Investment Strategy Outlook

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Each year investors like to reflect upon their investment portfolios, and we find this to be especially true at the end of a decade. As always, the last decade was full of countless surprises from an investment perspective. In hindsight, the 2010's will be known as the decade of the central banker, during which asset prices significantly outperformed the real economy. At the beginning of 2010, investors had 2008 - the worst equity bear market since the Great Depression - fresh in their minds. Many phrases and forecasts were being tossed around back at the beginning of the last decade, and some of the "smartest" investors / prognosticators had determined that the United States had officially entered a period described as the "new normal" in which both economic growth and investment returns would be permanently lower. While these projections were not entirely incorrect with regards to economic growth, they couldn't have been more mistaken about returns for U.S. stocks and bonds for the last decade.

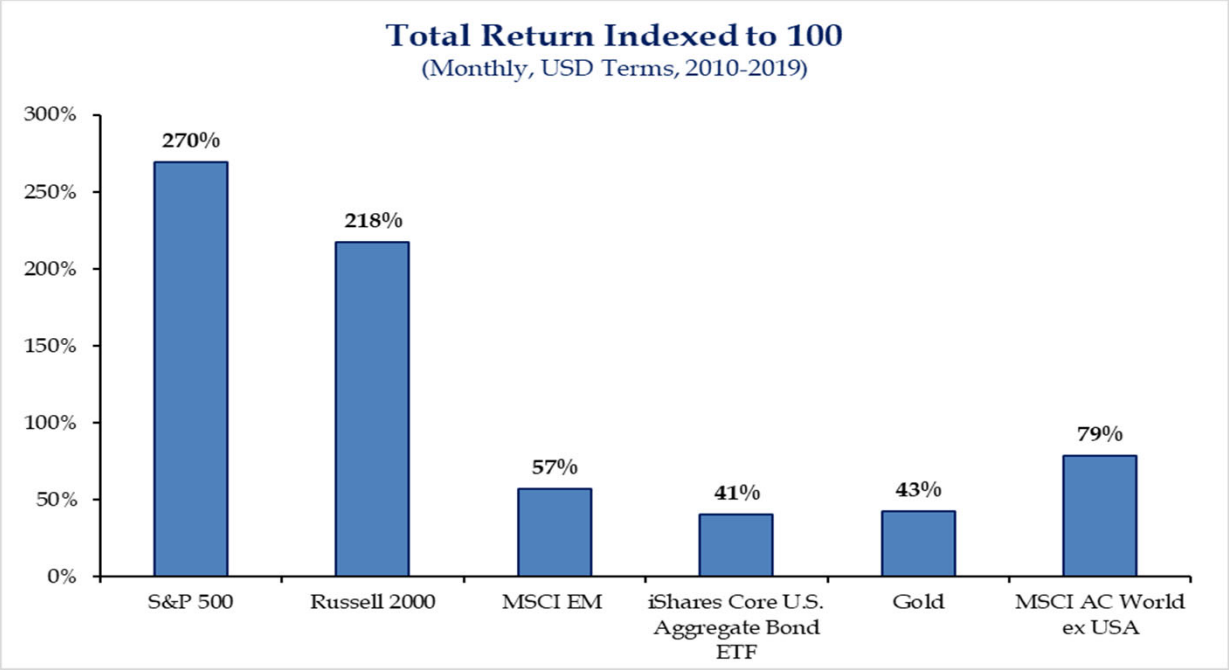
U.S. large cap stocks ended up being the best performing (large public market) asset class of the 2010's with U.S. small cap stocks close behind. Although returns were positive for non-U.S. equities, they generally left investors feeling underwhelmed, and returns from gold and other commodities were weak to flat out poor.

Some of the most popular asset classes at the beginning of the 2010's were emerging market equities, commodities, and hedge funds. Not coincidently, these were also some of the best performing asset classes of the 2000's. The 2000's were a historically bad decade for U.S. large cap stocks, which began with the bursting of the tech bubble and in turn made U.S. large cap equities a very unpopular asset class in 2010 and for the majority of the last decade.

In addition, back in 2010 countless investors were "positive" that interest rates "had to" go higher and that inflation was going to come back with a vengeance as the Federal Reserve was conducting unconventional monetary policies. Once again, to most everyone's surprise, bond yields went lower

throughout the course of the last decade, and inflation remained somewhere between subdued and nonexistent, at least by the various metrics economists use to gauge it.

Total Returns by Asset Class for the 2010's



Source:Strategas Research Partners

While turns in the calendar or even the decade clearly do not directly cause a change in an investment environment, it is somewhat rare to see the "best" performing asset class over the previous ten years also continue to be the best performing asset class for the next ten years. The same thing can be said for the "worst" performing asset class. To be clear, there have been many asset classes which have had great twenty plus year runs, thus best / worst should not be confused with good / bad.

None of the following forecasts for the next decade would be classified as anything close to courageous. Rather they would simply be bets on mean reversion in one form or another. Nonetheless, we believe that each of these outcomes is far more likely than not over the next ten years:

- U.S. large cap equities will have returns of something less than the 13.4% per year that they achieved during the 2010's as valuations are higher than historical averages and much higher than they were ten years ago. Having said this, the 2010's where only the 4th best decade out of the last nine for the S&P 500, going back to the 1930's. The 1980's and 1990's both produced returns well above the 2010's in back-to-back decades.

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- The gap in performance between U.S. stocks and non-U.S. stocks will be narrower than it was the last decade. Possibly both because non-U.S. equities exceed their returns from the last decade and because U.S. equities have lower returns relative to the 2010's.

- Fixed income returns will be lower than they were last decade since we are starting from historically low interest rates and tight spreads. In addition, central banks are likely to be less accommodative in the 2020's than they were in the 2010's when they were the only game in town as tax, regulatory, and fiscal policy all tightened financial conditions at one point or another.

- Returns from private asset classes such as private equity and real estate will also be lower than the last ten years as amazing amounts of liquidity have flooded into those asset classes while valuations and competition have consistently trended higher.

- We will likely have at least one economic recession at some point during the next decade. The 2010's were the first decade since at least the 1850's (when economic research began to track recessions) where we did not have a recession.

Economic & Market Viewpoint

Economic growth in the 2010's seemed to follow a very consistent pattern:

1. Most economists forecasted 3%+ growth for upcoming year.
2. The U.S. achieved 2% +/- real GDP growth in that given year.
3. Rinse and repeat.

The U.S. economy failed to grow by more than 3% in any single calendar year over the last decade. We achieved over 2.5% real growth during three of the last ten calendar years. Conversely, we had real GDP growth of below 2% in three of the last ten calendar years.

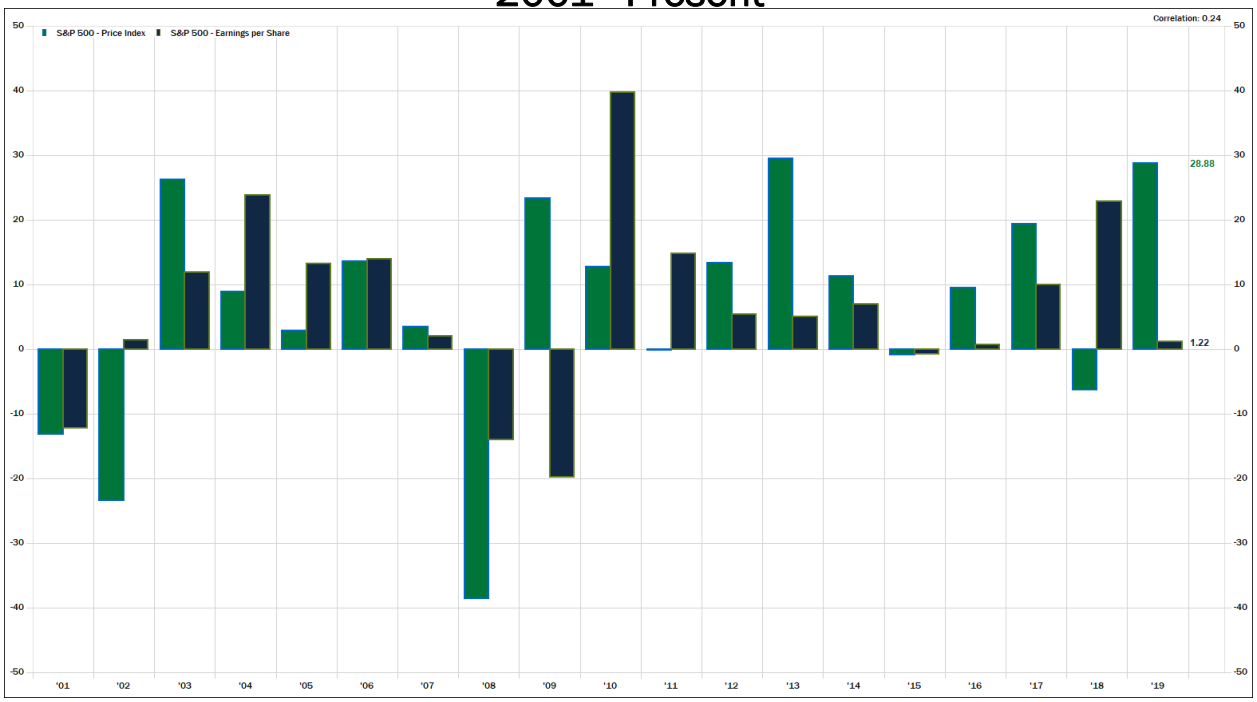
Most economists expect U.S. GDP growth for 2020 to be between 1.5% to 2.5%, with the majority of those estimates falling fairly close to the midpoint of 2%. Similarly, market strategists are even more clustered than usual in their forecasts for the S&P 500 in 2020. The vast majority of large investment houses, aside from a select few, expect the S&P 500 to end this year somewhere between 3300 to 3450.

In our opinion, the oversimplified explanation of why price targets are even more tightly bunched than usual is that many strategists have a similar story line which goes something as follows: (i) S&P 500 earnings per share should grow around 5% +/- this year, (ii) low interest rate and low inflation environments justify the above average valuations at which U.S. equities are currently trading, (iii) so there will be no significant change in valuations, and (iv) the S&P 500 will increase by roughly the same amount that earnings per share grow this year.

Over multi-decade periods this commentary (earnings and interest rates) explain the vast majority of returns for equity markets. Nonetheless, it is rare for shorter periods of time to play out this simplistically.

Historical evidence shows it is somewhat rare for the P/E ratio on the S&P 500 not to change in a given calendar year. When analyzing the last nineteen calendar years, only three years had little or no change in the trailing P/E ratio, during which the price change in the S&P 500 and the change in earnings per share growth for the S&P 500 were within 2% of each other. Thus, statistically it would not be in the investor's favor to bet on the consensus 2020 forecast, which is calling for little to no change in valuations for broad U.S. equity markets.

S&P 500 Price Return (green) **vs. S&P 500 Earnings Growth** (blue)
2001 - Present



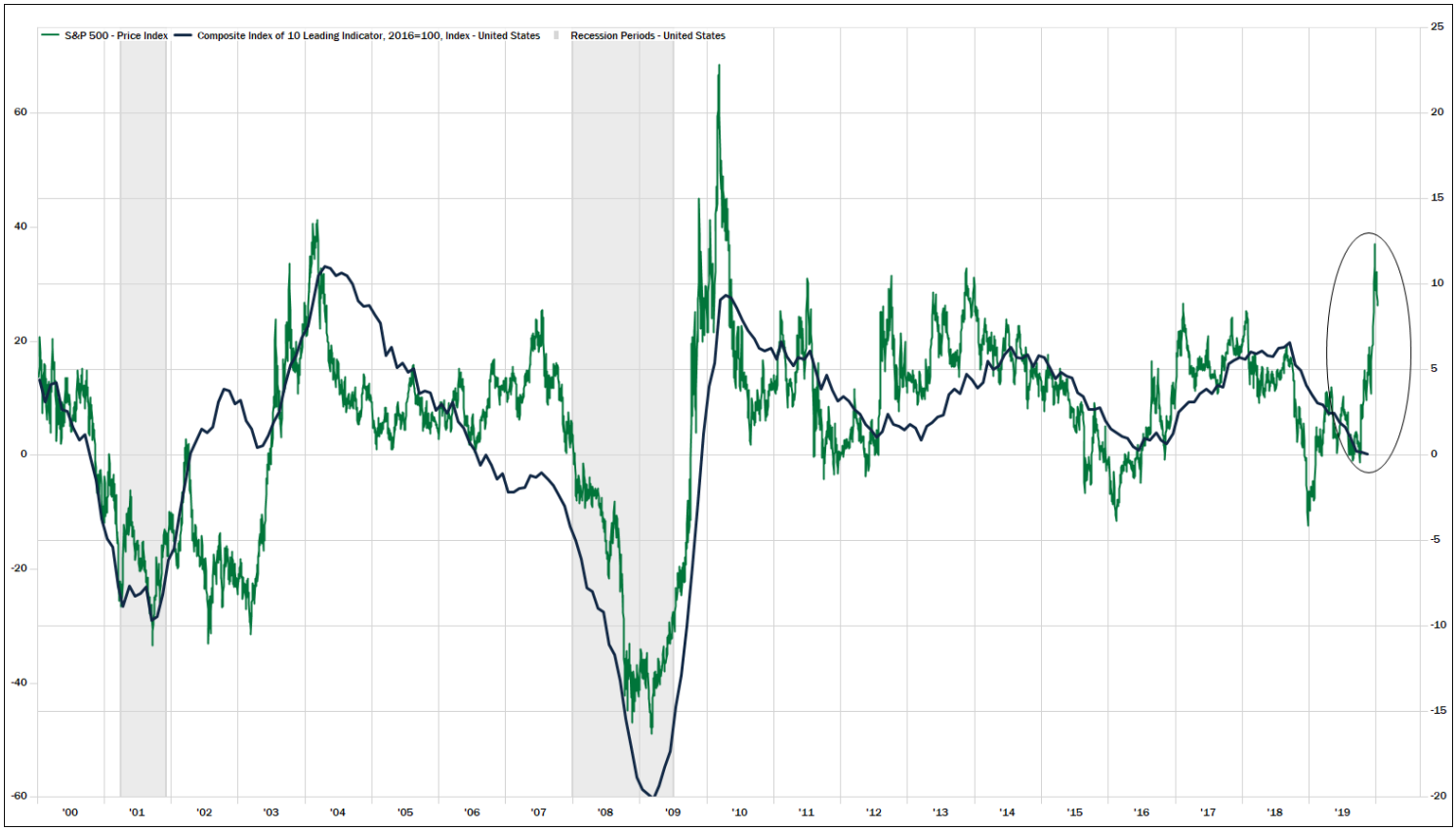
Source: MBL Advisors & FactSet

Investors are paying increasingly closer attention to a concept that is not universally agreed upon but certainly applicable to the current investment landscape:

- Do asset prices lead economic data and corporate fundamentals or
- Do corporate fundamentals and economic data lead asset prices?

Regardless of one's beliefs on this subject, we believe it is highly likely that asset prices and economic data will converge in the coming months, one way or another.

S&P 500 1 year % change (green) **vs. U.S. Economic Leading Indicators 1 year % change** (blue)
2000 - Present



Source: MBL Advisors & FactSet

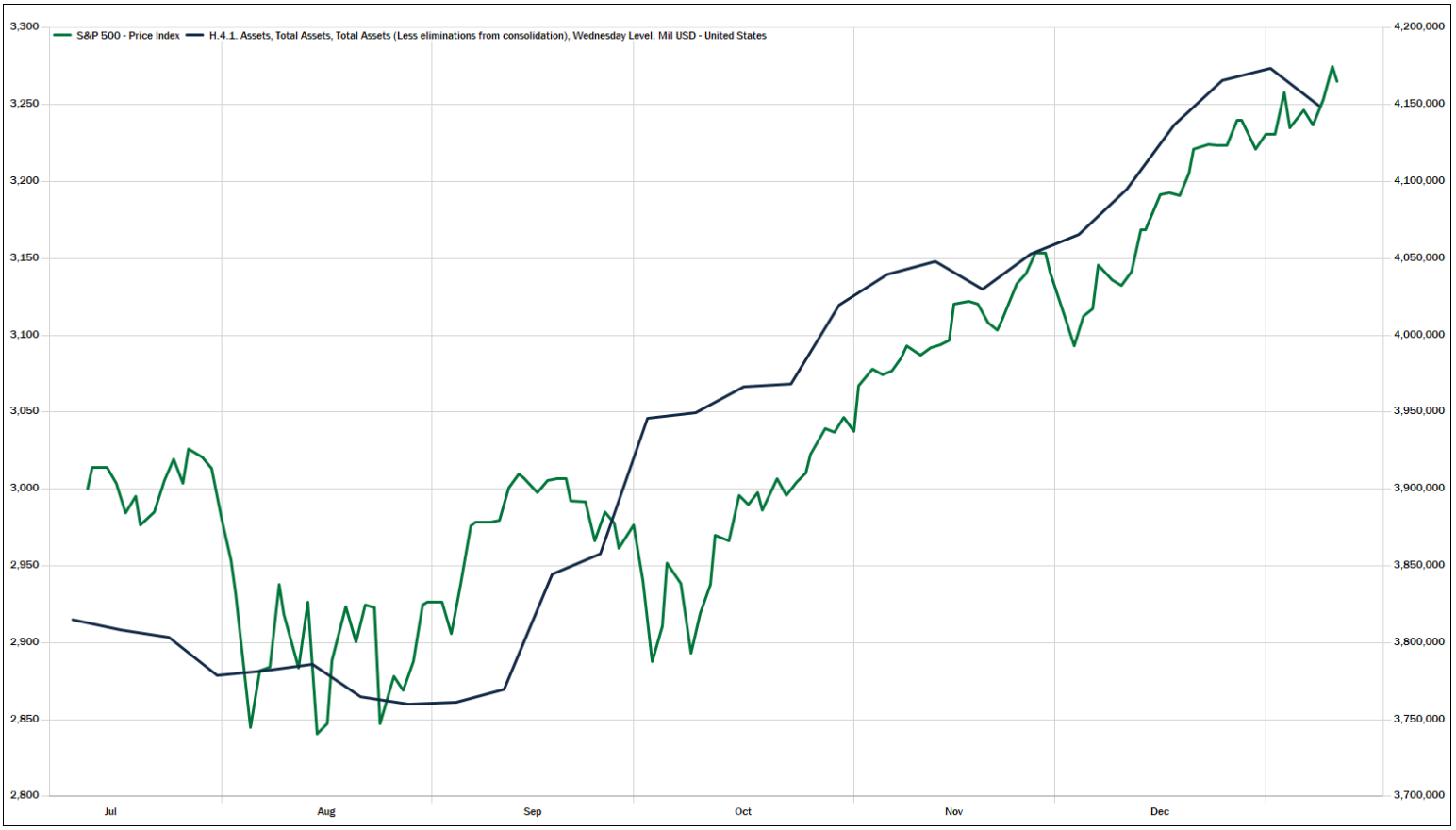
One example of this can be observed through the one-year percent change in the S&P 500 vs. the one-year percent change in U.S. leading economic indicators. This chart would make a strong case that the market has gotten ahead of economic fundamentals with the S&P 500 up 30% +/- year over year while U.S. Leading Economic Indicators are flat. Over the last few decades it has been rare to see these two data points diverge by such a wide degree, and certainly for any extended period.

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To make a strong case for U.S. equities to rise by 8% - 10% or more in 2020 one would have to believe that asset prices are leading fundamentals and that fundamentals will at least partially catch up to asset prices possibly through an upside surprise to both economic growth and earnings growth.

The last decade was a constant reminder of the adage "Don't fight the Fed," and investors should continue to keep this in mind as we begin 2020 with the Fed remaining accommodative and expanding its balance sheet once again, although they are far less outspoken about it than when they were conducting balance sheet expansion under QE1, QE2 and QE3. The current Fed balance sheet expansion began in September, and U.S. equity markets have basically gone straight up since then. The extent to which Fed balance sheet expansion has been a significant contributor to risk assets appreciating over the last eleven years is a highly debated subject among investors.

S&P 500 (green) **vs. Fed Balance Sheet** (blue)
July 2019 - Present



Source MBL Advisors & FactSet

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An additional bullish market observation comes from Ryan Detrick and LPL Research, who have published some terrific insights into how the S&P 500 has historically performed the year after a very strong year.[1] Counter to the preconceived notions of many investors, on average, the following year produces higher than average historical returns and higher than average positive hit rates.

Excluding 2019 there have been 12 calendar years since 1950 during which the S&P 500 has had returns in excess of 30%. The S&P 500 was higher ten out of twelve times the following year by an average of 15.2%.

A Big 2019 For Stocks Could Be a Good Thing in 2020

S&P 500 Index up 30% For The Year And What Has Happened Next

Year	S&P 500 Index Total Return	S&P 500 Index Total Return Following Year	A Recession The Following Year?
1950	30.80%	23.70%	No
1954	52.60%	32.60%	No
1955	32.60%	7.40%	No
1958	43.70%	12.10%	No
1975	37.00%	23.80%	No
1980	31.70%	-4.70%	Yes
1985	31.20%	18.50%	No
1989	31.50%	-3.10%	Yes
1991	30.20%	7.50%	No
1995	37.20%	22.70%	No
1997	33.10%	28.30%	No
2013	32.20%	13.50%	No
2019	31.50%	?	?
	Average	15.20%	
	Median	16.00%	
	Higher	10	
	Count	12	

All indexes are unmanaged and cannot be invested into directly

Past performance is no guarantee of future results

The modern design of the S&P Index was first launched in 1957. Performance before then incorporates the performance of its predecessor index, the S&P 90.

Source: Ryan Detrick & LPL Research

While historical evidence says the year following a very strong year tends to be better than average, there are no shortage of factors and viewpoints to help make counter arguments to this thesis:

- Historically presidential election years tend to produce positive returns although they tend to be below historical averages.

[1] https://lplresearch.com/2020/01/03/what-a-year-it-was-in-2019/

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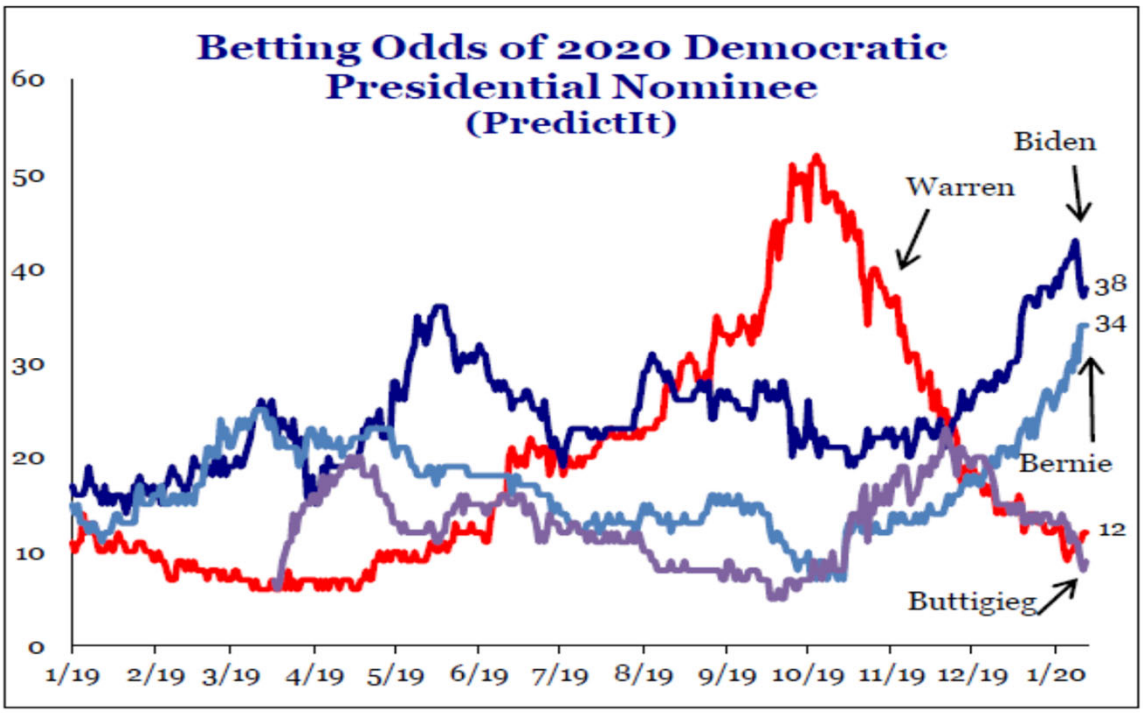
-Next, we are coming close to matching January 2018 in several valuation metrics, which means U.S. equities are at or near the highest valuation levels we have seen since the bursting of the tech bubble in the early 2000's. A similar thing can be said for investor sentiment as many gauges are flashing some short-term overbought signals for US equities.

-We believe that geopolitical risks have been gradually rising for several years now, although these flareups are quickly forgotten by investors. It seems to us that risk assets could be underpricing the legitimacy of such an event ever occurring in the future.

-Finally, our clients and friends who are reading this letter will run the gamut regarding their beliefs around the current political condition of the United States and who the most qualified presidential candidate is to lead us forward in 2021. While we strive to remain apolitical as investment advisors, one must acknowledge that this election could have implications for capital markets over short and intermediate term time horizons. While there could be several strong points to be made on both sides of the aisle regarding which economic policies are best for the "average" American and the future direction of our country, it would be difficult to argue that U.S. equity markets would act favorably, at least in the short term, to the potential of a progressive overhaul of the United States economy.

We believe that the betting markets for the Democratic nominee do a good job of reflecting real time trends and this could be an important metric to watch as we move into the spring. It should be noted that the odds of Senator Sanders winning the Democratic presidential nomination have been surging over the last few months, basically since AOC began campaigning with Senator Sanders. A democratic sweep with Senator Sanders at the top of the ticket is a scenario which risk assets are currently giving almost no credence towards.

Democratic Presidential Nomination Betting Odds



Source: Strategas Research Partners

Conclusion

In our opinion, "obvious investment decisions" rarely present themselves to investors. We have never prided ourselves on our ability to correctly forecast asset prices, and we are not aware of anyone who does this terrifically well on a consistent basis. Rather, we pride ourselves on conducting a disciplined investment process which strives to make prudent investment decisions. We wholeheartedly believe we will be pleased with long term outcomes if we can execute on this methodology in which we focus on the process and remain equal parts disciplined and opportunistic.

As 2020 begins, we are in one of those periods in which some "obvious" portfolio management actions have presented themselves. Again, this is not because we believe we have any edge as to where various asset prices will be 12 months from now, but because our process dictates that these are prudent investment decisions. Regardless of one's views on any of the previously discussed topics, rebalancing portfolios closer to long term strategic asset allocation targets is clearly the prudent action to be taking early in 2020.

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Many portfolios have become more overweight to equities relative to other asset classes (mainly fixed income) and most of that overweighting is towards U.S. large cap equities. We are in the process of making some modest adjustments to both slightly reduce our weightings to equites in general, and to lessen our overweighting to U.S. large cap equities, which have been the best performer of the last year, last few years, and last decade.

Having said this, we continue to maintain our view that "we are going to give this bull market the benefit of the doubt" unless we see some further evidence of deteriorating economic data and corporate fundamentals. When we think about posturing within our clients' portfolios, MBL Advisors will remember 2019 for maintaining and slightly increasing our weightings to equities, while also becoming far more defensive within the equity exposure, especially through the implementation of active trading strategies which use technical analysis to protect against very large drawdowns in equity markets. We have become even more highly convicted in these strategies as markets have continued to melt up and possibly become "priced for perfection" in the short term.

Within this same theme, one area to which we are increasing exposure during this rebalancing process is high yield bonds. High yield bonds are an asset class in which we have been underweight and still do not find to be overly attractive on their own merits. However, we are incrementally increasing high yield exposure within portfolios through an active trading strategy which will flip into intermediate term U.S. treasuries during a risk off scenario. In this sense, we feel good about clipping a 5% +/- yield from the asset class if equity markets behave themselves this year, while also feeling protected knowing this high yield exposure will move into treasuries if risk assets begin to deteriorate at any point.

It is important for investors to be aware of the possibility of contrarian market events occurring this year since "group think" and herding mentalities seem to be on the verge of becoming commonplace. Although none of these contrarian outcomes are necessarily forecasts or opinions of MBL Advisors, we do believe it is important to recognize that it seems many investors expect this year to be a relatively "easy" year with low (fixed income) to mid-single digit (equities) returns for most asset classes. Many investors seem to be acknowledging the word "volatility", but investor actions seem to have less than average concern with downside potential in equity markets. This is despite some signs of relatively aggressive investor sentiment seen through various investor surveys and market indicators.

One example of this is The Ned Davis Daily Trading Sentiment Composite which currently has a reading of "excessive optimism." [2] Another example of potential complacency among professional investors can be seen in the title to the 1/11/2020 Barron's annual Roundtable article; **There's Almost No Chance of a Recession This Year, Experts Say. Here's Why.** [3]

Here are a few scenarios which MBL Advisors believes would be contrarian / out of consensus outcomes:

- U.S. equity markets return less than 0% or more than 10%.
- S&P 500 earnings per share growth below 2% or above 8%.
- Ten-year U.S. treasury yields below 1.75% or above 2.25%.
- Inflation becoming an issue that the Fed must openly address.
- Commodity prices broadly doing well.
- U.S. GDP growth less than 1.6% or above 2.2%.
- Non-U.S. equities outperforming U.S. equities (people are talking about this, but we doubt many investors are positioned for it).
- U.S. value stocks outperforming U.S. growth stocks (once again investors are talking about it, but we doubt positioning has any conviction in this view).
- Experiencing extended periods (months, not days or weeks) of elevated volatility (VIX 18 and higher).

In conclusion, history tells us that markets usually do not "crash" from all-time highs, especially when the market internals look as strong as they do right now. According to Chris Verrone of Strategas Research Partners, more than 75% of the S&P 500 is in an uptrend and a plethora of "risk on" factors are performing well (stocks vs. bonds, consumer discretionary vs. consumer staples, industrials vs utilities, etc.). We believe these signals are telling investors to give some legitimate merit to the upside growth scenario. In addition, it would also be rare to break out to new all-time highs (which happened last fall) after a 20-month sideways period and not to have it sustain for more than a few months. Nonetheless, even if solid economic data follows through, markets could grapple with the question of "how much of this good news is already reflected in asset prices?"

[2] https://www.cnbc.com/2020/01/17/as-stocks-hit-more-more-records-there-are-signs-traders-may-be-getting-way-too-euphoric.html

[3] https://www.barrons.com/articles/why-markets-will-gain-despite-looming-risks-barrons-roundtable-panelists-say-51578707631

We feel especially good about having portfolios adequately positioned for a wide range of outcomes as we begin this new year and new decade.

As always, we are honored and grateful to work with and serve you and your families.

Sincerely,



Brian J. Gift, CFA

Chief Investment Officer

MBL Advisors

Investment Wisdom

"The man who can do the average thing when everyone else around him is losing his mind."
- Napoleon's definition of a military genius.

"Never think that lack of variability is stability. Don't confuse lack of volatility with stability, ever."
- Nassim Taleb

"Most people overestimate what they can do in 1 year and underestimate what they can do in 10 years."
– Bill Gates

Spending: day to day habits.

Saving: month to month habits.

Investing: year to year habits.

Compounding: decade to decade habits.
– Morgan Housel

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The Standard & Poor's 500 Index (S&P 500 TR) is an index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

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