CARY STREET PARTNERS
A LUXON FINANCIAL COMPANY

MARKET OUTLOOK

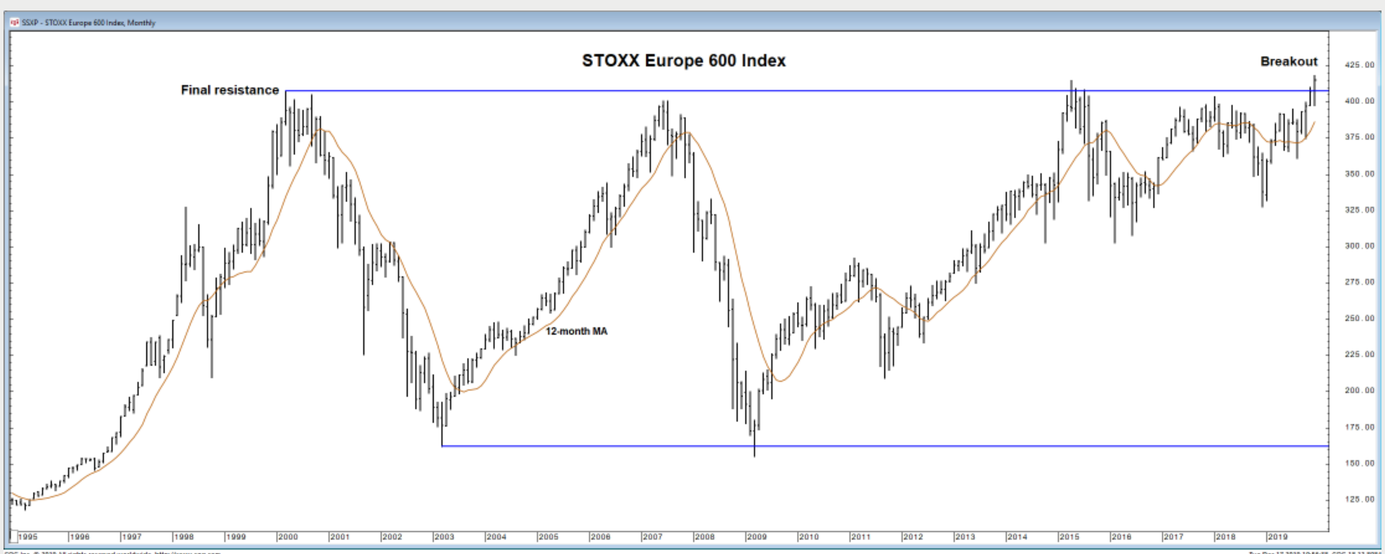
DECEMBER 16, 2019

As we conclude calendar year 2019, keep in mind where we were a year ago. Christmas Eve, 2018 witnessed a market drawdown approaching 20%. With that we established a low bar for the current year—the easiest money always comes off the bottom. But 2019 was undeniably a good year, with global equities exceeding a 25% return as of this writing. Bonds also put in a very good year as rates have fallen all over the world. Even better news is that these strong returns have not brought us to an extreme measure of sentiment—something we follow very closely. The market has climbed yet another wall of worry.

Markets typically follow a year such as the current one with solid performance, which is our base forecast. Based upon momentum, market breadth, and sentiment indicators we have a 3%–5% target return the first half of 2020. A typical follow through year would result in high single to low double digits for the full year return.

We hasten to add that within our full-year return expectations we would expect *two to four pullbacks in excess of 5%*. Among equity choices we find European stocks (which constitute the bulk of non-U.S. equities) and small company stocks especially appealing. We have a high conviction viewpoint for risk averse investors to hold hedged equity strategies, some of which also provide a source of strong current income.

EUROPEAN EQUITIES APPEAR TO BREAK OUT OF 25 YEAR RANGE



Source: http://www.cqg.com; Fairlead Strategies LLC

We are wary in fixed income markets—especially investment-grade corporate paper. The credit quality of this market segment has deteriorated dramatically over the last decade. When credit becomes an issue, we do not want to be holding paper facing a downgrade, particularly when that paper is dropping out of investment grade to a junk rating. That situation creates forced selling—always an ugly affair.

> THE ONLY FUNCTION OF ECONOMIC FORECASTING IS TO MAKE ASTROLOGY LOOK RESPECTABLE.
>
> —John Kenneth Galbraith

2020 ECONOMIC VIEWPOINT

First, our well-established thinking is that macro-economic factors are only one of many inputs into equity market performance. Examples are many and varied (here are two)—Australia has compiled over 25 years of economic expansion without a recession, but has experienced five 20% plus bear markets, with one being over 50%. Conversely, Germany experienced zero percent growth in 2019 yet had equity performance in excess of 25%. Prices move much sooner and faster than fundamentals, economic or otherwise. This is why we tend to focus on technical indicators such as sentiment and market breadth for equity forecasts.

With that said we will make this easy: around 2% is the answer (to all economic questions—real GDP, long-term interest rates, core inflation).

OUR STRONGEST CONVICTION CENTERS ON INTEREST RATES.

THE GIANT MISTAKE OF THE LAST 10 YEARS HAS BEEN TO CONFUSE LONGER-TERM INTEREST RATES WITH THE DEGREE OF FEDERAL RESERVE TIGHTNESS OR LOOSENESS.
There are periods when low interest rates are accompanied by very tight monetary policy—such as the 1930's. And there are periods when very high interest rates are accompanied by irresponsibly loose policy—such as the late 1970's.

GUIDE TO EQUILIBRIUM RATES IS NOMINAL GDP.
Nominal GDP is falling, and will be sub 4% in 2020, perhaps as low as 3.5%. GDP has been, and will continue to be, constrained by demographics. It is very hard to grow GDP with current population growth of one-half of one percent. The economy is literally beginning to run out of workers. Real GDP is estimated by subtracting a 2% inflation estimate from the nominal GDP rate.

IN THAT CONTEXT CURRENT FEDERAL RESERVE MONETARY POLICY IS PROBABLY A LITTLE TIGHT, further constraining nominal GDP growth. In this eventuality, the market rate forecast for the benchmark 10—year Treasury stays below 2%, and at worst re-traces to where it was 12 months ago due to unexpected economic strength (not exactly a bad thing).

CONTINUED LOW RATES ARE ALWAYS AND EVERYWHERE A POSITIVE FOR FINANCIAL ASSETS.