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Strengthening Our Clients' Financial Lives

Forza Investment Advisory, LLC

FROM THE DESK OF BOB CENTRELLA, CFA ***January 8, 2020***

2019 Review and 2020 Outlook

Forza wishes a Happy New Year and a healthy and prosperous 2020 for you and your families. This was also my opening line last year for my letter and it proved to be a great year so I'm pressing my bet! The decade ended on a very positive note as 2019 was a great comeback year for the financial markets and stocks in particular after the Q4 swoon in 2018. 2020 portends to be an interesting start of the next decade with the election only 11 months away, the Mideast still a burning fuse and the economy expanding for a record 127 consecutive months. Can it continue? Read on for my take.

Last year the news and mood often were dictated by progress or lack thereof on the China Trade deal. It was also a year where determined Democrats in Congress voted to impeach President Trump, the Mideast was the Mideast, Europe went through fits and starts, England voted in BoJo and moved forward with Brexit, and Washington DC got some good news – the Nats won the World Series. Through it all, there was one consistent theme – investors wanted to own stocks and bonds. The S&P 500 returned 31.2% and the Barclays Bond Aggregate 8.45%. It was an unusual year where both asset classes performed strongly. The main reason was the Fed lowered rates 3 times and provided liquidity to the financial markets. Following a year when 93% of all asset classes produced negative returns, almost all asset classes delivered positive returns in 2020. Beyond stocks, Oil rebounded 32.6% and even Gold rose 17.9%. The best sectors were Technology and Financials. The best foreign market was actually Russia (+40.8%).

Asset Class Performance Full Yr, Q4, and Dec. - Total Return (%)

US Related

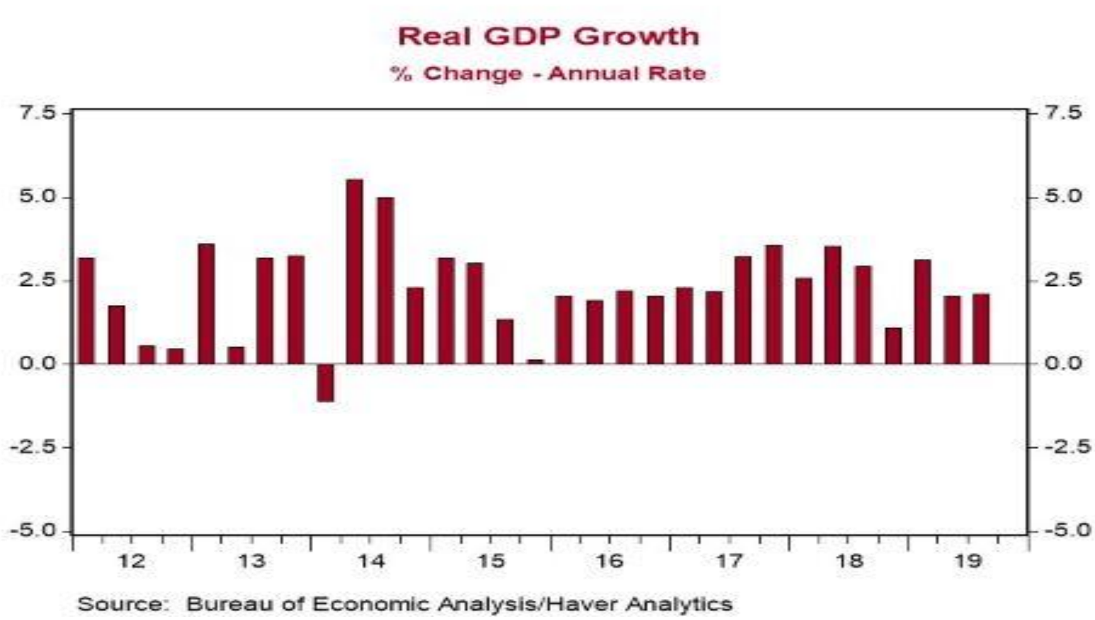
ETF	Description	Dec.	Q4	Full Yr
SPY	S&P 500	2.90	8.99	31.22
DIA	Dow 30	1.79	6.50	25.01
QQQ	Nasdaq 100	3.89	12.85	38.96
IJH	S&P Midcap 400	2.81	6.99	26.10
IJR	S&P Smallcap 600	3.00	8.26	22.82
IWB	Russell 1000	2.80	8.95	31.06
IWM	Russell 2000	2.78	9.87	25.39
IWV	Russell 3000	2.80	8.99	30.66
IVW	S&P 500 Growth	2.89	8.23	30.77
IJK	Midcap 400 Growth	2.46	6.71	25.96
IJT	Smallcap 600 Growth	3.03	8.67	20.99
IVE	S&P 500 Value	3.00	9.82	31.63
IJJ	Midcap 400 Value	3.08	7.31	25.67
IJS	Smallcap 600 Value	2.84	7.74	24.12
DVY	DJ Dividend	2.72	4.52	22.62
RSP	S&P 500 Equalweight	2.70	7.50	28.91
FXB	British Pound	2.42	7.70	3.87
FXE	Euro	1.71	2.65	-2.90
FXY	Yen	0.67	-0.59	0.37
XLY	Cons Disc	2.76	4.25	28.39
XLP	Cons Stap	2.41	3.37	27.43
XLE	Energy	6.03	5.47	11.74
XLF	Financials	2.61	10.49	31.88
XLV	Health Care	3.48	14.22	20.44
XLI	Industrials	-0.20	5.47	29.09
XLB	Materials	2.86	6.11	24.13
XLK	Technology	4.32	14.20	49.86
XLC	Comm Services	2.26	8.53	31.05
XLU	Utilities	3.29	0.59	25.92

Global

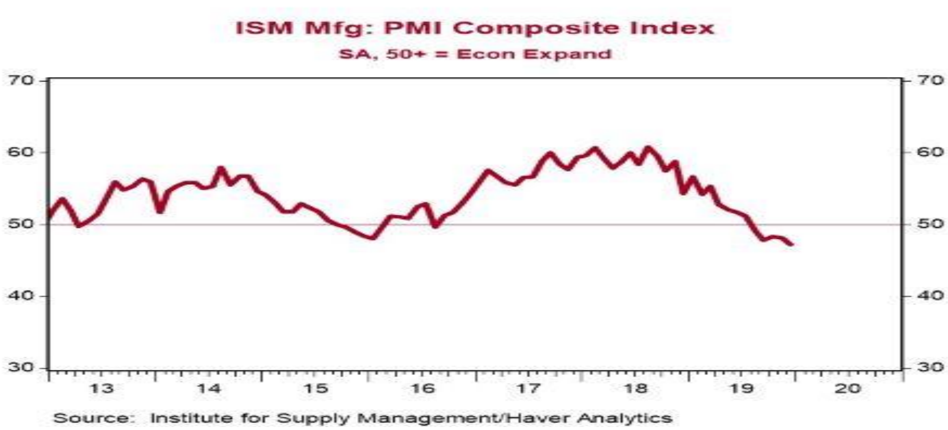
ETF	Description	Dec.	Q4	Full Yr
EWA	Australia	1.15	3.79	22.41
EWZ	Brazil	13.38	14.29	27.65
EWC	Canada	2.22	4.81	27.56
ASHR	China	8.54	10.50	36.51
EWQ	France	3.54	8.76	26.67
EWG	Germany	1.59	9.25	19.15
EWH	Hong Kong	4.25	8.11	10.71
PIN	India	1.72	4.45	4.85
EWI	Italy	2.82	7.75	26.97
EWJ	Japan	0.86	5.65	19.33
EWW	Mexico	4.45	6.41	12.64
EWP	Spain	4.33	6.32	11.91
RSX	Russia	8.82	15.73	40.79
EWU	UK	5.37	10.39	21.25
EFA	EAFE	2.98	7.67	22.03
EEM	Emerging Mkts	7.71	12.11	18.20
IOO	Global 100	3.90	9.97	30.00
EEB	BRIC	8.14	15.27	25.86
DBC	Commodities	5.85	7.75	11.84
USO	Oil	10.24	12.96	32.61
UNG	Nat. Gas	-5.44	-15.40	-31.77
GLD	Gold	3.66	2.90	17.86
SLV	Silver	4.77	4.77	14.88
SHY	1-3 Yr Treasuries	0.15	0.42	3.38
IEF	7-10 Yr Treasuries	-0.93	-1.42	8.03
TLT	20+ Yr Treasuries	-3.20	-4.66	14.12
AGG	Aggregate Bond	-0.05	0.13	8.46
BND	Total Bond Market	-0.07	0.20	8.84
TIP	T.I.P.S.	0.35	0.61	8.35

ECONOMY

We estimate that GDP growth for 2019 should average about 2.3%, peaking in Q3 at 3.1% after 2.1% and 2.0% in Q1 & Q2. Estimates for 2019 were 2.3-2.5% so the economy weathered the China trade war to come in line.



As mentioned earlier the economy is in midst of the longest recovery on record at 127 months and unemployment is at its lowest level in 50 years at 3.5%. The economy may be in the latter stages of expansion but a Phase 1 China Trade deal and a Federal Reserve ready to act is reason to think this expansion will continue. And one could argue that lower tax rates and a more lenient regulatory policy has something to do with it as well. One piece of negative data comes from the ISM index of manufacturing which has dipped below 50 indicating a possible coming recession.



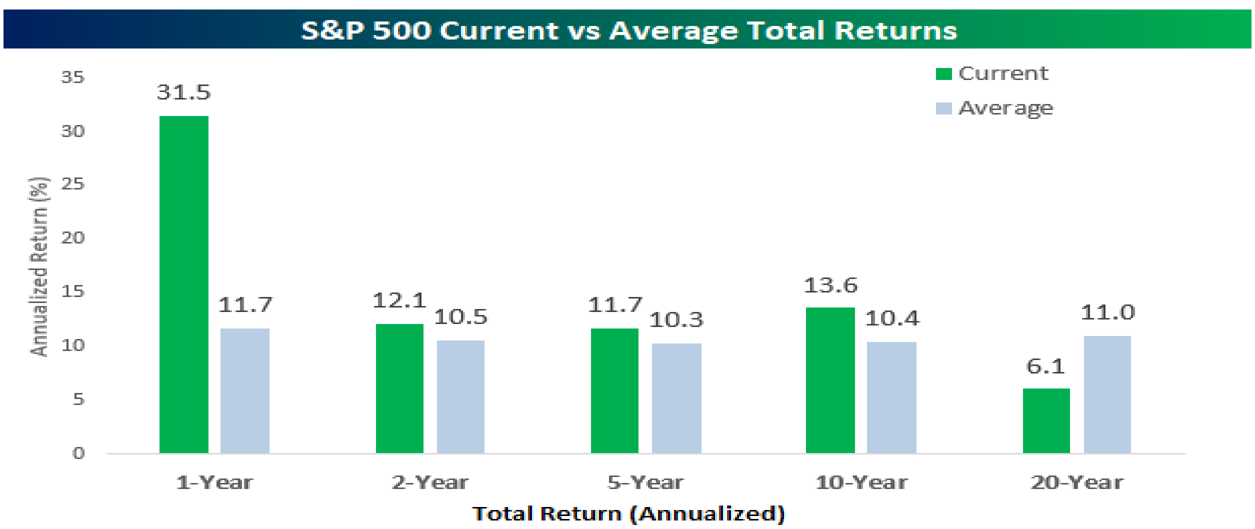
However, it is not a perfect science as it gave false signals in 2012, 2013 and 2015/16 and each time the economy kept growing. On the positive front, construction spending and personal income are still rising while the unemployment rate is at an all-time low. Look for 2020 GDP to be in the 2.3% to 2.5% range again with at least 1 quarter above 3%.

BONDS

The yield on the 10-Yr UST declined from 2.69% at the end of 2018 to 1.92% at the close of 2019. It reached a low of 1.5% in September as negative rates in Europe and Asia had investors considering the same in the US and an inverted yield curve stoking some talk of recession (mostly by the media). The Fed's lowering of rates then had the desired effect of "un-inverting" the curve and rates normalizing. For 2020 my feeling is that with the Fed basically on hold or ready to lower rates if necessary, the yield should stay in a trading range. I seem to get the bond yield prediction in the right direction every other year and since last year I missed to the upside, this year I'm feeling more confident. I'm going with a wide range of 1.50% to 2.25% depending on what the macro environment entails but most likely around 2.0%. During times of stress, the yield will head towards 1.5%. We recommend a diversified approach of short- to intermediate-term UST and Corporate bonds with a mix of preferred stock, convertibles and high yield to add yield.

EQUITIES

The last decade was a great one for equities with the annual return at 13.6% compared to the long-term average of 10.4%. We all look at 2019 as a banner year for stocks with the S&P returning 31.2%. Yes, it was, but let's not forget the pain we endured in Q4 of 2018. **I don't mean to throw shade on 2019, but if you go back to the peak reached in 2018 by the S&P 500 on September 18th of 2,931 the S&P returned 10.2% in the following 15 months**. That pain mentioned earlier was a 19.8% drop from that peak to the valley reached on Christmas eve 2018**.** Now suddenly that period looks like a normal return for the market right in-line with the 2-yr, 5-yr and 10-yr average market return. I bring this up because when people talk about the 31% full-year return and stocks getting ahead of themselves, you need to put it in context. Below is a chart of the long-term averages vs the current period. Interestingly the last 10 years have been great, but the last 20 are well below average after factoring in the great recession (and 9/11).



If you go back to the beginning of 2018, the last 2-year annualized return of 12.1% is not too far above the long-term average 2-yr return. On a valuation basis, we did see the forward 12-mo PE multiple of 18.3x for the S&P expand from a depressed 14.1x at the start of the year. But it is basically at the same level where it started 2018 and after a year of no growth in earnings in 2019, 2020 should see an acceleration of earnings growth of 6-10% each quarter.

I hate to mix politics with investing but in this election year we need to address the issue before I give the Forza forecast for equities. As an investor I try to put my political preferences aside to determine which party or candidate(s) would be market friendly. First, love him or hate him , Donald Trump is market friendly. The biggest risk for stocks would be one of the socialist-leaning candidates (Sanders or Warren) becoming President. Also, all of the Democrats have pledged to undo the 2017 tax reform act. This would cause a major earnings hit as companies would be forced to pay higher taxes again. This becomes an issue in 2021 and beyond, but markets tend to shoot first ask questions later.

Our base case for 2020 is sort of an as-is scenario politically (or a Moderate Democrat), economic GDP growth around 2.3-2.5% and that stocks return earnings growth plus the dividend or around 10%. Corporate earnings comparisons are easy vs 2019. That would get the S&P 500 to about 3500. Our upside case is that the economy and earnings grow a little faster, we get progress towards a phase-2 China deal and a Trump re-election. That scenario gets us to 12%-15% return and the S&P near 3700. Our downside case is predicated on a slowing economy, Congress sitting on its hands again until after the election and a new president who is not as market friendly or Trump with a Democrat Senate and Congress. Here I see the market floundering as we reach midyear until post the election where we could see selling leading to a down year. No matter the scenario, it won't be a straight line and we could see a return of volatility with at least a 5-10% correction somewhere based on all the rhetoric. We also believe that stock picking will be key and could add to returns by selectively owning above average growth companies.

OUTLOOK & SUMMARY

Framing the year ahead let's summarize our base case scenario:

- Economic growth to be similar to 2019 around 2.3% % to 2.5%, above trend. Jobs growth remains solid and inflation is at the Fed's preferred level of around 2%.
- Corporate earnings growth returns from a slightly down 2019 to about 6-9% in 2020
- Equity returns in line with earnings growth on a base case scenario plus dividends. Bonds flattish and returning their coupon and a little more.
- The Fed is on standby and no rate moves expected but likely to still provide financial market liquidity as are worldwide central banks.
- The election dominates news coverage and should increase volatility.

Some of the other worldwide factors that may impact markets:

- Global economic growth is still slow but improving a bit.
- Trade outlook improving with USMC approved and China trade deal helping growth there
- Mideast tensions in Iran and elsewhere. (But then again, there always are somewhere in the Mideast.)
- Brexit still need to resolve and other geopolitical events may occur
- Have stocks already priced in a lot of the good news?

In summary, Forza's recommendations for 2020 as follows:

1. We still prefer equities and are neutral on bonds but would maintain both in the overall allocation of assets for balanced portfolios. We are looking for stocks to return in the 10% range in a most-likely scenario. But expect a volatile and bumpy ride. It will not be a straight line up.
2. We will see ups and downs including another possible 5-10% correction during the year.
3. We continue to overweight US stocks and underweight International. We still believe in the show-me theory -- stay with what works until proven otherwise. International is a good hedge against our downside scenario.
4. We are neutral on bonds as the Fed should stay pat on rates. We see bonds return 2%-5% in a flat rate scenario but adding stability to a balanced portfolio.

We are entering the January corporate earnings season. Let's see if we get some decent outlooks to start the year off strong. Have a great 2020 (and decade) and feel free to call or email.

Bob