RDM CAPITAL ASSOCIATES
WEALTH MANAGEMENT

FOURTH QUARTER 2019 MARKET COMMENTARY and 2020 OUTLOOK
January 2020

STATE OF THE MARKETS AT YEAR-END

Markets ended 2019 in strong fashion, with the S&P 500 accelerating to close the year up nearly 30%. Much of the strong performance is attributable to the fact that the U.S.-China trade drama subsided in the fourth quarter as the two sides reached a "phase one" trade deal, reducing some of the market's trade headwind that prevailed throughout the year. Economic data in 2019 reflected some economic harm from the ongoing U.S. - China trade dispute, as trade is a contributor to GDP growth, and business investment and manufacturing data weakened as the year progressed due in part to the impact of tariffs. With trade out of the headlines for the time being, investors in the fourth quarter focused more on strong domestic economic data and an improving global economy.

Improvement in economic sentiment was noticeably present in the treasury yield curve. The much-publicized inversion of 2019 has since reversed and, as we noted in prior market commentaries, we believe the inversion in this instance was more anomalous (due in significant part to unusual and unorthodox monetary policies, domestically and abroad, over recent years) than predictive of an imminent recession. In comparison to other developed economies, with 2019 Euro GDP hovering around 1% for example, the U.S. is on relatively strong economic footing. This is reflected in modest but steady economic growth (~ 2-2.5% 2019 GDP growth), moderate inflation (~2%), low unemployment (~3.5%), and accommodative interest rates (1.5-1.75%). We view this as a positive economic backdrop for markets heading into 2020.

With respect to markets in 2019, equities surprised many market doomsayers, with returns of 22% and 29% for the Dow and S&P 500, respectively. Within stock sectors, the top performers for the year were technology, financials, communications and industrials, which all surpassed the broader market returns. Fixed income gained ~ 9% on average for the year with longer-duration bonds out-performing in a falling rate environment. Interest rates declined across the board after the Fed's "mid-cycle adjustment" that was intended to alleviate some of the negative economic consequences of rates rising too far at the end of 2018. With the Fed signaling a pause in rate adjustments for the time being, we expect monetary policy to play a less prevalent role in equity returns going forward than it has in recent years.

2020 Market Outlook

Looking ahead to 2020, investors are making investment decisions with three primary variables or concerns in mind: 1) additional progress or flare ups in international trade relationships; 2) geopolitical tensions in the Middle East, especially between the U.S. and Iran; 3) the 2020 presidential election and its implications for domestic economic policy. We expect these factors to play a major role in market behavior during 2020

U.S.-China Trade Relationship

With respect to the first variable, we believe that much of the U.S.-China trade drama that has dominated news headlines and market attention will subside somewhat in 2020, as the trade partners tout the progress accomplished so far, such as the phase one deal, as a "win" for each side. Particularly on the U.S. side, where President Trump is engaged in a re-election campaign that is going to emphasize the economy and recent stock market returns, political leadership will not want to see a major trade-induced bout of market volatility shortly before the election.

We view the probability of future U.S.-China trade progress as low and unlikely in the near term, given that the easily attainable agreements surrounding lower tariffs and increased agricultural purchases were already attained in the phase one deal. A resolution of more structural issues involving the Chinese economic and political system, such as theft of intellectual property and freer market access for U.S. companies to Chinese consumers, would be harder to attain because these issues turn on the reform of a highly centralized and authoritarian political leadership that has no inclination to loosen its grip on power.

Middle East Tensions

In the Middle East, U.S.-Iran tensions have the potential to escalate to a point where markets become increasingly more uncomfortable. The protest/attack on the U.S. embassy in Iraq by an Iranian-backed group, followed by the U.S. killing of top Iranian General Qassem Soleimani, has caused the world to brace for the worst case military scenario. While it is a near certainty that Iran will seek retribution and launch an attack on U.S. interests for Soleimani's death, most foreign policy experts believe that neither the U.S. nor Iran want to engage in a traditional military war. Particularly on the U.S. side, where President Trump campaigned on (and to some extent has carried through with) a promise to reduce the U.S. involvement in foreign wars and return U.S. troops home, it's unlikely he wants to escalate the situation further into a war with Iran while on the campaign trail. However, the current escalation feels like a new, more serious, stage of the long-running U.S.-Iran feud, and political experts are unable to predict where the U.S.-Iran conflict is headed. This is causing the kind of geopolitical uncertainty that markets abhor.

The most likely base-case scenario is that the nations will engage in a proxy war by directly or indirectly targeting interests in the Middle East, such as Israel, the Strait of Hormuz, or military installations in Iraq or Syria. While this scenario is certainly not ideal for markets, so long as the conflict is contained to the Middle East geography, resulting market volatility from developments would be muted. However, the uncertainty surrounding when the next attack will occur and whether it will have a serious economic impact is a market headwind in the short-term.

Presidential Election Year Uncertainty

Lastly, the presidential campaign kicks into full gear now that the calendar has turned to 2020, with the Democratic Iowa caucuses only weeks away on February 3rd. Markets will be closely watching the progress of the various Democratic candidates and their election probabilities with their related obvious implications for the U.S. economy. While most observers expect a continuation of President Trump's current economic policies should he win the election, the Democratic challenger is currently an unknown that presents a variable for markets to assess as the year goes by.

Regardless of the strong assertions that may be made during campaign stump speeches, the reality is most politicians take a softer tone once the nomination is secured. Further, once a president is elected, his/her ability to directly influence economic conditions is limited to those proposals that can also garner

Congressional support, which may not be controlled by the party that holds the White House. Thus, it is important to not read too much into proposals touted at this stage of the game – they will often get diluted long before inauguration or have little chance to become law afterwards.

Conclusion

We view the market setup for 2020 to be favorable, barring unforeseen developments. As discussed above, economic conditions are strong, monetary policy is accommodative and business and investor confidence is returning to the marketplace after a trade-induced hiatus. Exogenous, unpredictable shocks like war in the Middle East, a terrorist attack and the like are impossible to craft an investment plan around. It is our view that any domestic or global headwinds, while concerning, should not be enough to derail the bull market, given the strong economic and financial fundamentals already in place.

While the economic expansion is in its later stages, there is little evidence in the economic data that a recession is imminent and recession indicators like the recent yield curve inversion have dissipated. The U.S. consumer is strong and, along with a return of business investment, should underpin the U.S. economy in 2020. The average consensus of economic analysts is for 9.5% corporate profit growth in 2020 on 2% GDP growth. At current prices, stock valuations appear slightly above fair value so we would not be surprised to see a modest pullback in early 2020, particularly as investors take some 2019 gains that they deferred for tax purposes into 2020. We then expect equities to trade along with economic and geopolitical developments into the fourth quarter 2020, when markets will turn to political developments in the presidential election. Ultimately, we believe that the market, as represented by the Dow Jones Industrial Average, should trade within a range of 26,000 and 31,000 in 2020.

In late cycle markets, stock selection discipline is paramount. Despite the current full valuations, we still see value in stock sectors like industrials and consumer cyclicals with discrete opportunities across the market in other sectors like financials, healthcare/pharmaceuticals, and energy. Further, for investors in retirement or pre-retirement it is especially imperative to engage in financial planning and asset allocation reviews to ensure that retirement income nest eggs are invested appropriately. We are happy to engage with clients, or prospective clients, to conduct these reviews as appropriate during 2020. Along these lines, please see below for a summary of important wealth planning rules and limits that apply for 2020.

As always, all comments are welcome and appreciated.

Wealth Planning Rules for 2020

Retirement savings contribution limits:

- $19,500 ($26,000 if aged 50 and over) to a 401K
- $6,000 ($7,000 if aged 50 and over) to an IRA
- The lesser of $57,000 or 25% of compensation to a SEP IRA

Income limits to make a fully deductible IRA contribution if covered by a retirement plan at work:

- Single taxpayers covered by a workplace retirement plan, $65,000 with a phase out up to $75,000 (individual filers)
- Married taxpayers where the spouse making the IRA contribution is covered by a workplace retirement plan, $104,000 with a phase out up to $124,000 (married filing jointly)
- Married taxpayers where the IRA contributor is not covered by a workplace retirement plan and is married to someone who is covered, $196,000 with a phase out up to $206,000 (married filing jointly)

Income limits to make a Roth IRA contribution:

- $124,000 with a phase out up to $139,000 (individual filers)
- $196,000 with a phase out up to $206,000 (married filing jointly)

Long-term capital gains rates by taxable income:

Status	**0% Rate**	**15% Rate**	**20% Rate**
Single	Up to $40,000	$40,000 - $441,450	Above $441,450
Married Filing Jointly	Up to $80,000	$80,000 - $496,600	Above $496,600

Estate and gift tax:

- $15,000 annual gift tax exclusion
- Amount of assets that are exempt from the estate and gift tax is $11,400,000
- Due to the spousal portability election, the total exemption for a couple is $22,800,000