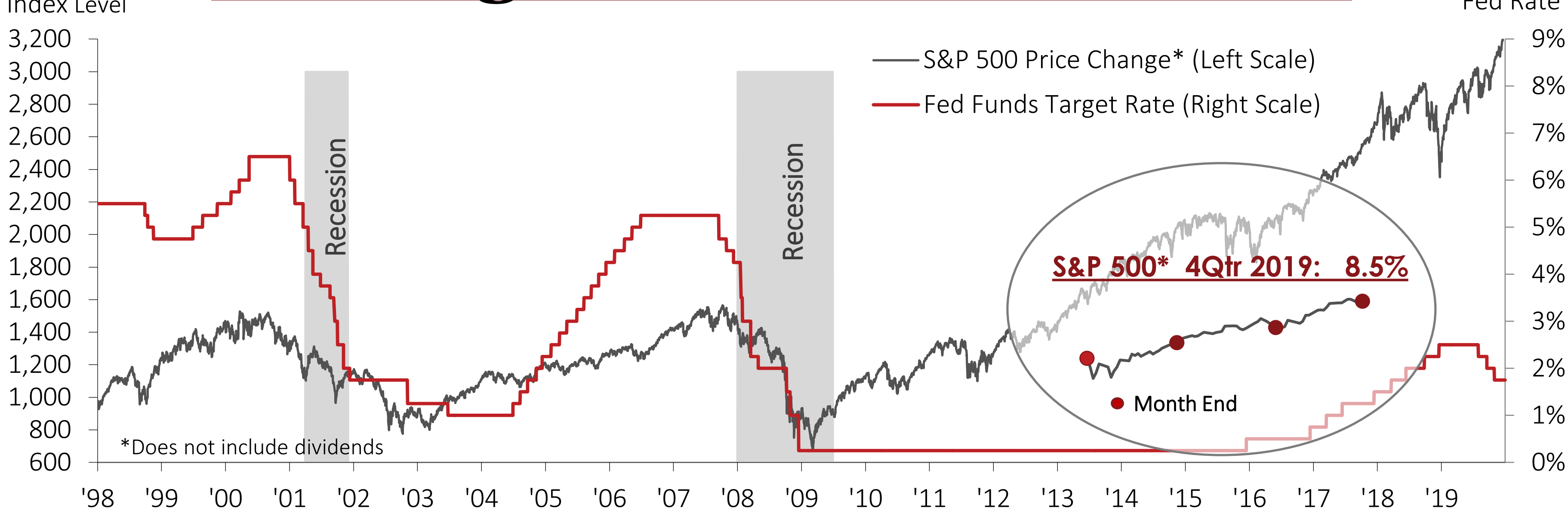
Capital Market Review

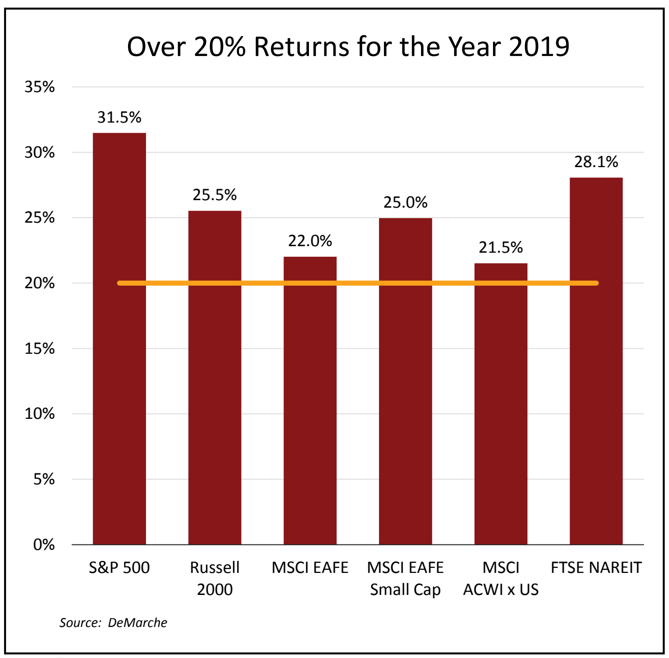
December 31, 2019

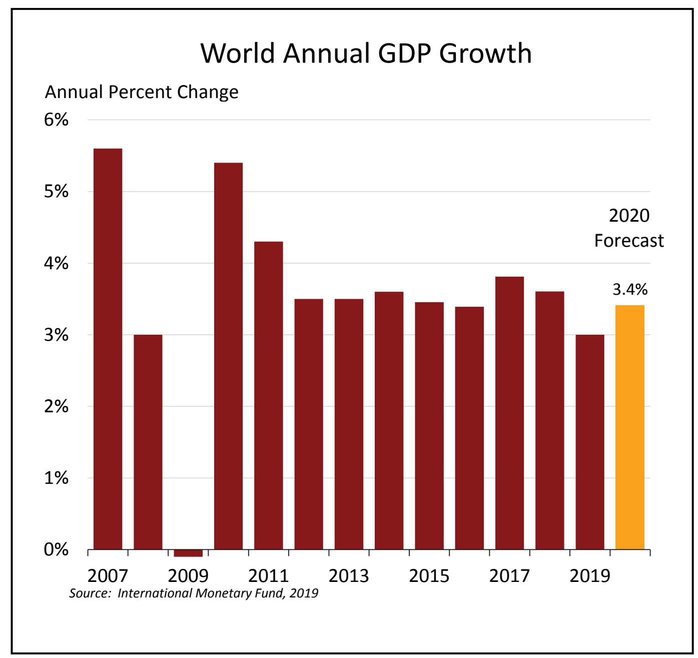
Roaring 20s! Vision for 2020?



Source: Standard & Poor's, Federal Reserve



Last January, if someone had said the year would start with talk of a global recession and a trade war, it would be pretty reasonable to expect 2019 to have been a challenging year. Top that off with impeachment and the conversation would have shifted to how much lower the "Bear Market" would go. Instead, the U.S. market raced ahead 31.5% as the globe shrugged off recession concerns. The chart to the right shows that during the year, expectations of 2020 growth turned positive. The chart to the left shows that not only did the U.S. cap off a strong year of outperformance, but strong equity returns above 20% were also commonplace.



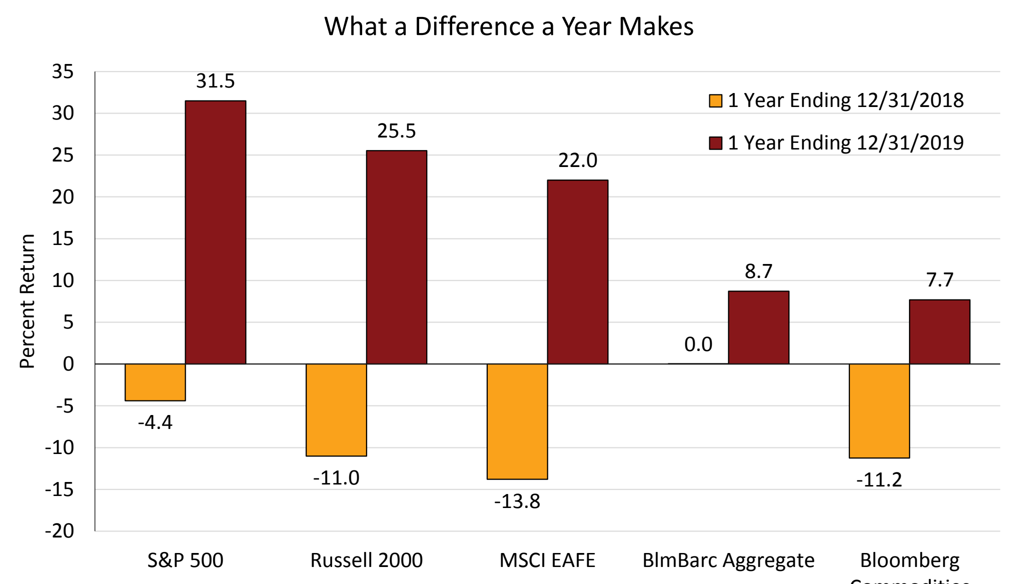
Broad Market Overview

December 31, 2019

INDEX	4th Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
MSCI World	8.6	27.7	12.6	8.7	9.5
DeMarche World*	9.0	24.6	11.3	8.1	8.3
DeMarche 3000	9.0	27.1	12.6	9.5	10.5
Russell 3000	9.1	31.0	14.6	11.2	13.4
S&P 500	9.1	31.5	15.3	11.7	13.6
DeMarche International	9.0	21.5	13.3	5.1	8.1
MSCI EAFE USD	8.2	22.0	9.6	5.7	5.5
BlmBarc Aggregate	0.2	8.7	4.0	3.0	3.7
FTSE Non-US Gov't Bond	-0.1	5.3	4.5	1.9	1.4
BlmBarc Global Aggregate	0.5	6.8	4.3	2.3	2.5
NCREIF (Private RE)	1.6	6.4	6.7	8.2	10.2
Bloomberg Commodity	4.4	7.7	-0.9	-3.9	-4.7

*Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized. *Does not include Canada or Brazil.*

Indicator Year Ending 12/31	2019	2018	2017	2016	50-Year Average
GDP Annual Growth Rate	2.3	2.5	2.8	1.9	2.8
Unemployment	3.5	3.9	4.1	4.7	6.2
Inflation (CPI)	2.3	1.9	2.1	2.1	4.0
10-Year Interest Rates	1.9	2.8	2.4	2.5	6.3



Source: DeMarche

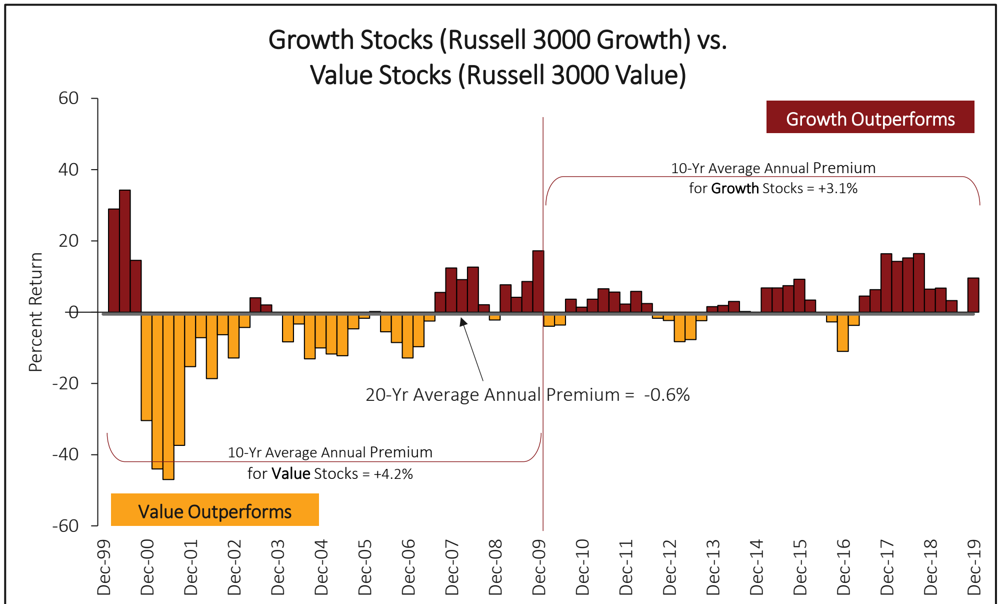
- Stock markets across the globe moved higher during 2019, recovering from a lackluster 2018 and its difficult 4th quarter. U.S. large cap equities, as measured by the S&P 500, outperformed all other equity classes for the year and posted a strong annualized return of 13.6% for the past 10 years.
- International stocks also moved higher during 2019, reporting a strong 22% return. However, over the past decade, international stocks have failed to keep pace with U.S. stocks, earning 5.5% and trailing U.S. large cap by 8.1%.
- Interest rates fell during 2019 as the Fed cut interest rates three times. However, in the 4th quarter, bond yields increased slightly, impacting bond returns for the quarter. Over the past year the BlmBarc Aggregate returned a robust 8.7%, but over 5 and 10 years returns were a meager 3.0-3.7%.
- Performance ended on a down note in 2018. Returns across asset classes were flat or negative as markets worried about global growth and trade. Fast forward a year and markets across the globe shrugged off these concerns. Global growth stabilized as central banks cut rates, Brexit was resolved, and trade pacts moved forward.

DeFact

During the 4th quarter, the Federal Reserve cut interest rates for the third time this year. The decision to cut rates despite overall economic growth and low unemployment showed the extent that trade and geopolitical uncertainty have weighed on the global outlook. The Fed also signaled that it will stay on the sideline for most of 2020, unless conditions worsen. The CME FedWatch tool predicts that the next rate cut won't occur until the second half of 2020, if at all. ~ Federal Reserve

INDEX	4th Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
DeMarche Growth	10.7	31.5	17.1	12.3	12.6
DeMarche Value	6.2	20.1	6.7	5.6	7.8
DeMarche Aggressive	13.0	26.8	8.5	4.7	8.4
DeMarche Defensive	8.7	27.2	13.0	9.9	10.7
DeMarche Large Cap	9.1	27.2	13.4	9.8	10.2
Large Cap Growth	11.3	31.8	18.5	13.1	12.5
Large Cap Value	5.4	19.7	6.9	5.5	7.1
DeMarche Small Cap	12.2	21.8	5.8	6.6	11.0
Small Cap Growth	12.9	24.9	8.1	7.2	11.0
Small Cap Value	11.6	19.6	4.1	6.0	10.9
S&P 500	9.1	31.5	15.3	11.7	13.6
S&P Mid-Cap 400	7.1	26.2	9.3	9.0	12.7
S&P Small-Cap 600	8.2	22.8	8.4	9.6	13.4
Russell 1000	9.0	31.4	15.0	11.5	13.5
Russell 1000 Growth	10.6	36.4	20.5	14.6	15.2
Russell 1000 Value	7.4	26.5	9.7	8.3	11.8
Russell 2000	9.9	25.5	8.6	8.2	11.8
Russell 2000 Growth	11.4	28.5	12.5	9.3	13.0
Russell 2000 Value	8.5	22.4	4.8	7.0	10.6

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.



Source: DeMarche

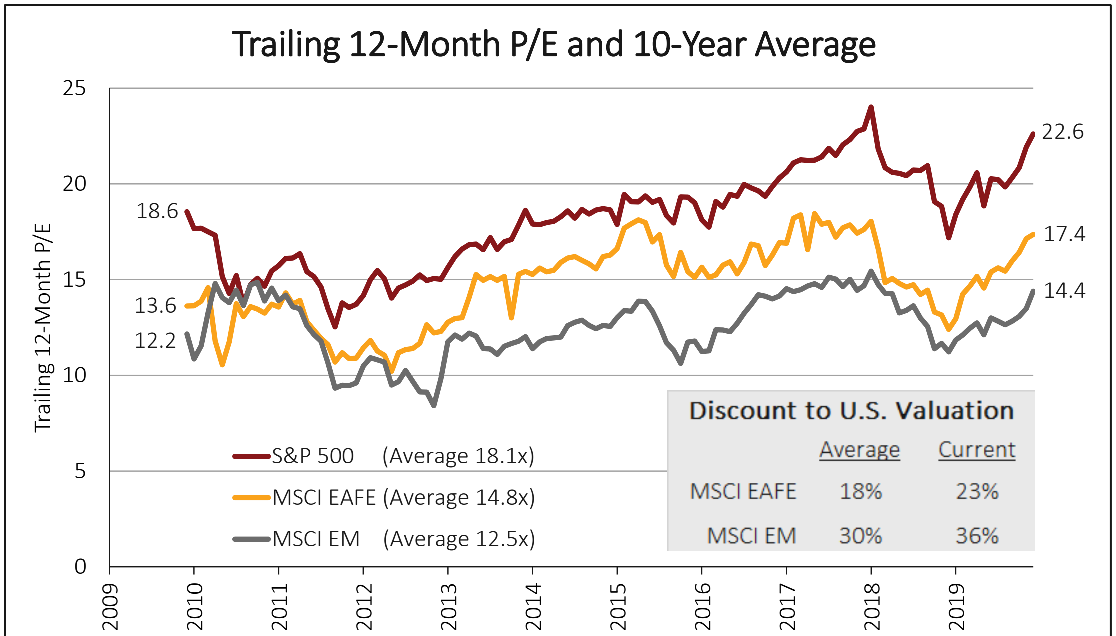
- Small cap stocks (Russell 2000) have failed to keep up with large cap stocks (Russell 1000) for the year but showed some life in the 4th quarter, outperforming large cap by 90 basis points. Over longer periods, small cap stocks have struggled to beat large cap. For example, in three years, small caps lag by 6.4%.
- Growth stocks, both large and small, have outperformed value stocks by a wide margin in all time frames. Over the past year, tech stocks have proven to be the winner, advancing over 50% in 2019. Technology makes up almost 39% of the Russell 1000 Growth index.
- The largest Russell 2000 Growth sector weight is health care, followed by technology. Small cap health care and technology each returned over 30% for the year, but did not keep up with the dominance of large cap technology. Small cap value is heavily weighted in financial stocks and has lagged the growth sectors mentioned above, even though the index has posted a good return of over 24% for 2019.
- Value stocks have trailed growth stocks for the past 10 years. The chart to the left shows just how dominant growth has been with only a few quarters of lagging performance. The picture is quite different when you contrast that trend with the first 10 years of the century, as value stocks dominated the landscape. In this case, stock leadership reversals take hold gradually.

DeFact

Since 1926, the calendar year return for the S&P 500 has exceeded 30% on 20 occasions, including 2019 when the return was 31.5%. Subsequent one-year returns for the previous 19 occurrences have an average return of 10.8%. Seven of those years had negative returns averaging -8.8% and 12 years were positive, averaging 22.2%. Therefore, a great return in one year does not automatically mean that investors have to experience a "reversion to the mean" return the next year. ~ DeMarche

INDEX	4th Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
DeMarche Int'l	9.0	21.5	13.3	5.1	8.1
Growth	9.2	24.3	13.4	6.7	9.0
Value	8.7	17.5	9.9	4.3	7.3
DeMarche Int'l Small Cap	13.3	29.5	10.8	6.4	7.6
DeMarche EM	11.6	12.9	8.6	4.9	6.5
MSCI EAFE Local	5.2	21.7	7.7	6.7	7.2
MSCI EAFE USD	8.2	22.0	9.6	5.7	5.5
Growth	8.4	27.9	12.8	7.7	6.9
Value	7.8	16.1	6.3	3.5	4.0
MSCI Japan	7.6	19.6	8.9	7.7	6.6
MSCI AC Asia-ex Japan	11.8	18.2	12.8	6.6	6.0
MSCI Germany	9.9	20.8	6.3	3.9	5.2
MSCI France	8.5	25.7	12.2	8.1	5.0
MSCI UK	10.0	21.0	8.3	3.3	5.0
MSCI EAFE Small Cap	11.5	25.0	10.9	8.9	8.7
MSCI EM	11.8	18.4	11.6	5.6	3.7
MSCI All Country-ex US	8.9	21.5	9.9	5.5	5.0

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.



Source: Morningstar Direct, DeMarche

- The dollar weakened against a trade-weighted basket of currencies during the 4th quarter. Easing trade tensions and a positive Brexit outcome boosted international currencies and increased U.S. dollar returns of international stocks. Since 2015, the dollar has moved into a new trading range versus other currencies, and over the 5- and 10-year periods, the stronger dollar translated into lower returns for international stocks as compared to local returns.

- Emerging market stocks rebounded nicely in the 4th quarter, outperforming U.S. stocks as trade tensions eased. Over the past three years EM stocks have outperformed developed international stocks and U.S. small cap, but have lagged U.S. large cap. Over the longer term, EM stocks have lagged other sectors as they have been weighed down by a stronger dollar, trade tensions, and falling commodity prices.

- Even in the overseas markets, growth stocks have continued their trend of outperformance. International value stocks are driven by financial and energy companies, (even more so than in the U.S.) which have struggled around the globe in the past decade.

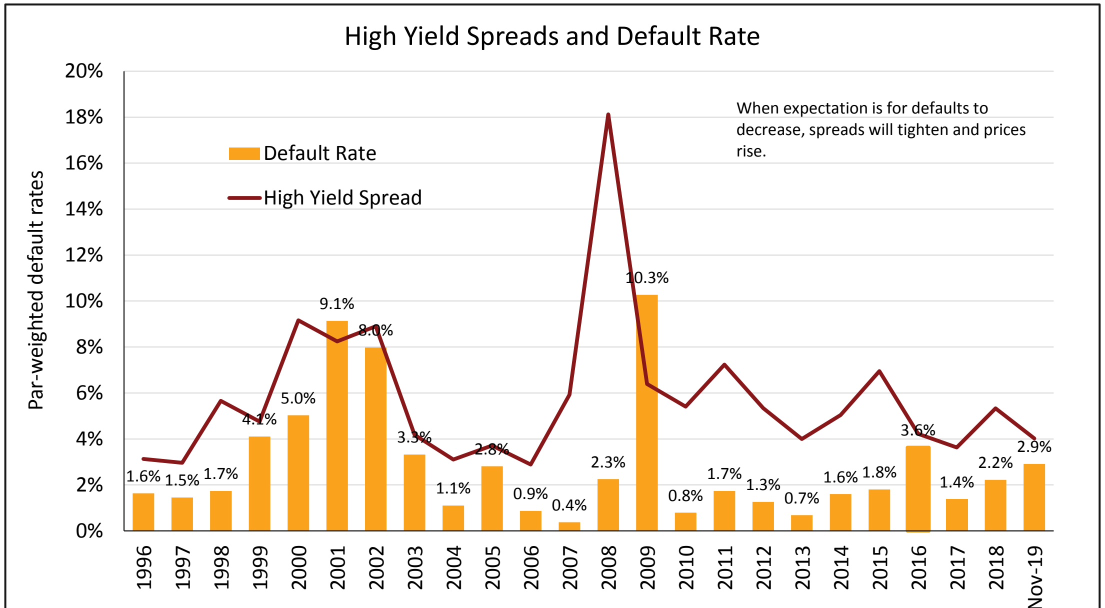
- It is no secret that U.S. stocks have been dominant for the past decade. But are they expensive compared to history and other stock sectors? Over the past 10 years, the P/E ratio on the S&P 500 has averaged 18.1 and the latest reading put it at 22.6. The international and emerging market sectors' current discount to U.S. stocks is greater than their averages for the past 10 years. This suggests that relative to history, non-U.S. stocks are currently undervalued to U.S. stocks.

DeFact

While U.S. stocks have had a strong year, some developed international countries outperformed the U.S. New Zealand posted 38.9%, Ireland 38.1%, Switzerland 33.6%, and the Netherlands 32.7%. But the big winner was Russia, which led the emerging markets with a return of 50.9%. It has been a long decade for EAFE and EM indexes, underperforming the U.S., but over the longer term, international stocks offer diversification and return potential to investors. ~Novel Investor

INDEX	4th Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
BlmBarc 1-3 Gov Credit	0.6	4.0	2.1	1.7	1.5
BlmBarc Aggregate	0.2	8.7	4.0	3.0	3.7
BlmBarc Gov Credit Long	-1.1	19.6	8.1	5.4	7.6
BlmBarc US TIPS	0.8	8.4	3.3	2.6	3.4
Merrill Lynch High Yield	2.6	14.4	6.3	6.1	7.5
CSFB Leveraged Loan (bank loans)	1.7	8.2	4.5	4.5	5.2
BlmBarc Global Aggregate	0.5	6.8	4.3	2.3	2.5
JPM EmgMkt Bd Glbl Dvrsfd (hard)	1.8	15.0	6.7	6.2	6.9

Notes: Data are presented as percent returns. All 3, 5-, and 10-year returns are annualized.



Source: Sit Investment, JP Morgan, FRED

- Bond yields fell during the year, but increased during the quarter. As yields fall, the price of bonds increase and is reflected in the return. Bonds posted an 8.7% return for the year, but very modest returns for the longer-term. Longer-term returns reflect coupon rates earned on bonds, while short-term interest rate changes cause return volatility.

- High yield bonds performed well for the past year, posting a strong 14.4% return. High yield credit spreads to Treasuries have tightened during the year, which improved total return. Spreads to Treasuries started the year at 535 bps and narrowed to 360 bps at the end of the year. Over longer periods, high yield bonds have returned between 3% and 4% over investment grade bonds.

- Emerging market bonds also performed well over the past year. Developed market bonds exist in a low or negative yield environment, so investors look to emerging market debt to bolster returns. In addition, a growing global economy helps relieve any significant concern about the repayment of principal.

- The chart to the left shows that even though defaults increased during the year, spreads tightened. Increased defaults were due to struggling energy companies. The latest data from the third quarter shows the default rate on energy credits was about 11%.

DeFact

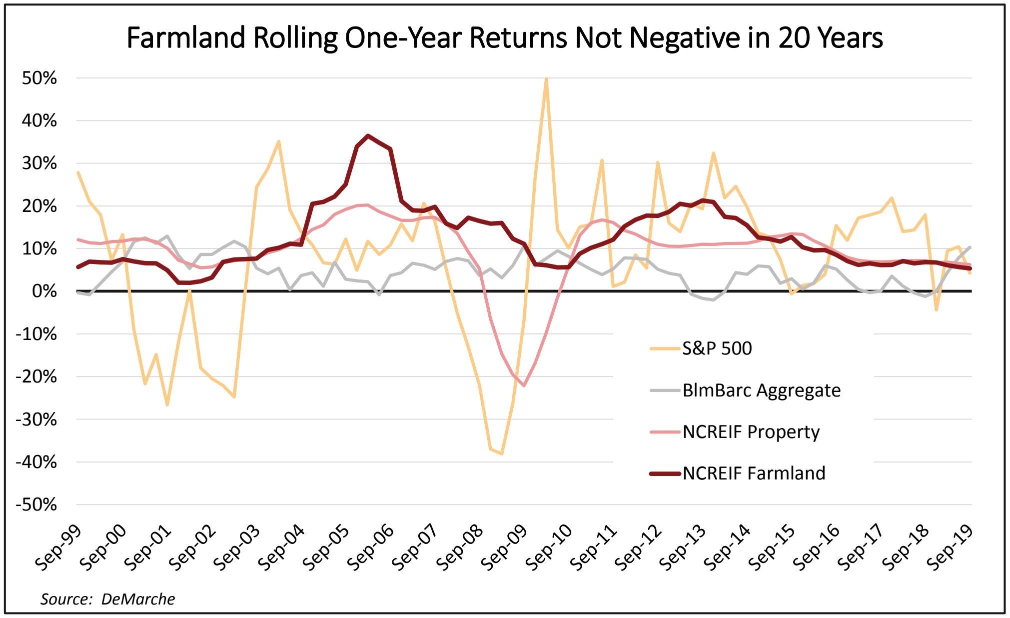
The Treasury yield curve was inverted a total of 107 days in 2019. The curve was inverted for all but one day in the 3rd quarter 2019. The inversion was viewed as a worrisome market signal about an impending recession in 2020. Then during October, the prospects of economic growth rebounded, longer-term rates increased, and the curve sloped upward starting on October 11, 2019. Specifically, the 10-year Treasury increased from 1.73% on October 11 to 1.92% by the end of the year. At the end of the year, the curve sloped upward 37 basis points. ~ DeMarche

Less Liquid Strategies

INDEX	4th Qtr	1-YEAR	3-YEAR	5-YEAR	10-YEAR
NCREIF Property (Private RE)	1.6	6.4	6.7	8.2	10.2
Apartment	1.5	5.5	5.9	7.4	10.2
Industrial	3.2	13.4	13.6	13.6	12.8
Office	1.7	6.6	6.5	7.6	9.4
Retail	0.0	1.9	3.2	6.7	9.7
NCREIF Timberland	0.0	1.3	2.7	3.1	4.4
NCREIF Farmland	2.3	4.8	5.9	7.0	11.0
NAREIT (Public RE)*	0.5	28.1	10.3	8.4	12.5
Bloomberg Commodity	4.4	7.7	-0.9	-3.9	-4.7
HFR FOF Composite	3.0	8.3	3.9	2.4	2.8
Conservative	1.9	6.6	3.2	2.4	2.8
Diversified	2.5	7.9	3.7	2.3	2.8
Strategic	4.6	10.6	4.7	2.7	3.1

Private Market Indexes as of 6/30/2019	**2nd Qtr**	**1-YEAR**	**3-YEAR**	**5-YEAR**	**10-YEAR**
Preqin Private Equity	3.6	10.8	14.9	12.3	14.0
Preqin Private Debt	1.5	4.5	7.5	6.4	10.3
Preqin Infrastructure	2.2	10.5	9.8	9.9	10.4

Notes: Data are presented as percent returns. All 3-, 5-, and 10-year returns are annualized.
**Public RE is not a less liquid strategy. It is listed for comparative purposes.*



- Real Estate continues to provide steady returns to investors. Industrial properties have experienced great returns, more than offsetting the subpar returns of the retail sector.
- Commodity prices rebounded in the 4th quarter and year. Energy prices and precious metals increased during the year, but agriculture prices were roughly flat or declined. Over the longer term, a drop in energy prices has negatively impacted the return of the broad commodity index.
- Hedge funds posted their best returns since 2009, with "risk-on" strategies posting the strongest gains. Equity hedge strategies such as long/short equity posted their best returns since 2013, another strong year for equities.
- Private equity returns, while lagged in the chart, continue to show robust returns over all time periods. A good public market comparison to private equity are mid cap and small cap stocks. As of the date on the chart (6/30/2019), these public stocks were lagging by almost 4% over the last 5 years.
- Over the years, Farmland has proved to be a good diversifier against traditional stocks and bonds, in addition to real estate. As the chart shows, during the past 20 years, Farmland has not posted a negative 1-year return.

DeFact

Gold ended 2019 at $1,523 per ounce, its highest year ending level since 2012, and close to its 2019 high posted in September. The upward move this year propelled gold to its best annual performance since 2010. The rally to these new levels began in 2018, when uncertainty and fears about a global trade slowdown caused investors to favor gold as protection against a market downturn. ~WSJ

Economic Outlook for 2020

We continue to expect steady GDP growth in 2020 at a pace of 1.5% to 2.0%, despite some recession risks such as slowing corporate earnings growth and trade tensions.

- Headlines will continue to drive investor sentiment.
- The primary risk to the markets is unexpected inflation, particularly wage inflation brought about by the economy rebounding in 2020.
- Inflation could drive up interest rates and the dollar relative to other currencies and global interest rates.

The Fed has stated that its progressively accommodative actions taken in 2019 will be put on hold in 2020.

- In response to the accommodative Fed, the market closed the year at all-time highs.
- The Treasury curve was inverted for a short while but is now upward sloping.
- This signal supports a growing US economy in 2020.

Headline inflation (including energy) remains at or near 2.0% due primarily to food prices.

- Energy prices did increase in the 4th quarter, particularly December.
- Wage inflation has trended up and is reflected in core CPI (ex food and energy) with rate above 2%.
- A modest growth economy should exert less upward pressure on prices, allowing the Fed to be data dependent and remain mostly on the sideline in 2020.

2020 VISION

Education Series

Look past the noise of economic volatility and political acrimony and focus on the critical investment issues, market forces, and industry trends that will impact your investment strategies and portfolio returns in 2020 and beyond.

Luncheons

January 30 | Wichita, KS
2020 Vision: Market Outlook and Opportunities

February 26 | Houston, TX

March | Des Moines, IA

April | Denver, CO

April | St. Louis, MO

May | Omaha, NE

June | Pittsburgh, PA

Half-Day Workshops

February 25 | Dallas, TX
2020 Vision: Building Successful Multi-Asset Class Portfolios

April 8 | Kansas City, MO
2020 Vision: Solutions to Ensure Positive Retirement Security Outcomes

May | Chicago, IL

June | Minneapolis, MN

Client Conference

September 23 – 25 | Kansas City, MO
Intercontinental Hotel, Plaza

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