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# Managing Expectations

Returns in 2019 highlighted the importance of investor expectations — and understanding what is already “priced in” to financial markets. For instance, the 2019 economic data did not seem to be the foundation for robust financial market returns. Global economic growth was muted, with manufacturing slumping as a result of the U.S.-China trade war. Global equity earnings growth was flat-to-negative. And yet global equities gained 27% in 2019, with U.S. equities up 31%.

How does this happen? Well, for starters, 2019 started from a very low base. Global equity markets were down 13% in the fourth quarter of 2018, pushing global equity valuations below long-term historical averages (data going back to 1970). Even U.S. equities, which have had a persistent valuation premium over recent years, came close to their own long-term average. When considering the low interest rate environment, such valuations were attractive but investor growth expectations were low. Investors believed the global economy would suffer from U.S.-China trade tensions. Further, they were unconvinced that central banks were willing

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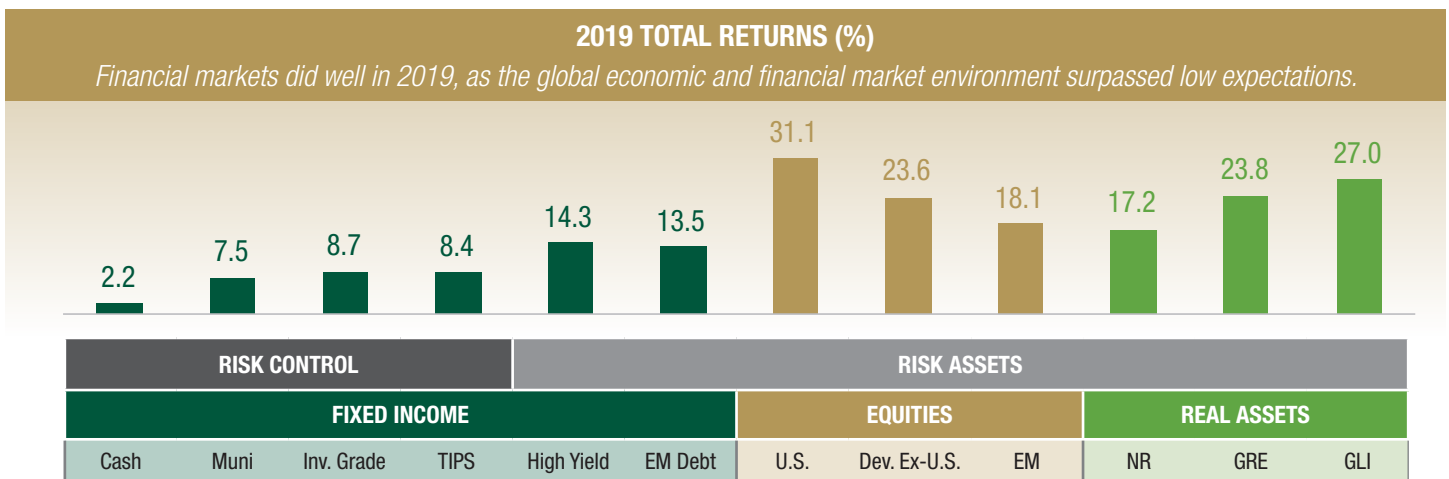
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to do anything about it. In fact, there was concern the Federal Reserve would continue raising interest rates.

As investors navigated 2019, they began to realize that things weren't so dire. First, U.S.-China trade tensions were hurting the manufacturing sector but the services sector (a much larger percentage of the global economy) was doing reasonably well, allowing the global economy to avoid recession. Second, despite widespread concerns that tariffs would push prices higher, inflation remained low. In fact, inflation was too low for central bankers' liking — and central banks finally relented on their monetary policy tightening campaigns. The Fed cut rates three times throughout 2019 (expectations coming into the year were for more rate hikes). Meanwhile, the European Central Bank cut rates further into negative territory and began a new quantitative easing program (expectations

were for the bank to begin positioning its exit strategy from negative interest rates). Finally, a U.S.-China trade armistice and hope for an orderly Brexit resolution removed some political uncertainties, capping a year that easily surpassed low expectations.

The obvious question now is whether expectations are too high going into 2020. The combination of strong equity returns and flat-to-negative earnings growth has resulted in valuations that are back to levels found prior to 2018's fourth quarter dip. These elevated valuations can be supported if: 1) global growth can continue (or even get a boost) as political uncertainties are reduced, allowing for a resumption of global equity earnings growth; and 2) inflation remains tame, allowing for a continuation of the easy money policy reinstated in 2019.

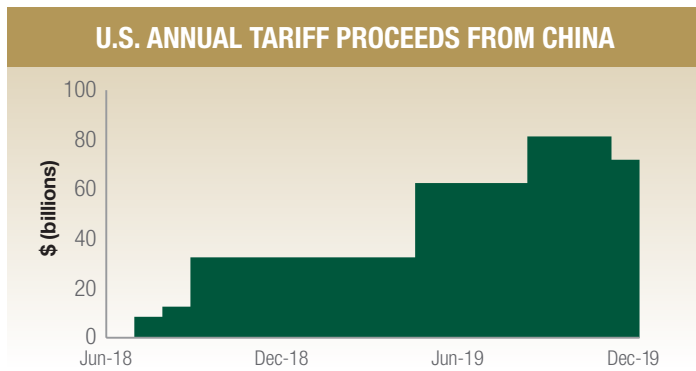


Source: Northern Trust Asset Management, Bloomberg. NR = natural resources; GRE = global real estate; GLI = global listed infrastructure. Indexes are gross of fees and disclosed on last page. It is not possible to invest directly in any index. Past performance is no guarantee of future results.

# Key Developments

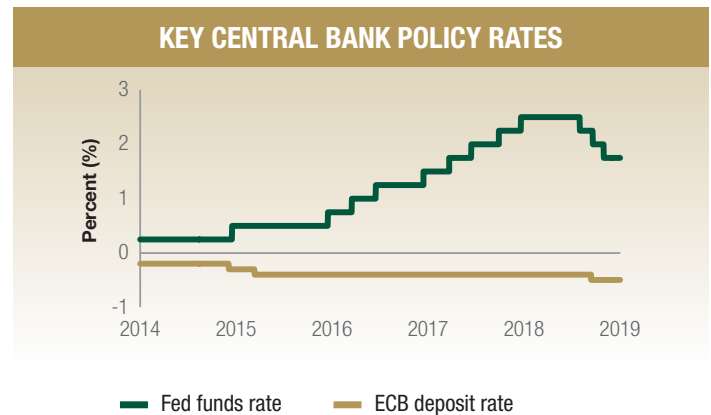
## U.S.-China Trade Armistice

U.S.-China trade tensions, which had been on investors' minds throughout 2019, fell in December. The "phase one" trade agreement is a good start but much work is still to be done. Some tariffs have been rolled back but a majority remain in place (see chart). China has promised to increase its U.S. imports but some question whether it can actually purchase what has been speculated (\$200 billion in goods over two years). Other parts of the deal come with questions on enforcement.



## The New Global Easing Cycle

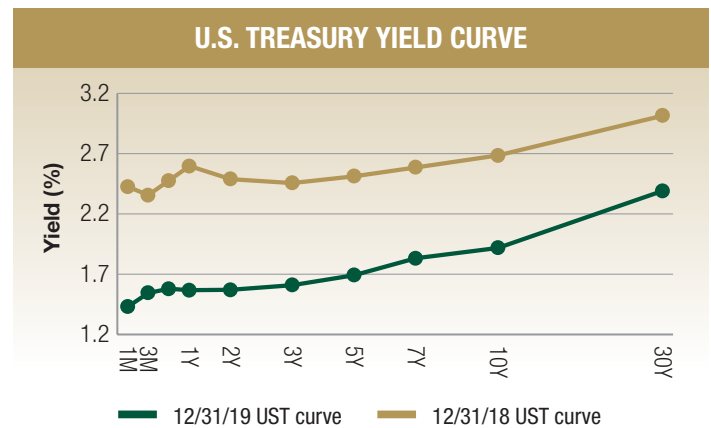
While the U.S.-China trade armistice put a nice bow on 2019 financial market returns, what really got 2019 off on the right foot was the start of the new global monetary easing cycle. The Fed responded to investor criticism through 2018's fourth quarter market sell-off by stopping rate hikes and then cutting three times in 2019. The European Central Bank also got into the action with a rate cut of its own as well as a new quantitative easing program. Easy monetary policy will likely remain throughout 2020.



# Market Review

## Interest Rates: Demand for Treasuries

The Treasury yield curve shifted lower during 2019 as constant pressure on long-term interest rates forced the Fed to reduce its key policy rate three times. Economic growth rates were subdued and inflation remained missing in action, lowering investors' required yields. Also, ongoing political concerns (U.S.-China) kept demand high for Treasuries. Finally, Treasury demand from Japan and Europe was the highest since 2012, keeping a lid on rates.



## Brexit Update

U.K. Prime Minister Boris Johnson scored a big win in the recent election, increasing Conservative Party seats by 47 for an 80-seat majority. Johnson's new mandate now positions the U.K. to leave the European Union on January 31. However, all work is not done. Johnson has stated his desire to finalize a new trade agreement by the end of 2020. This represents an aggressive timeline that will surely keep investors on their toes throughout the year.

## Democratic Merry-Go-Round

Last year was a good lesson in the futility of predicting elections. Former vice president Joe Biden began as the Democratic front runner for the November U.S. election before a strong June debate put Senator Kamala Harris into the favored position. Harris peaked at a 34% chance of nomination based on Real Clear Politics betting odds before she lost steam and exited the race. Senator Elizabeth Warren peaked at 53% — and unnerved investors with progressive policies — before regressing. Biden is now back in the lead at 33%.

Source: Northern Trust Asset Management, Cornerstone Macro, Bloomberg, BBC, Real Clear Politics.  
\*Peak of last six months.

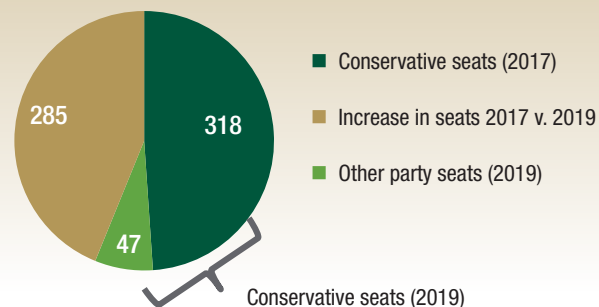
## Credit Markets: Falling Spreads

Credit spreads fell throughout the year, retracing all of the increase in the fourth quarter of 2018 — and then some. The path was not smooth, with periodic spikes in spreads generally driven by U.S.-China headlines. But, overall, credit spreads are supported by a steady economy and low default rates as well as strong demand for yield. The current 3.3% average high yield spread compares to the five-year low of 3.0% while the average 0.9% investment grade spread compares to the five-year low of 0.8%.

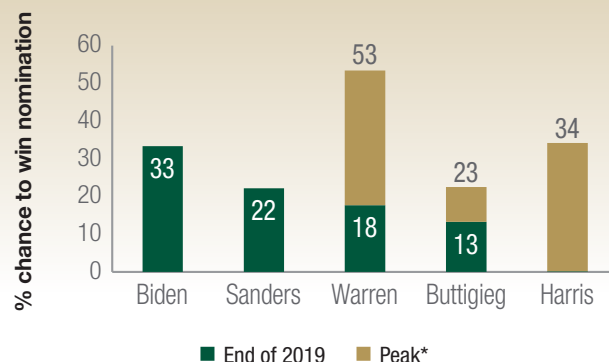
## Equities: U.S. Leads on Tech

It was the best year for global equities since 2008, with a total return of 27%. The gain was driven by U.S. equities, which were up 31%, thanks to a surging technology sector that was up 50%. Other major regions showed lower but still impressive returns. Despite continued economic struggles, Europe and Japan were up more than 20% and developed ex-U.S. markets in aggregate returned 24%. Meanwhile, emerging markets lagged at 18% because of on-and-off global trade tensions.

### CHANGE IN U.K. PARLIAMENT COMPOSITION

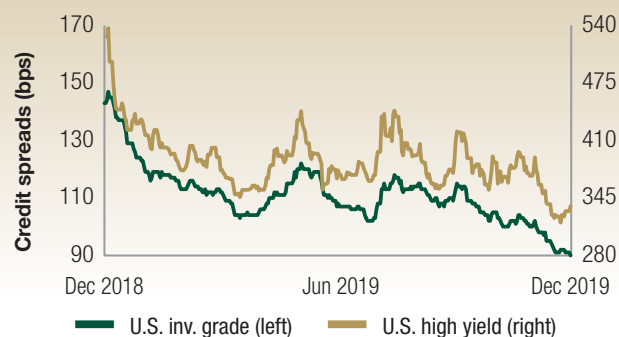


### U.S. DEMOCRATIC NOMINEE BETTING ODDS



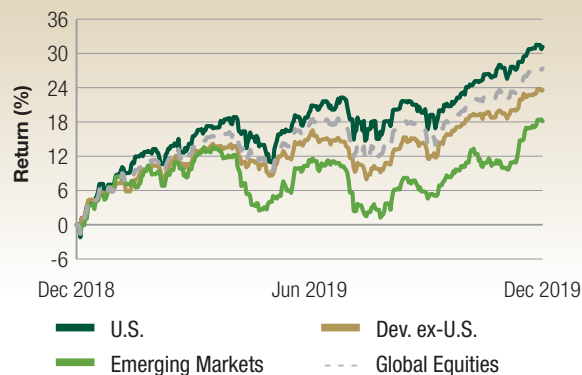
■ End of 2019 ■ Peak\*

### CREDIT SPREADS



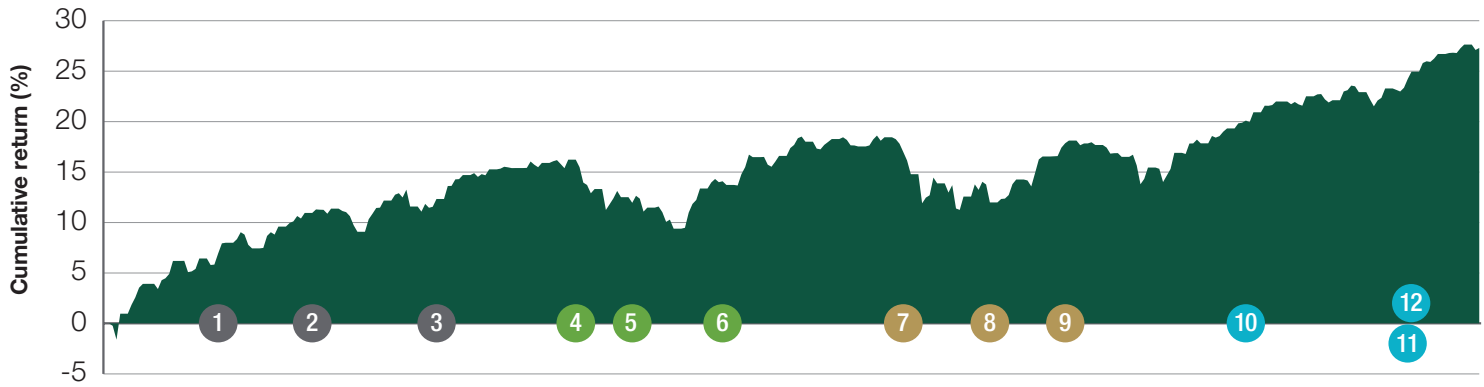
— U.S. inv. grade (left) — U.S. high yield (right)

### REGIONAL EQUITY INDICES



# Market Events

2019 global equity total return: 27.3%



Q1	Q2	Q3	Q4
<p><b>1</b> The Fed lists low inflation and global economic risks in its decision to put interest rates on hold and end the balance sheet runoff early.</p>	<p><b>4</b> Trump tweets that the U.S. will raise tariffs against China on the upcoming Friday as U.S. officials accuse China of renegeing on pledges.</p>	<p><b>7</b> Fed cuts interest rates for the first time since the financial crisis by 0.25% and concludes its balance sheet reduction earlier than planned.</p>	<p><b>10</b> The Fed cuts interest rates by 0.25% for the third time in 2019 putting rates in the 1.5%-1.75% channel.</p>
<p><b>2</b> U.S. President Donald Trump delays March 1 deadline, preventing the escalation of tariffs from 10% to 25% on \$200 billion worth of Chinese goods.</p>	<p><b>5</b> After trailing in the polls, Scott Morrison wins Australia's election for prime minister, sending Australian equity markets up 2%.</p>	<p><b>8</b> China announces new tariffs on \$75 billion of U.S. imports; Trump responds with an additional 5% of tariffs on \$250 billion of goods (October implementation).</p>	<p><b>11</b> U.K. Prime Minister Boris Johnson's Conservative Party wins a decisive majority in the House of Commons, clearing an easier path for Brexit.</p>
<p><b>3</b> U.K. Prime Minister Theresa May's third attempt to pass a Brexit withdrawal agreement fails, eventually forcing another extension.</p>	<p><b>6</b> Oil prices jump ~4% on reports that Iran attacked two oil tankers; other geopolitical events would impact the oil markets throughout the year.</p>	<p><b>9</b> ECB cuts interest rates by 0.1% (to -0.5%), and plans to buy €20 billion in bonds per month starting in November.</p>	<p><b>12</b> The U.S. and China agree to the text of a "phase-one" trade deal, preventing the tariffs on consumer goods from going into effect on December 15.</p>

Indexes used: Bloomberg Barclays (BBC) 1-3 Month UST (Cash); BBC Municipal (Muni); BBC Aggregate (Inv. Grade); BBC TIPS (TIPS); BBC High Yield 2% Capped (High Yield); JP Morgan GBI-EM Global Diversified (Em. Markets Fixed Income); MSCI U.S. Equities IMI (U.S. Equities); MSCI World ex-U.S. IMI (Dev. ex-U.S. Equities); MSCI Emerging Market Equities (Em. Markets Equities); Morningstar Upstream Natural Resources (Natural Res.); FTSE EPRA/NAREIT Global (Global Real Estate); S&P Global Infrastructure (Global Listed Infra.)

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# From the Managing Director

Dear Friends and Clients,

Happy New Year! I hope you enjoyed the holidays surrounded by family and friends and had time for rest, relaxation, and reflection.

As we turn the page to 2020 and begin a new decade, it's an opportunity to reflect on the passage of time and the events that impact all of us. Even with a fresh calendar, the economic environment does not feel much different than it did much of last year. The pattern of slow but steady economic growth, low interest rates, low inflation, and high employment will likely persist in the new year. The markets rewarded investors with stellar returns in 2019 as a result of the relatively docile environment.

The decade that passed provided investors with strong equity returns in the United States, unlike the tumultuous period we endured in the decade of the 2000s. While the economic environment continues to be appealing for financial assets, the risks from trade tensions, geopolitical turmoil, and political discourse may continue to cause anxiety in 2020. We can't predict what the economy, the markets, the election, and other events will bring in 2020, but it will be an interesting year.

As we begin a new year, please consider taking some time to review your finances. Are your assets aligned with your goals, is your saving and investment plan on track, is your estate plan prepared to serve your family needs should a life event occur, do you have burial instructions, and do you have the right insurance in place to protect your loved ones? The members of your Enterprise Wealth Management team are here to help.

You may have seen that Enterprise Bank was named #1 in the employee-based "Top Places to Work" survey by the Boston Globe for 2019 in the large-sized company category. It is a great pleasure to work with a dedicated team that puts our clients' interests first each day. Please help us share our story if you have a family member, friend, or colleague who may need help navigating this complex world in the year 2020.

Sincerely,

Stephen J. Irish, CFP®, CPA  
*Managing Director, Enterprise Wealth Management*  
*Chief Operating Officer, Enterprise Bank*



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