutual funds, closed-end funds, and passively managed ETFs.

We recognize that the management of some client assets may have multiple (sometimes competing) objectives: the need to generate income (to compound returns or cover current expenses) as well as the attempt to achieve a level of growth in anticipation of future inflation. The benefit of pursuing adequate investment returns through asset allocation and risk mitigation in an uncertain environment cannot be overstated. The next few years are crucial in setting the stage for a time when the return on various asset classes may be more modest when compared to the results of the past decade.

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