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## Slowing Growth and Increased Volatility in the Coming Year



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Despite records gains in the stock market, including an increase of 29 percent for the S&P 500, economic growth slowed in 2019. While increased optimism surrounding trade negotiations, pre-emptive interest rate cuts from the Federal Reserve, and the lingering tailwinds from the 2018 tax cuts helped maintain economic growth, we anticipate further slowdown in the coming year. Leading economic indicators continue to point to weakness in manufacturing and business spending. We expect GDP to slow in 2020, and though we do not expect a technical recession in the next 12 months, the economy does face several factors that keep it in the recessionary window.

Though a renewed sense of optimism regarding trade negotiations between the U.S. and China buoyed market sentiment in the last few weeks of the year, underlying structural issues make it unlikely that trade tensions will remain subdued in the long-term. Continued geopolitical uncertainty may continue to be a drag on corporate confidence and global supply chains, putting more importance on consumer spending. Though unemployment remains at a historic low, this is a lagging economic indicator and tells us little about the direction of the economy. There are concerns that the weakness in American manufacturing and business investment could begin to drag down the services sector. Such a turn could result in higher unemployment and stagnating wages. Such a turn could hurt corporate earnings. Corporations are already vulnerable because of the high levels of corporate debt, and would suffer if rates increase. All of this makes the market more vulnerable and increases the likelihood of a bear market.

### **U.S. Stock Market**

In periods of uncertainty in the markets, it is important to keep your long-term goals in mind and to be aware of the risk your portfolio carries. There are several reasons to expect market volatility in the coming year. The markets will likely swing, in both directions, with every piece of news regarding trade negotiations. Stock valuations remain historically high, making them susceptible to big slides. Corporate profits face headwinds from several fronts. The first is increasing cost pressure



from trade disruptions to the global supply chain and rising wages. Secondly, the Fed's stated plans to hold off on any further interest cuts leave little room for improvement with regards to corporations' interest expenses. Finally, the benefits of the 2018 tax cut have likely run their course, and there is increasing political pressure for corporate tax rates to increase.

However, there are reasons to be optimistic about the coming year. The American consumer continues to be a ballast amidst a slowing economy. Unemployment is at its lowest point in decades and wages have begun to see moderate growth. Increased spending should continue to drive corporate profits. Factors like easier monetary policy and favorable lending conditions that drove P/E expansions in 2019 should continue to do so in the coming year, albeit at a slower pace. While 2020's returns may not match last year's, we do expect to see moderate growth.

In the coming year, we are more heavily weighted to equities, particularly those of high quality. Companies with low debt, strong balance sheets, and consistent earnings are best poised to weather any downturns. During times of volatility, it is especially important to be aware of the level of risk your portfolio carries so that you know how comfortable you are with big swings in the market. Strategic asset allocation is also vital, allowing you to mitigate losses and take advantage of opportunities when they appear.

## **Bonds**

Red lights flashed earlier in the year when the yield curve for U.S. Treasuries inverted. The Fed implemented a series of "insurance" cuts and seem to have successfully "un-inverted" the curve, putting the U.S. bond market on firmer footing. Signs of stabilization in the global economy, a moderate increase in inflation, and the lagging impact of the rate cuts should result in increased yields for moderate and long-term bonds.

We prefer U.S. Treasury bonds or investment grade corporate bonds. High-yield bonds offer little yield advantage relative to Treasuries, and the possibility of lowered corporate profits in the coming year make them riskier. We also recommend investing only in corporate bonds with an "A" rating or higher. The high levels of corporate debt and the potential of decreased profits could see many of the "B" rated bonds have their ratings downgraded, relegating them to "junk" status.



## International Markets

Since the trade war began, much of the global economic slowdown has been attributed to the impact of the increased tensions between the U.S. and China. However, the Economic Research Cycle Institute points out that the global economy was heading for a downturn well before the trade war kicked off. ECRI points out that global industrial production started slowing



in late 2017. In fact, their leading production indexes began to signal a downturn as early as mid-2017. While ECRI acknowledges that the trade war has exacerbated the downturn, the slowdown was simply the next stage in the global economic cycle. While this means that a resolution to the trade war would not necessarily stop the global slowdown, it also means that economic growth may return, even if trade tensions persist.

The Eurozone's reliance on exports and manufacturing means it was hard hit by the global slowdown and trade war, with manufacturing powerhouse Germany bearing the brunt of the region's slowdown. Much of the region's prospects now hinge on a recovery in global manufacturing and the actions of the European Central Bank. Last year saw the ECB take rates further negative and restarted quantitative easing. This may result in a gradual uptick in growth in the coming year. The U.K. elections give the nation a clearer path forward for Brexit, which may help ease volatility both in the U.K. and Europe.

Japan's economy continues to suffer the after-effects of a consumption tax increase. It is further hampered by not only the trade tensions between the U.S. and China, but by its own trade disagreements with South Korea. There is the possibility that the government will launch a fiscal stimulus package, but the nation is likely to lag behind other developed nations. China, after failing to meet its 6 percent GDP target in 2019, is torn between the need for short-term stimulus and the long-term goal of reducing leverage in the economy. Any stimulus package will likely be smaller than previous ones and will seek to stabilize the economy rather than spur growth. It is unlikely that China will exceed its GDP target in 2020 either.

International stocks may remain volatile unless global growth accelerates. Despite this, global stocks provide opportunity for diversification. Currently, global stocks are not as synchronized as they have been in the past, making them less likely to move in tandem.

## Conclusion

2020 may see increased volatility and returns will likely not be as good as 2019, but we are still optimistic about the U.S. stock market's performance in the coming year. The impact of trade tensions may be lessened, and the overall momentum of the market will continue to be positive. The global economy is beginning to show signs of rebounding and several international markets will likely perform better this year.

While no one can predict what will happen in the next 12 months, it is important to be prepared for what could happen. Meeting with an advisor can help you ensure that your portfolio is protected against any unforeseen downturns, but also position you to take advantage of improving conditions. For expanded viewpoints on market conditions, additional insights about financial planning and updated information regarding economic trends, please visit the Insights section of our website at [www.hanoveradvisorsinc.com/insights/](http://www.hanoveradvisorsinc.com/insights/)

## Hanover Advisor Bulletins

### Special Reminders to all Hanover Clients

- ♦ **New enhancements to our portfolio reporting system.** All Hanover clients have free access to our internet-based reporting system known as Black Diamond. This robust system provides comprehensive performance reporting, asset allocation and risk assessment on clients' portfolios. The system will have a new look and major enhancements starting this fall. Our office is available to assist in accessing and utilizing the Black Diamond system.
- ♦ As a reminder to our clients, Hanover Advisors, Inc. now has an office in Greenville, SC. Meetings can be scheduled at either the Greenville office or our conference facilities at Concourse Parkway in Atlanta. Please see our website, [HanoverAdvisorsInc.com](http://HanoverAdvisorsInc.com), for detailed contact information.
- ♦ We want to invite all clients to contact our office to schedule a portfolio review. We would be happy to coordinate a sit-down meeting, a conference call, or an online meeting at your convenience. Please call our office to schedule an appointment.
- ♦ Tax season is here, and we want to inform you that the 2018 1099 Tax statement drafts are available. The final revised copy will be mailed out in the upcoming weeks. If you have any questions or concerns about tax statements and documents please call our office.
- ♦ Please see our quarterly review of the financial markets on our website at [HanoverAdvisorsInc.com](http://HanoverAdvisorsInc.com). Please click on "Insights" and then "Video/Presentations" to find the quarterly reports.

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