CARLTON | HOFFERKAMP & JENKS
WEALTH MANAGEMENT

For further information,
direct inquiries to John Sinitiere at
john@chjwealthmanagement.com.

WEB ADDRESS
www.chjwealthmanagement.com

PHONE
(281) 298-2700
(877) 824-4299

MAILING ADDRESS
10200 Grogan's Mill Road, Suite 340
The Woodlands, TX 77380

January 2020

1st QUARTER OUTLOOK

Mirror Image

Wow! What a year 2019 was for the markets. Despite some economic challenges, continuous worries about trade wars and tariffs, and extreme political theater which concluded with impeachment of the President in the House of Representatives, stocks erased all the losses from the 4th quarter of 2018 and forged ahead to new all-time highs. Talk about climbing a "wall of worry". After the amazing surge in stock prices in the first four months of the year, things did hit a slight bump in the road in late Spring. Trade talks were seemingly breaking down and the bears pounced, thus producing about a 7% pullback in the S&P 500. Interestingly, this mere slight disruption in stocks produced amazing misbehavior by investors, as net liquidations of U. S. equity mutual funds soared to levels not seen since the panicky days of 2008. This simply illustrated the continuous mistrust of the stock market we have seen over the past 10 years, and effectively added a few more bricks to the wall of worry that market participants were soon to scale for the remainder of 2019.

With regards to the economy and the stock market, 2019 was just the opposite of 2018. We had terrific earnings growth in 2018 as well as the best economic data we had seen in some time. Market participants rewarded that stellar performance with a nearly 20% bear market in the 4th quarter of 2018 and a down year for stocks in general.

2019 was really just the opposite. Though employment numbers held up rather well, economic data as represented by business investment and manufacturing, weakened. Perhaps having already experienced the benefits from corporate tax cuts in 2018, corporate earnings slumped in 2019. How did the stock market reward the economy's less than stellar performance in 2019? Well, as you already know stocks had a remarkably good year.

Stocks

As mentioned, despite flattening corporate earnings, share prices rose to all-time highs in 2019. The phenomenon of rising share prices despite weakening earnings is known as price to earnings, or P/E multiple expansion. The S&P 500 was trading near 14 times earnings as we entered 2019, and by the time we exited, the S&P was trading at more than 18 times earnings. So, despite the fact that earnings were softening, stock prices rose dramatically.

"The phenomenon of rising share prices despite weakening earnings is known as price to earnings, or P/E multiple expansion."

So, we came into 2019 with stocks at bargain prices, then exited 2019 with stocks slightly expensive. If we can get corporate earnings back on track, and analysts are predicting that earnings will indeed show single digit growth this year, then rising earnings, low inflation and continuously low interest rates can be supportive of stock prices. Even if stocks are not "cheap" at the moment, they could still enjoy a good year in 2020 given a stable economy, slightly growing earnings, low inflation and low interest rates.

Of course, in the back half of 2020 we will be dealing with an election. Trying to handicap that too early might be detrimental to your investment success, but come summertime the possibilities will be presenting themselves and investors are going to have to navigate what will likely be a lively political season.

We always caution folks not to let political bias interfere with your investment plan. The stock market has performed well during both Democrat and Republican administrations. Of course, both parties have experienced difficult markets as well. So, when we get to the second half of 2020, we will be monitoring and assessing the political landscape, but we will do so knowing that knee jerk reactions to political events is not an investment process.

The Economy and The Fed

We enter 2020 with the U. S. economy in pretty good shape. The employment picture is sound. It appears that if you want a job, you can find one. Now, it might not be your dream job, but my guess is that about 99% of Americans aren't exactly in their dream job. So, yes the system isn't perfect, but for as long as we have been measuring these things, the availability of jobs is about as good as it has ever been in this country.

As mentioned, not everyone is able to find their dream job, and wages, though rising year over year at about a 3% pace, have not exactly accelerated as workers would have liked. But, on the flip side the somewhat modest increase in wages has been a component of keeping inflation at bay. So, though their wages may not be rising as much as workers would like, their cost of living has also not risen at a penalizing rate.

One major economic concern entering 2020 is the weakness that we have seen in the manufacturing sector. Boeing's cutbacks in plane production is surely going to add to that weakness, so it will once again be up to the service sector to carry the water for the economy in 2020. Remember, the consumer drives about 70% of economic activity or GDP in the U. S., and for many quarters now the consumer has been able to deliver positive growth. Looking into 2020, the consumer, helped by jobs strength, rising wages, and low inflation continues to look healthy. Of course, at some point one worries that the consumer might get tapped out, so a little recovery in the manufacturing sector would be welcome in the second half of 2020.

Globally, it appears that economic conditions are improving. Though still prevalent, the proliferation of negative interest rates worldwide seems to be lessening. Interest rate moderation is signaling that economic improvement, though modest, is occurring in developed countries in Europe and Asia. That slight moderation in interest rates may begin to stem the flow of capital to U. S. Fixed income instruments, which could in turn ease the rising pricing pressure on U. S.

government debt and allow interest rates to rise a bit on the longer end of the curve, thus avoiding the dreaded inverted yield curve that spooked markets last year.

It would appear that the Fed will be on hold most of 2020 with regards to interest rates. Sure, there could be surprises, such as we have just seen with the whole Iranian tensions of the past week, any of which could alter the course of the economy. But, as we see things now the Fed seems to have made the “mid-cycle” adjustments that they felt were necessary, and are likely to keep interest rates where they are for now. It would likely take an economic shock for the Fed to consider lowering interest rates from here, and it would take a surprising spike in inflation to make the Fed begin to tighten (raise rates) once more.

“as we see things now the Fed seems to have made the “mid-cycle” adjustments that they felt were necessary, and are likely to keep interest rates where they are for now.”

Summary

After a dismal 4th quarter in 2018, the stock market surged in 2019, erasing those previous year losses and reaching all-time highs for the market averages. The stock market advance in 2020 was a classic example of P/E multiple expansion. Though earnings flattened, stock prices continued to rise. That P/E expansion has taken us from an undervalued to, what might be considered a slightly overvalued market, in a period of 12 months. Thus, it will be important for corporate earnings to get back on a positive track if we are to justify further price gains for stocks in 2020.

The Fed should continue to be a wind at the back of stock investors, as should modest economic growth and low interest rates. But, an inflationary surprise, or a disappointing year for corporate earnings, not to mention political or global stresses, could make 2020 more challenging.

2020 is likely to be a year with many twists and turns. Investors are going to be continuously challenged by headlines and overnight current events. We’ll be here to guide you through all the noise and commotion that a charged political season is sure to provide.

Finally

We always want to remember that a successful investment foundation is built upon a goal-focused, planning-driven process, and not headline/noise driven distractions. Simply put, long-term investment success comes from continuously *acting* on your plan, while investment failure comes from continually *reacting* to current events in the economy and the markets.

Indeed, we are long-term investors working steadily towards the achievement of our most cherished lifetime goals. Making bold forecasts or reacting to headlines only tends to distract us from our mission.

Since 1945 there have been about 15 “bear markets” in stocks. That means that we were likely to experience a bear market about every 5 years or so since the end of World War II. But, as the war concluded the broad market average, which today is represented by the S&P 500, was in the very low double digits (about 16) back then. The S&P 500 just closed at 3230 at the end of 2019. Thus, at least historically over the past 75 years or so, permanent advance has triumphed over termporary declines- quite emphatically I might add.

> “long-term investment success comes from continuously *acting* on your plan, while investment failure comes from continually *reacting* to current events in the economy and the markets.”

Your financial success is our goal. The only scorecard we care about is the one that indicates whether we are on track to accomplish those financial goals. Risk should be measured as the probability that we won’t achieve those goals, thus our investment plan should have the exclusive goal of minimizing that risk. That plan is tailored for you, and your wants and desires for your loved ones.

As always, we appreciate that you entrust us to manage your money and guide you on your road to financial success. We strive to keep you informed and to provide you with the best service in the industry. Please don’t hesitate to contact us with any thoughts or questions. If you feel that we can help someone you know and love, who may be going through a life changing event such as divorce, inheritance, selling a business, or retiring soon, be sure to let us know. We would love to help.