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2020 Outlook:
Continued Growth or Recession?

Dear Investor,

Happy new year!

Before we take a peek at 2020, let's look at some of the highlights from 2019:

- The market, measured by the S&P 500, had a total return of 33.07%. This was the best return since 2013.
- Fixed income and foreign markets also did very well.
- The economy entered the longest expansion in US history.
- Political drama in Washington, and trade wars with China, dominated the headlines over the course of the year.

Now, as we look ahead to a new year, the path is somewhat unclear. Will the economy continue in slow-growth mode? Or will we see the recession that many media and industry pundits have warned about?
The course 2020 takes will depend on how the overriding trends evolve. The risk of recession is real, but we've been in similar situations during this decade-long recovery, only to see the economy continue to grow. That continued growth remains the base case for several reasons.

Economic Growth
First, there are signs that economic news may be improving. Housing, for example, has been making gains lately, while personal income and spending levels have also improved. Second, the political risks and trade disputes are starting to subside. The economy today looks a bit slower than it did a year ago, but still on solid ground. These factors should leave growth overall for 2020 at around 1.50 percent to 2 percent; which is respectable at this point of the economic cycle.

The Fed's Monetary Policy
The real monetary policy story of 2020 is likely to be that there is no story. With slower economic growth, and with inflation around 1.5 percent to 2 percent, the Fed may leave rates alone in 2020. The Federal Reserve would also prefer to leave interest rates alone due to the election year. In the case of a recession, the Fed would likely take a more active stance and potentially lower rates to keep the economy going.

The Markets
A growing economy, and a supportive monetary policy, should reinforce global stock markets leaving them to trade on fundamentals. Revenue growth remains healthy, consistent with continued strength in consumer spending. Strong revenue growth should also support growth in earnings.

The remaining question concerns valuations. Through most of 2019, high levels of consumer confidence drove market valuations higher. We finished the year at the upper end of the range typical of the past five years or so. But, as confidence levels moderate and growth slows throughout 2020, we can expect valuations to drop down closer to the lower end of that range.

As a result, the S&P 500 could end 2020 with returns in the 5% to 9% range. There is upside potential if valuations remain near current levels. But, downside risk exists, as valuations are quite high historically.

The International Story
If the U.S. is likely to continue its slow growth path, what about international economies and markets? From a market perspective, valuations are generally cheaper abroad, which could lead to international markets outperforming those in the U.S. We're already seeing signs of this outperformance. That said, there are risks on the international front. The trade war, if not resolved, will continue to weigh on global growth and markets,

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as would a U.S. recession. International markets are likely to deliver both higher reward and risk than U.S. markets in 2020, although results will be primarily dependent on what happens here.

As I am writing this letter, news has been breaking about the US killing of a top Iranian commander. The headlines are scary—and deservedly so. This event could lead to a major escalation of the U.S.-Iran conflict, and could result in military actions from both sides. Expect more headlines. Also, expect more volatility in the markets as a result. Over time, though, any damage to your investments is likely to be relatively small and short term. The effect might even end up being positive. As a citizen, I am paying attention and concerned. As an investor, not so much.

Political Drama

The impeachment inquiry is likely to be resolved by early 2020, as will Brexit and, very possibly, the U.S.-China trade war. With the resolution of these issues, the perceived risks would be reduced materially, which could help both the economy and markets.

What About a Recession?

The predictions above assume continued slow growth and steady markets. But if we do get a recession, what would it look like?

To start, it's very unlikely to be as bad as the Great Recession of 2008. Current high employment levels and wages should keep consumer spending (at two-thirds of the economy) healthy, even during a downturn. Business spending is already flat. Government spending growth, meanwhile, should act as a cushion. In other words, a recession will probably be more of a deep slowdown than a collapse. This scenario is what we saw in the recessions of 1990 and 2000, and current conditions resemble those years more than 2008. The 2000 recession was not fun—but it was not like the crisis of 2008.

From a market perspective, we can draw the same conclusion. With interest rates low, stock market valuations have moved higher over the past several years. If S&P 500 valuations dropped to their lowest recent level, the index would decline about 18 percent—much less than the drops we saw in 2000 or 2008. Plus, a decline like this would be consistent with other S&P declines over the past couple of years. So, even if earnings decrease or valuations drop further, we could conclude that the market impact of a recession would likely not be nearly as bad as in 2008.

More of the Same

The past year was eventful, particularly in terms of political risks. Still, the economy and financial markets continued to grow, as the underlying fundamentals remained sound. The fundamentals are weakening, but the most likely outcome is continued slow growth. Even if growth becomes muted (both here and abroad) or any other issues (known or unknown) emerge, the underlying strength of consumer spending should limit the damage. And if we do get a recession? The impact is likely to be much milder than many of us fear.

Overall, 2020 looks likely to begin with more of what we've seen so far in this expansion—just slower. Despite the rising risks, which have the power to change things quickly, this is not a bad place to be.

All the best to you in the new year.

Sincerely,

Mike

Mike Ovshak, CFP®

President/Owner

Certain sections of this commentary contain forward-looking statements based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. All indices are unmanaged and investors cannot invest directly into an index. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks.

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