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As we started 2019, the outlook appeared very negative. The market had given up all its gains from 2018 and the S&P ended the year at -6.2%. We noted in our 2018 year end letter that the markets were plagued by a Federal Reserve that seemed determined to raise interest rates regardless of the mixed economic data, ongoing trade tensions with China, a government shutdown, and the prospect of a slowing global economy. However, we also noted that we remained positive about U.S. stocks due to record low unemployment with rising real wage growth, high consumer confidence, low inflation, and strong corporate earnings. This positive outlook proved to be correct, and the markets turned in their best performance in six years with the S&P 500 up 31.5% and the Dow up 25.3%. The gains were broad with over 90% of stocks showing a positive return. Recession fears receded as progress was made in trade negotiations with China, and the Federal Reserve cut interest rates three times during the year.

In addition to U.S. unemployment hitting a fifty-year record low of 3.5% in November, the uncertainty surrounding Brexit was diminished by the decisive victory of the Conservative Party in Great Britain. Recession fears surrounding the temporary inversion of the yield curve also dissipated as Fed easing brought rates down across the curve. Inflation remains quite low even though real wages for production and non-supervisory workers have been rising since 1995. Employment gains have been broad based across all racial and ethnic groups, all levels of educational attainment, as well as for people with disabilities. Inflationary pressures due to the increase in wages are being offset by continued low energy costs and mortgage rates. Even the uncertainty surrounding President Trump's impeachment did not affect the market in any meaningful way.

We will be keeping a close watch on the health of the corporate debt market. Spreads remain tight, but in this low rate environment, the search for yield has allowed lower rated borrowers to increase their debt loads. Junk bonds represent 34% of corporate debt, and the lowest rated level of investment grade bonds, BBB, represents 41% of the total. The U.S. is now the top energy producer in the world, but the debt load taken on to make that happen is coming due over the next several years. There is also the possibility of a geopolitical shock if the Iranian sponsored unrest in the Middle East continues to escalate.

Notwithstanding the uncertainties mentioned above, the outlook for global growth is starting to improve. The U.S. market has been performing better than overseas markets due to a stronger economy, disruptive technologies, the avoidance of crises, and bank balance sheets being in good shape. The technology sector was the strongest performer with a 50% gain, and energy was the worst performer with a 6.9% return. While Germany and Japan still have negative interest rates, some of the other Eurozone countries have come out of negative interest rate territory. The central bank of China just announced a new round of easing to give their economy a lift. Even though market valuations here are stretched with the forward P/E at 18.2x, a coordinated global recovery would allow our market to advance in line with earnings growth. The Fed is expected to hold rates steady in 2020 unless there is a big increase in inflation.

Thank you for your continued confidence in us. We wish you and your family a Happy, Healthy, and Prosperous New Year.

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