December 2019

BRIDGE ADVISORY

The S&P 500 experienced its best year since 2013 and ended on a high note with a very strong fourth quarter. The economic data released for the fourth quarter thus far points toward a stabilizing global economy following three quarters of deterioration. This created a tailwind for markets around the world driving all major indices to high single digit to low double digit returns for the quarter. Emerging market equities benefitted the most from the favorable conditions and a renewed appetite for risk, which propelled the asset class to the top of the equity market performance list. For the year as a whole, markets around the world climbed the proverbial "wall of worry" to end the period with double digits gains for equities and high single digit gains for bonds. Due to the weakening economic conditions earlier in the year, the Federal Reserve cut interest rates three times throughout and now is communicating that they will be in a holding pattern.

A new year always brings about a time of reflection for many and resolutions for some. How many of you keep to your resolutions is a whole other discussion! This turning of the year we get to start a new decade, which provides a unique milestone to reflect upon the last decade. Ten years is a long enough time frame when it comes to investing to pull some true insight. So, as we enter the 2020's let's look back on the decade that was.

The 2010s: A Decade in Review[1]

Imagine it is early January 2010 and you are reading a review of the financial markets. Investors have been on a roller coaster over the past three years, living through the stress of the global financial crisis and market downturn of 2008–2009, then experiencing the recovery that began in March 2009 and is still going strong.

Investors who rode out the market's slide are beginning to be rewarded. But the rebound is 10 months old, and markets have a long way to go to reach their previous highs. Opinions are mixed about what might unfold in the coming year. A December 2009 headline in the *Wall Street Journal* underscored the uncertainty: "Bull Market Shows Signs of Aging."[2] The publication pointed out that, although stocks have rallied and indices are on the rise, worries are mounting in some quarters that the market is running out of steam.

From the vantage point of early 2010, you may be wondering whether to stick with your investment plan or move into cash and wait for more evidence that the markets have recovered. Now, fast forward to today and consider what the global equity markets delivered to investors who stayed the course.

On a total return basis, global stocks more than doubled in value from 2010–2019, as Exhibit 1 shows. The MSCI All Country World IMI Index, which includes large and small cap stocks in developed and emerging markets, had

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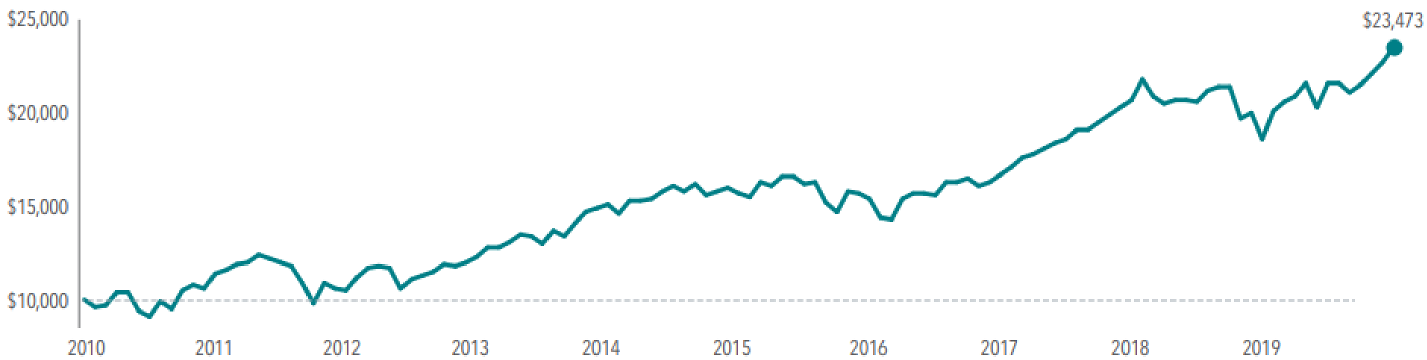
[1] Adapted from "*The 2010s: A Decade in Review*", published by Dimensional Fund Advisors and made available to us.

[2] "Bull Market Shows Signs of Aging," The Wall Street Journal, December 7, 2009.

a 10-year annualized return of 8.91%. From a growth-of-wealth standpoint, $10,000 invested in the stocks in the index at the beginning of 2010 would have grown to $23,473 by year-end 2019.

Exhibit 1: Growth of Wealth

MSCI All Country World IMI Index, January 2010–December 2019



Past performance is not a guarantee of future results.

Source: MSCI. In US dollars, net dividends. MSCI data © MSCI 2020, all rights reserved. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio.

Despite positive annual market returns during most of the decade, investors had to process ever-present uncertainty arising from a host of events, including an unprecedented US credit rating downgrade, sovereign debt problems in Europe, negative interest rates, flattening yield curves, the Brexit vote, the 2016 US presidential election, recessions in Europe and Japan, slowing growth in China, trade wars, and geopolitical turmoil in the Middle East, to name a few.

The decade also brought technological advances in electronic commerce and cloud computing, the global embrace of the smartphone and social media, increased automation and enhanced artificial intelligence, and new products like electric cars and early iterations of self-driving ones.

Looking back, you could conclude that the decade had its share of uncertainty—just like the decades before. But overall, the US equity market experienced moderate volatility compared with previous decades. Exhibit 2 displays this by looking at returns and standard deviation, where a higher standard deviation reflects wider market swings during that decade.

Exhibit 2: Volatility in Perspective

S&P 500 Index annualized returns grouped by decade (1930–2019)

	Annualized Return (%)	Annualized Standard Deviation
1930–1939	−0.05	37.83
1940–1949	9.17	15.90
1950–1959	19.35	11.84
1960–1969	7.81	12.15
1970–1979	5.86	15.93
1980–1989	17.55	16.41
1990–1999	18.21	13.43
2000–2009	−0.95	16.13
2010–2019	13.56	12.46

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S&P 500 Index data provided by Standard & Poor's Index Services Group. Standard deviation is a statistical measurement of historical volatility.

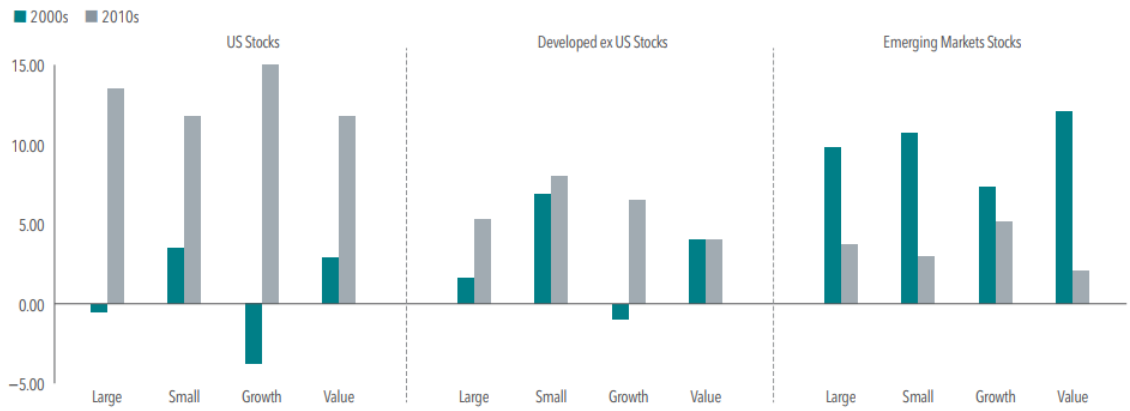
BENEFITS OF DIVERSIFICATION

Investors who committed to global diversification and areas of the market associated with higher returns—small cap stocks and value stocks (i.e., stocks trading at low relative prices)—were challenged over the past decade. As shown in Exhibit 3, during the 2000s, investors were generally rewarded for holding emerging market stocks and developed ex US stocks. During the 2010s, the US market outperformed developed ex US and emerging markets.

The performance of value stocks vs. growth stocks (i.e., stocks trading at high relative prices), and small vs. large cap stocks, also varied between decades. Small cap and value stocks outperformed large cap and growth stocks in the 2000s, while the 2010s produced mixed outcomes. Small caps underperformed large caps in the US and emerging markets but outperformed in the developed ex US market. Value underperformed growth in all three market regions. Despite underperforming large cap and growth stocks in the US, small cap and value stocks delivered 11.83% and 11.71%, respectively, for the decade.

Exhibit 3: The Past Two Decades—2000s vs. 2010s

Annualized returns (%)



Past performance is not a guarantee of future results.

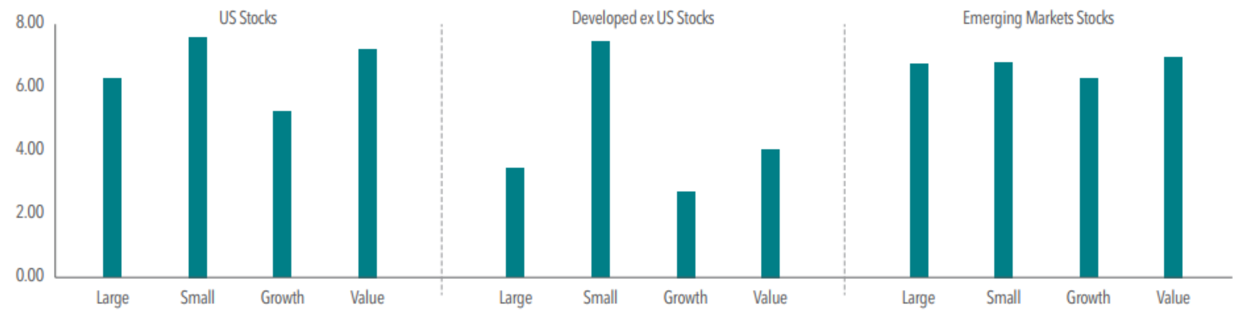
Market segment (index representation) as follows: ***US Stocks—****Large Cap (Russell 1000 Index), Small Cap (Russell 2000 Index), Growth (Russell 3000 Growth Index), Value (Russell 3000 Value Index);* ***Developed ex US Stocks—****Large Cap (MSCI World ex USA Index), Small Cap (MSCI World ex USA Small Cap Index), Value (MSCI World ex USA Value Index), Growth (MSCI World ex USA Growth Index);* ***Emerging Markets Stocks—****Large Cap (MSCI Emerging Markets Index), Small Cap (MSCI Emerging Markets Small Cap Index), Value (MSCI Emerging Markets Value Index), Growth (MSCI Emerging Markets Growth Index). Index returns are in US dollars, MSCI indices are net of withholding tax on dividends. Frank Russell Company is the source and owner of the trademarks, service marks, and copyrights related to the Russell Indexes. MSCI data © MSCI 2020, all rights reserved. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.*

Exhibit 4 shows the cumulative investment experience over both decades, with small cap and value stocks outperforming large cap and growth stocks, respectively, across the US, developed ex US, and emerging markets. The annualized 20-year returns illustrate how diversification can help investors ride out the extremes to pursue a positive longer-term outcome. Over the past decade, global fixed income also posted returns that may have surprised some investors. In 2010, investors looking at historically low interest rates may have expected rising rates as financial markets and economies recovered from the crisis. But over the decade, short-term rates increased while long-term rates decreased. Realized term premiums were positive, as long-term bonds generally outperformed shorter-term bonds. Realized credit premiums were also positive, as lower-quality bonds generally outperformed higher-quality bonds.[3]

[3] Bloomberg Barclays Indices

Exhibit 4: The Longer View

2000–2019: Annualized returns (%)



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ENDURING PRINCIPLES

That brings us to now—January 2020. Stocks and bonds in the US, and many other developed and emerging markets, logged strong returns last year. The US bull market is 10 years old, and current headlines can give investors other reasons to worry about the future—for example, a pushback on globalization, the effects of climate change, the limits of monetary policy, the fate of Brexit, and the vagaries of the 2020 US presidential race. And those are merely the *known* unknowns. Looking ahead, who can say what the next 10 years will bring? You can argue for continued strength in the market or for reasons to expect a correction. The only certainty is the decade will have its own set of surprises.

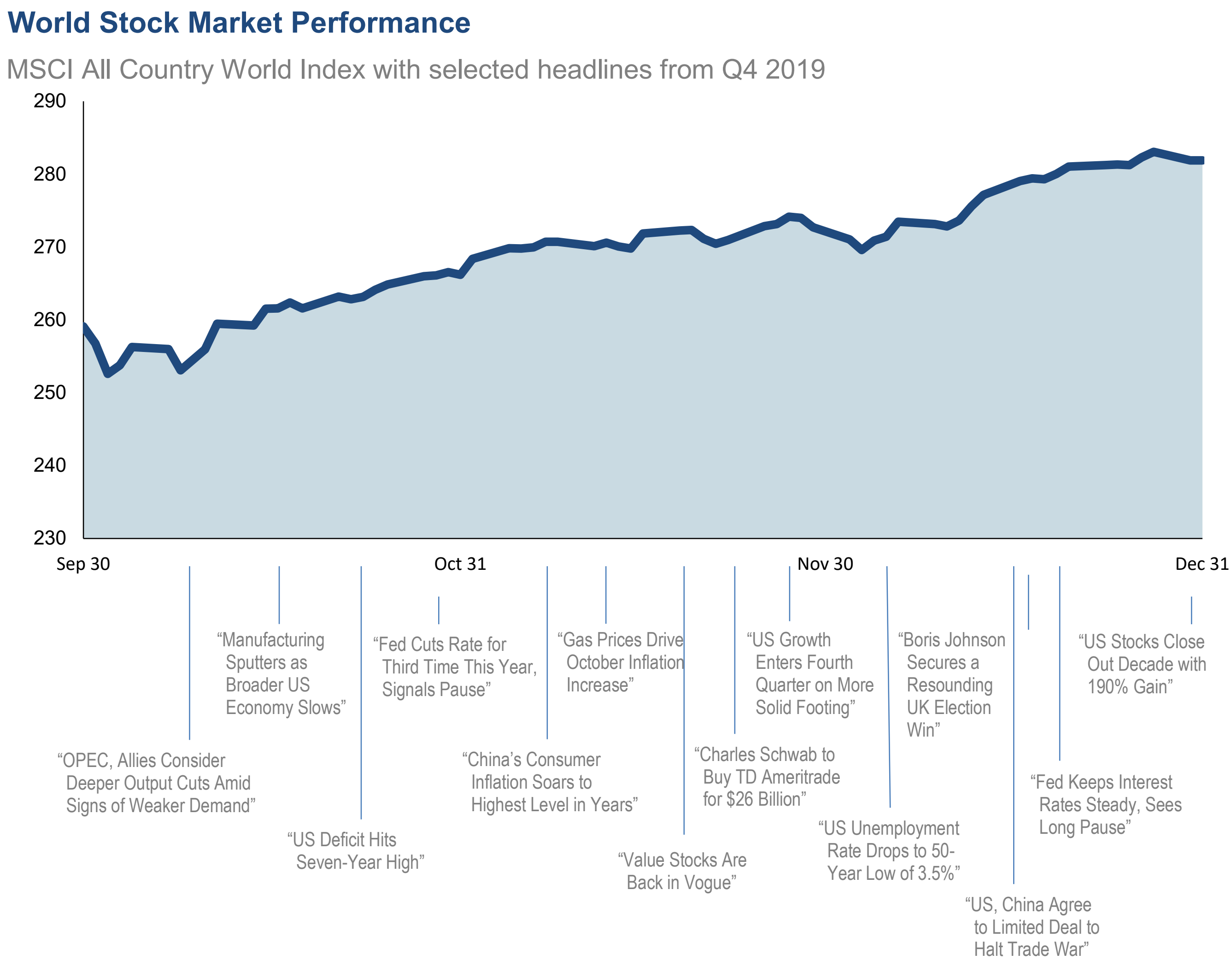
Here's what we can learn from the past decade (and the ones that came before it): Despite all the change and uncertainty, the fundamentals of successful investing endured. Diversify across markets and asset groups to manage risks and pursue higher expected returns. Stay disciplined and maintain a long-term perspective. Take the daily news with a grain of salt and avoid reactive investment decisions based on fear or anxiety. Don't try to time the markets. Instead, develop a sensible investment plan based on a strong philosophy—and stick with it.

Investors who follow these principles can have a better financial journey in any decade.

Market Update – A Brief Around the World Tour of Markets

Markets were bolstered by the perceived stability in the global economy and finished the year at or near record levels. Emerging market equities were the star of the quarter, returning close to 12% and finished the year up more than 18%. Positive developments on the trade front were cause for optimism. However, much remains to be negotiated and the impact is still very real, especially in the manufacturing sector – the sector contracted in December to its lowest level since 2009. Unemployment dipped back to a historic low of 3.5% though upward wage pressure is still subdued historically speaking. The varied economic landscape that was in place at the beginning of the quarter prompted the Federal Reserve to cut interest rates once more in October for a total of three cuts this year. These rate cuts were the first such actions by the Fed in a decade. The cuts helped normalize (or steepen) the shape of the yield curve (longer-term interest rates are higher than shorter-term interest rates).

In the fourth quarter, the stronger economic backdrop decreased demand for bonds, however, bonds still had a banner year overall.



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

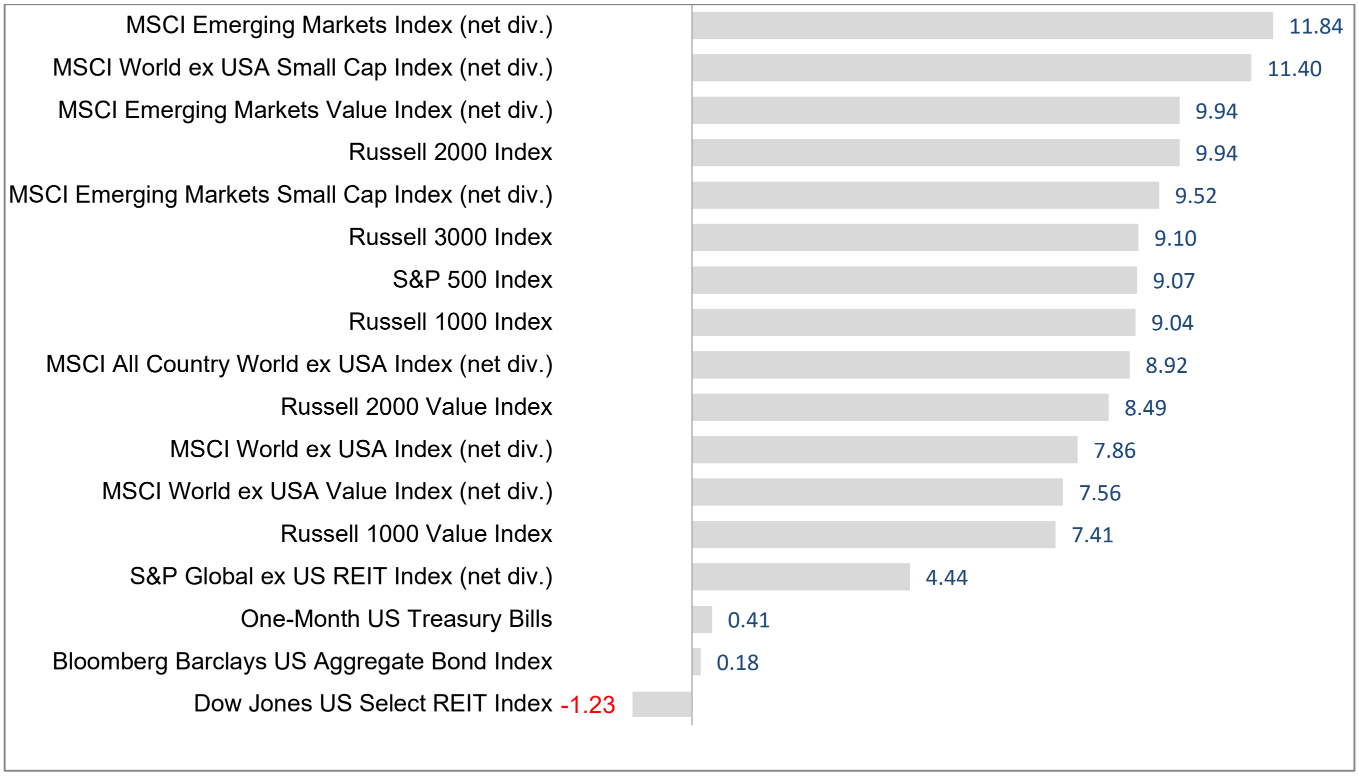
Graph Source: MSCI ACWI Index [net div.]. MSCI data © MSCI 2019, all rights reserved.
It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results.**

On Stocks

The S&P 500 jumped 9.1% in the quarter and wrapped up the year over 31% higher. International developed markets were not too far behind with a return of 8.9% in Q4 and 22.5% for the year. As mentioned, the emerging markets surpassed all broad market indices in the quarter with a return of 11.8% and finished the year up 18.4%. The real estate market (as measured by Real Estate Investment Trusts) was a weak performer relatively speaking but still managed a slightly positive return for the period and rose 23.1% for the year. The US dollar weakened due to the drop in rates but currency overall had little impact on asset returns both for the quarter and year. From a country perspective, and what may be surprising to some, the US was not the best performer in the developed world – Switzerland, The Netherlands, Ireland, and New Zealand all outperformed the US. Amongst emerging markets, Greece topped the charts by jumping 55.7% with Russia not too far behind at 50.1%.

World Asset Classes

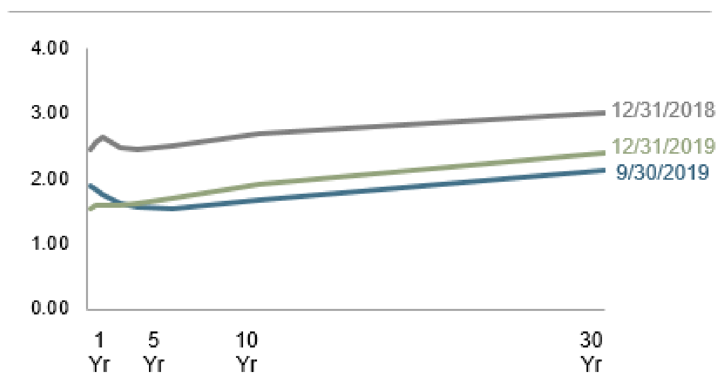
Fourth Quarter 2019 Index Returns (%)



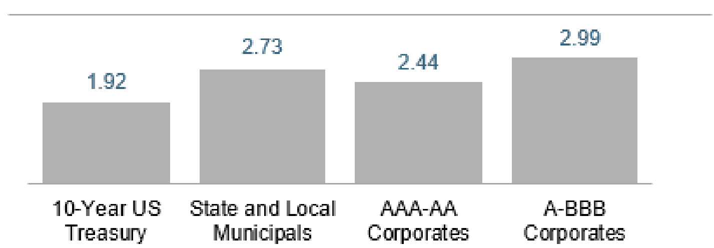
On Bonds

Bond markets were much more restrained in the fourth quarter yet had a solid year in total. US Bonds, as measured by the Bloomberg Barclays US Aggregate Bond Index, were ever so slightly positive at 0.18% for the period and posted an 8.72% gain for the year. Global Bonds declined 1.11% in the fourth quarter, which detracted slightly from the positive year overall to end with a 7.5% gain. Despite the Fed reducing rates, the 10-Yr Treasury yield climbed 24 bps to 1.92%. However, the rate cuts did contribute to a steepening yield curve with shorter-term rates dropping and rates 5 years and beyond ticking upwards. So far, the "inversion" we witnessed in previous quarters has not pointed to an economic slowdown as it often has in the past though it is far too soon to draw any conclusions.

US Treasury Yield Curve (%)



Bond Yields across Issuers (%)



Interest rates in developed markets around the world generally increased during the quarter, which helped pull rates out of negative territory in the long-term part of the market. This increase largely contributed to the negative return for global bonds for the quarter.

Period Returns (%)

*Annualized

Asset Class	QTR	1 Year	3 Years*	5 Years*	10 Years*
Bloomberg Barclays US High Yield Corporate Bond Index	2.61	14.32	6.37	6.13	7.57
FTSE World Government Bond Index 1-5 Years	1.01	2.43	2.40	0.74	0.19
Bloomberg Barclays US TIPS Index	0.79	8.43	3.32	2.62	3.36
Bloomberg Barclays Municipal Bond Index	0.74	7.54	4.72	3.53	4.34
ICE BofA 1-Year US Treasury Note Index	0.59	2.93	1.78	1.25	0.83
ICE BofA US 3-Month Treasury Bill Index	0.46	2.28	1.67	1.07	0.58
Bloomberg Barclays US Aggregate Bond Index	0.18	8.72	4.03	3.05	3.75
FTSE World Government Bond Index 1-5 Years (hedged to USD)	0.18	3.86	2.37	1.92	1.85
Bloomberg Barclays US Government Bond Index Long	-4.06	14.75	6.95	4.16	6.97

One basis point (bps) equals 0.01%. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.** Yield curve data from Federal Reserve. State and local bonds are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the ICE BofA US Corporates, AA-AAA rated. A-BBB Corporates represent the ICE BofA US Corporates, BBB-A rated. Bloomberg Barclays data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).