GRANT STREET ASSET MANAGEMENT, INC.

QUARTERLY LETTER

4TH QUARTER 2019

12/31/19

If you scanned the media headlines a bit over a year ago, you would have read: “Are You Ready for the Financial Crisis Of 2019?” (*NY Times*), and “Another Warning That A 2019 Recession Is Coming” (*Forbes*), and so on. In our first quarter 2019 letter, we disagreed with those calling for a recession. Those investors who looked past the dramatic headlines to remain invested through 2019 were handsomely rewarded. Within the U.S., larger companies outperformed smaller ones again, and growth stocks in technology and biotechnology achieved the highest returns by delivering above average earnings growth. Equities posted some of the best returns of the past two decades.

Index	**4Q 2019**	**2019**
S&P 500 (Large Companies)	9.1%	31.5%
S&P 400 (Mid-sized Companies)	7.1%	26.2%
Russell 2000 (Small-sized Companies)	9.9%	25.5%
MSCI EAFE (Europe, Australia & Far East)	8.2%	22.7%
MSCI Emerging Markets	11.9%	18.9%
MSCI ACWI (All Country World Index)	9.0%	26.6%

While fundamental economic and corporate earnings data was supportive of an ongoing climb in equities, we believe markets were driven equally as much by improved investor sentiment influenced by a number of geopolitical developments. First, the Federal Reserve cut interest rates three times in 2019 and committed to remaining “on hold” for the year. An accommodative central bank is historically a reliable catalyst for rising markets in the context of otherwise slowing growth. Second, investors welcomed small steps toward resolving the U.S.-China trade war that has plagued businesses with uncertainty for nearly two years. A Phase One agreement was announced in December and is to be signed on January 15th. Finally, three years after the initial vote for the U.K. to leave the European Union, its exit became all but certain in December when Prime Minister Boris Johnson’s Conservative Party won a majority in an early held election. Expectations are for the U.K. to leave the E.U. by January 31, 2020. The common factor for investors among these seemingly unrelated events is that in each instance, the level of uncertainty for markets was diminished, even if only slightly, allowing optimism to increase.

While stocks had a strong year, bonds also posted respectable returns despite a wild ride for interest rates throughout 2019. The 10-year U.S. Treasury rate began the year at 2.65%, rose in the first quarter to 2.79%, fell steadily throughout the year to a low of 1.45% and recovered to end the year at 1.92%. While those numbers may seem within a tight range, the moves represent a significant swing within interest rates and as a result, bond market returns.

Index	**2019**
Bloomberg Barclays U.S. Aggregate Bond	8.7%
Bloomberg Barclays 1-3 yr. U.S. Treasury	3.6%
U.S. 3-month T-Bills	2.3%
Bloomberg Barclays U.S. Corporate High Yield	14.3%
Bloomberg Barclays Municipal Bond	7.5%
Bloomberg Barclays Municipal 5-year	5.5%

With 2019 in the rear-view mirror, what may lie ahead in 2020? It's important to recognize that there are still a number of geopolitical risks facing investors in 2020:

- President Trump's impeachment in the House of Representatives and the stalled progress of his trial by the Senate is an ongoing overhang for U.S. markets, although investors barely reacted to the news in 2019. Sensitivity may become heightened given the trial's timing relative to the upcoming 2020 presidential election. We are of the opinion that politics should not drive overall investment strategy, but it is realistic to acknowledge that volatility is likely to return to U.S. markets this coming year.
- The U.S.-China trade war is far from resolved, and Phase Two negotiations will likely drag on throughout the year with the unpredictable resolutions investors have become accustomed to.
- The U.K.'s exit from the European Union appears more certain, but the outcome of dozens of trade deals that must now be negotiated during the 2020 transition year will have to be digested by investors.
- The U.S. strike and targeted killing of Iranian Military General Qasem Soleimani has heightened tensions in the Middle East. Iran's counterattack on U.S. military bases in Iran left no casualties, and tensions seem to be easing for now.

Investors looking to economic data may be more encouraged for 2020. The consumer, which drives 2/3 of U.S. GDP growth, has been a bright spot and has offset much of the weakness we have tracked in business confidence and manufacturing. Consumer confidence hit a high in the third quarter of 2018. While it has come down slightly over the past year, it has remained persistently high from a historical perspective. Due to help from low interest rates, debt payments as a percentage of disposable income are at 40-year lows, so household cash flow is manageable. Unemployment is measuring 3.5%, the lowest since 1969, and inflation remains low at 2.0%. On a cautious note, we are monitoring data for weakening hiring trends which may signal businesses beginning to pull back.

Valuations globally are above average, although not historically high. Given U.S. stocks' persistent outperformance over the past six years, it is not surprising that we find more opportunity outside the U.S. moving forward. Price to earnings ratios in the U.S. (S&P 500) are 18.5 times earnings, about 17% higher than the 20-year average. International stocks (All Country World Index ex-U.S.) are trading at 14.2 times, only a 3% premium to the 20-year average and a 78% discount to the U.S. markets. A weak dollar provides tailwind returns for U.S. investors, and while we acknowledge that there are central bank forces in play that may prevent an accelerated weakening of the dollar, we do not foresee many factors that could drive dollar strength. We believe that looking forward five years, international stocks have the potential to outperform U.S. stocks overall, and we maintain our weighting in international strategies.

Within portfolios, we did not make any significant strategy shifts in the fourth quarter. For the year, our changes were primarily within the bond/defensive side of portfolios. We increased duration/maturity and quality so that the defensive section of client portfolios should perform as a true hedge to stocks if we should experience increased volatility in 2020.

A significant piece of retirement legislation was passed in December in the U.S., and we wish to take a moment in this letter to highlight the relevant changes for our clients. The SECURE Act was signed into law on December 20. Here are some of the important changes that we will be discussing with clients in review meetings:

- The age for required minimum distributions (RMDs) from IRAs and corporate plans has been extended to 72 from 70.5. This only applies to those turning 70.5 in the years 2020 and beyond. If you are already taking RMDs, you will be required to continue taking them.
- IRA contributions are now permitted beyond the age of 70.5 if you are working and earning income.
- For non-spouse beneficiaries of IRAs, all inherited funds must be distributed within 10 years. The prior schedule stretched distributions over the lifetime of beneficiaries. This accelerated distribution schedule may have significant tax implications for beneficiaries depending on the size of inherited assets and their personal tax situation. This change only applies to IRA owners who die in 2020 and beyond. If you already have an Inherited IRA, your distribution schedule will not change.
- Parents may now withdraw up to $10,000 penalty free from 529 College Savings Funds to repay student loans.

There are other elements to this plan that relate to small businesses and corporate retirement plans. We will be discussing potential strategies relevant to families in our meetings as a result of these changes. Please reach out with specific questions at any time. We wish you and your family a happy, healthy and prosperous 2020!