Stark Financial Advisers, Inc.

A Registered Investment Adviser

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Special points of interest:

- Key Investment Trends for the 2020s
- Opportunities in the Emerging Markets
- How Do Markets Compare Under Recent Presidents?
- Politics will Drive Markets in 2020
- Investing for Income Remains Challenging
- Retirement Contribution Limits Rise for 2020

Inside this issue:

Eight Trends Expected to Impact Your Wallet

As we move into a new decade, what new mega-trends will influence investment decisions? We see peak globalization, the risk of recession, the possibility of quantitative failure, demographic trends, climate change, automation, smart everything and space as key drivers. Market trends are being influenced by trade negotiations between the U.S. and China. Have we reached the **peak in globalization** and the unrestricted free movement of goods, capital and labor? Perhaps trade tensions will become the norm and the cause of economic swings. In such an environment, national security and economic sovereignty will dominate policy. Aerospace, defense, energy, water and infrastructure companies should benefit. Easy money has inflated asset prices, but profits have gone to the wealthy, not to the workers. When the next **recession** comes, will the policy response be to correct the excesses of the 2010s? That will mean higher interest rates, lower earnings, or both. Gold and gold miners, utilities with pricing power and high-quality bank stocks may be recession resistant. Other sectors out of the political crosshairs should also be relative outperformers: defense, waste management, and global beverages. It's also possible that because interest rates are so low, central bankers may not be able to reflate the economy during the next recession. Such **quantitative failure** would favor gold and real assets, especially if the U.S. dollar cracks. Bond proxies, such as high yielding stocks (like utilities or dividend payers) could see another move up. **Demographic trends** will also drive demand. In the emerging markets, five people enter the middle class every second. This creates more demand for a range of products and services. As the population ages, expect more saving over spending which is deflationary. The arrival of Gen Z, which is focused on tech-savvy experiences, not conspicuous consumption, suggests the likely losers will be bricks and mortar retailers. Are we nearing an inflection point in the fight against **climate change**? If so, companies offering clean energy solutions will be winners. By 2035, many jobs could be **automated**. As processes become much more efficient, will global supply chains switch away from emerging markets? Investments that play into automation, such as big data and artificial intelligence, may be winners. By 2030, there may be 500 billion connectable devices; in this "**smart everything**" world, privacy will be killed. Companies involved in the Internet of things, connectivity and smart cities, as well as "big brother" surveillance technology, may all be beneficiaries. Finally, **space** is the ultimate frontier. Tourism and nanosatellites are the next industry that could be worth about $1 trillion by 2030. Look for aerospace and defense companies to blast off.

Are Emerging Markets Cheap?

Between trade tensions and near-recessionary conditions in Europe, international equities have had a tough run. After two years of underperforming American stocks, the MSCI Emerging Markets Index was trading at 13.5 times earnings at the end of October, compared with the S&P 500's multiple of 22.3. Since January 2018, through early December 2019 the MSCI Emerging Markets Index has produced a total return of approximately –5.5%. For the same period, the S&P 500 has returned about 20%. It's wise to remember that markets cycle and trends continue until they reverse. Thus far, trends continue to favor US equities. However, we continue to monitor the relative performance closely. As we discussed in the Megatrends article, the middle-class in emerging markets, such as China, India and Southeast Asia, is rapidly growing. This growth produces opportunities for companies able to capitalize on demographic shifts. Companies such as AIA Group, a Hong Kong-based insurer, and HDFC Bank, India's largest private sector bank, may be good picks. Alibaba Group, the world's largest retailer, continues to grow at a stunning rate. If you are not a stock picker, there are funds to consider with emerging market exposure. Two funds for consideration are the iShares Core MSCI Total International Stock (IXUS) and Vanguard FTSE All-World Ex-U.S. (VEU) ETFs. Both are top-rated funds for international exposure according to Morningstar. For a Moderately Aggressive investor, we remain underweight in the sector with an asset allocation of approximately 10%.

Market Performance by President

During Donald Trump's presidency, the S&P 500 has gained 38% from inauguration day through November 29 (721 days). How does the 38% gain compare with other modern presidencies for the same period? Ronald Reagan's first term was highlighted by high inflation, a recession in 1981 and unemployment that spiked to nearly 11%. Despite the state of the economy, the market gained 27%. Under George H.W. Bush, who served only one term, the economy and stocks surged during his first year in office with the S&P 500 climbing 27% in 1989. Then the savings-and-loan crisis and the gulf War struck. Oil prices doubled and growth slowed. The economy slipped into recession in 1990. Despite it all stocks were up 31% in the first 721 days. The performance of the markets under Bill Clinton was most like Donald Trump. During the same comparative period, the S&P 500 was up 38%. During the Clinton presidency, Wall Street celebrated the rise of the Internet and strong economic growth. The Clinton years were punctuated by the dot-com boom that later became the dotcom bust. George W. Bush was the only modern President to preside over a market decline in the comparative period during which the S&P lost -20%. Bush inherited the dotcom bust that birthed the 2001 recession. The downturn was deepened by the 9/11 terror attacks. Barack Obama inherited an economy in recession. Under George Bush's two terms the S&P had declined -43%. The stock market finally bottomed in March 2009 and the economy slowly healed. In the first 721 days, stocks gained 44%. However, annual GDP growth never topped 3% in the Obama era. Donald Trump's victory initially fueled a breathtaking rally in the stock market. His pro-business agenda carried the Dow from 18,332 on Election Day above 21,000 by March 2017. The tax overhaul sent the market higher with the Dow eventually surging above 27,000. Economic growth accelerated above 4% and the unemployment rate plunged. Markets now are choppier due to concerns over international trade, but the trend remains higher.

2020 Stock Market Prediction

Predicting the stock market in the short-term is dicey at best. But, it's a new year and customary for market watchers to espouse predictions and expectations. 2019 was a great year for U.S. stocks. Our first prediction is that 2019's performance is not likely to be repeated in 2020. We aren't saying things will be bad for domestic stocks, just not as robust. At year-end, the S&P 500 was trading near 3,200. For 2020, top Wall Street firms expect a range between 3,000 and 3,500. Of eight firms that have released 2020 forecasts, the mean target for the S&P 500 is 3,241, a gain of roughly 3%. The modest mostly bullish forecasts are based on the expectation that the U.S. economy is expected to continue to grow this year. Our next prediction is that monetary policy will remain supportive of stocks. The U.S. Federal Reserve Bank appears to be signaling no rate increases this year. History tells us that expectations for performance frequently change as unforeseen events alter the outlook; events such as the collapse of oil prices in 2015, the 2016 U.S. presidential election, and the big slide in global bond yields last year. At the moment, the outlook for 2020 looks solid so the biggest risk would appear to be not owning stocks. Supporting a positive view for the year is that recently, shares of economically sensitive companies, like banks, manufacturers and materials firms, have been leading the market higher. Our assumption is that earnings for U.S. companies will continue to strengthen. Should they falter, it would be a red flag. Other risks that will play out include global trade tensions, particularly between the U.S. and China, and the political environment. Should the 2020 election be won by a far-left, anti-business candidate, stocks will most likely suffer.

Interest Rates to Remain Steady

Perhaps the most disagreement on Wall Street is what to expect interest rates to do this year. Some see yield on the benchmark 10-year Treasury note rising above 3%, while others expect a drop. Perhaps it's a sign of confusion about the course of the economy and monetary policy. A recent survey of economists produced predictions ranging for the benchmark 10-year Treasury (currently trading around 1.88%) to yield anywhere from just slightly higher than 1% to above 3%. In 2019, many economists who expected yields to rise were surprised when prices rose to multiyear highs and yields fell to all-time lows. Most economists agree that the U.S. economy will continue to expand at about a 2% annual rate and that the Federal Reserve will keep interest rates steady. Analysts, however, are divided about the likelihood of the U.S. and China easing trade tensions. And like the stock market, the bond market will be affected by the outcome of the 2020 elections. It's probably 40 or 50 years since the country has been so divided and an election could produce such a wide range of policy outcomes. Our prediction is that a preliminary trade agreement will be negotiated at a minimum. A surge in business and consumer confidence will spur growth this year with investors willing to take more risk. Expect investors to buy stocks and sell bonds. The stock market should move higher and bond prices lower causing yields to rise. In such a scenario, we forecast a 2.5% yield for the 10-year Treasury. Nevertheless, we expect yields to remain closer to historic lows than highs. Lending costs will remain affordable, the real estate market should remain robust, and the stock market should trend higher. The flip side of the coin is that income investors will continue to earn relatively skimpy yields from many investment grade bonds and will be faced again with the ever-present risk of lower bond prices should yields move significantly higher. Income investors may, once again, be better served by looking at bond alternatives, such as stocks that pay attractive dividends and have the potential for growth.

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"Helping Clients Balance Risk and Return"

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We also understand the relationship between risk and return and seek to reduce risk through targeted asset allocation among numerous asset classes. Each asset class has separate and distinct characteristics, including returns and risk that can be measured over time. While all classes are cyclical, they often trend in different directions. Two portfolios, each having similar return prospects, may have substantially different short-term risk characteristics. Clearly, the lower risk portfolio would be the choice of most investors.

Of course, all investments contain risk and there is no guaranty of positive returns; losses can occur. For additional information and a complete performance history, please visit www.starkadvisers.com.

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Changes in Federal Tax Laws

The 2019 tax year is rapidly coming to an end. Let's look at some of the ways in which the federal tax return you file by April 2020 will differ from the last one you filed. The individual mandate penalty is gone. If you don't have health insurance, you won't owe a penalty. If you plan to itemize your deductions, your unreimbursed medical and dental expenses will have to exceed 10% of your 2019 adjusted gross income in order to be deductible. The alimony deduction has been eliminated. For divorce and separation agreements made or modified in 2019 and going forward, alimony payments will not be deductible. You can contribute more to your retirement accounts. The 401 (k) base contribution rises to $19,000. The catch-up contribution remains unchanged at $6,000. The IRA base contribution increases to $6,000. The catch-up limit remains unchanged at $1,000. Health Savings Account contribution limits are higher. Self-only coverage contributions are now $3,500, family coverage limit increases to $7,000. To account for inflation, standard deductions are somewhat higher. If you are married filing jointly, the deduction rises to $24,400. The head of household deduction increases to $18,350, and if you are single, the amount of your income subject to federal taxes is reduced by $12,200. Unfortunately, income brackets are also somewhat higher due to inflation. For complete 2019 tax rate tables you can review IRS Revenue Procedure 2018-57. They start on page 8 of the document.

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As always, the professional staff at Stark Financial Advisers thanks you for your confidence and business