4th Quarter 2019

Market Recap
Performance Review
and Near-term Outlook

Market Recap

As we close the chapter on Q4 and 2019, we also close the chapter on a decade rightly considered among the most note-worthy in economic and financial market history. As calendars first turned to 2010, the world's largest economies were undergoing great change. China took the mantel from Japan as the world's second largest economy. India was poised to grab from China the title of world's fastest growing economy. Changing political tides would soon upend generations-long alliances in the E.U. The U.S. and other developed economies were in the infancy of the long, slow grind out from the depths of the great financial crisis.

Despite economic maturity, and an often painful transition from an industrial to a service-based economy, a record shattering, uninterrupted U.S. expansion was just underway. For the decade just ended, the U.S. saw total GDP growth of 46%, and the creation of millions of new jobs, many barely imagined prior. The decade was notable as well for the investment rewards. U.S. stocks, as measured by the Russell 3000 Index — a measure of the largest 3,000 U.S. companies, and a proxy for the complete U.S. stock universe — climbed 252% cumulatively for the 10-year period, an average annualized return of 13.42%.

A Return

To The

Long Game

As we began 2010, so did we began 2019. The world's economies and financial markets were seemingly as fragile as they had been since the decade began. We had just endured a frightening Q4 2018 swing in equity prices, with a nearly 20% correction due to overly aggressive monetary policy, super-power trade wars, global growth scares, and fear of recession. But a sharp market recovery, buoyed by little more than faith in the strength of the U.S. consumer, despite a contraction in the U.S. manufacturing sector, was well underway.

Again, committed investors were well rewarded. Measured by the Russell 3000 Index, during Q4 U.S. stocks climbed 9.10%, for a 2019 annual total return of 31.02%. The information technology sector lead the way, with an annual sector total return of 50.3%. Telecommunication and Financial stocks would finish 2nd and 3rd, both well behind technology, but still besting overall market returns for the year. All sectors, styles, strategies, and company sizes finished comfortably higher.

Following the great financial crisis, both international developed and emerging market economies were much slower to recover. Many major world economies wrongly pursued disastrous austerity plans rather than pursue pro-growth investment strategies. After much slower starts, enduring unnecessarily prolonged economic contractions, and regional shocks such as regime changes, and Brexit fears, international stocks did provide positive outcomes for investors. But in total, both developed and emerging market returns significantly lagged U.S. returns for the decade.

Developed market countries finished the decade higher by a cumulative 73.4%, a 10-year average annualized return of 5.66%. Emerging markets, more sensitive to global effects, finished the decade higher by a cumulative 42.4%, a 10-year average annualized return of 3.60%. For Q4, and all of 2019, international allocations lagged the U.S., but did perform well. Certainly better than the decade long index returns imply.

Performance Review

Within the table below, we present the iShares (by Blackrock) Core Allocation ETF Portfolio Series benchmarks. Lake Jericho provides this information for a relative performance comparison against independent, balanced, globally diversified strategies that are managed to similar risk profiles. As the iShares information is publicly and freely available, this presentation enhances transparency and comparability for all clients.

Lake Jericho advised Plans and portfolios are, most typically, balanced, globally diversified strategies that incorporate varying combinations of multiple asset types and geographic diversification. Each asset type, and market location, has a meaningful impact upon returns. Reviewing asset returns that follow, you see where, and how, your investment options were, and your portfolio was, impacted.

- The Dow Jones Industrial Average, 30 “blue-chip” U.S. companies with an industrial company bias, finished Q4 with a total gain of 6.67%, for a 2019 annual total return of 25.34%.
- The S&P 500® Index, a broad index of the 500 largest U.S. companies, finished Q4 with a total gain of 9.07%, for a 2019 annual total return of 31.49%.
- The technology and consumer-cyclical heavy NASDAQ Composite Index finished Q4 with a total gain of 12.47%, for a 2019 annual total return of 36.69%.
- Small- and mid-sized companies, as measured by the Russell 2500™ Index, finished Q4 with a total gain of 8.54%, for a 2019 annual total return of 27.77%.
- International developed markets, as measured by the MSCI World (ex-U.S.) Investable Market Index, finished Q4 with a total gain of 8.36%, for a 2019 annual total return of 22.91%.
- International emerging markets, as measured by the MSCI Emerging Markets Investable Market Index, finished Q4 with a total gain of 11.59%, for a 2019 annual total return of 17.64%.
- Bonds, with the headwind of a slight reversal back towards rising interest rates, struggled during Q4, . But bonds generally managed to keep their gains for all of 2019 The Bloomberg Barclays U.S. Aggregate Bond Index, a broad measure of the performance of the U.S. investment grade bond market, finished Q4 with a total return of only 0.18%, and a 2019 annual total return of 8.72%.

The iShares Core Allocation ETF Portfolio Benchmark Series*

Performance Comparisons For All Periods Ending December 31, 2019

Core Allocation Portfolio Strategy	Q4 2019	YTD 2019	1 Year	3 Year Total Return	5 Year Total Return
Conservative (AOK)	2.63%	13.71%	13.71%	20.90%	25.88%
Moderate (AOM)	3.47%	15.58%	15.58%	24.01%	29.46%
Growth (AOR)	5.20%	18.91%	18.91%	29.67%	36.94%
Aggressive (AOA)	6.96%	22.61%	22.61%	35.60%	44.57%

* The iShares Core Allocation ETF Portfolio series is designed to meet the needs of investors who would like to maintain fixed target levels of exposure through a portfolio diversified across domestic, international, and emerging market equities, bonds, and other instruments. The Core Conservative Allocation Strategy seeks approximately 30% exposure to global equity markets. The Core Moderate Allocation Strategy seeks approximately 40% exposure to global equity markets.. The Core Growth Allocation Strategy seeks approximately 60% exposure to global equity markets. The Core Aggressive Allocation Strategy seeks approximately 80% exposure to global equity markets. Presented here is the iShares Core Allocation ETF Portfolio Benchmark performance, constructed with no management fees, and with no transaction costs, while Lake Jericho portfolio performance is actual performance, net of all fees, including investment management, administration, and transaction expenses.

Near-term Outlook

After 2019, investors naturally ask, “what comes next"? Particularly so when a strong year is the latest entry for an extended record-shattering bull-market run. Mindful that the economy is not the stock market, and that the two often diverge, I believe the performance of the two will be tightly connected in 2020. My outlook is for the U.S. economy and financial markets to remain relatively stable, both moving higher as the year progresses, lead by continued full employment, a strengthening consumer, low interest rates, and continued low inflation.

I was highly pessimistic about corporate earnings growth as we entered 2019. The end result supported this view, as earnings were basically flat. Without earnings growth, 2019's stock price appreciation was simply due to multiple expansion (the ratio of price paid for a stock to the earnings the company creates). Current multiples imply that stocks are not cheap. But the risk to current valuations is modest, so I am not concerned that stocks are “too” expensive. Corporate earnings will recover in 2020. With just single digit growth rates, current price levels can be supported, should interest rates remain low, allowing companies to "grow into" current valuations.

Q4 2019 brought much-needed clarity regarding trade. The USMCA (NAFTA 2,0) trade agreement made its way through the U.S. House and is a done deal. The "phase one" trade deal with China was signed just last week. If no other economic benefit materializes from the efforts, the optics of the end of trade war escalation, and more predictable Trump administration policy will put the global economy on more sturdy footing in 2020.

Despite the challenges of the last two years, the U.S. economy continues to expand at about a 2.0% rate. With more steady policy, I expect U.S. growth to tick higher in the back half of 2020, reaching 2.5%. The fully employed consumer is confident, spending solidly. Consumer spending now represents 2/3rds of our economy, and confident consumers drive economic growth. While the manufacturing sector has been a drag on economic growth this year, manufacturing’s influence on our economy continues to shrink. Nonetheless, that decline is showing signs of bottoming. Meanwhile, the expanding influence of the services sector remains strong.

After, in hindsight, ill-advised interest rate increases during Q4 2018, the Federal Reserve supported equity markets with a Q4 2019 interest rate cut. With Fed Chair Jerome Powell's ears still ringing from Trump’s political rebukes, I expect the Fed to remain sidelined in 2020. Powell recently said, "as long as incoming information about the economy remains broadly consistent with our outlook, the current stance of monetary policy will likely remain appropriate." Translation? It is an election year, and in hyper-partisan times, the Fed will stay out of it.

What to say about the 2020 U.S. Presidential election? It is too early to forecast impacts. We can, however, look at historical market performance through presidential terms and past election cycles as a guide. Based upon data from 1948 to 2016, presidential election years have generated average annual equity returns of about 6.0%. Year three of each presidential term produces the highest returns on average. Certainly a historical pattern followed in Trump’s first term. In a chicken-or-the-egg paradox, stocks perform better in presidential election years when the incumbent party wins. The old line "it's the economy, stupid" certainly holds true. And with higher predictive accuracy than most polling data, if markets are up in the three months leading up to election day, the incumbent party wins. If not, then the incumbent administration is ousted. This has held true in every election back to 1984, and in nearly 90% of presidential elections going back to 1928.

Trump knows that keeping an even hand on the economic wheel could determine his fate inNovember. Together with an inflection point in global economic growth as easier financial conditions start filtering through, a modest pickup in manufacturing, business spending and interest rate- sensitive sectors such as housing? With a little luck, and a quiet Twitter feed, by mid-2020 we should reach the 11th birthday of the current economic expansion and continue this record-setting bull market run.

As always, I am available at any time, any day of the week, to discuss specific portfolio performance questions. Until then, be well. Enjoy your week, and thank you!

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