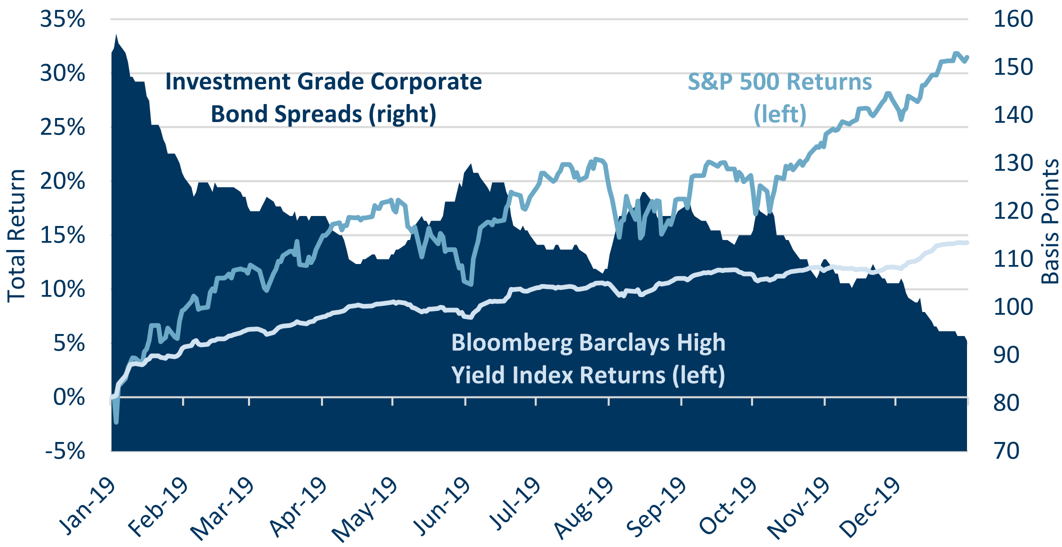
William Piel, CFA
Vice President,
Co-Head of Portfolio Management

JANUARY 2020

Fourth Quarter Commentary

Unlike previous periods of 2019, investors witnessed in the fourth quarter a de-escalation of the headlines that plagued them most of the year. Relations between the U.S. and China seemed to have found stronger footing, the risk of a "hard Brexit" greatly subsided, and the Federal Reserve – after cutting rates for the third time this year – announced a pause to see how economic data materialized. As a result, the equity markets continued their torrid pace as evidenced by the 9.06% return of the S&P 500 during the last three months of the year pushing the index to new all-time highs. Fixed income investors experienced more muted returns as longer-duration yields rose, offsetting strong performance of risk sectors, such as corporate bonds. The Bloomberg Barclays U.S. Aggregate Bond Index returned 0.18% for the quarter, though the full year's results were solid at 8.72%.

Exhibit 1: While volatile at times, the risk on trade dominated 2019



Source: Bloomberg

Tensions subsided in the quarter

Early in the quarter, investors were given hope of a potential "Phase One" trade deal between the U.S. and China as a first step towards thawing the cool relations that have existed between the two countries. Although the deal is not expected to be signed until January of the new year, the additional tariffs on $156B of Chinese imports that were set to go into effect in December were avoided. This deal will also scale back the 15% U.S. tariff on roughly $120B of Chinese goods to 7.5% in exchange for more agricultural purchases. Though some central issues remain, the hope is for further phased deals to resolve the quarrel that has gripped the global economy for the last few years.

In some regards, tensions have subsided in Congress as well. Towards the end of the year progress was being made on two fronts: lawmakers agreed to terms to fund the government to avoid another government shutdown and the momentum behind passing the United States-Mexico-Canada Agreement (USMCA), NAFTA's successor, seemed to be gathering energy. The USMCA is generally viewed as an update to NAFTA, so its impact to the U.S. economy should be incremental. Yet the auto industry, which has been caught in the crosshairs of trade policy, could be provided with some relief. However, cooperation has its limits as Trump became the third president to be impeached by Congress. It is anticipated that Trump will retain his position in the White House, but investors will be following the trial closely.

In October, the Federal Reserve cut interest rates for a third time during 2019 and has stated that they will likely be on hold throughout 2020. With inflation stubbornly below their 2% target, the Fed is more likely to react quickly by cutting rates if they see risks mounting for a slowdown than

For more information,
please contact:

**Kevin Seabury,
Director of Business Development
508-855-3112
kseabury@opusinvestment.com**

increasing rates due to inflation surpassing their target. In Europe, the European Central Bank (ECB) continued its accommodative stance under the new leadership of Christine Lagarde, the former head of the International Monetary Fund. The ECB maintained its negative deposit rates and reiterated that the rate will remain there, or lower, until their inflation outlook improves.

Turning to the economic data, global manufacturing surveys may have bottomed-out with the improvement in trade relations. However, the U.S. ISM Manufacturing Survey has been in contractionary territory for five consecutive months. Fortunately, surveys measuring the service-oriented economy in the U.S. have maintained their resilience and continue to show signs of expansion. Economic conditions for consumers are favorable with unemployment back at a 50-year low of 3.5%, low-levels of household debt on average, and modest growth in wages and salaries.

Valuations challenged

Looking back on 2019, performance figures for the capital markets are staggering as both equities and fixed income had banner years. As we look ahead to 2020, the strong performance of 2019 has resulted in valuations that give little opportunity for history to repeat itself. For example, the yield on the Bloomberg Barclays U.S. Aggregate Bond Index was 3.28% at the beginning of the year. During 2019, the ten-year Treasury yield fell about 75 basis points and corporate bond spreads declined 60 basis points. As a result, this widely used fixed income benchmark now yields 2.31%. Even U.S. high yield indices are close to their all-time low yields.

In terms of risk premiums, the amount of risk an investor must take to significantly out yield their benchmark has risen following the 2019 performance. Corporate bond spreads are close to their post-crisis lows and offer the least amount of yield pickup to Agency RMBS in about a decade. Additionally, BBB-rated corporate bond spreads are close to their lows as well. With investors facing limited opportunities to capture yield, the temptation to capture yield by taking incrementally more risk grows. Alternatively, and an approach we favor, there could be an opportunity to move into other investment grade asset classes with higher ratings and potentially less volatility without greatly sacrificing yield.

As we have written previously, economic growth continues to be on track in the U.S., but at a slower pace. Recent actions by global central banks have no doubt buoyed the current expansion and have provided a lift to financial assets. Cooperation on trade, and potentially further progress on trade deals, should be supportive of the economic backdrop as well, specifically for the manufacturing sectors that have struggled. Still, with valuations reflecting an optimal outcome, we continue to favor a defensively biased approach, particularly now that the loss in yield may not be substantial. Our focus remains on creating portfolios biased towards fundamental financial strength, capital preservation and liquidity.