2019 IN REVIEW AND 2020 OUTLOOK
WE BOUGHT A NEW WARDROBE, AND IT FEELS GOOD

<u>Chart I</u>
S&P 500 2015 to Present

Source: Strategas

If 2019 taught anything important to investors at all, it would be "don't try to time this market!" Coming off a huge decline in the fourth quarter of 2018, due in large part to a view that the Federal Reserve was initiating rate hikes, the U.S. equity markets made a strong U-turn in the first quarter of 2019. When the year ended, the market had returned more than 31% (Chart I). Perhaps more surprising is that nothing uniquely good occurred to generate the aforementioned returns. The market return can be attributed to:

- Strong corporate profit growth of +10%
- Reduced tensions between the U.S. and China
- Steady interest rates with a downward bias
- Valuations moving upward as the year ended versus moving downward

What strikes us as very odd is that despite the run up in equity prices and valuations, almost every strategist and portfolio manager remains bullish for 2020. This is a huge change from prior years when many forecasts predicted problems ahead.

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Like many of us that try to lose weight through dieting, we reach a point where we can't lose any more weight and give up. We end up buying a new "expanded" wardrobe and instantly feel better with our more comfortable clothes.

We think the same trends are at play in this current market. It has been ten years since the last bear market and financial crisis. Throughout most of those ten years, economists and strategists were concerned that the U.S. economy was only growing at about 2% versus the long-term historical norm of 3–3.5%. The concerns also occurred during a period when U.S. debt continued to rise. Only the FOMC "easy monetary policy" coupled with low rates globally was helping stave off future economic problems.

Now, lingering concerns about the equity market seem to have disappeared. It seems the market has finally purchased a new more comfortable wardrobe. Currently, most economists and strategists are complacent with the consensus projected 2% GDP growth despite a slowdown in corporate profits and an expanded valuation.

Chart II

Average Inflation, Treasury Yields, Valuation, Tax Rates & Nominal GDP by Decade

		CPI Y/Y % Change	S&P 500 Operating P/E	10 Year Treasury Yield	Dividend Tax Rate	Capital Gains Tax Rate	Nominal GDP
1950	1950s	2.1%	12.6	3.0%	91.0%	25.0%	7.1%
1960	1960s	2.3%	18.1	4.7%	80.3%	25.4%	7.0%
1970	1970s	7.1%	12.5	7.5%	70.2%	36.0%	10.2%
1980	1980s	5.6%	11.7	10.6%	48.4%	23.6%	7.8%
1990	1990s	3.0%	19.5	6.7%	37.0%	26.0%	5.6%
2000	2000s	2.6%	20.1	4.5%	23.4%	16.8%	4.0%
2010	2010s	1.8%	17.7	2.4%	20.0%	20.0%	4.1%
	Average	**3.5%**	**16.X**	**5.6%**	**52.9%**	**24.7%**	**6.6%**
	Current	**2.3%**	**20.4X**	**1.9%**	**23.8%**	**23.8%**	**3.8%**

Source: Strategas

Despite current P/E valuations on the higher end of "normal" (Chart II), investors seemingly feel good about the outlook for the market in 2020. When valuations expand, it is usually a sign that investors no longer fear rising interest rates, an overheated economy or geopolitical risks. We find ourselves entering 2020 with a comfortable outlook. The economic trends of the past, which we were uncomfortable with in 2019, now seem acceptable.

The expectation of "only" 2% GDP growth is no longer a concern. Fed policy is also clearly signaling further cuts if needed. Tariff wars are beginning to recede. As a result, consensus viewpoints suggest another up-year in the stock market. Indeed, history is on our side. The equity market has gone up every year preceding a presidential election since 1947.

Additionally, the U.S. stock market has only decreased three times in the year following a +20% year. In fact, the average return since 1950 has been around 11% (Chart III).

Chart III

S&P 500 Performance Following +20% Year

Year	Annual Performance	Next Quarter's Performance	Next Year's Performance
1950	21.7%	5.1%	16.3%
1954	45.0%	1.7%	26.4%
1955	26.4%	6.6%	2.6%
1958	38.1%	0.4%	8.5%
1961	23.1%	-2.8%	-11.8%
1967	20.1%	-6.5%	7.7%
1975	31.5%	13.9%	19.1%
1980	25.8%	0.2%	-9.7%
1985	26.3%	13.1%	14.6%
1989	27.3%	-3.8%	-6.6%
1991	26.3%	-3.2%	4.5%
1995	34.1%	4.8%	20.3%
1996	20.3%	2.2%	31.0%
1997	31.0%	13.5%	26.7%
1998	26.7%	4.6%	19.5%
2003	26.4%	1.3%	9.0%
2009	23.5%	4.9%	12.8%
2013	29.6%	1.3%	11.4%
2019	25.5%	?	?
	Average	3.2%	11.2%
	% Positive	77.8%	83.3%
	Historical Average	2.4%	8.9%
	Historical % Positive	63.8%	71.0%

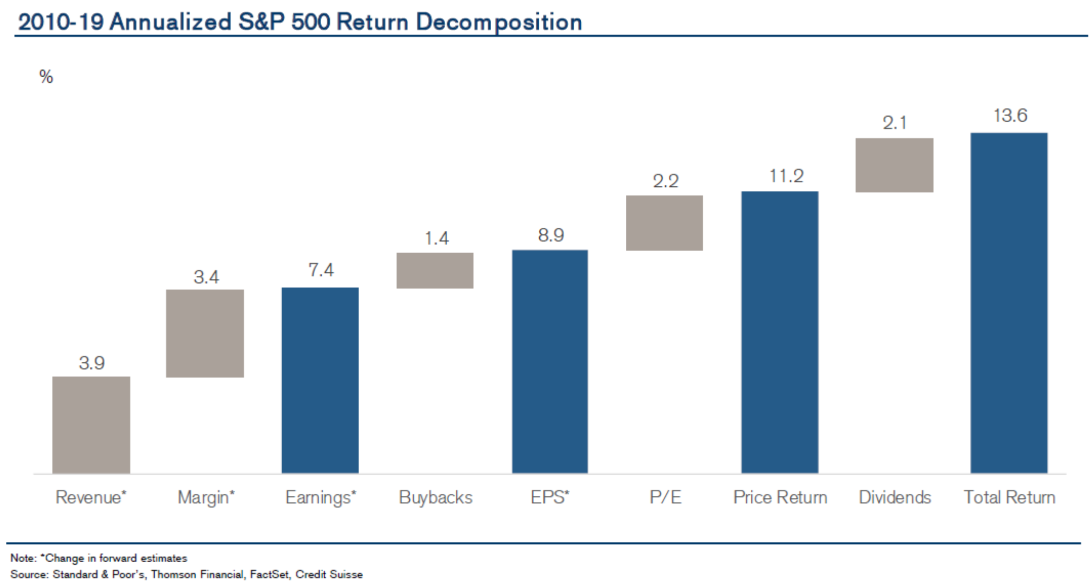
Source: Strategas

Given the expectation of 2% GDP growth, benign inflation, well-controlled interest rates and modest-to-moderate corporate profit growth, the U.S. equity market should rise 5–10% in 2020. We suspect it may well be more volatile than 2019, but at this juncture our current forecast looks achievable.

A LOOK DOWN MEMORY LANE – THE FUTURE MAY NOT BE AS BRIGHT

The next ten years should not be as good as the last ten years.

Chart IV



The annualized total return for the stock market for the 10 years, 2010–2019, was an impressive 13.6%. Earnings growth averaged 7.4%, EPS adjusted for stock repurchase was 8.9% and P/E expansion added another 2.2% to total return (Chart IV). Add in 2.1% in dividend yield, we get 13.6%.

The next ten years are unlikely to be as good. We doubt that P/E expansion will add another two points and, in fact, could decline if corporate profit margin expansion slows. We also doubt that revenue growth is likely to average 3.9% again this decade. Most importantly, the last ten years did not see a recession. The likelihood of a recession in the next ten years is probable (we are at full employment, historically low 10-year government yields and currently higher than average P/E ratio for the market). More likely, the market total return for the foreseeable future should be closer to 6–8%, which would be within historical norms. We suspect that 2020 may well be slightly above or below that historical return.

THEMATIC INVESTING FOR 2020

We have structured our overall portfolios to reflect broad based long-term thematic trends. We not only utilize our fundamental disciplines, such as ROIC, free cash flow, category dominance, margin expansion and other fundamental factors, but also place each into the context of thematic trends for investments.

We believe that the U.S. and the global economy is going through a technological shift as profound as the industrial revolution which occurred at the beginning of the 1900s. This shift is impacting employment, income growth, lifestyle changes and other factors, which we believe are still in the early stages of changing the economy. In just over 20 years, traditional retail has crumbled, only to be replaced by new innovative distribution and product selection. Traditional media has been dismantled to be replaced by streaming and, more importantly, expanded viewing on numerous devices. Centralized administration has moved from local storage to the cloud.

We see compelling changes continuing to emerge in banking, social lifestyles, energy consumption and healthcare, just to name a few significant industries. The emergence of 5G Internet speeds are likely to usher in even more disruption to existing norms in the next ten years. Lastly, we are in the earliest of stages in identifying AI (artificial intelligence) opportunities and the importance it may have in the future. While many of these broad themes are long term, we believe that identifying and investing in the likely winners makes logical sense.

One of our earliest themes has been "all things digital." This has led to many of our current investments. For example, we wanted to be invested in all the global hyperscalers. These companies control the backbone of the Internet. There are only four: Amazon, Alibaba, Google and Microsoft. Within the financial industry, our investments in PayPal, Global Payments and, to a lesser extent, Accenture are good examples of leaders in this rapidly growing area.

More recently, we have embarked on uncovering investments in the emerging alternative energy space. These companies meet the core fundamental requirements we seek. They are critical to the rapid growth of the industry. They are profitable and are free cash flow positive. They generate a ROIC above their cost of capital. Our initial investment was in a solar and wind focused utility; NextEra Energy. More recently, we added Generac Holdings, the largest back-up generator and storage battery company in the U.S. We expect to add a few more companies in this broad investment theme in the coming months and years.

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KINGS POINT IS GROWING

We are happy to announce that we have added two more employees to our growing staff. Megan Morin joined our Nashville office in the fourth quarter as a Reporting Analyst working with Hadley Doolittle. In January the New York office added Crystal Cohen, who is working directly with our Great Neck investment advisor group of Jake Marshall, Ken Lynn and Andres Fernandez.

As always, we request that each client provide us with written notice about any changes to their investment needs, goals, objectives, risk tolerances or investment restrictions to our advisory team. Should you have any questions, please contact us at your earliest convenience.

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