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Portfolio Comments
For the Quarter Ending December 31, 2019

In a rare long form interview granted to the Financial Times newspaper in April of this year, legendary value investor and octogenarian, Warren Buffett, remarked: "If you played golf and you hit a hole in one on every hole, nobody would play golf, it's no fun. You've got to hit a few in the rough and then get out of the rough . . . That makes it interesting." As we reflect on our commentary this time last year, 2019 may be characterized as a year when the markets made it out of the rough, for now. We'll leave it to you decide which part of the investment cycle is more interesting!

Close to the final trading days of the decade, both the S&P 500 and The Dow Jones Industrial Average (DJIA) rose to fresh record highs as an improving global economy and optimism surrounding an imminent U.S.-China trade deal further stoked the year-end rally. Coming off the back of a weak 2018, the route to this peak has been one of steady, but not exuberant rises, punctuated by only brief retreats that looks set to hand the benchmark S&P 500 returns on a par with the standout results of 2013.

The S&P 500 closed on December 31st at 3,231 representing a return of 9.08% for the final quarter of 2019 and an extremely robust 31.50% for the year. The Dow Jones Industrial Average also posted strong numbers, although lagged the S&P 500 in the final quarter. The DJIA ended December at 28,538 for a return of 6.68% in the past three months and 25.35% for 2019.

Reflecting over a longer period, the S&P 500 achieved annualized returns of 13.57% for the decade ending this December, compared to -0.95% for the prior 10 years, which is sometimes referred to the "lost decade" for U.S. investors.

To the extent investors in the U.S. stock markets exhibited nervousness this past year, their concerns consistently included the ramifications of a prolonged trade war between America and China. In a marked softening of his stance, President Trump announced in October that negotiators had reached a "Phase One" agreement, which removed the U.S.'s threat to raise tariffs on $250 billion of earmarked Chinese goods, reduced tariffs on another batch of goods, and secured the agreement from China to buy increased dollar amounts of American agricultural and other products, together with guidelines on how it manages its currency, the renminbi. Also included are increased protections for American intellectual property, which China has been accused of poaching, as well as expanded access to China's markets for financial services companies.

Such moves should alleviate some of the pressure the Federal Reserve has felt under to fully return to its most accommodative policies aimed at maintaining or accelerating economic growth. During 2019, the Fed cut interest rates three times and also began to expand its balance sheet again, but at their December meeting there was a unanimous vote to leave the central bank's benchmark rate in a range between 1.5% and 1.75%. Fed Chairman, Jerome Powell, concluded "our economic outlook remains a favorable one," but indicated no appetite to raise rates soon. Mr. Powell further elaborated, "inflation is barely moving up, notwithstanding that unemployment is at 50-year lows - and expected to remain there. And so the need for rate increases is less." The unemployment rate declined to 3.5% in November, a stark drop from 10% a decade earlier. Consumer spending in America also remains strong and many major corporations are reporting profit growth, while the technology industry, which has weathered a changing competitive landscape and sharp criticism over some of its practices, has proved resilient.

The 10-year Treasury yield had bottomed for the year below 1.5% by September, and then started to move higher, skirting close to 2% at times. With the Fed pushing the short-end of the yield curve lower, by cutting interest rates, and improved trade talks optimism, the March inversion of the yield curve (a situation where longer-term Treasury instrument yields are lower than short-term ones, typically indicative of increased demand for long-dated government paper as investors seek a safe haven) reversed itself in October. This was taken as a positive signal by the equity markets, as a sign of improved optimism towards domestic and global economic outlooks.

With the data in for all but a few remaining trading days of 2019, according to Raymond James, Information Technology proved to be the standout sector of the year for the S&P 500, followed by Communication Services and Financials. Even the laggard sectors posted positive returns, with Energy at the bottom of the pack, and Health Care, and Utilities rounding out the lowest three. It is interesting to note, however, that Healthcare went from being one the worst performers in the first three quarters to the best performing in the final quarter of the year, spurred on by a resurgence of defensive stocks as well as waning alarm over the potential impact or probability of "Medicare for All" in the near future. As a broader trend, after leading the market higher for much of 2018 and early 2019, Growth-oriented investment strategies ceded their position to Value in the second half of the year.

The upcoming year still brings plenty of unknowns, and we're certain you need no reminder that we are entering Presidential election season. One of the few non-controversial statements that can be made is that our country remains politically deeply divided, as evidenced by the December 18th decision by the House of Representatives to impeach Donald Trump over two articles presented for vote. With the House controlled by a Democrat majority, and the votes almost unanimously along partisan lines, the result was predictable. Mr. Trump joins Andrew Johnson and Bill Clinton as the only presidents to be impeached (Richard Nixon resigned ahead of his predicted impeachment). Like them, the likelihood is that he will be acquitted by the Senate at trial. President Trump derided the House's move to impeach as "a political suicide march" for Democrats. Other Republicans warned of lowering the bar for impeachment, setting a precedent for partisan political maneuvering in the future.

The two impeachment articles, which were presented as meeting the bar for high crimes and misdemeanors set by the Constitution, center on abuse-of-power and obstruction-of-Congress charges against Mr. Trump following talks between the American leader and Volodymyr Zelensky, President of Ukraine. The allegations purport that President Trump exerted undue pressure on the foreign leader, and explicitly linked promised military equipment aid from the U.S. in a quid-pro-quo scenario, with a view to influencing Mr. Zelensky's willingness to investigate matters related to a Ukrainian energy business with financial ties to former Vice President Joe Biden's family. Mr. Biden is a leading Democratic presidential candidate. It is further alleged that Mr. Trump subsequently took measures to impede House investigations into his actions.

When the matter moves to the Republican-controlled Senate for a trial, which is expected to begin in January, a two-thirds vote would be required to remove President Trump from office, an extremely unlikely outcome. In the court of public opinion, it remains to be seen whose reputations will emerge tarnished by the process. No president has run for re-election after being impeached, but, as of now, Mr. Trump remains very popular in Republican polls. His Democratic presidential adversary has yet to be decided among a still-crowded field recently expanded by the addition of billionaire businessman, and former mayor of New York City, Michael Bloomberg.

Against the backdrop of this political furor, in December the House approved a $1.4 trillion spending package that staves off a looming shutdown and funds the federal government through next September. Bipartisan concessions to demands by both sides are in contrast to standoffs this time last year that led to a 35-day government shutdown. Such concessions, however, often entailed increased commitments in numerous areas, with the legislation adding almost $50 billion in new spending. According to the Congressional Budget Office, the budget deficit - or annual gap between government spending and tax revenue - for fiscal year 2019 totaled $984 billion, an increase in shortfall of $205 billion over 2018. Measured as a share of GDP, the deficit increased to 4.6 percent in 2019, up from 3.8 percent in 2018 and 3.5 percent in 2017. 2020 may be the year the deficit eclipses $1 trillion.

Across the Atlantic, sitting Prime Minister Boris Johnson secured the biggest Conservative Party majority in a generation in the December 12th U.K. general elections. It proved to be a terrible night for both Labour and the Liberal Democrats, and the matter of Britain's exit from the European Union, or Brexit, overshadowed all other issues. Many typical Labour strongholds, notably mining and industrial northern areas, having originally voted to leave the EU, fell to the Conservatives.

It has been three-and-a-half years since the nation voted, by a narrow majority, to leave the bloc and progress since has been divisive and faltering. It cost Theresa May, Mr. Johnson's predecessor, her job this year and Boris' hardline stance on extricating Britain in an expedited fashion proved popular with voters. As it stands, European leaders have, over time, granted three extensions to the formal divorce date, which is now set for January 31st 2020. This past October, Boris Johnson and the European negotiators announced that they had struck a draft deal, and on December 20th, The Withdrawal Agreement Bill, which enshrines the deal in British Law, passed the House of Commons vote, thanks to the now strong Conservative majority. The bill ambitiously prohibits extending the U.K.'s transition period beyond 2020, so tough talks, including those around trade deals are looming. Britain's leader will also be facing political unrest from Scotland and Northern Ireland, with both countries having originally voted to remain as part of the EU.

Elsewhere in Europe, beleaguered French Prime Minister, Emmanuel Macron, is dealing with the longest strike the country has faced since the 1980's, with protesters opposing the country's pension reforms. Civil unrest also rages on in Hong Kong, where earlier this year, an attempt to amend an extradition law set off the worst crisis in the region since its handover to China in 1997. Protests there have since morphed into a wider pro-democracy movement, at times involving violent clashes between demonstrators and law enforcement.

In Canadian elections, Justin Trudeau's Liberals were returned to power in October, but with a minority government in the wake of a political scandal. Israel, which held two inconclusive elections this year, will be heading to the polls again in March 2020. In November, Prime Minister Benjamin Netanyahu was indicted for bribery and fraud. Mr. Netanyahu denies any wrongdoing and has accused police and state prosecutors of an "attempted coup" against him.

In conclusion, headlines proved much more volatile in 2019 than stocks reactions. Despite the presidential impeachment, a slowing macro global environment, more accommodating central banks, and the back and forth of trade tensions and tariffs, 2019 stock reactions were less volatile than "normal". Only 14.6% of days in 2019 saw market moves of greater than 1%, which is below the long-term average (since 1985) of 23.9% of days.

While we shy away from making broad predictions, it is natural as we enter a new year, indeed a new decade, to look ahead. A solid job market, a supportive Federal Reserve that has put interest rate raises on hold for now, encouraging trade deal prospects, a positive yield curve, and healthy consumer spending, all point to a solid domestic economic and corporate outlook. A repeat of the near 30% gain in U.S. stocks experienced in 2019 seems highly unlikely, given the drop that coincided with the end of last year provided a temporarily low starting point, and markets are now sitting at an all-time high.

In addition, the aggregate market P/E (price divided by earnings) ratio based on the last 12-months earnings is now over 19x. This indicates that market gains of late have been driven in large part by higher valuations attributed to stocks in general, and for further significant rises we also need earnings to expand more. Introducing elements of uncertainty, global growth remains tepid and the impact of the presidential impeachment, as well as the outcome of the U.S. 2020 election represent unknowns. While we can't predict magnitudes or direction, we concur with Raymond James' statement that "despite our positive bias, we warn the path to equity gains will not be devoid of typical periods of volatility".

At this time of reflection, we remain extremely grateful for the continued trust you place in us as your financial advisor, and we wish you and your loved ones a spectacularly happy, healthy and prosperous year to come!