GOLDILOCKS

This past year was one of the best years in history for the stock market. The S&P 500 return was up 31.49% for the year; the Dow was up 25.34% and the Nasdaq was up 36.69%. In the 4th quarter the S&P 500 increased by 9.07%. All of the news was good. The Trump administration reached a "Phase One" agreement with China, unemployment remained low at 3.5%, wages were rising especially in low income jobs, the Fed let everyone know they were on pause but ready to lower interest rates again if necessary, rates further out in the yield curve remained low, consumers spent more during the holiday season than they did in 2018, there is plenty of liquidity in the system, surveys showed that investors are optimistic about the economy, and CEOs are optimistic. It could not get any better.

The most likely things that can derail the markets are a rise in inflation, a rise in interest rates, the presidential election or a geo-political event.

FactSet

FactSet Earnings Insight publishes its predictions based on what Wall Street analysts are estimating for the economy, revenue growth and earnings growth for the S&P 500. Please see the table below:

Quarter	Current Economy's Growth Estimate	Current Revenue Growth Estimate
4th Qtr 2019	(2.0%)	2.6%
CY 2019	.02%	3.9%
1st Qtr 2020	4.6%	4.3%
2nd Qtr 2020	6.4%	4.9%
CY 2020	9.4%	5.4%

The forward 12-month P/E Ratio is 18.4X.

As you can see Wall Street analysts are expecting a pickup in earnings growth in 2020. Earnings growth in 2019 was flat but the stock market went up 30% and the P/E Ratio of the S&P 500 expanded to 26.0X. The market went up in anticipation of revenue and earnings growth this year.

Abby Joseph Cohen
Goldman Sachs Advisory Director&
Senior Investment Strategist

Ms. Cohen appeared on Bloomberg TV over the weekend of January 4-5, 2020 and made the following excellent points:

- With a forward P/E Ratio for the S&P 500 of 18X, no recession, and profit growth is priced into the market. There is no margin of error going forward.
- Interest rates are historically low managed by central banks around the world including the U.S.
- There is compression in yield from low quality bonds to high quality. (The spread between the yields.)

- Fed has historically fought inflation and now is fighting deflation.
- U.S. interest rates are being held down in part because interest rates are negative in other countries.
- Yields are lower than they would be because of negative rates in other countries.
- In the “financial crisis” it was assumed that rates would be low for a short period of time. They continue to be low causing savings rates to go up and without stimulating the economy overall.
- The Fed would like to have real rates positive but is limited by the tools it has to do this.
- The other issues causing low rates are:
  - Globalization bringing wages low
  - Population growth is low in Japan, China and Europe
  - The U.S. population is higher but not as high as it has been in the past due to a lower birth rates and higher death rates
  - The U.S. is better off because of immigration

Immigration

- The U.S. has the highest population growth compared to Japan, China and Europe because one half of our population growth is due to immigration.
- Immigration is the life blood of any nation’s economic growth.
- In the U.S. 40-50% of doctorates in STEM (Science, Technology, Engineering, Mathematics) are immigrants. Sixty percent of college students in STEM are immigrants.
- These immigrants are not taking jobs away from others because the demand is so high.
- Since 2015 there has been a decline in foreign students in the U.S. and a 20% decline in immigrants coming to the U.S. for jobs. High paying jobs are in STEM and low paying jobs are in services.

Hoisington

The following commentary is from the Hoisington Investment Management Company “Quarterly Review and Outlook Fourth Quarter 2019”:

> **Treasury Bond Fundamentals**
>
> The yield on the thirty-year Treasury bond declined from 3.02% at the end of 2018, to 2.39% on December 31, 2019. This was the lowest yearly close on the thirty-year bond since its introduction in 1977, and the average yield of long term Treasuries for the year of 2.5% was the second lowest since 1950.
>
> Inflation was once again the driving force as evidenced by the core personal consumption expenditures deflator which dropped from 2% in December of 2018 to 1.6% at the end of 2019.
>
> **Real Rates**
>
> U.S. economic performance in 2019 was substantially below expectations. This was most evident in observing Federal Reserve actions. In December 2018 they increased the federal funds target range from 2.25% to 2.5%, while they simultaneously announced that three more rate hikes would be necessary in 2019. Instead, the year unfolded with three cuts in the target rate as economic activity disappointed. This lower growth and decline in inflation expectations reinforced investor perception that lower real yields were warranted. The decline in U.S. real yields was consistent

with global trends. U.S. economic growth, while disappointing, has exceeded that of other major economic regions.

Lower Growth, Inflation and Interest Rates

Five considerations indicate that inflation, real growth and interest rates will be less in 2020 than in 2019. First, momentum is to the downside since 2019 economic growth was fading as the domestic and global economy prepared to enter the new year. Second, U.S. monetary conditions are still restrictive. Third, the domestic and worldwide debt overhang became even greater in 2019. Fourth, average U.S. economy-wide profits have been flat since 2012. Fifth, excess manufacturing capacity is greater than a year ago, indicating that firms do not having pricing power.

2020

These five factors – loss of momentum, monetary restraint, high debt levels, flat profits and excess capacity – will bring about slower growth and continue to subdue core inflation in 2020. Over the past 65 years, yields on long dated risk-free U.S. treasury securities moved in the same direction as core inflation on an annual basis roughly 80% of the time. We believe that there is a high probability that this relationship will hold in 2020 as inflationary pressures continue to subside.

Other Items

Monroe Vos has been a leader in our industry for more than 25 years. Since our partnership started in 1988 at PaineWebber, we have influenced changes in our industry by focusing on our clients' best interests to lower fees and improve performance. The attached chart shows some of the things we have done for the first time in our industry. Many of them have to do with the Defined Contribution (401(k)/403(b)) marketplace.

For example, at a breakfast in Boston in January 1989, I convinced Peter Smail, EVP of Defined Contribution at Fidelity, to allow Open Architecture for the first time in the history of Fidelity. Before that Fidelity would only allow all Fidelity funds in the 401(k) plans that they were recordkeeping.

In 1989 we gave our clients credit for the revenue sharing we received from mutual funds and applied it against our fee. Clients only paid the difference, and still do.

In 1995 we started returning the Client Allowance (revenue sharing from mutual funds) to our clients which include 401(k)/403(b) plans. Initially the ERISA attorneys for the plans said that it could not be done because it would be a prohibited transaction and disqualify the plan. After discussing it with the Monroe Vos ERISA attorney, they decided it could be done. They initially said no because they had never been asked the question.

In 2002 we required recordkeepers of larger 401(k) plans to charge a dollar-per-participant fee rather than a percentage of assets. All of the recordkeepers told us they had never done that before.

Our argument was they do not make the funds grow, so why would they deserve to benefit from the increase in assets? Contributions from 401(k) participants, the plan sponsor match and the fund managers make the assets grow, not the recordkeeper. This was a major change for the industry.

As the 401(k) plans got larger, the revenue sharing dollars returned to the plan were more than could be used for plan expenses. In 2011 we started requiring recordkeepers to return the excess revenue sharing to the plan participants on an annual basis. Today we require them to do it monthly. This was another first in the industry.

These are just some examples of how we have changed our industry. We continue to create innovative ways to benefit our clients.

Conclusion

The market got ahead of itself in 2019 expecting the economy and corporate earnings to improve in 2020. If they do improve, the P/E Ratio expansion in 2019 will be justified. We expect continued volatility in the market throughout 2020.

Jamison Monroe
Chairman & CEO
Director of Consulting

Monroe Vos has over $5.5 billion under advisement for 100 clients. Recent rankings are as follows:

- The 2nd largest independent registered investment advisor ("RIA") in Texas
- The 8th largest independent RIA in the Southeast
- The 54th largest independent RIA in the United States

As reported by *Financial Advisor* magazine in July 2019

We appreciate your relationship. If you would like more information about what we do at Monroe Vos, please call us. If you know someone else that can use our services, please refer them to us.

Leader in the Industry

MONROE VOS CONSULTING GROUP, INC.

- **1988** Firm established
- **1989** Client Allowance to give credit from mutual fund revenue sharing (finder's fees/12b-1 fees) to pay fees
- **1989** Persuaded Fidelity to allow open architecture in 401(k) fund lineup for the first time
- **1994** Became independent firm.
- **1995** Returned Client Allowance dollars to clients
- **1995** Plan administrator (recordkeeper) request for proposal
- **1995** Investment policy comparison
- **2000** Dynamic asset allocation
- **2002** Fee Analysis
- **2002** Required recordkeeper to charge a dollar per participant fee rather than a percentage of assets
- **2002** Capping of recordkeeping fees and return of excess revenue sharing to the plan
- **2002** Asset Allocation Strategies
- **2004** Full transparency of manager search process
- **2008** Risk Based Retirement Date Strategies™
- **2011** Required recordkeepers to return excess revenue sharing above expenses back to individual participants' accounts