J.W. Burns & Company

Investment Counsel

Quarterly Update and 2020 Outlook - January 2020

Three Yards Ahead And A Cloud of Dust

"Be at war with your vices, at peace with your neighbors, and let every new year find you a better man - Benjamin Franklin

Dear Clients and Friends,

Question: What was there not to like about financial markets in 2019?

Answer: Nothing!

Indeed, 2019 was a fabulous year for the global stock market and just about all financial assets, with the S&P 500 Index finishing the year 31.49% higher, the Dow

Jones Industrial Average up 25.34%, international stocks climbing 21.21%, and the Lipper Balanced Index gaining 19.20%. Even low-yielding bonds had a great year with the Barclays Aggregate Bond Index finishing up nearly 10%! We were very pleased with both the operating results and price performance of your portfolio companies and continue to believe the fundamental backdrop remains favorable for stocks. We are bullish heading into 2020, though increased volatility and more muted returns should be the expectation.

Markets enjoyed a stellar 2019 largely due to the actions of the Federal Reserve. Chairman Jerome Powell did a complete 180°, switching from a very hawkish stance in the fourth quarter of 2018 to a much more accommodative, dovish stance in early January 2019. Indeed, corporate earnings for the full year of 2019 were basically flat (albeit better than expected), and the economy grew at a subpar pace. However, in December 2018, most economists were forecasting the Fed to increase interest rates two or even three times over the next 12 months. ***Instead, the Fed would actually cut rates three times!*** Looked at another way, the gains in the stock market reflected only multiple expansion due to lower interest rates. The price-to-earnings ratio on the S&P 500 Index (the price investors are willing to pay for a company's earnings) climbed from 14 times earnings at the beginning of the year to 18 times by December 31.

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So, thank you Chairman Powell.

Our client portfolios have been performing superbly, and I hope you are pleased. As I write this, we now have over $600 million in assets under management – with absolutely no dedicated marketing efforts. We have grown smartly through prudent investing and word-of-mouth referrals. What we have noticed is that when potential clients talk with us, the common problems they are having

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with their current advisors are 1) too many bonds, 2) too much international exposure, and 3) a lack of a coherent, well-defined portfolio structure. While we will always remain flexible to adding to the above mentioned asset classes when needed, our overall focus has been on owning high-quality stocks – the very best place to be over the last ten years. ***Furthermore, we have continued to remain fully invested with your hard earned money throughout this record-setting bull market which has added immense value to our clients.***

Below is a chart that shows the ebbs and flows of this market since 2008. As you can see, there have always been different geopolitical events and news headlines that give reasons to get out of the market. In fact, it has been reported in various financial media that many, if not most, investors have missed out on the majority of this bull market's gains, simply because they have not had the discipline to stay invested. We have ensured that you, our valued clients, stay invested in high-quality companies, and work relentlessly to keep you on track to meet your long-term financial goals.

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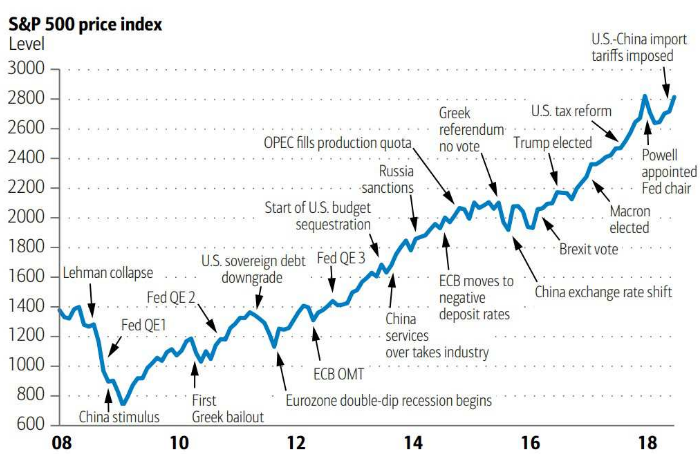
S&P 500 Since 2008 with Key Events Along the Way.



Sources: Chief Investment Office, Bloomberg. Data as of July 2018.
Past performance is no guarantee of future results.

Source: Bank of America

Looking forward, the U.S. economy continues to chug along at a slow but steady pace, entering into its 11th straight year of expansion and shrugging off this past summer's fears of a recession. The U.S. economy alone created over 2 million new jobs in 2019, dropped its unemployment rate to a 50-year low 3.5%, and saw faster than expected wage growth. The U.S. consumer continues to be strong, with the most recent results showing a 3.2% year-over-year increase in total consumer spending, and final 2019 holiday spending results are expected to show a 5% increase from 2018.[1] It is also important to point out that Federal Reserve actions typically have a lag time of six to nine months before the economy begins to feel its effects.[2] Since the Fed cut rates three times in 2019, many of their positive effects likely have yet to be felt and should materialize midway through 2020.

Over the last ten years, the global economy has lagged the United States and, in fact, was feared to possibly fall into recession early last year. However, recent global leading economic indicators are showing an uptrend in economic growth and productivity fueled by historically low global interest rates, inflation and oil prices. Furthermore, easing trade tensions between the U.S. and China should help alleviate worldwide corporate concerns of an all-out trade war and may boost consumer confidence. Currently, estimates are for the global economy to grow at a 3.4% pace in 2020.[3] In our view, anything above 2% will be a positive for global stocks.

On trade, the U.S. and China have started to show some tangible progress in the reduction of trade tensions. Late last year the two countries announced that they would be suspending any further tariffs and went on to sign a "Phase I" trade deal on January 15. In addition to agreeing to purchase some $200 billion in U.S. goods over the next two years, China has promised to make changes to its currency policy. In a surprising move, on January 13, the United States announced it would remove China from a list of countries considered to be currency manipulators ahead of the Phase I signing. Bottom line, trade issues appear to be moving modestly in the right direction – for now.

Over the long term, earnings drive stock prices, and 2020 should bring about solid growth in corporate earnings. Currently, consensus estimates are calling for a 9-10% increase in total S&P 500 earnings growth for 2020.[4] I believe these estimates will likely come down as the year goes on (analysts are usually overly optimistic at the beginning of the year), but any mid-to-high single digit earnings growth in this low interest rate environment can support stock price appreciation. If we assume a stable P/E multiple of 18 times earnings, and earnings grow 6-10%, it is reasonable to expect a similar market return in 2020. Adding to that return is the dividends paid to you by many of the companies you own with the average yield on the S&P 500 Index around 1.7%.

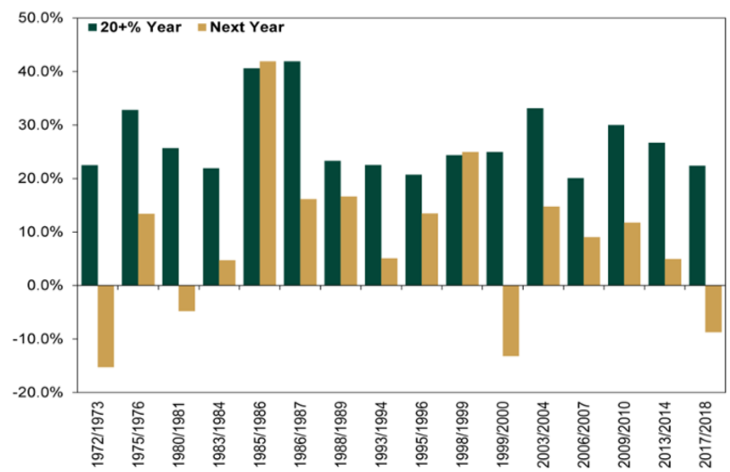
Risks – There are a lot of them and that is usually a good sign, as historically the stock market is known for climbing the proverbial "wall of worry." Geopolitical concerns – such as an escalation in tensions with Iran, terrorism, a serious breakdown in trade negotiations, or any black swan event – are a real and present danger to this bull market. Additionally, rising inflation or an unexpected slowdown in economic growth would certainly throw this market for a loop.

Our base scenario, however, is for a continuation of both modest growth and stable interest rates as we head into 2020. This year will not be the straight upward, smooth 30% rise as in 2019, but the U.S. stock market will likely continue to grind out a solid return for investors. As they say in football parlance, ***"three yards ahead and a cloud of dust."***

In January 2019, we were bullish on the outlook for stocks largely due to the positive fundamental economic backdrop and also due to history. The third year of a President's term is almost always the best for equities, and 2019 sure provided all that. In 2020, we are entering into the fourth year of the presidential election cycle, historically the second best year for stocks. On average, stocks gain around 7% during the fourth year as Presidents do all they can to keep boosting the economy and sentiment ahead of an election.

One more important data point: going back to 1950, after a year of a 20% or more gain, the S&P 500 Index is up the following year 83% of the time with an average gain of over 11%![5] ***Bottom line, great years in the stock market are usually followed with good years, and we believe that is the highest probability in 2020.***

Exhibit 2: Global Stocks Often Keep Going After Great Years



Source: FactSet, as of 12/18/2019. MSCI World Index annual returns with net dividends for the years shown.

One thing is for sure – 2020 is an election year that will be chock-full of campaign promises and media headlines, which will likely lead to heightened market volatility. However, keep in mind, in 2016 the consensus on Wall Street was A) Hillary Clinton would win and B) in the unlikely scenario that Trump won, markets would immediately correct 15-20%. As we all know, Trump won the presidency, and markets are now up approximately 50% since election night. In fact, if there is anything the last four years have taught us, it is that American business is a juggernaut that will keep plowing forward regardless of who is in office and what the political headlines are. So in 2020, let's ignore the noise from various campaign promises and stay the course!

Thank you for your continued confidence, and I wish you a happy and healthy start to the New Year!

Best Wishes,

Jim

James C. Burns, CFA
President & Chief Investment Officer

<u>P.S.</u>

This quarter I wanted to highlight another one of our Senior Portfolio Managers, Jim Sanderson. By way of background, Jim began his career at Marine Midland Bank (now HSBC) and then served as Chief Investment Officer for the Cornell University Investment Office. In 1993, Jim left as CIO at Cornell to start his own investment management firm, Sanderson Capital, with his daughter Ali serving as back office administration. In 2006, however, Ali and her husband moved to Boston with exciting new career opportunities. As such, Jim, with a very impressive list of clients in tow, began interviewing various money managers in Upstate NY. He joined J.W. Burns & Company in June 2007. In his own words, "it was a great business decision."

To which I will reply, "for both sides."

Jim is directly involved in firm-wide investment decisions, research and analysis, along with portfolio management. Jim brings a wealth of knowledge and experience in working with endowments, foundations, and individual clients. As the second Jim in our office, we fondly call him "Sir James" which seems to make him feel like royalty.

He has earned it with his dedication and performance, and we are proud to have Jim Sanderson on our team.

Jim lives in Ithaca with his lovely wife Stoozie, and their dog, Toto.

1 Jonathan Jozy, Merrill Lynch Outlook 2020

2 Haverford 2020 Outlook

3 International Monetary Fund

4 Akane Otani, *Investors are Counting on Earnings to Rebound in 2020* -

Wall Street Journal, January 2020.

5 Mark DeCambre, Marketwatch.com 2020