HERITAGE CAPITAL
PRIVATE ASSET MANAGEMENT

A TrueNote Company

January 2020

The New Year is always a good time for reflection—and anticipation. Let's review 2019 and look forward to possible market influences at the start of this new decade. While investment markets were robust in 2019, both what is and *isn't* currently in the headlines can be a guide to the factors that are shaping the trends for 2020.

DRIVING FACTORS FOR THE NEW DECADE

This year's headlines will continue to include the U.S.-China trade deal, Brexit, and the U.S. presidential election. The most significant economic impact of these for 2020 is the trade deal as it affects much of Asia and directly impacts the cost of goods for U.S. consumers and companies. Brexit will not be a significant event for the U.S. economy, but it does destabilize the Euro region. Our presidential election creates uncertainty for the U.S. stock market and will likely generate short-term volatility that will resolve after November. Any change in power would influence policies and laws that would affect the U.S. business and economic environments and trickle into global markets.

Non-headline factors include global interest rates, the Federal Reserve stimulus bond purchases, technology, a new generation, and inflation. Negative interest rates in both foreign bonds and Fed bond purchases create significant demand for U.S. Treasuries, and that demand will keep U.S. interest rates low. Should companies continue borrowing at low rates and buy back shares, we'll see stock prices driven even higher. Both factors—low rates and higher stock prices—could lead to asset inflation, which could parallel price inflation caused by tariffs and higher production costs. While technology advances create efficiencies, the high value of technology companies may lead to excesses akin to the 2000-2002 era.

Shifting demographics, changes to global trade, and technology advancements will lead to improvements for companies and the consumers they serve. In the coming decade, we'll see millennials become a driving economic force. Medical advances will continue to extend human lives and reduce suffering. The speed of digital transfer and sharing of data will continue to expand our capabilities and will improve the use of our natural resources.

LAST YEAR'S DRIVING FACTORS

Oil

Energy costs were not a significant factor for 2019. Oil's price oscillated between $51 and $62 per barrel, with December ending at the same high achieved in early April. Muted prices were mainly driven by slowing Asian and European growth combined with increased U.S. production.

Interest Rates

With relatively strong economic data in November and December and key inflation near their 2% annual target, the Federal Reserve Bank has not reduced rates since September. They are continuing to purchase bonds, which is another way to keep rates low without changing the rates in the banking system.

Low rates were a key factor in the continued expansion of the U.S. economy in 2019 and will likely continue to drive economic decisions in 2020. Companies and consumers have access to inexpensive capital, which consumers can use to purchase assets like homes, cars, and appliances and companies can use to expand or repurchase their stock with cheap debt.

U.S. Growth

During 2019 the U.S. economy continued to move forward with positive growth and low inflation. As previously mentioned, low interest rates, cheap commodities, technology advances, and consumer spending have all fueled U.S. growth, and asset prices have been moving higher in tandem with the expansion.

EFFECTS ON ASSET CLASSES

Equities

U.S. stock prices rallied again in the fourth quarter of 2019 to finish the year with record highs in most indexes.[1] The S&P 500 was up over 31.5% for the year. Foreign stocks also rallied, with Europe and Latin America posting more than 20% for the year and the Pacific and emerging market regions posting between 18-19%. There were a few exceptions: Hong Kong, India, Spain, and South Korea all grew only between 5-10% during 2019.

Bonds

Bond markets also rallied during 2019, with big gains in the first few months of the year and a slight bump in Q4, when fund flows were positive for money market, municipal bonds, and corporate bonds. Stock fund flows turned negative during December, as investors may have been "locking in" stock gains prior to year-end.

High yields ended up 2.61% during Q4 and up 14.32% for the year. High-yield muni bonds were up 0.90% for the quarter and 10.68% for 2019. Lastly, emerging market bonds were up 2.09% for Q4 and 14.42% for the year.

LOOKING FORWARD

Economy: The U.S. economy continues to plod forward, fueled by low rates, strong consumer spending, low unemployment, and a lack of inflation. Worries about a coming recession seem unfounded but persist as the expansion moves toward its 11-year anniversary. We believe the low growth/low interest rate scenario will continue to play out well into 2020.

Equities: Record high stock prices for year-end 2019 will make future gains more difficult, and uncertainty generated by the coming elections will spur volatility. This year's returns will be more modest than last year's 20-30% gains, which were created by expansion in the multiples and are not likely to continue. Resolving trade issues, maintaining growth with low interest rates, and corporate earnings and profits will be key drivers for U.S. stock prices this year.

Bonds: Bond prices are relatively high, which means the yields are relatively low. We'll only see further bond price increases if stock prices fall and drive up bond demand. Historically, when bond yields and stock dividend yields are similar, investors mistakenly purchase stocks with a high yield as a "bond substitute." When stock prices fall, investors flock back to bonds, reinforcing the notion that bonds are much less risky than stocks and that yields are more sustainable as a core part of any well-balanced portfolio.

Low-yield bonds offer safety and comparatively high returns against global bond markets. We believe continued economic strength will support the values of higher yielding bonds for now, but a business-cycle decline would change any optimal bond strategy. We don't anticipate any economic decline for at least a few quarters.

We continue to strive to earn the target return that matches your financial plan. We look forward to reviewing your strategy, goals, and tax picture in a coming meeting.

Warm regards,

Kelly F. Crane
CFP®, CFA, CLU, MBA
President &
Chief Investment Officer

Kelly

Phil Philbrook
Retirement & Financial
Planning Analyst

[1] All data in this section is sourced from LPL Financial. Data as of 12/31/2019.

6333 Potrero Avenue, Suite 200, El Cerrito, CA 94530 | (510) 235-1046
HeritageCapitalAssetManagement.com | info@HeritageCapitalAssetManagement.com