STOKES CAPITAL ADVISORS, LLC

Market Commentary
December 31, 2019

Quarterly Market Review

U.S. equities added to already impressive gains for 2019 with a year-end rally that produced record highs and the best performance for the S&P 500 Index since 2013. The Q4 gain of 9.1% was in sharp contrast to last year's Q4 selloff of -13.5% and the 31.5% gain for 2019 was a dramatic reversal compared to the -4.4% decline for 2018.

Small cap equities posted strong quarterly results with the Russell 2000 Index surging 9.5% for the quarter versus the Q4 2018 -20.5% decline. For the year, small cap equities finished 2019 up 25.5%, the best showing since 2013 but sharply lag large cap equites by almost 3.5% on an annualized 10-year trailing return comparison.

Foreign markets surged alongside domestic markets as trade war tensions eased during the final quarter and economic conditions in the Eurozone appeared to stabilize. Emerging markets significantly underperformed developed markets for 2019 and trail the S&P 500 Index on a cumulative basis by more than 168% over the last decade.

Gold prices rallied in the final trading weeks of the year closing above $1,500, a six year high for the precious metal. Concerns over rising geopolitical risks created greater demand for safe-haven assets. Brent crude oil spiked during the quarter to close over $68/barrel as markets price in supply disruptions and a possible military conflict with Iran.

Turning to bonds, investors earned mid to high single digit returns in 2019 as the Federal Reserve changed course and cut interest rates three times thereby providing a lift to bond prices and subsequent total return. The Barclays Aggregate Bond Index finished up 8.7% for 2019 compared to 0.1% return in 2018. High yield and credit outperformed investment grade bonds as investors remain willing to take on risk as the search for real yields in an ultra-low interest rate world continues.

Global Economic Outlook

United States: Economic growth is seen cooling in 2020. Lingering uncertainty regarding the U.S.-China trade relationship and the upcoming presidential elections will likely suppress investment. Nevertheless, the labor market should stay tight, while low interest rates, which are lifting the housing market, will also buffer growth. Ongoing domestic policy uncertainty poses a risk to the outlook. Analysts see GDP expanding 1.7% in 2020, which is up 0.1 percentage points from last month's forecast, and 1.8% in 2021.

Eurozone: Momentum is set to remain feeble next year. Soft global growth and an uncertain external backdrop will dent exports and investment activity; smaller job gains, due to rigid labor markets in key countries, will restrain consumer spending; while political uncertainty in Italy and Spain, coupled with Brexit negotiations and a possible resurgence in global trade tensions, cloud the outlook. Growth is seen at 1.0% in 2020, which is unchanged from last month's forecast. In 2021, GDP is seen increasing 1.3%.

Japan: In 2020, economic growth is likely to slow notably, largely as the sales tax hike will constrain private consumption. Moreover, continuing trade tensions will weigh on the external sector. That said, the economy should benefit from ultra-low interest rates, spillovers from the 2020 Olympics and low unemployment. Analysts see the economy growing 0.4% in 2020, which is unchanged from last month's forecast, and 0.8% in 2021.

China: Next year, the economy will continue to moderate amid a long-lasting trade rift with the United States. Moreover, the property sector is expected to suffer from tight financing, which will weigh on overall economic growth. Although supportive fiscal and monetary policies are expected to cushion the slowdown, the scale of the measures will be limited. Analysts see the economy growing 5.9% in 2020, which is unchanged from last month's forecast, before decelerating to 5.7% in 2021.

Investment Strategy & Outlook

December 31, 2019 marked the end of a decade for investors. Over the last ten years, the annualized return for the S&P 500 Index of 13.5% ranks in the middle quartile for index going back to the 1930's, but the strong performance provided a much needed recovery from the lost decade that was the 2000's.

A key driver or tailwind for equites over the last decade was Global Central Bank policy accommodation. Indeed, since the 2008-2009 Financial Crisis, Central Banks signaled to investors they were willing to do "whatever it takes" to achieve their dual mandate of maximum employment and stable prices, which included experimenting with asset purchases or quantitative easing (QE) and forcing real bond yields into negative territory. The Fed lowered their policy rate from 5.25% to 0.25% and kept it there for six years then slowly increasing rates to 2.50% before recently signaling their intention to arrest any rate increases for the foreseeable future. In addition, the Fed's asset purchases program(s) ballooned the Fed's balance sheet north of $4 trillion, where it remains to this day. Unemployment has declined to 50-year lows and inflation remains below their 2% target. So, mission accomplished?

Investors will have no complaints. Since the March 2009 low, the S&P 500 Index is up more than 490% for an annualized return of 17.9%. By comparison, the Barclays Aggregate Bond Index recorded a 54% gain for an annualized return of 4.1%. Risk averse savers however did not benefit and were essentially punished. The 90-day U.S. Treasury Bill (considered a risk-free return) gained only 6.3% for an annualized return of 0.57% during the same period.

While monetary policy may be the elixir for whatever ails the markets, i.e. slowing global economic growth, a corporate earnings recession and other late cycle pressures, savers and investors seeking income have been unmercifully punished, aptly described by some as "the decade of financial repression". However, corporations recognized this was a once in a lifetime opportunity to refinance future liabilities and raise capital via new debt issuance at historically low borrowing costs.

While most investors clearly benefited in the last decade, there are liabilities we have inherited: The National debt has increased from $10 trillion to $23 trillion; U.S. budget deficit of $1.0 trillion, U.S. Debt to GDP has increased from 100% to 135%. There is $12 trillion of negative yielding global debt, corporate debt has ballooned to a record $10 trillion of which almost half is rated just one notch above "junk". The entitlement programs collectively have a future unfunded liability of $127 trillion.

The long-term implications of these financial challenges have for the most part been ignored by market participants. Bond yields remain low, credit spreads remain tight and we are witnessing new record highs in equity markets as we begin 2020. So, should investors simply turn a blind eye to the secular challenges that lie ahead and ride the wave of easy money and a central bank prepared to do "whatever it takes"? At some point in the future the monetary policy induced tailwind will turn into a fiscal headwind in which hard decisions will be thrust upon policy makers and politicians alike. For investors, this could translate into a decade marred by higher borrowing costs and inflation, widening credit spreads, higher tax rates, below trend growth and ultimately lower capital market returns. In the meantime, the record setting bull market is expected to continue higher in 2020 with few signs of a recession and no mention of the world's decade long addiction to ultra-low interest rates and debt.

Finally, as we say goodbye to the decade that was so heavily influenced by Central Bank policy we usher in a new era where markets are driven by fundamentals with active management making a comeback. Indeed, for the first time in history, there are now more assets in the hands of machines than in the hands of humans. Passive management strategies worked exceptionally well during the era of ultra-accommodative central bank policy which effectively forced security correlations higher and created distortions in asset prices. This essentially compromised the ability to add value via security selection. We believe the discipline of selecting companies that have a long history of increasing dividends, institute strict corporate governance and operate critical businesses to run the global economy will be a better approach than hiring a machine to replicate a popular index.

Performance Scorecard

Benchmark Description	Q4	YTD
U.S. Treasury 3 Month T-Bill	0.5%	2.3%
Barclays Aggregate Bond Index	0.2%	8.7%
Barclays US High Yield Corp Bond	2.6%	14.4%
S&P 500 Index Total Return	9.1%	31.5%
NASDAQ Dividend Achievers Index	4.9%	29.6%
Russell 2000 Index TR	9.9%	25.5%
Alerian MLP Index TR	-4.1%	6.5%
U.K. FTSE 100 Index USD	2.7%	17.3%
German DAX Index USD	9.6%	22.9%
China SCI 300 Index USD	10.1%	37.2%
Japan Nikkei 225 Index USD	8.0%	22.3%
MSCI Emerging Markets USD	9.6%	18.9%