Schaper, Benz & Wise
INVESTMENT COUNSEL
Trusted Advisor for Generations

18 Jewelers Park Dr., Suite 200 | P.O. Box 628
Neenah, WI 54957-0628 | 920.727.1137

Economic & Market Summary
January 2020

The longest US economic expansion on record continued in 2019 albeit with slower growth. Supported by a strong job market and solid wage gains, consumer spending has been robust. The business sector, on the other hand, faces several obstacles. A tight labor market has made finding qualified workers difficult and costly. Trade uncertainty, slowing global growth, and weak spending in the energy sector have also been challenges. In response, companies have cut back on investing which has pulled recent GDP growth down to about 2% compared to 3% in 2018. However, we believe growth has room to accelerate. The new trade agreement between the US, Canada, and Mexico is about to become law. Negotiations with China appear to be heading in the right direction. Housing and the yield curve, two leading indicators that were signaling caution, are beginning to improve. Single-family housing starts and building permits are rising again after declining in 2018. Mortgage rates have dropped by more than one point over the last 13 months. The yield curve has uninverted meaning long-term interest rates are once again above short-term rates. An inverted curve is a well-cited recession warning, and its reversal should be viewed positively. For 2020, we believe that a strong consumer, a better trade environment, and improved residential construction will nudge GDP growth up to about 2.5%.

One long-term risk we're monitoring is the growing debt load in the economy. Declining lending standards, low interest rates, and yield-hungry investors have created an environment where even the riskiest companies can attract capital on favorable terms. In Washington, fiscal discipline has vanished as evidenced by the worsening federal budget deficit. Total household debt is above its '08-'09 peak and trending higher. Such aggressive borrowing is sustained by low rates and faith that debtors will repay their loans. If either of these factors materially change, public and private spending will need to decline, potentially to the detriment of economic growth.

The Federal Reserve lowered rates three times in 2019. Rates will likely remain unchanged this year barring an unexpected outbreak of inflation. If anything, rates could be cut again if the trade situation worsens or growth weakens. The Fed is considering a policy that allows inflation to run above the 2% target in order to compensate for past shortfalls. A potential shift in the Fed's inflation tolerance combined with easing trade tensions could drive long-term yields higher. Therefore, we remain cautious on bonds.

Earnings for S&P 500 companies likely grew about 4.5% for 2019 with mid-single digit revenue growth partially offset by higher costs. A strong dollar and wage pressures were notable headwinds. Modest earnings growth didn't stop equities from having a stellar year; the S&P 500 returned 31.5% including dividends. The strong rally in stock prices has pushed valuations to a level we consider somewhat expensive. The PE on forward earnings is over 18x – above the historical average of about 15x. Looking ahead, we expect 2020 to be volatile. Valuations could contract, trade negotiations with China could falter, and conflict could spread across the Middle East. Markets could also react negatively to news from the presidential race, especially if momentum builds behind candidates proposing punitive taxes on businesses and investors. However, the fundamental backdrop for equities remains favorable. The Fed is accommodative, the economy is healthy, and corporate earnings are forecasted to grow low double-digits. While we expect a bumpy ride, 2020 should be a solid year for stocks.

Mark J. Sprtel, CFA

To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address above.