# Bangor Wealth Management

A Division of Bangor Savings Bank



## Key Points for Q4 and 2019

- Amid rising international trade tensions and apparent economic headwinds, the Fed cut short term interest rates three times in 2019 in a bid to safeguard the economic expansion.
- Despite weakness in manufacturing at home and abroad, the U.S. economy stayed on solid footing. It grew at 2.4% through the first three quarters, supported by strong consumer consumption.
- Not only did stock investors enjoy a 32% return from the S&P 500, but most other major asset classes also delivered strong returns, despite a barrage of negative headlines.
- S&P 500 corporate earnings were flat for the first three quarters of 2019 and are expected to decline 1.5% in the final quarter.
- The U.S. and China took steps toward inking phase one of a trade deal, although much remains to be negotiated in future agreements.

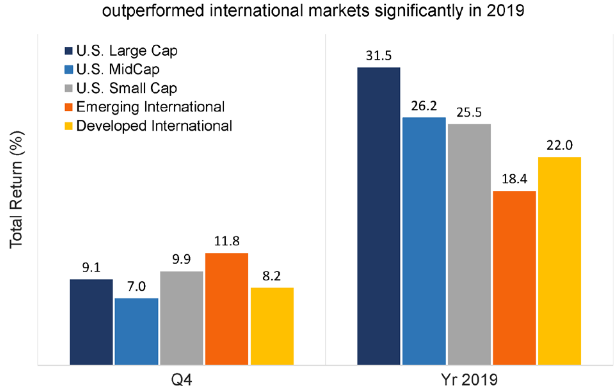
## Stock Market Review

2019 was quite a contrast to 2018. After a year in which most investors lost money, 2019 rewarded investors in almost every asset class. The S&P 500 rose 31.5% for the full year, the best showing since 2013, and the second-best calendar year in 22 years. It is even more remarkable given the length of both the economic expansion and the bull market in stocks.

Other major U.S. stock indexes also produced strong returns, but it was large-cap U.S. stock that topped the list. The S&P 500 index outperformed small-cap stocks materially as investors favored more established companies to weather geopolitical and economic headwinds.

Outside the US, global stocks moved higher following easing from the European Central Bank and a cease fire in the trade war. Both the MSCI EAFE index and the MSCI Emerging Market index had a strong fourth quarter, although they lagged the U.S. market for the full year (Fig 1.)

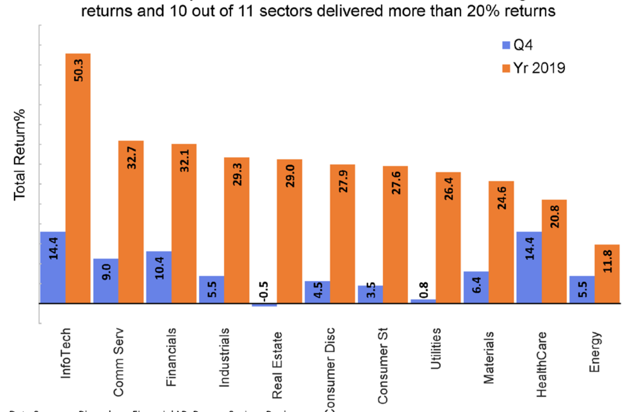
Fig 1. Domestic and international stock markets rallied strongly in Q4 amid easing trade tensions. The U.S. stock market outperformed international markets significantly in 2019




Data Sources: Bloomberg Financial LP, Bangor Savings Bank

Led by the mega-cap dominated information technology sector, ten out of 11 S&P sectors returned more than 20%. The worst performer, energy, still produced double-digit gains. In comparison, no sector in 2018 returned 10% or more (Fig 2.)

Fig 2. Tech and health care sectors led the stock market rally in Q4. For the year 2019, all S&P 500 sectors had double digit returns and 10 out of 11 sectors delivered more than 20% returns




Data Sources: Bloomberg Financial LP, Bangor Savings Bank

## Bond Market Review

Perhaps the biggest surprise of 2019 was the strong returns from bonds. In the first three quarters, escalating trade tension and a dramatic slowdown in global trade saw yields steadily fall. The yield curve briefly inverted at the end of August as the 10-year U.S. Treasury yield dipped below the 2-year yield (Table 1.)

At this point the Federal Reserve initiated the third rate cut of 2019. They also began adding liquidity into the banking system, smoothing the overnight funding market. The ten year U.S. Treasury yield steadily rose along with the equity market.

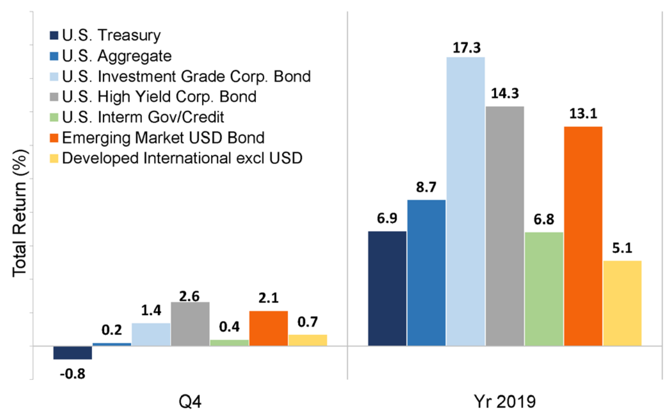
**Table 1. Interest rates declined significantly from a year ago after three rate cuts by the Fed, but longer maturity bond yields started to rise in Q4**

| | 12/31/18 | 09/30/19 | 12/31/19 | Rate Chg from 2018 | Rate Chg from Q3 |
|---|---|---|---|---|---|
| Fed Funds Rate | 2.40 | 1.90 | 1.55 | -0.85 | -0.35 |
| 2-Yr Yield | 2.49 | 1.62 | 1.57 | -0.92 | -0.05 |
| 3-Yr Yield | 2.46 | 1.56 | 1.61 | -0.85 | 0.05 |
| 5-Yr Yield | 2.51 | 1.54 | 1.69 | -0.82 | 0.15 |
| 10-Yr Yield | 2.68 | 1.66 | 1.92 | -0.77 | 0.25 |
| 30-Yr Yield | 3.01 | 2.11 | 2.39 | -0.62 | 0.28 |

Data source: Bloomberg LP; Bangor Savings Bank

Both investment-grade and the high yield corporate credit market saw increased demand, pushing spreads to near historic lows. As a result, investment grade and high yield corporate bonds had some of the best full-year returns in fixed income markets: 17% and 14%, respectively (Fig 3).

Fig 3. Led by investment grade credit, all bond markets rallied strongly last year primarily driven by sychronized monetary easing policies from the major central banks



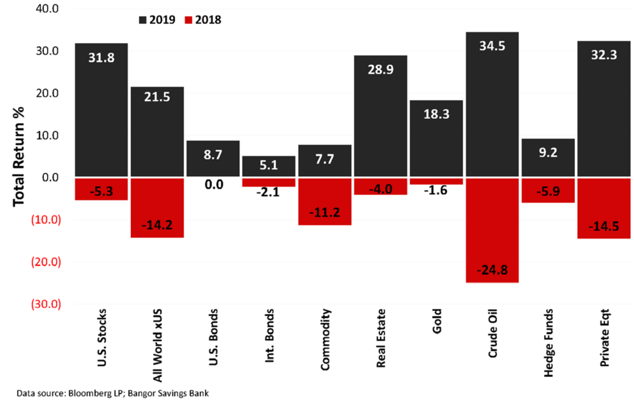

Data Sources: Bloomberg Financial LP, Bangor Savings Bank

## 2020 Outlook

On the heels of the rout in stocks at the end of 2018, 2019 began with broad concerns about the market. Heightened international trade tensions and decelerating corporate profit growth lent credence to the notion that it would be single-digit returns for investors at best. Fast forward, and it turns out that expectations for fundamentals in 2019 were reasonably accurate. But despite a trade war with China, lower corporate profits, and a slowing global economy, financial assets of all types delivered well above average returns (Fig 4.)

We believe the overriding difference is central bank intervention. Remember, in 2018, the Federal Reserve was removing stimulus, and while in 2019, they reversed course and lowered rates three times, followed by ongoing liquidity injections for the overnight markets.

Fig 4. In startling contrast to 2018, all the major asset classes across the risk spectrum produced strong positive returns in 2019




Data source: Bloomberg LP; Bangor Savings Bank

As we look forward to 2020, a return to tighter monetary policy clearly would be a major risk to markets. However, this seems a low probability event given current economic metrics and the Federal Reserve's communications on the subject.

With the increase in price for stocks last year against a flat corporate profits backdrop, valuations have risen. By some metrics, valuations are extremely high at the moment. As of today, S&P 500 earnings expectations for 2020 are for 10% growth. It will be crucial for companies to deliver on expectations to justify higher prices. While the majority of S&P 500 earnings are generated within the U.S., more than a third comes from overseas. With many economists predicting stronger global growth, this could provide a slight boost to earnings over 2019.

Trade and geopolitical risk will likely continue to be a significant factor in 2020. While the U.S. and China have made the first steps toward a trade resolution, it has been a slow process thus far, and a significant amount of trade between the U.S. and China is still subject to tariffs. Perhaps the best part of the current state of affairs is that tensions have not escalated further, and both sides have made concessions.

Last but not least, it is an election year. As news from the pollsters ebb and flow, expect the markets to do the same.

Nobel laureate Paul Samuelson said: "Investing should be like watching paint dry or grass grow. If you want excitement, go to Las Vegas." If you feel that your portfolio might be more exciting than necessary or if you have questions, please contact your Relationship Manager or Portfolio Manager.