2020 Economic Overview and Market Outlook

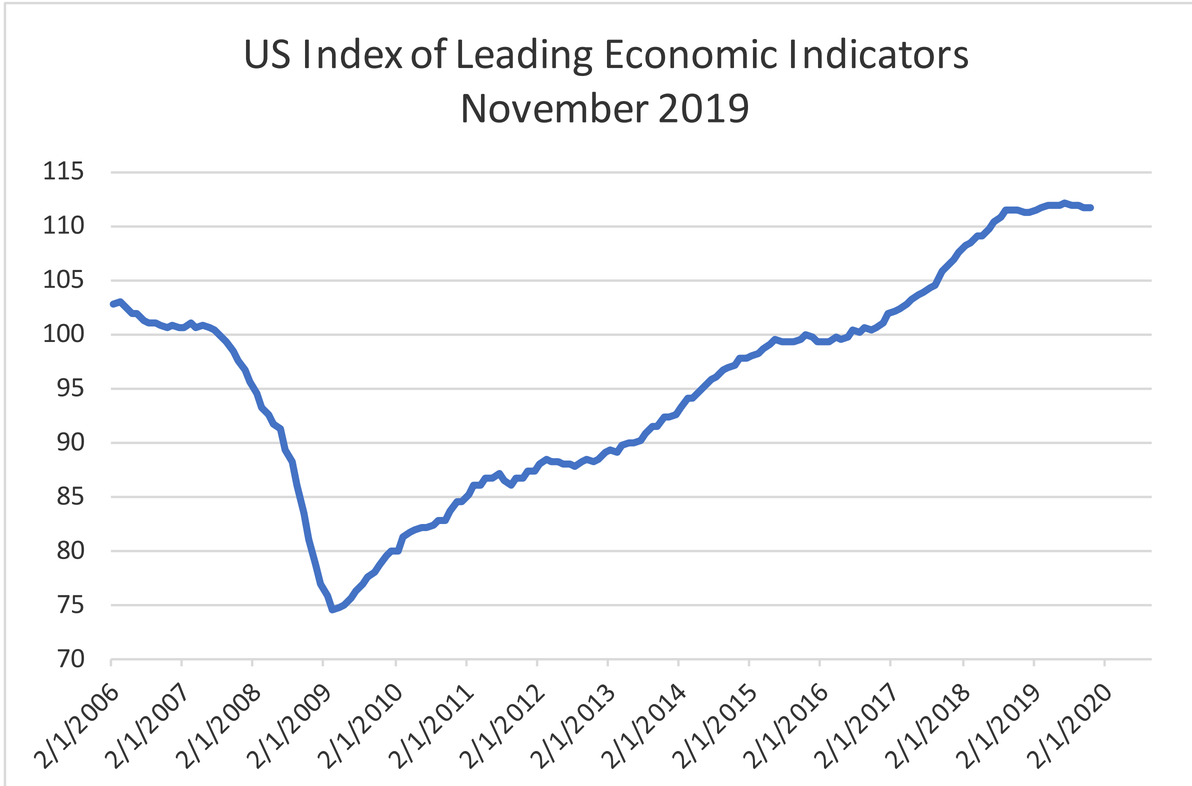
Market Overview

Leading economic indicators point toward slower growth and elevated recession risks persisting in 2020. Inflation should remain dormant over the next 12 to 24 months. The Fed will likely resume its easing cycle at some point during this period, leading long term yields lower once the easing cycle is anticipated to resume. Equity returns are likely to be modest at best.

- Leading Economic Indicators are Weak
  - US economy retains modest momentum going into 2020 but growth will remain slow and risks to the expansion remain elevated
- Policy uncertainty will remain elevated related to trade, election and other potentially disruptive global developments
- Imbalances in debt outstanding, financial market valuations and household net worth are potential triggers for changes in policy and economic performance
- Financial Markets
  - Low inflation and interest rates to prevail in 2020 and beyond
    - Next move a continuation of rate cutting cycle
  - New all-time low for 30-year Treasury yields was reached in 2019
    - Bounce in yields may continue near term, long term downtrend in place
  - Credit Fundamentals
    - New high in corporate debt outstanding, performance likely sensitive to both changes in growth conditions and changes in Treasury yields
  - Equity returns - 2019 was an anomaly in a low growth, low return world
    - Lower returns, more volatility and downside risk in 2020

Leading Economic Indicators Are Down During The Last Six Months

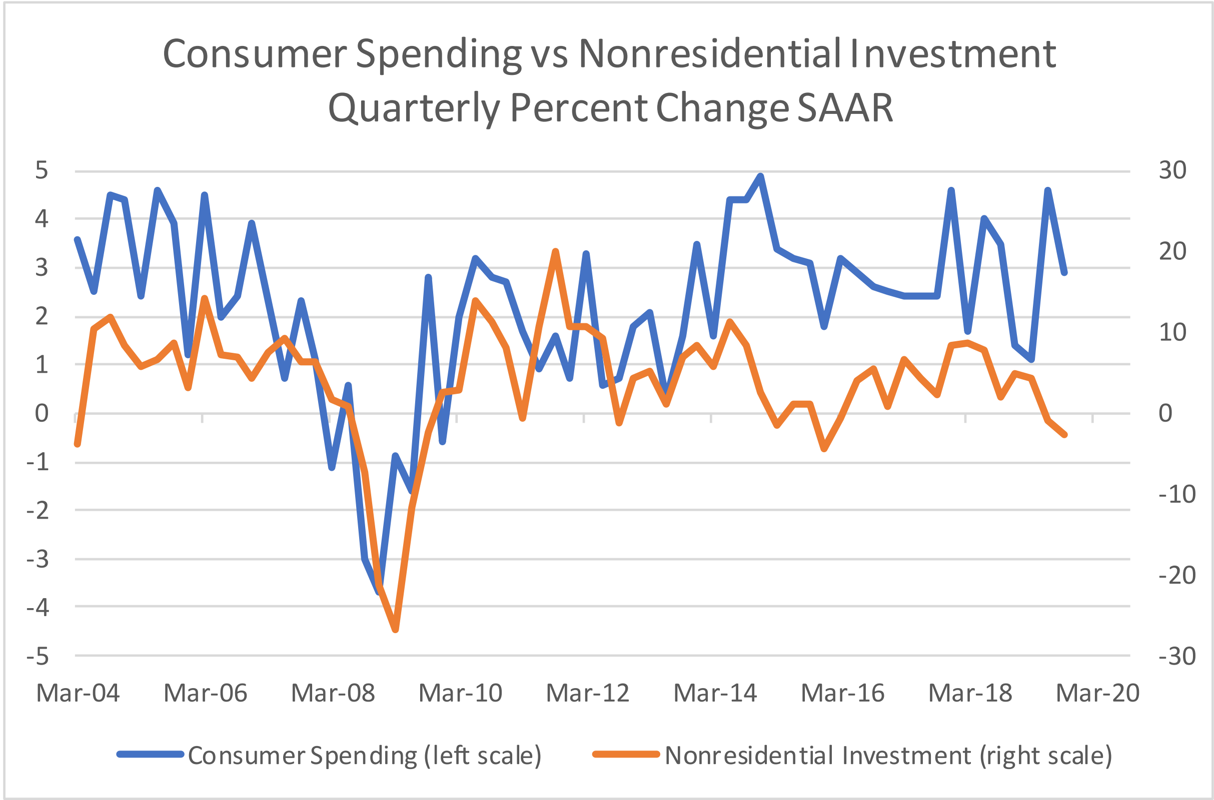
The Index of Leading Economic Indicators has softened in recent months. The yield curve and manufacturing oriented components have been the main sources of weakness, but surprisingly consumer expectations have also weakened lately. The index does not suggest a recession is imminent, but further weakness would raise concerns.



Source: Conference Board.

Economic Growth Was Unbalanced in 2019

Strong labor markets and consumption spending compensated for weakness in investment, exports and manufacturing activity in 2019. Manufacturing indicators have stabilized at modest growth levels recently, but there are few signs of impending reacceleration. Leading indicators suggest a continuation of slower growth in early 2020.



Source: Bureau of Economic Analysis. Q3 2019

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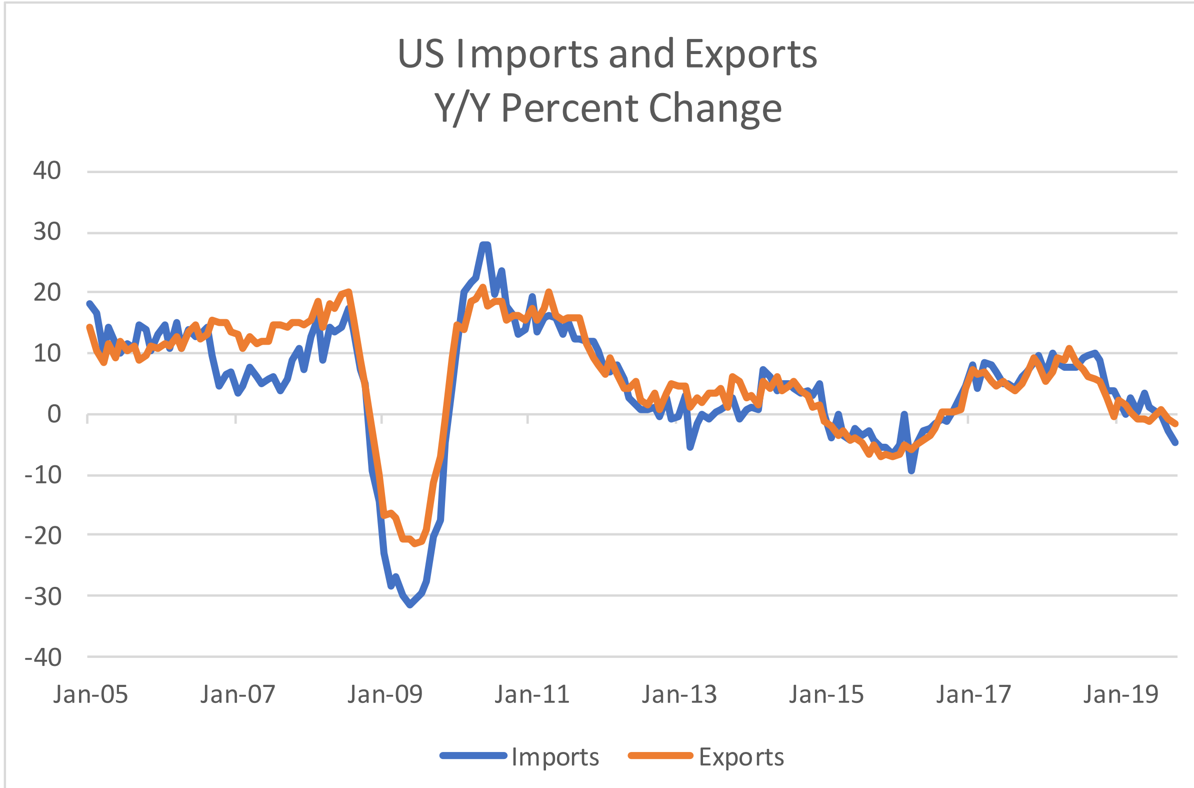
Export Growth Very Weak but Trade Did Not Weigh on GDP

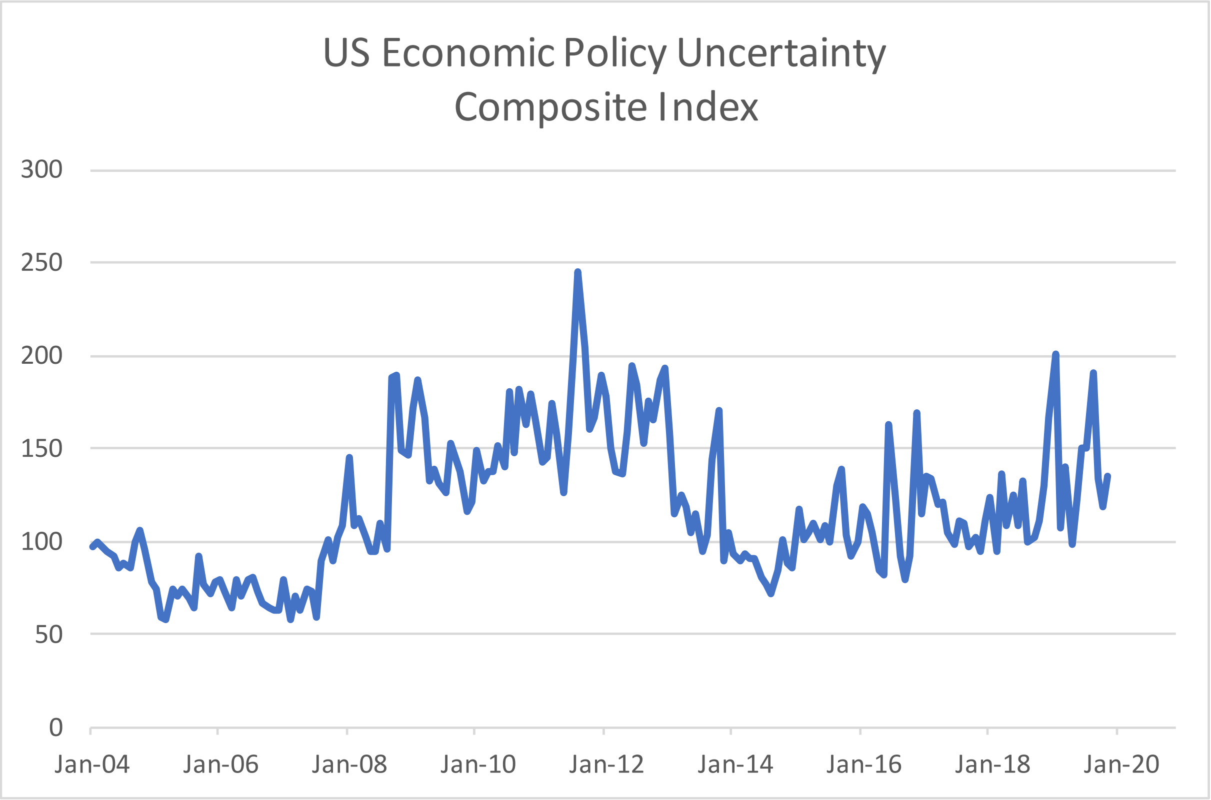
Export growth has been mildly negative in 2019, though falling imports have resulted in net exports essentially being a neutral factors for GDP growth this year. The weakness trade measures reflects weak global economic growth and US policy pressures to reduce the trade deficit. Global indicators have recently stabilized but a sharp acceleration is unlikely.



Source: US Census Bureau, October 2019

Policy Uncertainty: More than Trade in 2020

Policy uncertainty has been oscillating higher in recent years. The level of uncertainty has come down sharply as tariffs have been delayed along with the phase one US/China trade agreement. The potential for backsliding in trade, the potential outcome of US elections late in the year, and other global developments are likely to keep policy uncertainty elevated in 2020.



Source: Baker, Bloom and Davis. November 2019

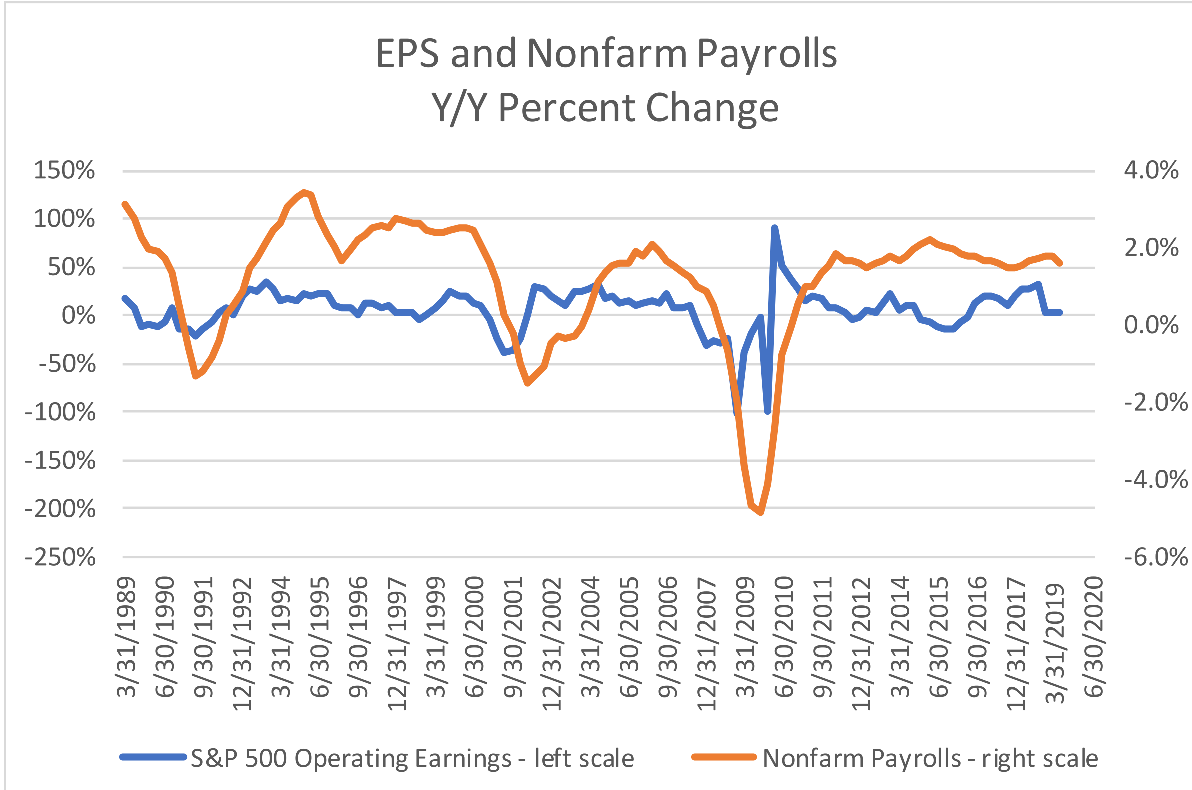
Potential Trigger: Job Openings Data Leads Other Labor Market Indicators

Job openings are down since early in 2019. A drop in job openings occurred before the uptrend in initial jobless claims occurred during the past labor market cycle. Claims remain at a historically low level but have begun to rise in recent months. They are a component of the index of leading economic indicators and suggest some potential softening in labor market conditions.

Source: Bureau of Labor Statistics

Potential Trigger: Corporate Profit Growth Leads Payroll Growth

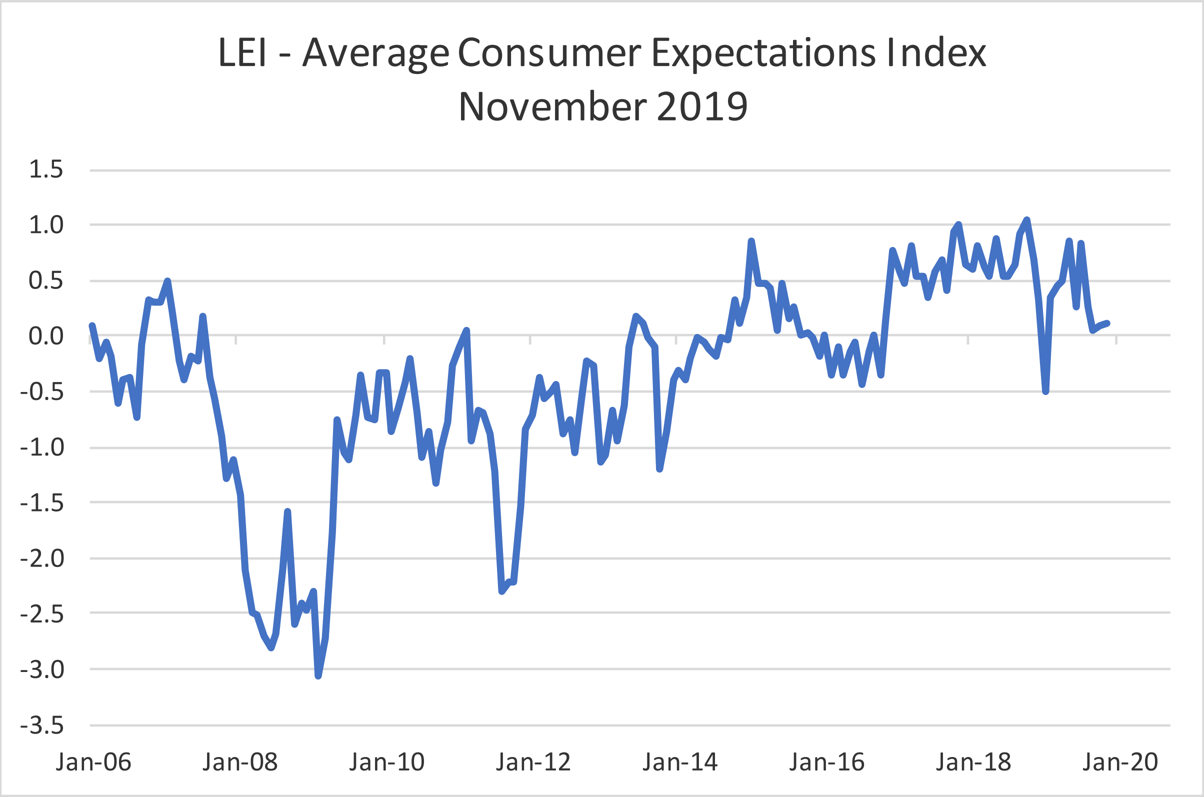
Corporate earnings growth has stalled according to both S&P 500 operating earnings and the Commerce Department's tally of corporate profits over the past several quarters. Historically, swings in earnings growth have occurred ahead of swings in the pace of job growth. The recent level of earnings growth points to slower employment gains in 2020.



Source: Bureau of Labor Statistics, Standard and Poors. Q3 2019

Potential Trigger: Consumer Expectations Have Softened

The combination of strong labor markets, buoyant financial markets and lower interest rates have kept consumer confidence at elevated levels. However, consumers assessment of current conditions improved while expectations have softened in recent months. Expectations are a leading indicator of consumer spending and broader economic growth.



Source: Conference Board

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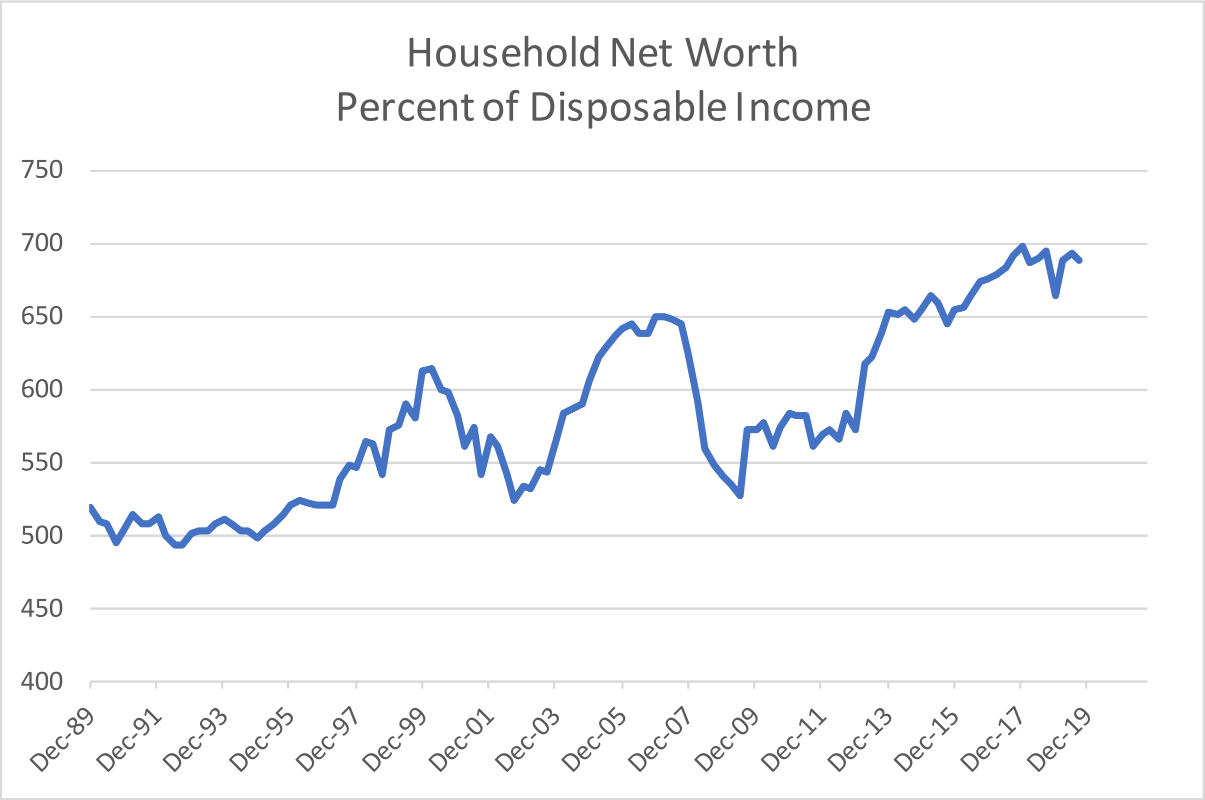
Potential Trigger: Household Net Worth Leveraged to Markets

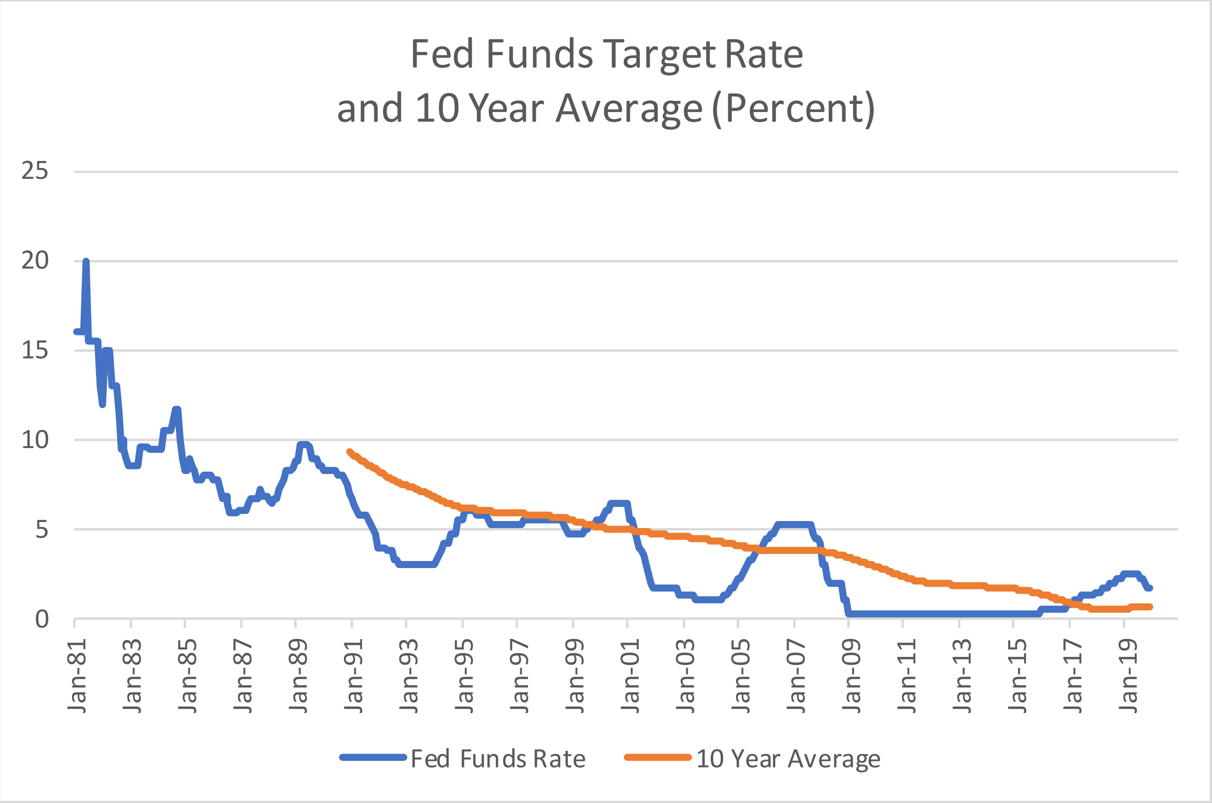
Household net worth has recovered sharply throughout the year as equity markets have risen. The sharp increase in equities during the final quarter of this year has likely lifted net worth to a record level relative to disposable income. The high level of net worth along with low interest rates should support consumer spending in early 2020.



Source: Federal Reserve, US Bureau of Economic Analysis. Q3 2019

Fed Policy: Rates to Trend Lower

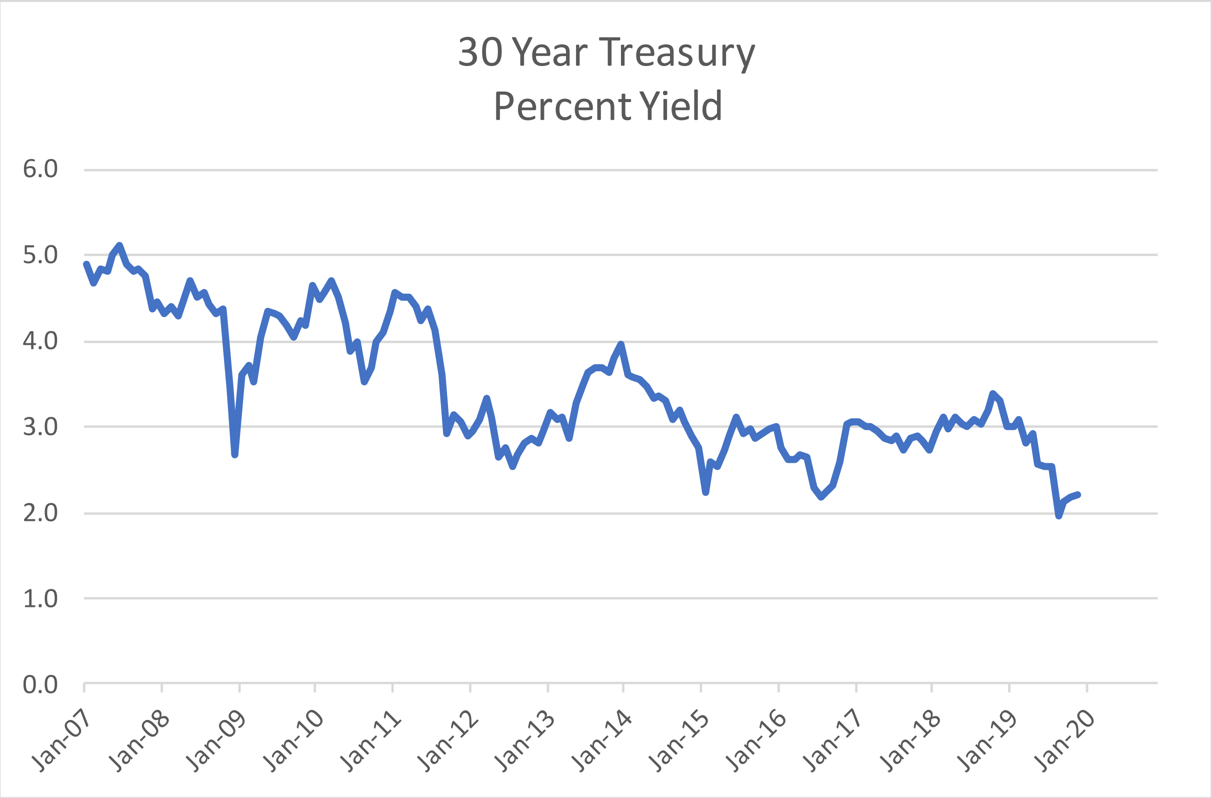
Following 75 basis points of policy rate reductions during the second half of 2019, the Fed suggests policy will remain on hold in the coming months. Futures markets currently give better than 50 percent odds to an additional rate cut in 2020. We expect the next Fed move will be a continuation of the rate cuts that began this year with low inflation and modest growth.



Source: Federal Reserve

Bond Market: Treasury Yields Still Likely to Trend Lower

Thirty-year Treasury yields fell to a record low of 1.95 percent in late August before rebounding by nearly 50 basis points by early November. While yields may continue to bounce in the near term, yields are likely to resume their declining trend once additional Fed easing becomes anticipated by the markets or a recession appears likely.



Source: Bloomberg

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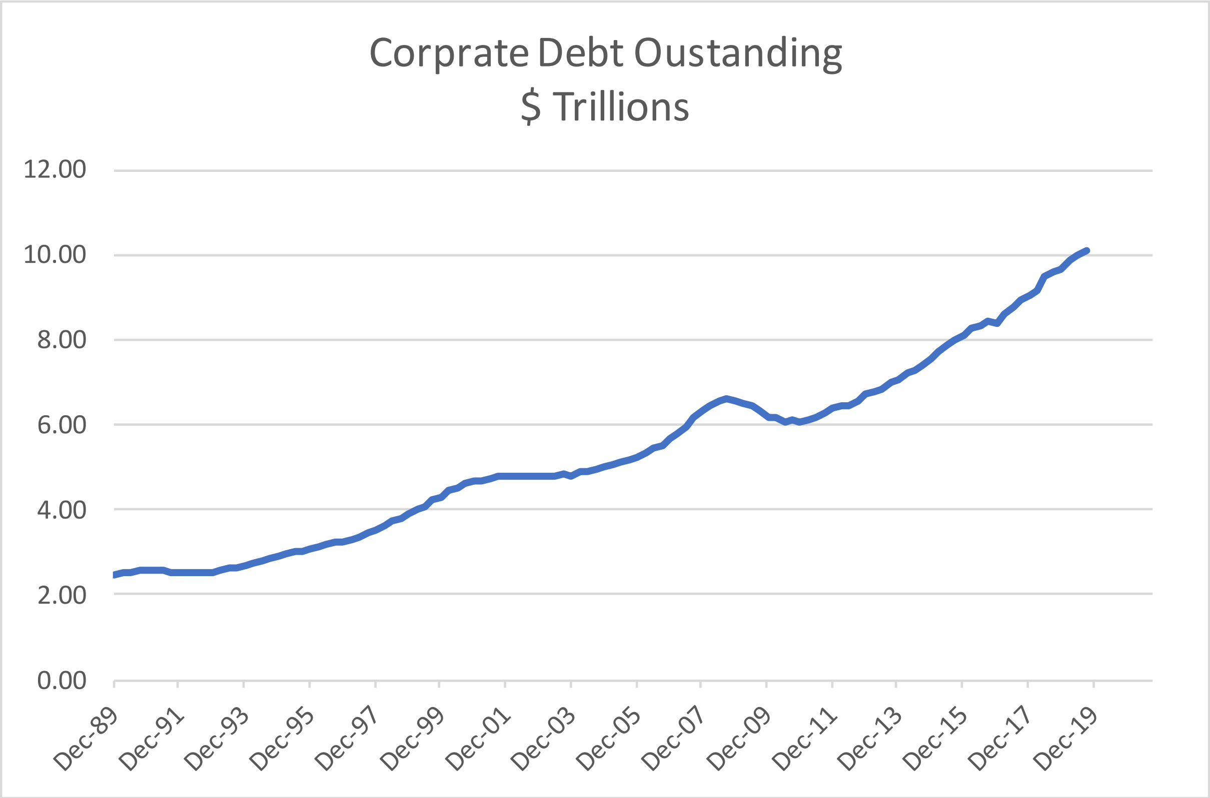
Bond Market: Corporate Debt Outstanding at a New High

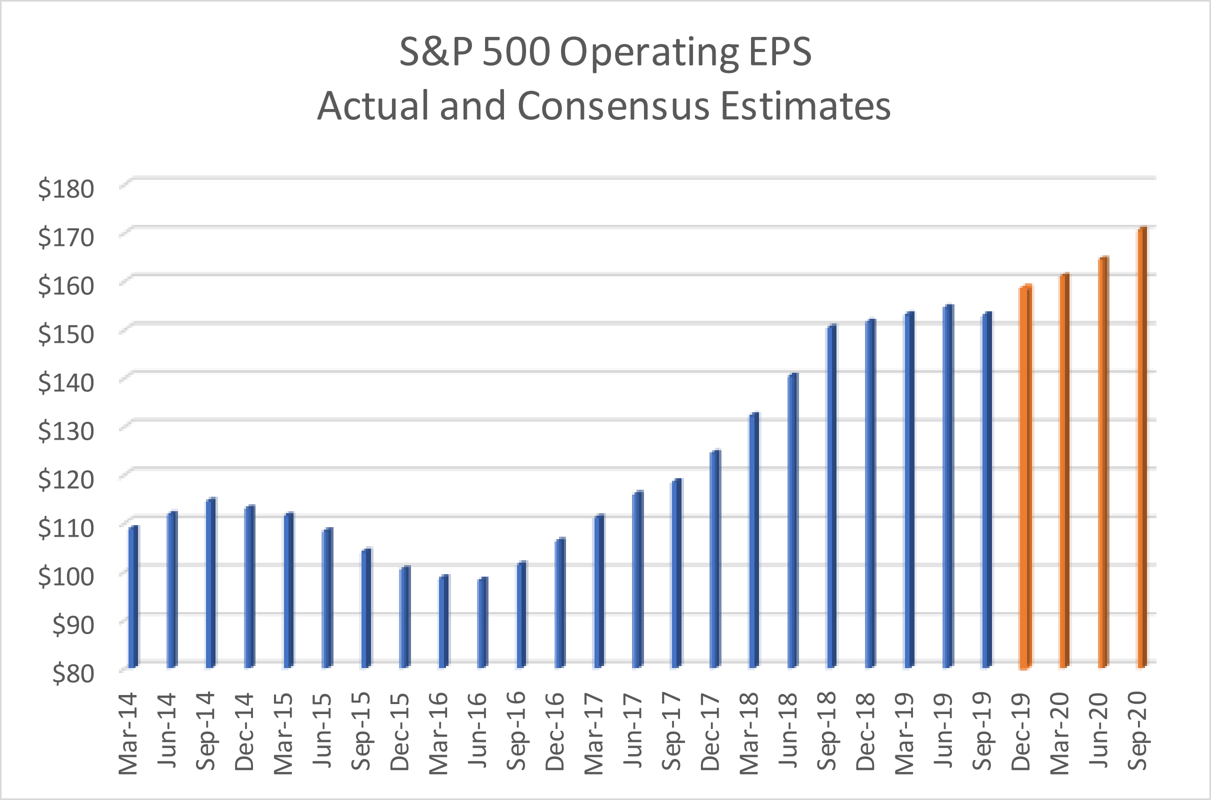
The sharp increase in corporate debt over the course of the current cycle suggests an increased sensitivity to higher interest rates, particularly if the flattening in corporate profit performance in recent quarters persists. Heightened liquidity pressures in funding markets late this year may in part reflect this increase in leverage.



Source: Federal Reserve. Q3 2019

Profit Outlook: Consensus Expectations Are Too Robust

Expectations for earnings growth remain robust for 2020 despite several quarters of relatively flat growth and weakness in leading economic indicators. Earnings sit at a high absolute level and as a share of GDP, but macro conditions here and abroad seem inconsistent with robust consensus earnings growth expectations for the coming year.



Source: Standard and Poors. December 2019

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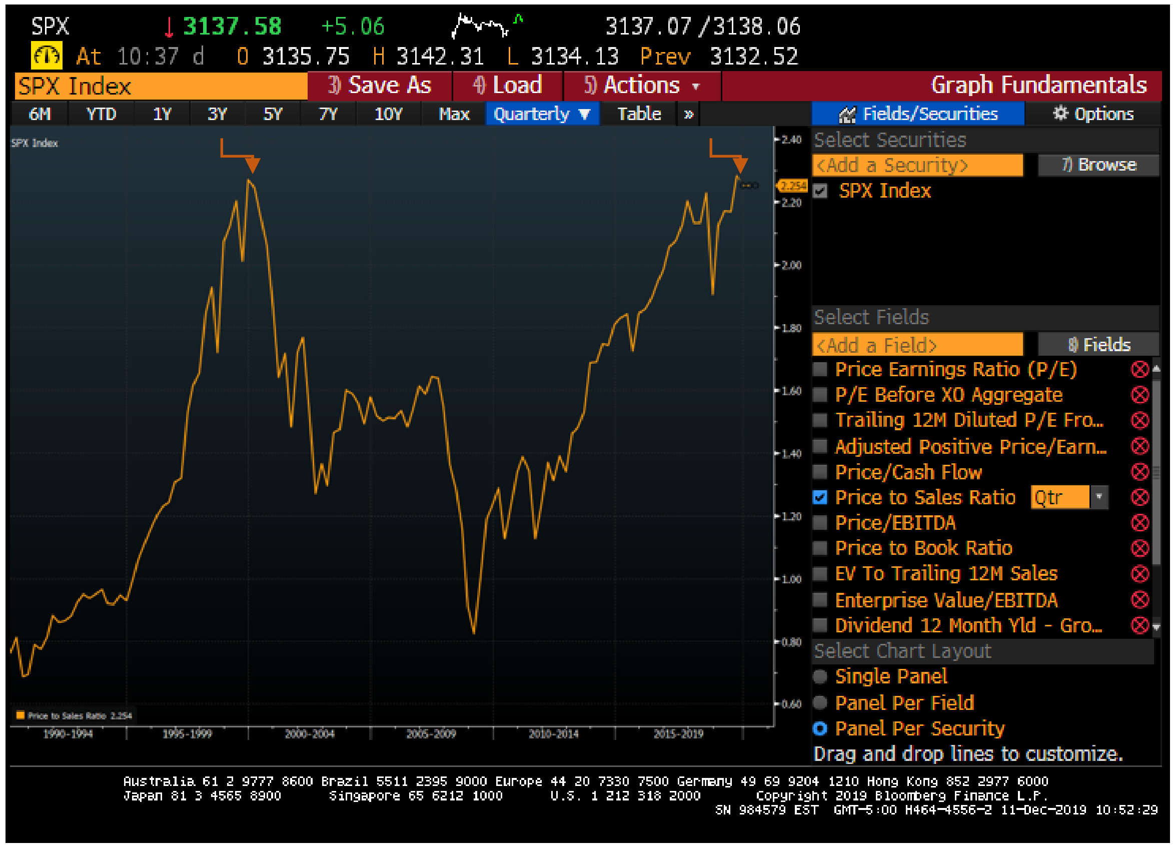
Equity Markets: Little Profit Growth and Rich Valuations

The extremely strong rally in equity markets in 2019 largely reflects sentiment driven multiple expansion. Earnings have essentially been stagnant as margins have moved incrementally lower. The price to sales ratio for the S&P 500 stands at its highest level since early 2000. With valuations at historical extremes and earnings growth likely muted, modest returns at best are likely in 2020.

S&P 500 Price to Sales Ratio



Source: Bloomberg. December 2019

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2020 Outlook

Equity valuations in US markets are very high and headwinds for earnings growth are likely to persist. While expected returns are low, US bonds are attractive on a relative basis to global alternatives. We see volatility moving higher in the coming year due to fundamental considerations and high valuations.

- Economic conditions
    - Leading indicators suggest slower growth continues
    - Labor market likely to see slower job growth in 2020
    - Recession risks remain elevated
- Policy uncertainty and market volatility likely higher than 2019
- Policy rate cuts likely only in reaction to market and/or economic weakness
- Long term Treasury yields likely to remain in longer term declining trend
- US equities – modest returns at best likely in 2020
    - Extreme valuation
    - Tepid earnings growth

LINIAM Capital: Our Team

Mark Austin

Founder and Managing Director

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Mark Austin is the CEO of Liniam Capital LLC, a boutique investment management firm based in Minneapolis, MN. Over the course of his 27-year career, Mark has worked extensively with pension funds, endowments, foundations, corporate funds, and high net worth investors in a variety of business development, client service, and product management capacities.

Mark's capital markets experience spans a range of asset classes, including domestic and international equity, fixed income, private equity, real estate, infrastructure, and options trading. Prior to founding LINIAM Capital, Mark was a Managing Director at North Sky Capital and also held marketing positions at FAF Advisors, Piper Capital Management, and Investment Advisers, Inc.

Mark earned his MBA from the University of St. Thomas and his B.S. from the University of Minnesota. He also served as the President of the North Hennepin Community College Foundation.

Mark's interests include most sports, coaching, fishing, hunting, and volunteering at church. Mark has two young adult children and an Australian Shepard named Bogart.

LINIAM Capital: Our Team

Keith Hembre, CFA

Managing Director & Chief Investment Officer

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Keith joined Liniam Capital at the beginning of 2019 to lead the firm's investment management and research efforts. He has 25 years of financial market experience. Prior to joining Liniam Capital he served as Chief Economist and Investment Strategist, and Head of Quantitative Strategies for Nuveen Asset Management for much of the past decade. In this role he was responsible for all of the firm's quantitative equity and asset allocation strategies. Keith joined Nuveen as a result of the combination of Nuveen Asset Management and FAF Advisors where he served in a similar role at FAF Advisors for several years while also serving as Chief Economist for US Bank.

Keith has managed portfolios or served in an advisory capacity for some of the nation's wealthiest individuals, family offices, foundations and largest financial institutions. He has been a member of the American Bankers Association Economic Advisory Committee and was named the most accurate economic forecaster by Businessweek magazine in 2007.

Keith worked in the banking studies group at the Federal Reserve Bank of Minneapolis prior joining FAF predecessor Piper Capital Management. And prior to joining the Minneapolis Fed he was a Visiting Lecturer at the St. Petersburg (Russia) University of Economic and Finance. He received a Master of Science degree in Economics from Baylor University, a Bachelor of Arts degree from the University of Minnesota with majors in economics and political science, is a CFA charter holder, a CPA certificate holder and has completed the program on Investment Decisions and Behavioral Finance at Harvard University.

Keith enjoys time with his wife and children, family travel and time at the cabin. He is active in coaching youth sports and participates in a variety of other extra-curricular activities with his children.