MV FINANCIAL

3 Bethesda Metro Center, Suite 650
Bethesda, MD 20814
301 656 6545, 301 656 2722 fax

January 2020

Dear Donor

Fourth Quarter Review: TINA Wins the Quarter

At first it looked like one of those Octobers with more tricks than treats, as the S&P 500 stumbled in its first few trading days of the quarter. But the uncertainty lasted less than a week, and what followed was one of those storied year-end holiday rallies to propel US equity indexes to their best performances in more than two decades. The tech sector – everyone's favorite go-to destination when the animal spirits kick into high gear – booked a total return of more than 50 percent for the full year. Not bad given that just one quarter earlier the conventional wisdom seemed to have talked itself into the near-certainty of a looming recession. For now, that recession appears to have...well, recessed into the fog of low-probability events.

What caused the change of heart? There was not much in the way of new news. The Fed did nothing dramatic other than to pronounce itself satisfied with the progress of economic growth. Headline macro numbers underscored that confidence with basically the same story we've been hearing for most of the decade: slow real growth, strong labor market, subdued inflation. The return to favor by risk asset markets mostly boiled down to one thing: the evident diminishing of hostilities in the US-China trade war. Again – there was nothing new here. The so-called trade war has been stalled out between long stretches of inaction and periodic spasms of strident rhetoric for the better part of the past year. Its impact on global growth – past, present or future – is debatable. But investors were in a forgiving mood. All it took was a handful of vague references to a "Phase One" deal (which effectively pushed all the really tough issues between the US and China back into a much foggier and ill-defined "Phase Two" formulation) to unleash the bulls. And out they went.

The glass-half-full approach also applied to corporate earnings. These have not been particularly impressive. The growth rate for S&P 500 companies was negative for the third quarter (i.e. the quarter for which companies reported last fall) and projected to be flat for the full year. But "could have been worse" seems to be the response garnering the most likes by market participants. In fact, "could have been worse, so let's keep buying" has been a persistent theme of this bull market and it comes down to the basic fact of TINA – There Is No Alternative. Central banks' monetary policy has effectively pushed major institutional investors like pension funds and insurance companies out of the safe fixed income markets that are their normal habitat, and into equities. But only up to a point: blue chip equities, preferably ones with generous dividend payouts or a proclivity to buy back shares. That, in turn, explains why blue chip indexes like the S&P 500 routinely outperform every other risk asset class, year in and year out. Even highly risk-averse investors need to earn positive real returns. TINA won the quarter.

First Quarter Outlook: Noise, and Stretched Valuations

2020 has the potential to be a very noisy year. By "noisy" we mean a preponderance of political and geopolitical stories that may have a deeply lasting effect on how we will be living on this planet for many years to come. But "noisy" does not necessarily mean "meaningful for the market." As we noted above: money has to go somewhere, at least until or unless a clear and present threat becomes too obvious to ignore. Neither contentious domestic political controversies here at home nor geopolitical flashpoints in the Middle East or the South China Sea or wherever are likely to rise to that level of clear and present danger. There may well be short-term reactions to specific events. A vast amount of the short term money in the market is algorithm-driven and speculative. Mostly the directions of travel for these algorithms cancel each other out, like waves buffeted by tradewinds at the Cape of Good Hope. Sometimes they all move in the same direction and become something larger. But, except in the case of a very rare tsunami, they eventually dissipate.

So the good news, such as it is, is that asset markets may well be calmer in 2020 than the daily news headlines would have you believe. But there are risks. The first of these is that equity valuations are currently very stretched. Most of the market gains in 2019 came from price appreciation, while underlying earnings lagged. There will have to be a marked improvement in earnings this year if indexes are to avoid stretching into real bubble territory. It is by no means clear that global economic conditions are favorable enough to provide a tailwind for double-digit earnings growth.

The second major risk, as we see it, involves the limits of central bank powers to fight any emergent threats with their firehoses of easy money. The assumption firmly baked into investor logic is that the central banks are there as a last resort to do whatever it takes to keep asset prices from going down. That logic has worked splendidly for the duration of the economic recovery since 2009. Does it have a limit? Investors are hoping they won't find out the answer in 2020.

With warm regards,

Masood Vojdani

www.mvfinancial.com

MV Financial Group, Inc. I MV Capital Management, Inc.
Investment Advisory Services offered through MV Capital Management, Inc., a Registered Investment Advisor.
MV Financial Group, Inc. and MV Capital Management, Inc. are independently owned and operated.

MVCM 2020 0003
DOFU: Jan 2020