



November Market Commentary

December 3, 2019

November delivered solidly positive returns for US equity investors, but less so for International Developed and Emerging Markets. Early month trading extended October's strong finish but by mid-month, non-US markets had turned lower. Broad based US indexes scored a series of new all time highs until trade based concerns reemerged just before the Thanksgiving holiday. Moderate selloffs, reflecting generally negative trade news, have persisted into early December.

Positive profit surprises and overall strong third quarter earnings reports buttressed equity prices throughout November. Numerous all-time highs have been posted by widely followed and broad based domestic benchmarks over roughly the past six weeks. Performances of representative global and domestic equity indexes for November and YTD 2019 are illustrated below.

<u>Benchmark Index</u>	<u>November 2019</u> <u>Return (%)*</u>	<u>YTD 2019</u> <u>Return (%)*</u>
S&P 500 Index	3.6	27.6
Russell 2000 Index	4.1	22.0
Russell 1000 Value Index	3.1	23.2
NASDAQ Composite Index	4.6	31.9
Dow Jones U.S. Total Stock Market Index (Full Cap)	3.7	26.6
FTSE All-Share Index	2.2	15.3
MSCI EAFE Index (gross div.)	1.1	18.8
MSCI Emerging Markets Index (gross div.)	(0.1)	10.6

**Return figures include reinvested dividends*

Source: Dimensional Fund Advisors Returns database

We have included the Russell 1000 Value Index in a revised benchmark table. This index tracks Large Capitalization companies whose share price is close to their book value per share. Over the last several years, higher risk company stocks (Small Capitalization and Value) have underperformed significantly relative to Large Capitalization and Growth issues. Value companies have posted annual returns close to average historical expectations, but Growth companies have outpaced their historical annual average returns by almost 100% over the past ten years. This is an anomalous performance disparity that will likely be corrected at some point.

As noted over the summer and fall, a series of interest rates reductions by the Federal Reserve have returned the Treasury yield curve to a normal, positive slope, which has coincided with increased strength in both the Small Capitalization (Russell 2000 Index) and Value sectors of the US equity market. Whether this trend continues remains unknowable.

President Trump continues to negotiate trade disputes in public, using Twitter and impromptu press briefings to deliver admonitions about unfair practices to China and more recently the EU. Trump has indicated he feels no pressure to consummate a deal with China on a short timetable and could be content to “wait until after the [2020] election” if China remains recalcitrant.¹

On the eve of the 70th annual meeting of NATO in London, the President announced that re-imposing tariffs on Argentine and Brazilian steel and aluminum imports is under consideration in view of those countries’ “currency manipulation.”² Mr. Trump is also troubled by a proposed French digital services tax on US technology companies such as Apple (OTC-AAPL) and Alphabet (OTC-GOOG). His response has been to threaten tariffs potentially as high as 100% on French luxury wines and cheeses.³

The efficacy of the Administration’s tariff regimes has received mixed verdicts to date. Pressure on China has had a discernible impact on its willingness to negotiate and obvious negative consequences for the Chinese economy as measured by the Hong Kong stock market. On the other hand, domestic manufacturing activity has slowed as uncertainty about the timing or implementation of a China/US trade deal slows decision making in corporate boardrooms. The situation with the EU appears to be more of a back and forth escalation, which could have undesirable consequences for both sides. To demonstrate the effect tariffs and a general reduction of economic growth is having on Chinese equities the below chart illustrates YTD closing prices of the Hang Seng Index.



Source: www.finance.yahoo.com

For 2019 through December 3, the index has gained 2.1%. The return is positive but hardly in the same league as either US benchmarks or the EAFE Index of Developed markets as noted on page one.

¹ “Trump says he is prepared to wait to strike US-China trade deal,” www.ft.com, December 3, 2019.

² “Trump to Levy Tariffs on Brazil, Argentina,” www.wsj.com, December 2, 2019.

³ “France Promises EU Retaliation After U.S. Trade Threats,” www.wsj.com, December 3, 2019.

US credit markets were quiet in November with no meaningful net change in either yields or the spreads between maturity points on the Treasury yield curve. No further action on interest rates is expected by the Federal Reserve through at least year end. Inflation remains at levels that suggest current short term rates are appropriate and the Fed's posture neutral. We will have an update on inflation and other important economic and statistical indicators through November's releases in an upcoming blog post.

In the UK, a December 12 general election is looming. Polls that had shown a widening lead for PM Johnson's Conservative Party during early November have narrowed significantly within the last several days.⁴ What had appeared to be a likely comfortable Parliamentary majority less than a week ago, has now diminished to a bare majority in at least 5 recent results. It is difficult to evaluate the party preference composition of UK poll samples, but the general trend appears to be a closing of the gap by Labour.⁵ Traditionally, however, polls do tend to narrow as election day nears.

A small conservative majority or a "hung" Parliament would likely lead to a second public referendum on Brexit, which Mr. Johnson has vowed to resist. The unknown quantity at this juncture is The Brexit Party. The impact of this new force, which is clearly to the political right of the Conservatives could make the difference between a solid coalition majority for Johnson or more delay and wrangling to deliver Brexit. We suspect that if Conservatives make a strong showing, it will be accompanied by The Brexit Party unseating numerous existing Labour MPs.

Impeachment proceedings in the House moved to the Judiciary Committee this week, with Articles of Impeachment for the President expected late this month or by early January. Republican members of the House Intelligence Committee released a "prebuttal" report presenting their conclusions from last month's hearings. Not surprisingly, the report concludes that no impeachable offense has been committed by President Trump.⁶ The corresponding report from Democrats, delivered to the Judiciary Committee, concludes the opposite.⁷

Our expectations for this process remain unchanged. It is likely that Articles of Impeachment will be delivered to the House out of the Judiciary Committee and odds favor the House voting to adopt and send some or all of the Articles to the Senate. A trial in the Senate with Mr. Chief Justice Roberts presiding would follow. In our view, conviction and subsequent removal of the President from office remain remote.

In the days since the House Intelligence committee concluded its public hearings, national polls have failed to move toward favoring impeachment. In several battleground state polls, support has declined significantly below previous levels. Democrats have, in the last few days, floated a new trial balloon in the form of possible Presidential censure in lieu of impeachment. One question that naturally flows from this possible change of direction is that if there is insufficient support to impeach, what is the rationale behind a censure?

Equity markets remain far more concerned with trade negotiations than political developments as evidenced by the strong negative reaction to President Trump's assertion that he feels no pressure to conclude negotiations with the Chinese soon.

⁴ "General election 2019 latest polls: Boris Johnson's lead falls to single digits as voting day looms," www.telegraph.co.uk, December 3, 2019.

⁵ *Ibid.*

⁶ "READ: Republican Report On The Impeachment Inquiry," www.npr.org, December 2, 2019.

⁷ "READ: Impeachment Inquiry Report By House Intelligence Committee," www.npr.org, December 3, 2019.

It is undeniable that tariffs have disrupted the flow and volume of world trade and diminished US manufacturing activity, based on statistics and surveys released over the past several months. Sudden equity market downdrafts in response to unproductive news on this front attest to the impact of trade developments in shaping investors' expectations.

Regardless of the ultimate resolution of ongoing talks with major trading partners, equities are poised to record a strong year as of the end of November. Trade tensions have risen and relaxed throughout 2019 and the negotiating process appears likely to extend well into 2020. Coupled with impeachment proceedings, a likely Senate trial and a US election in under 11 months, markets will have a plethora of news to digest.

But as we have seen over the past several months, corporate earnings, current and future, remain the ultimate drivers of equity performance. Trade has accounted for sharp rallies and declines and political strife has had minimal impact, but the net gains for 2019 so far are significant and reflect positive earnings and revenue trends.

Year over year earnings growth rates are projected to increase next year from the 2018/2019 pace. Remaining patient and disciplined has long proven an effective posture to achieve long term goals, a philosophy we do not expect to change. Declines are uncomfortable and inevitable, but no one has yet been able to consistently predict their timing. Repositioning assets to dodge or anticipate a selloff then missing the equally inevitable recovery is a significant impediment to realizing long term investment success.

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