The Stan Clark Financial Team's

PERSPECTIVES

Year-End REVIEW

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How were the stock markets in 2019? Michael Chu and I have put together this concise review of what went on in Canada, the United States and other important economies around the world – and how it affected stock markets. We also look ahead to the rest of 2020 and beyond.

We hope you find this review informative and useful.

Enjoy!

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Year-End (and Decade-End) Review
A positive year closes out a positive decade

By Stan Clark - Senior Investment Advisor and Michael Chu - Investment Advisor

With the new year beginning, we thought it would be useful to review the events of both the past year and the past decade. Then, to look at what 2020 and beyond may hold for us.

What a difference a year makes! At the end of 2018, we were in the midst of a sudden and sharp decline in the stock market. Interest rates were going up and the yield curve had inverted, prompting fears of a recession. Uncertainty swirled around interest rates, U.S.-China trade relations and Brexit, just to name a few!

Fast forward to the end of 2019. We had a remarkable comeback in the stock market. Some uncertainties eased, with apparent progress in U.S.-China trade, improved Brexit clarity, and a recommitment of central banks around the world to lower interest rates.

Stocks have rallied significantly since the Christmas low in 2018. The current bull market, which started in March 2009, is now 130 months old – making it the longest one ever. But it doesn't hold the distinction of the largest percentage gain. That goes to the 1990s bull market. The current bull is up 387% vs. the'90s bull, up 417% (S&P 500).

In economic terms, how do the just-ended 2010s rank? The 1980s delivered supercharged economic growth; the 1990s, the best real stock market returns. The opening decade of the new millennium was the opposite: The 2000s took the doubtful honour of being the worst decade *ever* in real stock market returns. By contrast, the 2010s were a Goldilocks decade, not too hot and not too cold, with moderate economic growth and moderate stock market gains. We have been able to sustain our current long economic recovery partly because it has been such a modest recovery, without huge peaks or valleys.

How did we do this past year?

Our strategies had good returns in 2019, despite slightly underperforming the benchmarks.

Our Canadian stock strategies (Disciplined Canadian Stock) returned 17.8%; the TSX Index was 22.9%. Our U.S. stock strategies (Disciplined U.S. Stock), returned 23.7%; the S&P 500 was 31.5% (in US$).

We also have two global portfolios made up of our multiple stock strategies. The Disciplined World Equity composite returned 19%, compared

	Q1	Q2	Q3	Q4	2019	2010-2019
Canada (S&P/TSX)	13.3%	2.6%	2.5%	3.2%	22.9%	6.9%
U.S. (S&P 500)	11.2%	2.3%	2.8%	7.0%	25.2%	15.9%
EAFE (Europe, Australia, Far East)	7.7%	1.7%	0.0%	6.1%	16.2%	7.7%
Emerging Markets	7.6%	-1.3%	-3.2%	9.7%	12.8%	5.8%
World	10.1%	2.0%	1.7%	6.5%	21.6%	11.7%

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Stan Clark Financial Team Strategy Returns

Composite	2019 Strategy	2019 Benchmark	10 year Strategy	10 year Benchmark
Disciplined Canadian Stock	17.8%	22.9%	10.7%	6.9%
Disciplined U.S. Stock (in US$)	23.7%	31.5%	12.1%	13.6%
Disciplined World Equity	19.0%	21.2%	11.4%	10.0%
Dividend Select World Equity	17.6%	19.9%		
Disciplined North America Equity	20.3%	24.1%		

Source: Bloomberg

to a benchmark 21.2%. This portfolio is 40% in Canada, 40% in the U.S. and 20% in international.

Our second global portfolio, the Dividend Select World Equity composite, returned 17.6%, compared to a benchmark of 19.9%. This portfolio has a slightly higher weighting in Canada and dividend payers. This portfolio is 50% in Canada, 35% in the U.S. and 15% in international.

We also have a North American composite, which returned 20.3%, compared to the benchmark of 24.1%. This portfolio is invested 40% in Canada and 60% in the U.S.

Note: These returns are just for stocks. Clients with less than 100% in stocks will have proportionately less returns. These returns are also before fees.

As we discussed in last year's review and in our June issue of *Perspectives*, value investing has suffered for well over a decade. This has had a negative impact on our performance and on value investors in general. Fortunately, we still have a good 10+ year track record, as we've been able to mitigate the negative impact of value for the majority of years. This is due to, among other things, our using different factors. But we have underperformed in the last two years as the current negatives of value have become more extreme.

How does value look today? Quite cheap on a variety of measures, compared to history. There isn't a good way of timing factors, but it increasingly looks like value is a shunned, out-of-favour factor – which may be a good sign for value investing going forward. We've also made some small adjustments to our strategies that should help.

We don't like underperforming and understand it is difficult to not overreact to the short-term performance. But we feel strongly that our approach to investing still makes sense and is likely to produce above-average returns in the future.

Valuations

One way of looking at stock market valuations is seeing at how they compare to bonds. The table below shows how earnings over the last 12 months and dividends compare to 10-year interest rates.

As you can see, dividends from Canadian stocks are much higher than the respective 10-year bond yield. And U.S. stocks are pretty close. This makes stocks look favourable, using yield as a valuation method. Dividend yields from international markets look very attractive, too.

Misery loves company

Top economist Ed Yardeni refers to a model called the *misery index*, i.e., the sum of the unemployment rate and the annual percentage change in inflation. A high misery index occurs with more unemployment and more inflation – things that tend to make people unhappy. Unhappy people aren't in the mood to drive up the stock market. On the other hand, a low misery index occurs when more people are working and inflation is low. Happy people tend to be more exuberant, driving up stock valuations.

According to Yardeni, there is a good inverse relationship between the misery index and forward stock valuations. It may not seem like it, but most Americans have never been less miserable – perhaps due to the positive effects of the economy and stock market. The current reading of the misery index is historically low and as a result may justify higher valuations that exceed historical averages.

More, but not irrational, exuberance

Remember Robert Shiller, the Nobel-Prize-winning economist who coined the term *irrational exuberance*? Shiller's claim to fame was calling the bear market in 2000 because of his cyclically adjusted price-to-earnings (CAPE) valuation ratio. He also made the bear call on home prices in 2008. Today, his CAPE ratio is high again, as we discussed in our March issue of *Perspectives*, but surprisingly this time Shiller is bullish on the economy and stock market.

In fact, he recently said that a recession may be years away, partly due to President Trump's bullish impact on the economy. Shiller predicts the next recession won't hit for three years, and even then it could be mild.

Lower chance of imminent recession

Given the record length of the current economic expansion, earlier in 2019 many feared an imminent recession. Remember all the chatter about the inverted yield curve as the harbinger of economic recession? In past issues of *Perspectives* we've discussed how this time the inversion might not matter as much. Regardless, the yield curve is no longer inverted. The U.S. Federal Reserve, among other major central banks, lowered interest rates to provide economic stimulus. As a result, the low-yield world we live in is likely to persist, given low inflation and slow economic growth.

	Trailing P/E	Trailing Earnings Yield	Dividend Yield	10-Year Bonds
Canada	16.0	6.3%	3.1%	1.7%
U.S.	23.1	4.3%	1.8%	1.9%
EAFE (Europe, Australia, Far East)	16.3	6.1%	3.2%	
Emerging Markets	15.2	6.6%	3.0%	
World	20.0	5.0%	2.3%	

Source: Bloomberg

All together, now!

In late 2018, the U.S. Federal Reserve signaled that it would halt interest rate hikes for a while. In 2019, the Fed completed the pivot by lowing interest rates four times. The Fed also started buying Treasury bills, again expanding its balance sheet as it had for quantitative easing. The European Central Bank and Bank of Japan have also initiated programs to keep interest rates low and encourage borrowing. So, all three major central banks are coordinated in expanding their balance sheets. This has been good for the stock market.

What big stock market returns in 2019 mean for 2020

The S&P 500 was up almost 30% in 2019. What does this mean for 2020? Some reversion to the mean, or a continuation of a strong trend? To help find out, let's look at the numbers.

Since 1926, the stock market has been up double digits 54 times. The average return following double-digit gains has been 11.5%. The year following double-digit gains has been positive 39 times (72% of the time) and negative 15 times (28% of the time). Only three times have double-digit losses followed a double-digit gain.

The funny thing is, the stock market results were similar regardless of what happened the year before. On average, the S&P 500 was up 12% per year. An up year, a down year, a double-digit gain, a double-digit loss – following all of these, the average returns ranged from 10 to 13%. So, it doesn't seem to matter much what happened in a previous year. Historically, stocks are up roughly three out of every four years going back 95 years. It's far from guaranteed, but those are pretty good odds.

Earnings growth vs. stock market performance

You would think that if company earnings were good, the stock market would also be good. Perhaps this is true in the long term. But in the short term, anything can happen. In 2018, S&P 500 earnings were up 20%, yet the stock market was down 4% for the year. In 2019, earnings ended the year about flat, but the market was up almost 30%. Seems strange – until you think about all the clashes between fiscal and monetary policy plus trade tensions and geopolitical issues. Also having a big impact: How close actual earnings are to expected earnings. Interestingly, if we simply combine the two years, the performance is kind of normal.

Expectations for 2020 earnings growth are about 10%. Based on this, the U.S. stock market is not that expensive, compared to prior market tops. With no recession in sight, the stock market should be up modestly in 2020.

Predicting the future

You already know how we feel about predictions: most economic and stock market forecasts will turn out wrong. People tend to forget about all the previous wrong forecasts, recalling only the few that were right – making the dubious practice of forecasting seem necessary and valuable. So, people keep on demanding forecasts and supposed experts keep providing them.

We can safely say this much. If everything goes according to plan, the economy has a good chance to do well in 2020. Specifically, there should be some second-wind effects from the major tax cuts, as was the case with past ones like the 1986 Reagan and 2003 Bush cuts. The 2017 Trump tax cuts should be no different. We may not agree with a lot of the things President Trump has done, but on balance, from a short- and intermediate-term perspective, the tax cuts have been good for company profits, the economy, and the stock markets.

Decade in review

As mentioned earlier, the first decade of the century was extremely unkind to investors. We experienced two recessions, one being the worst since the Great Depression. We also had two huge stock market crashes, which saw stocks drop by half each time. The 2000s have been referred to as the lost decade, with no stock market gains. Although stocks started to rally mightily from the March 2009 lows, many market watchers gloomily predicted more crashes, volatility and calamities in the decade ahead.

At the end of 2019, the Dow was nearly just short of 29,000. No question the U.S. stock market is at record levels. With the 2000s in mind, though, does this mean things will go down or plateau? Or will they just go up even more?

Remarkably, the subsequent decade turned out completely opposite to the naysayers' forecasts. The 2010s were the first decade since 1850 that the U.S. did not experience a recession. Sure, there was volatility, but each correction turned out to be a buying opportunity. The S&P 500 was up nine times in the last 10 years. The only negative year was 2018.

Everyone also predicted rising interest rates. But rates turned out to be pretty range-bound for the decade, staying low if not lower.

So, perhaps the lesson is don't rely on the predictions! No one really knows what's in store for the next decade.

Taking a mulligan

Remember 20 years ago? The index was at its bull market peak of about 12,000. The market was euphoric. Stocks were *melting up*, that is, dramatically improving. Then came the dotcom collapse, lasting almost three years.

At the end of 2019, the Dow was nearly just short of 29,000. No question the U.S. stock market is at record levels. With the 2000s in mind, though, does this mean things will go down or plateau? Or will they just go up even more? During the current bull market, the Dow has been up 340% in nearly 11 years. That might raise eyebrows. However, if you take the long view, i.e., what's happened in the last 40 years, the rise actually isn't all that spectacular.

From 2000 to 2020, the Dow annualized 4.7% per year, which is not very much. From 1980 to 2000, the Dow annualized 14% (including three recessions and the 1987 market crash). If the Dow had gone up at the same rate from 2000 to 2020 as it did from 1980 to 2000, it would be at almost 160,000! Suddenly the Dow at 30,000 or even 40,000 doesn't seem so outrageous. The first decade of 2000 was a bad decade for stocks. The second decade was good, but kind of a make-up or *mulligan* decade.

Looking ahead

Uncertainty will always be around. It's just part of investing. If there's excessive optimism, like in a euphoric market, you should probably worry the most.

As we enter a new decade, the biggest uncertainties are: slowing economic growth, technological change and, as always, investor psychology.

Global trade disruptions have had their part in slowing economic growth. While there seems to be some progress in U.S.-China trade relations, we've been here before and nothing is guaranteed. The fact that we've been in an economic expansion for over 10 years adds to the concerns. But whether the current slowdown is just part of the normal business cycle, or the making of something greater, is yet to be seen.

Technological change has had an amazing impact on the economy. Technology allows us to do more, and do it faster and smarter. And part of the reason inflation has been so low is that technology

improves efficiencies and reduces consumption.

It is unlikely that 2020 stock returns will be as good as 2019's, as valuations are less attractive (though still much better than bonds). Going forward, we believe that our style of investing and having a financial plan is the best approach. The next decade will have its share of uncertainty, including fickle investor emotions. But our approach will be to remain consistent, helping us to navigate the future — and whatever uncertainties it holds. ■

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Performance results in this document are based on a composite of CIBC Wood Gundy Advisor Managed Account ("AMA") retail accounts with more than $75,000 invested in the "Disciplined Canadian Stock strategy" (created in March 2008 and includes AMA performance data from May 1, 2008, two months after the Strategy's inception in the AMA program), "Disciplined U.S. Stock strategy" (created in March 2008 and includes AMA performance data from May 1, 2008, two months after the Strategy's inception in the AMA program), "Disciplined World Equity (CAD) strategy" (created in November 2008 and includes AMA performance data from January 1, 2009, two months after the Strategy's inception in the AMA program), "Dividend Select World Equity strategy" (created in November 2010 and includes AMA performance data from January 1, 2011, two months after the Strategy's inception in the AMA program), "Disciplined North America Stock strategy" (created in November 2015 and includes AMA performance data from January 1, 2016, two months after the Strategy's inception in the AMA program).

The composite includes open fee-paying discretionary managed accounts where the Strategy has been held for at least two months, through a purchase or a switch from another investment or a different AMA strategy. Also included in the composite are closed accounts that held the Strategy, up to the last full month the Strategy was held.

Composite performance returns are geometrically linked and calculated by weighting each account's monthly performance, including changes in securities' values, and accrued income (i.e., dividends and interest), against its market value at the beginning of each month, as represented by the market value at the opening of the first business day of each month. This Strategy can be purchased either in U.S. or Canadian dollars. Unless specified otherwise, performance returns in this document are expressed in Canadian dollars and are calculated by converting U.S. dollar accounts into Canadian dollars using the month-end Bank of Canada noon rate. Performance returns are gross of AMA investment management fees, and other expenses, if any. Each individual account's performance returns will be reduced by these fees and expenses.

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