Last year’s equities performance was the best since 2013, with investment-grade bonds posting their best single-year returns in 17 years. While uncertainty loomed, last year’s market was calm by historical measures. We don’t think 2019’s outsized performance will be duplicated in 2020. But equities’ outperformance over bonds is likely to be repeated this year.

**Rocky start, strong finish for equities** – With prices subdued and earnings growth still strong, large-cap stocks entered 2019 with the most attractive valuations since 2013. Large-cap equities returned 32%, powered in large part by the high-growth tech sector (up 50%). Small-cap companies and international stocks lagged large-cap performance, facing headwinds from slowing economic fundamentals and trade uncertainty.

**Federal Reserve rate cuts boost bond returns** – Last year, the Federal Reserve cut rates from a target range of 2.25%-2.5% to 1.5%-1.75%. The Fed also stopped its program to shrink its balance sheet and purchased more than $234 billion in short-term bonds to stabilize corporate lending markets. Monetary stimulus from central banks led to $11 trillion in negative-yielding debt worldwide and increased demand for positive-yielding U.S. Treasuries. The effect of this coordinated monetary stimulus was to lift U.S. investment-grade bond returns by 8.7%, even as equities, which tend to respond differently from bonds, instead soared.

**Recession fears came and went** – In March 2019, the gap between short- and long-term interest rates, known as the yield curve, inverted for the first time in over a decade. Cuts to short-term interest rates by the Fed helped the curve steepen back closer to its normal shape, signaling a modestly growing economy. Subsequent data highlighting a healthy labor market, solid consumer spending and modest inflation eased recession fears.

### Action for Investors

Asset classes tend to perform differently from one another in that economic and corporate conditions that produce declines in one asset class may lead to smaller declines or even gains in other asset classes. Since we expect lower returns and higher volatility in 2020, we recommend broadly diversifying across asset classes to help buffer your portfolio from market swings in the year ahead.

Diversification does not guarantee a profit or protect against loss in declining markets.
We believe economic growth is set to slow in 2020 to just below the 10-year expansion average, with no catalysts such as tax cuts expected to reinvigorate growth. We expect consumers to fuel the economic expansion. Interest rate cuts enacted last year should provide a modest support to the economy in the first half of 2020.

Consumer demand propels the economy forward – A healthy labor market and low interest rates will help drive spending again this year, though with less potency than last year. As shown in the chart, U.S. retail sales grew 3.4% in the first 11 months of 2019, in line with the average pace of sales for the 10-year expansion. Monthly job gains are leveling off; we still expect the unemployment rate to stay under 4% this year. After a rough patch last year, the housing market should contribute to GDP growth in 2020, fed by historically low interest rates, a pickup in inventory and a steady return of homebuying demand.

Manufacturing ekes out growth – Trade uncertainty and lackluster business investment will likely continue to dampen growth in manufacturing. We don’t expect a comprehensive trade deal between the U.S. and China this year. Additionally, new tariffs against handful of countries could signal the trade overhang on manufacturing will continue in 2020. In our view, manufacturing should show a slow but steady expansion. Importantly, the lull in manufacturing growth has not spilled over to the much larger service sector.

Central bank policy, the oil that greases the wheel – We expect the Federal Reserve to maintain the current target of benchmark interest rates at 1.5%-1.75%, unless there is a downward shift in economic conditions. We expect the rate cuts enacted last year to help ease the frictions from geopolitical headwinds and election uncertainty, and help the economy avoid a recession this year.

Action for Investors
Though slowing, economic fundamentals are solid enough to support rising share prices this year, but we expect lower returns and more volatility than last year. We recommend reviewing your portfolio to ensure that after a year of soaring equity returns, your equity-bond mix still reflects your risk tolerance.
QUARTERLY MARKET OUTLOOK: FIRST QUARTER 2020

Equity Outlook

2019’s gains were among the strongest of the 2000s and well outpaced our expectations. We don’t think this exhausts the bull market’s tank heading into 2020, but it does temper our expected return for the coming year. Modest earnings growth and full valuations should drive more moderate gains this year, but the strong year-end rally sets the stage for a potentially rockier start.

Market may take a breather – Stocks rallied sharply heading into this year, and we think there is now an air of complacency in the market. We think an uptick in volatility, and a short-term pullback, is a reasonable expectation. And we think 2020 is likely to endure more frequent swings, as was the case in 2016 and 2018, when election and trade uncertainties rose.

The bull isn’t exhausted – We don’t think pullbacks will give way to a bear market, as the conditions that are historically associated with a bear market are not in place. Economic growth should continue to offer support to the market. In the 16 years since 1950 in which unemployment was below 4.5% heading into year-end (currently 3.5%), the average S&P 500 return in the following year was 9.9%. Past performance is not a guarantee of what will happen in the future.

More moderate gains ahead – 2019’s sizable returns won’t likely be replicated this year, in our view, but since 1950, when the S&P 500 rose by more than 20%, the average return in the next year was 11.27%, indicating great years don’t have to be followed by bad ones. Stocks enter 2020 with valuations slightly above long-term averages. But to us, there is limited potential for material expansion in the price-to-earnings ratio from here, meaning the pace of market gains will be set by the pace of earnings growth.

Action for Investors

Sharp stock gains offer a timely opportunity to rebalance to your long-term target weight in equities. Pullbacks would offer a compelling buying opportunity. An extended economic expansion supports the case for appropriate allocations to U.S. small-caps, while a slightly better global outlook and discounted valuations support our ongoing favorable view of international equities.

Investing in equities involves risks. The value of your shares will fluctuate and you may lose principal. Small-cap stocks tend to be more volatile than large company stocks.

Special risks are inherent to international investing, including those related to currency fluctuations and foreign political and economic events.
We expect equities to outperform bonds this year as moderate economic growth continues, with no recession imminent, in our view. However, political and other uncertainties could drive volatility higher, highlighting the stabilizing role fixed-income investments typically play during market pullbacks.

**Long-term rates to rise modestly** – Last year’s sizable decline in long-term interest rates reflected recession fears, a global slowdown and expectations of a Federal Reserve policy shift. With global growth showing signs of stabilization, trade tensions easing and market expectations more aligned with current monetary policy, the 10-year Treasury yield is not likely to fall materially below 2%, in our view. We think bond yields will rise modestly, with accommodative central bank policies and slow growth continuing to act as anchors.

**Fed on pause through 2020** – Last year, the Fed cut interest rates three times as insurance against recession risks. As a result, financial conditions eased substantially, and recession fears receded. We believe the bar for the Fed to either lower or raise interest rates is set very high leading up to the 2020 election. Improving economic data and lower risk of a further slowdown in global growth should mean no further rate cuts are needed. At the same time, inflation is running stubbornly below the Fed’s target, providing flexibility to remain accommodative without having to raise rates.

**Policy remains a tailwind** – Monetary policy changes impact the real economy with a lag of typically six to nine months. Therefore, we expect the markets and the economy to continue to benefit from last year’s interest rate cuts. The housing sector, which is sensitive to interest rates and Fed policy, has recently strengthened, adding to economic growth last quarter for the first time since late 2017.

**Action for Investors**

Despite ongoing low yields, we still think fixed-income investments play an important part in portfolios. We recommend an appropriate allocation to bonds, including U.S. investment-grade, high-yield and international bonds.

Before investing in bonds, you should understand the risks involved, including credit risk and market risk. Bond investments are also subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity.
Global Manufacturing Activity Recovering from Low Levels

<table>
<thead>
<tr>
<th>U.S. Recessions</th>
<th>Global Manufacturing PMI</th>
<th>Expansion/Contraction Threshold</th>
</tr>
</thead>
</table>

Source: Bloomberg, 12/31/2019.

QUARTERLY MARKET OUTLOOK: FIRST QUARTER 2020

International Outlook

International stocks performed well in 2019 but still trailed U.S. stocks amid trade and other geopolitical uncertainties, a slump in European manufacturing and a slowdown in China. Challenges remain, but there are signs global manufacturing may be stabilizing. We expect a modest re-acceleration in global growth. Together with depressed valuations and a likely softening U.S. dollar, this could position international investments to outperform in 2020.

Manufacturing activity is recovering – Forward-looking business surveys have shown signs of bottoming in economic activity in emerging and developed markets and are consistent with a still-soft but improving demand environment. At the same time, activity in the services sectors of most major economies remains relatively robust, and central bank policies are likely to stay accommodative until growth or inflation picks up.

Valuations reflect pessimism – Even with last year’s rally, international developed stocks are priced at a 20% discount to U.S. stocks, with emerging-market stocks at a 30% discount.* While valuations alone don’t necessarily translate to better short-term results, they have historically been a good predictor of long-term returns. Although past performance is not an indicator of what will happen in the future, we believe higher dividend yields and better valuations support the possibility of above-average long-term returns for international equities and position them to outperform U.S. large-cap stocks over time.

Currency less of a headwind – In six of the past seven years, the rising dollar reduced returns for international developed stocks by an average of about 3% per year when compared with returns in local currencies. We expect the dollar to flatten or fall as global growth stabilizes and potentially rebounds, increasing the chances of improved returns for U.S. investors.

Action for Investors

We recommend adding international equity investments as appropriate to take advantage of the likely re-acceleration in global growth. We recommend an appropriate allocation to international bonds.

*Source: Forward price-to-earnings ratio, MSCI EAFE and MSCI Emerging Market relative to S&P 500.

Equity investing involves risks. The value of your shares will fluctuate and you may lose principal.

Special risks are inherent to international and emerging-market investing, including those related to currency fluctuations and foreign political and economic events.
There has been no shortage of risks in the market lately, from trade wars to yield curve inversions to an escalation of geopolitical tensions with Iran. These have been countered by a healthy economy, allowing markets to climb the wall of worry. We think this investment dynamic will continue, but rising debt levels are a risk we’re watching. While it’s not an imminent threat, we think debt will play a role in economic and investment conditions longer term.

Corporate borrowing at record highs – Corporate debt levels have risen to a record $10.1 trillion, or 47% of GDP.¹ We don’t think this will spark an economic downturn, but we do believe it will put additional drag on an eventual recession, as corporations are forced to pull back further to address their leverage. Rising corporate debt is not surprising or unreasonable. Further, debt as a percentage of corporate equity is roughly half its level before the financial crisis and in line with levels of the early ’90s, reflecting strong earnings and stock market values. We don’t expect corporate defaults and financial conditions to become a material headwind in 2020, but weaker GDP growth and/or rising interest rates could pose a challenge down the road.

Government debt: large but longer-term – U.S. federal debt has surpassed $23 trillion, with persistent annual budget deficits set to add to that figure. However, U.S. debt-to-GDP² is slightly under 80% – still well below levels that portend financial stress or insolvency. Nevertheless, shifting demographics and ongoing deficits are likely to make rising government debt a more prominent risk down the road. We don’t think this will threaten the long-term opportunities in investment markets, but elevated government debt does pose a headwind to potential economic growth over time by limiting the flexibility of fiscal policy, raising government borrowing costs and, if left unchecked, crowding out private investment.

¹ Source: Ned Davis Research, non-financial corporate debt.
² Source: St. Louis Federal Reserve, federal debt held by the public as a percent of GDP.

Action for Investors

Ensure appropriate diversification within fixed-income portfolios, with the majority allocated to investment-grade bonds. To address corporate debt risks, we favor high-quality companies with sound financial positions and stable earnings. To address long-term government debt/interest rate risks, ensure a proper allocation to global equities and domestic equities with rising dividend potential.

Diversification does not guarantee a profit or protect against loss in declining markets.

Investing in equities involves risks. The value of your shares will fluctuate and you may lose principal. Special risks are inherent to international investing, including those related to currency fluctuations and foreign political and economic events.
**QUARTERLY MARKET OUTLOOK: FIRST QUARTER 2020**

**Asset Class Outlook**

**Equity versus Fixed Income (Target = Middle)** – We think the bull market in stocks can continue, supported by modest economic growth and slow-but-accelerating earnings growth. Interest rates remain low, and the Federal Reserve will likely stand pat after having cut interest rates to help extend the expansion. A laddered bond portfolio and an above-average amount in cash may help provide downside protection for portfolios when markets are volatile.

**Domestic versus International (Target = Middle)** – We recommend overweighting international equities (including emerging-market stocks) and underweighting international fixed income. Global growth remains slow, but the outlook is improving, in our view, and international equities look attractive due to low valuations.

**Asset Class Diversification**

**Aggressive (Target = Middle)**: We remain cautious on commodity investments but recommend adding emerging-market equities, which we think are attractively valued and could benefit if trade tensions ease and global growth improves.

**Growth (Target = Middle)**: Opportunities and risks appear balanced for U.S. small- and mid-cap stocks and international small-cap stocks as concerns about slower economic growth are offset by low interest rates and easy monetary policy.

**Growth & Income (Target = Middle)**: We think risks and opportunities are balanced for real estate investments and U.S. large-cap stocks. We recommend overweighting international developed-market large-cap equities, within the recommended range of international equity holdings, because expectations are low, dividend yields are attractive, and we expect them to benefit from policies to improve global economic growth.

**Income (Target = Low)**: Long-term interest rates tend to move with inflation, which may rise slightly as labor markets tighten. The aggressive income target is middle because we think rates on high-yield bonds compensate for their additional risk and default rates remain low. We recommend an appropriate allocation to international bonds.

**Cash (Target = High)**: We recommend overweighting cash to cover short-term expenses and to invest during pullbacks.

Investors should understand the risks involved in owning investments, including interest rate risk, credit risk and market risk. The value of investments fluctuates, and investors can lose some or all of their principal. The prices of small-cap, mid-cap and emerging-market stocks are generally more volatile than those of large company stocks. Special risks are inherent in international investing, including those related to currency fluctuations and foreign political and economic events.

---

1 Alternative investments and Stocks trading less than $4 align with the Aggressive investment category, but they are not recommended.
2 Large-cap stocks that do not pay a dividend are in the Growth investment category.

Asset classes we don’t recommend separately include alternative investments and micro-cap equities.
Investment Performance Benchmarks

It’s natural to compare your portfolio’s performance to market performance benchmarks, but it’s important to put this information in the right context and understand the mix of investments you own. Talk with your financial advisor about any next steps for your portfolio to help you stay on track toward your long-term goals.

As of Dec. 31, 2019

<table>
<thead>
<tr>
<th>Benchmarks for Investment Categories</th>
<th>Total Return</th>
<th>1-Year</th>
<th>3-Year</th>
<th>5-Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. Cash</td>
<td>2.3%</td>
<td>1.7%</td>
<td>1.1%</td>
<td></td>
</tr>
<tr>
<td>U.S. Bonds</td>
<td>8.7%</td>
<td>4.0%</td>
<td>3.0%</td>
<td></td>
</tr>
<tr>
<td>U.S. High-yield Bonds</td>
<td>14.3%</td>
<td>6.4%</td>
<td>6.1%</td>
<td></td>
</tr>
<tr>
<td>International Bonds</td>
<td>5.1%</td>
<td>4.4%</td>
<td>1.6%</td>
<td></td>
</tr>
<tr>
<td>U.S. Large-cap Stocks</td>
<td>31.5%</td>
<td>15.3%</td>
<td>11.7%</td>
<td></td>
</tr>
<tr>
<td>Real Estate</td>
<td>28.7%</td>
<td>10.3%</td>
<td>8.4%</td>
<td></td>
</tr>
<tr>
<td>International Large-cap Stocks</td>
<td>22.0%</td>
<td>9.6%</td>
<td>5.7%</td>
<td></td>
</tr>
<tr>
<td>U.S. Mid-cap Stocks</td>
<td>30.5%</td>
<td>12.1%</td>
<td>9.3%</td>
<td></td>
</tr>
<tr>
<td>U.S. Small-cap Stocks</td>
<td>25.5%</td>
<td>8.6%</td>
<td>8.2%</td>
<td></td>
</tr>
<tr>
<td>International Small-cap Stocks</td>
<td>25.0%</td>
<td>10.9%</td>
<td>8.9%</td>
<td></td>
</tr>
<tr>
<td>Emerging-market Stocks</td>
<td>18.4%</td>
<td>11.6%</td>
<td>5.6%</td>
<td></td>
</tr>
<tr>
<td>Commodities</td>
<td>17.6%</td>
<td>2.4%</td>
<td>-4.3%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>U.S. Equity Sector Performance</th>
<th>Total Return</th>
<th>1-Year</th>
<th>3-Year</th>
<th>5-Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic Materials</td>
<td>24.6%</td>
<td>9.6%</td>
<td>7.1%</td>
<td></td>
</tr>
<tr>
<td>Communication Services</td>
<td>32.7%</td>
<td>4.7%</td>
<td>7.9%</td>
<td></td>
</tr>
<tr>
<td>Consumer Discretionary</td>
<td>27.9%</td>
<td>16.6%</td>
<td>13.1%</td>
<td></td>
</tr>
<tr>
<td>Consumer Staples</td>
<td>27.6%</td>
<td>9.9%</td>
<td>8.3%</td>
<td></td>
</tr>
<tr>
<td>Energy</td>
<td>11.8%</td>
<td>-3.2%</td>
<td>-1.9%</td>
<td></td>
</tr>
<tr>
<td>Financials</td>
<td>32.1%</td>
<td>12.0%</td>
<td>11.2%</td>
<td></td>
</tr>
<tr>
<td>Health Care</td>
<td>20.8%</td>
<td>16.2%</td>
<td>10.3%</td>
<td></td>
</tr>
<tr>
<td>Industrials</td>
<td>29.4%</td>
<td>10.7%</td>
<td>9.5%</td>
<td></td>
</tr>
<tr>
<td>Technology</td>
<td>50.3%</td>
<td>27.7%</td>
<td>20.2%</td>
<td></td>
</tr>
<tr>
<td>Utilities</td>
<td>26.3%</td>
<td>13.8%</td>
<td>10.3%</td>
<td></td>
</tr>
<tr>
<td>S&amp;P 500</td>
<td>31.5%</td>
<td>15.3%</td>
<td>11.7%</td>
<td></td>
</tr>
</tbody>
</table>

Source: Morningstar Direct, 12/31/2019. U.S. large-cap stocks represented by the S&P 500 Index. U.S. mid-cap stocks represented by the Russell Mid-cap Index. U.S. small-cap stocks represented by the Russell 2000 Index. International large-cap stocks represented by the MSCI EAFE Index. U.S. bonds represented by the Barclays U.S. Aggregate Bond Index. Cash represented by the Barclays U.S. Treasury Bellweathers 3Mon Index. High-yield bonds represented by the Barclays U.S. HY 2% Issuer Cap Index. Commodities represented by the S&P GSCI Index. Emerging-market stocks represented by the MSCI EM Index. International bonds represented by the Barclays Global Aggregate Ex U.S. Index. International small-cap stocks represented by the MSCI EAFE Small-cap Index. Real Estate represented by the FTSE NAREIT All Equity REITs Index. All performance data reported as total return. An index is unmanaged and is not available for direct investment. Performance does not include payment of any expenses, fees or sales charges, which would lower the performance results. The value of investments fluctuates, and investors can lose some or all of their principal. Past performance does not guarantee future results.